

HKAS 24 “Related Party Disclosures”

(Relevant to AAT Examination Paper 7: Financial Accounting and Paper I: PBE Financial Accounting)

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Introduction

Related party relationships and transactions are a normal feature of commerce and business. The objective of HKAS 24 “Related Party Disclosures” is to ensure that an entity’s financial statements contain the disclosures necessary to draw users’ attention to the possibility that its financial positions and operating results may have been affected (1) by the existence of related parties and (2) by transactions and outstanding balances with such parties. HKAS 24 was revised in November 2009. The revised standard amends the definition of a related party and simplifies the disclosure requirements for government-related entities. This article provides a summary of the possible related party relationships and their disclosure requirements as prescribed in HKAS 24 (Revised).

Scope

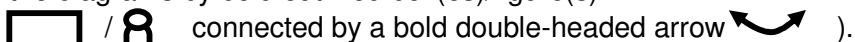

The scope of HKAS 24 (Revised) has been amended to clarify that the standard applies to individual, separate¹ and consolidated financial statements.

However, as intragroup transactions and balances are eliminated on consolidation, they do not form part of the consolidated financial statements and their disclosures in the consolidated financial statements are therefore not needed.

Defining Related Party

A related party is a major shareholder, group member, key management, or post-employment plan (e.g., pension fund). Close relatives of persons in this list are also included because of the possible influence from them. Similarly, post-employment benefit plans are included because they are often managed by key management personnel of a company.

HKAS 24 (Revised) defines a related party as (1) a person *or* (2) an entity that is related to the reporting entity, as detailed and illustrated below (related parties are illustrated in the diagrams by bold outlined box(es)/figure(s)

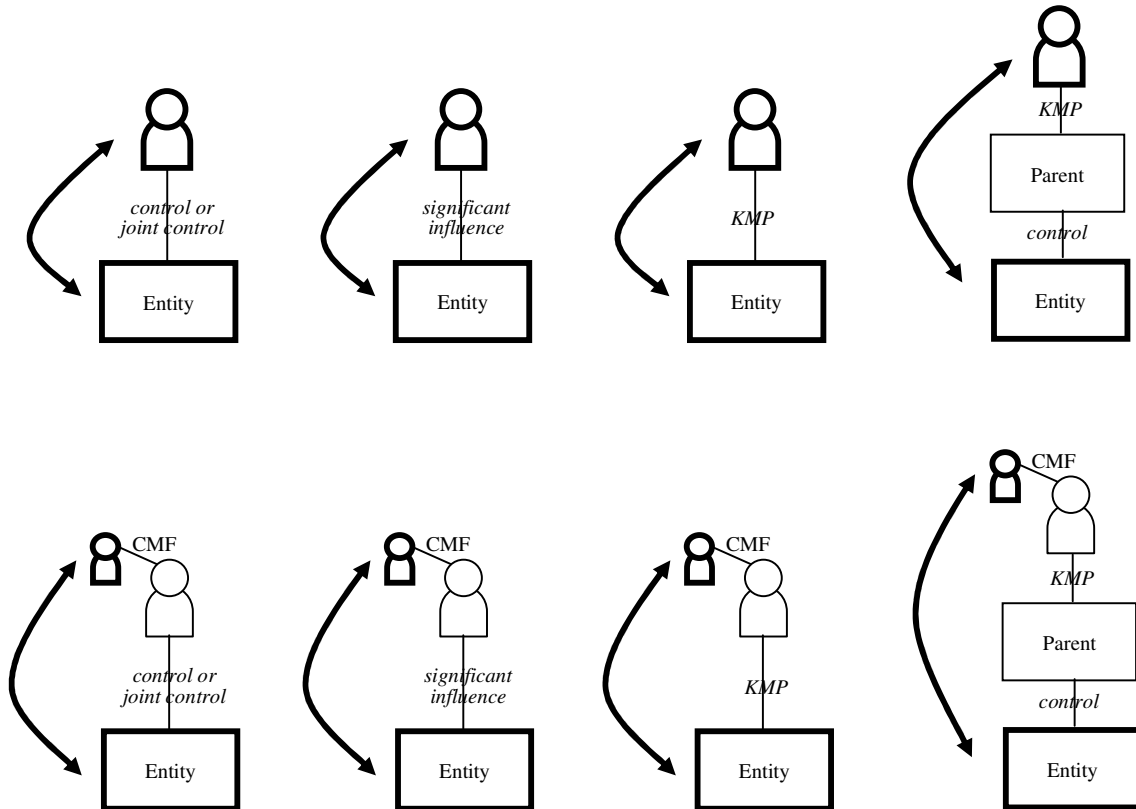
 connected by a bold double-headed arrow ).

