

## Topic 4: REPORTING PERFORMANCE INVOLVING EARNINGS PER SHARE, IMPAIRMENT OF ASSETS AND RELATED PARTY TRANSACTIONS

### 4.1. EARNINGS PER SHARE (IAS 33)

#### 4.1.1. Introduction

AS 33 *Earnings Per Share* sets out how to calculate both basic earnings per share (EPS) and diluted EPS. The calculation of Basic EPS is based on the weighted average number of ordinary shares outstanding during the period, whereas diluted EPS also includes dilutive potential ordinary shares (such as options and convertible instruments) if they meet certain criteria.

#### 1<sup>o</sup> Objective and scope

The **objective of IAS 33** is to prescribe principles for determining and presenting earnings per share (EPS) amounts to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity.

IAS 33 applies to entities whose securities are publicly traded or that are in the process of issuing securities to the public. Other entities that choose to present EPS information must also comply with IAS 33. If both parent and consolidated statements are presented in a single report, EPS is required only for the consolidated statements.

#### IAS 33 has the following scope restrictions:

- (a) Only companies with (potential) ordinary shares which are **publicly traded** need to present EPS (including companies in the process of being listed).
- (b) EPS need only be presented on the basis of **consolidated results** where the parent's results are shown as well.
- (c) Where companies **choose** to present EPS, even when they have no (potential) ordinary shares which are traded, they must do so according to IAS 33.

#### 2<sup>o</sup> Definitions

The following definitions are given in IAS 33.

- **Ordinary share:** an equity instrument that is subordinate to all other classes of equity instruments.
- **Potential ordinary share:** a financial instrument or other contract that may entitle its holder to ordinary shares. **e.g.:** convertible debt; convertible preferred shares; employee stock purchase plans; contractual rights to purchase shares; etc.
- **Options, warrants and their equivalents:** financial instruments that give the holder the right to purchase ordinary shares.
- **Contingently issuable ordinary shares** are ordinary shares issuable for little or no cash or other consideration upon the satisfaction of certain conditions in a contingent share agreement.
- **Contingent share agreement:** an agreement to issue shares that is dependent on the satisfaction of specified conditions.
- **Dilution** is a reduction in earnings per share or an increase in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of certain conditions.
- **Anti-dilution** is an increase in earnings per share or a reduction in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of certain conditions.

### 3<sup>0</sup> Requirements

- An entity whose securities are publicly traded (or that is in process of public issuance) must present, on the face of the statement of comprehensive income
- If an entity presents the components of profit or loss in a separate income statement, it presents EPS only in that separate statement.
- Basic and diluted EPS must be presented with equal prominence for all periods presented.
- Basic and diluted EPS must be presented even if the amounts are negative (that is, a loss per share).

#### 4.1.2. Basic and Diluted EPS

##### 1<sup>0</sup> Basic EPS

**Basic EPS** is calculated by dividing the **net profit** or loss for the period attributable to ordinary equity holders of the parent entity by the **weighted average number of ordinary shares** outstanding during the period.

$$EPS = \frac{\text{Earnings}}{\text{Number of ordinary shares outstanding}}$$

- The numerator (**earnings**) (profit or loss from continuing operations and net profit or loss) used for the calculation should be after deducting all expenses including taxes, non-controlling interest, and preference dividends.
- The denominator (**weighted average number of shares**) is calculated by **adjusting the shares in issue at the beginning of the period by the number of shares bought back or issued during the period, multiplied by a time-weighting factor.**

When shares are issued during the financial year **at a full market price**, the number of shares is a weighted average number of shares in issue during the year. This can be calculated as follows:

Number of shares at the beginning of the year, plus	A
Add: Number of shares issued at full market price during the year × [Number of months in the year after the share issue /12]	B
<i>Weighted average number of shares in the year</i>	A+B

The **time-weighting factor** is the number of days the shares were outstanding compared with the total number of days in the period. A reasonable approximation is usually adequate. IAS 33 includes guidance on appropriate recognition dates for shares issued in various circumstances.

