

1st DRAFT (15 Dec'20)

FOR REVIEW BY DAAB

(On 21 Dec'20)

The Digital Accounting and Assurance Board (DAAB) of The Institute of Chartered Accountants of India (ICAI) invites comments on a new Forensic Accounting and Investigation Standard (FAIS) on – **Related And Connected Parties** .

Comments are most helpful if they indicate a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments can be Submitted at

<https://forms.office.com/Pages/ResponsePage.aspx?id=DOHF0zhjoU6NJ-O1tggEOvuF6SRz25pIvVExBjm2K8JURTEwR09XSExIRUFYWkxQREFOR Dg5WVvk0Ui4u>

Last date for sending comments is January 28, 2021.

FORENSIC ACCOUNTING AND INVESTIGATION STANDARD No. 540

RELATED AND CONNECTED PARTIES

Contents

	Paragraph(s)
Introduction and Scope	1
Objectives	2
Requirements	3
Explanatory Comments	4
Documentation for Compliance	5
Effective Date	6
Annexure 1: Additional Procedures involving Related and Connected Parties	

This Forensic Accounting and Investigation Standard Number 540, on “Related and Connected Parties,” issued by the Council of the Institute of Chartered Accountants of India (ICAI) should be read in conjunction with the “Preface to the Forensic Accounting and Investigation Standards”, the “Framework Governing Forensic Accounting and Investigation Standards” and “Basic Principles of Forensic Accounting and Investigations” issued by the ICAI.

1 Introduction and Scope

- 1.1 Businesses may enter into arrangements with other businesses where they have a relationship or connection not in the ordinary course of business. This raises additional risks which requires special focus and attention by the Professional when conducting Forensic Accounting and Investigation (FAI) assignments.
- 1.2 **Definitions:** For the purpose of FAI Standards, some key terms are defined as follows:
- 1.2.1 **Related Parties (RPs) and Transactions (RPTs):** A Related Party is identified under various statutes or prevailing laws based on the relationship of the parties involved, such as the personal relationship of the individual or in the case of entities, through shareholding or position of key personnel. Transactions with such parties are referred to as Related Party Transactions (RPTs).
- 1.2.2 **Connected Parties (CPs):** Connected Parties are those where one has the ability to influence the decisions or transactions of another, in a manner which is prejudicial to the interest of either party, or collude against the interest of any other third party. Such relationship may not fall under the statutory definition of a Related Party, but has the principal characteristics of one.
- NOTE: The substance of the relationship, and not merely the legal form, shall be considered while identifying any RPs for the purpose of FAI Standards, and any reference to the broader term of CPs is deemed to include RPs.
- 1.2.3 **Connected Party Transactions (CPTs):** A Connected Party Transaction refers to any transaction, deal or arrangement involving RPs or CPs. Due emphasis is expected from the Professional on the analysis of CPTs, as these present a greater risk for collusion, concealment, management over-ride of controls, or otherwise prejudicial to the interests of any person (legal or natural).
- 1.3 This Forensic Accounting and Investigation Standard (FAIS) 540 on Related and Connected Parties outlines the Professional's responsibilities in identifying and examining CPTs, based on the scope of work agreed with the Client.
- 1.4 **Scope:** The scope of this Standard applies to all FAI engagements, where an examination of transactions involving Related or Connected Parties is specifically covered by the scope of work as agreed between the Professional and the Client.

2 Objectives

- 2.1 This Standard on Related and Connected Parties explains the principles and practices relevant when conducting assignments involving transactions and arrangements with RPs and CPs.
- 2.2 The main objective of the Standard is to ensure that the Professional (and other stakeholders) have clarity on:

- (a) the requirements related to the proper identification and evaluation of risks emanating from the relationships or connections involving RPs and CPs;
- (b) certain unique aspects of RPTs and CPTs that need to be evaluated by the Professional to establish their legitimacy; and
- (c) the additional work procedures which need to be conducted with respect to RPs or CPs and arrangements or transactions thereof.

