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SUMMARY

- a** Financial Reporting Standard 8 'Related Party Disclosures' requires the disclosure of:
- (i) information on related party transactions and
 - (ii) the name of the party controlling the reporting entity and, if different, that of the ultimate controlling party whether or not any transactions between the reporting entity and those parties have taken place.
- Aggregated disclosures are allowed subject to certain restrictions.
- b** Two or more parties are related parties when at any time during the financial period:
- (i) one party has direct or indirect control of the other party; or
 - (ii) the parties are subject to common control from the same source; or
 - (iii) one party has influence over the financial and operating policies of the other party to an extent that that other party might be inhibited from pursuing at all times its own separate interests; or
 - (iv) the parties, in entering a transaction, are subject to influence from the same source to such an extent that one of the parties to the transaction has subordinated its own separate interests.
- c** No disclosure is required in consolidated financial statements of intragroup transactions and balances eliminated on consolidation. A parent undertaking is not required to provide related party disclosures in its own financial statements when those statements are presented with consolidated financial statements of its group.
- d** disclosure is not required in the financial statements of subsidiary undertakings, 90 per cent or more of whose voting rights are controlled within the group, of transactions with entities that are part of the group or investees of the group qualifying as related parties provided that the consolidated financial statements in which that subsidiary is included are publicly available.

FINANCIAL REPORTING STANDARD 8**OBJECTIVE**

- 1** The objective of this FRS is to ensure that financial statements contain the disclosures necessary to draw attention to the possibility that the reported financial position and results may have been affected by the existence of related parties and by material transactions with them.

DEFINITIONS

- 2 The following definitions shall apply in this FRS and in particular in the Statement of Standard Accounting Practice set out in paragraphs 3-7.

2.1 *Close family:-*

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.

2.2 *Control:-*

The ability to direct the financial and operating policies of an entity with a view to gaining economic benefits from its activities.

2.3 *Key management:-*

Those persons in senior positions having authority or responsibility for directing or controlling the major activities and resources of the reporting entity.

2.4 *Persons acting in concert:-*

Persons who, pursuant to an agreement or understanding (whether formal or informal), actively co-operate, whether by the ownership by any of them of shares in an undertaking or otherwise, to exercise control or influence* over that undertaking.

2.5 *Related parties:-*

- (a) Two or more parties are related parties when at any time during the financial period:

- (i) one party has direct or indirect control of the other party; or
- (ii) the parties are subject to common control from the same source; or
- (iii) one party has influence over the financial and operating policies of the other party to an extent that that other party might be inhibited from pursuing at all times its own separate interests; or
- (iv) the parties, in entering a transaction, are subject to influence from the same source to such an extent that one of the parties to the transaction has subordinated its own separate interests.

- (b) For the avoidance of doubt, the following are related parties of the reporting entity:

- (i) its ultimate and intermediate parent undertakings, subsidiary undertakings, and fellow subsidiary undertakings;
- (ii) its associates and joint ventures;
- (iii) the investor or venturer in respect of which the reporting entity is an associate or a joint venture;
- (iv) directors** of the reporting entity and the directors of its ultimate and intermediate parent undertakings; and
- (v) pension funds for the benefit of employees of the reporting entity or of any entity that is a related party of the reporting entity;

- (c) and the following are presumed to be related parties of the reporting entity unless it can be demonstrated that neither party has influenced the financial and operating policies of the other in such a way as to inhibit the pursuit of separate interests:

* in terms of paragraph 2.5 (a) (iii).

** Directors include shadow directors, which are defined in companies legislation (see Appendix I) as persons in accordance with whose directions or instructions the directors of the company are accustomed to act.

