REPORTING RELATED PARTY TRANSACTIONS

Background

This article considers the current reporting requirements for related party transactions within the UK, as well as those to be introduced by Financial Reporting Standard (FRS) 102, *The Financial Reporting Standard applicable in the UK and the Republic of Ireland*. This standard is expected to be approved by the Financial Reporting Council (FRC) before the end of 2012 and to be issued in the early part of 2013. It is effectively the UK version of the *International Financial Reporting Standard for Small and Medium Sized Entities* (IFRSME), but has been amended to incorporate options not available in the IFRSME, but which are currently available to entities in the UK, eg the ability to revalue fixed assets. The main requirements and key differences between the reporting frameworks are summarised in Appendix 1.

Current UK GAAP reporting regime

The Companies Act 2006, FRS 8 *Related Party Disclosures*, and the Financial Reporting Standard for Smaller Entities (FRSSE), are currently the main points of reference for the disclosure of related party transactions within the UK company reporting environment. For those companies applying international financial reporting standards (IFRS) adopted by the EU, International Accounting Standard (IAS) 24 *Related Party Disclosures* is the extant standard.

Companies Act 2006 disclosure requirements

The Companies Act 2006 (the Act) requirements apply both to abbreviated and full accounts. As abbreviated accounts are not required to show a true and fair view, then the disclosure requirements of FRS 8/the FRSSE or, if IFRS as adopted by the EU is being used, those of International Accounting Standard (IAS) 24 *Related Party Disclosures*, do not have to be complied with if abbreviated accounts are being prepared.

Related party disclosure requirements are contained in the Act and Statutory Instruments 2008/409 (Small Companies and Groups) and 2008/410 (Large and Medium Companies and Groups). Section 413 of the Act requires the following disclosures in relation to transactions with directors:

- the amount, the interest rate and conditions and the amounts repaid in relation to advances or credits granted to the directors of any individual or parent company, by that company or by any of its subsidiary undertakings; and
- the terms, the amount of the maximum liability that may be incurred and any amount paid or liability incurred by the company in fulfilling the guarantee for guarantees of any kind entered into on behalf of the directors of any individual parent company, by that company or by any of its subsidiary undertakings.

These disclosure requirements relate solely to directors of a company, although there is no specific requirement to name the director or directors concerned. Unlike the Companies Act 1985, there is no requirement to provide disclosures in relation to ‘transactions in which the director had a material interest’. Therefore, the only transactions which are required to be disclosed by the Act are ones in which the director is due monies to the company. Previously, amounts due by the company to a director would also have required to be disclosed. In addition, the legislation now refers to advances rather than loans. Advances can be viewed as loans, increases to amounts loaned, or, where an advance has taken a director’s loan account previously in credit, into debit.
Despite being contrary to what is stated in the legislation, best practice has developed that such amounts can be aggregated for disclosure purposes. It should also be noted that the requirement to disclose the maximum overdrawn amount on a director’s loan account during the year was not transferred to the 2006 Act.

Legislation also requires a subsidiary company to disclose details of the company (if any) regarded by the directors as the company’s ultimate parent company and the parent undertaking. This will include the name of the undertaking and its country of incorporation, if not the United Kingdom. If group financial statements are being prepared, the address from which copies of the group’s financial statements can be obtained and the principal place of business should also be disclosed.

In summary, the main point to be emphasised is that the Companies Act requirements, as stated above, also apply to abbreviated accounts. Of course, in the full accounts, FRS 8/FRSSE/IAS 24 would also require disclosure of any other material transactions with directors as well as other related parties.

Financial Reporting Standard 8 Related Party Disclosures

Since first being issued, this standard has been more closely aligned to IAS 24 Related Party Disclosures. The most recent revision to FRS 8 took place following the old Accounting Standards Board’s Improvements to Financial Reporting Standards 2010 exercise. Indeed the two standards now share the definition of a related party. However, some differences between the two standards remain.

The definition of a related party in FRS 8 and IAS 24 for accounting periods beginning on or after 1 January 2011 is as follows:

‘A related party is a person or entity that is related to the entity that is preparing its financial statements (in the Standard referred to as the ‘reporting entity’).

