

# Related Party Transactions

Key implementation Impediments

Case Studies

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# OECD Guide on Fighting Abusive RPT

## Regulatory framework to monitor RPTS

- Definitions of connected persons and related parties
- Thresholds for Board and Shareholders' approval
- RPT disclosure policies to investors
- Role of External Auditor
- Role of Independent Directors and Independent Advisors
- Independence of Independent Directors
- Shareholding voting mechanism and process
- Legal Redress for the minority shareholders

# Related Party Transactions –

## **Types of Abusive Related Party Transactions**

- Injection of assets
- Cross guarantees and loans to associates
- Privatization and sale of assets
- Transfer of wealth schemes
  
- Recurring Related party Transactions – Revenue rather than capital/ Asset transactions

# Definitions – Who are Related Parties

## Family Relationships

- Spouse, brother, sister, mother, father, son and daughter
- Cousin, step sister, mother in-law, auntie, uncle
- Grandparent, grandson, second cousins

## Company relationships

- Parent / holding company, subsidiary
- Associates of the holding company
- Associates of the listed entity



# Examples of related party transactions under FASB and IASB

FASB	IASB
<p>Services received or furnished, such as accounting, management, engineering and legal services;</p> <p>Sales, purchases and transfers of realty and personal property;</p> <p>Use of property or equipment by lease or otherwise;</p> <p>Borrowings and lendings;</p> <p>Guarantees;</p> <p>Inter-company billings based on allocations of common costs</p>	<p>Rendering or receiving of services;</p> <p>Leases;</p> <p>Purchases or sales of property and other assets;</p> <p>Purchases or sales of goods;</p> <p>Transfers of research and development;</p> <p>Transfers under license agreements;</p> <p>Transfers under finance agreements (including loans and equity contributions in cash or in kind);</p> <p>Provisions of guarantees or collateral;</p> <p>Settlement of liabilities on behalf of the entity or by the entity on behalf of another party.</p>

# RPT Disclosure Policies

Timely and Adequate Information is important to investors/ shareholders.

## **Malaysia, Singapore and Hong Kong -**

Thresholds established for making announcements to shareholders

A circular is tabled at AGM for revenue and recurring items to be approved by shareholders.

## **Company Practice**

Some companies disclose their RPT policies and procedures in the annual report; example- Bank of China

# Recurring RPT Disclosure – SGX requirement

RRPT

**General Mandate from shareholders at AGM**  
RPT is revenue or trading in nature -

## **Circular to Shareholders**

- The nature of the transactions
- Methods for determining transaction prices
- Independent financial advisors opinion
- Opinion from audit committee if different from IFA
- “interested persons” will abstain from voting on the resolution
- Aggregate value of the transactions



# Recurring RPT in Malaysia– Announcement if deviation is >10 per cent

## Announcement

Date	Cumulative Value of Transaction * (RM'000)	% of deviation since prev. ann. Based on mandated amount	Announcement ?
31-Apr-09 (AGM)	1,500	-	-
31-Aug-09	1,680	12%	Yes
30-Sep-09	1,800	8%	No
30-Oct-09	1950	18%	Yes

\* period should be from previous AGM to the next AGM

source: bursa Malaysia

# A sampling of related-party transactions disclosed to the Hong Kong Exchange

Listed company	Nature of disclosed transaction
C Y Foundation Group Ltd	Acquisition of 100% of a company owned by chairman and his spouse
Wo Kee Hong (Holdings) Ltd	Purchase of a unit of vintage Ferrari from a director and controlling shareholder
Great Wall Motor Co Ltd	Acquisition of companies in China
China Resources Logic Ltd	Acquisition of China Resources Gas Ltd
Sino Union Petroleum & Chemical International Ltd	Acquisition of HK\$600 million worth of shares from the Chairman of the Board
Central China Real Estate Ltd	Acquisition of 100% of CCRE Forest Peninsula from a connected person
Lippo China Resources Ltd	Joint announcement of continuing connected transactions (tenancy agreement)
Hong Kong Chinese Ltd	
Honghua Group Ltd	Continuing connected transactions (sales and purchases framework agreements)
Advanced Semiconductor Manufacturing Corp Ltd	Continuing connected transactions (product sales, technology transfer and software licensing)
Zhongda International Holdings Ltd	Continuing connected transactions (sales of products and raw materials)

# Role of External Auditor

External Auditors complement the role of the Board in monitoring and curbing abusive RPTs.

