# Related parties

## made simple

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# Introduction

The charity sector is hugely diverse, both in terms of size of charity and the activities they undertake. Retaining and enhancing the reputation of the charity sector is a responsibility we all share and effective accountability is a vital factor in achieving this.

## Transparency

In the United Kingdom this has been recognised by setting a framework for accounting by charities – the *Statement of Recommended Practice for Charities*. The most recent version is effective 1 January 2015 and known as "SORP 2015". Recognising that effective accountability is much more than simply complying with the law, the whole spirit of transparency in annual reporting requires more disclosure than one might expect in the commercial sector. Transparency is important where the relationship between the charity and another party to a transaction suggests that the transaction could have been influenced by interests other than those of the charity. There is a risk that the financial results and financial position reported have been affected by these transactions and further information for users of the charity's accounts is needed.

## SORP

The SORP provides a comprehensive framework of recommended practice for charity accounting and reporting. It enables charities to meet the legal requirements for their annual accounts to give a true and fair view and also provides consistency in the sector's interpretation of accounting standards. The SORP also provides recommendations for annual reporting that are relevant to both sector and stakeholders' needs and are in line with wider developments in reporting. This encompasses the reporting of transactions with related parties or connected organisations.

## Financial Reporting Standard

As well as the SORP, charities have to follow Financial Reporting Standard 102 which determines who and what are "related parties" and the disclosures necessary to draw attention to the possibility that the reported financial position and results may have been affected by the existence of related parties and by material transactions with them. The Companies Act 2006 contains relevant requirements in relation to the duties of directors and managing conflicts of interest.

This guide explains when somebody or an organisation is considered connected or related, what types of transactions might be related party transactions and which ones must be reported in annual financial statements, as well as the extent of the disclosures required.

# What do we mean by related parties?

Related party is a term used by the SORP that combines the requirements of charity law, company law and the accounting standard FRS102. The term is used to identify those persons or entities that are closely connected to the reporting charity or its trustees.

Related parties include a charity's trustees and their close family members and those entities which they control or in which they have significant interest.

## Individuals who are related parties

FRS102 says a person or a close member of that person's family is a related party if they have:

- control or joint control over the entity; or
- significant influence over the entity; or
- authority and responsibility for planning, directing or controlling the activities of the entity, either directly or indirectly (the key management personnel).

SORP 2015 defines the following people as related parties:

1. A charity trustee or custodian trustee of the charity.
2. A person who has donated land to the charity.
3. A close family member of a trustee or donor of land; specifically a child, parent, grandchild, grandparent or sibling.
4. An officer, agent or employee of the charity who has authority and responsibility for the charity as key management personnel. This includes senior staff members who make decisions, or budget holders who have power to spend significant amounts of the charity's resources.
5. A spouse or civil partner of any of the above persons mentioned in 1 to 4 above.
6. A business partner of any of the above persons mentioned in 1 to 5 above.
7. A person who has control or joint control over the charity, or a close member of that person's family.
8. A person who has significant influence over the charity, or a close member of that person's family.

## Organisations who are related parties

Having a trustee or senior staff member in common does not necessarily mean that the charities are related parties; they are only related if one charity subordinates its interests to the other charity in any transaction because of this relationship. Charities do need to be conscious of conflicts of interest in these relationships, which is explored in greater detail later in this guide.

FRS102 and SORP 2015 define the following entities as related parties:

- An entity in the same group, related as a parent, subsidiary or fellow subsidiary.
- An associate or joint venture of the charity.
- A fellow joint venture or associate of the same third party.
- A pension fund for the benefit of the employees of the charity.
- An entity that is controlled or jointly controlled by a person, or two of more persons, who are individual related parties above.
- An entity in which one or more individual related parties above have significant interest in or significant influence over.

## Controlling interests

Control is presumed to exist when one or more individuals who are related parties hold more than half the voting power of an entity. However, control can also exist if they have:

- Power over more than half the voting rights.
- Power to govern the financial and operating policies.
- Power to appoint or remove the majority of the members of the governing body.
- Power to cast the majority of votes.
- Anyone who has the power to appoint or remove a significant proportion of an organisation's board of trustees or has the power to direct the actions of the trustees.

