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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: 15 November 2007, London

Project: Amendments to IAS 24 Related Party Disclosures

Subject: Redeliberations: Definition of a related party
(Agenda paper 5A)

INTRODUCTION

1. This paper considers the main issues regarding Question 2 raised in the ED (Definition of a related party) and asks the Board to make a decision about these issues.
2. This paper considers the following main issues regarding the definition of a related party:
 - (a) how strongly a member of key management personnel influences an entity of which that person is a member of key management personnel;
 - (b) the definition of 'state' and state-controlled entities;
 - (c) close members of the family;
 - (d) significant voting power; and
 - (e) extra amendment and inconsistencies in the proposed definition.
3. This appendix provides extracts of the definitions of a related party from the ED and IAS 24.

DETAILED DISCUSSION OF ISSUES

How strongly a member of key management personnel influences an entity of which that person is a member of key management personnel

4. In the ED, the Board proposed that the relationship between associates of an investor should not fall within the definition of a related party relationship. This is because there is insufficient influence through the common investment in two associates to warrant concluding that they are related.
5. Also, the Board proposed that when a member of the key management personnel of an entity (Entity A) significantly influences another entity (Entity B), then Entity A and Entity B are related parties of each other. This is because the person could influence transactions between the entities through the management position in Entity A and the ownership interest in Entity B.
6. Some respondents suggested that those two decisions above taken by the Board are inconsistent with each other, particularly when neither entity is controlled by a member of key management personnel. The proposed definition assumes that influence of key management is always control or stronger than significant influence. However, this is not always the case where they are a director, for example, where a majority shareholder controls the board. Furthermore, an individual member of key management generally would be viewed as having no more than significant influence over the entity.

7. Some respondents asserted that there appears to be an anomaly with respect to key management personnel. For example:
- (case 1) when A has significant influence over both B and C, they are not related;
 - (case 2) When A is a member of key management of both B and C, they are not related; and
 - (case 3) when A has significant influence over B and is a member of the key management of C, B and C will be related.

These respondents suggest explaining the distinction given to key management in case 2 (significant influence or less) and case 3 (stronger than significant influence) in the Basis for Conclusions.

8. The staff observes that the current IAS 24 (revised 2003) contains the following amendments to the previous IAS 24 (reformatted 1994) in relation to key management personnel:

<i>Comparison</i>	IAS 24 (reformatted 1994)	IAS 24 (revised 2003) and ED
Definition of key management	Those persons having authority and responsibility for planning, directing and controlling the activities of the reporting enterprise including <u>directors and officers of companies</u> .	Those persons having authority and responsibility for planning, directing and controlling the activities of the entity including <u>any director (whether executive or otherwise) of that entity</u> .
Entity that has a member of key management in common with a reporting entity	<u>Defined as a related party of the reporting entity</u>	<u>Deleted in the definition of a related party</u>
One example that two entities are not necessarily related parties	Two companies simply because <u>they have a director in common</u>	Two entities simply because <u>they have a director or other member of key management personnel in common</u>

9. The staff thinks that as pointed out in paragraphs 6 and 7 above, there are the following differential treatments of a member of key management personnel in paragraphs 9(b)(v)-(vii) of the ED and paragraph 11(a)¹ of IAS 24.
- (a) Paragraphs 9(b)(v)-(vii) of the ED seem to assume that influence of a member of key management personnel is always stronger than significant influence, whereas paragraph 11(a) of IAS 24 considers that influence of a member of key management personnel could be significant influence or weaker.
 - (b) From a different perspective, paragraphs 9(b)(v)-(vii) of the ED seem to assume that when a person is a member of key management of one entity and significantly influences another entity, that person is always able to influence the policies of those two entities in their mutual dealings, whereas paragraph 11(a) of IAS 24 considers that when a person is a member of key management of two entities, that person might not be able to influence them.
10. The staff proposes the following two alternatives to resolve this issue:
- (a) *Alternative A*: To delete the term ‘significant influence’ in Paragraphs 9(b)(v)-(vii) of the ED and to add the wording ‘two entities simply because a member of key management personnel of one entity has significant influence over the other entity’ to paragraph 11(a) of IAS 24.
 - (b) *Alternative B*: To include one new paragraph in a final Standard as the following example and delete the wording ‘notwithstanding (d) and (f) in the definition of ‘related party’ in paragraph 11(a) of IAS 24.
- 10A In applying paragraphs 9(b)(vi) and (vii), it is necessary to consider the possibility that a member of key management personnel would not be able to affect the policies of two entities in their mutual dealings when that member not controls or jointly controls but significantly influences another entity.*

