

**SSAP 20**  
**STATEMENT OF STANDARD ACCOUNTING PRACTICE 20**  
**RELATED PARTY DISCLOSURES**

*(Issued August 1997)*

*The standards, which have been set in **bold italic type**, should be read in the context of the background material and implementation guidance and in the context of the Foreword to Statements of Standard Accounting Practice and Accounting Guidelines. Statements of Standard Accounting Practice are not intended to apply to immaterial items (see paragraph 8 of the Foreword).*

**Scope**

1. ***This Statement should be applied in dealing with related parties and transactions between a reporting enterprise and its related parties. The requirements of this Statement apply to the financial statements of each reporting enterprise.***
2. ***This Statement applies only to those related party relationships described in paragraph 3, as modified by paragraph 6.***
3. This Statement deals only with those related party relationships described in (a) to (e) below:
  - a. enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);
  - b. joint ventures and associated companies of the reporting enterprise, and enterprises that, directly or indirectly, have significant influence over or are under common significant influence with the reporting enterprise;
  - c. individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and close members of the family of any such individual (close members of the family of an individual are those that may be expected to influence, or be influenced by, that person in their dealings with the enterprise);
  - d. key management personnel of the reporting enterprise and its holding companies, and close members of the family of such individuals. Key management personnel are those persons that have authority and responsibility for planning, directing and controlling the activities of an enterprise (in the case of a company, this would include directors and officers); and
  - e. enterprises over which any person described in (c) or (d) is able to exercise control or significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

4. *No disclosure of transactions is required:*
- a. *in consolidated financial statements in respect of intra-group transactions;*
  - b. *in the holding company's own financial statements when they are presented together with the consolidated financial statements;*
  - c. *in financial statements of a wholly-owned subsidiary provided that the consolidated financial statements in which the subsidiary is included contain related party disclosures comparable to those required by this Statement, and that reliance on this exemption is disclosed in the subsidiary's financial statements; and*
  - d. *in financial statements of a reporting enterprise in respect of transactions that specific exemptions on disclosure are granted by statute. In such circumstances, reliance on the legal dispensation should be disclosed in the financial statements.*

## **Definitions**

5. *The following terms are used in this Statement with the meanings specified:*

*"Related party" - parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.*

*"Related party transaction" - a transfer of resources or obligations between related parties, regardless of whether a price is charged.*

*"Control" (for the purpose of this Statement) - ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or a substantial interest in voting power and the power to direct, by statute or agreement, the financial and operating policies of the management of the enterprise.*

*"Significant influence" (for the purpose of this Statement) - participation in the financial and operating policy decisions of an enterprise, but not control of those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors but also by, for example, participation in the policy making process, material intercompany transactions, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. With share ownership, significant influence is presumed in accordance with the definition contained in SSAP 10 "Accounting for associated companies".*

6. In the context of this Statement, the following are deemed not to be related parties:
- a. two enterprises simply because they have one or more non-executive directors (or equivalent persons in an unincorporated enterprise) in common, notwithstanding paragraphs 3(d) and (e) above (but it is necessary to consider the possibility, and to assess the likelihood, that the persons would be able to affect the policies of both enterprises in their mutual dealings);
  - b.
    - i. providers of finance;
    - ii. trade unions;

- iii. public utilities;
- iv. government departments and agencies,

in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of an enterprise or participate in its decision-making process); and

- c. a single customer, supplier, franchisor, distributor, or general agent with whom an enterprise transacts significant volume of business merely by virtue of the resulting economic dependence.

### **The related party issue**

7. Related party relationships are a normal feature of commerce and business. For example, enterprises frequently carry on separate parts of their activities through subsidiaries, joint ventures or associated companies and acquire interests in other enterprises - for investment purposes or for trading reasons - that are of sufficient proportions that the investing enterprise can control or exercise significant influence on the financial and operating decisions of its investee.
8. A related party relationship could have an effect on the financial position and operating results of the reporting enterprise. Related parties may enter into transactions which unrelated parties would not enter into. Also, transactions between related parties may not be effected at the same terms as between unrelated parties.
9. The operating results and financial position of an enterprise may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the reporting enterprise with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the holding company of a fellow subsidiary engaged in the same trade as the former partner. Alternatively, one party may refrain from acting because of the significant influence of another - for example, a subsidiary may be instructed by its holding company not to engage in research and development.
10. Because there is an inherent difficulty for management to determine the effect of influences which do not lead to transactions, disclosure of such effects is not required by this Statement.
11. Accounting recognition of a transfer of resources is normally based on the price agreed between the parties. Between unrelated parties the price is an arm's length price. Related parties may have a degree of flexibility in the price-setting process that is not present in transactions between unrelated parties.
12. A variety of methods is used to price transactions between related parties.
13. One way of determining a price for a transaction between related parties is by the comparable uncontrolled price method, which sets the price by reference to comparable goods sold in an economically comparable market to a buyer unrelated to the seller. Where the goods or services supplied in a related party transaction, and the conditions relating thereto, are similar to those in normal trading transactions, this method is often used. It is also often used for determining the cost of finance.

