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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

Board Meeting:	**18 September 2007, London**
Project:	**Amendments to IAS 24 Related Party Disclosures**
Subject:	**Comment Letter Summary and Preliminary Planning (Agenda paper 11)**

INTRODUCTION

1. The purpose of this paper is:

   (a) to summarise the comment letters received on the exposure draft [ED] of proposed Amendments to IAS 24 Related Party Disclosures – *State-controlled Entities and the Definition of a Related Party*. This summary, which is in the Appendix: Comment Letter Summary by Question to this paper, introduces the Board to the issues raised in the comment letter prior to future redeliberations. Therefore, this paper does not include staff's analyses and recommendations; and

   (b) to present the staff's preliminary project plan for the redeliberations. The staff will ask the Board to consider and approve this plan.

2. The ED was issued on 22 February 2007 and the comment period ended on 25 May 2007. We received 72 comment letters from respondents worldwide. Those respondents can be categorised into the following groups by type and geographic region.

Type / Region	Africa	Asia-Pacific	Europe	North America	Internatio-nal	Total
Accounting firm	-	-	1	1	5	7 (10%)
Preparer (bank/insurer)	1	3	3	-	-	7 (10%)
Preparer (the others)	4	8	7	-	-	19 (26%)
Professional body	-	9	9	-	1	19 (26%)
Regulator	-	2	-	-	1	3 (4%)
Standard-setter	1	7	7	1	-	16 (23%)
User	-	-	1	-	-	1 (1%)
Total	6 (8%)	29 (40%)	28 (39%)	2 (3%)	7 (10%)	72 (100%)

3. This paper divides into three sections:

(a) Section 1: A reminder of the project objectives and the main changes proposed in the ED

(b) Section 2: Overview of comments received

(c) Section 3: Preliminary project plan

Appendix: Comment letter summary by question

SECTION 1: A REMINDER OF THE PROJECT OBJECTIVES AND THE MAIN CHANGES PROPOSED IN THE ED

4. This exposure draft contains proposals to amend IAS 24 Related Party Disclosures. The amendments would exempt entities that are controlled or significantly influenced by a state from the disclosure requirements in paragraph 17 of IAS 24 in relation to transactions with other entities controlled or significantly influenced by that state. The exemption does not apply when influence exists in such relationships.

5. The exposure draft also proposes amending the definition of a related party, for four reasons. First, the Board considered the relationship between an associate and a subsidiary of an entity (‘the investor’). IAS 24 requires disclosure of transactions between an associate and a subsidiary of the investor in the individual or separate financial statements of the associate, but not in the individual or separate financial statements of the subsidiary. The Board proposes to change the definition of a related party to ensure that an associate and a subsidiary of an entity are related parties for the purposes of their individual, or separate, financial statements. Similarly, the Board proposes that when the investor is a person, an entity that is significantly influenced by that person and another entity that is controlled by that person are related parties.

6. Secondly, the Board considered the relationship between associates of the investor. IAS 24 does not define associates as related to each other if the investor is an entity. However, an entity that is significantly influenced by a person, and another entity that is significantly influenced by a close member of the family of that person, are related parties. The Board proposes to amend the definition of a related party to exclude such entities, thereby ensuring consistent treatment of all associates.

7. Thirdly, IAS 24 treats some investees* of the key management personnel of an entity preparing its financial statements (in this exposure draft referred to as the ‘reporting entity’) as related to the reporting entity. However, the definition in IAS 24 does not include the reciprocal of this—ie in the financial statements of the investee, the reporting entity is not a related party. The Board

proposes to amend the definition to ensure that in both sets of financial statements the entities are defined as related parties.

* *Investees include entities controlled, jointly controlled or significantly influenced by an investor or in which the investor holds significant voting power.*

8. Lastly, in response to comments that the definition of a related party is difficult to understand and interpret, the Board proposes to restructure it. The restructuring is not intended to change the meaning of a related party except for the changes described in paragraphs 5–7 above.

SECTION 2: OVERVIEW OF COMMENTS RECEIVED

9. This section summarises the main comments by respondents on the ED of proposed amendments to IAS 24 and then summarises some suggestions to Q1 (State-controlled entities) by the respondents that are state-controlled entities. The appendix to this paper provides further detail.

