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International
Accounting Standards
Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **20 July 2006, London**

Project: **IAS 24 *Related Party Disclosures***

Subject: **Agenda Proposal – IAS 24 *Related Party Disclosures* (Agenda Paper 15)**

INTRODUCTION

1. The purpose of this paper is to recommend that the Board add a project to its technical agenda. The project will update and clarify the requirements in IAS 24 *Related Party Disclosures.* The main objectives of the project would be to address:

   (a) the requirements of IAS 24 for state-controlled entities[1] when they transact with similar entities; and

   (b) whether, when an associate of an entity is preparing its own financial statements, the requirements of IAS 24 should include as related party transactions, transactions between the associate and a subsidiary of the associate's significant investor[2].

[1] The staff will refer to such entities as 'state-controlled entities' throughout this document. This wording is currently included in IAS 24 IN 6. If the project is accepted staff will consider which entities any amendments should apply too, ie whether they should apply specifically to state-controlled entities, entities with significant state ownership, or perhaps an even broader group of entities.
[2] Refer to paragraph 24 below for a diagram of the situation described.

2. The Standards Advisory Council (SAC) met last month and discussed the staff proposal for adding a project to the Board's agenda. The SAC were extremely positive about the need for such a project, in particular they expressed a desire to make the amendments for state-controlled entities. SAC members raised a number of concerns however regarding where to 'draw the line' on what transactions between state-controlled entities should or should not be disclosed. SAC members noted that staff should be cautious about exempting all disclosures for state-controlled entities because certain transactions will be important to users of the financial statements.

3. This paper sets out the staff's project proposal. It outlines the two issues ((a) and (b) in paragraph 1 above) and evaluates them against the agenda criteria in the Due Process Handbook. Lastly, the paper offers a proposed project plan. Three appendix have been included detailing:

   (a) examples of disclosures made by state-controlled entities;

   (b) a review of issues raised on IAS 24 with the Board and the IFRIC, issues discussed during the Improvements project, concerns raised by China's Ministry of Finance (MOF)[3] and issues raised by the Accounting Standards Board of Japan (ASBJ); and

   (c) the IFRIC Agenda Paper discussing the request for guidance on how to apply IAS 24 to state-controlled entities.

   The staff previously provided these three appendices to the Board at the May 2006 meeting.

RECOMMENDATIONS

4. The staff's view is that the proposed project satisfies the Board's criteria for adding a project to its technical agenda. Therefore, the staff recommend that the Board add to its agenda a project to amend IAS 24.

5. **Does the Board agree with the staff's recommendations?**

[3] The Chinese accounting standard setters.

6. **If the Board agrees with the staff recommendation, the staff ask if there any further issues that should be considered during the staff's work regarding IAS 24?**

ISSUE 1 – TRANSACTIONS BETWEEN STATE-CONTROLLED ENTITIES

Background

7. During the Improvements project, the Board amended IAS 24 to remove the scope exemption for disclosure of transactions between state-controlled entities. The previous version of the standard included the following wording:

> 'No disclosure of transactions is required in financial statements of state-controlled enterprises of transactions with other state-controlled enterprises'[4]

Although the Board had received objections to the proposed change, it decided to go ahead with the amendment in the revised IAS 24. As a result, state-controlled entities are required to comply with all of the requirements of IAS 24 in the same way as other entities.

8. The Basis for Conclusions on IAS 24 does not explain why the Board removed the exemption for state-controlled entities. However, the staff understand that the Board's intention was to ensure that, where there is a related party relationship between state-controlled entities, information about the relationship and any transactions are disclosed. Such transactions were regarded as relevant to users and the Board did not believe the disclosure would involve undue cost.

9. The IASB has been working with the MOF towards the convergence of Chinese Accounting Standards (CAS) and IFRSs. Over the course of the project, the MOF has made it clear that the removal of the exemption for disclosure of transactions between state-controlled entities is a major concern for China's overseas listed entities that apply IFRS. Further, The People's Republic of China (PRC) has a significant number of state-controlled entities

[4] IAS 24 (Reformatted 1994) paragraph 4(d).

listed on the two Chinese stock exchanges[5], and to converge IFRS with CAS would create major problems for these entities. Specifically, IAS 24 creates the following concerns:

(a) It is onerous, (and in some cases impossible), for a state-controlled entity to identify all of its related parties. Identification will involve extensive work, the accuracy of which will be limited because of practical difficulties. Furthermore, China is implementing substantial privatisation; thus, even when a list of related parties is established, it will constantly need updating.

(b) The number of transactions that need to be disclosed could be excessive and in some cases related party disclosure for a large percentage of the total transactions of the entity will be required. For example, purchases, sales, deposits of cash etc may need to be identified and disclosed as related party transactions. The majority of these transactions will be on normal trading terms, thus the benefit from disclosure is less than for other related party transactions.[6] Further, the utility of such extensive amounts of information to users is questionable, and important related party disclosures could be hidden among trivial information.

