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# Transactions not at Arm's Length: Considerations for Auditors

Presenter: **Lettie Janse van Vuuren CA(SA)**

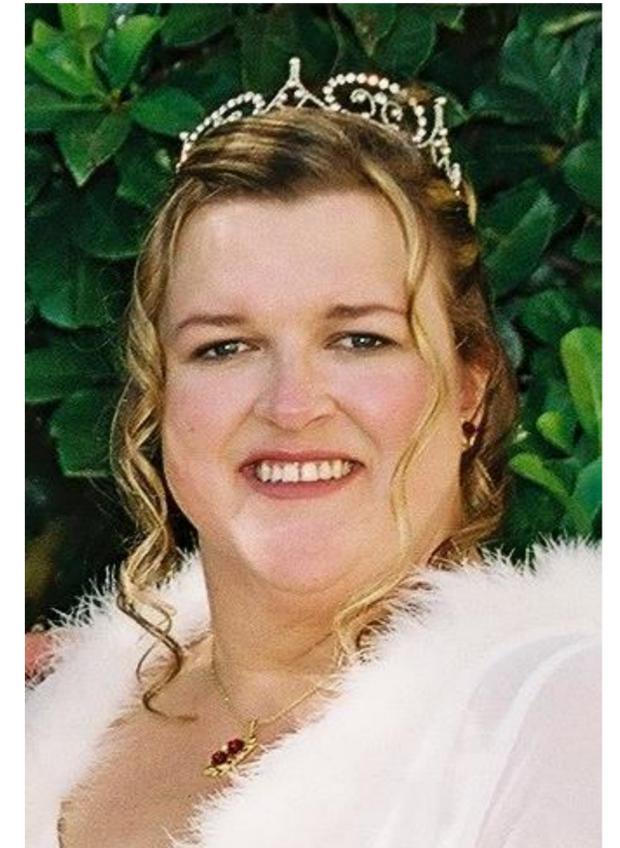
**26 AUGUST 2020**

***IRBA Staff Audit Practice Alert 5: The Auditor's Considerations  
with respect to Transactions that are not at Arm's Length***

# Presenter

## Lettie Janse van Vuuren CA(SA), RA, CBA(SA)

- Lettie joined SA Accounting Academy in November 2017 as Head of Technical. She is a Chartered Accountant, Registered Auditor and Certified Business Accountant.
- She is a **professional trainer and webinar host**, and with her relaxed and humorous presentation style, she is able to hold the attention of an audience. She has a unique ability to communicate with delegates at their respective levels of knowledge and experience. Over the last 20 years, she has trained thousands of partners, managers, trainee accountants and other professionals.
- She is responsible for our MCLU (Monthly Compliance and Legislation Updates).
- She was the Professional Development Manager at SAICA for 4 years and in charge of accrediting new training offices and monitoring existing ones (including the moderation of training offices and trainee assessments).
- Lettie is passionate about improving the efficiency and standardisation at practices. She has extensive experience on a variety of technical and practical topics which she consults on, including: SAICA re-accreditation assistance and preparation, IRBA inspection assistance and preparation, audit file reviews (post-issuance monitoring and EQCR), Quality control implementation, other office-specific manuals, and FASSET skills development facilitation.



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**Where appropriate, a **Q & A Summary** will be uploaded to your profile as soon as all answers have been documented.**

# WHAT'S ON THE AGENDA?

# Table of Contents

**Module 1:** Introduction

**Module 2:** ISA 550 in a Nutshell

**Module 3:** Risk Assessment Procedures

**Module 4:** Specific considerations relating to transactions that are not arm's length

**Module 5:** Illustrative procedures (for risk assessment & further procedures)



# On the lighter side...



Search ID: sat0244

"Your trouble is, you're too short in the arms!"