State-controlled entities

10. Most respondents support the Board's proposal to provide relief from the disclosure requirements in paragraph 17 of IAS 24 for entities that are related simply because of control or significant influence by a common state. Main comments related to this proposal are:
    (a) extending the exemption to other type of entities (i.e. non-state-controlled entities) (see appendix paragraph 23); and
    (b) providing the exemption additionally to entities that are jointly controlled by a state (see appendix paragraph 26).

11. Most respondents also support the indicator approach proposed in the ED, with some suggestions for clarifying how and when to apply the indicators. Main comments related to this proposal are:
    (a) the appropriateness of an indicator approach (see appendix paragraphs 31-34) ; and
    (b) amending the paragraph 17A(b) to include the influence exercised directly by a common state (see appendix paragraph 38);
    (c) clarifying whether the indicators suggested in paragraph 17B of the ED are rebuttable presumptions (see appendix paragraph 43).

Definition of a related party

12. Most respondents agreed with the Board's proposal to amend the definition of a related party to include, for a subsidiary's individual or separate financial statements, an associate of the subsidiary's controlling investor as a related party of the subsidiary. However, several raised practical and cost-benefit concerns (see appendix paragraph 58).

13. Most respondents agreed with the Board's proposal to exclude from the definition of a related party an entity that is significantly influenced by a person and an entity that is significantly influenced by a close member of the family of that person, to align with the treatment for associates of an entity. However, several respondents expressed some concerns about the absence of a clear principle and potential anomalies with other aspects of the standard (see appendix paragraph 61).

14. Most respondents agreed with the Board's proposal to expand the definition to ensure that when the entity that a person controls, jointly controls or significantly influences, or in which the person has significant voting power, is the reporting entity and that person is a member of the key management personnel of another entity, that other entity is defined as related to the reporting entity. However, some respondents are concerned about situations when neither entity is controlled by a member of key management personnel (see appendix paragraph 63).

15. All the respondents agreed with the proposal to clarify the definition of a related party. All the respondents except for two (see appendix paragraph 67) agreed that the wording proposed captures the same set of related parties as the current IAS 24. Most respondents agreed that the proposed wording improves the definition. However, a large number of respondents believe that the revised definition is still complex and will prove difficult to understand and apply. Main comments are:
    (a) defining the term 'significant voting power' (see appendix paragraphs 71-73);
    (b) reinstating the word 'may' in the proposed definition of 'close members of the family of a person' (see appendix paragraphs 74-75); and
    (c) removing inconsistency related to key management personnel in paragraph 9(b)(vii) (see appendix paragraph 80).

Definition of a related party transaction

16. Most respondents agreed with the proposal to clarify the definition of related party transaction. However, many are concerned by the new example of a

related party transaction proposed in paragraph 20(j) of the ED (see appendix paragraph 85).

The views and suggestions relating to Q1 (State-controlled entities) made by the respondents that are state-controlled entities

17. We received 11 comment letters (9 from China, 2 from South Africa) from respondents that are state-controlled entities. All the respondents generally support the proposed exemption and indicator approach. However, some respondents raise the following suggestions:

    (a) exclude state-controlled entities from the definition of a related party unconditionally or if transactions are fully conformed to the market mechanism;

    (b) provide the exemption for state-controlled entities without any preconditions; and

    (c) view the indicators suggested in the paragraph 17B of the ED as rebuttable presumptions not rules.

SECTION 3: PRELIMINARY PROJECT PLAN

18. A provisional project timetable is outlined below. In compiling this timetable the staff gave priority to decisions involving the project objective and scope, then the main issues. This decision was made based on mainly the nature of the proposed amendments and the requests for urgency from constituents.

19. The timetable identifies the Board meeting at which the staff expects to introduce each of the identified topics based on its current assessment. If considered necessary, the staff will request Board time for additional follow-up sessions which may also affect the overall timetable.