Treatment for the issue of ordinary shares in different circumstances is as follows:

In exchange for cash	When cash is receivable
On the voluntary reinvestment of dividends on ordinary/preferred shares	The dividend payment date
As a result of the conversion of a debt instrument to ordinary shares	Date interest ceases accruing
In place of interest or principal on other financial instruments	Date interest ceases accruing
In exchange for the settlement of a liability of the entity	The settlement date
As consideration for the acquisition of an asset other than cash	The date on which the acquisition is recognized
For the rendering of services to the entity	As services are rendered

##### Bonus issue

Bonus issue or scrip issue or capitalisation issue is a company's free issue of shares to its existing

shareholders. Since bonus issue does not provide additional resources to the issuer means that the shareholder owns the same proportion of the business before and after the issue.

The problem for calculating EPS when there has been a bonus issue in the period is that it distorts the comparison of EPS in the current year with the EPS in the previous year (for which a comparative figure is shown in the statement of comprehensive income or income statement). So to ensure that the bonus issue does not distort the comparison of EPS in the current year and previous year:

- EPS for the current year is calculated as if the bonus issue took place at the start of the year, and
- Previous year's EPS is also re-stated as though the bonus shares had been in existence throughout the whole of that year too.

In the calculation of EPS:

- the bonus shares are deemed to have been issued at the start of the year
- comparative figures are restated to allow for the proportional increase in share capital caused by the bonus issue.

### Rights issue

A rights issue of shares is an issue of new shares for cash, where the new shares are offered initially to current shareholders in proportion to their existing shareholdings. The issue price of the new shares in a rights issue is always below the current market price for the shares already in issue.

Because rights issues are usually at less than full market price they include a bonus element. Since there is a bonus element in the issue price, an adjustment is needed for the EPS calculation, to ensure a fair comparison of the current year EPS with the previous year EPS.

#### Current year EPS

To adjust for the bonus element in the rights issue, the number of shares in the current financial year must be adjusted. You should multiply the number shares in issue before the rights issue by a factor (a 'rights factor') of:

$$\frac{\text{Actual cumulative rights price}}{\text{Theoretical ex rights price}}$$

#### Previous year EPS

In addition, to provide a fair comparison of the current year EPS with the previous year's EPS, the comparative EPS for the previous year is obtained by adjusting the EPS actually reported last year. The previous year's EPS is reduced by the following factor:

$$\frac{\text{Theoretical ex rights price}}{\text{Actual cumulative rights price}}$$

- ✓ The **actual cum-rights price** is the market price of the shares before the rights issue.
- ✓ The **theoretical ex-rights price** is the price that the shares ought to be, in theory, after the rights issue. It is a weighted average price of the shares before the rights issue and the new shares in the rights issue.

In short, rights issues present special problems:

- they contribute additional resources
- they are normally priced below full market price.

Thus, they combine the characteristics of issues at full market price and bonus issues and determining the weighted average capital, involves two steps as follows:

(1) adjust for bonus element in rights issue, by multiplying capital in issue before the rights issue by

this **rights factor** (to ensure a fair comparison of current year EPS with previous year EPS):  
(2) calculate the weighted average capital in the issue as above.

## 2<sup>o</sup> Diluted EPS

Equity share capital may change in the future owing to circumstances which exist now – **known as dilution**. The provision of a diluted EPS figure attempts to alert shareholders to the potential impact on EPS. **Examples** of dilutive factors are:

- the conversion terms for convertible bonds
- the conversion terms for convertible preference shares
- the exercise price for options and the subscription price for warrants.

## Convertibles

**The principles applicable to the convertible bonds and convertible preference shares are similar.**

If the convertible bonds/preference shares had been converted:

- the interest/dividend would be saved therefore earnings would be higher
- the number of shares would increase.

## Options and warrants to subscribe for shares

*An option or warrant gives the holder the right to buy shares at some time in the future at a predetermined price.* Cash does enter the entity at the time the option is exercised, and the DEPS calculation must allow for this.