- (1) A person *or* a close member² of that person’s family (CMF) is related to a reporting entity if that person:

¹ Separate financial statements are those presented by a parent (i.e. an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with HKFRS 9 “Financial Instruments”. Separate financial statements are those presented in addition to consolidated financial statements or in addition to financial statements in which investments in associates or joint ventures are accounted for using the equity method, except for those circumstances set out in paragraph 4(a) of the HKFRS 10 “Consolidated Financial Statements” or paragraph 17 of HKAS 28 “Investment in Associates and Joint Ventures”.

² Close members of the family (CMF) of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include: (a) that person’s children and spouse or domestic partner; (b) children of that person’s spouse or domestic partner; and (c) dependants of that person or that person’s spouse or domestic partner

- (i) has control³ or joint control⁴ over the reporting entity;
- (ii) has significant influence⁵ over the reporting entity; or
- (iii) is a member of the key management personnel⁶ (KMP) of the reporting entity or of a parent of the reporting entity.



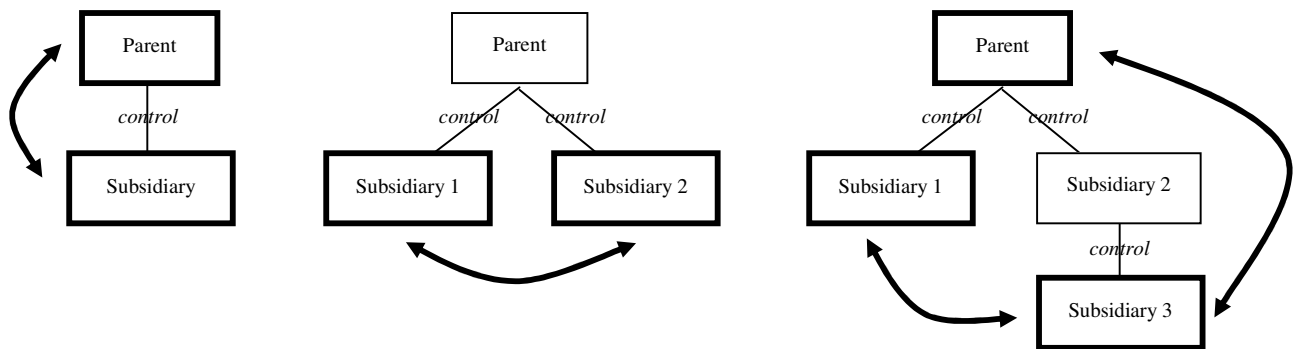
- 2) An entity is related to a reporting entity if *any* of the following conditions applies:
- (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary are related to the others).

³ A investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

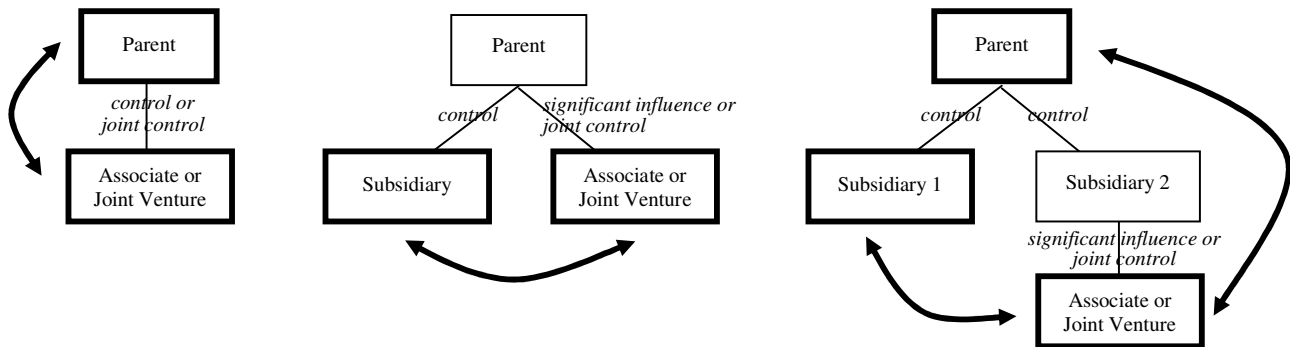
⁴ Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

⁵ Significance influence is the power to participate in the financial and operating policy decisions of an investee, but is not control or joint control of those policies. An associate is an entity over which the investor has significance influence. If an entity holds, directly or indirectly (e.g. through subsidiaries), 20 percent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless otherwise demonstrated.