Meeting date	Issue
September 2007	**Redeliberation overview** • Discuss the comment letter summary • Affirm the project plan
October 2007	**Project objective and scope** • Extending the proposed exemption • Fundamentally reconsidering the definition of a related party **Redeliberation: Issues raised in response to Question 1** • Entities that are jointly controlled by a state • The appropriateness of an indicator approach • The term ‘influence’ • Applying an indicator approach: transaction level vs. entity level • Indicators proposed in paragraphs 17B-17E of the ED • Statement proposed in paragraph 17E of the ED
November 2007	**Redeliberation: Issues raised in response to Question 1** • Two entities that are both significantly influenced by a common state **Redeliberation: Issues raised in response to Question 2** • Issues related to three definitions • Removal of the extra inconsistencies left in the proposed definition **Redeliberation: Issues raised in response to Question 3** • Objective and scope of the paragraph 20(j) of the ED **Other issues** • Effective date & transition provision • Consequential amendments to other pronouncements • Issues related to the proposed wording and clarifications • The other comments

APPENDIX: COMMENT LETTER SUMMARY BY QUESTION

20. This section summarises respondents' comments to each question in the ED.

Question 1 – State-controlled entities

21. The ED proposes an exemption to 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?*

22. All the respondents to Question 1(a) generally support the Board's intention to provide relief from the disclosure requirements in paragraph 17 of IAS 24 for entities that are related simply because of control or significant influence by a common state. However, about half of these respondents raise concerns or suggestions regarding the following issues:

(a) extending the exemption;

(b) entities that are jointly controlled by a state;

(c) two entities that are both significantly influenced by a common state; or

other comments.

Extending the exemption

Extending the exemption to other types of entities

23. Many respondents ask the Board to consider extending the proposed exemption to other types of entities for the following reasons:
    - (a) results in a more robust and principle-based standard with a single, universally applied principle as opposed to a principle and an exception to that principle;
    - (b) reduces clutter in the notes to financial statements;
    - (c) aligns the principle underlying paragraph 17 with the stated objective in paragraph 1 of IAS 24;
    - (d) overcomes a major weakness in the ED, which is that the exemption as set out in the ED would grant a competitive advantage to state-controlled or influenced entities in comparison to other entities; and
    - (e) all of the considerations included in BC11 and BC12 of the ED are equally valid to other industries.

Extending the exemption to transactions between state-controlled entities and a state

24. A few respondents ask the IASB to consider extending the proposed exemption to transactions between state-controlled entities and a state or state organisations. One of them suggests inserting the following additional exemption after paragraph 17A:

    A reporting entity is exempt from the disclosure requirements of paragraph 17 if:

    - *the entity is a related party only because the reporting entity is controlled or significantly influenced by the state and the transaction is with that state; and*
    - *there are no indicators that the state influenced the reporting entity in the undertaking of transactions between the reporting entity and the state.*

Extending the exemption to transactions between a reporting entity (including state-controlled entities) and a person

25. A few respondents suggest extending the proposed exemption to transactions between a reporting entity including state-controlled entities and a person who is a related party, such as key management personnel for the following reasons:

(a) The word ‘entity’ in paragraph 17A suggests that the exemption will not apply when an individual that is a related party, such as key management personnel, transacts with a state-controlled entity at arms’ length.

(b) In some instances, key management personnel do not know that the counterparty is a member of the group (including a state-controlled entity). As such, the related party information required of key management personnel and their close family members can be incomplete, unuseful and irrelevant.

(c) Transactions between the reporting entity and key management personnel or their close family members are domestic in nature and unrelated to the person’s position with the entity.

Entities that are jointly controlled by a state

26. 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 why the proposed exemption does not apply to entities that are jointly controlled by a state in the Basis for Conclusions.

Two entities that are both significantly influenced by a common state

27. Many respondents noted that paragraph 17A(a) of the ED implies that two entities that are both significantly influenced by a common state are related parties of each other.

28. These respondents argue that disclosure should be required only when a state controls one entity and controls or significantly influences another. The reasons are:

(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; and

(b) this is consistent with the definition of a related party in the ED, where two entities that are significantly influenced by the same party are not considered related parties to each other.

Other comments

29. 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?*

30. Most respondents to Q1(b)(i) agree with the indicator approach proposed in the ED. However, a large number of respondents (including both respondents who agree and disagree with the indicator approach) raise concerns or suggestions regarding the following issues:
    (a) the appropriateness of an indicator approach;
    (b) the term 'influence'; and
    (c) applying an indicator approach: transaction level vs. entity level.

The appropriateness of an indicator approach

31. Many respondents (including both respondents who agree and disagree with the indicator approach) question whether an indicator approach is appropriate. The reasons are:
    (a) the reporting entity has to identify 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.

32. 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 with another state-controlled entity to benefit from the exemption. One respondent considers that this is a true indicator approach.