A person or a close member of that person’s family is related to a reporting entity if that individual:

• has control or joint control (see Box 1) over it; or
• has significant influence over it; or
• is a member of the key management personnel (see Box 2) or of a parent of it; or
• is a party with significant voting rights over it.

An entity is related to a reporting entity if any of the following conditions apply:

• the entity and the reporting entity are members of the same group.
• one entity is an associate or joint venture of the other entity (or of a member of a group of which the other entity is a member).
• both entities are joint ventures of the same third party.
• one entity is a joint venture of a third entity and the other entity is an associate of the third entity.
• the entity is a retirement benefit scheme for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a scheme, the sponsoring employers are also related to the reporting entity.
• the entity is controlled or jointly controlled by a person identified above.
• a person identified above who has significant influence (see Box 3) over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
• the entity is a pension fund (although the contributions paid in a pension fund by the entity are exempt).
• is an entity managing or managed by the reporting entity.
The list of potential related parties includes members of the close family (see Box 4) of identified related parties, as well as companies, trusts or partnerships in which any individual or close family member has a controlling interest.

A related party transaction as defined in FRS 8 is: ‘the transfer of assets or liabilities or the performance of services by, to, or for a related party irrespective of whether a price is charged’.

The following are deemed by FRS 8 not to be related parties:

a) two entities simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.

b) two venturers simply because they share joint control over a joint venture.

c) (i) providers of finance, (ii) trade unions, (iii) public utilities, and (iv) departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).

d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

Disclosure

Disclosure is required under FRS 8 of material related party transactions. An item would be considered material if its disclosure might reasonably be expected to influence decisions made by the users of financial statements. With respect to FRS 8, the materiality of related party transactions should be judged in terms of significance to the reporting entity and in relation to the other related party. If it is deemed to be material to either party, then disclosure is required. The disclosures required are:

- the names of the related parties;
- a description of the relationship, transactions and amounts involved;
- any other elements of the transactions as necessary for a full understanding of the financial statements;
- amounts due to or from related parties at the balance sheet date and any amounts written off in relation to debts due to or from them;
- guarantees and securities granted on behalf of a related party;
- reference should also be made to the ultimate controlling party or, if unknown, this fact should be stated;
- the payment of a dividend to a related party, such as a director or other major shareholders, if material. (Note: the repeal of the statutory requirement to disclose directors’ interests has brought this issue into focus and the standard provides no exemption in this respect).

The relevant disclosures are required, regardless of whether any related party transactions have occurred.

Items of a similar nature may be disclosed in aggregate, unless separate disclosure is deemed necessary for an understanding of the effects of the transaction.

Disclosure is not required of:

- in consolidated financial statements, any transactions or balances between group entities that have been eliminated on consolidation (this fact should be stated);
- transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by a member of that group;
- pension contributions paid to a pension fund; and
emoluments in respect of services as an employee of the reporting entity.

Nor does FRS 8 require disclosure of the relationship between the entity and providers of finance; utility companies, government bodies or general customers and suppliers. Also, no disclosure is required of compensation for key management personnel.

FRSSE

Disclosure requirements under the FRSSE remove the need to consider the materiality of transactions to each related party. Only materiality in relation to the entity needs to be considered. In addition:

- For periods commencing on or after 6 April 2008, FRS 8 only exempts wholly-owned subsidiaries from disclosure of intragroup related party transactions; the FRSSE, like the previous version of FRS 8, allows subsidiaries that are at least 90% owned to take this exemption.
- the simpler definition of a related party in the FRSSE has not been changed to align with the change to FRS 8 and is as follows:

‘Two or more parties are related parties when at any time during the financial period:

- one party has direct or indirect control of the other party; or
- the parties are subject to common control from the same source; or
- one party has significant influence over the financial and operating policies of the other party. Significant influence would occur if that other party is inhibited from pursuing its own separate interests.’