In other words, both the ability of an entity to ensure the completeness of the disclosures, and the relevance of such disclosures to users, is limited.

10. During the staff's investigations, we have become increasingly aware that this requirement is a major concern for state-controlled entities around the world, and is not confined to China. Many countries such as Germany, France, Russia and other Eastern European governments have large state-controlled entities which face the same practicality issues.

11. Appendix A to this paper sets out examples of disclosures made by state-controlled entities that are complying with either IFRS or with an equivalent standard under a local GAAP. The disclosures indicate three main styles of

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[5] The Chinese government has set up many 'asset holding entities' under each of its counties (ie Beijing or Shanghai). The asset holding entities are independent of each other in that they compete against each other like normal businesses. However, the companies within each holding entity may not be independent of each other.

[6]It is important to note that even if transactions take place on normal trading terms and conditions, disclosure is still important, because the existence of the transactions and the number of transactions can impact the financial statements.

interpretation of IAS 24. One requires extensive detail about transactions and balances outstanding. The second includes disclosure that the entity is a state-controlled entity, as well as general information on the existing relationships, with no specific quantitative details. The third style explains that the entity is a state-controlled entity but either that the relationships with other similar entities could not be *determined*, or that the directors did not believe the relationship *created* a related party relationship, and therefore no disclosures were made. Although some entities are not using IAS 24, the relevant GAAP in each case has no exemption for state-controlled entities. In the staff's view, the examples permit comparison with entities applying IAS 24.

12. These differences in reporting give rise to concern about the lack of comparability and the divergence in practice. The staff think that in some cases it will be impossible for entities to comply fully with the standard. Further, any attempt to apply the strict wording of the standard will provide results that are not informative for users. However, on the other hand, entities indicating that being a state-controlled entity does not give rise to a related party relationship and therefore have made no disclosures, are not complying with IAS 24. This is because IAS 24 does not exempt state-controlled entities from its scope, and where common control exists, the relationship will meet the definition of a related party. The staff conclude that this situation needs to be amended with changes to IAS 24.

13. The staff wish to highlight that this is an issue for *business entities* that have some public sector ownership and are required to prepare financial statements under IFRS. It is not a *public sector* accounting issue (ie out of the scope of IFRS), more it is an issue that the IASB should be addressing for all government business entities that apply IFRS.

Analysis

14. In the light of the concerns raised and the apparent divergence in practice, the staff reconsidered the main objective of IAS 24 (paragraph 1):

> '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 such parties'

Paragraphs 5-8 of IAS 24 further emphasise that knowledge of related party transactions may affect the assessment of the entity by users of the financial statements. It the existence of the relationship that users need to be made aware of, not just situations when that relationship has caused special advantages or benefits for an entity. The assessment of whether there have been special advantages or benefits created is a matter of interpretation and is up to users of the financial statements. Therefore, users should be made aware of the existence of related party relationships and the transactions that have occurred. It is also important to note that the assessment of whether a related party exists also depends on the substance of the relationship and not merely the legal form[7].

15. In the majority of cases, the reality is that the relationship between state-controlled entities may not create a related party relationship in the sense that IAS 24 is trying to capture (ie one where common control may influence decisions of entities and ultimately affect a user's assessment of the financial statements). Thus, the requirement to disclose every transaction between state-controlled entities is, in the staff view, excessive.

16. The staff acknowledge that in China entities with state control currently meet the definition of a related party in IAS 24. However, the staff recognise that in many cases the required disclosures are not achievable. Consider the following example:

> Company A, whose 'asset holding company' is owned by Shanghai City government, hold a meeting at a hotel in Beijing, which is owned by an asset holding company owned by the Beijing government. Company A has no reason to prefer a hotel with significant state ownership over a hotel with foreign investment if the latter provides a better service with a lower charge, nor is Company A being forced to use this specific hotel. The hotel has no obligation to give special treatment to Company A.

[7] IAS 24 paragraph 10.

17. Company A and the hotel may not even be aware that the entities they are transacting with are in fact state-controlled entities. This situation highlights the extent of the problem in China. Such transactions would be carried out daily by entities and the ability for them to account for each one as a related party is extremely impractical and in many cases impossible to achieve. Furthermore, the staff think that the relevance of such extensive disclosures for users is minimal, and could result in the more important related party transactions being obscured.

Alternative remedies

18. The staff have identified five possible remedies if the Board believes disclosure of state-controlled entities should be amended in some way under IAS 24:

(a) Inclusion of the wording in the Chinese Accounting Standard (or other similar wording), specifically:

> 'Enterprises simply because they are subject to control from the State, but other related party relationships do not exist, shall not be regarded as related parties'.

This option attempts to ensure that, when there is a relationship that is 'in substance' a related party relationship, the entity will make the required disclosures. The staff will further analyse the specific wording if the Board believes this option is viable.

