Related party disclosures as of December 31st, 2007: a survey of the Eurostoxx 50 companies
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The preparation of financial statements under IFRS has led a number of groups to raise questions about the issues of the related party concept and the required disclosures. The answers are in IAS 24 - *Related party disclosures*.

The objective of this standard is very clear: it is to "ensure that an entity’s financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with them" (IAS 24.1). However, its implementation raises a number of issues, such as:

- What is the definition of a related party?
- What types of key management personnel meet the definition of a related party?
- When should a shareholder be considered as a related party?

Some clues were provided by the European market regulators and the Mazars survey published in 2006. The results of the survey showed wide divergences between the companies in the Eurostoxx 50. In addition, the IASB published two exposure drafts on this subject in February 2007 and December 2008.

Two years after our first survey, we have decided to assess the current situation on this complex issue. We have focused on six key points in the financial statements as of December 31st, 2007 for companies in the Eurostoxx 50. Each point compares the provisions of IAS 24 with current practices observed.
Scope of the survey

Mazars analysed the consolidated financial statements as of December 31st, 2007 of the 50 groups forming the Eurostoxx 50 on October 1st, 2008. This index includes:

- 36 industrial and commercial groups: 72 % of the sample.
- 14 financial institutions (banks, insurance companies): 28 % of the sample;

For the purpose of this survey, Mazars' analysis focused on:

- the definition and the identification of related parties;
- disclosures on transactions with related parties who are not key management personnel;
- disclosures on the remuneration and benefits of key management personnel.

The 50 groups analysed in this survey are:

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1. What is the definition of a related party?

**What does IAS 24 state?**

According to IAS 24 (paragraph 9), "a party is related to an entity if:

(a) directly, or indirectly through one or more intermediaries, the party:
   (i) controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
   (ii) has an interest in the entity that gives it significant influence over the entity; or
   (iii) has joint control over the entity;

(b) the party is an associate (as defined in IAS 28 *Investments in Associates*) of the entity;

(c) the party is a joint venture in which the entity is a venturer (see IAS 31 *Interests in Joint Ventures*);

(d) the party is a member of the key management personnel of the entity or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d);

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or

(g) the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity".

This definition should be more precisely set out in the future IAS 24.
What are the Eurostoxx 50 companies doing?

Of the 50 companies in the Eurostoxx 50:

- only 8 % provide a full definition of related parties;
- 24 % provide a list of the categories of related counterparties (without providing a clear definition);
- 68 % do not provide a definition of related parties.

Nevertheless, disclosures by the groups allow us to identify the following categories of related parties:

This graph demonstrates that there is no unanimous approach to the identification of related parties among the groups in our sample. Where they exist, associated and jointly controlled entities are the related parties which are most frequently identified (93 % and 88 %).

Several groups also include pension funds as related parties.
What does IAS 24 state?

The definition of related parties includes the key management personnel of the relevant entity. They are defined by the standard as the 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.

What are the practices of the Eurostoxx 50 companies?

42 groups out of the Eurostoxx 50 (84 % of the panel) report that key management personnel are related parties of the issuer. The various categories of management personnel regarded as related parties are as follows:

- Cat 1: members of the Board of Directors or of the Supervisory Board
- Cat 2: Category 1 plus members of the Board of Management and of the Executive Committee/Board and/or key managers
- Cat 3: Members of the Executive Committee/Board or of the Board of Management
- Cat 4: Legal representatives
- Key management personnel are not considered as related parties
The majority of groups have adopted a definition of key management personnel in line with the standard. For most of them, the concept of manager corresponds with the following employees and legal representatives: members of the Board of Directors (or of the Supervisory Board), members of the Board of Management, members of the Executive Committee/Board and key non-executive managers.

Nevertheless, some groups often apply a more restrictive definition which does not appear to be consistent with the generally observed rules of Governance (categories 1, 3 and 4).

It is interesting to notice that eight groups (16 % of the sample) consider that key management personnel are not related parties. It is all the more surprising that management personnel are typically the related party category common to all 50 groups of our sample. The disclosures required on the compensation of these managers are, however, included in most cases, either in another part of the notes or in a separate document provided to the shareholders (management report, compensation report, etc.).
3. Are companies with common key management personnel related parties?

**What does IAS 24 state?**

IAS 24 states that two entities having a key manager in common are related parties only if one of the entities has control, joint control, significant influence or significant voting power over the other entity. The standard states that two entities having a director or other member of key management personnel in common are not necessarily related parties.

