



# HM TREASURY

## Financial Reporting Advisory Board Paper

### **IAS 24 *Related party disclosures* as applied to Ministers**

<b>Issue:</b>	The application of IAS 24 to Ministers
<b>Impact on guidance:</b>	To inform guidance included in the IFRS-based FReM.
<b>IAS/IFRS adaptation?</b>	Yes – to avoid reference to a ‘parent’ entity in government
<b>IPSAS compliant?</b>	Yes
<b>Interpretation for the public sector context?</b>	Yes – to ensure that only transactions that are not ‘normal dealings’ with departments are disclosed.
<b>Impact on budgetary regime?</b>	No
<b>Alignment with National Accounts</b>	N/a – IAS 24 relates only to disclosures
<b>Impact on Estimates?</b>	No
<b>Recommendation:</b>	That the FRAB accept the proposed adaptation and interpretation of IAS 24 in relation to Ministers. If the FRAB accepts this interpretation, it is further recommended that a consultation with ministers is held.
<b>Timing:</b>	Not yet known: depends on future decision on date for moving to EU-adopted IFRS.

## DETAIL

### Introduction and Background

1. The application of IAS 24 *Related party disclosures* to government financial reporting has previously been considered by the Board.
2. The application of the Standard to Ministers has remained an outstanding issue.
3. The purpose of this paper is to consider the issue from first principles in order to conclude on the application of IAS 24 to Ministers.

#### *Definition*

4. The IAS 24 definition of a related party is reproduced in Annex A, paragraph A.3. The key elements for consideration are:
  - a. To what extent a department's Ministers satisfy the definition of "key management personnel" (A.3.d)
  - b. Whether Ministers, directly or indirectly, have an interest in the entity that gives them significant influence over the entity (A.3.a.ii)
  - c. Whether Ministers can be deemed to control, or be under common control via collective Cabinet responsibility (A.3.a.i)

#### *The current situation*

5. The 'Dear Accounting Officer' (DAO) letter concerning FRS 8 (Related Party Disclosures) is 2/97, issued by the Treasury Officer of Accounts team (TOA) on 21 March 1997.
6. DAO 2/97 states that:

"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."

7. There is no mention of Ministers in DAO 2/97. When departments subsequently queried this, a conclusion was reached that, because of the political and practical implications of seeking confirmation from Ministers (or perhaps more significantly, from members of their close families), a consultation with Ministers should be undertaken. To date, attempts to arrange such a consultation have been unsuccessful. If the FRAB accepts the proposals outlined in this paper, further attempts to arrange consultation will be made.
8. Notwithstanding the above, the current FReM states that, in applying the Companies Act requirement to disclose transactions with directors, entities should interpret 'directors' as follows:

"... persons in senior positions having authority or responsibility for directing or controlling the major activities of the entity. This means those who influence the decisions of the entity as a

whole rather than the decisions of individual directorates or sections within the entity. Such persons will include advisory and non-executive Board members and, in the case of departments, Ministers.”<sup>1</sup>

9. The disparity in interpretations of the DAO letter and the FReM has led to inconsistent consideration and disclosure of transactions with Ministers by different departments.

### **Key management personnel and significant influence**

10. IAS 24 defines *Key management personnel* 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’.

11. IAS 24 defines *Significant influence* as ‘the power to participate in the financial and operating policy decisions of an entity, but not control over those policies. Significant influence may be gained by share ownership, statute or agreement’.

#### *Parent entity*

12. IAS 24 states that, amongst other things, related parties are key management personnel of the entity *or its parent*. This discussion is deferred to the consideration of control below.

#### *Corporate governance considerations*

13. The management structure of entities in central government and the degree of delegation from Ministers to officials vary considerably. However, the Code of good practice: ‘Corporate governance in central government departments’ issued by HM Treasury contains a number of principles that departments should apply.

14. Under the principle of parliamentary accountability, the minister in charge of the department is:

“...responsible and answerable to Parliament for the exercise of the powers on which the administration of that department depends. He or she has a duty to Parliament to account, and to be held to account, for all the policies, decisions and actions of the department including its executive agencies.”<sup>2</sup>

15. Although Ministers are answerable for the department’s affairs in Parliament, responsibility for ‘planning, directing and controlling’ the activities of the department may be delegated to departmental officials. In particular:

“Each department should be managed by an effective board which, within the strategic framework set by the minister (or, in the case of a non-ministerial department, by legislation), supports the head of the department by advising Ministers and taking ownership of the department’s performance.”<sup>3</sup>

16. The distinction between control exercised by Ministers and that exercised by the management board is difficult to draw.

