

technical factsheet 180

Related parties

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1. INTRODUCTION

This factsheet provides guidance on the collection and disclosure of related party transactions within statutory financial statements. It will consider the provisions within the Companies Act 2006 and the accounting and disclosure requirements within the related accounting regulations, FRS 8 Related Party Disclosures, Financial Reporting Standard for Smaller Entities 2008, FRSSE 2015 and FRS 102 The Financial Reporting Standard Applicable in the UK and Republic of Ireland.

It will not address the specific requirements of IAS 24, although the provisions contained within the revised FRS 8 are consistent with this standard.

2. LEGISLATIVE REQUIREMENTS

The provisions are contained within three pieces of legislation:

Companies Act 2006

Part 10 A Company's Directors

This part of the Companies Act sets out amongst other things the specific rights and duties of the company directors and shadow directors. Many of the disclosure requirements flow from the provisions within these sections. Familiarity with the contents of the sections is therefore desirable.

Chapter 2, Sections 170-181 sets out the general duties of directors under the Act. This provides a framework under which the Directors need to ensure that there is a full disclosure of the interest that they may have in transactions.

Chapter 3, Sections 182-187 sets out the duties of directors and shadow directors to declare any interest that they may have in an existing contract.

Chapter 4, Sections 188-226 sets out the details of transactions that require the approval of members

Part 15 Accounts and Reports

Chapter 4 in the sections dealing with items that should be disclosed in the notes to the accounts within sections 409, 410, 412 and 413 contains information on specific issues that need to be disclosed. Guidance on the application of these principles is contained within the accounting regulations.

The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008

Schedule 3 provides detailed guidance on directors' benefits: remuneration

The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008

These regulations apply to all companies that do not qualify as small or are not preparing accounts under these provisions.

Schedule 4 provides details of the requirements for companies to disclose specific details in respect of holdings in subsidiary and associated undertakings.

Schedule 5 provides detailed guidance on directors' benefits: remuneration

This is an area that causes confusion, and this is probably due to the overlap between the disclosure required by Companies Act 2006 regarding directors' transactions and the requirements of FRS 8.

Companies Act 2006 and the related provisions are accessible on the legislation website:

<http://www.legislation.gov.uk/>

Disclosure issues under the legislation

Section 413 requires the following information to be disclosed in respect of transactions with directors:

1. *In the case of a company that does not prepare group accounts, details of:*
 - (a) *advances and credits granted by the company to its directors, and*
 - (b) *guarantees of any kind entered into by the company on behalf of its directors, must be shown in the notes to its individual accounts.*
2. *In the case of a parent company that prepares group accounts, details of:*
 - (a) *advances and credits granted to the directors of the parent company, by that company or by any of its subsidiary undertakings, and*
 - (b) *guarantees of any kind entered into on behalf of the directors of the parent company, by that company or by any of its subsidiary undertakings, must be shown in the notes to the group accounts.*
3. *The details required of an advance or credit are:*
 - (a) *its amount*
 - (b) *an indication of the interest rate*
 - (c) *its main conditions*
 - (d) *any amounts repaid.*
4. *The details required of a guarantee are:*
 - (a) *its main terms*
 - (b) *the amount of the maximum liability that may be incurred by the company (or its subsidiary)*
 - (c) *any amount paid and any liability incurred by the company (or its subsidiary) for the purpose of fulfilling the guarantee (including any loss incurred by reason of enforcement of the guarantee).*
5. *There must also be stated in the notes to the accounts the totals:*
 - (a) *of amounts stated under subsection (3)(a), (the amounts of any advance or credit)*
 - (b) *of amounts stated under subsection (3)(d), (details of any repayments)*
 - (c) *of amounts stated under subsection (4)(b), (the maximum liability) and*
 - (d) *of amounts stated under subsection (4)(c). (amounts paid in respect of any guarantee)*
6. *References in this section to the directors of a company are to the persons who were a director at any time in the financial year to which the accounts relate.*
7. *The requirements of this section apply in relation to every advance, credit or guarantee subsisting at any time in the financial year to which the accounts relate:*
 - (a) *whenever it was entered into*
 - (b) *whether or not the person concerned was a director of the company in question at the time it was entered into*
 - (c) *in the case of an advance, credit or guarantee involving a subsidiary undertaking of that company, whether or not that undertaking was such a subsidiary undertaking at the time it was entered into.*
8. *Banking companies and the holding companies of credit institutions need only state the details required by subsection (5)(a) and (c).*

Director's loan account

What this will broadly mean in practice is that quite detailed disclosure will be required in the notes to the accounts when a company has an overdrawn director's loan account.