# What is a related party transaction?

A *related party transaction* is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged. This may involve the transfer of assets or liabilities or the performance of services by, to or for a related party.

## Related party transactions include:

- Purchases or sales of goods.
- Donations of money or other assets.
- Supply of services.
- Provision of loans and guarantees.

### Examples of related party transactions

- Salaries and expenses paid to employees.
- Expenses paid to trustees for travel to attend board meetings.
- Reimbursement of costs incurred by trustees in purchasing goods for the charity.
- Rental of a property by a trustee to the charity.
- Overseas travel by a trustee to visit the work undertaken by the charity.
- Employment of the son or daughter of a trustee.
- Donation made by a trustee to the charity.
- The charity contracts the chief executive's husband to undertake some PR for the charity, which is his business.
- One of the trustees is a solicitor and a partner in a law firm, which provides the charity with pro-bono help with a new property lease.
- The charity is a member of a network and pays affiliation fees to the umbrella body.
- A trustee is also a trustee of another charity, which receives grants from your charity.
- The charity has a trading subsidiary and lends money to the subsidiary to fund its working capital.
- A funder provides funding and one of their trustees becomes a trustee of your charity.

All related party transactions should be carefully considered to ensure that the terms are appropriate and payments made in accordance with the agreed policies and procedures. Not all related party transactions have to be disclosed, but it is important to recognise all the transactions that come within the definition. The next step will be to decide whether disclosure in the notes to the accounts is required.

# Which related party transactions have to be disclosed in the annual accounts?

Some related party transactions do not have to be disclosed in the annual accounts unless the terms are unusual, which may indicate that the related party has influenced the charity's activities or use of resources. The following do **not** need to be disclosed:

- Individual staff salaries paid to employees of the charity (unless they are a trustee or other related party).
- Services provided by a related party as an unpaid general volunteer.
- Purchases of minor articles from the charity by a related party where they are on sale under the same terms to the general public, such as in a charity shop.
- Services provided to a related party where they are received on the same terms as other charity beneficiaries.
- Transactions between related entities that are eliminated on consolidation or where they are disclosed in the parent's consolidated accounts.

Other transactions involving a trustee or other related party must always be regard as material, regardless of their size. Transactions with related parties should be disclosed to provide assurance that the charity is operating for public benefit in the interests of the charity and not for private benefit.

## Transactions with trustees

There should always be a note to the accounts for disclosure of trustees' remuneration and expenses, even if the amounts are nil. Individual trustees do not have to be named for the expenses note, only the total amount and the number of trustees in receipt of expenses during the year. Transactions which should be disclosed include all travel, accommodation, subsistence and similar expenses incurred directly by the trustee and reimbursed or incurred on their behalf by the charity.

Reimbursing trustees for purchases they have personally and properly made on behalf of the charity are not counted as expenses, for example, the purchase of stationery for the charity. Such costs are accounted for as part of the charity's general expenditure and not disclosed as trustee expenses.

If a trustee incurs expenses for the charity and does not claim them, SORP 2015 requires disclosure of the amount of waived expenses where the amount is material in the context of a charity's total expenditure.

Where trustees are remunerated for their role as a trustee or as an employee of a related entity, information must be provided about the remuneration including why it was paid, who was paid, how much was paid and details of any other benefits received. Authority to pay a trustee needs to be granted by the Charity Commission, so this authority should be quoted too.

Payments by the charity where a trustee is a related party should always be disclosed. This will include grants to charities where another trusteeship is held, use of professional services and payments to the spouses or business partners of trustees.

## Related party transactions that are specifically disallowed

The Companies Act 2006 limits or does not allow certain types of related party transactions, so it is important that organisations have policies in place so they are aware of these limitations. For example, the sale of property or loans from a charitable company to any member of its trustee board is not allowed.

Generally, trustees are not entitled to receive any payments from the charity's funds other than any reasonable and necessary out-of-pocket expenses, such as the cost of travel to attend trustee meetings. Also trustees must not benefit either directly or indirectly from the charity by:

- taking a lease of the charity's property
- borrowing money from the charity
- making contracts to do business with the charity.