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<sup>1</sup> FReM 2006-07 paragraph 7.2.24

<sup>2</sup> Code of good practice: ‘Corporate governance in central government departments’

<sup>3</sup> Code of good practice: ‘Corporate governance in central government departments’

“Within the standards expected by Parliament, and subject to the overall control and direction of their Ministers, departments have considerable freedom about how they organise, direct and manage the resources at their disposal. It is for the Accounting Officer in each department, acting within Ministers’ instructions, to control the department’s business.”<sup>4</sup>

17. In practice, many departments operate a two-tier structure with a ‘ministerial’ board (which may be chaired by the Secretary of State) established to monitor progress against strategy and policy and a ‘management’ board (usually chaired by the Permanent Secretary/Head of department/Accounting Officer) responsible for delivery of that strategy.

18. In this case the authority and responsibility for planning, directing and controlling the activities of the entity lies with the Accounting Officer and management board. It is also reasonable to assume that in such a structure Ministers will not have the ‘the power to *participate* in the financial and operating policy decisions of an entity’; instead they will set the framework within which the Accounting Officer may act:

“Heads of Departments and chief executives of executive agencies are appointed as Accounting Officers. The essence of the role is a personal responsibility for the propriety and regularity of the public finances for which he or she is responsible; for keeping proper accounts; for the avoidance of waste and extravagance; and for the efficient and effective use of resources. Accounting Officers answer personally to the Committee of Public Accounts on these matters, within the framework of ministerial accountability to Parliament for the policies, actions and conduct of their departments.”<sup>5</sup>

19. It should be noted that Ministers do have the power to direct Accounting Officers in the event of any conflict between the minister’s instructions and the Accounting Officer’s duties. In such a situation the formal direction should be copied to the C&AG, who will normally inform the Public Accounts Committee.

20. Due to the checks in place on Ministers’ use of this power, and the rarity of such situations, it is not considered appropriate to include it in the determination of related party relationships.

#### *Consideration of international public sector accounting standards*

21. The relevant standard is IPSAS 20 *Related party* disclosures. The key elements of this standard are included in annex A.

22. IPSAS 20 is broadly consistent with IAS 24. However, it does clarify the definition of key management personnel in relation to Ministers, stating that:

“Where an entity is subject to the oversight of an elected or appointed representative of the governing body of the government to which the entity belongs, that person is included in key management personnel if the oversight function includes the authority and responsibility for planning, directing and controlling the activities of the entity.”<sup>6</sup>

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<sup>4</sup> Managing Public Money, working draft 5, December 2006

<sup>5</sup> Ministerial Code – a code of ethics and procedural guidance for ministers

<sup>6</sup> IPSAS 20 paragraph 7

## Summary

23. Where a minister sits on a board that is responsible for the financial and operating policy decisions of an entity or that has responsibility for planning, directing and controlling the activities of the entity, it is clear that the minister will have the power to exert significant influence over that entity and will therefore be a related party.

24. Where a minister does not sit on a 'management' board entities will need to consider whether:

- a. the minister has the authority and responsibility for planning, directing and controlling the activities of the entity (and is therefore key management personnel); or
- b. the minister or any ministerial board is able to 'participate in the financial and operating policy decisions' of the entity, either by statute or agreement (and therefore exerts significant influence).

The presumption is that this will not be the case.

25. In order for these conclusions to hold, the shadow FReM will need to define 'directors' as those holding positions on the management board.

## Control

26. IAS 24 and IAS 27 *Consolidated and separate financial statements* define *Control* as 'the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities'.

27. The definition of control in FRS 2 *Accounting for subsidiary undertakings* is similar to IFRS.

28. The Board has not yet considered the application of IAS 27 to the UK public sector, and the interpretation of control for consolidation purposes may well differ from that for related party identification. However, the FRAB have previously considered control in relation to the Whole of Government Accounts (WGA) process.

### *Previous considerations of control*

29. European System of Accounts (ESA) 95 defines control as the ability to determine general corporate policy by choosing appropriate directors if necessary. It goes on to say that control exists through ownership of more than half the voting shares or, in the case of government, through special legislation or regulation empowering the government to determine corporate policy.