- (i) the key management of the reporting entity and the key management of its parent undertaking or undertakings;
 - (ii) a person owning or able to exercise control over 20 per cent or more of the voting rights of the reporting entity, whether directly or through nominees;
 - (iii) each person acting in concert in such a way as to be able to exercise control or influence* over the reporting entity; and
 - (iv) an entity managing or managed by the reporting entity under a management contract.
- (d) Additionally, because of their relationship with certain parties that are, or are presumed to be, related parties of the reporting entity, the following are also presumed to be related parties of the reporting entity:
- (i) members of the close family of any individual falling under parties mentioned in (a) - (c) above; and
 - (ii) partnerships, companies, trusts or other entities in which any individual or member of the close family in (a) - (c) above has a controlling interest.

Sub-paragraphs (b), (c) and (d) are not intended to be an exhaustive list of related parties.

2.6 Related party transaction:~

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.

* in terms of paragraph 2.5 (a) (iii).

STATEMENT OF STANDARD ACCOUNTING PRACTICE*Scope*

- 3** Financial Reporting Standard 8 applies to all financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period. The FRS does not, however, require disclosure:
- (a) in consolidated financial statements, of any transactions or balances between group entities that have been eliminated on consolidation;
 - (b) in a parent's own financial statements when those statements are presented together with its consolidated financial statements;
 - (c) in the financial statements of subsidiary undertakings, 90 per cent or more of whose voting rights are controlled within the group, of transactions with entities that are part of the group or investees of the group qualifying as related parties, provided that the consolidated financial statements in which that subsidiary is included are publicly available;
 - (d) of pension contributions paid to a pension fund;
and
 - (e) of emoluments in respect of services as an employee of the reporting entity.

Reporting entities taking advantage of the exemption in (c) above are required to state that fact.

- 4** The FRS does not require disclosure of the relationship and transactions between the reporting entity and the parties listed in (a)-(d) below simply as a result of their role as:
- (a) providers of finance in the course of their business in that regard;
 - (b) utility companies;
 - (c) government departments and their sponsored bodies,
- even though they may circumscribe the freedom of action of an entity or participate in its decision making process; and
- (d) a customer, supplier, franchiser, distributor or general agent with whom an entity transacts a significant volume of business.

Disclosure of control

- 5** When the reporting entity is controlled by another party, there should be disclosure of the related party relationship and the name of that party and, if different, that of the ultimate controlling party. If the controlling party or ultimate controlling party of the reporting entity is not known, that fact should be disclosed. This information should be disclosed irrespective of whether any transactions have taken place between the controlling parties and the reporting entity.

Disclosure of transactions and balances

- 6** Financial statements should disclose material transactions undertaken by the reporting entity with a related party. Disclosure should be made irrespective of whether a price is charged. The disclosure should include:
- (a) the names of the transacting related parties;
 - (b) a description of the relationship between the parties;
 - (c) a description of the transactions;

- (d) the amounts involved;
- (e) any other elements of the transactions necessary for an understanding of the financial statements;
- (f) the amounts due to or from related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and
- (g) amounts written off in the period in respect of debts due to or from related parties.

Transactions with related parties may be disclosed on an aggregated basis (aggregation of similar transactions by type of related party) unless disclosure of an individual transaction, or connected transactions, is necessary for an understanding of the impact of the transactions on the financial statements of the reporting entity or is required by law.

Date from which effective

- 7 The accounting practices set out in the FRS should be regarded as standard in respect of financial statements relating to accounting periods commencing on or after 23 December 1995. Earlier adoption is encouraged but not required.