The Charities Act does allow trustees to be paid in certain circumstances when they are providing services to the charity over and above their normal trustee duties. In addition, some charities allow the payment of trustees in their governing document.

## Other transactions to be disclosed

A related party transaction may be on terms that are beneficial to the charity, or they may be on normal terms, known as *arm's length transactions*. Such transactions may still require disclosure. Transactions involving trivial amounts do not have to be disclosed, but material transactions do have to be disclosed, other than the exceptions noted at the beginning of this section.

## Donations from related parties

Related parties may make donations to the charity. These donations may or may not have conditions attached to them that require the charity to alter significantly the nature of its activities. Conditions that make the donation a transaction that must be disclosed include requiring the charity to purchase goods or services from a specified supplier; making an interest bearing loan to the charity; or requiring that payments be made to a specified third party.

Donations with no conditions attached do not require individual disclosure in the financial statements. However, SORP 2015 requires the charity to provide disclosure of the aggregate amount of donations received without conditions from related parties.

## Remuneration of key management personnel

The *key management personnel* are the senior management team who are responsible for the day-to-day management of the charity and report to the trustees. They are related parties of the charity as defined above.

SORP 2015 requires all charities to disclose the total amount of any employee benefits received by trustees and key management personnel for their services to the charity. Charities are therefore required to disclose the aggregate amount paid to the group of staff defined as key management personnel. There is no requirement to provide details of the salaries of individual employees in this group, although a charity may choose to do so.

## What are the disclosure requirements?

The annual financial statements have to include a note to the accounts for disclosure of any related party transactions. If there are no related party transactions in the period that require disclosure, SORP 2015 requires that this fact must be stated.

For those related party transactions which must be disclosed, the note should provide the following information:

- The names of the parties involved in the transaction.
- A description of the relationship between the parties.
- A description of the transaction and the amounts involved.
- Any amounts due from or to the related parties at the year-end, or provisions for bad or doubtful debts with related parties.
- The terms and conditions of the transaction and details of any guarantees given or received.
- Any other elements of the transactions necessary for an understanding of the financial statements, such as particulars of relationships that led to the transactions, or other information. For example, it may be useful to note that the transactions were on normal commercial terms or on terms that were beneficial to the charity.

Disclosures can be given in total for similar transactions and type of related party, except where the disclosure of an individual transaction is necessary to understand the impact of the transaction or is required by law.

### Some examples of related party disclosures in charity accounts

- *A lease for the drop-in centre in South Molton was agreed between the charity and Jones Limited, a company owned by the Chief Executive and her husband. The rent paid to Jones Limited during the year amounted to £12,500 (2014: £nil).The lease was agreed on terms that were favourable to the charity and monthly rent payments are 20% below the market rate for the property as assessed by an independent external surveyor. At 31 December 2015 there were no amounts outstanding between the charity and Jones Limited.*
- *Payments totalling £18,415 (2014: £nil) were made to Aztec Communications in respect of consultancy services. John Marsh, who resigned as Trustee of the charity on 22 January 2015, is a director of Aztec Communications. At 31 December 2015 there were no amounts outstanding between the charity and Aztec Communications (2014: £265).*
- *A donation of £10,000 (2015: £nil) was made to the Basin Farm. In addition £1,500 was paid to the Basin Farm (2015: £1,755) in respect of food purchases for the charity's café. Jane Smith is a trustee of the charity and is a trustee of the Basin Farm. At 31 March 2016 there were no amounts outstanding between the charity and the Basin Farm. (2015: £450).*
- *During the year legal fees of £25,450 (2014: £8,250) were paid to BJ solicitors in respect of legal services provided to the charity in connection with an on-going legal dispute. Tom Watts is a trustee of the charity and an equity partner in BJ solicitors.*
- *The charity has engaged the services of Woods Employee Benefits Limited (WEB Limited) in the design and implementation of a Group Personal Pension Scheme. Three of the directors of WEB Limited are related to a trustee of the charity. Fees to WEB Limited have been agreed on normal commercial terms and the trustee took no part in the decision to use WEB Limited nor in the fee negotiations. At 31 March 2016 fees amounting to £1,870 had been paid or accrued to WEB Limited.*

# Policies, procedures and record keeping

Organisations are required to:

1 be aware of who their related parties are,

2 actively manage any transactions with them,

3 disclose any related party transactions in the annual statutory accounts.

