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TIRUPUR BRANCH OF SICASA

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Your views / suggestions / comments are Welcome. Kindly send your Contributions in the form of articles to tiruicai@gmail.com

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Dear Future Chartered Accountants,

As we step into the vibrant month of October, I extend my warm greetings to each one of you. This period is significant, as many of you may be in the midst of your academic pursuits or preparing for the upcoming examinations. I want to take this moment to remind you all of the importance of perseverance and dedication.

Our journey as CA students is undoubtedly challenging, but it is these challenges that shape us into the professionals we aspire to become. The discipline, commitment, and focus you invest today will pave the way for a successful career tomorrow. Remember that every small effort you make, every concept you master, and every extra hour you dedicate is bringing you closer to your goal.

At SICASA Tirupur, we are continually working towards providing you with enriching experiences and opportunities. From knowledge-sharing sessions to skill-building workshops, we aim to support you in your journey towards becoming a well-rounded professional. I encourage you all to take full advantage of these initiatives.

In the spirit of the festival season, let us all embrace the values of community, collaboration, and mutual growth. As we celebrate our cultural heritage, let us also celebrate the spirit of learning and self-improvement.

Wishing you all the very best for your studies, exams, and beyond. Stay focused, stay motivated, and continue to move forward with confidence.

Thanks and Regards

CA Saravana Raja K,

Chairman,

Tirupur Branch of SICASA

RELATED PARTY TRANSACTIONS: AUDIT AND TAX IMPLICATIONS

INTRODUCTION

Related party transactions (RPTs) are financial dealings that occur between entities that have a pre-existing relationship, such as between a parent company and its subsidiaries, or between companies under common control. These transactions can range from sales and purchases to loans and management fees. The nature of RPTs raises important considerations in both auditing and taxation, as they can affect the accuracy of financial statements and have significant income tax implications. This essay explores the intricacies of RPTs in the context of auditing and their implications for income tax.

NATURE AND TYPE OF RELATED PARTY TRANSACTIONS

RPTs can take various forms, including:

1. Sales and Purchases: Transactions involving the sale of goods or services between related entities.
2. Loans and Guarantees: Financial arrangements where one entity lends money to another or guarantees loans.
3. Management Services: Agreements for management or consulting services provided between related parties.
4. Asset Transfers: Transactions involving the transfer or lease of property, equipment, or other assets.

While RPTs are often legitimate business arrangements, they can also pose risks of manipulation, as parties may not adhere to arm's length principles, which dictate that transactions should be conducted as if they were between unrelated parties.

REGULATORY FRAMEWORK

Both auditing and taxation of RPTs are governed by a set of standards and regulations. International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP) require disclosures of related party relationships and transactions in financial statements. Similarly, the Internal Revenue Service (IRS) in the United States has guidelines regarding how RPTs should be treated for tax purposes.

Under IAS 24, entities must disclose their related party relationships and the nature of RPTs in their financial statements, ensuring transparency for investors and stakeholders. From a tax perspective, the IRS requires that RPTs adhere to arm's length principles to prevent tax avoidance through income shifting.

AUDIT IMPLICATIONS

Auditors must navigate several critical steps when evaluating RPTs:

1. Risk Assessment: During the planning phase, auditors must assess risks associated with RPTs, including the possibility of management override or non-disclosure.
2. Identifying Transactions: Auditors should employ inquiries, analytical procedures, and reviews of documentation to identify RPTs. This step often involves scrutinizing contracts and board minutes.
3. Evaluating Disclosure: Once identified, auditors assess whether RPTs are disclosed adequately and comply with relevant accounting standards.
4. Testing Fairness: Auditors must evaluate whether the terms of RPTs are consistent with market conditions. This involves comparing transaction terms to those in similar arm's length transactions.

5. Documenting Findings: Comprehensive documentation of identified RPTs and the auditor's conclusions is essential for maintaining an audit trail.

INCOME TAX IMPLICATIONS

The tax implications of RPTs can be complex and multifaceted:

1. Arm's Length Principle: For tax purposes, the IRS requires that transactions between related parties be conducted at arm’s length. This principle aims to ensure that income is accurately reported, preventing tax avoidance through manipulation of prices and terms.
2. Transfer Pricing: Transfer pricing rules govern the pricing of transactions between related parties, especially for multinational corporations. Companies must document and justify their pricing methods to ensure compliance with tax regulations. Failure to do so can result in penalties and adjustments by tax authorities.
3. Tax Deductions: The deductibility of expenses related to RPTs can also come under scrutiny. For instance, management fees paid to a related party may be challenged by tax authorities if they are deemed excessive or not aligned with market rates.
4. Withholding Taxes: Certain RPTs may trigger withholding tax obligations, especially in cross-border transactions. Companies must be aware of these obligations to avoid tax liabilities and penalties.
5. Reporting Requirements: Both auditors and taxpayers must ensure compliance with reporting requirements related to RPTs. For example, the IRS requires certain forms to be filed that disclose related party transactions, helping maintain transparency and adherence to tax laws.