(b) Inclusion of the wording included in IAS 24 before the Improvements project. Previously paragraph 4(d) of IAS 24 stated:

> 'No disclosure of transactions is required in financial statements of state-controlled enterprises of transactions with other stated controlled enterprises'.

This option would result in state-controlled entities not having to disclose any information regarding such relationships and transactions. This would be the case even if there is 'in substance' a related party relationship where transactions are occurring because of this relationship. Such transactions would not be disclosed in this situation.

The staff do not believe this option would provide appropriate information to users and thus would not recommend this option to amend IAS 24.

(c) Acceptance that state-controlled entities are related parties under IAS 24, but acknowledging that enforcing the disclosure requirements under IAS 24 are excessive. Instead, disclosure requirements for state-controlled entities could be limited to qualitative disclosures identifying the existence of the state-control, and any significant transactions, without requiring detailed quantitative disclosures. The staff think that difficulties will arise when trying to determine which transactions are ‘significant’ enough to be disclosed.

(d) Include a cost/benefits exclusion clause for state-controlled entities. The staff think that this suggestion could result in very minimal disclosure being made in situations where actual related party relationships may exist. The staff do not believe this would achieve the objective of IAS 24.

(e) Include the requirement that state-controlled entities disclose transactions only where there is an ‘ownership interest’ in other state-controlled entities. Situations where there is ‘common’ control create the most problems for state-controlled entities. This is because the information may not be easily accessible for the reporting entity, because it does not have an ownership interest in that entity or any contractual right to the information (eg employment contract). Where the entity has an ownership interest in the related party, or a contractual right to the information, the information required under IAS 24 should be more readily available to the reporting entity. A possible solution would be to require full disclosures in situations when ownership interest or a contractual obligation exits, and in other situations, require only qualitative disclosures.

19. Further work will be completed to consider the merits of these five alternatives as well as other possible solutions, if the project is accepted onto the Board’s agenda. Which ever option is decided, the staff will also define state-controlled entities or more specifically those entities that the exemptions will

apply to, eg whether the proposals will apply at Federal or State level. The staff's initial thought is that option (c) could be the best model as it does not require extensive disclosure but ensures that relevant information is disclosed.

20. The staff note that in recommending this project to the Board we are taking the opposite view to the staff recommendation made at the IFRIC Agenda Committee in 2004. The main reason for this is our enhanced understanding of the situation that exists in China. Due to the work completed in the Convergence project with the MOF the staff are more aware of the extent of the disclosures required and the impact of enforcing the requirements (see discussion above). Refer to Appendix C for the agenda paper that went to the IFRIC Agenda Committee in 2004.

21. **Does the Board agree that amendments should be made to IAS 24 for state-controlled entities?**

22. **Does the Board have a preference for one of the alternatives given above?**

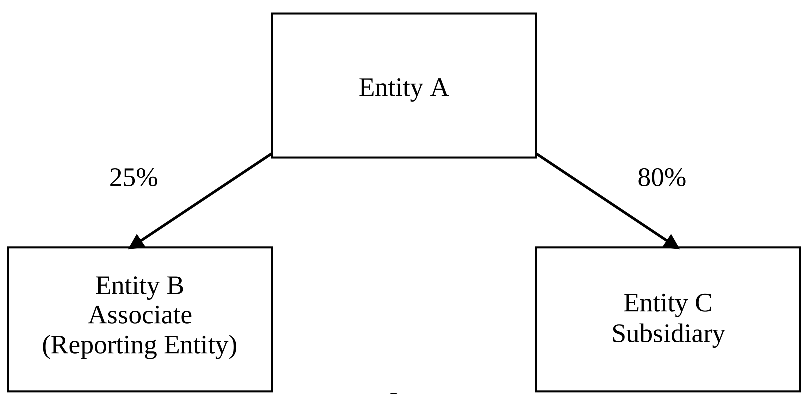
ISSUE 2 – TRANSACTIONS BETWEEN TWO RELATED PARTIES OF AN ENTITY

23. During the past 18 months, the IASB and the ASBJ have met to discuss convergence issues for Japan. One of the standards the ASBJ has included on the convergence agenda is IAS 24. The ASBJ has raised a question about what the requirements of IAS 24 are when:

    (a) an entity has both subsidiaries and associates which transact with each other; and

    (b) the associate is the reporting entity.

    The following diagram depicts the exact relationship and transactions to which the staff are referring (assuming Entity B is the reporting entity):



Transactions

24. IAS 24 does not specifically mention Entity C within the definition of a related party. IAS 24 paragraph 9 states that 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.

The staff do not think that Entity C would meet any of these criteria and hence would not be considered a related party of Entity B.