## **ISA 550 – Auditing Standard – guide to auditing RPT**

Are they arms length transactions?

Is the pricing right for both recurring and one – off deals?

What is the best method to identify RPTs?

Are RPTs reported by the company complete?


Are there missing transactions?

# Valuation Report Requirements - Malaysia

- ❖ Requirement of valuation report on real estate irrespective on the mode of sale/purchase consideration (cash or securities) for RPT:
  - all transaction which are  $\geq 5\%$  of the relevant percentage ratio
- ❖ Valuation report to be submitted to Bursa not later than 1 month before the submission of circular/draft circular (as the case maybe)
- ❖ Valuation must comply with SC's Valuation Guidelines
- ❖ Significant change – issuer/ valuer must update valuation report

## Bursa

- Refer valuation report to SC
- May request for a valuation report on any assets
- May appoint second opinion valuer



Valuation Report  
must not > 6  
months old

Source : bursa Malaysia

# Role of Independent Director

**Case Study:** CNOOC. CNOOC was listed in Hong Kong in 2001. It holds exclusive rights to PRC offshore oil and natural gas exploration rights as stated in prospectus when listed. It also provides technical services to its parent company. CNOOC called for an EGM in 2005.

CNOOC asked for raising of caps for continuing transactions for technical services provided to the parent company. It also asked for reclassifying of technical services into 3 categories; exploration services, oil and gas development and marketing and management.

CNOOC's parent gave CNOOC a non compete undertaking at time of listing. CNOOC sought minority shareholder approval to give consent to the parent to engage in competing business, both onshore and offshore.

How would you respond to the EGM notice for both the transactions?  
What information and reports would you want to review in deciding on your vote?

# Role of Independent Director

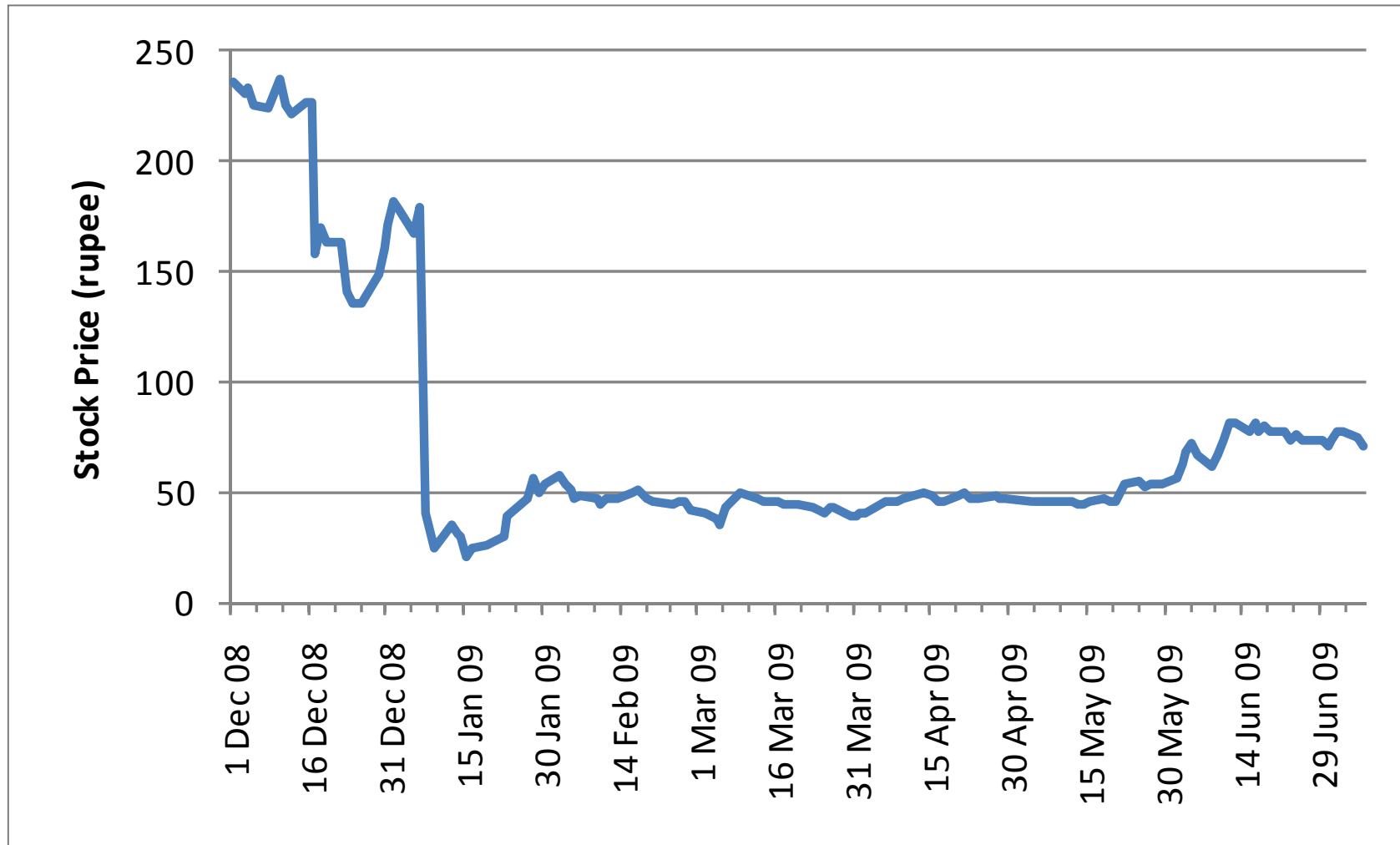
**Case study: Satyam** – an Indian company – provides computer network and outsourcing services to Coca Cola, Citigroup, Nissan Motors and Quantas. Employs 53,000 staff in Bangalore, Chennai and Hyderabad. Listed on NYSE and won the Golden Peach Award by World Council of CG in 2007.