14. Where goods are transferred between related parties before sale to an independent party, the resale price method is often used. This reduces the resale price by a margin, representing an amount from which the re-seller would seek to cover its costs and make an appropriate profit, to arrive at a transfer price to the re-seller. There are problems of judgement in determining a compensation appropriate to the re-seller's contribution to the process. This method is also used for transfers of other resources, such as rights and services.
15. Another approach is the cost-plus method, which seeks to add an appropriate mark-up to the supplier's cost. Difficulties may be experienced in determining both the elements of cost attributable and the mark-up. Among the yardsticks that may assist in determining transfer prices are comparable returns in similar industries on turnover or capital employed.
16. Sometimes prices of related party transactions are not determined under one of the methods described in paragraphs 13 to 15 above. Sometimes, no price is charged - as in the examples of the free provision of management services and the extension of free credit on a debt.
17. Sometimes, transactions would not have taken place if the relationship had not existed. For example, an enterprise that sold a large proportion of its production to its holding company at cost might not have found an alternative customer if the holding company had not purchased the goods.

### **Materiality**

18. Transactions are material if their disclosure could reasonably be expected to influence the economic decisions of users of financial statements. The materiality of related party transactions is to be judged in terms of their significance to the reporting enterprise. When assessing materiality, consideration should be given to the fair value of the resources transferred. However, it should be noted that items judged immaterial for the purpose of this Statement might still fall within the disclosure requirements of the law and other regulations.

### **Disclosure**

19. The following are examples of situations where related party transactions may lead to disclosures by a reporting enterprise in the period which they affect:
  - a. purchases or sales of goods (finished or unfinished);
  - b. purchases or sales of property and other assets;
  - c. rendering or receiving of services;
  - d. agency arrangements;
  - e. leasing arrangements;
  - f. transfer of research and development;
  - g. licence agreements;
  - h. finance (including loans and equity contributions in cash or in kind);
  - i. guarantees and collaterals;

- j. management contracts; and
  - k. provisions against or write off of amounts due from related parties and write back of such provisions.
20. ***If there have been transactions between related parties, the reporting enterprise should disclose the nature of the related party relationships as well as the types of transactions and the elements of the transactions necessary for an understanding of the financial statements.***
21. The elements of transactions necessary for an understanding of the financial statements would normally include:
- a. an indication of the volume of the transactions, either as an amount or as an appropriate proportion;
  - b. amounts or appropriate proportions of outstanding items; and
  - c. pricing policies.
22. Transactions between related parties cannot be presumed to be effected at the same terms as between unrelated parties. Accordingly, it is inappropriate for disclosures about related party transactions to indicate that such transactions were effected on an arm's length basis unless such an assertion can be substantiated.
23. ***Items of a similar nature may be disclosed in aggregate except when separate disclosure is required by law or is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.***
24. The purpose of disclosing similar items in aggregate is to avoid unnecessarily voluminous disclosures. Dissimilar items are not disclosed in aggregate, for example, purchases or sales of goods are not aggregated with purchases or sales of fixed assets. Similarly, a significant transaction with a specific related party is not to be concealed within an aggregated disclosure.
25. Disclosure of transactions between members of a group is unnecessary in consolidated financial statements because consolidated financial statements present information about the holding company and subsidiaries as a single reporting enterprise. Transactions with joint ventures and associated companies accounted for under the equity method of accounting are not eliminated (although profits or losses on these transactions are eliminated) and therefore require separate disclosure as related party transactions.
26. ***Where a reporting enterprise has taken advantage of paragraphs 4(c) and (d) for not disclosing related party transactions, such fact should be disclosed in the financial statements.***

## Effective date

27. ***The practices set out in this Statement should be regarded as standard in respect of financial statements relating to periods beginning on or after 1 October 1997. Earlier adoption is encouraged but not required.***

## Transitional arrangements

28. *When comparative information for prior periods is not available when this Statement is first adopted, such information need not be presented. In such circumstances, this fact should be disclosed in the financial statements.*