30. The Board has previously considered the interpretation of control for the public sector via, inter alia, FRAB papers 45 (2) (Whole of Government Accounts – Definition of a subsidiary, associate or joint venture) and FRAB (83) 05 (Common Control – Application in the Public Sector). Relevant extracts of these papers are included in annex B.

31. These papers conclude that the Cabinet and Ministers, with the Monarch (together representing 'the Crown') control the whole of government through their activities, with no associated entity:

“...the equivalent to the role of the board of directors in a parent undertaking is performed by the Cabinet and Ministers.”<sup>7</sup>

32. These conclusions hold under IFRS.

33. By implication, Ministers are key management personnel of ‘the Crown’.

#### *Application to Ministers individually*

34. Control by Ministers in an individual capacity is dealt with through the consideration of the definition of significant influence and key management personnel above.

#### *Summary*

35. The Crown controls the whole of government. Ministers are key management personnel of the Crown.

36. IAS 24 states that, amongst other things, related parties are key management personnel of the entity *or its parent*.

37. Therefore, under IAS 24, Ministers are related parties of the whole of government.

### **Possible exceptions**

#### *Key management personnel of a parent entity*

38. IPSAS 20 does not include the IAS 24 extension of the related party definition to key management personnel of a parent entity (perhaps because the concept of a parent entity in WGA is not easily interpreted).

39. Adapting IAS 24 for use in the UK public sector in a similar way would avoid all Ministers being classified as related parties of the whole of government.

#### *Normal dealings*

40. IAS 24 does not include any specific exemptions from its disclosure requirements. However, paragraph 11 of the Standard does state that government departments and agencies 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).

41. If this principle is applied to Ministers (and their close family members), then normal dealings is an allowable exception from disclosure.

42. Intuitively, to except normal dealings from disclosure is a reasonable course of action; any such disclosure is likely to be excessively long and will not assist users in determining whether the financial position has been affected by such transactions. In fact, this principle is reflected in the current Local Authority SORP where the following example of a related party transaction is given:

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<sup>7</sup> FRAB 45 (2)

“Transactions with individuals who are related parties of an authority or a pension fund, *except those applicable to other members of the community or the pension fund, such as Council Tax, rents and payments of benefits.*”<sup>8</sup>

## Summary and recommendation

43. Under IAS 24 Ministers are related parties of the whole of government through their position in government.

44. Without adaptation or interpretation this conclusion is likely to place onerous reporting obligations on Ministers and could lead to lengthy disclosure in departments’ resource accounts, the value of which is questionable.

45. An **adaptation** for the public sector is therefore proposed to remove reference to the key management personnel of a parent entity (refer to A.3 for full definition). This is consistent with the IPSAS 20 definition:

“A party is related to an entity if ... the party is a member of the key management personnel of the entity ~~or its parent.~~”

46. An **interpretation** is also proposed to except normal dealings (i.e. those applicable to other citizens) from disclosure.

47. Under IAS 24, as adapted and interpreted, transactions with Ministers (or their close family members) will only need to be considered if:

- a. the minister has the authority and responsibility for planning, directing and controlling the activities of the entity (and is therefore key management personnel); or
- b. the minister or any ministerial board is able to ‘participate in the financial and operating policy decisions’ of the entity, either by statute or agreement (and therefore exerts significant influence).

The presumption is that this will not be the case unless the Minister sits on the management board of the entity.

Where the assertions under a or b hold true, only those transactions with Ministers (or their close family members) that are not applicable to other citizens will need to be disclosed.

48. The Board is asked to agree the proposed adaptation and interpretation of IAS 24; if agreed, this will then form the basis of a consultation with ministers. Proposed text for the shadow FReM is included in Annex C.

**Financial Reporting Policy Team**  
**19 March 2007**

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<sup>8</sup> Code of practice on local authority accounting in the united kingdom 2005

## **KEY STANDARDS AND DEFINITIONS**

### **IAS 24 Related party disclosures**

#### *Objective*

1. The objective of IAS 24 is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.
2. Knowledge of related party transactions, outstanding balances and relationships may affect assessments of an entity's operations by users of financial statements, including assessments of the risks and opportunities facing the entity.