## Register of interests

To fulfil the first requirement, charities commonly maintain a register of interests. All trustees and senior staff (those with authority to let contracts or commit the organisation to expenditure) should declare their interests annually. The interests should include for themselves and close family members (such as spouse):

- trusteeships of other charities
- directorships of other organisations
- businesses in which they have a holding of more than 25%

It is not usually relevant to ask charity trustees for details of their shareholdings. The register should be updated annually and nil returns obtained.

### Model declaration of interests

Organisations need to be aware of situations where there is a potential conflict of interest. A register of interests assists the process of identifying related parties. Asking for this information in advance adds transparency and enables the organisation to enter into any such transactions knowingly.

Name ______________________________

Relationship to [name of charity] ______________________________

**Please complete and sign this form, even if there are no interests to declare**

As a minimum, you are required to detail the names of all related parties, whether or not there have been any transactions.

| Name of related party | Nature of relationship | Details of transactions* | Donations** |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |

Signed ______________________________

Date ______________________________

* Details of transaction to include:

- name of organisation in which interest is held
- nature of the interest (e.g. trustee, employee, shareholder)
- indication of any likely trading

** Please provide details of any donations made to the charity (whether restricted or not)

## Notes to model declaration of interest: SORP definition of related parties and related party transactions

Related parties is a term used by the SORP that combines the requirements of charity law, company law and the Financial Reporting Standard applicable in the UK and the Republic of Ireland. The term is used to identify those persons or entities that are closely connected to the reporting charity or its trustees.

The following 'natural persons' are classed as related parties:

A Any charity trustee and custodian trustee of the charity

B A person who is the donor of any land to the charity (whether the gift was made on or after the establishment of the charity)

C Any person who is:

1. A child, parent, grandchild, grandparent, brother or sister of any such trustee (A) or donor (B) of land
2. An officer, agent or a member of the key management personnel of the charity
3. The spouse or civil partner of any of the above persons (A, B, C1 and C2)
4. Carrying on business in partnership with any of the above persons (A, B, C1, C2 and C3)
5. A person, or a *close member of that person's family*, who has control or joint control over the reporting charity
6. A person, or a *close member of that person's family,* who has significant influence over the reporting charity

*Close member of a person's family* refers to:

- That person's children or spouse
- The children, stepchildren or illegitimate children of that person's spouse or domestic partner
- Dependents of that person
- That person's domestic partner who lives with them as husband or wife or in an equivalent same-sex relationship

A charity is not necessarily related to another charity simply because a particular person happens to be a trustee of both. It will only be 'related' if the relationship means that one charity, in furthering its charitable aims, is under the direction or control of the trustees of another charity.

The following entities, which are not 'natural persons', are classed as related parties of a reporting entity (including a reporting charity) if any of the following conditions apply:

- The entity and the reporting charity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
- One entity is an associate or joint venture of the other entity (or a member of the group in which the other entity is the parent or a member).
- Both entities are joint ventures of the same third entity.
- One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- 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.

- An entity that is controlled or jointly controlled by a person, or two or more.
- Persons, identified in A, B or C.
- An entity in which a person, or two or more such persons, identified in A, B or C, taken together, have a substantial interest or significant influence over the entity.

Control is presumed to exist when one or more persons identified in A, B or C, taken alone or together, hold directly or indirectly, more than half the voting power of an entity. However, control can also exist when they, directly or indirectly, control half or less than half of the voting power of an entity, if they have:

- Power over more than half of the voting rights by virtue of agreement with other investors;
- The power to govern the financial and operating policies of the entity under a statute or an agreement;
- The power to appoint or remove the majority of the members of the board of directors or equivalent governing body, and control of the entity is by that board or body; or
- The power to cast the majority of votes at the meetings of the board of directors or equivalent governing body, and control of the entity is by that board or body.