**What are the practices of the Eurostoxx 50 companies?**

In view of IAS 24, cases in which two entities having a key manager in common are related parties should be rare in practice if the entities are of significant size. Nevertheless, despite the definition provided in the standard, 13 companies in the Eurostoxx 50 consider that entities having a key manager in common are related parties. However, they do not always provide disclosures of non-significant transactions or of transactions carried out under market conditions.
4. What disclosures are required on the compensation of key management personnel?

**What does IAS 24 state?**

In paragraph 16, IAS 24 states that an entity must disclose key management personnel compensation in total and for each of the following categories:

- short-term employee benefits;
- post-employment benefits;
- other long-term benefits;
- termination benefits, and
- share-based payments.

**What are the practices of the Eurostoxx 50 companies?**

In practice, Eurostoxx 50 companies do not provide in a consistent manner the required disclosures in the notes to the financial statements. Therefore, out of the 42 groups (84% of the Eurostoxx 50 companies) that consider key management personnel as related parties, only 25 (50%) provide disclosure on compensation in line with the various components defined by the standard.

The 17 other groups (34%) provide the following information:

- 4 groups (8%) refer to a specific report;
- 6 groups (12%) provide no disclosures on key management personnel compensation or its breakdown in the notes on related parties;
- 7 groups (14%) do not include the component in compensation related to share-based payments or pension liabilities.
5. What types of shareholder should be considered as related parties?

**What does IAS 24 state?**

According to IAS 24, shareholders are a related party if they have at least a significant influence on the issuer. Significant influence is presumed when a shareholder holds 20% or more of the voting rights.

**What are the practices of the Eurostoxx 50 companies?**

The equity of listed companies is often held by a large number of shareholders. A shareholder holding a small part of the equity may nevertheless have a significant influence over the entity. A case by case review is often performed instead of relying on pre-determined thresholds.

In practice, 17 groups include shareholders as related parties. These companies seldom mention the threshold at which a shareholder should be regarded as a related party. Shareholders identified as related parties hold at least 5% or 10% of the equity of the relevant company. Only four groups identify shareholders with less than 10% of the group as related parties.

However, 13 groups belonging to the Eurostoxx 50 do not recognise some of their shareholders as a related party, despite the fact that they hold more than 10% of the Group's equity. Four groups even have a shareholder with more than 20% of the Group's equity, the threshold at which significant influence is presumed.
6. What are the required disclosures for state-controlled companies?

**What does IAS 24 state?**

IAS 24 considers that companies controlled either by the State or State-controlled entities are covered by the standard and are therefore not exempt from the requirement to provide related party disclosures. However, in the exposure draft on IAS 24 published in December 2008, the Board suggested that the advantages of publishing such disclosures may be less than the associated costs in those countries where a large number of companies are controlled by the State.

The Board has accordingly proposed a reduction in the disclosure requirements in IAS 24 for entities that are controlled, jointly controlled or significantly influenced by a state in relation to transactions with other state controlled entities.

**What are the practices of the Eurostoxx 50 companies?**

The State is a significant shareholder in several companies. The relationship between the issuer and the State is represented in a number of ways:

- 4 groups state that they are controlled by or under significant influence from the State. Of these, two mention transactions concluded with other entities controlled by the State;

- 3 other groups in which the State is a significant shareholder (holding more than 10% of the equity) do not provide any disclosures.

In addition, two groups have added a column to both their balance sheet and profit and loss account to indicate separately, for each line, the amount of operations carried out with State-related parties.
Towards a change in IAS 24

This survey highlights the difficulties in the implementation of IAS 24. Despite the experience accumulated, there are as many disparities in these disclosures as there were two years ago, when we carried out our first survey. Whether in terms of identifying related parties or providing disclosures regarding management personnel and the principal shareholders of an entity, there remain divergences in practice.

In February 2007 the IASB published an exposure draft in response to these problems, aiming to change the definition of a related party and to address the specific case of companies controlled by the State. A fresh exposure draft was published on December 11th, 2008, demonstrating that related parties disclosures is a complex matter to be dealt with.
Michel Barbet-Massin, Pascal Jauffret, Jean-Louis Lebrun and Julien Herveau have contributed to the writing of this research.
If you have any queries or need further information, please send us an e-mail at doctrine@mazars.com.