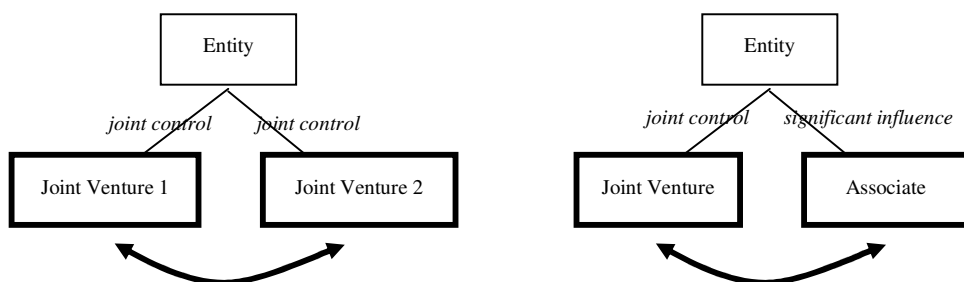
⁶ Key management personnel (KMP) are those persons having authority and responsibility for planning, directing and controlling the activities the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.



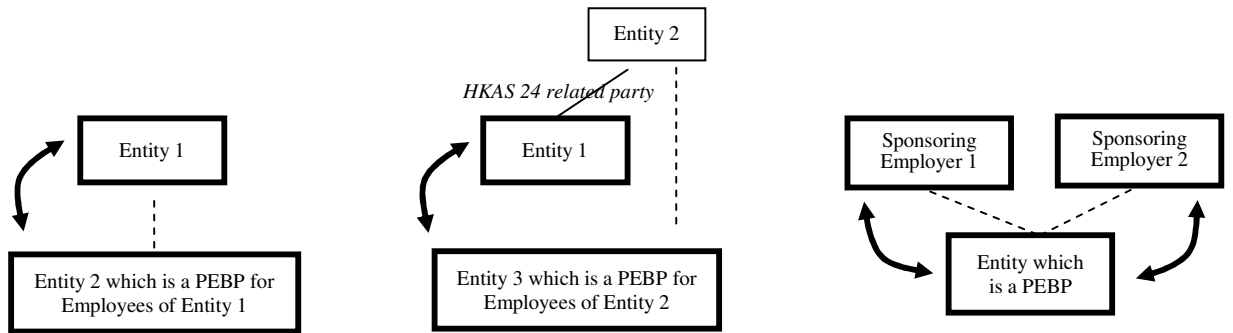
- (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).



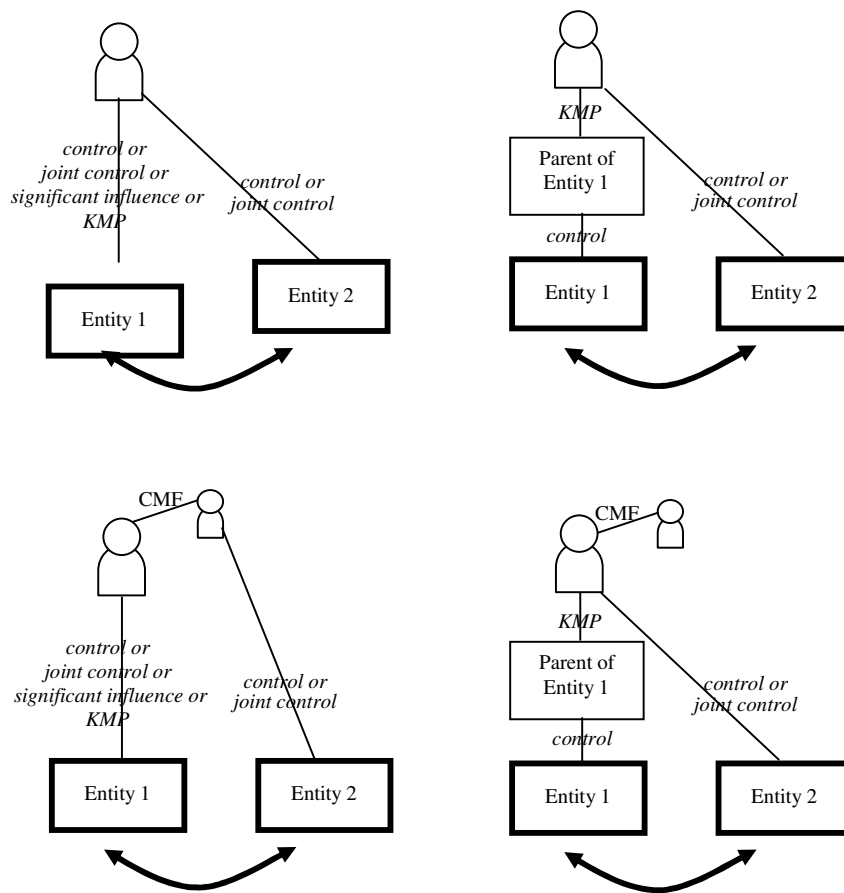
- (iii) Both entities are joint ventures of the same third party.
 (iv) One entity is a joint venture of a third party and the other entity is an associate of the third party.