#### *IAS 24 – key definitions*

3. *Related party*. A party is related to an entity if:
  - a. directly, or indirectly through one or more intermediaries, the party:
    - i. controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
    - ii. has an interest in the entity that gives it significant influence over the entity; or
    - iii. has joint control over the entity;
  - b. the party is an associate (as defined in IAS 28 *Investments in Associates*) of the entity;
  - c. the party is a joint venture in which the entity is a venturer (see IAS 31 *Interests in 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 (a) or (d);
  - f. the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
  - g. the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.
4. *Key management personnel* are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

5. *Significant influence* is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies. Significant influence may be gained by share ownership, statute or agreement.

### **IPSAS 20 Related party disclosures**

#### *Objective*

6. The objective of IPSAS 20 is to require the disclosure of the existence of related party relationships where control exists and the disclosure of information about transactions between the entity and its related parties in certain circumstances. This information is required for accountability purposes and to facilitate a better understanding of the financial position and performance of the reporting entity. The principal issues in disclosing information about related parties are identifying which parties control or significantly influence the reporting entity and determining what information should be disclosed about transactions with those parties.

#### *IPSAS 20 – key definitions*

7. *Related party* – parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control. Related parties include:

- a. Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the reporting entity;
- b. Associates (see IPSAS 17 *Accounting for Investments in Associates*);
- c. Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;
- d. Key management personnel, and close members of the family of key management personnel; and
- e. Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.

8. *Key management personnel* are:

- a. All directors or members of the governing body of the entity; and
- b. Other persons having the authority and responsibility for planning, directing and controlling the activities of the reporting entity. Where they meet this requirement key management personnel include:
  - i. Where there is a member of the governing body of a whole-of-government entity who has the responsibility for planning, directing and controlling the activities of the reporting entity, that member;
  - ii. Any key advisers of that member; and

- iii. Unless already included in (a), the senior management group of the reporting entity, including the chief executive or permanent head of the reporting entity.

9. *Significant influence* (for the purpose of IPSAS 20) is the power to participate in the financial and operating policy decisions of an entity, but not control those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors or equivalent governing body but also by, for example, participation in the policy making process, material transactions between entities within an economic entity, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by an ownership interest, statute or agreement. With regard to an ownership interest, significant influence is presumed in accordance with the definition contained in IPSAS 7 *Accounting for investments in associates*.

## ANNEX B

### EXTRACTS OF PREVIOUS FRAB PAPERS

#### 45 (2): WHOLE OF GOVERNMENT ACCOUNTS – DEFINITION OF A SUBSIDIARY, ASSOCIATE OR JOINT VENTURE

##### Parent undertaking

In general subsidiaries are identified in terms of control by their parent undertaking. Following a significant amount of discussion, we have concluded that it is not possible to define one individual body as the parent undertaking for the public sector. However, the equivalent to the role of the board of directors in a parent undertaking is performed by the Cabinet and Ministers. For simplicity, the tests refer to 'the Crown', which also recognises the role of the Monarch as Head of State, particularly in appointing the board members of some public undertakings (for example the BBC).

##### Interpretation of FRS 2 tests for a 'subsidiary'

Subject to the views of the Board, the intention is that undertakings which are deemed to be 'subsidiaries' within WGA will be defined according to the following tests which have been derived from those for the corporate sector in FRS 2 because control is often exercised by different means in the public sector. Where any one of the tests is met the undertaking will be a subsidiary for WGA:

1. For corporate undertakings, the tests as set out in FRS 2 will apply directly.
2. The Crown is a quasi-member of the undertaking and the Crown, the Monarch or Ministers (on behalf of the Government) have the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all matters.
3. The Crown has the right to exercise dominant influence over the undertaking:
  - a. By virtue of provisions contained in the undertaking's memorandum or articles, an Act of Parliament or through the activities of the body being substantially restricted by specific legislation;
  - b. By virtue of a control contract.
4. The Crown is a quasi-member of the undertaking and Ministers control a majority of the voting rights in the undertaking.
5. The Crown has a participating interest in the undertaking and:
  - a. It actually exercises dominant influence over the undertaking; or

It and the undertaking are managed on a unified basis."

## **(83) 05 COMMON CONTROL – APPLICATION IN THE PUBLIC SECTOR**

### **FRS 6**

1. The FReM applies UK GAAP ... Entities within the public sector are subject to common control as being part of UK general government<sup>9</sup>, or under the control of general government<sup>10</sup>.