## Notes on legal requirements in Hong Kong

29. The references to "section" and the "Tenth Schedule" below are to the Companies Ordinance.
30. Section 128 requires that if at the end of its financial year, a company has subsidiaries, the following should be disclosed:
- a. the subsidiary's name;
  - b. its country of incorporation; and
  - c. the description and proportion of the classes of shares held.
31. Section 129 requires that if at the end of its financial year, a company holds more than 20% of any class of issued shares of another body corporate (not being a subsidiary), or the shareholding in another body corporate (not being a subsidiary) exceeds 10% of the total assets of the company, the following should be disclosed:
- a. the name of that other body corporate;
  - b. its country of incorporation; and
  - c. the description and proportion of the classes of shares held.
32. Section 129A requires disclosure of the name and country of incorporation of the body corporate regarded by the directors as being the company's ultimate holding company.
33. Section 129D(3)(i) requires disclosure in the directors' report of the names of the persons who, at any time during the financial year, were directors of the company.
34. Section 129D(3)(ia) requires disclosure in the directors' report of a statement of the existence and duration of any contract in force during the year for the management and administration of the whole or any substantial part of the company's business, together with the name of any director interested therein.
35. Section 129D(3)(j) requires disclosure in the directors' report of any interest of a director in a contract with the company or its subsidiary, holding company or fellow subsidiary, if the contract is significant in relation to the company's business and the director's interest is material, whether directly or indirectly, at any time in the year, stating:
- a. the fact that the contract subsists or subsisted;
  - b. the names of the parties involved (other than the company);
  - c. the name of the director (if not a party);
  - d. the nature of the contract; and

- e. the nature of the director's interest.

This does not apply to directors' service contracts nor to contracts between the company and another body corporate where a director's only interest is by virtue of his being a director of that other body.

- 36. Section 129D(3)(k) requires disclosure in the directors' report of any directors' rights to acquire shares or debentures, in the company or any other body corporate, under any arrangement to which the company or its subsidiary, holding company or fellow subsidiary is a party, explaining the effects of the arrangement and giving the names of all directors during the year who held shares or debentures acquired pursuant to the arrangement.
- 37. Section 161 requires disclosure of the following, distinguishing between emoluments in respect of services as director (of the company or its subsidiary) and other emoluments:
  - a. the aggregate amount of directors' emoluments;
  - b. the aggregate amount of directors' or past directors' pensions; and
  - c. the aggregate amount of any compensation to directors or past directors in respect of loss of office, distinguishing between sums paid by or receivable from the company, its subsidiaries and any other persons.
- 38. Section 161B(1) requires disclosure of the following particulars of every relevant loan (including loan to directors and officers):
  - a. the name of borrower and, where applicable, the name of director involved;
  - b. the terms of loan;
  - c. the amount of the loan outstanding at the beginning and end of the financial year and the maximum amount so outstanding during that financial year; and
  - d. the amount of interest due but unpaid and the amount of any provision made.
- 39. Sections 161B(2) and (3) require disclosure of the following particulars of every guarantee entered into and of every security provided by the company in connection with a relevant loan:
  - a. the name of borrower and, where appropriate, the name of director involved;
  - b. the maximum liability of the company under the guarantee or in respect of the security at the beginning and end of the financial year; and
  - c. any amount paid or liability incurred by the company in fulfilling the guarantee or in discharging the security.
- 40. Paragraph 18(2) of the Tenth Schedule requires the aggregate amounts owing from (and indebtedness to) the company's subsidiaries to be set out separately from all other assets (and liabilities) of the company.
- 41. Paragraph 19(1) of the Tenth Schedule requires disclosure of the aggregate amounts owing from and indebtedness to the company's holding companies and fellow subsidiaries, and the aggregate amount of assets consisting of shares in fellow subsidiaries.

### **Notes on Stock Exchange requirements**

42. The Rules Governing the Listing of Securities (Listing Rules) published by The Stock Exchange of Hong Kong Limited (Stock Exchange) deal with connected party transactions, which are defined somewhat differently from related party transactions covered in this Statement, albeit with a large degree of overlap. The Listing Rules defines "connected person" and "connected transaction" and sets out disclosure requirements for connected party transactions (such disclosures could be made in the directors' report or in the financial statements). Enterprises whose securities are listed on the Stock Exchange are also required to comply with the provisions of the Listing Rules.

### **Compliance with International Accounting Standards**

43. International Accounting Standard IAS 24 "Related Party Disclosures" requires disclosure of related party relationships (where control exists) irrespective of whether there have been transactions between related parties, but such disclosure is not required by this Statement. Except for the above difference, compliance with this Statement ensures compliance in all material respects with IAS 24.