30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **19 October 2007, London**

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

Subject: **Redeliberations: State-controlled entities (Agenda paper 15B)**

INTRODUCTION

1. This paper considers the main issues related to Question 1 raised in the ED (State-controlled Entities). Other suggestions in comment letters that this paper does not cover will be considered as other issues at the Board's next meeting.

2. The main issues related to State-controlled Entities raised and identified in the comment letters include the following. Appendix A to this paper provides further detail:

   (a) assessing influence and applying an indicator approach: entity level vs. transaction level;
   (b) clarifying or defining the term 'influence' referred to in paragraph 17A(b) of the ED;
   (c) clarifying whether it is actual influence or potential influence that precludes the exemption;
   (d) clarifying an indicator approach by amending the indicators proposed in paragraphs 17B-17D of the ED;

(e) extending the exemption to entities that are jointly controlled by a state; and

(f) amending paragraph 17A(b) of the ED to include ‘influence exercised directly by a common state’.

3. This paper divides into two sections:

(a) Section 1: Summary of discussion on an indicator approach

(b) Section 2: Detailed discussion of issues

Appendix A: Extracts from comment letter summary in the September Board paper

Appendix B: Extracts of paragraphs 17A-17E regarding an indicator approach from the ED

SECTION 1: SUMMARY OF DISCUSSION ON AN INDICATOR APPROACH

4. This paper deals with the issues (a)-(d) regarding an indicator approach in paragraph 2 as one set together in two frameworks because those issues are related to each other. One framework is an entity level approach that the staff recommends and the other framework is an transaction level approach that the staff considers as an alternative. Further details are in section 2 of the paper. To summarise these two frameworks:

Item / Framework	Framework 1	Framework 2
Assessing influence	Entity level	Transaction level
Application level	Entity level	Transaction level
Definition of 'influence'	Significant influence between entities as defined in IAS 24.9, which is the power to participate in the financial and operating policy decisions of an entity	An effect on the terms of a transaction , or on whether a transaction occurs
What precludes the exemption: actual influence or potential influence?	Actual influence	Actual influence
Subject of disclosure	All transactions with an entity if influence as defined in Framework 1 exists by or over that entity	Only transactions with actual influence as defined in Framework 2
Specific indicator approach	Three alternatives A, B and C (summarised in paragraph 5 below)	Three alternatives B, C and D (summarised in paragraph 6 below)

5. Framework 1 as introduced in paragraph 4 has three alternatives regarding a specific indicator approach. The staff recommends alternative A. Further details are in section 2 of the paper. To summarise these three alternatives:

Item / Alternative	Alternative A	Alternative B	Alternative C
Indicators in ED.17B	Indicators, which trigger assessment	Primary indicators, which indicate influence	Criteria, which confirm influence
Indicators in ED.17C	Indicators, which trigger assessment	Supporting indicators, which trigger assessment	Supporting indicators, which trigger assessment
Weight on indicators in ED.17B-17C	Same weight on all indicators in ED.17B and 17C	Priority to indicators in ED.17B	Priority to indicators in ED.17B
Relocation of indicators in ED.17B-17C	In one paragraph by merging ED.17B and 17C	In two paragraphs as set out in the ED	In two paragraphs as set out in the ED
Rewording of ED.17A(b)	‘there is no <u>evidence</u> …’	The same as the wording in the ED	‘there is no <u>evidence</u> …’
Analogy in other IFRS	IAS 36 *Impairment of Assets*: approach to impairment test	IAS 21 *The Effects of Changes in Foreign Exchange Rates*: approach used to determine the functional currency	N/A
Strengths	✓ can resolve most issues raised by respondents on indicators ✓ does not require separation of indicators by weight ✓ keeps general meaning of indicator, a factor triggering assessment	✓ does not require further assessment once a primary indicator is identified	✓ does not require further assessment once a criterion exists
Weaknesses	✓ always requires further assessment if an indicator is identified	✓ fails to achieve the matters listed in strengths of alternative A ✓ requires further assessment if a supporting indicator is identified	✓ fails to achieve the first and second matter listed in strengths of alternative A ✓ requires further assessment with a supporting indicator

6. Three alternatives for Framework 2 comprise alternatives B and C in framework 1 and another new alternative D. Alternative D is the same as alternative C in framework 1 except for replacing the indicators in paragraph 17B of the ED with the following:

(a) transact business on non-arm's length terms; or

(b) enter into an unnecessary transaction.