25. The ASBJ has expressed concern that these relationships are not included in the definition of a related party. The ASBJ argue that it is likely that there will be some influence over transactions between Entity B and C, because Entity A has control of Entity C and significant influence over Entity B. The objective of IAS 24 as, noted in paragraph 14 above, is to disclose transactions to draw attention to the fact that certain relationships may have affected the financial

statements. The staff think the relationship mentioned above could affect the financial statements.

26. As indicated in paragraph 39 below, the majority of national standard setters agree with the ASBJ that such transactions could affect the financial statements and thus information regarding this should be disclosed.

27. One concern about including these transactions is that entities may not be aware that such relationships exist. As Entity B does not itself hold significant influence or control over the Entity C, it may not be able to obtain the information needed to satisfy the requirements of IAS 24.

28. The staff think that further work should be completed to assess whether such transactions should fall within the requirements of IAS 24. During discussions at the SAC meeting, it was noted that work has recently been completed to investigate situations similar to the one raised by the ASBJ. The staff acknowledge that this work should be investigated further. The staff think it is important to review other similar situations to understand whether they give rise to possible related party relationships and thus should be amended during this project. Decisions will need to be made about whether disclosures should be required for associates transacting with a subsidiary and vice versa, and possibly even two common associates transacting with each other.

29. **Does the Board agree that consideration should be given to the situations mentioned above?**

IASB AGENDA CRITERIA

30. The Due Process Handbook sets out five criteria to be considered in deciding whether to add a potential item to the agenda:

    A. the relevance to users of the information involved and the reliability of information that could be provided;

    B. existing guidance available;

    C. possibility of increasing convergence;

    D. quality of the standards to be developed; and

E. resource constraints.

A The relevance to users of the information involved and the reliability of information that could be provided

31. The objective of a project should be to address a demand for better quality information that is of value to all users of financial statements. In the light of this, there are three main factors to consider:

International relevance and pervasiveness

32. Issue 1 is of particular importance to China because the government has significant ownership in a large number of entities listed overseas. Many other jurisdictions and countries also experience problems similar to China's such as Germany, France, Russia and other Eastern European countries. The staff note this issue will affect only state-controlled entities that transact with other state-controlled entities. At present, there is a move towards privatisation in China which *may* decrease the impact of a change in the standard (if the government decides to hold less than a controlling or significant influence in privatised entities); however, the timing and extent of privatisation are unknown. Also, privatisation may cause increased problems because of constant changes to an entity's list of related parties.

33. Issue 2 will affect only those specific entities which are associates of an entity that also has a subsidiary, and the associate and the subsidiary transact between each other. This issue will affect most jurisdictions around the world because normal business structures are set up to include both subsidiaries and associates.

Urgency

34. Some entities in China that are listed overseas are reporting using IFRSs and thus are already making disclosures required under IAS 24. For example, in PetroChina Company Limited's 2005 interim report 8 of 34 pages (24%) were devoted solely to related party transactions[8]. Refer to Appendix A for details of the disclosures in the 2005 Annual Report of PetroChina. Further listed entities in Europe have been applying IFRS from 1 January 2005. Thus,

[8] The disclosures described transactions with associates, fellow subsidiaries and 'other state-controlled enterprises'.

entities are at present attempting to comply (as far as is practically possible) with the requirements of IAS 24.

35. There is no specific urgent need to resolve Issue 2 in the near future. However, there is a general need to ensure that users of financial statements obtain the information they require to make informed decisions. To do this the staff recommend that the amendments discussed regarding Issue 2 should be investigated.

Consequences of not taking on this project

36. The staff think that there are important consequences if changes are not made to IAS 24 in relation to both Issue 1 and Issue 2. The burden placed on state-controlled entities which transact with other similar entities will be substantial, creating extensive work to ensure compliance. Furthermore, such disclosures could be irrelevant, creating confusion for users of the financial statements. In contrast, not disclosing the transactions highlighted in Issue 2 could mislead users because relevant information regarding the environment in which the entity operates is not being disclosed.

B Existing guidance available

Other national accounting guidance

37. The staff reviewed accounting standards from Australia, Canada, New Zealand, the UK and the US and obtained the following results for Issue 2:

Issue 2	**Required**	**Details**
Australia	Yes	AASB 1017 *Related Party Disclosures* paragraph 9.1 – 'Related party means, in relation to an entity: any other entity that at any time during the financial year is controlled by the same entity that significantly influences the entity or; any other entity that, at any time during the financial year, is significantly influenced by the same entity that controls the entity'.
Canada	Yes	3840 *Related Party Transactions* paragraph .04 (h) – 'Any party that is subject to significant influence … by another party that also has significant influence over the reporting enterprise'.

New Zealand	Yes	SSAP 22 *Related Party Disclosures* paragraph 3.1 – 'Parties are considered to be related when they are subject to common significant influence'.
United Kingdom	Yes – in some cases.	FRS 8 *Related Party Disclosures* paragraph 2.5 (a) (iv) – 'Two or more parties are related parties when … the parties, in entering a transaction, are subject to influence from the same source to such an extent that one of the parties to the transaction has subordinated its own separate interests'.
United States	Not specifically. This paragraph could include such situations.	FAS 57 *Related Party Disclosures* paragraph 24 (f) – '… other parties with which the enterprise may deal is one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests'.