33. Other respondents propose the following alternatives to the indicator approach:

(a) exclude state-controlled entities from the definition of a related party unconditionally or if transactions between them are fully conformed to the market mechanism; and

(b) provide an exemption for state-controlled entities without any preconditions.

34. 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 do not have the same obligation.

The term 'influence'

35. In addition to commenting on the indicator approach, several respondents asked the Board to clarify the term 'influence' used in paragraph 17A. These respondents made a number of editorial suggestions, including those outlined below.

36. 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 because of the arm's length conditions?

37. 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.

38. 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) aligns paragraph 17A(b) with paragraph 17C, which refers specifically to 'direction or compulsion by a state'; and
(c) ensures that the exemption is consistent with paragraph BC16 of the ED.

Applying an indicator approach: transaction level vs. entity level

39. Many respondents suggest clarifying whether the exemption applies only to specific transactions (transaction level) or to all transactions (entity level) with a state-controlled entity, where an influence exists only in a transaction or a group of transactions with a state-controlled entity.

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

41. Others favour transaction level, arguing that only transactions at non-market rates are relevant information for the users of the financial statements. Otherwise, the influenced transactions are hidden among a plethora of other transactions and the outcome will be counter-productive to the objective of the proposals, and reasons in BC12 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?*

42. The majority of respondents to Q1(b)(ii) support the proposed indicators in paragraphs 17B, 17C and 17D. However, about half (including both respondents who agree and disagree with the proposed indicators) raise concerns or suggestions regarding the following issues:

(a) general comments on the indicators proposed in paragraphs 17B-17E of the ED;

(b) specific comments on the indicators proposed in paragraphs 17B-17E of the ED; and

(c) statement proposed in paragraph 17E of the ED.

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

Indicators or rules

43. 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 in proposed paragraph 17B seem to be definitive. 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 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 … <u>may include</u> …', 'Indicators … <u>may (or could) exist</u> …' or 'Indicators …<u>exists may (or could) be</u> 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, and* *entity shall consider, as a minimum, the following indications.'; and*

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

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

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

Underlying principle for indicators

44. 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

45. 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.

46. 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.

47. Another respondent proposes moving the indicators to "Application Guidance" like that in IAS 39. Furthermore, this respondent thinks that the proposed indicators are not considered appropriate especially in a state

controlled environment, especially, proposed indicators 17B(b) and (c) because these indicators will not bring the intended relief in most of the state owned entities.

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

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

48. 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 in requiring them to exercise sound professional judgement; and

(d) it is consistent with paragraph 21 of IAS 24.

49. 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.

50. 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.

51. 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~~ a rate~~s~~ 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 ~~(otherwise than by way of regulation)~~’.

Share resources – paragraph 17B(b)

52. 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)

53. 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;

(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

54. 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 decision 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

55. 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.

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

Question 2 – Definition of a related party

57. The ED also proposes amending the definition of a related party to clarify the intended meaning and to remove some inconsistencies when the definition is considered from the perspective of different reporting entities.

Q2(a) The definition of a related party in IAS 24 does not include, for a subsidiary's individual or separate financial statements, an associate of the subsidiary's controlling investor. The Board has decided that it should be included, and thus proposes to amend the definition of a related party. The Board similarly proposes that when the investor is a person, entities that are either significantly influenced or controlled by that person are to be treated as related to each other. Do you agree with this proposed amendment?

If not, why? What would you propose instead and why?

58. Most respondents to Q2(a) support the proposed revised definition of a related party above. However, while supporting the proposal, a few share the practical and cost-benefit concerns of those who disagree. Specifically:

(a) It is not practicable for subsidiary to gather full information with regard to associates of its controlling investor, particularly when the investor is a person.

(b) A subsidiary has no influence over the associate of its controlling investor.

(c) It is difficult to measure the amount of related party transaction and the cost of doing so is too high.

(d) If the transaction is under the market mechanism, or in view of the distant nature of the relationships, the information is unlikely to be meaningful and decision-useful to shareholders.

(e) The information is already supplied in the consolidated financial statement of the controlling investor.

59. One respondent considers that financial statement of a subsidiary can be affected by a transaction with an associate of a parent only when the parent exercises significant influence in the transaction. Therefore, this respondent asserts that an alternative to require disclosures of such transactions without expanding the scope of related parties would be to define a 'related party transaction' so as to include only a transaction in which any related party exercises significant influence. Another respondent suggests revising the disclosure requirement to exempt the transactions between a subsidiary and an associate of the subsidiary's controlling investor although they are considered related parties.