¹ IAS 24.11 In the context of this Standard, the following are not necessarily related parties:

- (a) two entities simply because they have a director or other members of key management personnel in common, notwithstanding (d) and (f) in the definition of ‘related party’.
- (b)-(d)

11. The reasons for the alternatives in paragraph 10 are as follows:
- (a) It would result in influence of a member of key management personnel being treated consistently.
 - (b) It would reflect the views suggested in paragraph 11 of IAS 24, which the staff views as more appropriate than those in paragraphs 9(b)(v)-(vii) of the ED. The views are that a member of key management (for example, a director) does not always exercise stronger than significant influence over an entity.
 - (c) It would result in the same treatment in the following cases, assuming that associates of an investor are not related parties any more as proposed in the ED:
 - (i) when a person is a member of key management of one entity and significantly influences another entity
 - (ii) when an investor significantly influences two entities – i.e. associates.
12. ***Does the Board agree with an amendment to the ED and IAS 24 to resolve this issue? If yes, which of the alternatives proposed in paragraph 10 does the Board prefer? Or what else would the Board prefer?***

The definition ‘state’ and state-controlled entities

13. The ED proposed defining ‘state’ as follows:
- A state is a national, regional or local government.*
14. Paragraph 11A of the ED, which supports this definition, explains that the term ‘state’ in this Standard refers to any governing jurisdiction that has statutory or regulatory powers of government, whether that state is at a national, regional or local level.
15. Some respondents raise the following points regarding the proposed definition of ‘state’:
- (a) Should each of the regional or local governments be viewed on its own or as one composite whole? For example, if 20 municipalities each have 5% of the shares of a regional utility company, would that company be considered ‘controlled by the state’?

- (b) Would entities controlled or significantly influenced by different levels of government be considered to be related?
 - (c) Could a central or federal government control or significantly influence a local or provincial government?
16. Some respondents note that in Europe, a number of different structures are formed to control (or influence) entities that are in effect state-controlled (or state-influenced) entities. For example, in some countries, the entities are not controlled or influenced by the government directly, but by an agency that is neither strictly speaking a governmental body nor a private sector body. They suggest the definition and supporting material be further reviewed to embrace a wider range of structures in state-controlled entities under the exemption.

What is a state?

17. The staff believes that the following should be considered in defining 'state':
- (a) How to define 'state' affects the scope of the proposed exemption for state-controlled entities. A narrow definition will limit the scope of the exemption more. An extensive definition will be more appropriate to cover a wide range of governing structures and to achieve the purpose of the proposed exemption.
 - (b) The definition of 'state' should be principle-based with some key concepts such as statutory or regulatory power and governing jurisdiction.
18. The staff thinks that the definition of 'state' proposed in the ED generally covers all the considerations outlined in paragraph 17. Also, the staff thinks that the questions raised by respondents as set out in paragraphs 15 and 16 should be assessed based on the proposed principle-based definition and situations involving governing structure. As a result, the staff recommends that the definition of 'state' proposed in the ED should remain the same as in the ED. ***Does the Board agree with the staff's recommendation?***

How to identify state-controlled entities under common control?

19. How should a state-controlled entity determine whether it and the other transacting party are controlled by the same state (a common state)? The staff thinks that this is an application issue rather than a conceptual issue. The staff believes that a state-controlled entity should identify a common state considering the following:
 - (a) How to identify a common state affects the scope of the proposed exemption for state-controlled entities. If two entities are both controlled by a state, they are related to each other but fall within the scope of the exemption. On the other hand, if two entities are not controlled by the same state, the two entities are excluded directly from the definition of a related party and the exemption is irrelevant.
 - (b) Like entities that are not state-controlled, state-controlled entities should determine whether they are controlled by the same state by using judgement to assess the extent of independence between states at a national, regional or local level.