Four of those five national standard-setters specifically required these disclosures, which indicates the importance attached to the disclosure of these transactions.

38. None of the standards mentioned above allowed an exemption for state-controlled entities if such entities fall within the normal related party relationship definition (ie control, significant influence or common control etc). In saying this, the staff think that there are other important reasons for not requiring the disclosure as noted above. Further, the staff note that the International Public Sector Accounting Standards Board (IPSASB) have the following exclusion from the definition of a related party transaction in IPSAS 20 *Related Party Disclosures*:

> 'Related party transactions exclude transactions with any other entity that is a related party solely because of its economic dependence on the reporting entity or the government of which it forms part'.

C Possibility of increasing convergence

39. Giving an exemption for state-controlled entities (Issue 1) would not converge with any of the standard-setters reviewed in paragraph 37. However, it would increase convergence with CAS. China is incorporating the principles of IFRSs for all listed business entities from 1 January 2007: from that date. There are two substantial differences between IFRS and the CASs created

using IFRS principles. One is the related party disclosures for state-controlled entities. The other is the accounting for impairments of assets. An amendment to IAS 24 would therefore improve convergence.

40. Furthermore, making an amendment to IAS 24 would give the Board the opportunity to provide a solution to a difficult situation that entities are facing in a jurisdiction new to IFRSs. As noted above in paragraph 37, amendments to the standard for Issue 2 will converge with other national standard setters.

D Quality of the standards to be developed

41. In the staff's view, to meet the objectives set out in IAS 24, the changes discussed need to be made. Making amendments on both of the issues will allow entities to produce related party disclosures that are useful and capture the transactions the standard was always attempting to capture.

E Resource constraints

42. [Paragraph omitted from observer notes].

43. [Paragraph omitted from observer notes]. .

DRAFT PROJECT PLAN

44. The staff will aim to achieve the following project plan if the Board decides to add this project to its agenda:

Meeting	Topic
One	• A review of current guidance regarding state-controlled entities • Assessment of possible solutions to the problem of reporting all transactions between state-controlled entities. • Board members would identify areas on which they believe further work is needed.
Two	• Review of current guidance for disclosure of transactions between associates and subsidiaries with the same significant investor. • Assessment of possible recommendations regarding such transactions • Board members would identify areas on which they believe further work is needed. • Reassessment of issues discussed in meeting One.
Three	• Reassessment of suggested solutions raised in meeting two, in light of Boards comments Proposed pre-ballot draft of amendments • Board members asked to express their intention to support or give alternative views on paper.
Four	• Sweep issues.

45. This plan envisages an Exposure Draft published by the end of 2006 with a 120-day exposure period. Redeliberations would begin in the second quarter of 2007. Allowing a reasonable time for analysis of comment letters and Board redeliberations would lead to the amendment being issued in the second half of 2007 with an application date some time after this.

APPENDIX A - EXAMPLES OF CURRENT DISCLOSURES BY ENTITIES

China

1. **China Telecom Corporation Limited**, accounts are prepared under IFRSs, Auditor KPMG.

   China Telecom Corporation Limited has included a paragraph stating that as from 1 January 2005 the adoption of IFRS has required disclosure of transactions with state-controlled entities. This was previously not required. The following paragraph was included in the related party transaction note:

   > ‘The Group is a state-owned enterprise and operates in an economic regime currently predominated by state-owned entities. Apart from transactions with parent company and its affiliates, the Group conducts certain business activities with enterprises directly or indirectly owned or controlled by the PRC government and government authorities and affiliates (collectively referred to as ‘state-owned entities’) in the ordinary course of business. *These transactions, which include sales and purchase of goods, rendering and receiving services, lease of assets and obtaining finance, are carried out at terms similar to those that would be entered into with non-state-owned entities and have been reflected in the financial statements* [Emphasis added].
   >
   > Further information of the Group’s principal transactions with other state-owned telecommunications operators in the PRC in the normal course of providing telecommunications services are set out in Note 32 [Concentrations of Credit Risk].
   >
   > *Management believes the above information has provided meaningful disclosures of related party transactions*’ [Emphasis added].

2. **China Resources Power Holdings Company Limited**, accounts prepared under New Hong Kong Financial Reporting Standards[9], Auditor Deloitte.