EXPLANATION*The effect of related parties*

- 8 In the absence of information to the contrary, it is assumed that a reporting entity has independent discretionary power over its resources and transactions and pursues its activities independently of the interests of its individual owners, managers and others. Transactions are presumed to have been undertaken on an arm's length basis, ie on terms such as could have obtained in a transaction with an external party, in which each side bargained knowledgeably and freely, unaffected by any relationship between them.
- 9 These assumptions may not be justified when related party relationships exist, because the requisite conditions for competitive, free market dealings may not be present. Whilst the parties may endeavour to achieve arm's length bargaining the very nature of the relationship may preclude this occurring. Sometimes the nature of the relationship between the parties is such that the disclosure of the relationship alone will be sufficient to make users aware of the possible implications of related party transactions. For this reason, transactions between a subsidiary undertaking, 90 per cent or more of whose voting rights are controlled within the group, and other members and investees of the same group are not required to be disclosed in the separate financial statements of that subsidiary undertaking.
- 10 Even when terms are arm's length, the reporting of material related party transactions is useful information, because the terms of future transactions are more susceptible to alteration as a result of the nature of the relationship than they would be in transactions with an unrelated party. Although the existence of a related party relationship sometimes precludes arm's length transactions, non-independent parties can deal with each other at arm's length, as in the situation where a parent undertaking places no restrictions on two subsidiaries, giving them complete freedom in deciding whether to deal with each other and on what terms. However, assertions in financial statements about transactions with related parties should not imply that the related party transactions were effected on terms equivalent to those that prevail in arm's length transactions unless the parties have conducted the transactions in an independent manner.

*Applying the definition of 'related party'**Party*

- 11 The definition of a related party encompasses both an individual or an entity, such as a company or unincorporated business, and a group of individuals or entities acting in concert. Groups of individuals or entities are included in this definition because, although a single individual or entity (having, for example only a small shareholding) might not be able to divert a particular reporting entity from pursuing its own separate interests, this could be achieved by the individual or entity acting in concert with others.

Relationship

- 12 The definition is limited to parties having a relationship with a reporting entity that affects the pursuit of separate interests of either the reporting entity or the other party, since transactions with such parties could have a significant effect on the financial position and operating results of the reporting entity. Consequently, subsidiary undertakings and associates are related parties of the investor. The reporting entity and a major customer or supplier are not related parties by virtue of that connection alone because the reporting entity still retains the freedom to make decisions in its own separate interests.

Common control

- 13 Entities subject to common control are included in the definition of a related party because the controlling entity could cause such entities to transact or not to transact with one another or to transact on particular terms. The relationship could therefore have a material effect on the performance and financial position of the reporting entity. Common control is deemed to exist when both parties are subject to control from boards having a controlling nucleus of directors in common.

Common influence

- 14 The difference between control and influence is that control brings with it the ability to cause the controlled party to subordinate its separate interests whereas the outcome of the exercise of influence is less certain. Two related parties of a third entity are not necessarily related parties of each other. For example:
- (a) entities are not related parties by reason only of their being associated companies of the same investor. The parties are subject only to influence rather than common control, hence the relationship between them is normally too tenuous to justify their being treated as related parties of each other;
 - (b) similarly when one party is subject to control and another party is subject to influence from the same source, those two parties are not necessarily related parties of each other. Since one of the parties is subject only to influence rather than control, the relationship between them would not normally justify their being treated as related parties of each other; and
 - (c) two entities are not related parties simply because they have a director in common.

In all circumstances, however, it will be appropriate to consider whether one or both transacting parties, subject to control and influence from the same source or common influence, have subordinated their own separate interests in entering into that transaction.

Pension funds

- 15 The fact that certain pension funds are related parties of the reporting entity is not intended to call into question the independence of the trustees with regard to their fiduciary obligations to the members of the pension scheme. Transactions between the reporting entity and the pension fund may be in the interest of members but nevertheless need to be reported in the accounts of the reporting entity.

Scope

- 16 Related party disclosure provisions do not apply in circumstances where to comply with them conflicts with the reporting entity's duties of confidentiality arising by operation of law (although operation of law would not include the effects of terms stipulated in a contract). For example, banks are obliged by law to observe a strict duty of confidentiality in respect of their customers' affairs and the FRS would not override the obligation to preserve the confidentiality of customers' dealings.

Exempt subsidiary undertakings

- 17 The FRS grants certain exemptions to subsidiary undertakings 90 per cent or more of whose voting rights are controlled within the group. These subsidiaries do not have to disclose transactions with other group companies and investees of the group qualifying as related parties. The latter includes associates and joint ventures of other group companies with whom the reporting subsidiary has transacted in circumstances falling under paragraph 2.5(a)(iv). Disclosure would, however, be required of transactions with related parties of the reporting subsidiary other than those that are excluded by the exemption.