REPORTING RELATED PARTY TRANSACTIONS IN AUDIT REPORT

When reporting on RPTs in the audit report, auditors should consider the following elements:

1. Description of Transactions: The audit report should include a clear description of the nature of the related party relationships and transactions identified during the audit.
2. Compliance with Standards: Auditors should state whether the entity has complied with the relevant accounting standards for the disclosure of RPTs.
3. Materiality Assessment: If any RPTs are deemed material, the audit report should explicitly mention this, highlighting the potential impact on the financial statements.
4. Comments on Disclosure: The auditor may provide comments on the adequacy of the disclosures made in the financial statements, noting any omissions or weaknesses.
5. Opinion on Financial Statements: The overall audit opinion may be affected by the treatment of RPTs. If RPTs are not disclosed appropriately, the auditor may issue a qualified opinion or adverse opinion.

CHALLENGES IN AUDITING RELATED PARTY TRANSACTIONS

Auditors face several challenges in addressing RPTs, including:

1. Complex Relationships: The intricate nature of related party relationships can complicate the identification of all relevant transactions.
2. Management Override: The risk of management overriding internal controls can lead to undisclosed or manipulated transactions.

3. Limited Access to Information: Auditors may encounter difficulties obtaining complete information, particularly in privately held companies where disclosures may be minimal.
4. Cultural Factors: In some business cultures, RPTs may be commonplace, complicating the auditor's assessment of what constitutes appropriate behaviour.

CONCLUSION

Related party transactions present significant challenges in the fields of auditing and taxation. The potential for manipulation and misrepresentation makes it essential for auditors to rigorously assess these transactions and ensure compliance with relevant standards and regulations. Simultaneously, understanding the income tax implications of RPTs is crucial for maintaining regulatory compliance and ensuring fair tax treatment. By navigating the complexities of RPTs with diligence and transparency, auditors can help safeguard the integrity of financial reporting and uphold the principles of fair taxation, ultimately protecting the interests of stakeholders and the broader financial system.

KIRUTHIKA P
SRO0626139

THE NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA) HAS INDEED REVISED STANDARDS ON AUDITING, SPECIFICALLY ADDRESSING GROUP COMPANY AUDITS BEING TAKEN OVER BY LARGE CA FIRMS.

COMPANIES/CA FIRMS COVERED UNDER NFRA

The NFRA covers companies listed in India, unlisted companies with a net worth or paid-up capital of ₹500 crore or more, or annual turnover of ₹1000 crore or more, and companies whose securities are listed outside India [1]. Additionally, audit firms or auditors conducting audits of 200 or more companies in a year, 20 or more listed companies, or companies with significant net worth, paid-up capital, or annual turnover are also covered [1).

THE REAL ISSUE AND AMENDMENT REQUIREMENT

The issue at hand involves large CA firms dominating Group company audits, potentially compromising audit quality and independence. To address this, the NFRA has revised Standards on Auditing, specifically SA 600, to clarify responsibilities of principal auditors and other auditors in Group audits [2]. This amendment aims to improve audit quality, ensure better oversight, and prevent potential conflicts of interest.

POTENTIAL IMPACT

The revised standards are expected to:

- Enhance Audit Quality: By clarifying responsibilities, the NFRA aims to improve audit quality and prevent errors or biases.

- Increase Transparency: The standards promote transparency in audit procedures, ensuring stakeholders have accurate financial information.

- Promote Independence: The revised standards help maintain auditor independence, reducing the risk of compromised audit quality.

- Impact Large CA Firms: The changes may affect how large CA firms operate, potentially leading to changes in their audit practices and procedures.

These developments reflect the NFRA's efforts to strengthen financial reporting and auditing standards in India, aligning with global best practices .

AYUSH A PALEJA

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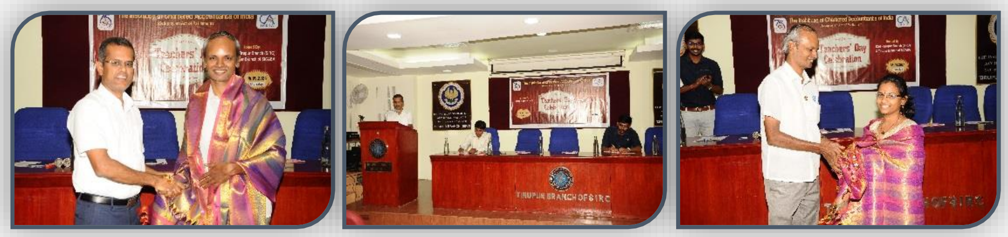
PHOTO GALLERY



TEARCHES DAY CELEBRATION ON 05TH SEP

ADV. ITT AND ORIENTATION PROGRAMS WERE CONDUCTED FROM 24TH SEP