# IAS 24, Related Party Disclosures - A Closer Look

Muthupandian, K S

The Institute of Cost and Works Accountants of India

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# Related Party
# Disclosures
# - A Closer Look


## K.S.Muthupandian*


International Accounting Standard (IAS) 24, *Related Party Disclosures,* prescribes the disclosures of related party transactions. In March 1983, the International Accounting Standards Committee (IASC) issued the Exposure Draft E25, *Disclosure of Related Party Transactions*. In July 1984, the IASC issued IAS 24, *Related Party Disclosures,* effective from January 1, 1986. In 1994, the IASC reformatted IAS 24. In April 2001, the International Accounting Standards Board (IASB) resolved that all Standards and Interpretation issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn. On December 18, 2003, the IASB issued the revised version of IAS 24. The effective date of IAS 24 (2003) was fixed as January 1, 2005. In February 2007, the IASB issued the Exposure Draft of Proposed Amendments to IAS 24. On December 11, 2008, the IASB issued the Revised Exposure Draft of Proposed Amendments to IAS 24. On November 4, 2009, the IASB issued revised IAS 24, *Related Party Disclosures*. The effective date of IAS 24 (2009) was fixed as January 1, 2011.

**Objective**

IAS 24 requires entities to disclose in their financial statements information about transactions with related parties. In broad terms, two parties are related to each other if one party controls, or significantly influences, the other party. The objective of IAS 24 is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

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***M.Com., FICWA**
**Email: ksmuthupandian@ymail.com / ksmuthupandian@gmail.com**

**Application**

IAS 24 shall be applied in:
• identifying related party relationships and transactions
• identifying outstanding balances between an entity and its related parties
• identifying circumstances in which disclosure of the relevant items is required
• determining the disclosures to be made about those items

**Key Definitions**

**Close members of the family of an individual** are family members, who may be expected to influence, or be influenced by, that individual in their dealings with the entity, including:
a. the individual’s domestic partner and children
b. children of the individual’s domestic partner
c. dependants of the individual or the individual’s domestic partner

**Compensation** includes all employee benefits (as defined in IAS 19, *Employee Benefits*) including employee benefits to which IFRS 2 applies. Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity. Compensation includes:
(a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees
(b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care
(c) other long-term employee benefits, including long service leave or sabbatical leave, jubilee or other long service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation
(d) termination benefits
(e) share-based payment

**Key management personnel** are 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.

**Related party** — a party is related to an entity if:
a. directly or indirectly through one or more intermediaries, the party
i. controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries)
ii. has an interest in the entity that gives it significantly influence over the entity
iii. has joint control over the entity
iv. the party is an associate of the entity
b. the party is a joint venture in which the entity is a venturer (see IAS 31, Interests *in Joint Ventures*)
c. the party is a member of the key management personnel of the entity or its parent
d. the party is a close member of the family of an individual referred to in (a) or (c)
e. the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (c) or (d)
f. the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity

A **related party transaction** is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

**Who are Related Parties?**

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

- (a) A person or a close member of that person's family is related to a reporting entity if that person:
  - (i) has control or joint control over the reporting entity;
  - (ii) has significant influence over the reporting entity; or
  - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
  - (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
  - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
  - (iii) Both entities are joint ventures of the same third party.
  - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
  - (v) The entity is a post-employment defined benefit plan 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 plan, the sponsoring employers are also related to the reporting entity.

- (vi) The entity is controlled or jointly controlled by a person identified in (a).
- (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

The following are deemed not to be related:

- two entities simply because they have a director or key manager in common
- two venturers who share joint control over a joint venture
- providers of finance, trade unions, public utilities, and 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)
- a single customer, supplier, franchiser, distributor, or general agent with whom an entity transacts a significant volume of business merely by virtue of the resulting economic dependence

**Prescribed Disclosures**

Disclosure of related party transactions and outstanding balances in the separate financial statements of a parent, venturer or investor shall be presented in accordance with IAS 27, *Consolidated and Separate Financial Statements*.

Specific disclosure requirements include:

• **Parent / Subsidiary relationships:** Relationships between parents and subsidiaries shall be disclosed regardless of transactions between those related parties. The entity shall disclose the name of the parent entity, and if different the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent shall be disclosed.