**The total number of shares issued on the exercise of the option or warrant is split into two:**

- the number of shares that would have been issued if the cash received had been used to buy shares at fair value (using the average price of the shares during the period)
- the remainder, which are treated like a bonus issue (i.e. issued for no consideration).

*The number of shares issued for no consideration is added to the number of shares when calculating the DEPS.*

**Diluted EPS** is calculated by adjusting the net profit attributable to ordinary shareholders and the weighted average number of shares outstanding for the effects of all dilutive potential ordinary shares. The DEPS is calculated as follows:

$$DEPS = \frac{\text{Earnings} + \text{Notional extra earnings}}{\text{Number of shares} + \text{Notional extra shares}}$$

## Notional extra earnings

The earnings calculated for basic EPS should be adjusted by the **post-tax** (including deferred tax) effect of the following:

- (a) Any **dividends** on dilutive potential ordinary shares that were deducted to arrive at earnings for basic EPS
- (b) **Interest recognised** in the period for the dilutive potential ordinary shares
- (c) Any **other changes in income or expenses** (fees and discount, premium accounted for as yield adjustments) that would result from the conversion of the dilutive potential ordinary shares

The conversion of some potential ordinary shares may lead to changes in **other income or expenses**.

The number of ordinary shares is the weighted average number of ordinary shares calculated for basic EPS plus the weighted average number of ordinary shares that would be issued on the conversion of all the **dilutive potential ordinary shares** into ordinary shares.

It should be assumed that dilutive ordinary shares were converted into ordinary shares at the **beginning of the period** or, if later, at the actual date of issue.

There are two other points.

- (a) The computation assumes the most **advantageous conversion rate** or exercise rate from the standpoint of the holder of the potential ordinary shares.
- (b) A **subsidiary, joint venture or associate** may issue potential ordinary shares that are convertible into either ordinary shares of the subsidiary, joint venture or associate, or ordinary shares of the reporting entity. If these potential ordinary shares have a dilutive effect on the consolidated basic EPS of the reporting entity, they are included in the calculation of diluted EPS.

#### 4.1.3. Presentation

An entity should present in the **statement of profit or loss and other comprehensive income** basic and diluted EPS for:

- (a) Profit or loss from continuing operations; and
- (b) Profit or loss for the period for each class of ordinary share that has a different right to share in the net profit for the period.
  - The basic and diluted EPS should be presented with **equal prominence** for all periods presented.
  - Basic and diluted EPS for any **discontinuing operations** must also be presented.
  - Disclosure must still be made where EPS and/or DEPS figures are **negative** (i.e a loss per share).

#### 4.1.4. Significance of EPS

- Earnings per share (EPS) is one of the most frequently quoted statistics in financial analysis. Because of the widespread use of the price earnings (**P/E**) **ratio** as a yardstick for investment decisions, it became increasingly important.
- It seems that reported and therefore, EPS can, through the P/E ratio, have a **significant effect on a company's share price**. Therefore, a share price might fall if it looks as if EPS is going to be low. This is not very rational, as EPS can depend on many, often subjective, assumptions used in preparing a historical statement, namely the statement of profit or loss and other comprehensive income. It does not necessarily bear any relation to the value of a company, and of its shares. Nevertheless, the market is sensitive to EPS.

#### 4.1.5. Retrospective adjustments

The calculation of basic and diluted EPS for all periods presented is adjusted retrospectively when the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalization, bonus issue, or share split, or decreases as a result of a reverse share split. If such changes occur after the balance sheet date but before the financial statements are authorized for issue, the EPS calculations for those and any prior period financial statements presented are based on the new number of shares. Disclosure is required.