The following paragraph was included in the related party transaction note:

> 'The Group operates in an economic environment currently predominated by entities directly or indirectly owned or controlled by the PRC government ('state-controlled entities'). In addition, the Group itself is part of a larger group of companies under CRNC which is controlled by the PRC government. Apart from the transactions with CRNC, CRH and fellow subsidiaries disclosed in (a) above, the Group also conducts business with other state-controlled entities. *The directors consider those state-controlled entities are independent third parties so far as the Group's business transactions with them are concerned* [Emphasis added].
>
> The Company constructs and operates power plants in the PRC and sells electricity to the power grid companies which are also state-controlled entities in the PRC. In addition, the Group has certain deposits placements, borrowings and other general banking facilities, with certain banks which are state-controlled entities in its ordinary course of business. In view of the nature of those transactions, *the Directors are of the opinion that separate disclosure on these transactions and balances would not be meaningful'* [Emphasis added].

3. **Industrial and Commercial Bank of China (Asia) Limited**, accounts prepared under New Hong Kong Financial Reporting Standards[10], Auditor PricewaterhouseCoopers.

The following paragraph was included in the related party transaction note:

> 'The state-controlled entities are those over which the PRC government directly holds over 50% of the outstanding shares or voting rights, and has the ability to control or the power to govern their financial or operating policies.
>
> *It should be noted, however, the PRC government may indirectly hold interest in many PRC companies. Some of these [indirectly held] interests may, in*

[9] This is basically IFRSs with few differences. IAS 24 and NHKFRS 24 have no material differences.
[10] This is basically IFRSs with few differences. IAS 24 and NHKFRS 24 have no material differences.

themselves or when combined with other indirect interests. Such interests, however, would not be known to the Group and are not reflected below [Emphasis added].

The Group enters into banking transactions with other state-controlled entities in the ordinary course of business. These include loans, deposits, investment securities, money market transactions and off-balance sheet exposures. These transactions are executed at the relevant market rates at the time of the transactions.

The outstanding balances of related party transactions and related provisions at the period/year end, and the related major income and/or expenses for the period/year and are as follows:'

The disclosures then go on to detail an extensive list of transactions and balances under the following headings – loans and advances to customers, investment securities, due from other banks and financial institutions, due to other banks and financial institutions, due to customers, others and off balance sheet exposures.

4. **China Unicom Limited**, accounts prepared under New Hong Kong Financial Reporting Standards[11], Auditor PricewaterhouseCoopers.

The following paragraph was included in the related party transaction note:

'The Group is ultimately controlled by the PRC government, which also controls a significant portion of the productive assets and entities in the PRC. The Group provides telecommunications services as part of its retail transactions, thus, is likely to have extensive transactions with employees of state-controlled entities, including their key management personnel and their close family members. These transactions are carried out on commercial material transactions with the Group included other telecommunication service operators, equipment vendors, construction vendors, services providers and state-owned banks in the PRC.

Management believes that meaningful information relative to related party disclosures has been adequately disclosed' [Emphasis added].

[11] This is basically IFRSs with few differences. IAS 24 and NHKFRS 24 have no material differences.

The accounts proceed to detail the amounts due from and to other major state-owned enterprises under the following headings – prepayment and other current assets, short term bank deposits, bank balances and cash, long term bank loans, payables and accrued liabilities, short term bank loans, current portion of long term bank loans.

5. **PetroChina** accounts prepared under IFRSs, Auditor PricewaterhouseCoopers

The following paragraph was included in the related party transaction note:

> 'CNPC, the immediate parent of the Company, is a state-controlled enterprise directly controlled by the PRC government. The PRC government is the Company's ultimate controlling party. State-controlled enterprises and their subsidiaries, in addition to CNPC group companies, directly or indirectly controlled by the PRC government are also related parties to the Group. Neither CNPC nor the PRC government publishes financial statements available for public use.

The accounts go on to detail a number of transactions and balances due to 'state-controlled entities' under the following headings: bank deposits, sales of goods and services, purchases of goods and services, purchases of assets, year-end balances arising from sales/purchases of goods/services/assets, leases, loans, key management compensation, contingent liabilities and collateral for borrowings.

Rest of World

6. **Air New Zealand Limited**, New Zealand GAAP[12], Auditor Deloitte

The following paragraph was included in the related party transaction note to the accounts:

> 'The Crown, the major shareholder of the Company, owns 80% of the issued capital of the company. The balance is owned by the public. The Group enters into numerous transactions with Government departments, Crown agencies and State owned enterprises on an arm's length basis. *These are not considered to be related party transactions'* [Emphasis added].

7. **Canada Post Corp**, Canadian GAAP[13], Auditor Deloitte.

The following paragraph was included in the related party transaction note to the accounts:

> 'The Government of Canada compensates the Corporation for foregone postage revenue from Government free mail services and mailing of materials for the blind, as well as for the Food Mail program, under which services are provided at rates less than cost pursuant to an agreement with the Department of Indian and Northern Affairs. Compensation payments on behalf of postal users amounting to $59 million (2004 – $60 million) are included in revenue from operations. The Corporation has also incurred net operating costs of $2 million (2004 – $4 million) with respect to real property agreements with Public Works and Government Services Canada. In addition, the Corporation has other transactions with the Government of Canada, its agencies and other Crown corporations in the normal course of business at normal commercial prices and terms. These transactions are measured at the exchange amount. For the year ended December 31, 2005, the amounts of accounts receivable and deferred revenue from these related parties are $35 million (2004 – $11 million) and $4 million (2004 – $5 million), respectively'.

