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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

CL-25-1 | Corporate Financial Reporting

Corporate Level (2025 – Curriculum)

- LKAS 24 – Related Party Disclosures

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Related Party Disclosures

LKAS 24

1. INTRODUCTION

Related party relationships and transactions between related parties are **a normal feature of commerce and business**. Many entities carry on their business activities through subsidiaries, joint ventures, and associates and there are inevitably transactions between these parties.

1.1 The related party issue

The problems posed by related party relationships and transactions are described in IAS 24 as follows:

- A related party relationship could have an effect on the profit or loss and financial position of an entity. Related parties may enter into transactions that unrelated parties would not.
    - *For example, an entity that sells goods to its parent at cost might not sell on those terms to another customer. Also, transactions between related parties may not be made at the same amounts as between unrelated parties.*
- The profit or loss and financial position of an entity 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 entity with other parties.
    - *For example, a subsidiary may terminate relations with a trading partner on acquisition by the parent of a fellow subsidiary engaged in the same activity as the former trading partner. Alternatively, one party may refrain from acting because of the significant influence of another—for example, a subsidiary may be instructed by its parent not to engage in research and development.*

1.2 Possible Solutions

1. **Disclosure of related party transactions**
    - *The purpose of disclosing the information required by IAS 24 is to give users of financial statements knowledge about transactions (for example, whether they are at fair value), outstanding balances, including commitments, and relationships with related parties that may affect their assessment of an entity's operations, including assessments of the risks and opportunities facing an entity*

2. **Remeasurement of related party transactions at fair values**
    - *An alternative solution to the problems posed by related party relationships and transactions would be to adjust the financial statements in order to value related party transactions as if they occurred with an independent third party and recognise any such transactions at an arm's length price (i.e., fair value).*
    - *However, IAS 24 does not propose the remeasurement of related party transactions at fair values and focusses on disclosure alone.*

2. OBJECTIVE

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, including commitments, with such parties

3. SCOPE

LKAS 24 applies in:

(a) Identifying related party relationships and transactions
(b) Identifying outstanding balances, including commitments, between an entity and its related parties
(c) Identifying the circumstances in which disclosure of the items in (a) and (b) is required And
(d) Determining the disclosures to be made about those items

4. DEFINING RELATED PARTIES

A related party is defined as "**a person or entity that is related to the entity that is preparing its financial statements**" (the 'reporting entity'). ***[Para 09]***

- *Here, the use of the word '**party**' means that the disclosure applies to both **individuals** and to **entities**.*

According to para 09 following lengthy definition can be used to identify related parties.

(a) A **person** or a **close member of that person's family** is related to a reporting entity if that person:
    i. has control or joint control of the reporting entity;
    ii. has significant influence over the reporting entity; or
    iii. is a member of the key management personnel of the reporting entity or of a parent of the reporting entity

(b) An **entity** is related to a reporting entity **if any** of the following conditions applies:

i. The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

ii. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

iii. Both entities are joint ventures of the same third party.

iv. One entity is a joint venture of a third entity, and the other entity is an associate of the third entity.

v. The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

vi. The entity is controlled or jointly controlled by a person identified in (a).

vii. A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity)

viii. The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

Important

In the definition of a related party, an **associate** includes subsidiaries of the associate, and a joint venture includes subsidiaries of the joint venture. Therefore, for example, an associate's subsidiary and the investor that has significant influence over the associate are related to each other ***[Para 12]***.

Related Party Transaction	A transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged
Close Members of The Family Of A Person (CFM)	Those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include: a) that person's children and spouse or domestic partner; b) children of that person's spouse or domestic partner; and c) dependants of that person or that person's spouse or domestic partner
Compensation	All employee benefits (as defined in LKAS 19) including employee benefits to which SLFRS 2 applies.

	• Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity.
Key Management Personnel (KMP)	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

The standard requires to check on the substance of the relationship rather than the legal form when deciding whether it is a related party or not.