Disclosure of control

- 18 If the reporting entity is controlled by another party, that fact is relevant information, irrespective of whether transactions have taken place with that party, because the control relationship prevents the reporting entity from being independent in the sense described in paragraph 8. Indeed, the existence and identity of the controlling party may sometimes be at least as relevant in appraising an entity's prospects as are the performance and financial position presented in its financial statements. The controlling party may establish the entity's credit standing, determine the source and price of its raw materials, determine the products it sells, to whom and at what price, and may affect the source, calibre and even the primary concern and allegiance of its management.

*Disclosure of transactions**Transactions*

- 19 Disclosure is required of all material related party transactions. As transactions include donations to or by the entity, related party transactions are required to be disclosed whether or not a price is charged. The following are examples of related party transactions that require disclosure by a reporting entity in the period in which they occur:

- purchases or sales of goods (finished or unfinished);
- purchases or sales of property and other assets;
- entering or receiving of services;
- agency arrangements;
- leasing arrangements;
- transfer of research and development;
- licence agreements;
- provision of finance (including loans and equity contributions in cash or in kind);
- guarantees and the provision of collateral security; and
- management contracts.

Materiality

- 20 Transactions are material when their disclosure might reasonably be expected to influence decisions made by the users of general purpose financial statements. The materiality of related party transactions is to be judged, not only in terms of their significance to the reporting entity, but also in relation to the other related party when that party is:

- (a) a director, key manager or other individual in a position to influence, or accountable for stewardship of, the reporting entity; or
- (b) a member of the close family of any individual mentioned in (a) above; or
- (c) an entity controlled by any individual mentioned in (a) or (b) above.

Aggregation

- 21 Disclosure of details of particular transactions with individual related parties would frequently be too voluminous to be easily understood. Accordingly, similar transactions may be aggregated by type of related party. For example, in the individual accounts of a group company, purchases or sales with other group companies can be aggregated and described as such. However, this should not be done in such a way as to obscure the importance of significant transactions. Hence purchases or sales of goods should not be aggregated with purchases or sales of fixed assets. Nor should a material related party transaction with an individual be concealed in an aggregated disclosure.

Other elements of the transaction

- 22 Paragraph 6(e) requires disclosure of any other elements of the [related party] transactions necessary for an understanding of the financial statements'. An example falling within this requirement would be the need to give an indication that the transfer of a major asset had taken place at an amount materially different from that obtainable on normal commercial terms.

Relationship with statutory and London Stock Exchange requirements

- 23 There are extensive statutory and London Stock Exchange requirements and reliefs regarding disclosure of related party transactions and relationships. In certain instances, the FRS will extend existing disclosure requirements; in other instances, the statutory and London Stock Exchange disclosure requirements go beyond those of the FRS. The location of the principal statutory and London Stock Exchange requirements is given in Appendices I and II respectively.

ADOPTION OF FRS8 BY THE BOARD

Financial Reporting Standard 8 - 'Related Party Disclosures' was approved for issue by the ten members of the Accounting Standards Board.

Sir David Tweedie

(Chairman)

Allan Cook

(Technical Director)

David Allvey

Ian Brindle

Michael Garner

Richard Goeltz

Raymond Hinton

Huw Jones

Professor Geoffrey Whittington

Ken Wild

APPENDIX I

NOTE ON LEGAL REQUIREMENTS

Great Britain

- 1 The following table lists only the main statutory provisions relating to related party disclosures.

