

HM Treasury

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Dear Accounting Officer

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FINANCIAL REPORTING STANDARD (FRS) 8

I attach a note dealing with the application of Financial Reporting Standard (FRS) 8 "Related Party Transactions" to central government.

2. The objective of the Standard 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.

3. FRS 8 requires the disclosure of:

C information on material related party transactions; and

C the name of the party controlling the reporting entity, whether or not any transactions have taken place between the various parties.

Related parties include both corporate bodies as well as individuals such as directors and key managers, including members of their close families (further details are given in the attached note).

4. It should be noted that FRS 8 does not replace the Companies Act's requirements for information to be provided of transactions between a body and its directors (board members in the context of central government bodies). In some cases, the requirements of FRS 8 are consistent with, but go beyond, those of the Companies Act and the disclosures can be combined.

5. The Cabinet Office has recently issued guidance on codes of practice for board members of public bodies which covers the declaration of interests in registers and participation in meetings and decisions. The interests involved can extend to those of close family members, persons living in the same household of the board member and organisations with which the board member is connected. The provisions of FRS 8 in effect supplement this guidance with

regard to actual transactions.

Scope of the Standard

6. The Standard applies to financial statements that are intended to give a true and fair view. The recommendations in this note should be applied to executive agencies, trading funds, executive non-departmental public bodies and public corporations.

Application to central government bodies

7. Under FRS 8, a related party relationship exists between, in effect, all the members of a group of companies, ie the parent company and its various subsidiary undertakings. Although the relationship between a Government Department and its sponsored bodies (mainly, but not confined to, executive agencies, trading funds, non-departmental public bodies, and public corporations) is not exactly the same as that between a parent company and its subsidiaries, it is considered that the principles of FRS 8 should apply to transactions between Government Departments and their sponsored bodies. In particular, it is proposed that the accounts of central government bodies to which this DAO letter applies should contain a note that the body has had transactions with related parties, including where appropriate departments and other central government bodies. A suggested form for such a note is attached at the appendix.

8. Paragraph 4(c) of the Standard notes that the FRS does not require disclosure of the relationship and transactions between the reporting entity and various parties where the relationship arises simply as a result of the role of those parties. One such category of party is “government departments and their sponsored bodies” and there has been debate about whether this paragraph exempts government departments and their sponsored bodies from the rules on disclosure. Having given the matter considerable thought, however, and following consultation with the National Audit Office and others, our view is that the paragraph was not intended to provide a wholesale exemption on these lines, but rather to address a different issue - the problem that a related party relationship might be thought to arise between a department and a company simply because the department imposed conditions in a transaction between them (eg the offer of financial assistance) and, except for this transaction, there was no other relationship between the parties. In interpreting paragraph 4 (c), we need to bear in mind that, accounting standards are written to apply to companies in the private sector and, as noted in the Foreword to Accounting Standards, it is for the Government to decide the extent to which accounting standards should be applied to the public sector. The Accounting Standards Board does not have the power to disapply a standard for government departments and their sponsored bodies.

9. If bodies are able to provide information about material transactions with related parties, they are not discouraged from so doing.

10. Bodies to which this DAO letter applies should provide details of any material transactions with related parties defined to include board members and key management staff and the close family members of both. Further details are provided in the attached note.

Date from which effective

11. FRS 8 became effective in respect of financial statements relating to accounting periods commencing on or after 23 December 1995. For most central government bodies, this will mean that they should apply the Standard for the financial year ending 31 March 1997. As discussed in more detail in the note, the suggested disclosure requirements for central government bodies are simpler than those required by the Standard, and it is hoped that bodies will be able to comply with this timetable.

Obtaining copies of FRS 8

12. Although the attached note addresses the main issues raised in FRS 8, it is not intended to be a comprehensive summary and analysis of its implications for central government. Reference to the Standard should be made where it appears from the note that there may be implications for a department or a sponsored body. Copies of FRS 8 can be obtained from ASB Publications, PO Box 939, Central Milton Keynes, MK9 2HT (telephone 01908 230344). It costs £6.00 post-free and its ISBN number is 1 85712 037 X. Please note that the Treasury cannot provide copies of the Standard.