SECTION 2: DETAILED DISCUSSION OF ISSUES

7. This section specifically discusses the issues (a)-(d) regarding an indicator approach in paragraph 2 as one set, and then discusses the other main issues one by one. The staff's recommendation and question for the Board follows each discussion.

AN INDICATOR APPROACH

Summary of comments on the indicator approach proposed in the ED

8. Most respondents supported the indicator approach proposed in the ED. However, they suggested clarifying how and when to apply the indicators. Specific suggestions include:
   (a) clarifying whether the influence referred to in paragraph 17A(b) of the ED refers to the exercise of influence in the overall relationship between state-controlled entities or over the specific transactions concerned;
   (b) when actual influence exists in some transactions undertaken by an entity, clarifying whether the exemption is precluded only for those specific transactions or for all transactions with the state-controlled entity;
   (c) clarifying or defining the term 'influence' referred to in paragraph 17A(b) of the ED;
   (d) clarifying whether it is the actual influence or potential influence that precludes the use of the exemption; and
   (e) clarifying whether the indicators proposed in paragraph 17B of the ED are rebuttable presumptions or definitive rules.

Two frameworks

9. The staff thinks that the issues summarised in paragraph 8 are related to each other. That is, the conclusion on one issue affects a conclusion on another issue. Therefore, this part deals with those issues in two frameworks, one of which is an entity level approach and the other of which is a transaction level approach.

Principle of IAS 24 vs. Principle of the exemption in the ED

10. The staff understands that particularly considering the objective in paragraph 1 of IAS 24[1], the principle of IAS 24 is to require disclosure of all related party transactions, irrespective of whether there is actual influence or potential influence between a reporting entity and a related party. Also, the definition of a related party based on significant influence, joint control or control between two parties supports this principle.

11. The staff considers two possible views for a principle underlying the exemption proposed in the ED, which is an exception to the principle of IAS 24:
    (a) One is that a state-controlled entity is required to disclose all transactions with another entity controlled by that state only when actual influence exists between them.
    (b) The other view is that a state-controlled entity is required to disclose only those specific transactions with another state-controlled entity when actual influence exists in some transactions. For example, only some transactions between those entities may have been actually influenced.

12. In this paper, the former is called as an entity level approach and underlies framework 1. Meanwhile, the latter is called as a transaction level approach and underlies framework 2. An indicator approach supports both principles.

Framework 1: Entity level approach

13. Under framework 1, a state-controlled entity shall assess on an entity level whether actual influence exists. This framework takes the view that actual influence between entities precludes the exemption for all transactions between those entities and reinstates the principle of IAS 24. Furthermore, a state-controlled entity shall apply or not apply the exemption to all transactions with other state-controlled entities. This is logically consistent with the approach to assess influence.

[1] IAS 24.1 states that its objective 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 such parties.

14. In this framework, if actual influence occurred in some transactions, for example, entering into some transactions at non-market rates, but this was not significant influence on the entity, no disclosure would be made of any transactions (even those transactions affected by actual influence).

15. This framework regards the term 'influence' referred to in paragraph 17A(b) of the ED as being significant influence as defined in paragraph 9 of IAS 24[2]. In addition, this framework takes the view that it is actual influence (not just potential influence) that precludes the use of the exemption, as understood in paragraph 11. The wording 'influenced, or was influenced' in paragraph 17A(b) of the ED also supports this view.

16. The exemption proposed in the ED is supported by an indicator approach. That is, an entity uses the indicator approach to determine whether to apply the exemption. This framework considers three alternatives for a specific indicator approach as discussed below, responding to requests for clarification from many respondents.

Alternative A: all indicators equal

17. This alternative views all indicators as factors which trigger further assessment about whether influence exists, and gives the same weight to all indicators. This approach would treat the indicators proposed in paragraphs 17B and 17C of the ED equally as rebuttable presumptions not definitive rules. There is no reason to separate into paragraphs 17B and 17C to provide indicators with same function. It would be necessary to amend the ED to be consistent with this approach. For example, rewording 'indicators' in paragraph 17A(b) of the ED to 'evidence' and merging paragraphs 17B and 17C of the ED. This alternative is similar to the approach to impairment test set out in IAS 36 *Impairment of Assets*.

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[2] *Significant influence* is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies. Significant influence may be gained by share ownership, statute or agreement.