An individual has a substantial interest or significant influence in an entity where that person, or two or more persons identified in A, B or C, taken together, have an interest in the equity share capital of that entity of a nominal value of more than one-fifth of that share capital, or is entitled to exercise, or control the exercise of, more than one-fifth of the voting power at any general meeting of that entity.

*Related party transactions* are the transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

## Policies to manage potential conflicts of interests

Potential conflicts of interest will arise from time to time. Conflicts of interest arise where an individual's personal or family interest or loyalties conflict with those of the organisation they are involved with. Such conflicts can create problems, such as:

- Constraining free discussion.
- Decisions or actions that are not in the interests of the organisation.
- Risk of giving the impression to the public, employees and users of the accounts that the organisation has acted improperly.

The Companies Act 2006 limits or does not allow certain types of related party transactions, so it is important that organisations have policies and procedures in place so they are aware of these limitations.

Key procedures would include:

- Clear role descriptions for trustees/directors that include legal responsibilities and duties.
- A robust process for declaring interests which will include maintaining an up to date register of interests.
- Keeping clear minutes recording board resolutions on how the board have managed any conflicts of interest.
- Seeking legal advice as necessary to ensure all is in order.

Charities will often want trustees with experience of other similar charities to be on their board. However, they do need a code to help them manage potential conflicts.

This code should also extend to the recruitment of new trustees, so that there is consideration of any possible conflicts of interest before they are appointed.

Where new trustees are elected by the charity's membership, it would be good practice to ensure the membership is made aware of any possible conflict of interests involving the individuals standing for election, so that they can take this into account when voting.

Charity trustees and company directors owe a duty of care foremost to the organisation of which they are an officer. Inevitably, they may obtain information while performing their duties which may bring them into a conflict of loyalty with another position they hold. If this is considered a significant issue, for example, because the two organisations are regularly competing for new work, then the trustee may be asked to step down. The Companies Act 2006 creates a positive duty to avoid unauthorised conflicts of interest and states:

"A director of a company must act in the way he considers in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole"; and

"A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company."

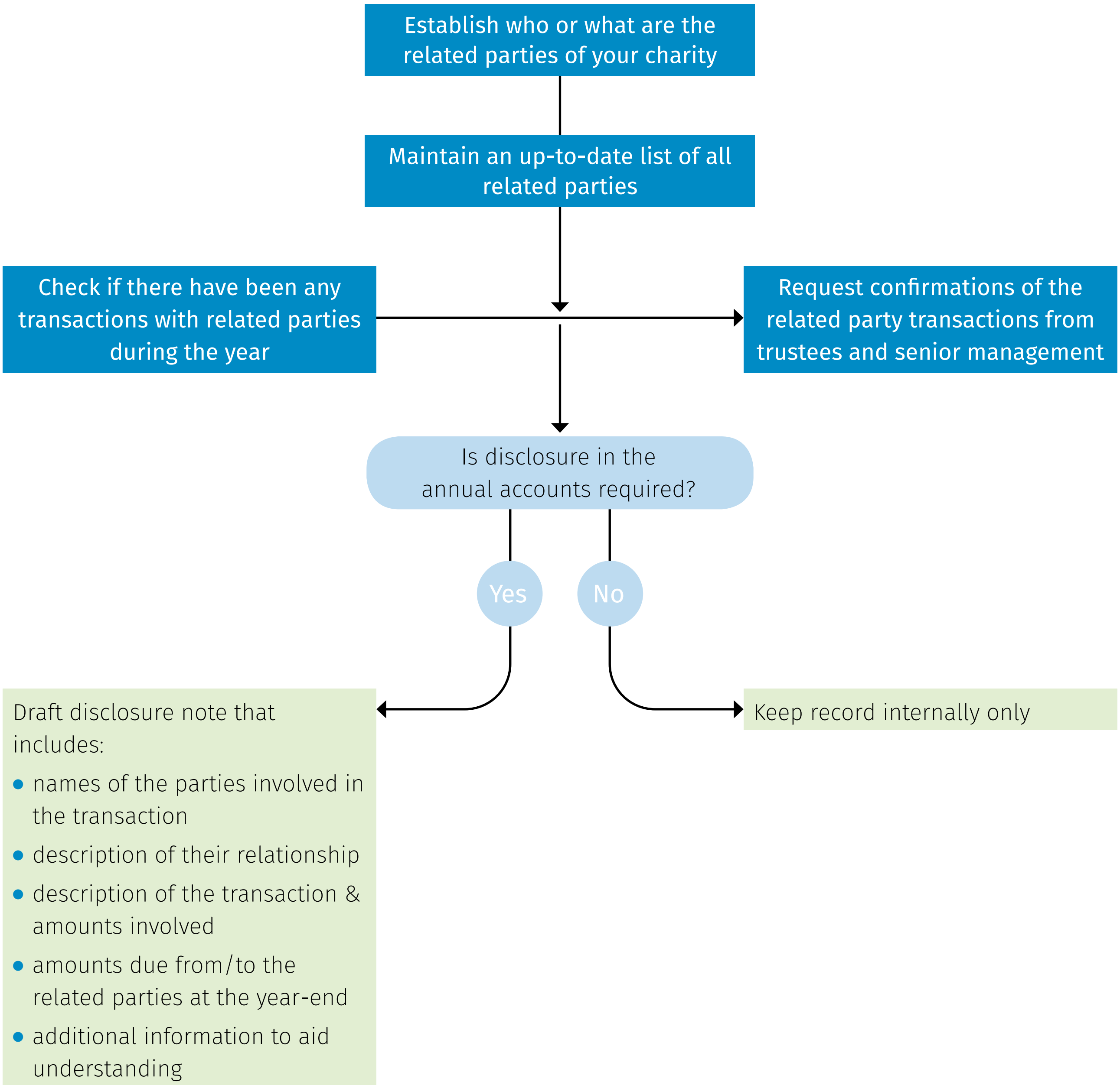
If the potential conflict is not a regular occurrence, then it may be sufficient for the trustee to leave the room while the matter is discussed and decided by the remaining trustees. For this the chair of the board will usually ask at the beginning of any meeting if any trustee has a potential conflict of interest for any item on the agenda. This allows the chair to re-order the agenda as appropriate to manage an individual's absence from the meeting for the particular agenda item.