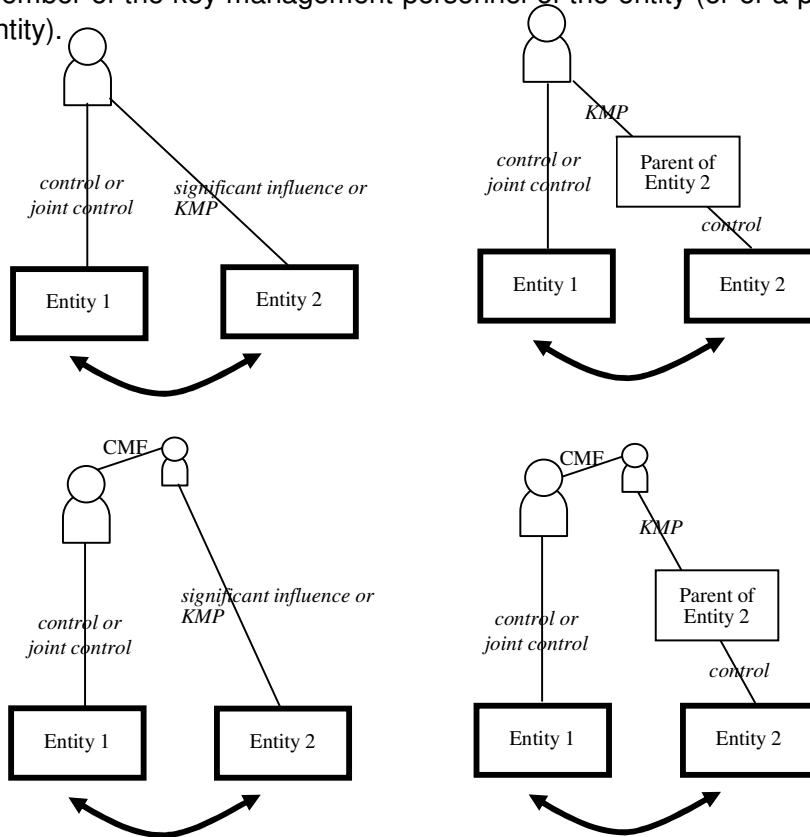
- (v) The entity is a post-employment benefit plan (PEBP) for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.





(vi) The entity is controlled or jointly controlled by a person identified in (1).