# MODULE 1

# INTRODUCTION

# Module 1

The following items are dealt with here:

## 1. IRBA Communiqué

- Based on **IRBA Staff Audit Practice Alert 5: The Auditor's Considerations with respect to Transactions that are not at Arm's Length**

## 2. General

- What does arm's length mean?
- Implications of transactions that are not arm's length
- Decision-making process when any transaction not at arm's length has been identified

## **IRBA Staff Audit Practice Alert 5: The Auditor's Considerations with respect to Transactions that are not at Arm's Length**

- ❑ *Published in June 2020*
- ❑ *IRBA Communiqué released on 30 June 2020*

### **The release of this IRBA Staff Audit Practice Alert:**

- **serves to provide auditors with guidance and considerations to be made with respect to transactions that are not at arm's length, and the possible auditor's responses to the resulting audit risks**
- **The focus of this IRBA alert is on identifying transactions that are not at arm's length, and does not focus on parties that are related.**

➤ ***This IRBA Staff Alert is available to you as a Source Document***

## What is fraud? **ISA 240 defines Fraud as:**

- ❑ Fraud is defined as an intentional act, by one or more individuals among management, those charged with governance, employees or **third parties**, involving the use of deception to obtain an unjust or illegal **advantage**

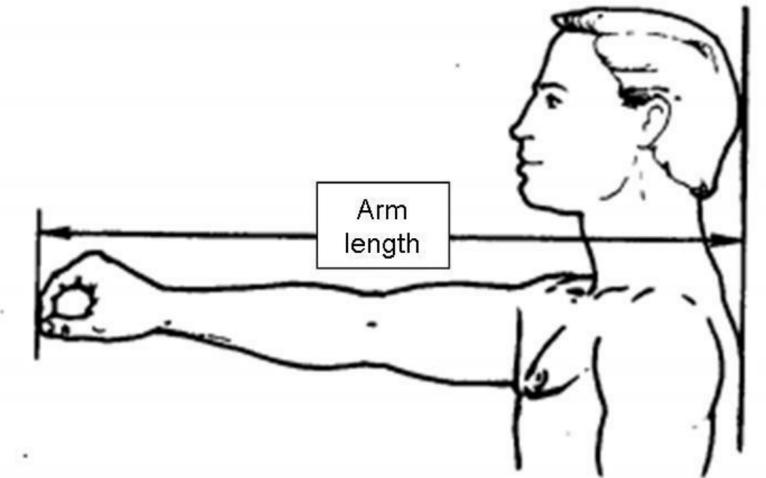
## What must auditors do?

- Registered auditors (RAs) are required to **be alert to the possibility of fraud**, thereby enabling them to respond appropriately
- **NB! = Auditors are NOT required to find fraud – unless they have been engaged to perform a forensic audit!**

# What is arm's length?

An **arm's length transaction** indicates a transaction:

- between two independent parties
- in which both parties are acting in their own self-interest.
- Both buyer and seller are independent,
- Both possess equal bargaining power,
- Both are not under pressure or duress from the opposing party, and
- Both are acting in their own self-interest to attain the most beneficial deal.