[12] NZ GAAP uses SSAP 22 *Related Party Disclosures*. There is no exclusion for state-controlled entities transacting with other state-controlled entities in SSAP 22.
[13] Canadian GAAP HB 3840 *Related Party Transactions* has no specific exemptions for state-controlled entities.

8. **Deutsche Post World Net**, 2005 IFRSs, Auditors PricewaterhouseCoopers

> ‘In addition to the consolidated subsidiaries, Deutsche Post World Net has direct and indirect relationships with a large number of unconsolidated subsidiaries and associates in the course of its ordinary business activities. In the course of these activities, all transactions for the provision of goods and services entered into with unconsolidated companies were conducted on an arm’s length basis at standard market terms and conditions.
>
> Deutsche Post AG and Deutsche Postbank AG have a *variety of relationships with the Federal Republic of Germany and other companies controlled by the Federal Government* [Emphasis added]’.

The disclosures then detail the types of relationships they have with the government.

APPENDIX B – BACKGROUND

1. Below is an extract from the May 2006 Board paper which discusses recent considerations regarding IAS 24 at the IASB. It specifically discusses the Improvements project, IFRIC matters and the discussions with the ASBJ.

IASB deliberations

2. IASC approved IAS 24 in July 1984 and reformatted it in 1994. The IASB amended the standard in the Improvements project completed in 2003. The Improvements ED of IAS 24, published in May 2002, invited comments on two questions. The first was whether constituents agreed with the proposal not to require disclosure of management compensation, expense allowances and similar items. In the light of constituents' negative response, the revised standard included a requirement to disclose the compensation of key management personnel.

3. The second question was on the proposal not to require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or wholly-owned subsidiary that are published with consolidated financial statements for the group to which that entity belongs. Again, in the light of constituents' negative response, the revised standard requires disclosure of transactions in the separate financial statements.

4. In commenting on the ED, respondents also mentioned the following:

   (a) Some constituents commented on the proposed removal of the exemption for disclosure of transactions between state-controlled entities. One constituent pointed out whilst such disclosure can be important, 'a blanket requirement to disclose all transactions with other state-controlled enterprises is quite onerous in many countries'. To insist on disclosure of all transactions with state-controlled entities would mean that the achievement of 'transparent and timely' financial statements would not be possible for many of those entities.

(b) Some respondents were concerned about the definition of a related party. They argued that IAS 24 should set out an underlying principle of what constitutes a related party, and not merely list entities that fall within the definition. Having a principle in place would better capture what the Board was trying to achieve with IAS 24.

(c) Many respondents disagreed with the requirement to disclose the existence of relationships between a parent and its subsidiaries only. Respondents argued that this requirement was too narrow. They suggested that disclosure of relationships where 'control' existed would be a better requirement as it would ensure that a broader range of relationships would be disclosed, not just the parent/subsidiary relationship. For example, disclosure would then be made in situations where a 'person' has control over an entity.

(d) Some respondents pointed out that materiality is especially important in related party transactions, and argued that materiality should therefore be addressed specifically in the standard. Some suggested that quantitative criteria for materiality should be included. Another suggested that materiality should be determined in the context of both parties to the transaction, not merely the reporting entity.

5. The Board considered these issues and decided that only the comments at (c) above should be reflected in the revised standard. The other issues were regarded as outside the scope of the Improvements project.

6. The revised standard issued in 2003 incorporated the following significant changes from the previous version:

(a) a requirement to disclose specific information about the compensation of key management personnel;

(b) removal of the exemption for state-controlled entities from disclosing transactions with other state-controlled entities;

(c) inclusion within the definition of a related party of the following:

  (i) parties with joint control over the entity;

  (ii) joint ventures in which the entity is a venturer; and

  (iii) post-employment benefit plans for the benefit of employees of an entity or of any entity that is a related party to that entity; and

(d) new disclosure requirements were added with some existing disclosures clarified.

Issues raised with the IFRIC

7. Since 2002, the following issues on IAS 24 have been raised with the IFRIC.

April 2003 – Determination of material transactions with key management personnel

8. The IFRIC was asked for guidance on how to determine when transactions with key management personnel were material.[14] This request was based on the belief that the materiality threshold for disclosure of management compensation should be lower than that for other transactions. The staff recommended against taking the issue onto the agenda on the grounds that the *Framework* and IAS 1 *Presentation of Financial Statements* give sufficient guidance on the meaning of material. Furthermore, materiality depends on the existing circumstances, thus, to provide specific guidance could impede the objective of appropriate disclosure. The IFRIC Agenda Committee agreed with the staff's recommendations.