### **Public Sector Boundary**

2. The Office for National Statistics (ONS) sets the boundary for the public sector. The CLASS (2000)1 document outlines the Treasury and ONS agreed methodology for establishing whether a body is private or public sector. CLASS (2000)1 employs the tests of control used in FRS 2 in determining whether the control exercised by the public sector is sufficient to merit classification as a public sector body.

### **Whole of Government Accounts (WGA)**

3. In preparing WGA, other than a very few (mainly) parliamentary exceptions, the Treasury relies on the ONS classification process. As such, if a body is classified as being within the public sector it will be consolidated in WGA.

### **Common Control**

4. In applying FRS 6 the Treasury takes the ONS classification of the public sector as forming the boundary of general government's common control.

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<sup>9</sup> General government is the ONS term used to define central and local government.

<sup>10</sup> Such bodies being market bodies classified as Public Corporations by the ONS

## 5. ANNEX C

# PROPOSED TEXT FOR THE IFRS-BASED GOVERNMENT FINANCIAL REPORTING MANUAL

## ***IAS 24 Related Party Disclosures***

### **Applicability**

IAS 24 applies as adapted in paragraph a.b.c. and as interpreted by paragraph a.b.c.

### **Objectives of IAS 24**

The objective of IAS 24 is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

### **Interpretations of IAS 24 for the public sector context**

The following interpretations of IAS 24 for the public sector context apply:

- Although entities to which this Manual applies should disclose transactions with individuals who are regarded as related parties in accordance with the requirements of IAS 24, other disclosures may be restricted to the name of the parent department (if any) and a note of the main entities within government with which the entity has had dealings (that is, no information about those transactions need be given). Suggested wording for the disclosures is given in Annex 00;
- Charitable non-departmental public bodies shall follow the disclosure requirements for related party transactions given in the Charities SORP;
- The requirement to disclose the compensation paid to management, expense allowances and similar items paid in the ordinary course of an entity's operations will be satisfied by the disclosures made in the Remuneration Report;
- Transactions with individuals (including, where applicable, Ministers) who are related parties of an entity do not need to be disclosed where they are equally applicable to other citizens, such as Council Tax, rents and payments of benefits.

## Adaptation of IAS 24 for the public sector context

The following general adaptation applies to entities required to prepare their financial statements in accordance with the guidance in this Manual.

### *Definition of a related party*

The requirement to disclose transactions with key management personnel of any parent entity is removed in recognition of the fact that it is not possible to define one individual body as the parent undertaking for the public sector.

## Application of IAS 24 to Ministers

Transactions with Ministers (or their close family members) will only need to be considered if:

- a. the minister has the authority and responsibility for planning, directing and controlling the activities of the entity (and is therefore key management personnel); or
- b. the minister or any ministerial board is able to 'participate in the financial and operating policy decisions' of the entity, either by statute or agreement (and therefore exerts significant influence).

The presumption is that this will not be the case unless the Minister sits on the management board of the entity.

ANNEX 00

## Note on related party transactions

This annex suggests forms of words that might be used by entities to which the interpretations of IAS 24 apply.

*[either]* The Department is the parent of the agencies [and other bodies, if appropriate] shown in note x and sponsor of the non-departmental public bodies shown in note x. These bodies are regarded as related parties with which the Department has had various transactions during the year.

*[or]* [Name of body] is a [category of body: for example, executive agency] of [name of department]. [Name of department] is regarded as a related party. During the year, [name of body] has had a [significant] number of 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, non-departmental public bodies and other bodies sponsored by or the responsibility of the parent Department.]

*[and]* In addition, [name of department or body] has had [a number of] [various] transactions with other government departments and other government bodies. Most of these transactions have been with [name of main entities].

*[either]:* During the year, no Board member, key manager or other related party has undertaken any transactions with [name of department or body].

*[or]* During the year [name of department or body] entered into the following transactions with [give name and type of related party (for example, Board member etc.)]. Details of the transactions are as follows:

[information about the nature of the transaction(s); the amount of the transaction(s); the amount of any outstanding balances and their terms and conditions, including whether they are secured and the nature if the consideration to be provided in settlement, and details of any guarantees given or received; provisions for doubtful debts related to the amount of the outstanding balances; and the expense recognised during the period in respect of bad or doubtful debts due from related parties].