18. This alternative has the following strengths and weaknesses:

Strengths

(a) It could resolve most of the issues raised by respondents on indicators because if an indicator is identified, then an entity shall assess whether actual influence exists between the entity and a related party. The issues raised by respondents include difficulties in identifying all other state-controlled entities and transactions with them, questions about the appropriateness of an indicator approach, guidance on how to apply individual indicators and clarification of the statement required by paragraph 17E of the ED when the exemption applies.

(b) It does not require an entity to separate indicators by weight into two groups, such as primary indicators and supporting indicators, or criteria or supporting indicators.

(c) It keeps a general meaning of the term 'indicator'. An indicator is a factor which triggers further assessment rather than a definitive rule.

Weaknesses

(a) This alternative always requires an entity to assess further whether actual influence exists if an indicator is identified. While this indicates that this alternative would cost more to implement, it disallows the exemption in appropriate circumstances – i.e. when actual influence exists.

Alternative B: primary and supporting indicators

19. This alternative views some indicators as factors which directly indicate actual influence, and other indicators as factors which trigger further assessment about whether influence exists. Therefore, this alternative gives priority to some indicators. This approach would treat the indicators proposed in paragraph 17B of the ED as primary indicators–i.e. definitive rules, and the indicators in paragraph 17C of the ED as supporting indicators–i.e. rebuttable presumptions. It would be necessary to amend the ED to be consistent with this approach. This alternative is similar to the approach used to determine the functional currency in IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

20. This alternative has the following strengths and weaknesses:

Strengths

(a) It does not require an entity to assess further whether actual influence exists once a primary indicator is identified. That is, it costs less to implement.

Weaknesses

(a) It fails to achieve the matters listed in the strengths of alternative A.
(b) It requires an entity to assess further whether actual influence exists if a supporting indicator is identified.

Alternative C: criteria or supporting indicators

21. This alternative is the same as alternative B except that:
(a) it uses the wording 'criteria' for the indicators proposed in paragraph 17B of the ED instead of the wording 'primary indicators';
(b) it is necessary to amend the wording 'indicators' in paragraph 17A(b) of the ED to 'evidence'; and
(c) it does not refer to any IFRS and only refines the ED conceptually.

22. This alternative also has the same strengths and weaknesses as alternative B except that unlike alternative B, this alternative keeps the general meaning of the term 'indicator' as set out in paragraph 18(c).

Framework 2: Transaction level approach

23. Framework 2 requires a state-controlled entity to assess on a transaction level whether actual influence exists. It takes the view that actual influence on transactions precludes the exemption only for those specific transactions and does not reinstate the principle of IAS 24 for other transactions with the same entity. Thus, a state-controlled entity shall not take advantage of the exemption in respect of specific transactions when an influence exists. For example, entering into some transactions at non-market rates. This is logically consistent with the approach to assess influence.

24. This framework defines the term ‘influence’ referred to in paragraph 17A(b) of the ED by reference to the effect on transaction terms, or on whether to enter into a transaction. This would be consistent with the view that actual influence on transactions precludes the exemption for those specific transactions but does not reinstate the principle of IAS 24 for other transactions with the same party. In addition, this framework takes the view that it is actual influence (not just potential influence) that precludes the exemption in the same way as framework 1.

25. This framework also considers three alternatives for a specific indicator approach. They comprise alternatives B and C in framework 1 and another new alternative (referred to as alternative D).

26. Alternative A in framework 1 considers paragraph 17B(a) of the ED ‘transact business at non-market rates (otherwise than by way of regulation)’ as an indicator. Alternatives B and C of framework 1 do not include the factor ‘enter into an unnecessary transaction’ in primary indicators or criteria. The staff thinks that these points are a weakness under framework 2 because considering the definition of ‘influence’ in framework 2 (as set out in paragraph 24), factors such as ‘transact business on non-arm’s length terms’ and ‘enter into an unnecessary transaction’ are more appropriate to view as primary indicators or criteria.

27. Therefore, alternative D was devised to overcome this weakness. It is the same as alternative C in framework 1 except for replacing the indicators in paragraph 17B of the ED with the following:

   (a) transact business on non-arm’s length terms; or

   (b) enter into an unnecessary transaction.