Companies Act 1985

section 231	Disclosure required in notes to accounts: related undertakings
Schedule 5	Disclosure of information: related undertakings
<i>Part I</i>	<i>Companies not required to prepare group accounts</i>
<i>Part II</i>	<i>Companies required to prepare group accounts</i>
section 232	Disclosure required in notes to accounts: emoluments and other benefits of directors and others
section 741	“Director” and “shadow director”
Schedule 6	Disclosure of information: emoluments and other benefits of directors and others
section 234	Duty to prepare directors’ report
Schedule 7	Matters to be dealt with in directors’ report
Schedule 4	Form and content of company accounts
<i>Part I</i>	
<i>Section B</i>	<i>The required formats for accounts</i>
<i>paragraph 50</i>	<i>Guarantees and other financial commitments</i>
<i>paragraph 59</i>	<i>Dealings with or interests in group undertakings</i>
<i>paragraph 59A</i>	<i>Guarantees and other financial commitments in favour of group undertakings</i>
Schedule 4A	Form and content of group accounts
<i>paragraph 1(2)</i>	<i>General rules - application of Schedule 4 paragraph 59 to group accounts</i>
<i>paragraph 21</i>	<i>Consolidated balance sheet and profit and loss account formats for associated undertakings and for other participating interests.</i>

Special provisions relating to banking and insurance companies and groups are contained in Schedules 9 and 9A respectively.

Northern Ireland

- 2 The statutory requirements in Northern Ireland are identical with those in Great Britain. The following table shows the provisions in the Companies (Northern Ireland) Order 1986 that correspond to the following provisions in the Companies Act 1985 (see paragraph 1 above).

Great Britain

section 231

Schedule 5

Parts I and II

section 232

section 741

Schedule 6

section 234

Schedule 7

Schedule 4

*Part I Section B
paragraphs 50, 59
and 59A*

Schedule 4A

paragraphs 1(2) and 21

Banking companies and groups

Schedule 9

Insurance companies and groups

Schedule 9A

Northern Ireland

Article 239

Schedule 5

Parts I and II

Article 240

Article 9

Schedule 6

Article 242

Schedule 7

Schedule 4

*Part I Section B
paragraphs 50, 59
and 59A*

Schedule 4A

paragraphs 1(2) and 21

Schedule 9

Schedule 9A as amended by the Companies (1986 Order) (Insurance Companies Accounts) Regulations (Northern Ireland) 1994.

Republic of Ireland

- 3 The following table shows the provisions in the European Communities (Companies: Group Accounts) Regulations 1992, and the Companies Acts 1963 - 90 that correspond to the provisions in the Companies Act 1985 (see paragraph 1 above).

Great Britain

section 231

Schedule 5

Parts I and II

section 232

section 741

Schedule 6

section 234

Republic of Ireland

regulation 36

section 16
regulation 44
schedule,
paragraphs
4, 18-22

section 191

section 27

schedule,
paragraph 16
sections 41-43
schedule,
paragraph 17

section 158

1992 Regulations

Companies (Amendment) Act 1986
1992 Regulations
1992 Regulations

Companies Act 1963

Companies Act 1990

1992 Regulations

Companies Act 1990
1992 Regulations

Companies Act 1963

Schedule 7	sections 13,14 & 16 regulation 37 section 63	Companies (Amendment) Act 1986 1992 Regulations Companies Act 1990
Schedule 4		
<i>Part I</i>		
<i>Section B</i>	schedule, paragraphs 1-3	Companies (Amendment) Act 1986
<i>paragraph 50</i>	schedule, paragraph 36	Companies (Amendment) Act 1986
<i>paragraph 59</i>	schedule, paragraph 45	Companies (Amendment) Act 1986
<i>paragraph 59A</i>	schedule, paragraph 45A	Companies (Amendment) Act 1986
Schedule 4A		
<i>paragraph 1(2)</i>	regulation 15 (2)	1992 Regulations
<i>paragraph 21</i>	schedule, paragraph 2	1992 Regulations
<i>Banking companies and groups</i>		
Schedule 9	European Communities (Credit Institutions: Accounts) Regulations 1992	
<i>Insurance companies and groups</i>		
Schedule 9A	Part III, Schedule 6 Companies Act 1963	

(NB EC Directive 91/674, Accounts and consolidated accounts of Insurance Undertakings, has not yet been implemented in the Republic of Ireland.)

