

**NEPAL STANDARDS ON AUDITING
RELATED PARTIES**

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Introduction

1. The purpose of this Nepal Standard on Auditing (NSA) is to establish standards and provide guidance on the auditor’s responsibilities and audit procedures regarding related parties and transactions with such parties regardless of “Related Party Disclosures,” or similar requirement, is part of the financial reporting framework.
2. This NSA is to be read in conjunction with the Preface to Nepal Standards on Auditing.
3. This NSA contains the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material.
4. This NSA needs only be applied to material matters.
5. **The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management of related parties and the effect of related party transactions that are material to the financial statements.** However, an audit cannot be expected to detect all related party transactions.
6. As indicated in NSA 01, “Objective and General Principles Governing an Audit of Financial Statements,” in certain circumstances there are limitations that may affect the persuasiveness of evidence available to draw conclusions on particular financial statement assertions. Because of the degree of uncertainty associated

with the financial statement assertions regarding the completeness of related parties, the procedures identified in this NSA will provide sufficient appropriate audit evidence regarding those assertions in the absence of any circumstance identified by the auditor that:

- (a) increases the risk of misstatement beyond that which would ordinarily be expected; or
- (b) indicates that a material misstatement regarding related parties has occurred.

Where there is any indication that such circumstances exist, the auditor should perform modified, extended or additional procedures as are appropriate in the circumstances.

- 7. Definitions regarding related parties and related party transactions are given hereunder for the purposes of this NSA:
 - a) Related party- parties are considered to be related if one party has the ability to control the other party or exercise significant influence over party in making financial and operating decisions.
 - b) Related party transactions- a transfer of resources or obligations between related parties, regardless of whether a price is charged.
- 8. Management is responsible for the identification and disclosure of related parties and transactions with such parties. This responsibility requires management to implement adequate accounting and internal control systems to ensure that transactions with related parties are appropriately identified in the accounting records and disclosed in the financial statements.
- 9. The auditor needs to have a level of knowledge of the entity's business and industry that will enable identification of the events, transactions and practices that may have a material effect on the financial statements. While the existence of related parties and transactions between such parties are considered ordinary features of business, the auditor needs to be aware of them because:
 - (a) the financial reporting framework may require disclosure in the financial statements of certain related party relationships and transactions;
 - (b) the existence of related parties or related party transactions may affect the financial statements. For example, the entity's tax liability and expense may be affected by the tax laws in various jurisdictions which require special consideration when related parties exist;

- (c) the source of audit evidence affects the auditor's assessment of its reliability. A greater degree of reliance may be placed on audit evidence that is obtained from or created by unrelated third parties; and
- (d) a related party transaction may be motivated by other than ordinary business considerations, for example, profit sharing or even fraud.

Existence and Disclosure of Related Parties

10. **The auditor should review information provided by the directors and management identifying the names of all known related parties and should perform the following procedures in respect of the completeness of this information:**

- (a) review prior year working papers for names of known related parties;
- (b) review the entity's procedures for identification of related parties;
- (c) inquire as to the affiliation of directors and officers with other entities;
- (d) review shareholder records to determine the names of principal shareholders or, if appropriate, obtain a listing of principal shareholders from the share register;
- (e) review minutes of the meetings of shareholders and the board of directors and other relevant statutory records such as the register of directors' interests;
- (f) inquire of other auditors currently involved in the audit, or predecessor auditors, as to their knowledge of additional related parties; and
- (g) review the entity's income tax returns and other information supplied to regulatory agencies.

If, in the auditor's judgement, the risk of significant related parties remaining undetected is low, these procedures may be modified as appropriate.

11. **Where the financial reporting framework requires disclosure of related party relationships, the auditor should be satisfied that the disclosure is adequate.**

Transactions With Related Parties

12. **The auditor should review information provided by directors and management identifying related party transactions and should be alert for other material related party transactions.**
13. **When obtaining an understanding of the accounting and internal control systems and making a preliminary assessment of control risk, the auditor should consider the adequacy of control procedures over the authorisation and recording of related party transactions.**
14. During the course of the audit, the auditor needs to be alert for transactions which appear unusual in the circumstances and may indicate the existence of previously unidentified related parties. Examples include the following:
 - Transactions which have abnormal terms of trade, such as unusual prices, interest rates, guarantees, and repayment terms.
 - Transactions which lack an apparent logical business reason for their occurrence.
 - Transactions in which substance differs from form.
 - Transactions processed in an unusual manner.
 - High volume or significant transactions with certain customers or suppliers as compared with others.
 - Unrecorded transactions such as the receipt or provision of management services at no charge.
15. During the course of the audit, the auditor carries out procedures which may identify the existence of transactions with related parties. Examples include the following:
 - Performing detailed tests of transactions and balances.
 - Reviewing minutes of meetings of shareholders and directors.
 - Reviewing accounting records for large or unusual transactions or balances, paying particular attention to transactions recognised at or near the end of the reporting period.
 - Reviewing confirmations of loans receivable and payable and confirmations from banks. Such a review may indicate guarantor relationship and other related party transactions.

- Reviewing investment transactions, for example, purchase or sale of an equity interest in a joint venture or other entity.

Examining Identified Related Party Transactions

16. **In examining the identified related party transactions, the auditor should obtain sufficient appropriate audit evidence as to whether these transactions have been properly recorded and disclosed.**
17. Given the nature of related party relationships, evidence of a related party transaction may be limited, for example, regarding the existence of inventory held by a related party on consignment or an instruction from a parent company to a subsidiary to record a royalty expense. Because of the limited availability of appropriate evidence about such transactions, the auditor would consider performing procedures such as:
 - Confirming the terms and amount of the transaction with the related party.
 - Inspecting evidence in possession of the related party.
 - Confirming or discussing information with persons associated with the transaction, such as banks, lawyers, guarantors and agents.

Management Representations

18. **The auditor should obtain a written representation from management concerning:**
 - (a) **the completeness of information provided regarding the identification of related parties; and**
 - (b) **the adequacy of related party disclosures in the financial statements.**

Audit Conclusions and Reporting

19. **If the auditor is unable to obtain sufficient appropriate audit evidence concerning related parties and transactions with such parties or concludes that their disclosure in the financial statements is not adequate, the auditor should modify the auditor's report appropriately.**

Compliance with International Standards on Auditing

20. Compliance with this NSA ensures compliance in all material respects with ISA 550 (Related Parties).

Effective Date

21. This Nepal Standards on Auditing becomes operative for the audit commencing on or after 01 Shrawan 2062 corresponding to 16 July 2005. Earlier application is encouraged.

Public Sector Perspective

1. In applying the audit principles in this NSA, auditors have to make reference to legislative requirements which are applicable to public sector entities and employees in respect of related party transactions. Such legislation may prohibit entities and employees from entering into transactions with related parties. There may also be a requirement for public sector employees to declare their interests in entities with which they transact on a professional or commercial basis. Where such legislative requirements exist, the audit procedures would need to be expanded to detect instances of noncompliance with these requirements.
2. “Related Party Disclosures” does not require that transactions between government controlled enterprises be disclosed. Definitions of related parties do not address all circumstances relevant to public sector entities. For example, the status, for purposes of application of this NSA, of the relationship between ministers and departments of government, and departments of government and statutory authorities or government agencies is not discussed.