### 4.2. IMPAIRMENT OF ASSETS (IAS 36)

**IAS 36 *Impairment of Assets*** seeks to ensure that an entity's assets are not carried at more than their recoverable amount (i.e. the higher of fair value less costs of disposal and value in use). With the exception of goodwill and certain intangible assets for which an annual impairment test is required, entities are required to conduct impairment tests where there is an indication of impairment of an asset, and the test may be conducted for a 'cash-generating unit' where an asset does not generate cash inflows that are largely independent of those from other assets.

## Scope

IAS 36 applies to all tangible, intangible and financial assets *except*

- inventories,
- assets arising from construction contracts,
- deferred tax assets,
- assets arising under IAS 19 *Employee benefits* and
- financial assets within the scope of IAS 32 *Financial instruments: presentation*.

This is because those IASs already have rules for recognising and measuring impairment. Note also that IAS 36 does not apply to non-current assets held for sale, which are dealt with under IFRS 5 *Non-current assets held for sale and discontinued operations*.

### 4.2.1. Impairment of individual assets

In some cases, an entity may hold assets that are reported in their financial statements at a value greater than their recoverable value. Such positions come to the light during periods of economic downturns or financial crisis as witnessed at the start of this century. IAS 36 seeks to ensure that financial statements do not include assets at a value for which they cannot be recovered.

#### 1<sup>o</sup> Definitions

- **Impairment** is a reduction in the recoverable amount of an asset or cash-generating unit below its carrying amount.
- **Recoverable amount** of an asset or a cash generating unit is the higher of its fair value less cost of disposal and its value in use.
- **Fair value** is the price that would be recovered on the disposal of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- **Costs of disposal** are costs directly attributable to the disposal of an asset or a cash generating unit, excluding finance costs and income tax expense.
- **Value in use** is the present value of the future cash flows expected to be derived from an asset or cash generating unit.
- **Impairment loss** is the amount by which the carrying amount of an asset or cash-generating unit exceeds its recoverable amount.

#### 2<sup>o</sup> Identifying an asset that may be impaired

- An entity should carry out an impairment review at least annually if:
  - an intangible asset is not being amortised because it has an indefinite useful life
  - goodwill has arisen on a business combination.
- Otherwise, an impairment review is required only where there is evidence that an impairment may have occurred.

At the end of each reporting period, an entity is required to assess whether there is any indication that an asset may be impaired (i.e. its carrying amount may be higher than its recoverable amount). IAS 36 has a list of external and internal indicators of impairment. If there is an indication that an asset may be impaired, then the asset's recoverable amount must be calculated.

The recoverable amounts of the following types of intangible assets are measured annually whether or not there is any indication that it may be impaired. In some cases, the most recent detailed calculation of recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period:

- an intangible asset with an indefinite useful life
- an intangible asset not yet available for use
- goodwill acquired in a business combination

## Indications of impairment

### External sources:

- market value declines
- negative changes in technology, markets, economy, or laws
- increases in market interest rates
- net assets of the company higher than market capitalization

### Internal sources:

- obsolescence or physical damage
- asset is idle, part of a restructuring or held for disposal
- worse economic performance than expected
- for investments in subsidiaries, joint ventures or associates, the carrying amount is higher than the carrying amount of the investee's assets, or a dividend exceeds the total comprehensive income of the investee

The lists are not exhaustive. Further, an indication that an asset may be impaired may indicate that the asset's useful life, depreciation method, or residual value may need to be reviewed and adjusted.

## Determining recoverable amount

- If fair value less costs of disposal or value in use is more than carrying amount, it is not necessary to calculate the other amount. The asset is not impaired.
- If fair value less costs of disposal cannot be determined, then recoverable amount is value in use.
- For assets to be disposed of, recoverable amount is fair value less costs of disposal. Fair value less costs of disposal
- Fair value is determined in accordance with IFRS 13 *Fair Value Measurement*
- Costs of disposal are the direct added costs only (not existing costs or overhead). Value in use

The calculation of value in use should reflect the following elements:

- an estimate of the future cash flows the entity expects to derive from the asset
- expectations about possible variations in the amount or timing of those future cash flows
- the time value of money, represented by the current market risk-free rate of interest
- the price for bearing the uncertainty inherent in the asset
- other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset

Cash flow projections should be based on reasonable and supportable assumptions, the most recent budgets and forecasts, and extrapolation for periods beyond budgeted projections. IAS 36 presumes that budgets and forecasts should not go beyond five years; for periods after five years, extrapolate from the earlier budgets. Management should assess the reasonableness of its assumptions by examining the causes of differences between past cash flow projections and actual cash flows. Cash flow projections should relate to the asset in its current condition – future restructurings to which the entity is not committed and expenditures to improve or enhance the asset's performance should not be anticipated. Estimates of future cash flows should not include cash inflows or outflows from financing activities, or income tax receipts or payments.

#### 4.2.2. Impairment of cash-generating units

In most situations, one asset is not capable of generating cash flows individually. Instead, assets are used together with other assets. When a group of assets together generate the cash flows, and they are called a 'cash generating unit' (CGU).

A **cash generating unit** is the smallest identifiable group of assets that generates cash outflows that are largely independent of those of other assets or groups of assets.

Cash generating units are segments of the business whose income streams are largely independent of each other. In practice they are likely to mirror the strategic business units used for monitoring the performance of the business. It could also include a subsidiary or associate within a corporate group structure.

#### Testing cash-generating units with goodwill for impairment

There are two situations to consider.

- (a) Where goodwill has been allocated to a cash-generating unit
- (b) Where it has not been possible to allocate goodwill to a specific cash-generating unit, but only to a group of units

A cash-generating unit to which goodwill has been allocated is tested for impairment annually. The **carrying amount** of the unit, including goodwill, is **compared with the recoverable amount**. If the carrying amount of the unit exceeds the recoverable amount, the entity must recognise an impairment loss.

Where goodwill relates to a cash-generating unit but has not been allocated to that unit, the unit is tested for impairment by **comparing its carrying amount** (excluding goodwill) **with its recoverable amount**. The entity must recognise an impairment loss if the carrying amount exceeds the recoverable amount. The annual impairment test may be performed at any time during an accounting period, but must be performed at the **same time every year**.

#### Corporate assets

The net assets of the business (including capitalised goodwill, but excluding tax balances and interest bearing debt) are allocated to cash generating units.

There are two particular problem areas.

- Corporate assets: assets that are used by several cashgenerating units (e.g. a head office building or a research centre). They do not generate their own cash inflows, so do not themselves qualify as cash generating units.
- Goodwill, which does not generate cash flows independently of other assets and often relates to a whole business.

It may not be possible to allocate corporate assets and/or goodwill over other cash generating units on a reasonable basis. A cash generating unit to which goodwill has been allocated must be tested for impairment at least annually.

If no reasonable allocation of corporate assets or goodwill is possible, then a group of cash generating units must be tested for impairment together in a two-stage process:

1. Carry out an impairment review on each of the cash generating units (excluding the goodwill) and recognise any impairment losses that haven arisen.
2. Then carry out an impairment review for the entity as a whole, including the goodwill.



### Allocation of an impairment to the unit's assets

If an impairment loss arises in respect of a cash generating unit, it is allocated among the assets in the unit in the following order:

- first, to any individual assets that are obviously impaired
- next, to the goodwill **allocated to** the cash-generating unit
- next, to the other assets in the cash-generating unit, on a pro-rata basis.

When there are no individual assets are obviously impaired, the impairment loss should be allocated to reduce the

1. carrying amount of any goodwill allocated to the cash-generating unit (group of units); then
2. carrying amount of the other assets of the CGU on a pro-rata basis

**However**, the carrying amount of an asset should not be reduced below the higher of:

- Its fair value less cost to disposal (if measurable)
- Its value in use (if measurable), or
- Zero

### 4.2.3. Impairment of goodwill

- Goodwill must not be amortised.
- Goodwill should be tested for impairment annually (IAS 36, IFRS 3)
- As goodwill does not generate cash flows of its own, its impairment is tested within the cash-generating unit to which the goodwill belongs.
- The goodwill is allocated to a specific cash-generating unit (CGU), or multiple cash generating units where the goodwill cannot be allocated to a single CGU, and the impairment test is carried out on the group of assets including the goodwill.

