

## AU Section 9334\*

### ***Related Parties: Auditing Interpretations of Section 334***

#### **[1.] Evaluating the Adequacy of Disclosure of Related Party Transactions**

[.01–.05] [Withdrawn August 1983, by SAS No. 45.] (See section 334.)

#### **[2.] Disclosure of Commonly Controlled Parties**

[.06–.09] [Withdrawn August 1983, by SAS No. 45.] (See section 334.)

#### **[3.] Definition of "Immediate Family"**

[.10–.11] [Withdrawn August 1983, by SAS No. 45.] (See section 334.)

### **4. Exchange of Information Between the Principal and Other Auditor on Related Parties**

**.12 Question**—Section 334, *Related Parties*, paragraphs .04–.07, states that "during the course of his audit, the auditor should be aware of the possible existence of material related party transactions," and that determining the existence of related party transactions may require the inquiry of the "principal, or other auditors of related entities concerning their knowledge of existing relationships and the extent of management involvement in material transactions." When should that inquiry be made?

**.13 Interpretation**—The principal auditor and the other auditor should each obtain from the other the names of known related parties and the other information referred to above. Ordinarily, that exchange of information should be made at an early stage of the audit.

[Issue Date: April 1979.]

### **5. Examination of Identified Related Party Transactions with a Component**

**.14 Question**—According to section 334 paragraph .09, once related party transactions have been identified, "the auditor should apply the procedures he considers necessary to obtain satisfaction concerning the purpose, nature and extent of these transactions and their effect on the financial statements." When there is a principal auditor-other auditor relationship, how may the auditors obtain that satisfaction regarding transactions that may involve not only the components<sup>1</sup> they are auditing, but also, other components?

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\* [Section number changed August 1983, to correspond to section 334, *Related Parties*.]

<sup>1</sup> For the purpose of this interpretation, the entities whose separate financial statements collectively comprise the consolidated or other financial statements are referred to as components.

**.15 Interpretation**—Audit procedures may sometimes have to be applied to records of components being audited by the other. One auditor may arrange to perform those procedures himself, or he may request the other to do so.<sup>2</sup> There may be circumstances when there are unusual or complex related party transactions and an auditor believes that access to relevant portions of the other's work papers is essential to his understanding of the effects of those transactions on the financial statements he is auditing. In those circumstances, access ordinarily should be provided.<sup>3</sup>

[Issue Date: April 1979.]

## 6. The Nature and Extent of Auditing Procedures for Examining Related Party Transactions

**.16 Question**—Section 334, *Related Parties*, provides general guidance about the types of procedures an auditor might apply to identified related party transactions. How extensive should the auditor's procedures be to examine related party transactions?

**.17 Interpretation**—The auditor's procedures should be sufficient to provide reasonable assurance that related party transactions are adequately disclosed and that identified related party transactions do not contain misstatements that, when aggregated with misstatements in other balances or classes of transactions, could be material to the financial statements taken as a whole. As in examining any other material account balance or class of transactions, the auditor needs to consider audit risk<sup>4</sup> and design and apply appropriate substantive tests to evaluate management's assertions.

**.18** The risk associated with management's assertions about related party transactions is often assessed as higher than for many other types of transactions because of the possibility that the parties to the transaction are motivated by reasons other than those that exist for most business transactions.<sup>5</sup>

**.19** The higher the auditor's assessment of risk regarding related party transactions, the more extensive or effective the audit tests should be. For example, the auditor's tests regarding valuation of a receivable from an entity under common control might be more extensive than for a trade receivable of the same size because the common parent may be motivated to obscure the substance of the transaction. In assessing the risk of the related party transactions the auditor obtains an understanding of the business purpose of the transactions. Until the auditor understands the business sense of material transactions, he cannot complete his audit. If he lacks sufficient specialized knowledge to obtain that understanding for a particular transaction, he should consult with persons who do have the requisite knowledge. In addition, to understand the transaction, or obtain evidence regarding it, the auditor may have to refer to audited or unaudited financial statements of the related party, apply procedures at the related party, or in some cases audit the financial statements of the related party.

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<sup>2</sup> In this case, the auditor should follow the guidance in Interpretation No. 1, "Specific Procedures Performed by Other Auditors at the Principal Auditor's Request," of section 543, *Part of Audit Performed by Other Independent Auditors* (sec. 9543 par. .01-.03).

<sup>3</sup> There is no intention in this interpretation to modify section 543 paragraph .12c regarding the principal auditor's consideration of review of the other auditor's workpapers when he decides not to make reference to the other auditor.

<sup>4</sup> Audit risk and its components are described in section 312, *Audit Risk and Materiality in Conducting an Audit*.

<sup>5</sup> See section 334 in paragraph .06.

**.20 Question**—Section 334, *Related Parties*, paragraph .07 states that specific audit procedures should be applied to determine if related parties exist. That paragraph also suggests some specific audit procedures to identify related parties that the auditor should consider. What other audit procedures for determining the existence of related parties should the auditor consider?

**.21 Interpretation**—The auditor should consider obtaining representations from the entity's senior management and its board of directors about whether they or any other related parties engaged in any transactions with the entity during the period.

[Issue Date: May 1986.]

## **7. Management's and Auditor's Responsibilities With Regard to Related Party Disclosures Prefaced by Terminology Such As "Management Believes That"**

**.22 Question**—Management discloses in its financial statements that a related party transaction was consummated on terms equivalent to those that prevail in arm's length transactions, and prefaces the representation with a phrase such as "Management believes that" or "It is the Company's belief that." Does the use of such terminology change management's responsibility to substantiate the representation?

**.23 Interpretation**—No. Financial Accounting Standards Board *Accounting Standards Codification* 850-10-50-5 states that the representations about a related party transaction "shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated. "A preface to a disclosure such as "Management believes that" or "It is the Company's belief that" does not change management's responsibility to substantiate the representation. Section 334, *Related Parties*, paragraph .12 indicates that if such a representation is included in the financial statements and the auditor believes that the representation is unsubstantiated by management, he should express a qualified or adverse opinion because of a departure from generally accepted accounting principles, depending on materiality.

[Issue Date: May 2000; Revised: June 2009.]

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