➤ ***Refer to Webinar Material for detail***

# Why worry about arm's length?

**Implications of transactions that are not at arm's length:**

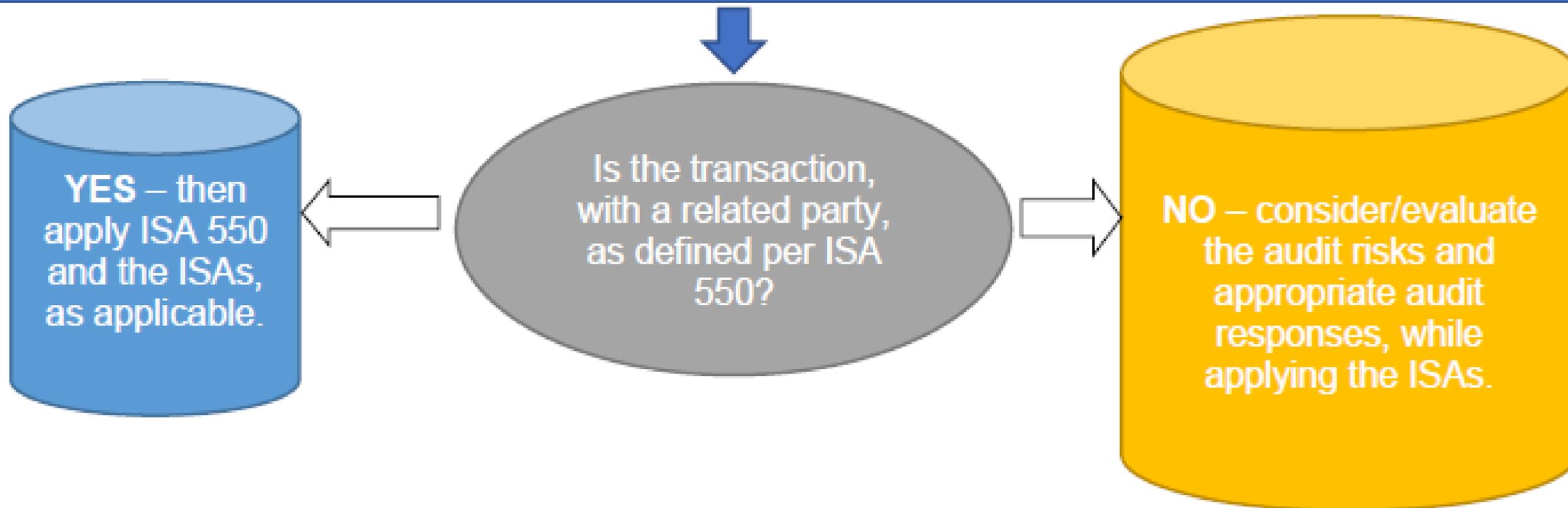
- ❑ **Transactions that are not at arm's length may pose risks in an audit of the financial statements, because if such transactions are not identified by management and/or the auditor it could give rise to risks that are not addressed in the audit, and ultimately in misstatements in the financial statements.**

➤ ***Refer to IRBA Staff Alert [page 2](#)***

# Decision flowchart

The following decision making process is useful when any transaction not at arm's length has been identified

For any transaction not at arm's length that is identified when obtaining an understanding of the entity, its control environment or other risk assessment procedures



# MODULE 2

# ISA 550 IN A NUTSHELL

# ISA 550 in a Nutshell

The following items are dealt with here:

1. Summary of Definitions of a Related Party

➤ *Refer to Webinar Material for detail*

ISA 550 expands on how ISA 315 (Revised) and ISA 330 are to be applied in relation to risks of material misstatement due to fraud.

***We will not be dealing with this ISA in detail. Instead, we will focus on the issues that have been highlighted in this alert, and other specific considerations that have been published for the 1st time.***