March 2004 – Disclosures for state-controlled entities

9. A constituent asked the IFRIC to consider developing guidance on how to comply with IAS 24 in situations where the entity faced practical difficulties in identifying certain related party transactions. An example was the difficulty for state-controlled entities in identifying all related parties (whether because of non-disclosure by government, or the extent of all possible related parties in places such as China). The constituent pointed out that, owing to the

[14] This issue was raised in relation to IAS 24 (Revised 1994), not the present version.

voluminous disclosures required for some entities, the disclosures could in fact be misleading and irrelevant.

10. At the time, the staff argued that the difficulty described was not unique to state-controlled entities. Furthermore, public sector entities preparing for privatisation could be required to prepare such information for due diligence purposes; and would therefore need to collect the information anyway. The staff pointed out that the Board had recently considered the issue in its Improvements project, when it had voted to include all disclosure requirements for state-controlled entities. It was therefore inappropriate for the IFRIC to provide guidance on this application issue. Lastly, the staff did not think that divergent interpretations would arise from IAS 24 for state-controlled entities, as the standard was clear in its requirements. The IFRIC Agenda Committee agreed with the staff's recommendation.

July 2004 – Interpretation of the term information in paragraph 17 of IAS 24

11. The IFRIC was asked by the IAASB to provide guidance on how preparers and auditors should interpret the term 'information' in IAS 24 paragraph 17, which states:

> '… an entity shall disclose the nature of the related party relationship 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'.

12. The IAASB believed that preparers and auditors were unclear about the disclosures required and that practice would vary from entity to entity. The IAASB therefore asked for the following detailed list of requirements to be included in IAS 24 to establish exactly what 'information' should be provided by entities:

(a) the business purpose and economic substance of the transactions;

(b) the identity of the related parties, where appropriate;

(c) the effects of the transactions on the financial statements;

(d) where management is participating in the transactions, the nature and extent of involvement including compensation or rewards, regardless of whether such rewards are contingent on future events or can only be estimated;

(e) any special risks or contingencies arising from the related party transactions; and

(f) any other facts critical to a fair assessment of the related party transactions.

13. The staff recommended that this agenda proposal should be rejected because 'information' should be read in the context of the whole sentence. The sentence states 'information about the transactions and outstanding balances…' which clearly identifies the types of information to be disclosed. The staff argued that the intention of the standard was to establish a disclosure principle with certain minimum requirements. Creating a list of requirements could result in the omission of important disclosures. Finally, the agenda proposal was not recommended because the IFRIC did not usually spend time on disclosure issues. The IFRIC Agenda Committee agreed with the staff's recommendation.

July 2004 – Differences between IAS 24 (1994) and IAS 24 (2003)

14. A constituent wanted to confirm whether the 1994 version of IAS 24 required disclosure of key management personnel and whether the inclusion of this requirement in the 2003 version gave rise to a change in the scope of IAS 24. The matter was raised because the Institute of Chartered Accountants of Guyana had issued a formal statement indicating that IAS 24 (1994) did not specifically require the disclosure of key management personnel. The constituent noted that paragraph IN5 of IAS 24 (2003) states 'the standard requires disclosure of key management personnel' and had included this as a change in scope, implying that the previous version did not require this.

15. However, the staff argued that the intention of paragraphs IN4 and IN5 of IAS 24 (2003) was to highlight that the change in scope arises between the ED and the final version of IAS 24 (2003) not between the 1994 version and the 2003 version. The ED did not require the disclosure of the compensation of

key management personnel but the final version did. Furthermore, paragraph BC4 of IAS 24 (1993) indicates that there was no exemption for disclosure of management compensation. Thus, the staff thought that this was not an issue for the IFRIC to deal with. This was the recommendation made to the IFRIC, which the IFRIC Agenda Committee agreed with.

16. Except for the issue affecting state-controlled entities, the staff do not believe that any of the issues raised with the IFRIC should be revisited for the same reasons given at the time the submission was made.

Discussions with the ASBJ

17. In the Board's discussions with the ASBJ on IAS 24 the following issues were raised.

Principal owners

18. [Paragraph omitted from observer notes].

19. [Paragraph omitted from observer notes].

Material transactions

20. [Paragraph omitted from observer notes].

21. [Paragraph omitted from observer notes].

Third party transactions

22. [Paragraph omitted from observer notes].

Associates and subsidiaries of the same entity

23. [Paragraph omitted from observer notes].

Transactions among related parties

24. [Paragraph omitted from observer notes].

Nature of changes in terms of transactions between related parties

25. [Paragraph omitted from observer notes].

26. [Paragraph omitted from observer notes].

APPENDIX C – IFRIC AGENDA PAPER MARCH 2004

Compliance by state-controlled entities with IAS 24 disclosures

Issue

1. [Paragraph 1 to 13 omitted from observer notes].