Action by Departments

13. Departments should arrange for copies of this letter to be sent to sponsored bodies to enable them to take suitable action. The proposals have already been the subject of a letter to Principal Finance Officers and it is hoped that many bodies will already be aware of the suggested approach.

Enquiries

14. Departments should initially take up any questions with their accounting advisers. Any questions to the Treasury should be addressed to Nick Bailey in the Central Accountancy Team (0171 270 4535).

Yours sincerely

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Treasury Officer of Accounts

FINANCIAL REPORTING STANDARD (FRS) 8 “RELATED PARTY TRANSACTIONS”

1. FRS 8 was issued in October 1995 and became effective for financial years beginning on or after 23 December 1995. It requires the disclosure of material transactions between related parties, and a note of the party which controls the reporting entity.

Definition of a related party transaction

2. A related party transaction is defined in chapter 2.6 of the Standard as “the transfer of assets or liabilities or the performance of services by, to or for related parties, irrespective of whether a price is charged”. All transactions are covered including those undertaken in the normal course of business or at arm’s length prices.

Definition of related party

3. As defined in chapter 2.5 of the Standard, two or more parties are related if:

C one has direct or indirect control over the other;

C the parties are subject to common control from the same source;

C one party has influence over the financial and operating policies of the other to an extent that the other party might be inhibited from pursuing at all times its own separate interests;

C 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.

4. The Standard (chapter 2.5 (b)) considers that the following are always to be regarded as related parties of the reporting entity:

C the ultimate and intermediate parent undertakings, subsidiary undertakings and fellow subsidiary undertakings;

C associates and joint ventures;

C the investor or venturer in respect of which the reporting entity is an associate or a joint venture;

C directors of the reporting entity and the directors of the ultimate and intermediate parent undertakings (“directors” includes shadow directors); and

C pension funds for the benefit of the employees of the reporting entity or of any entity that is a related party of the reporting entity. NB: contributions to a pension fund need not be disclosed.

5. As described in chapter 2.5(c) and (d) of the Standard, there is a rebuttable presumption that the following are related parties of the reporting entity:

C the key management of the reporting entity (and that of the parent undertaking or undertakings)¹;

C 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;

C each person acting in concert in such a way as to be able to exercise control or influence over the reporting entity;

¹ “Key management” is defined as “those persons in **senior** (emphasis added) positions having authority or responsibility for directing or controlling the major activities and resources of the reporting entity” (Chapter 2.3 of the Standard).

- C an entity managing or managed by the reporting entity under a management contract;
- C members of the close family ²of any individual who is a related party; and
- C entities (eg companies, partnerships) controlled by any individual who is a related party.

Emoluments in respect of services as an employee do not have to be disclosed.

Application to central government

6. The provisions of FRS 8 will apply directly to any central government body which has been incorporated under the Companies Act. They should therefore provide details of material transactions with related parties rather than comply with the provisions described in this note.

7. The Standard provides that transactions between a parent company and its subsidiary undertakings need not be disclosed where they will be eliminated on consolidation. This dispensation cannot be applied to central government as, with one or two exceptions, consolidated accounts are not produced.

8. To avoid the possibility that accounts might contain a note of related party transactions of undue length, and following discussion with the National Audit Office and consideration of the proposal by departments, it has been agreed that central government bodies should provide:

²"Close family" means "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" (Chapter 2.1 of the Standard). FRS 8 applies the concept of influence rather than a specific relationship. However, based on the definitions given in the exposure draft (FRED 8), "close family" would include (but not be confined to) a spouse, parent, child (minor or adult), brother, sister, or the spouses of any of these. The guidance on codes of practice for board members of public bodies also refers to personal partners as being members of the close family.

- C the name of the sponsor or parent department (if any);
 - C a note of the main entities within government with which the body has had dealings. No information about those transactions need be given; and.
 - C details of material transactions between the body and individuals who are regarded as related parties.
9. An example of recommended wording is given in the attached appendix. Bodies are free to amend it to reflect their particular circumstances. In particular, the name of the parent department is often given in the Annual Report or Foreword to the accounts, and there is no suggestion that the information should be duplicated.