20. The staff does not recommend that the Board should define ‘common state’ or include an application guidance on how to identify a common state because the notion ‘common state’ is self-evident and application guidance is not appropriate to cover various and complicated situations involving governing structure. ***Does the Board agree with the staff’s recommendation?***

Two entities that are both significantly influenced by the same state

21. Many respondents inferred from paragraph 17A(a)² of the ED that if two entities are both significantly influenced by the same state, they are related to each other.
22. The staff recommends that the Board should amend the wording in that paragraph to avoid that confusion, noting the following:
 - (a) Paragraph BC15 of the ED states that the exemption for state-controlled entities includes situations in which the state controls one entity and significantly influences another.
 - (b) The definition of a related party proposed in the ED excludes two entities that are significantly influenced by the same party.
23. ***Does the Board agree with the staff's recommendation in paragraph 22?***

Including 'influence exercised by a common state'

24. Many respondents indicated that paragraph 17A(b) (see footnote 2) of the ED refers only to influence between state-controlled entities, and suggest amending that paragraph to include 'influence exercised by a common state', giving the following reasons:
 - (a) the influence of the state is likely to matter more than the reporting entity's influence by or over the other transacting entity; and
 - (b) this would align paragraph 17A(b) of the ED with paragraph 17C of the ED, which refers specifically to 'direction or compulsion by a state', and with paragraph BC16 (influence from the state or the related party).

² ED.17A A reporting entity is exempt from the disclosure requirements of paragraph 17 in relation to an entity if:

- (a) the entity is a related party only because the reporting entity is controlled or significantly influenced by a state and the other entity is controlled or significantly influenced by that state; and
- (b) there are no indicators that the reporting entity influenced, or was influenced by, that entity.

25. The staff recommends that the Board should include ‘influence exercised by a common state’ in paragraph 17A(b) of the ED for the following reasons in addition to those outlined in paragraph 24:
- (a) Paragraph 17A(b) provides one criterion for the proposed exemption. The Board tentatively decided at its October meeting that the exemption would not be available if either:
 - (i) the reporting entity influenced a transaction with that other state-controlled entity, or that entity influenced a transaction with the reporting entity; or
 - (ii) the reporting entity influenced, i.e. participated in, the operating and financial policy decisions of that other entity, or that entity influenced the operating and financial policy decisions of the reporting entity.The staff thinks that the above Board’s decision views actual influence, whether on a transaction or between state-controlled entities, as being the most important factor. Therefore, the staff believes that if transactions between state-controlled entities were influenced by a common state, all transactions between them should also be disclosed.
 - (b) Paragraph 17A(b) should focus on the principle although that principle will give rise to some application issue such as identifying a common state.

26. *Does the Board agree with the staff’s recommendation in paragraph 25?*

Close members of the family

27. The ED proposed defining ‘close members of the family of a person’ as follows:

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with an entity and include:

- (a) *that person’s domestic partner (such as a husband or wife or equivalent) and children;*
- (b) *children of that person’s domestic partner; and*
- (c) *dependants of that person or that person’s domestic partner.*

28. Many respondents observed that the word ‘may’ was deleted in the proposed definition of ‘close members of the family of a person’. This suggests that the persons described in subsections (a)-(c) are always close members of the family, whereas the previous wording implied a rebuttable presumption. Furthermore, these respondents favour re-instating the word ‘may’.
29. The staff recommends that the Board should reinstate the word ‘may’ in the definition of close members of the family of a person because the persons described in subsections (a)-(c) may not always influence or be influenced by that person. *Does the Board agree with the staff’s recommendation?*

Significant voting power

30. Many respondents propose defining the term ‘significant voting power’. This is because the term is used in the current text of IAS 24 and in a number of other standards, but is not a defined term in IFRS. This creates inconsistencies and divergence in practice.
31. A few respondents proposing deleting ‘significant voting power’ from paragraphs 9(b)(vi) and (vii) because:
- (a) paragraphs 9(b)(vi) and (vii) are inconsistent with paragraph 9(a)(iii), which only refers to ‘significant influence’;
 - (b) ‘significant voting power’ is not a commonly understood term;
 - (c) in most circumstances, significant voting power would convey significant influence; and
 - (d) paragraphs 9(b)(vi) and (vii) already includes control and significant influence, which are the key terms identifying a related party relationship.
32. The staff recommends that the Board should delete the term ‘significant voting power’ in paragraphs 9(b)(vi)-(vii) of the definition of a related party for the following reasons in addition to those outlined in paragraphs 30-31:
- (a) The staff confirmed that unlike the assertion raised in paragraph 30 that the term is used in a number of other standards, no IFRSs except for IAS 24 use the term ‘significant voting power’ at all. Other national accounting standards including US-GAAP do not use the term either.