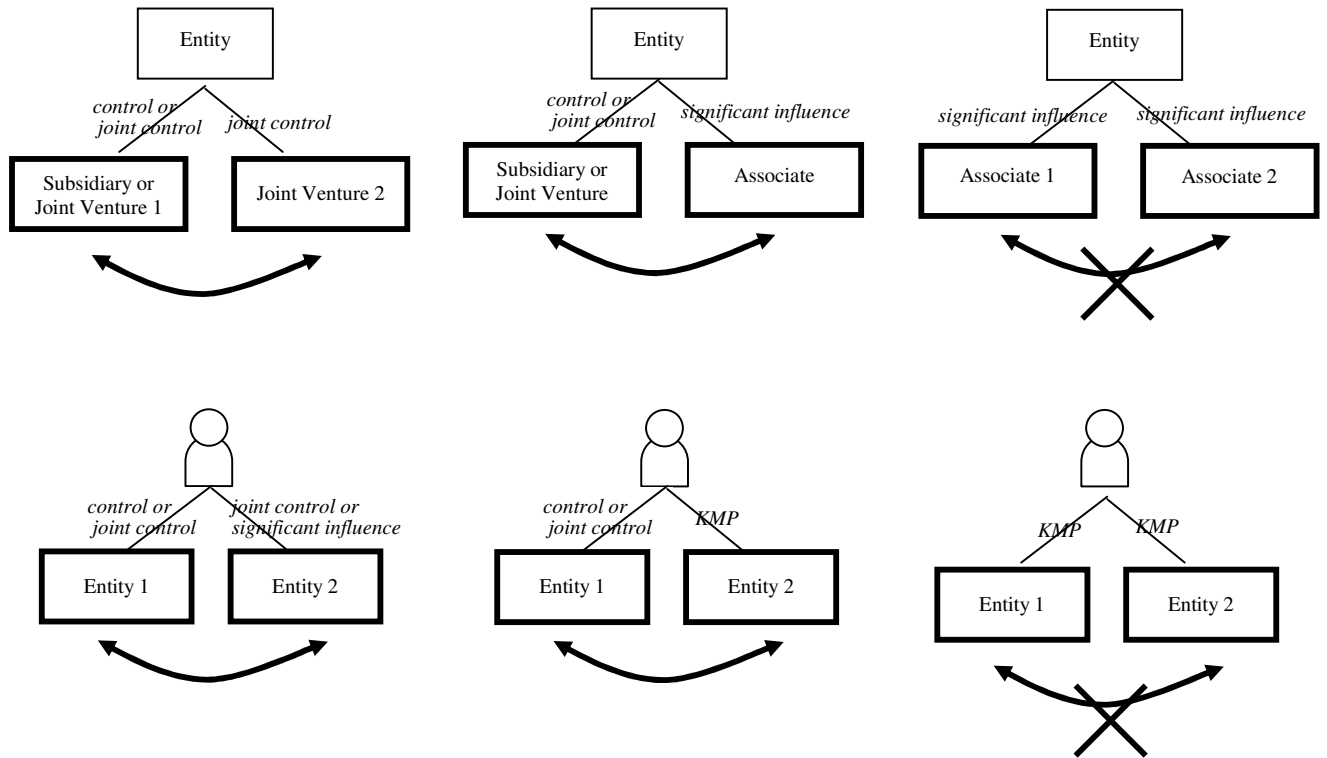


- (vii) A person identified in (1) (i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).



Key Approaches in Identifying a Related Party

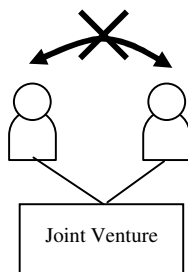
- (1) Substance over form – in considering each possible related party relationship, HKAS 24 requires that attention should be directed to the substance of the relationship and not merely the legal form.
- (2) Related party relationships are symmetrical: if A is related to B, then B is also related to A.
- (3) All direct relationships involving control, joint control or significant influence are related party relationships.
- (4) In analyzing related party relationships in respect of the reporting entity:
 - (i) A person and close family members of that person are treated as one party.
 - (ii) Members of the same group (i.e., the parent and all its subsidiaries) are treated as one party.
 - (iii) Investors, whether a person or an entity, are treated the same.
 - (iv) A PEBP, whether it is for the employees of the reporting entity or any entity that is a related party of the reporting entity, are treated the same.
- (5) Significant influence is treated as equivalent to the KMP relationship. These relationships are however not as close as a relationship of control or joint control. The following diagrams illustrate these (related relationship illustrated by  and un-related relationship illustrated by ).



Not Necessarily Related Parties

HKAS 24 (Revised) specifies that the following are not necessarily related parties:

- (1) Two entities are not necessarily related simply because they have a KMP in common or because a KMP of one entity has significant influence over the other entity.
- (2) Two venturers are not necessarily related simply because they share joint control over a joint venture. The following diagram illustrates this.



- (3) (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, are not necessarily related parties 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).
- (4) 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, is not necessarily a related party.

Related Party Transaction

HKAS 24 (Revised) defines a related party transaction as a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

Disclosure Requirements for All Entities

- (1) Name of the following related parties (even if there is no transaction with them):
 - (i) the immediate parent entity;
 - (ii) the ultimate parent entity; and
 - (iii) the ultimate controlling party.
- (2) Name of and relationship with the related parties (only if there are transactions with them), *plus* the following minimum disclosures:
 - (i) the amount of the transactions;
 - (ii) the amount of outstanding balances, including commitments, and their terms and conditions and details of any guarantees given or received;
 - (iii) provisions for doubtful debts related to the amount of outstanding balances; and
 - (iv) the expense recognized during the period in respect of bad and doubtful debts due from related parties.