APPENDIX II**NOTE ON LONDON STOCK EXCHANGE REQUIREMENTS**

'The Listing Rules' published by the London Stock Exchange deal with related party transactions, which are defined somewhat differently from those in the FRS, albeit with a large degree of overlap. Chapter II 'Transactions with related parties' defines related party transactions and sets out the requirements and exceptions for such transactions. Further disclosure requirements in respect of related parties are contained in Chapter 12 'Financial information'.

APPENDIX III**COMPLIANCE WITH INTERNATIONAL ACCOUNTING STANDARDS**

Compliance with the FRS will ensure compliance with International Accounting Standard 24 'Related Party Disclosures' in all material respects except for the exemption in relation to certain subsidiaries. The FRS does not require disclosure in the financial statements of subsidiary undertakings, 90 per cent or more of whose voting rights are controlled within the group, of transactions with entities that are part of the group or investees of the group qualifying as related parties, provided that the consolidated financial statements in which that subsidiary is included are publicly available. IAS 24 does not require disclosure in the financial statements of a wholly-owned subsidiary if its parent is incorporated in the same country and provides consolidated financial statements in that country.

APPENDIX IV THE DEVELOPMENT OF THE FRS**History of documents issued*****ED 46***

- 1 ED 46 'Disclosure of related party transactions' was issued by the Accounting Standards Committee in April 1989. The major disclosure proposal was to report abnormal related party transactions. Detail required included the name and relationship of the transacting parties as well as the basis on which the transaction price had been determined. Aggregated disclosures were permitted subject to certain restrictions. Other proposals were: disclosure of the existence and nature of controlling related party relationships, whether or not any transactions had taken place between the parties; and disclosure of economic dependence. Economic dependence was deemed to exist where the transactions between an entity and another party, or other facts arising from a relationship with another party, had a pervasive influence on the entity.

FRED 8

- 2 FRED 8 'Related Party Disclosures' was published in March 1994. There were two main differences between ED 46 and FRED 8. First, FRED 8 proposed that *all* material related party transactions should be disclosed because reporting control relationships and related party transactions drew attention to the possibility that the financial statements might have been affected by the relationship. The provision in ED 46 allowing aggregated disclosures by aggregating similar transactions by type of related party was retained. The other major change from ED 46 was that FRED 8 did not require the disclosure of economic dependence. The Board believes that disclosure of any such dependence, if required, should not be in a standard dealing with related party transactions since a customer or supplier is not normally regarded as a related party.

International and overseas accounting standards

- 3 The International Accounting Standard, IAS 24 'Related Party Disclosures', requires the disclosure of all material related party transactions. This approach is also adopted in the US standard FAS 57 'Related Party Disclosures', and the Australian, Canadian and New Zealand related party standards. In all material

respects the definition of a related party and the disclosure requirements are the same in those standards as in FRS 8.

Statutory and London Stock Exchange requirements

- 4 There are extensive statutory and London Stock Exchange requirements regarding disclosure of related party transactions. The requirements principally concern transactions between companies and their directors and principal shareholders and their connected parties. Both sets of requirements are designed to focus on the stewardship aspect of directors' duties, whilst the FRS concentrates on the relevance of the information to users of accounts.

Matters considered in the light of responses to FRED 8

- 5 The following paragraphs refer to comments made by respondents to FRED 8, and explain, with reasons, the changes made by the Board to the proposals of the FRED or the Board's reasons for rejecting arguments for change.

Definition of a related party

Influence

- 6 Several respondents remarked that the phrase in the definition section of the FRED that described influence was too vague and should specify the level of influence that would trigger related party status. The description of the level of influence has therefore been strengthened so as to include the notion of the possible restriction on the ability of one of the parties to pursue at all times its own separate interests.