Related parties of the reporting entity include parent undertakings, subsidiary and fellow subsidiary undertakings; associates and joint ventures; investors with significant influence and their close families; and directors of the reporting entity and its parent undertakings and their close families.

The definition of ‘close family’ in the FRSSE is narrower than that in FRS 8 and is as follows:

‘Close members of the family of an individual are those family members, or members of the same household, who may be expected to influence, or be influenced by, that person in their dealings with the reporting entity.’

Disclosure is required of:

- the names of the related parties;
- a description of the relationship, transactions and amounts involved;
- any other elements of the transactions as necessary for a full understanding of the financial statements;
- amounts due to or from related parties at the balance sheet date and any amounts written off in relation to debts due to or from them;
- personal guarantees given by directors over the borrowings of the entity;
- the name of the controlling party and a description of the relationship.

IFRS reporting requirements under IAS 24

As stated earlier, the FRS 8 definition of a related party is mirrored in IAS 24. However, the definition of a related party transaction in IAS 24 is defined differently as:

‘a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.’
An entity is related to a reporting entity under the same conditions as previously listed in FRS 8, except for situations where:

- the entity is a pension fund (although the contributions paid into a pension fund by the entity are exempt.
- the entity is an entity managing or managed by the reporting entity.

The list of parties not considered to be related in IAS 24 is identical to that in FRS 8.

**Disclosure:**

Disclosure is required of the relationship between a parent and its subsidiaries, even if no transactions have taken place between them. The name of the parent, and the ultimate controlling party should also be disclosed for all entities.

The information to be disclosed shall, as a minimum, include:

- The amounts involved in the transactions.
- The outstanding balances along with their terms and conditions, as well as any guarantees granted.
- Provisions for doubtful debts and the remaining outstanding balances.
- Bad or doubtful debts from related parties expensed in the period.

These disclosures shall be made separately for: the parent; entities who exercise joint control or significant influence over the entity; subsidiaries, associates; joint ventures; directors and key management personnel and any other related parties.

**Note:** Unlike FRS 8, disclosure is not required of the names of the transacting related parties, however, separate disclosure is required for each of: the parent; entities with joint control (see Box 1) or significant influence (see Box 3); subsidiaries, associates and joint ventures; key management personnel and other related parties.

Although IAS 24 does not provide clear guidance on the application of materiality to both the individual and the entity, best practice would advocate that the same considerations towards materiality are applied under IFRS as would be applied under UK GAAP.

Disclosure is required of key management personnel compensation analysed between short-term employee benefits, post-employment benefits, other long-term benefits, termination benefits and share-based payments.

Examples of the types of transaction that should be disclosed are: purchase or sales of goods, property or other assets; provision or receipt of services; leases; provision of finance; transfer of licences or research & development; guarantees provided and settlement of the related party’s liabilities.

Items of a similar nature may be disclosed in aggregation unless separate disclosure is deemed necessary for an understanding of the effects of the transaction.

An entity shall not state that related party transactions were made on an arm’s length basis unless such terms can be substantiated.
Group transactions

IAS 24 does not provide the same exemption available under FRS 8 from disclosure of group transactions in the financial statements where consolidated financial statements have been produced.

Government-related entities

An exemption from some disclosure requirements is available if the relationship is with a government that has control, joint control or significant influence over the entity or with another entity over which the same government exerts the same level of control and influence. However, if this exemption is applied, the name of the government and the nature of the relationship as well as the nature and value of any significant transactions should be disclosed.

Looking ahead to future UK reporting requirements

Reporting under UK GAAP will follow the requirements of FRS 102 which is expected to take effect for accounting periods commencing on or after 1 January 2015, with early adoption likely to be permitted. Recent indications are that a modified version of the FRSSE is likely to be retained under the new accounting framework, although this has not yet been confirmed. Therefore, this standard will be of most relevance to those companies who do not currently use the FRSSE and are not inclined to use full IFRS.

The FRS 102 definition of a related party is the same as defined in FRS 8 and IAS 24.

A person or an entity is related to a reporting entity under the same circumstances as IAS 24, ie, as per FRS 8 but with the exceptions previously listed.