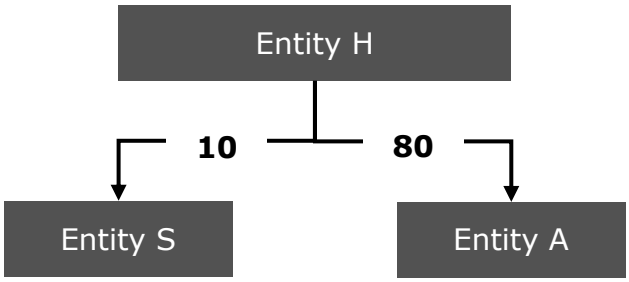
Following are not related parties *[Para 11]*

a) Two entities simply because they have a director or other member of key management personnel in common or because a member of key management personnel of **one entity has significant influence over the other entity**.
b) **Two joint venturers** simply because they share joint control of a joint venture.
c) 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).
   I. providers of finance,
   II. trade unions,
   III. public utilities,
   IV. departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity
d) A customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

Let's dive into the definition of related entities

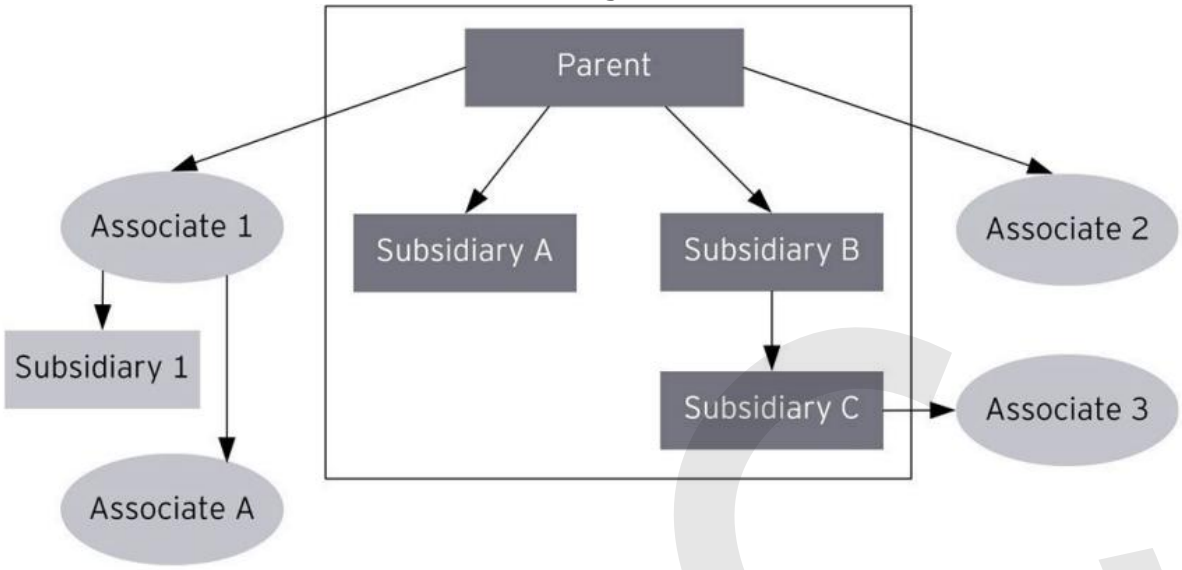
4.1 Entities that are members of the same group

All entities controlled by the same ultimate parent are related parties. This would include entities where the reporting entity holds less than a majority of the voting rights but which are subsidiaries as defined in SLFRS 10.



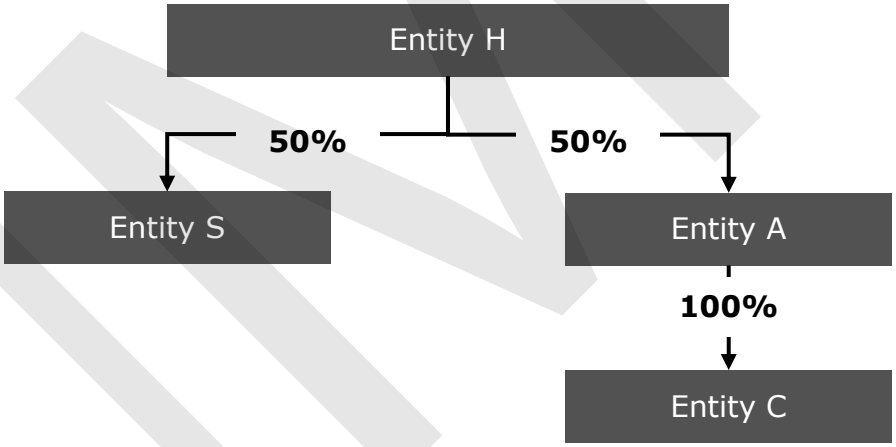
- *Entities H, S and A are all related parties to each other as they are members of the same group*

4.2 Entities that are associates or joint ventures



- *In Parent's separate and consolidated financial statements: Subsidiaries A, B, C and Associates 1 (including its subsidiary), 2 and 3 are related parties. Associate A is not a related party.*