3 Requirements

- 3.1 **Scope of work:** The Professional shall, as per FAIS 220 on “Engagement Acceptance and Appointment”, agree on the scope of work to be undertaken with respect to either RPs or CPs (or both).
- 3.2 **Risk Assessment:** The Professional will undertake an assessment of the risk, as follows:
 - 3.2.1 The Professional shall review and identify attributes of CPs, such as the background of the parties involved, official or unofficial arrangements and transactions undertaken, timing, pricing and valuation of these transactions, mode of payment or settlement, nature of disclosure, etc. to assess the possibility of any fraud risk or internal control gaps.
 - 3.2.2 In line with FAIS 120 on “Understanding Fraud Risk”, the Professional shall obtain an understanding of the relevant fraud risk environment which relate to existence of CPs, and relevant fraud risk factors such as their transactions, valuation, or business conditions under which the parties operate (refer Para 4.1).
 - 3.2.3 The Professional shall consider the substance of a relationship in a transaction and give it precedence over the legal form, when assessing fraud risks (refer Para 4.2).
- 3.3 **Professional Skepticism:** The Professional shall maintain due skepticism throughout the assignment, especially when examining relationships and transactions or when inspecting records, documents or other evidence for possible arrangements or other information that may indicate the existence of CPs. If the disclosure or valuation issues surface, and appear intentional, or otherwise indicative of fraud risk, the Professional shall evaluate the implications on the scope and extent of planned procedures.
- 3.4 **Additional Procedures:** The Professional shall evaluate the need to conduct additional work procedures that relate to review of CPs based on the results of Risk Assessment or findings during the course of the assignment. For example, the Professional may consider undertaking additional procedures as enumerated in **Annexure 1**.
- 3.5 **Evidence and Reporting:** Refer Para 4.3.
 - 3.5.1 Suitable and sufficient evidence shall be collected by the Professional in line with the requirements of FAIS 320 on “Evidence and Documentation”. In

particular, this evidence shall identify the relationship of the parties involved, the nature of the transactions in question and the manner in which they point to possible fraud risk, if appropriate.

3.5.2 The Assignment Report shall, in line with FAIS 360 on “Reporting Results”, highlight any RPT or CPT related concerns which may have come to light during the course of the assignment. Where there is an uncertainty regarding the legal suitability of the evidence discovered, the same shall be specifically mentioned in the report.

3.5.3 The Professional shall report any constraints or lack of cooperation in conducting work procedures related to CPTs.

4 Explanatory Comments

4.1 **Fraud Risk Factors (refer Para 3.2.2):** Absence of policy or framework on dealing with related party issues or use of complex corporate structures may be prime risk factors of a possible intent to disguise business relationships and transactions.

4.2 **Substance over form (refer para 3.2.3):** An individual or entity can influence the underlying arrangements or transactions with CPs, or create a network thereof, in a manner beyond the ambit of Regulatory Compliance Framework (applicable laws and regulations). Thus, evidence pointing to controlling interest or ability to exert undue influence shall be considered while identifying any CPs during the course of the assignment.

4.3 **Evaluation of arm's length aspects (refer para 3.5):** In some cases, evidence may be readily available regarding how the valuation of a Related Party Transaction compares to that of a similar arm's length transaction. In other cases, the Professional may face practical challenges that limit the Professional's ability to obtain sufficient and appropriate evidence. Depending on the access and reliability of various sources of internal and external information, it is a matter of professional judgement on how best to arrive at arm's length price of the transactions in question. The Professional may decide to engage an expert to determine a market price and or other business terms in accordance with the requirements laid down in FAIS 230 on “Using the help of Experts”.

5 Documentation for Compliance

5.1 Document all undisclosed RPs or CPs and whether there are any arrangements or transactions with them.

- 5.2 When evaluating the nature of CPs, factors which are relevant to the relationship and other external environmental factors which indicate how such significant control or influence exists, shall be documented.
- 5.3 Document all the supporting evidence which are forming part of the Professional's report in line with FAIS 320 on "Evidence and Documentation".

6 Effective Date

- 6.1 This Standard is applicable for all engagements beginning on or after ... (a date to be notified by the Council of the ICAI).

Annexure 1

ADDITIONAL PROCEDURES INVOLVING RELATED AND CONNECTED PARTIES

1. Examination of Records or Documents: Certain records or documents, may indicate the presence of related or connected relationships or arrangements (indicative list):
 - (a) Business volumes and transactions of Related and Connected Parties flowing primarily from one source.
 - (b) Connected Parties maintaining books of accounts at the same premises and in the same accounting software as the target entity.
 - (c) Common registration address of Connected Parties.
 - (d) Common IP addresses or email addresses being used by the target entity with Connected Parties.
 - (e) Resignation of key employees followed by setup of entities under their names.
 - (f) Existence of similar professional setup for compliances of Connected Parties as the target entity.
 - (g) Phone numbers used for OTPs and authentication of banking or tax compliances being same as the target entity.

2. Risk factors to consider: Certain transactions may indicate arrangements outside the normal course of business (indicative list):
 - (a) Complex equity transactions, such as corporate restructurings or acquisitions.
 - (b) Transactions with offshore entities set-up in certain foreign jurisdictions with opaque corporate structures.
 - (c) The leasing of assets (with or without buy-back provisions) or the rendering of management services to CPs, especially without exchange of any consideration.
 - (d) Sales transactions with unusually large discounts or returns, or transactions under contracts where terms are changed close to expiry.
 - (e) Unusual terms of trade, such as prices, interest rates, guarantees and repayment terms.
 - (f) Insufficient viable business reason for the transaction/arrangement.
 - (g) Large after-date transactions recorded outside the regular accounting process and through Journal Entries.