Conclusion and the staff's recommendation

28. The staff concludes that framework 1 (entity level approach) and alternative A (all indicators equal) of framework 1 are more appropriate approaches than any others to achieve the objective of the proposed exemption and the indicator approach, for the following three reasons:

(a) The proposed exemption is an exception to the principle of IAS 24 but if actual influence exists, then that reinstates the principle of IAS 24. Therefore, the exemption should apply or not apply on an entity level to be consistent with the principle of IAS 24.

(b) Alternative A of framework 1 shows a true indicator approach, which is that if an indicator is identified, then an entity should assess further whether influence exists. Additionally, this alternative has more strengths and could resolve most of the issues raised on the indicator approach in the ED, as shown in paragraph 18.

(c) Finally, the ED suggests in places that it intends framework 1 and alternative A of framework 1. These suggestions may be found in the wording 'the reporting entity influenced, or was influenced by, that entity' in paragraph 17A(b), other wordings in paragraphs 17C-17E, and nature of the indicators proposed in paragraphs 17B-17D.

29. Therefore, the staff recommends that the Board should clarify an indicator approach by adopting framework 1 and alternative A of framework 1. **Does the Board agree with the staff's recommendation?**

OTHER ISSUES

Extending the exemption to entities that are jointly-controlled by a state

30. Many respondents questioned why the proposed exemption in paragraph 17A of the ED does not include entities that are jointly controlled by a state. They suggest extending the proposed exemption to those entities, or explaining in the Basis for Conclusions why the proposed exemption does not apply to them.

31. The staff notes that state-jointly controlled entities would face the same situations as state-controlled or significantly influenced entities and there actually exist many entities that are jointly controlled by a state, for example, motor companies in China. Therefore, the staff recommends that the Board extend the proposed exemption to entities that are jointly controlled by a state. **Does the Board agree with the staff's recommendation?**

Including 'influence exercised directly by a common state'

32. Many respondents suggest amending paragraph 17A(b) of the ED to include 'influence exercised directly 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;
    (b) aligns paragraph 17A(b) of the ED with paragraph 17C of the ED, which refers specifically to 'direction or compulsion by a state'; and
    (c) ensures that the exemption is consistent with paragraph BC16 (influence from the state or the related party) of the ED.

33. The staff believes that the reasons as outlined in paragraph 32 are all reasonable enough to accept the suggestion above, and recommends that the Board should include 'influence exercised directly by a common state' in paragraph 17A(b) of the ED. **Does the Board agree with the staff's recommendation?**

APPENDIX A: EXTRACTS FROM COMMENT LETTER SUMMARY IN THE SEPTEMBER BOARD PAPER

Question 1 – State-controlled entities

34. The ED proposes an exemption from disclosure requirements in paragraph 17 of IAS 24 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.

    Paragraphs 17B-17E go on to explain indicators that the influence referred to in paragraph 17A(b) exists.

Q1(a)	*Do you agree with the proposal to provide, in the circumstances described in this exposure draft, an exemption for entities controlled or significantly influenced by the state?* *If not, why? What would you propose instead and why?*

Entities that are jointly controlled by a state

35. Many respondents questioned why the proposed exemption in paragraph 17A of the ED does not include entities that are jointly controlled by a state. They suggest extending the proposed exemption to those entities, or explaining in the Basis for Conclusions why the proposed exemption does not apply to them.

Other comments

36. One respondent wonders whether paragraph 13 of IAS 24 is consistent with the proposed exemption in the ED. Paragraph 12 talks clearly about parent-subsidiary relationships, but paragraph 13 talks more vaguely about related party relationships where ‘control exists’. Therefore, paragraph 13 could be read as applying to relationships that would fall within the exemption. This

respondent believes that if a relationship falls within paragraph 17A, it should not be required to provide the paragraph 12 and 13 disclosures.

Q1(b) Do you agree: *(i) that an indicator approach is an appropriate method for identifying when the exemption should be provided for entities controlled or significantly influenced by the state; and* *If not, why? What would you propose instead and why?*

The appropriateness of an indicator approach

37. Many respondents (including both respondents who agree and disagree with the indicator approach) question whether an indicator approach as proposed in the ED would significantly reduce the burden of compliance. The reasons are:
    (a) the reporting entity has to identify all other entities potentially controlled or significantly influenced by the state anyway; and
    (b) after having gone through the identification process, the reporting entity has to assess whether actual influence was exercised.