4.3 Entities that are joint ventures of the same third party

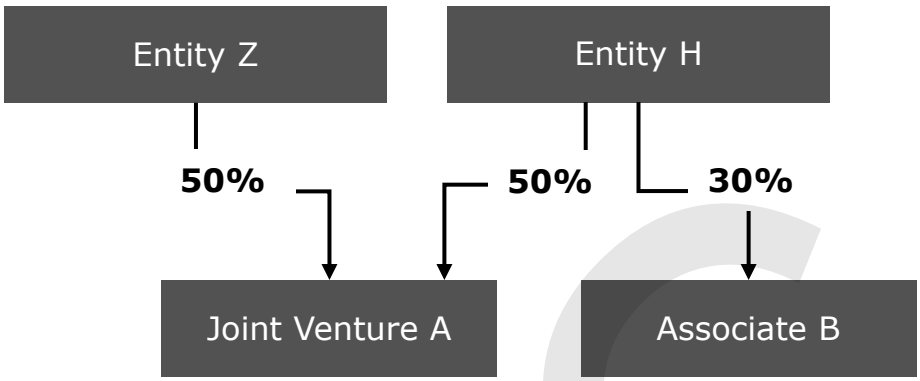


In this Illustration, Entities S and A are joint ventures of Entity H and are therefore related parties of one another. Entity C, as a subsidiary of Entity A, is also a related party of Entity H and Entity S. If, however, Entities S and A were associates (rather than joint ventures) of the Entity H, then they would not be related parties, as there is no control in either leg of this indirect relationship.

4.4 Entities that are joint ventures of a third party and associates of the same third entity

This definition treats joint ventures in a similar manner to subsidiaries and therefore an associate and a joint venture are related parties where they have an investor in common and that investor has control over the one and joint control

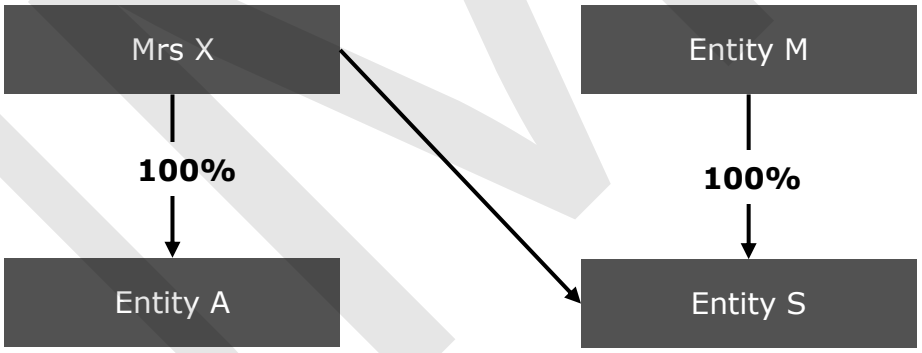
over the other. This is because joint control exists in one leg of the indirect relationship between the investees.



Joint Venture A is a joint venture of Entity H and Associate B is an associate of Entity H. Therefore, Joint Venture A and Associate B are related parties. However, Entities Z and H are not related parties.

4.5 Entities under control or joint control of certain persons or close members of their family

This is intended to address situations in which an entity is controlled or jointly controlled by a person or close family member of that person and that person or close family member also controls, jointly controls, has significant influence over, or is a member of key management personnel of, the reporting entity or of a parent of the reporting entity



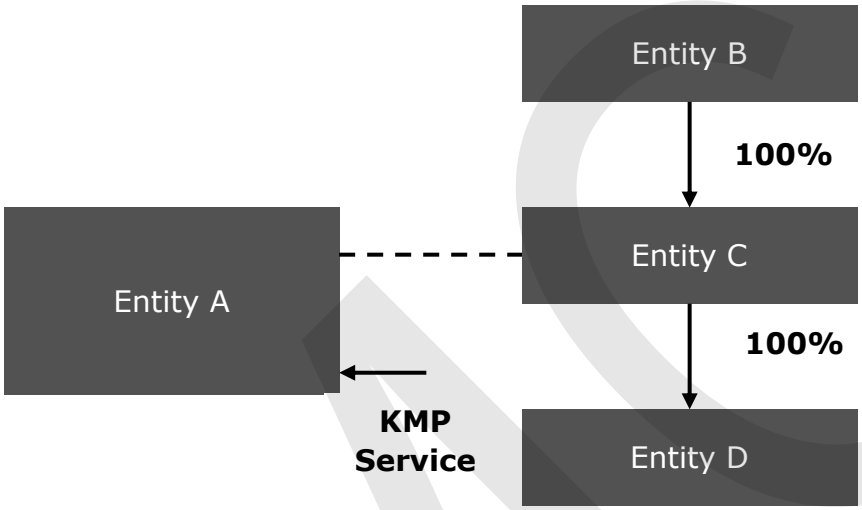
For Entity S's financial statements, Entity A is related to Entity S because Mrs X controls Entity A and is a member of the key management personnel of Entity S. For Entity S's financial statements, Entity A is also related to Entity S if Mrs X is a member of the key management personnel of Entity M and not of Entity S.