There was a great deal of debate in respect of this area when the legislation first came out but the accepted interpretation would suggest the following:

- Details of transactions with individuals should not usually be aggregated together – hence where you have more than one related party with similar transactions these should be shown separately.
- Transactions that are not individually significant (usually seen as the lower of £10,000 or materiality level, judgement will be required when considering aggregation as technically all transactions should be disclosed) can be aggregated with similar transactions – hence if a director takes regular cash amounts from the company totalling £50,000 in the year these can be shown together provided that no one drawing is for over £10,000
- Where you have a range of different transactions going through the account you should only aggregate those that are similar so for example where the company pays bills on behalf of a director the total of these amounts would be shown separately from cash drawn
- Where the account has gone overdrawn at any time during the year even where it is not overdrawn at the end of the year then the details above, along with the maximum balance outstanding during the year should be disclosed

Directors' emoluments and remuneration

Disclosure in respect of the above is included in the checklist below in line with the requirements in the legislation. These are requirements from the legislation and are not covered in the standards.

One area that requires disclosure, 'dependent on the Company size', is the situation where the total of the following exceeds £200,000:

- the aggregate amount of remuneration paid to or receivable by directors in respect of qualifying services;
- the aggregate of the amount of gains made by directors on the exercise of share options;
- the aggregate of the amount of money paid to or receivable by directors, and the net value of assets (other than money and share options) received or receivable by directors, under long term incentive schemes in respect of qualifying services

In this case, the details of the amounts paid to the highest paid director in respect of the above needs to be separately disclosed. In addition details of the pension contributions attributable to that director should be shown. If the pension scheme is a defined benefit scheme then you also need to disclose the value of the accrued pension and any accrued lump sum for that individual.

Finally details should be disclosed of any share options exercised by this director and whether any shares were received or receivable by that director in respect of qualifying services under a long term incentive scheme.

3. ACCOUNTING STANDARDS

The relevant accounting provisions are contained within three standards:

- FRSSE (2008) – contains the disclosure relevant to companies that qualify for the small company regime. This will be replaced by FRSE 2015 for accounting periods commencing on or after 1 January 2015. There are no changes in the accounting requirements proposed by this update but the definition of related parties has been updated to bring it more closely in line with the full standard
- FRS 8 Related Party Transactions – applies to all other entities
- FRS 102 The Financial Reporting Standard Applicable in the UK and Republic of Ireland – this standard applies for all entities adopting UK GAAP for accounting periods commencing on or after 1 January 2015 where the FRSSE has not been used.

FRS 8 defines related parties as:

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 significant influence over the entity; or*

- III. has joint control over the entity*
- (b) the party is an associate (as defined in FRS 9, 'Associates and joint ventures') of the entity*
 - (c) the party is a joint venture in which the entity is a venturer (as defined in FRS 9, 'Associates and joint ventures')*
 - (d) the party is a member of the key management personnel of the entity or its parent*
 - (e) the party is a close member of the family of any individual referred to in subparagraph (a) or (d)*
 - (f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for*
 - (g) which significant voting power in such entity resides with directly or indirectly, any individual referred to in (d) or (e); or*
 - (h) the party is a retirement benefit scheme for the benefit of employees of the entity, or of any entity that is a related party of the entity.*

This definition is broadly in line with FRSSE 2008

FRS 102 and FRSSE 2015 define a related party as follows:

A related party is a person or entity that is related to the entity that is preparing its financial statements (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 apparent of the reporting entity.*
- (b) An entity is related to a reporting entity if any of the following conditions apply:*
 - (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 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).*

Key management is defined in the standards 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

Significant influence is the power to participate in the operating and financial policy decisions of an entity; it is not control over those policies. Significant influence would be assumed where a shareholder holds 20% or more of the voting rights of the entity

When looking at the disclosures in this area the first major step is to ensure that all appropriate parties have been identified.

The above definition was amended to ensure that the definition is consistent within both accounting standards and the legislation.

The general rule under all of the standards is that the following information should be disclosed in respect of all transactions with related parties:

- the names of the parties
- the relationship with the parties

- details of the transactions
- the amounts
- additional information required for any understanding
- the amounts due to or from any related parties
- any amounts written off in respect of such debts.