Chairman Raju ( Major Shareholder ) proposed to Board of Directors to buy two related companies Maytas Infrastructure and Maytas Property for USD1.6 billion on 16 Dec 2008. They seek only Board Approval – shareholder approval not required. BOD approved the deals. There are 6 INEDS and some are prominent businessmen and an academic. Nevertheless the Board approved it in the morning.

At Analyst briefing later that day –

- Investors questioned the deal. What questions would you ask?
- What is the role of Independent Non Executive Directors in the approval process of this transaction?

# Satyam's fall from grace



Source: NSE, CFA Institute

# Board and Shareholder Approval

Board Approval - Interested Directors must not be allowed to vote.

Shareholder Approval - Interested shareholders must not be allowed to vote.

This practice is followed in Singapore, Malaysia, Hong Kong, China and Indonesia.

Independent Directors to approve RPT where controlling shareholders are usually the related party.



# Threshold for Shareholder Approval

China	Singapore	Indonesia	Korea	Malaysia	India
Value above RMB30million or 5 per cent of NTA	<p>Single transaction 5 per cent of group latest audited NTA</p> <p>Recurring transaction 5 per cent on aggregate basis in one financial year</p> <p>Transaction S\$100k and below is exempted</p>	No specific thresholds, but law requiring RPTs to be approved by independent shareholders.	Shareholder approval not required, only notification after board approval.	<p>5 per cent of relevant ratios</p> <p>Asset ratio Profit ratio Consideration Ratio Revenue Ratio</p> <p>Transaction 0.25 per cent and below exempted from reporting</p>	Shareholder approval not required Only Board Approval.

# Shareholder Voting Mechanism

**Case Study:** CNOOC. In 2004, shareholder approval was sought to deposit RMB6.6billion cash to CNOOC Finance for a 3 year period. This amounts to 16.6% of NTA of CNOOC. The EGM will be held on 29 April 2004, right after the Easter holidays in Hong Kong. You just received the notice as an investor with only one week to respond.

As an investor what information would you require to make a decision on your vote?

This case also bring up another practical issue to address. Voting process and voting proxies. What are your views on how this can be improved?

# The Way Forward