Common influence

- 7 In FRED 8, two or more parties were related parties when, *inter alia*, for all or part of the financial period one of the parties was subject to control and the other to influence from the same source. It was pointed out to the Board that, for those subsidiaries that are part of a large group, this could impose a reporting burden in their individual financial statements. A subsidiary not qualifying for an exemption from disclosure of transactions with other group companies and investees of the group qualifying as related parties might be unaware that it had had transactions with a related party being an associate of the group where the investment in that associate was held by another group company. In acknowledgement of this difficulty and that for two parties to be related parties there has to be a relationship between them, the Board has changed this part of the definition to include only transacting parties subject to influence from the same source to such an extent that one of the parties has subordinated its own separate interests.

Deemed/presumed

- 8 In the FRED, the definition of a related party was followed by two lists of types of related party:
 - (a) those deemed to be related parties; and
 - (b) those presumed to be related parties.

A number of respondents commented that, in some cases, the nature of the relationship of some parties classed as 'deemed' in the FRED did not justify this classification. Hence, in the standard, close families of directors have been moved to the 'presumed' list. This meets the criticism that those parties may not always have the requisite level of influence to qualify as a related party.

Immediate family

- 9 The immediate family of directors, substantial shareholders and key employees was stated in the FRED to be a possible type of related party. Several commentators asked for 'immediate family' to be more closely defined, some querying the use of the phrase 'members of the same household' and some the references to certain relatives and not others. The Board, in recognition of the fact that the emphasis should be on influence rather than on the immediacy of the family relationship, decided to substitute 'close family' for 'immediate family', in line with IAS 24. 'Close family' is defined 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.' The phrase 'members of the same household' has been retained to accommodate the view of the Board that related parties in this context are not necessarily confined to the individual's legal family.

10 per cent shareholding threshold

- 10 FRED 8 included the presumption that a shareholder owning 10 per cent or more of the voting rights of the reporting entity was a related party. Twenty-eight out of the forty-six respondents addressing this issue wanted the threshold to be raised (the most common figure mentioned being 20 per cent). Subsequent research indicated that the presumption of related party status at 10 per cent would capture many situations where the requisite level of influence was not present but rebuttal of the presumption would be necessary nonetheless. The Board accordingly decided to raise the threshold to 20 per cent.

Scope

WHOLLY-owned subsidiary exemption

- 11 Disclosure of transactions with entities that are part of the group or associates or joint ventures of the group was not required by the FRED in the financial statements of wholly-owned subsidiaries. The Board's reasons for granting this exemption were that the ultimate holding company is named in the notes to the financial statements and those wishing to find out more information about the group could do so provided that consolidated financial statements were 'publicly available'.
- 12 Those who supported the wholly-owned subsidiary exemption in general terms wished to extend its scope by:
- (a) describing the wholly-owned subsidiary as a 'wholly-owned subsidiary undertaking';
 - (b) reducing the threshold to 90 per cent owned subsidiaries; and
 - (c) widening the definition to take into account preference shares held by a third party and small numbers of shares held by employees, in what would otherwise be a wholly-owned subsidiary, as part of an employee share scheme.

In response to the above comments, the Board decided to widen the exemption with the effect that disclosure is not required in the financial statements of subsidiary undertakings, 90 per cent or more of whose voting rights are controlled within the group, of transactions with entities that are part of the group or investees of the group qualifying as related parties.

- 13 Several commentators remarked that disclosure of transactions with group companies is not available in the consolidated financial statements as such transactions are eliminated on consolidation and disclosure should therefore be made in the individual financial statements of the subsidiary. The Board, however, believes that in the case of a subsidiary undertaking, 90 per cent or more of whose voting rights are controlled within the group, the nature of the relationship is such that disclosure of the fact that the exemption has been invoked is sufficient to alert the reader of the financial statements to the possible existence of related party transactions.