This information can be aggregated where the individual amounts are not material when producing accounts in accordance with FRSSE. Where FRS 8 applies aggregation can only take place when the amounts are neither material to the company nor the related party. Under FRS 102 an entity may disclose items of a similar nature in the aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity

Dividends to directors do meet the definition of related party transactions and are discloseable as such. Prior to 06 April 2007, under the Companies Act 1985, directors' interests were disclosed in directors reports and it was generally accepted that a reader could determine the dividends to directors on the basis of the shareholdings disclosed, and therefore there was a consensus of opinion that this was sufficient to meet the related party disclosure requirements.

Of course the other major issue with directors' overdrawn loan accounts is taxation. If a director's loan account, of ANY amount, is overdrawn at the year end, and not repaid within nine months of the balance sheet date, section 455 (formerly section 419) tax (at 25%) will be due to be paid by the company. In addition to this, if the loan is at no or low interest and exceeds £5000, the director should include it on his P11D, and it will be a taxable benefit in kind."

The standard also requires disclosure of the ultimate controlling party. This is the individual or small group of individuals who control the entity. Where the identity of this individual is not known then that fact also needs to be disclosed in the accounts. This disclosure is required even where there are no transactions between the parties.

4. EXAMPLES

The following are examples of the related party disclosure required in a set of statutory accounts. The disclosure under transactions with directors is as a result of the Companies Act requirements; and the related party disclosure is as a requirement of the accounting standards; a distinction is made between the two as the latter does not need to be included within the abbreviated accounts prepared for small companies.

Example 1

Directors' remuneration

The directors' aggregate remuneration in respect of qualifying services were:

20XX	20YY	As restated	
£	£		
Aggregate remuneration	25,000	25,000	
Pension contributions		<u>2,000</u>	<u>2,000</u>

4 directors (20YY - 4) were accruing benefits under the company's defined contribution pension scheme.

Transactions with directors

Included in debtors is an amount owing to the company by one of the directors. This was an advance of £1,750 made to Mr A. Arthur, a director of the company to provide funds for overseas travel expenses he expected to incur on company business. This trip was completed shortly after the year end and the director has repaid the advance in full. The balance represents the highest amount outstanding in the year.

Related party transactions

During the year the company purchased goods amounting to £15,015 (20YY - £14,765) from Blue Glass Limited a company in which Mr A Arthur has a controlling interest. These goods were purchased on an arms length basis. There were no amounts outstanding to or from the company at the period end (20YY - £0).

During the year the following dividends were paid to the directors of the company:

- Mr A Arthur: £300 in respect of 6% redeemable preference shares (20YY - £300) and £2,450 in respect of ordinary shares (20YY - £1,750).
- Mr B Benedict, Mrs C Clements and Mr D Duncan: £350 each in respect of ordinary shares (20YY - £250)

Ultimate controlling party

The ultimate controlling party was Mr A Arthur, a director and shareholder of the company

Example 2

Related party disclosures

During the year under review the company has paid rent of £21,000 to Mr A and Mr B; Directors and shareholders of the company for use of freehold property by the company which is jointly owned by them.

The lease is under a formal contract terms and has an independently verified rent review period of every three years.

The directors have jointly given a loan to the company of £278,000 which they are not going to withdraw until the company has sufficient funds to repay without affecting the cash flow of the company.

Dividends of £50,000 paid in the year have been paid equally to all the shareholders who are also directors of the company.

Example 3

Transaction with directors

The company had an outstanding directors loan in the name of Mr XXXXX of £11,000 (Prior year £26,000) at the year end. This is included in other creditors in note 13. This loan is interest free and repayable on demand. The highest amount during the year was £26,000 with £15,000 being paid to the company by Mr XXXX.

Related parties

The company owns 51% of the shares in BB Ltd which is online sale arm of this company.

The company was owed £30,000 (£Nil) by its subsidiary undertaking which is repayable on demand.

The company had sold £430,000 (£28,000) worth of goods to its subsidiary during the year.

The company was owed £151,000 (2010 - 213,000) by CC Ltd which is a company under common control of the directors.

During the year the company sold goods to the value of £531,000 (£270,000) to CC Ltd