The above disclosures shall be made separately for each of the categories: the parent; entities with joint control or significance influence over the entity; subsidiaries; associates; joint ventures in which the entity is a venturer; the KPM of the entity or its parent; and other related parties.

- (3) In addition, an entity shall disclose KPM compensation in total and for each of the following categories: short-term employee benefits; post-employment benefits, other long-term benefits; termination benefits; and share-based payments.
- (4) Examples of transactions that are disclosed if they are with a related party:
 - (i) purchases or sales of goods, property and other assets;
 - (ii) rendering or receiving of services;
 - (iii) leases;
 - (iv) transfers of research and development;
 - (v) transfers under licence agreements or finance arrangements;
 - (vi) provision of guarantees or collateral;
 - (vii) commitments;
 - (viii) settlement of liabilities.

- (5) Disclosures that “related parties transactions were made on terms equivalent to those that prevail in arm’s length transactions” are made only if such terms can be substantiated.
- (6) 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.

Modified Disclosure Requirements for Government-related Entities⁷

Although the HKFRSs are not written for the public-sector entities, it is common for a government-related entity (e.g., Kowloon-Canton Railway Corporation, Post Office Trading Fund) to prepare financial statements in accordance with HKFRSs. In situations in which the government directly or indirectly continues to hold a significant stake in the commercial or business sector, it is difficult for the government-related entities to comply with the related party disclosure requirements. It is not easy to identify all the related party transactions and balances and the volume of related party disclosures could be substantial.

HKAS 24 (Revised) addresses these issues and provides for a partial exemption for transactions between government-related entities as well as with the government itself. For these entities, the general disclosure requirements (for the amount of related party transactions, outstanding balances, provisions for doubtful debts, and expenses in respect of bad or doubtful debts with related parties) do not apply. Instead, alternative disclosures have been included that require:

- (1) Name of the government and the nature of its related party relationship with the reporting entity (i.e., control, joint control or significant influence).
- (2) Nature and amount of each individually significant related party transaction (e.g., a substantial loan from the government).
- (3) A qualitative or quantitative indication of the extent of other related party transactions that are collectively, but not individually, significant (e.g., where a large proportion of the sales and purchases of raw materials are with government-related entities).
- (4) In determining the level of detail to be disclosed, the reporting entity shall consider the closeness of the related party relationship and other factors such as whether it is:
 - (i) significant in terms of size;
 - (ii) carried out on non-market terms;
 - (iii) outside normal day-to-day business operations;
 - (iv) disclosed to regulatory or supervisory authorities;
 - (v) reported to senior management;
 - (vi) subject to shareholder approval.

⁷ Government refers to government, government agencies and similar bodies whether local, national or international. A government-related entity is an entity that is controlled, jointly controlled or significantly influenced by a government.

Example of Related Party Disclosures

Excerpts from Annual Report of Esprit Holdings Ltd for the year ended 30 June 2009

Notes to Consolidated Financial Statements

NOTE 27: RELATED PARTY TRANSACTIONS

The Group entered into transactions with related companies in the ordinary course of business and on similar terms made available to those unrelated third parties during the year. Details relating to these related party transactions are as follows:

	2009	2008
	HK\$ million	HK\$ million
Transactions with associates		
Sales of finished goods	1,210	999
Royalty and accrued interest receivable/received	37	46
Commission received	7	6

Saved as above and the key management compensation as set out in Note 12, the Group had no material related party transactions during the year.

Corporate Governance Report

OWNERSHIP STRUCTURE

The Company is publicly owned with no controlling shareholder presents. This ownership structure minimizes any conflicts of interests.

Conclusion

Related party relationships and transactions could have an effect on the financial position and operating results of the reporting entity, due to the possibility that transactions with related parties may not be effected at the same amounts as those between unrelated parties. Related party disclosures are therefore important to ensure transparency of financial statements. This article addresses the related-party issue and covers the extensive disclosure requirements of HKAS 24 "Related Party Disclosures".

Reference

Hong Kong Accounting Standard 24 "Related Party Disclosures" (Revised)

Modified in December 2011