### Fair value method of valuing NCI (Full goodwill)

- In this case goodwill shown in the group statement of financial position represents full goodwill, and so together with the rest of the CGU it can be compared to recoverable amount of the CGU on a like for like basis.
- Any impairment of goodwill is therefore allocated between the group and the NCI based upon their respective shareholdings. Note this could result in the NCI share of impairment exceeding their share of goodwill upon acquisition.

### Proportion of net assets of valuing NCI (Partial goodwill)

- Where this method is adopted, the NCI share of goodwill is not reflected in the group accounts.
- Any comparison between the carrying value of a CGU (including goodwill) and its recoverable amount will not be on a like for like basis.
- In order to address this problem, **goodwill must be grossed up to include goodwill attributable to the NCI** prior to conducting the impairment review.
- This **grossed up goodwill** is known as '**total notional goodwill**'.
- Once any impairment loss is determined, it should be allocated firstly to the total notional goodwill and then to the CGU's assets on a pro rata basis.
- As only the parent's share of the goodwill is recognised in the group accounts, only the parent's share of the impairment loss should be recognised.

#### 4.2.4. Accounting treatment of an impairment loss

If, and only if, the recoverable amount of an asset is less than its carrying amount in the statement of financial position, an impairment loss has occurred. This loss should be **recognised immediately**.

- (a) The **impairment loss** should be **recognised immediately in statement of profit or loss** as an **expense** (unless it relates to a revalued asset where impairment loss is treated as a revaluation decrease) to the same heading as the related depreciation (e.g. cost of sales or administration).  
If the asset has previously been revalued upwards (the impairment reverses a previous gain), the impairment is recognised as comprehensive income and is debited to Revaluation reserve until the surplus relating to that asset has been exhausted. The remainder of the impairment loss is recognised in the profit or loss.
- (b) The asset's **carrying amount** should be reduced to its recoverable amount in the statement of financial position (non-current asset). The **depreciation charge** should then be based on the new carrying amount, its estimated residual value and its estimated remaining useful life.

#### 4.2.5. Reversal of an impairment loss

The annual assessment to determine whether there may have been some impairment should be **applied to all assets**, including assets that have already been impaired in the past.

In some cases, the recoverable amount of an asset that has previously been impaired might turn out to be **higher** than the asset's current carrying value. In other words, there might have been a reversal of some of the previous impairment loss.

- (a) The reversal of the impairment loss should be **recognised immediately** as income in profit or loss.  
If the original impairment was charged against the revaluation surplus, it is recognised as other comprehensive income and credited to the revaluation reserve.  
The reversal must not take the value of the asset above the amount it would have been if the original impairment had never been recorded. In other words, the increased carrying amount due to reversal should not be more than what the depreciated historical cost would have been if the impairment had not been recognized.  
The depreciation that would have been charged in the meantime must be taken into account.
- (b) The carrying amount of the asset should be increased to its **new recoverable amount**. An exception to this rule is for **goodwill**. An impairment loss for goodwill should not be reversed in a subsequent period.

### 4.3. RELATED PARTY TRANSACTIONS (IAS 24)

#### 4.3.1. Distortion of financial statements

A user of financial statements will normally expect the financial statements to reflect transactions that have taken place on normal commercial terms (**'at arm's length'**).

The user of the financial statements would want to be informed if:

- transactions have taken place that were not at **'arm's length'**, or
- there are parties that could enforce transactions on the entity that are not on an **'arm's length'** basis.

For **example**, in a group of companies:

- an entity might sell goods to its parent or fellow-subsiidiaries on more favourable terms than it would sell to other customers
- a parent company may make supplies to a struggling subsidiary on more favourable terms than it would to other companies. This would boost the apparent profitability of that subsidiary.