# Definitions as per...

## Definitions of a Related party as per:

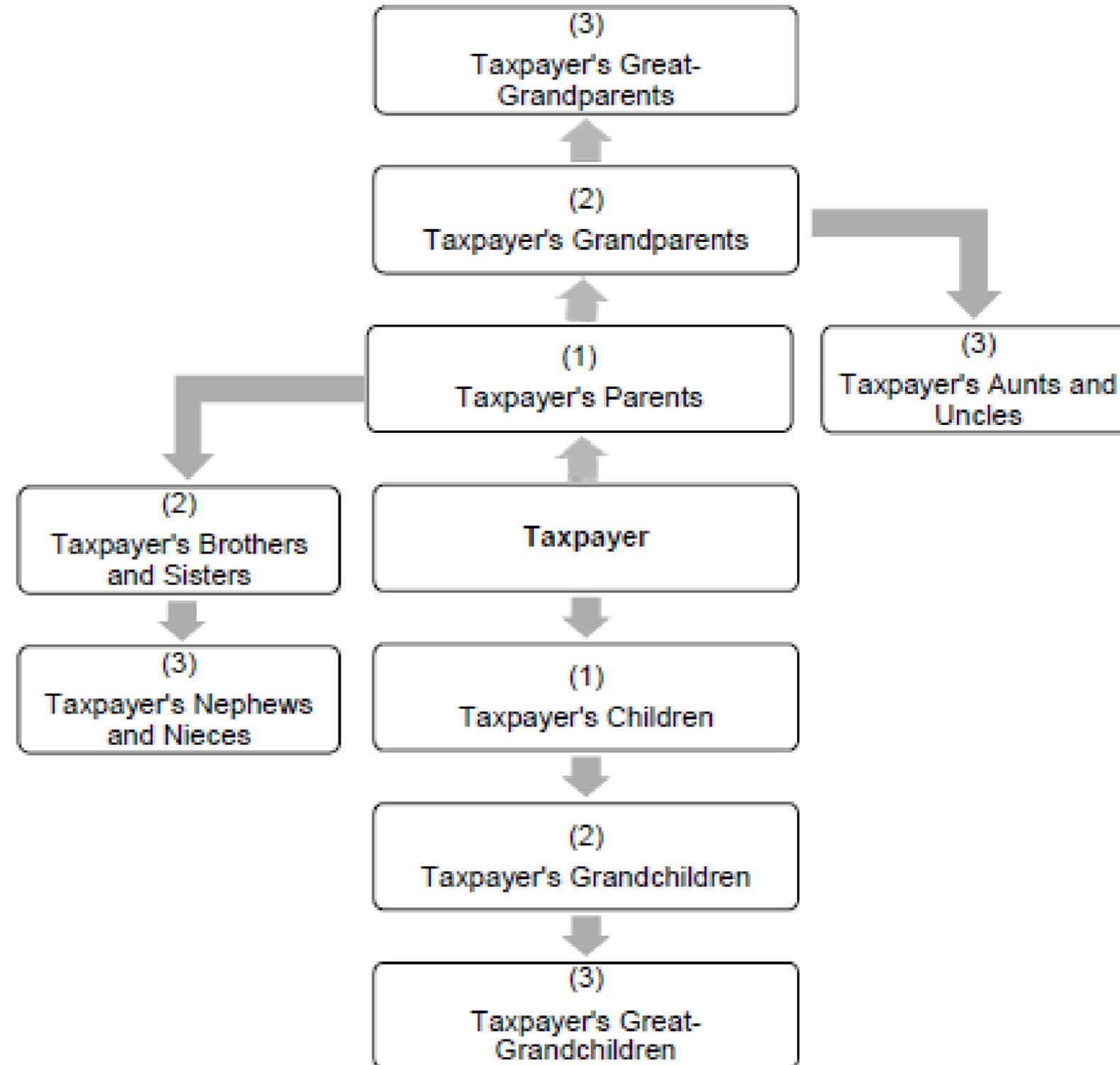
- ISA 550
  - IFRS (IAS 24)
  - the Companies Act
  - JSE Listing Requirements
  - National Treasury's Accounting Manual for Departments
  - King IV Report on Governance for South Africa 2016
  - South African Income Tax Act No. 58 of 1962 (Income Tax Act, 1962) – Definition of “connected person”
  - IRBA Code (Revised November 2018) – Reference to Related Entities
- ***Refer to IRBA Staff Alert Appendix B***

# IN 67 – Connected Persons

## Appendix B

Diagram illustrating the rule for determining persons who are related within the third degree of consanguinity

*This Interpretation Note is available to you as a Source Document*



# MODULE 3

# RISK ASSESSMENT PROCEDURES

The following items are dealt with here:

1. How ISA 550 expands on how ISA 315 (Revised) and ISA 330 are to be applied in relation to risks of material misstatement due to transactions that are not arm's length

➤ ***Refer to Source Document pages 3 to 4***

The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.