5. CHECKLIST

Issue	FRS 8	FRSSE 2008	FRS 102	FRSSE 2015	Comment/Reference
<p>Identify all the related parties as defined by the legislation and accounting standards. For FRS 8 and FRSSE 2008 this includes anyone satisfying the following conditions:</p> <ul style="list-style-type: none"> (a) directly, or indirectly through one or more intermediaries, the party: <ul style="list-style-type: none"> (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 significant influence over the entity (iii) has joint control over the entity (b) the party is an associate (as defined in FRS 9, 'Associates and joint ventures') of the entity (c) the party is a joint venture in which the entity is a venturer (as defined in FRS 9, 'Associates and joint ventures') (d) the party is a member of the key management personnel of the entity or its parent (e) the party is a close member of the family of any individual referred to in subparagraph (a) or (d) (f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for (g) which significant voting power in such entity resides with directly or indirectly, any individual referred to in (d) or (e) (h) the party is a retirement benefit scheme for the benefit of employees of the entity, or of any entity that is a related party of the entity. 					
<p>For FRS 102 and FRSSE 2015 a related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity).</p> <ul style="list-style-type: none"> (a) A person or a close member of that person's family is related to a reporting entity if that person: <ul style="list-style-type: none"> (i) has control or joint control over the reporting entity (ii) has significant influence over the reporting entity (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 apply: <ul style="list-style-type: none"> (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 					

<p>entity is a member)</p> <p>(iii) both entities are joint ventures of the same third party</p> <p>(iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity</p> <p>(v) the entity is a post-employment 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</p> <p>(vi) the entity is controlled or jointly controlled by a person identified in (a)</p> <p>(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).</p>					
<p>For subsidiary undertakings ascertain the following details for each subsidiary:</p> <ul style="list-style-type: none"> • Name • Country of incorporation or address if unincorporated • The number and percentage of shares held directly and indirectly in each specific class of shares • The aggregate amount of capital and reserves at the period end • The profit or loss for the period 					
<p>For other companies where there is a substantial shareholding (more than a 20% interest) ascertain the following details for each holding:</p> <ul style="list-style-type: none"> • Name • Country of incorporation or address if unincorporated • The number and percentage of shares held directly and indirectly in each specific class of shares • The aggregate amount of capital and reserves at the period end • The profit or loss for the period 					
<p>Where an interest is held in a partnership or unlimited company ascertain the following details for each holding:</p> <ul style="list-style-type: none"> • The name and legal form of the entity • The address of its registered office or main place of business • Details of the financial information to be appended to the accounts 					
<p>Ascertain details of the ultimate parent undertaking</p>					
<p>Ascertain details of the following in respect of directors:</p> <ul style="list-style-type: none"> • Remuneration (this includes salaries, fees, bonuses, cash expenses and the monetary value of benefits) for qualifying services • Details of any amounts paid or due under long term incentive schemes • Amounts paid or payable into defined benefit and 					

<p>defined contribution pension schemes</p> <ul style="list-style-type: none"> • The number of directors accruing benefits under either type of pension scheme • Any amounts paid as compensation for loss of office • Any amounts paid to third parties in respect of loss of office • Details (that is the amount; interest rate; conditions and any amounts repaid) of any advances or credits granted to directors • Details (that is its main terms; details of the maximum liability of the company and any amounts paid under the guarantee) of any guarantees granted to or on behalf of the directors by the company • Details of any dividends received in respect of shares in the company • Details of any dividends waived in respect of shares in the company • Details of the amounts paid to the highest paid director where the total emoluments paid to all directors exceeds £200,000, this should include: <ul style="list-style-type: none"> ○ The emoluments and the pension contributions paid to this individual. ○ Where a defined benefit scheme is operated details of the accrued pension and where applicable the accrued lump sum should also be ascertained ○ Details of any share options exercised by this director and whether any shares were received or receivable by that director in respect of qualifying services under a long term incentive scheme. 					
<p>Ascertain details of the individual or group of individuals who control the entity</p>					
<p>Ascertain details of any guarantees offered by related parties in respect of the company debts</p>					
<p>Ascertain details of the following in respect of any other transactions with any of the parties detailed above:</p> <ul style="list-style-type: none"> • The names of the parties • The relationship with the parties • Details of the transactions • The amounts • Additional information required for any understanding • The amounts due to or from any related parties • Any amounts written off in respect of such debts 					
<p>Ascertain whether transactions have been entered in to on an arm's length basis and disclose details</p>					

6. SOURCES OF INFORMATION

Legislation

The legislation can be accessed at this website: www.legislation.co.uk. The following legislation should be referred to when required:

- Companies Act 2006
- The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008
- The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008

Accounting standards

The relevant standards can be accessed on the Financial Reporting Council website at the following link: <http://www.frc.org.uk/Our-Work/Codes-Standards.aspx>. The following standards should be referred to when required:

- FRS 8 – Related Party Disclosures
- FRSSE (effective April 2008) – Financial Reporting Standard for Smaller Entities
- FRS 102 - The Financial Reporting Standard Applicable in the UK and Republic of Ireland.
- FRSSE (effective April 2015) – Financial Reporting Standard for Smaller Entities