Transactions with a pension fund

10. Although transactions between a body and a pension fund (other than contributions to the fund) should be disclosed, this type of transaction is not covered explicitly in the suggested note as it is considered that such transactions are unlikely to arise in practice very often.

Transactions with individuals

11. Details of material transactions with individuals who are related parties (see paragraphs 4 and 5 above), including close family members, must be disclosed in the interests of public accountability. “Directors” should be interpreted as applying to board members (whether advisory or executive). “Key management” will include the chief executive (if he or she is not a board member) and persons in a senior position who direct or control the major activities or resources of the entity, such as heads of departments or divisions within the entity.

12. Advisory Board Members are often appointed because of their knowledge of and interest in the activities undertaken by the body. In some cases, these activities may include giving financial assistance to organisations in related industries, and a Board Member or an entity in

which he or she has an interest may receive such financial assistance. In such circumstances, the body must assess the materiality of the transaction (see below); if the assistance is generally available there may be no need to disclose the transaction. If, however, there is an element of discretion about providing the assistance, there is a presumption in favour of disclosure.

13. Bodies may be ignorant of the occupation of any close family member of a director of a company with which it transacts. If the close family member is a government official, it has been argued that a related party relationship might arise. Departments will need to consider the materiality of the transactions; if they are material, it may be necessary to confirm whether or not a related party relationship has arisen.

Materiality

14. Only material transactions need be considered for inclusion in the note. The Standard notes that transactions are material when their disclosure might reasonably be expected to influence decisions made by users of general purpose financial statements. It may be that informed readers of the accounts of central government bodies would be expected to have knowledge of the relationship between the body and other parts of central government and disclosure of transactions would have little influence.

14. However, materiality must also be considered in relation to other related parties where that party is a Board member, key member of the managerial staff or other individual in a position to influence or be accountable for stewardship of the body, or a member of his or her close family. Thus a similar transaction between the body and different individuals may need to be disclosed in some cases but not others depending on the personal circumstances of the individual.

SUGGESTED WORDING FOR NOTE ON RELATED PARTY TRANSACTIONS

[Name of body] is a [category of body, eg executive agency] of the Department of³

[Name of Department] is regarded as a related party. During the year, [name of body] has had [a (significant) number of / various] material transactions with the Department, and with other entities for which the Department is regarded as the parent Department, viz:

[list of main other agencies, trading funds, NDPBs and other bodies sponsored by or the responsibility of the parent Department.]

In addition, [name of body] has had a significant number of / various material transactions with other Government Departments and other central Government bodies. Most of these transactions have been with [list of main bodies].

EITHER: During the year, none of the Board Members, members of the key management staff or other related parties has undertaken any material transactions with [name of body].

OR: During the year, [name of body] entered into the following material transactions with the following Board Members, members of the key management staff and other related parties:

[details].

NB: The attached appendix illustrates how the note might appear in practice. It should not, however, be regarded as definitive and bodies may amend it to suit their particular circumstances.

³ This information is often given in the annual report or in the foreword to the accounts. If it shown elsewhere, it need not also be given in the note on related party transactions. As some bodies are departments in their own right, the wording in the note will need to describe the status of the body (if the information is not already provided elsewhere in the accounts).

RELATED PARTY TRANSACTIONS

Zeta is an Non-Departmental Public Body (NDPB) sponsored by Department Yellow [*].

Department Yellow is regarded as a related party. During the year, Zeta has had various material transactions with the Department and with other entities for which Department Yellow is regarded as the parent Department, viz (Executive Agencies) Alpha, Beta and Gamma; (Trading Funds) Delta; and (NDPB) Epsilon.

In addition, Zeta has had a small number of material transactions with other Government Departments and other central government bodies. Most of these transactions have been with Department Green, and one of its executive agencies (Omega agency).

None of the board members, key managerial staff or other related parties has undertaken any material transactions with Zeta during the year.

* If this information is given in the foreword to the accounts or in the annual report it need not also be shown in the note on related party transactions.