• **Management Compensation:** An entity shall disclose key management personnel's compensation as defined in total and for each of the following categories:
— short-term employee benefits
— post-employment benefits
— other long-term benefits
— termination benefits
— share-based payment benefits

• **Related party transactions:** Where there have been transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. At a minimum, disclosures shall include:
— the amount of the transactions
— the amount of outstanding balances, terms and conditions (including whether they are secured), and the nature of the consideration to be provided in settlement and details of any guarantees given or received
— provisions for doubtful debts related to outstanding balances
— the expense recognised during the period in respect of bad or doubtful debts due from related parties

• **Categories:** The required disclosures shall be made separately for each of the following categories:
— the parent
— entities with joint control or significant influence over the entity
— subsidiaries
— associates
— joint ventures in which the entity is a venturer
— key management personnel of the entity or its parent
— other related parties

• **Aggregation:** Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity
A statement that related party transactions were made on terms equivalent to those that prevail in arm's length transactions should be made only if such terms can be substantiated.

**Examples of the kinds of Transactions that are disclosed if they are with a Related Party**

- purchases or sales of goods
- purchases or sales of property and other assets
- rendering or receiving of services
- leases
- transfers of research and development
- transfers under licence agreements
- transfers under finance arrangements (including loans and equity contributions in cash or in kind)
- provision of guarantees or collateral
- commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognised and unrecognised)
- settlement of liabilities on behalf of the entity or by the entity on behalf of another party

**February 2007 Exposure Draft**

On February 22, 2007, the IASB published for public comment, by May 25, 2007, an exposure draft of proposed amendments to IAS 24 *(State-controlled Entities and the Definition of a Related Party)*. The proposals are to amend the requirements for entities to disclose in their financial statements information about related parties.
The main change proposed is to eliminate the disclosure requirements in paragraph 17 of IAS 24 for some entities that are controlled or significantly influenced by a state in relation to transactions with other entities controlled or significantly influenced by that state. The IASB has used an indicator approach to establish when an entity can apply the exemption. The changes respond to concerns expressed by interested parties about the difficulties that these entities have in obtaining the information required by IAS 24. In many cases, the entities affected may not even know that they are related to others controlled or influenced by the state. The IASB concluded that for those entities affected the cost of complying with IAS 24 is likely to outweigh the benefits of the disclosures to users of their financial statements. The exemption proposed is limited to those circumstances in which it is clear that the related entities are not influencing each other.

The proposed indicators of circumstances in which the relationship should not be exempt include:

- the presence of common members of the board
- the existence of direction or compulsion by a state
- related parties transacting business at non-market rates
- related parties sharing of resources
- related parties undertaking economically significant transactions.

The Exposure Draft also proposes to amend and clarify the definition of a related party to remove inconsistencies and improve readability. The main amendments to the definition are:

- the inclusion, in the definition of a related party, of the relationship between a subsidiary and an associate of the same entity, in the individual or separate financial statements of both the subsidiary and the associate.

- the removal, from the definition of a related party, of situations in which two entities are related to each other because a person has significant influence over one entity and a close member of the family of that person has significant influence over the other entity. The IASB concluded that the definition of IAS 24 does not include two associates of the same entity as related to each other. Therefore, when the investor is a person and a close member of the family of that person, the same conclusion should apply.

- the inclusion, within the definition of a related party, of two entities where one is an investee of a member of key management personnel (KMP) and the other is the entity managed by the person that is a member of KMP. At present, investees of KMP are related to the entity that the KMP managed but IAS 24 does not include the reciprocal of this.

Introducing the Exposure Draft, Sir David Tweedie, IASB Chairman, said: “The proposals aim to remove a significant burden of disclosure from some entities, particularly in jurisdictions with extensive state control of, and significant influence over, businesses. The IASB believes that eliminating requirements that, in those circumstances, produce information that is often of little or no value will enable preparers and users of financial statements to focus on the substance of those related party relationships that are likely to affect the financial statements. We are also taking the opportunity to respond to some valid requests to clarify the definition of a related party.”

**December 2008 Revised Exposure Draft**

On December 11, 2008, the IASB published for public comment, by March 13, 2009, an exposure draft of proposed amendments to IAS 24 *(Relationships with the State).* The revised proposal was published to eliminate the unnecessary disclosure requirements that apply to state-controlled entities. The February 2007 proposal was issued to exempt state-controlled entities from providing disclosures about transactions with other state-controlled entities if specified conditions were met. Respondents generally agreed that the IASB should provide an exemption for these entities. However, they had concerns about the complexity of the proposals, caused in particular by a proposed requirement to assess whether state influence actually existed. They were also asked for numerous clarifications.