In both situations, the financial performance or financial position reported by the financial statements

would be misleading. In each situation there is a special relationship between the parties to the business transactions. This is referred to as a **‘related party relationship’**.

IAS 24: *Related party disclosures* comments that a related party relationship could have an effect on the profit or loss, or on the financial position of an entity, because related parties might enter into transactions with each other on terms that other entities or individuals (unrelated parties) would not.

**A related party relationship can affect the financial position and operating results** of an entity in a number of ways:

- Transactions are entered into with a related party which may not have occurred without the relationship existing.
- Transactions may be entered into on terms different to those with an unrelated party.
- Transactions with third parties may be affected by the existence of the related party relationship.

#### 4.3.2. Objective of IAS 24

The **objective** of IAS 24 *Related party disclosures* is to ensure that an entity’s financial statements contain sufficient disclosures to draw attention to the possibility that the entity’s financial position, or profit or loss may have been affected by:

- the existence of related parties, and
- transactions and outstanding balances with related parties.

IAS 24 is a **disclosure** standard. It does not require the redrafting of financial statements. Such redrafting would be difficult as without the related party relationship the transactions might never have taken place, and even if they had, it may not be possible to determine at what amount.

Specified disclosures are required of:

- related party relationships, and
- related party transactions.

#### 4.3.3. Definitions

##### **Related party**

*Two 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, or the parties are under common control.*

A party is related to an entity (it is a related party) in **any** of the following circumstances:

- The party controls the entity, or is controlled by it.
- It has significant influence over the entity.
- It has joint control over the entity.
- The parties are under common control.
- The party is an associate.
- The party is a joint venture in which the entity is a venturer.
- The party is a member of the key management personnel of the entity or its parent.
- The party is a **close family member** of any of the above.

##### **Close family members**

Close family members are those family members who may be expected to influence, or be influenced by that individual.

Close family members **include**:

- an individual’s partner, children and dependents; and
- children or dependents of the individual’s partner.

### **Related party transaction**

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 following examples of related party transactions are given in IAS 24. These are related party transactions when they take place between related parties:

- Purchases or sales of goods
- Purchases or sales of property and other assets
- Rendering or receiving of services
- Leases
- Transfer of research and development costs
- Finance arrangements (such as loans or contribution to equity)
- Provision of guarantees
- Settlement of liabilities on behalf of the entity or by the entity on behalf of another party.

#### **4.3.4. Exemption for government-related entities**

Before the 2009 revision of IAS 24, if a government controlled or significantly influenced an entity, the entity was required to disclose information about all transactions with other entities controlled, or significantly influenced, by the same government. The revised standard still requires disclosures that are significant to users of the financial statements, but **eliminates the need to disclose information that is costly to gather, and of less value to users**. It achieves this by limiting disclosure required to transactions that are individually or collectively significant.

#### **4.3.5. Disclosure requirements**

IAS 24 requires disclosure in the notes to the financial statements of the following, **whether or not transactions have taken place** between those related parties:

- the **name of the entity's parent**
- if different, the name of the ultimate controlling party

**Where transactions have taken place** between the related parties, **irrespective of whether a price was charged**, the following should be disclosed:

- The nature of the related party relationship
- The amount of the transactions
- In respect of outstanding balances
  - the amount
  - their terms and conditions
  - any guarantees given or received
  - any provision for doubtful/irrecoverable debts
- The expense recognised in the period in respect of irrecoverable debts due from related parties.

The above disclosures should be given separately for each of the following categories of related party:

- The parent
- Entities with joint control or significant influence over the entity
- Subsidiaries
- Associates
- Joint ventures in which the entity is a venturer
- Key management personnel of the entity or its parent
- Other related parties

In addition, IAS 24 requires disclosure of **compensation to key management personnel**, in total, and for each of the following categories:

- Short-term employee benefits
- Post-employment benefits
- Other long-term benefits
- Termination benefits
- Share-based payments.