In the context of the standard, the persons or entities specified as not necessarily related parties are the same as both FRS 8 and IAS 24.

The definition of a related party transaction in FRS 102 is the same as the definition in IAS 24.

Disclosure

The disclosure requirements under FRS 102 are the same as per IAS 24 with the following exceptions:

- **Key management personnel** - Disclosure is required, but only in total, of compensation paid to key management personnel.
- **State-related entities** - Disclosure requirements for transactions with state-related entities are the same as in IAS 24, with the exception of disclosure of the value of any significant transactions.
- **Group transactions** - There is an exemption from disclosing a related party transaction between two or more members of a group, provided that any transacting subsidiary is wholly owned by a member of that group.
Box 1
Control - Control is defined in FRS 8 as ‘the ability to direct the financial and operating policies of an entity with a view to gaining economic benefits from its activities’. This differs from IAS 24 which defines control as ‘the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities’. In practice, however, the difference should have no significance.

Joint control - Although not explicitly defined in FRS 8, IAS 24 defines joint control as ‘the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.’

Box 2
Key management personnel - Key management personnel are defined in FRS 8 and IAS 24 as ‘those persons having authority and responsibility for planning, directing, and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity’.

Box 3
Significant influence - Not specifically defined in FRS 8, but IAS 24 defines significant influence as ‘the power to participate in the financial and operating policy decisions of the investee but not control of those policies’.

Box 4
Close family – This is defined in FRS 8 and IAS 24 as: ‘those family members or members of the same household, who may be expected to influence, or be influenced by, that person in their dealings with the reporting entity and include: that person’s children and spouse or domestic partner; children of that person’s spouse or domestic partner; and dependents of that person or that person’s spouse or domestic partner.’
## APPENDIX 1

Main requirements and key differences between the reporting frameworks

<table>
<thead>
<tr>
<th>Disclosures</th>
<th>Current UK GAAP (FRSSE exemptions in italics)</th>
<th>Current IFRS</th>
<th>Future UK GAAP: FRS (Applicable UK &amp; ROI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definition of related party</td>
<td>A person or entity that is related to the entity that is preparing its financial statements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Definition of related party transaction</td>
<td>The transfer of assets or liabilities or the performance of services by, to, or for a related party irrespective of whether a price is charged.</td>
<td>A transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.</td>
<td></td>
</tr>
<tr>
<td>Names of parties transacting</td>
<td>Disclose the names of transacting parties</td>
<td>Not required</td>
<td></td>
</tr>
<tr>
<td>Materiality</td>
<td>Consider for individual and entity FRSSE consider for entity only</td>
<td>Consider for both individual and entity - No specific guidance but best practice would advise</td>
<td></td>
</tr>
<tr>
<td>Compensation of key management personnel</td>
<td>Not required</td>
<td>Required with analysis between components</td>
<td>Required but only as a total</td>
</tr>
<tr>
<td>Ultimate parent and controlling party</td>
<td>Required</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inter-company transactions</td>
<td>No disclosure required in consolidated accounts for transactions eliminated on consolidation Details of relationship with subsidiaries required FRSSE allows exemption for 90% owned subsidiaries</td>
<td>Disclosure required Details of relationship with subsidiaries required</td>
<td>No disclosure of when two or more members of a group transact if subsidiary is wholly owned Details of relationship with subsidiaries required</td>
</tr>
<tr>
<td>Shareholder transactions</td>
<td>Required</td>
<td></td>
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<tr>
<td>Aggregation</td>
<td>Permitted except where necessary for full understanding</td>
<td></td>
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</tr>
<tr>
<td>Disclosure of transactions with directors</td>
<td>Names Relationship and amounts Balances due at year end Director guarantees Advances and credits to/from directors</td>
<td>Names not required Relationship and amounts Outstanding balances and any security Guarantees Advances and credits to/from directors</td>
<td>Name, nature of relationship and value of significant transactions as a minimum Name and nature of relationship</td>
</tr>
<tr>
<td>Government departments</td>
<td>No disclosure required if within their normal governmental role</td>
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</tbody>
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