38. Some respondents suggest applying the exemption as long as no indicator of possible influence exists. That is, if an indicator is identified, then the reporting entity should demonstrate that the transactions were not affected by the relationship. One respondent considers that this is a true indicator approach.

39. Other respondents propose the following alternatives to the indicator approach:
    (a) exclude state-controlled entities from the definition of a related party unconditionally;
    (b) exclude state-controlled entities from the definition of a related party if transactions between them are fully conformed to the market mechanism; and
    (c) provide an exemption for state-controlled entities without any preconditions.

40. One respondent is also not in favour of compelling state-controlled entities to adopt an indicator approach while other entities i.e. entities listed in paragraph

11 of IAS 24 do not have the same obligation. Paragraph 11 lists various types of entity that are not necessarily related parties. For example, two entities simply because they have a director or other member of key management personnel in common, government department and agencies simply by virtue of their normal dealings with an entity.

The term 'influence'

41. Several respondents suggest clarifying or defining the term 'influence' in paragraph 17A(b) of the ED in connection with the objective in paragraph 1 of IAS 24. Specific comments include:

    (a) 'influence' appears to be a lower level of influence than 'significant influence';

    (b) confusion about whether 'influence' has the same meaning as 'significant influence' in IAS 28. For example:

    - under IAS 28, the focus is on the ability to exercise (significant) influence. It does not matter whether (significant) influence actually is exercised. The Exposure Draft is ambiguous in this respect (for instance, ED IAS 24.17A-D, BC18); and
    - according to ED IAS 24.17D there might be factors or circumstances other than those mentioned in ED IAS 24.17B-C that suggest the reporting entity could influence, or is influenced by, a related party. It is not clear whether the reporting entity would have to draw back on the indicators mentioned in IAS 28.7 not already included in ED IAS 24.17B-C; and

    (c) if a transaction was made under arm's length conditions, but it would not have been made without pressure of the state, shall it be considered as an influenced transaction or as a non-influenced transaction?

42. Several respondents point out that the wording in paragraph 17A(b) (influenced, or was influenced) suggests actual exercise, whereas the wording in paragraphs 17D ('could influence') and BC16 ('might influence') suggests potential to influence. Most suggest aligning these paragraphs to state that it is the actual exercise of influence rather than the potential exercise of influence that would preclude the use of the exemption. Others simply request clarification.

43. Many respondents suggest amending paragraph 17A(b) to include the influence exercised directly 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;
(b) this could align paragraph 17A(b) with paragraph 17C, which refers specifically to 'direction or compulsion by a state'; and
(c) this would make the exemption consistent with paragraph BC16 (influence from the state or the related party) of the ED.

Applying an indicator approach: transaction level vs. entity level

44. Many respondents suggest clarifying whether the exemption does not apply only to those specific transactions (transaction level) or to all transactions with an entity (entity level), where actual influence exists in some transactions with that entity.

45. Some respondents favour entity level although only transactions at non-market rates are relevant information for the users of the financial statements.

46. Others favour transaction level, arguing that only transactions at non-market rates are relevant information for the users of the financial statements. Otherwise, they believe that the influenced transactions would be hidden among a plethora of other transactions and the outcome would be counter-productive to the objective of the proposals, and reasons in BC12 (cost/benefit principle, extensive disclosures of unaffected transactions, incompleteness of disclosures, useful information might be obscured by excessive disclosures of unaffected transactions) of the ED.

Q1(b) Do you agree:
(ii) that the proposed indicators are appropriate?
If not, why? What would you propose instead and why?

General comments on the indicators proposed in paragraphs 17B-17D of the ED

Indicators or rules

47. Many respondents note that paragraphs 17C and 17D suggest that judgement should be applied by a reporting entity in determining whether the influence exists, whereas the indicators proposed in paragraph 17B seem to be definitive

rules. Also, a large number of respondents note that it is not clear whether the indicators suggested in paragraph 17B of the ED are rebuttable presumptions. They suggest that the Board view these indicators as rebuttable presumptions not definitive rules. Specific suggestions include:

(a) paragraphs 17B and 17C, or paragraphs 17B, 17C and 17D should be merged because all indicators in those paragraphs are only examples that could indicate influence;

(b) the wording in paragraph 17B should be changed to 'Indicators … may include …', 'Indicators … may (or could) exist …' or 'Indicators …exists may (or could) be when …' so that it will be clear the indicators trigger only an assessment of whether the influence exists;

(c) if the Board intends that indicators are to help determine whether influence has been exercised, the Board should apply the approach used in paragraph 12 of IAS 36 *Impairment of Assets*, which states:

'In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications.'; and

(d) one respondent proposes the following amendments to paragraphs 17C and 17D.