The Charity Commission encourage trustees to ensure the charity operates as transparently as possible. Ways that a charity could do this include making the charity's policy on conflicts of interest available to the public and/or making some or all of the charity's register of interests publicly available. Care needs to be taken as such information may be subject to the provisions of the Data Protection Act 1998, and advice should be sought before making personal information publicly available.

Further information about the Data Protection Act is provided by the Information Commissioner at http://www.ico.gov.uk

# Summary

The practical steps charities can take to address related party transactions can be summarised as follows:



# Further information

### Accounting and Reporting by Charities:

Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) (effective 1 January 2015)

www.charitiessorp.org/media/619101/frs102_complete.pdf

### Financial Reporting Standard 102 – section 33

www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-applicabl.aspx

### Model register of interests forms with brief description, put together by the ICSA:

www.icsa.org.uk/assets/files/pdfs/guidance/070612.pdf

### Model conflict of interest policy, put together by the ICSA:

www.icsa.org.uk/assets/files/pdfs/guidance/070610.pdf

### Charity Commission guide to conflicts of interest for charity trustees:

www.charity-commission.gov.uk/Charity_requirements_guidance/Charity_governance/Good_governance/conflicts.aspx

### Charity Commission guide on Trustee Expenses and Payments (CC11)

www.charity-commission.gov.uk/Publications/cc11.aspx

# Notes

## Made simple guides

Made Simple guides are aimed at finance professionals and other managers working in charities. They cover technical areas such as tax and VAT treatments as well as information management areas and aim to provide practical guidance to busy managers and trustees in charities.


## Made to measure

Sayer Vincent is a firm of chartered accountants working solely with charities and social enterprises. Through tailored audit and advice services, we provide trustees and managers with the assurance that their charity is managing its resources effectively.

As well as being commercial accountants, Sayer Vincent people have an in-depth knowledge of the governance and management of charities and social enterprises. We can advise on a range of business activities to achieve the best financial outcomes, keeping in mind the context of your organisation's objectives.

Working with Sayer Vincent, you will feel that you have extra people on your team.

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