The risk assessment procedures shall include the following:

- Inquiries of management, of appropriate individuals within the internal audit function (if the function exists) and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.
- Analytical procedures
- Observation and inspection.

➤ *Refer to Source Document **page 3***

# MODULE 4

# SPECIFIC CONSIDERATIONS

# Specific Considerations

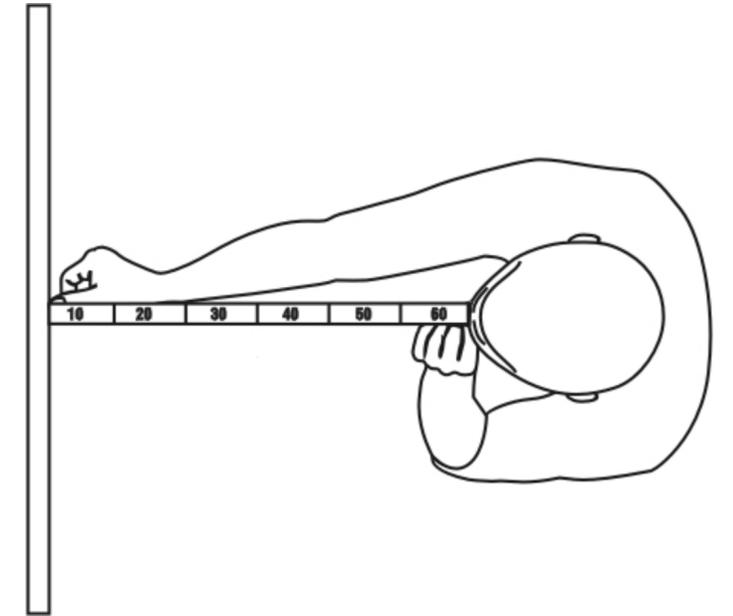
The following items are dealt with here:

1. Possible indicators of Transactions that are not at Arm's Length during the audit (including possible indicators of the existence of Related Parties)
2. Questions to be considered to determine the Audit Implications of Transactions that are not at Arm's Length

# 2 NB steps

## STEP 1

- **Identify** the transactions that are **not** at arm's length



## STEP 2

- Consider the **audit implications** of transactions that are not at arm's length

# STEP 1 = Indicators

## Refer to the table on page 4

- Lists **17 categories** with examples

*This table is not exhaustive, and lists possible indicators of transactions that are not at arm's length during the audit*

➤ **Refer to Source Document *pages 4 to 7***

# STEP 2 = Questions to ask

- The auditor is guided by the requirements and application material contained in the relevant ISAs.
- Per the ISAs, the auditor shall plan and perform an audit with professional scepticism, recognising that circumstances exist that cause the financial statements to be materially misstated.
- Once the transactions that are not at arm's length have been identified as per paragraph 12, the questions to be considered, as set out in the table, can be **used by the auditor when considering the audit implications of transactions that are not at arm's length.**

**Refer to the 16 Questions set out in the Table on pages 7 to 9**

*The above table is not an exhaustive list of considerations and should not detract from the requirements of the audit engagement team to exercise its professional judgement.*

➤ **Refer to Source Document pages 7 to 9**

# MODULE 5

# ILLUSTRATIVE PROCEDURES

# Illustrative Procedures

The following items are dealt with here:

1. Appendix A – Illustrative Procedures which may be used for risk assessment and further procedures for transactions with the entity that might not be at arm's length

**Refer to the table on pages 10 and 11**

- which provides 11 illustrative procedures at the assertion level

*This table is not exhaustive, and lists possible indicators of transactions that are not at arm's length during the audit*

➤ **Refer to Source Document *Appendix A***

# QUESTIONS?



# Formal Q&A Session

We will now take a **quick comfort break** before we discuss some questions received during the webinar.

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**Thank you for your  
participation!**

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