17C The influence referred to in 17A(b) may also be evidenced in other ways. For example, (hereafter, the same as in the ED)

17D The indicators described in paragraph 17B and potential indicators described in 17C are not exhaustive. (abbreviation, the same as in the ED) Judgment will be required to assess whether the influence referred to in paragraph 17A(b) exists.

Underlying principle for indicators

48. Several respondents do not believe that the indicators in paragraph 17B represent a clear underlying principle. Therefore, they can not be presented as being indicators of influence in absolutely all cases. As a result, they ask the Board to clarify the underlying principle. Two respondents think that the principle underpinning the indicators in paragraphs 17B and 17C might, despite paragraph 17A(b), actually be about the extent to which the two entities operate independently of each other.

Difficulties in applying indicators

49. Many respondents think that it is very difficult to apply the indicators in paragraph 17B, particularly 17B(b) and (c). For example, under what circumstances would shared resources be an indicator triggering a related party relationship for which disclosures should be provided? And why would/ could economically significant transactions between two parties result in one party influencing the other? These respondents ask the Board to clarify and provide additional information about how to apply the indicators in practice.

50. Two respondents argue that without guidance, there will be inconsistencies in the reporting of state-controlled entities as one entity's evaluation of existence of influence may differ from the other entity with which it has transactions.

51. Another respondent proposes moving the indicators to "Application Guidance" like that in IAS 39. Furthermore, this respondent thinks that the proposed indicators are not appropriate especially in a state controlled environment, especially, proposed indicators 17B(b) and (c) because these indicators will not bring the intended relief for most state-owned entities.

Specific comments on the indicators proposed in paragraphs 17B-17D of the ED

Transact business at non-market rates (otherwise than by way of regulation) – paragraph 17B(a)

52. Several respondents have a practical concern about paragraph 17B(a) or believe the indicator in paragraph 17B(a) should be deleted for the following reasons:
   (a) a reporting entity would have to identify all the related parties that are state-controlled or influenced and to study all transactions with them;
   (b) in many situations, it will not be possible to compare a given transaction with a similar transaction at normal prices;
   (c) this requirement would not only be burdensome or even impossible for preparers, but it would also place a heavy burden on the auditors; and
   (d) it is consistent with paragraph 21 of IAS 24.

53. Several respondents indicated that it is not clear whether there is a difference between ‘regulation’ (paragraph 17B(a)) and ‘direction or compulsion by state’ (paragraph 17C). More specifically:

(a) Two respondents indicated that paragraph 17B(a) may be viewed as inconsistent with paragraph 17C because regulation is one of the instruments for a state to set rules.

(b) Two respondents suggest that the Board should clarify that the regulation in paragraph 17B(a) refers to the regulation that is applicable to all types of entities regardless of their ownership.

(c) Two respondents propose that the reference to ‘regulation’ be deleted because regulated non-market rates might indicate that the state has influenced the transaction.

54. A few respondents recommend amending ‘non-market rates’ to read ‘abnormal commercial payment and conditions (or terms)’ because the term ‘rate’ is too restrictive and likely to lead to translation difficulties and there is not always a market.

55. Many transactions in the not-for-profit and public sectors could be considered to be at non-market rates because pricing is often based on cost recovery rather than the generation of a commercial return. In addition, there may be no market. Therefore, two respondents suggest amending paragraph 17B(a) to cover all sectors as follows:

17B(a) ‘transact business at ~~non-market~~ <u>a</u> rate~~s~~ <u>which is more or less favourable than those which it is reasonable to expect would have been adopted if the transaction had been carried out at arm’s length in the same circumstances</u> ~~(otherwise than by way of regulation)~~’.

Share resources – paragraph 17B(b)

56. Many respondents ask the Board to clarify the meaning of ‘sharing resources’ and provide examples of circumstances when shared resources indicate influence. Specific suggestions include:

(a) replacing 17B(b) with ‘undertake transactions which are not of economic benefit to one or other party;

(b) amending paragraph 17B(b) to ‘sharing of resources other than public goods’ because a state has the responsibility to provide public goods to the public; and

(c) deleting the indicator.