60. One respondent questioned the Board's interpretation of current IAS 24 in the BC2 of the ED that for an associate's individual or separate financial statements, a subsidiary of the investor is already related to the associate under current IAS 24. As such, this proposal would not merely constitute a clarification. The respondent views that significant influence is not sufficient to establish a related party relationship and it is necessary to control financial and operating policy decisions of an entity. Therefore, the respondent suggests amending the definition of a related party in IAS 24 accordingly.

Q2(b) IAS 24 does not define associates of an entity as related parties. However, when a person has significant influence over an entity and a close member of the family of that person has significant influence over another entity, IAS 24 defines those two entities as related parties. The Board proposes to align the definition for both types of ownership by excluding from the definition of a related party an entity that is significantly influenced by a person and an entity that is significantly influenced by a close member of the family of that person. Do you agree with the proposed amendment?

If not, why? What would you propose instead and why?

61. Most respondents to Q2(b) support the proposed revised definition of a related party above. However, while supporting the proposal, a few share the concerns of those who disagree. Specific criticisms of the proposal include:

(a) the definition of a related party should include associates of the same investor only where they enter into a transaction which subordinates one of the entity's own separate interests, as defined in UK FRS 8;

(b) this proposal demonstrates that the definition of a related party is still complex, and lacks a clear principle. It would be helpful to be able to look to a single principle that articulates the circumstances in which disclosure of transactions between two associates is required;

(c) it is unclear whether the proposed amendment requires two entities which are both significantly influenced by the state to provide disclosure of transactions between them when influence exists;

(d) there appears to be an anomaly with respect to key management personnel. For example, (case 1) when A has significant influence over B and is a member of the key management of C, B and C will be related. However, (case 2) when A has significant influence over both B and C, they are not related. (case 3) When A is a member of key management of both B and C, they are not related. These respondents suggest explaining the distinction given to key management in case 1 (more than significant influence) and case 3 (significant influence or less) above in the Basis for Conclusions; and

(e) if the reporting entity actually has influence over its associate through a close member of the family, the transactions should nevertheless be disclosed as related party transactions although not meeting the proposed revised definition.

Q2(c) IAS 24 defines any entity over which a member of the key management personnel of the reporting entity has control, joint control or significant influence, or in which the member holds significant voting power, as related to the reporting entity. However, the converse is not true. Thus, when the entity that a person controls, jointly controls or significantly influences, or in which the person has significant voting power, is the reporting entity and that person is a member of the key management personnel of another entity, that other entity is not defined as related to the reporting entity. The Board proposes to remove this inconsistency by expanding the definition to encompass both situations. Do you agree with the proposed amendment?

If not, why? What would you propose instead and why?

62. Most respondents to Q2(c) support the proposal above. However, while supporting the proposal, several share the concerns of those who also disagree.

63. Some respondents do not support the Board's proposal above, in particular when neither entity is controlled by a member of key management personnel. The reasons provided include:

(a) 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. On the other hand, an individual member of key management of a reporting entity generally would be viewed as having no more than significant influence over that entity and in this case, there is no sufficiently strong relationship to be considered a related party relationship;

(b) inconsistency with the Board's intent to clarify that two associates are not deemed to be related to each other simply because they are both significantly influenced by the same investor;

(c) a reporting entity may have difficulty in identifying the entities of which the person who has control (joint control/ significant influence) over the reporting entity is a member of key management personnel. As a result, cost will far outweigh benefit;

(d) it is unclear to what level within the group structure this requirement would extend. For example (refer to Example 2 of the exposure draft), what should be disclosed by the reporting entity if Entity C has a subsidiary, associate or joint venture? This respondent recommends additional guidance to address this issue; and

(e) can an entity be a key management person as defined in IAS 24? If so, the definition of a related party should make it clear that if a reporting entity is the key management person of one of its associates (Associate A) and the reporting entity also has significant influence over another entity (Associate B), then Associate A and Associate B would be related parties, even though IAS 24 does not define associates of an entity as related parties.

64. One respondent suggests that the two entities should be considered related to each other only when the relationship between the entity and the person is especially strong like control. For example, when the person has the right of representation. Another respondent suggests defining a 'related party transaction' so as to include only a transaction in which any related party exercises significant influence.