- (b) IAS 24 (reformatted in 1994) used the wording ‘interest in the voting power of the reporting entity that gives it significant influence’ and ‘substantial interest in the voting power’ to indicate ‘significant influence’ and ‘control’ respectively. However, IAS 24 (revised in 2003) changed ‘interest in the voting power of the reporting entity’ to ‘interest in the reporting entity’ and does not use ‘substantial interest in the voting power’ any more. Instead, it uses the term ‘significant voting power’.
- (c) The staff observes that the term ‘significant voting power’ is used only for a person *not* an entity. However, the staff could not find a particular reason to use the term ‘significant voting power’ to distinguish between a person and an entity because the term seems to suggest only a tool to exercise significant influence.

33. ***Does the Board agree with the staff’s recommendation in paragraph 32?***

Extra amendment and inconsistencies in the proposed definition

Extra amendment in the proposed definition

34. Two respondents refer to cases when an individual has joint control³ over a reporting entity (paragraph 9(a)(iii) of IAS 24) and that person or a close member of the family of that individual (paragraph 9(e) of IAS 24) controls, jointly controls or significantly influences, or has significant voting power in another entity. They note that the reporting entity and the other entity will be considered related parties (paragraph 9(f) of IAS 24) under the existing definition of a related party. However, the ED definition would not identify them as related parties. These respondents assert that the proposed definition does not capture the same parties as the existing IAS 24.
35. The staff recommends that the Board amend paragraphs 9(b)(v)-(vi) of the ED to reinstate the cases indicated in paragraph 34 in the definition because:
- (a) the staff does not think that the Board intended to make a change in the area described in paragraph 34’; and

³ IAS 24.9 *Joint control* is the contractually agreed sharing of control over an economic activity.
IAS 31.3 *Joint control* is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

(b) the staff thinks that unlike associates of a person, the cases indicated in paragraph 34 would enable that person to influence transactions between the entities.

36. ***Does the Board agree with the staff's recommendation in paragraph 35?***

Inconsistency relating to post-employment benefit plan

37. Some respondents indicated that definition in paragraph 9(b)(iv) of the ED does not require the post-employment benefit plan to regard the sponsoring employing entity as a related party. They recommend eliminating this inconsistency by making further amendments to the definition.

38. The staff recommends that the Board should amend paragraph 9(b)(iv) of the ED to include the sponsoring employing entity as a related party of the post-employment benefit plan. ***Does the Board agree with the staff's recommendation?***

Inconsistency relating to key management personnel

39. Several respondents note that paragraph 9(b)(vii) of the definition does not include a close family member of key management personnel. For example, X is a member of key management of entity A. Y is a close member of the family of X and has significant influence over entity B. In this example,

- if entity A is the reporting entity, entity B is related to entity A based on paragraph 9(b)(vi); whereas
- if entity B is the reporting entity, entity A is not related to entity B because paragraph 9(b)(vii) does not include a close family member.

Therefore, these respondents suggest including a close member of the family of key management in paragraph 9(b)(vii) of the proposed definition.

40. The staff recommends that the Board should amend paragraph 9(b)(vii) of the ED to include a close member of the family of a member of key management, which would remove that inconsistency indicated in paragraph 39. ***Does the Board agree with the staff's recommendation?***

APPENDIX: EXTRACTS OF THE DEFINITIONS OF A RELATED PARTY FROM THE ED AND IAS 24

THE ED

PROPOSED REVISED DEFINITION

A related party is a person or entity that is related to an entity that is preparing its financial statements (in this Standard referred to as the ‘reporting entity’).

- (a) A person or a close member of the family of that person is related to a reporting entity if either person:**
 - (i) is a member of the key management personnel of the reporting entity or a parent of the reporting entity;**
 - (ii) has control over the reporting entity; or**
 - (iii) has joint control or significant influence over the reporting entity.**
- (b) An entity is related to a reporting entity if:**
 - (i) the entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others);**
 - (ii) the reporting entity is an associate or joint venture of the entity (or an associate or joint venture of a member of a group of which the entity is a member);**
 - (iii) the entity is an associate or joint venture of the reporting entity (or an associate or a joint venture of a member of a group of which the reporting entity is a member);**
 - (iv) 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;**
 - (v) the entity is controlled by a person identified in (a);**
 - (vi) the entity is one in which a person identified in (a)(i) or (a)(ii) holds significant voting power or has joint control or significant influence; or**
 - (vii) a member of the key management personnel of the entity, or a parent of the entity, has control, joint control or significant influence over, or significant voting power in, the reporting entity.**

IAS 24

EXISTING DEFINITION

Related party 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.**