4.6 Entities, or any member of the group of which they are a part, that provide key management personnel services

This is intended to address situations **in which an entity** (described as a '**management entity'**), or a member of its group, provides key management

personnel services to the reporting entity and is most commonly seen in the fund management sector.

It applies to the provision of key management personnel services by the separate management entity. Staff acting for the management entity that are responsible for planning, directing and controlling the activities of the reporting entity are not considered to be key management personnel of the reporting entity. It is not necessary to look through the management entity to determine natural persons as key management personnel.



Entity C provides key management personnel services to Entity A. For Entity A's financial statements, Entities B, C and D are all related parties. For the financial statements of Entities B, C and D, there is no related party relationship with Entity A. The related party relationship between the management entity and the reporting entity is not symmetrical. In the absence of any other indicator of a related party relationship, the reporting entity (Entity A) cannot affect the management entity's (Entity C's) activities, financial position or profit or loss.

Direct and indirect relationships

To address this complexity in identifying related parties is to identify within a group direct and indirect relationships of the reporting entity.

- A **direct relationship** is where one entity has either control, joint control or significant influence over another entity (for example, a parent and a subsidiary)
    - *For direct relationships, if control, joint control or significant influence is present, a related party relationship exists*

- **Indirect relationship** is where two entities may share a common investor, but neither entity has control, joint control or significant influence over the other entity (for example, two subsidiaries in a group)

- *For indirect relationships, control or joint control must exist in one leg of that indirect relationship for a related party relationship to exist.*
- *Significant influence exists in both legs of the relationship, there is no related party relationship*
    - *Thus, two associates with a common investor are related to that investor, but not to each other*

Question 01 – Identifying Related Parties

Entity A owns 60% of entity B and 70% of entity C. Further, entity C owns 35% of entity D.

Required to identify the related party relationships within the above structure.

Question 02 – Identifying Related Parties

Consider each of the following situations:

a) Mr P controls entity A having 70% of shareholding and is able to exert significant influence over entity B having 30% of shareholding.
b) Mr P is able to exert significant influence over entity A and entity B having 25% and 30% shareholding in both the companies respectively.

Required: For each situation explain whether or not entity A and entity B are related parties.

Question 03 – Identifying Related Parties – KMP

Mr P owns all of the issued share capital of entity A. He also is a member of the key management personnel of entity B which, in turn, owns all of the issued share capital of entity C.

Required: Discuss the related party relationships arising from the above structure.

Question 04 – Identifying Related Parties – CFM

Mr T controls entity A. His spouse, Mrs T, exercises significant influence over entity B.

Required: Discuss the related party relationships arising from the above.

Question 05 – 2023 December PP

The following information is relevant to MPN (Pvt) Limited (MPN).

- X is the CEO of MPN
- X is married to Y
- Y is the sole owner of JN (Pvt) Limited (JN)
- X is also an independent director of COI PLC (COI)

Which of the following correctly identifies all the related parties of MPN per LKAS 24 Related Party Disclosures?

a) X, Y and JN
b) X, JN and COI
c) X, Y, JN and COI
d) X, Y and COI

5. RELATED PARTY TRANSACTIONS

A **related party transaction** is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

The standard lists some examples of transactions that are disclosed if they are with a related party in Para 21.

i. purchases or sales of goods (finished or unfinished);
ii. purchases or sales of property and other assets
iii. rendering or receiving of services
iv. leases
v. transfers of research and development
vi. transfers under license agreements transfers under finance arrangements (including loans and equity contributions in cash or in kind)
vii. provision of guarantees or collateral
viii. commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognised and unrecognised)
ix. settlement of liabilities on behalf of the entity or by the entity on behalf of that related party.

6. DISCLOSURES

Disclosure is required in respect of the **controlling party** and **parent-subsidiary relationships**, **transactions with key management personnel** and other related party transactions.

6.1 Controlling Party Disclosures [Para 13]

Relationships between a **parent and its subsidiaries shall be disclosed** irrespective of whether there have been transactions between them. An entity shall disclose the name of its parent and, if different, the ultimate controlling party.