Engage in economically significant transactions with each other – paragraph 17B(c)

57. Many respondents ask the Board to explain why ‘economically significant transactions’ indicates influence and to clarify the meaning of this indicator. Specific questions and comments include:

(a) ‘economically significant transactions’ should not automatically result in the entities being treated as related parties because entities can engage in economically significant transactions with each other in the ordinary course of business under normal clauses;

(b) move this indicator to paragraph 17C as a factor for assessing whether the influence exists;

(c) this indicator contradicts paragraph 11(d) of the current IAS 24, which states that a customer, supplier and others. with whom an entity transacts a significant volume of business, merely by virtue of the resulting economic dependence are not necessarily related parties of that entity;

(d) is there a difference between ‘economically significant’ and ‘material’ as used in IAS 1? One respondent believes that the Board should clarify that materiality should be determined in the context of the reporting entity; and

(e) a transaction may be economically significant for one of the entities and it may not be so for the other entity. The respondent also suggests that in that case, it should be clear whether both entities have to disclose or only the entity for whom it is economically significant has to disclose.

Existence of direction or compulsion by a state or the existence of common board members – paragraph 17C

58. Most comments on this indicator relate to clarity of wording. Specific comments and suggestions include:

(a) the existence of common board members is the logical consequence of the control exercised by a state and thus is not necessarily an indicator that a transaction may have been influenced by the state;

(b) this indicator would be contrary to the explanation in paragraph 11(a) of IAS 24. Therefore, the respondent suggests that it should be clear that this indicator is relevant only if the number of the common board members is significant enough to exert influence;

(c) amend 'direction or compulsion' to describe influence and joint control in addition to control because those words imply only control;

(d) this indicator can remove the use of the exemption where an entity or a department is formed to approve some of the decisions made by the Board of directors of the state owned entities;

(e) clarify that the reference to "the existence of direction or compulsion by a state" is not intended to bring state-regulated entities within the scope of the paragraph;

(f) clarify that the 'common board members' in paragraph 17C include persons as well as entities; and

(g) that the definition of 'state' will vary according to each jurisdiction and that this will in turn determine whether board members are 'common' or not.

Statement proposed in paragraph 17E of the ED

59. Two respondents asked for more guidance on the level of detail required to comply with paragraph 17E – i.e. a simple generic statement or more detailed statement.

60. A few respondents express the following concerns about the requirement in paragraph 17E:

(a) the requirement implies that an entity is able to identify all the entities controlled or significantly influenced by a common state which are related parties;

(b) in certain jurisdictions where compliance with accounting standards is a legal requirement, it is not feasible for such a statement to be made when the entity might not even be aware if it had comprehensively identified all related state-controlled entities;

(c) this proposal, if adopted, would impose an impractical burden on auditors of establishing completeness, and also notes that IAS 24.21 does not require disclosures that related party transactions were made at market-rates; and

(d) provide guidance on how extensively a reporting entity needs to search for all related parties about which it may not otherwise be aware.

APPENDIX B: EXTRACTS OF PARAGRAPHS 17A-17E REGARDING AN INDICATOR APPROACH FROM THE 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.

17B Indicators that the influence referred to in paragraph 17A(b) exists are when the related parties:

(a) transact business at non-market rates (otherwise than by way of regulation);

(b) share resources; or

(c) engage in economically significant transactions with each other.

17C The existence of direction or compulsion by a state for related parties to act in a particular way could indicate that the influence referred to in paragraph 17A(b) exists. Furthermore, the presence of common members on the boards of the reporting entity and the other entity could lead to the relationship having an effect on the profit or loss and financial position. Entities shall consider whether the existence of direction or compulsion by a state or the existence of common board members indicates that the influence referred to in paragraph 17A(b) exists.

17D The indicators of influence described in paragraphs 17B and 17C are not exhaustive. A reporting entity might identify other factors or circumstances that suggest the reporting entity could influence, or be influenced by, the related party that would require the reporting entity to comply with the requirements in paragraph 17.

17E When there are no indicators that the reporting entity influenced, or was influenced by, any other entity controlled or significantly influenced by the state, as provided by paragraph 17A, the reporting entity shall disclose a statement to that effect. When a reporting entity does not qualify for the exemption in paragraph 17A it shall comply with all the disclosure requirements of this Standard for that related party.