In the light of respondents’ concerns, the IASB decided to revise and simplify its proposed exemption for state-controlled entities. Unlike the original proposal, the revised exemption would not require state-controlled entities to assess the extent of state influence. It would exempt such entities from providing full details about transactions with other state-controlled entities and the state. Instead, (unlike the 2007 exposure draft) it would require general disclosures about the types and extent of significant transactions. The IASB would particularly like to hear from respondents whether the proposals would give investors and analysts the information they need without imposing unnecessary burdens on preparers of financial statements.

The 2007 exposure draft also proposed to amend the definition of a related party to clarify the intended meaning and remove inconsistencies. Respondents were largely in agreement with the revised definition of a related party. The IASB intended to finalise the definitions of a related party and of a related party transaction without further exposure (apart from one minor matter raised in the 2008 exposure draft) and decided to issue them when it issues the amendments resulting from the 2008 exposure draft.

**Revised Standard**

On November 4, 2009, the IASB issued a revised version of IAS 24 that simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. The revised standard is effective for annual periods beginning on or after January 1, 2011, with earlier application permitted.

The IASB has revised IAS 24 in response to concerns that the previous disclosure requirements and the definition of a 'related party' were too complex and difficult to apply in practice, especially in environments where government control is pervasive. The revised standard addresses these concerns by:

**Providing a partial exemption for government-related entities -** Until now, if a government controlled, or significantly influenced, an entity, the entity was required to disclose information about all transactions with other entities controlled, or significantly influenced by the same government. These requirements were onerous in territories where government control is pervasive. Government-related entities are now defined as entities that are controlled, jointly-controlled or significantly influenced by the government. The revised standard still requires disclosures that are important to users of financial statements but eliminates requirements to disclose information that is costly to gather and of less value to users. It achieves this balance by requiring disclosure about these transactions only if they are individually or collectively significant. For example, a government-controlled railway was theoretically required to disclose details of the transactions with the postal department. This information is not necessarily useful to users of the financial statements but is costly and time-consuming to collect.

The revised standard introduces an exemption from all of the disclosure requirements of IAS 24 for transactions between government-related entities and the government, and all other government-related entities. Those disclosures are replaced with a requirement to disclose:

(a) The name of the government and the nature of their relationship; and

(b) (i) The nature and amount of any individually-significant transactions; and

(ii) The extent of any collectively-significant transactions qualitatively and quantitatively.

This is a significant relaxation of the disclosure requirements and should be of substantial benefit to government-related entities. The complexity and volume of the disclosures in the financial statements and the costs of record-keeping will be reduced. The new disclosures will provide more meaningful information about the nature of an entity's relationship with the government and material transactions.

**Providing a revised definition of a related party -** The previous definition was complicated and contained a number of inconsistencies. These inconsistencies meant, for example, that there were situations in which only one party to a transaction was required to make related party disclosures. The definition has been amended to remove the inconsistencies and to make it simpler and easier to apply. The amended definition means that some entities will have more related parties and will be required to make additional disclosures. For example, a subsidiary is now required to disclose transactions with an associate of its parent. An entity that is controlled by an individual that is part of the key management personnel of another entity is now required to disclose transactions with that second party. The entities that are most likely affected are those that are part of a group that includes both subsidiaries and associates and entities with shareholders that are involved with other entities.

**Comparative Indian Standard**

The Accounting Standard issued by the Institute of Chartered Accountants of India (ICAI) comparative to IAS 24 is AS 18, *Related Party Disclosures.* AS 18 is based on IAS 24 (reformatted 1994). The major differences between these two standards are Conceptual differences:

1. According to AS 18, as notified by the Government, a non-executive director of a company should not be considered as a key management person by virtue of merely his being a director unless he has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. However, IAS 24 provides for including non-executive director in key management personnel.
2. In AS 18 the term 'relative' is defined as "the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise" whereas the comparable concept in IAS 36, *Impairment of Assets*, is that of 'close members of the family of an individual' who are "those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity. They may include:

(a) the individual's domestic partner and children;
(b) children of the individual's domestic partner; and
(c) dependants of the individual or the individual's domestic partner."

**Conclusion**

The global financial crisis widened the range of entities subject to the related party disclosure requirements. The revised standard will affect the disclosures required in the financial statements of all government-related entities. The disclosure burden will be significantly reduced and replaced with more useful summarized information and details of significant transactions.

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