If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

The requirement to disclose related party relationships between a parent and its subsidiaries is in addition to the disclosure requirements in LKAS 27 and SLFRS 12 Disclosure of Interests in Other Entities.

6.2 Key Management Personnel Disclosures [Para 17]

An entity shall disclose key management personnel compensation in total and for each of the following categories:

1. short-term employee benefits
2. post-employment benefits
3. other long-term benefits
4. termination benefits
5. share-based payment

If an entity obtains key management personnel services from a management entity, there is no requirement to disclose compensation payable by the management entity to its employees.

6.3 Other Related Party Transaction Disclosures [Para 17]

If there are transactions between related parties, the **nature of the related party relationship** should be disclosed as well as **information about the transactions** and **outstanding balances** necessary for an understanding of the potential effect of the relationship on the financial statements. At a **minimum**, disclosures should include:

(a) The amount of transactions
(b) The amount of outstanding balances and their terms and conditions and details of guarantees given or received
(c) Provisions for doubtful debts related to outstanding balances

(d) The expense recognised in the period in respect of bad or doubtful debts due from related parties

These disclosures **should be made separately** for each of the following categories:

(a) The parent
(b) Entities with joint control of, or significant influence over, the entity
(c) Subsidiaries
(d) Associates
(e) Joint ventures in which the entity is a joint venturer
(f) Key management personnel of the entity or its parent
(g) Other related parties

Items of a similar nature may be disclosed in aggregate **unless** separate disclosure is necessary for an understanding of the effect on the financial statements.

Disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such disclosures can be substantiated **[Para 23]**.

6.4 Government Related Entities [Para 25]

The disclosures listed above are **not required (Exempted)** in respect of transactions with:

a) a government that has control, joint control or significant influence over the reporting entity and
b) another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

Instead, the reporting entity **shall disclose**:

a) the name of the government and the nature of its relationship with the reporting entity and
b) information in sufficient detail to allow uses of the financial statements to understand the effect of related party transactions on the financial statements.

Note 7 provides information about the Group's structure, including details of the subsidiaries and the holding company. The following table provides the total amount of transactions that have been entered into with related parties for the relevant financial year.

		Sales to related parties	Purchases from related parties	Amounts owed by related parties*	Amounts owed to related parties*
		€000	€000	€000	€000
Entity with significant influence over the Group:					
International Fires P.L.C.	2024	7,115	–	620	–
	2023	5,975	–	550	–
Associate:					
Power Works Limited	2024	2,900	–	551	–
	2023	2,100	–	582	–
Joint venture in which the parent is a venturer:					
Showers Limited	2024	–	590	–	30
	2023	–	430	–	12
Key management personnel of the Group:					
Other directors' interests	2024	225	510	–	10
	2023	135	490	–	10

* The amounts are classified as trade receivables and trade payables, respectively (see Notes 23 and 30).

Compensation of key management personnel of the Group

	2024	2023
	€000	€000
Short-term employee benefits	435	424
Post-employment pension and medical benefits	110	80
Termination benefits	40	–
Share-based payment transactions	18	12
Total compensation paid to key management personnel	**603**	**516**

Question 06

The following information relates to the Colombo Group companies and transactions with other parties:

- Mrs C, a director of Kandy, a 90% subsidiary of Colombo, has borrowed Rs. 10,000,000 from Colombo.
- Mrs B, one of the directors of Colombo, is paid by Moratuwa, a 75% subsidiary, to act as an independent consultant. She is paid an annual sum of Rs. 4,000,000.
- Galle, a company controlled by the brother of a director of Colombo, is a customer of Kandy. During the year ended 31 December 2010, Galle purchased Rs. 15,000,000 goods from Kandy; at the year end, Rs. 6,000,000 is outstanding. Rs. 1,000,000 of this amount is six months overdue and the directors of Kandy have decided to provide for this amount in full.

- Kandy has provided a bank guarantee to its main customer in order to ensure continuing trading.
- Directors of group companies are remunerated as follows:

	Salary (Rs.)	Bonus (Rs.)	Pension (Rs.)
Colombo			
Mr. A	12,000,000	3,000,000	5,000,000
Mrs. B	7,800,000	2,600,000	5,000,000
Kandy			
Mrs. C	8,900,000	4,000,000	4,400,000
Mrs. D	8,800,000	3,800,000	5,300,000
Moratuwa			
Mr E	8,200,000	3,700,000	4,200,000
Mr F	7,900,000	3,700,000	4,200,000

Required Prepare the related party disclosure note for the Colombo Group financial statements for the year ended 31 December 20X4.

JMC