Small company exemption

- 14 A majority of those who responded to the question of whether small companies should be granted an exemption from the disclosure of related party transactions considered that no exemption should be granted. The reason given was that these transactions were likely to be of greater significance in small than in larger companies. The minority who would have preferred the granting of an exemption cited as their main reason the fact that the costs of providing the additional disclosures would outweigh the benefits of reporting them. Subsequent to the receipt of comments on FRED 8, further consultation was undertaken. Representations from those auditing and using the accounts of small companies reinforced the view that appropriate related party disclosure is particularly important and relevant information in their financial statements, since transactions with related parties are more likely to be material in small companies.

- 15 The Board noted that Parts II and III of Schedule 6 to the Companies Act 1985, which applies equally to companies of all sizes and is concerned mainly with dealings in favour of directors and connected persons, overlapped in many respects with the disclosure requirements of the FRS; however, the FRS was broader in scope and, in particular, expressed more clearly than the statute the spirit of Schedule 6; it also clarified, to the benefit of both preparers and auditors, the disclosures necessary to meet the fundamental requirement that accounts should give a true and fair view.
- 16 In considering this question, the Board was aware of the work, which it had itself commissioned, of a working party of the Consultative Committee of Accountancy Bodies (CCAB) investigating possible bases for exempting small companies from some of the requirements of accounting standards. Concern was expressed that if small companies were to be exempt from the requirements of the FRS in advance of the outcome of this work, some transactions which would normally be disclosed could be hidden using the exemption as justification. Accordingly, the Board decided that the FRS should apply to all financial statements that are intended to give a true and fair view, with no exemption for small companies. For the reasons given above, the Board believes that the FRS essentially clarifies existing requirements applicable to small companies, rather than extends them to a significant degree. Its decision on the FRS should not be taken as an indication of how it might react to the eventual final report of the CCAB working party in relation to this or other accounting standards.

Banker/client confidentiality

- 17 Concern was expressed by banking entities and associations that disclosure of all material related party transactions in the accounts of banks could result in a breach of the confidentiality of the relationship between banker and client. The confidentiality of this relationship is part of the common law and is also a provision of the 'Good Banking' code of practice. Consequently the Board agreed to include a further paragraph in the Explanation section of the FRS to recognise the legal obligation borne by banks in this respect.

Disclosure of all material related party transactions

- 18 FRED 8 proposed disclosure of all material related party transactions. This proposal was supported by the majority of respondents. Those who suggested a return to the ED 46 proposal that the disclosure requirement should be confined to abnormal transactions with related parties argued that reporting all related party transactions did not provide useful information. The Board's view is that, when transactions with related parties are material in aggregate, they are of interest whatever their nature.

Materiality

- 19 A number of commentators noted that the area of materiality was one on which further guidance was required in addition to that given by the FRED. In response to this concern, further explanation has been given to address the perspective that needs to be considered when a related party transaction has been undertaken directly or indirectly with an individual in a position to influence, or accountable for stewardship of, the reporting entity (for example, a director or a substantial shareholder).

Fair value

- 20 FRED 8 required 'any other elements of the [related party] transactions necessary for an understanding of the financial statements' to be disclosed and suggested, as an example, a material difference between the fair value and the transacted amount where material transfers of assets, liabilities or services had taken place. Commentators addressing this issue were evenly divided in their views. Those in favour of the disclosure endorsed the Board's view that such information is useful because there is more scope for transactions between related parties to be at artificial prices as a result of the relationship. Those who opposed the disclosure argued that ascertaining a fair value for these transactions would be unduly burdensome and impracticable, since in many cases a fair value could not be obtained, particularly within groups. Whilst retaining its original view that this disclosure is relevant for an understanding of the financial statements, the Board acknowledged the observations of commentators. The Explanation has been amended to suggest as an example of any other elements of the [related party] transactions necessary for an understanding of the financial statements' an indication that the transfer of a major asset has taken place at an amount materially different from that obtainable on normal commercial terms. The Board believes that the absence of this information could reasonably be expected to influence decisions made by users of general purpose financial statements.