Q2(d)	*Do you agree with the proposal to clarify the definition of a related party? Does the wording proposed capture the same set of related parties as IAS 24 at present (except for the amendments described in (a), (b) and (c) above)? Do you agree that the proposed wording improves the definition of a related party?* *If not, why? What would you propose instead and why?*

Proposal to clarify the definition of a related party

65. All the respondents to Q2(d) agree with the proposal to clarify the definition of a related party.

Does the wording proposed capture the same set of related parties as IAS 24 at present?

66. All the respondents except for two (one indication by them is set out below) agree that the wording proposed captures the same set of related parties as the current IAS 24.

67. Two respondents note that when an individual has joint control over the reporting entity (paragraph (a)(iii)) and that person or a close member of the family of that individual (paragraph (e)) controls, jointly controls or

significantly influences, or has significant voting power in another entity, the reporting entity and the other entity will be considered related parties (paragraph (f)) under the existing definition of a related party. However, they would not be identified as related parties under the proposed revised definition in the ED. These respondents assert that the revised definition does not capture the same parties as the existing IAS 24.

Improving the definition of a related party

68. Most respondents agreed that the proposed wording improves the definition. However, a large number of respondents believe that the revised definition is still complex and will prove difficult to understand and apply. Therefore, they also present various suggestions about the following issues.

(a) fundamentally reconsidering the definition of a related party;

(b) issues related to three definitions;

(c) removal of the extra inconsistencies left in the proposed definition; and

(d) other comments

Fundamentally reconsidering the definition of a related party

69. Several respondents observe the following about both the current and the proposed definition of a related party:

(a) significant influence is enough to influence transaction between the reporting entity and the related party; and

(b) the revised definition looks like rules based rather than principles based. As a result, it is not possible to tell from what principle the current exhaustive listing of related parties is derived.

70. Some respondents suggest providing a principle for the definition of a related party. Furthermore, they think that with a principle, either indicators or examples of the principle could be provided in the Application Guidance. One respondent proposes that the Board reconsider both the current and proposed definition fundamentally and in doing so, the definition should be limited to those relationships distinguished by control. This approach would significantly alleviate the burden on preparers and increase the decision-

usefulness of the reported disclosures because many irrelevant disclosures would be eliminated.

Issues related to three definitions

'Significant voting power' in both the current definition and the proposed definition

71. 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.

72. 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) the paragraph already includes control and significant influence, which are the key terms identifying a related party relationship.

73. A few respondents suggest removing 'significant voting power' if it is not substantially different from 'significant influence'. But clarify if its meaning is substantially different from 'significant influence'.

Proposed definition of 'close members of the family of a person'

74. 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 rebuttable presumption that the persons described in subsections (a)-(c) are close members of the family in the current definition is now a rule. Furthermore, these respondents favour re-instating the word 'may'.

75. A few respondents think that it would be extremely difficult to comply with such the proposal because it is not realistic to expect entities to have this amount of information about the private lives and private affairs of individuals. Two suggest including a 'best efforts/best endeavours' clause.

Others propose limiting ‘close member of the family of a person’ to a smaller group of dependants determined on the basis of a clear underlying principle or to the under age children and children under guardianship or clarifying the terms ‘equivalent’, ‘domestic’ and ‘dependants’.

76. One respondent pointed out that in many jurisdictions, the term ‘domestic partner’ usually does not include husband or wife, but is used to define two unrelated, unmarried adults who share the same household. Therefore, the wording proposed probably involves internal contradiction that may be not easy to translate and interpret in other languages. The respondent propose to change the wording of the sub-paragraph (a) of the close members of the family definition as follows:

(a) *the person’s <u>spouse</u> or domestic partner (such as a husband or wife or equivalent) and children;*

Proposed definition of ‘state’

77. 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 transactions between 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?

78. A few 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. One respondent suggests that the Board should add the necessary clarity by

focusing on a more robust definition of ‘state’ so that the supporting paragraph 11A is unnecessary.

Removal of the extra inconsistencies left in the proposed definition

Post-employment benefit plan as a reporting entity

79. Some respondents indicated that the proposed revised definition as set out in paragraph 9(b)(iv) 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. Furthermore, two question the usefulness of considering a multi-employer plan to be a related party of the reporting entity and thus recommend the exclusion of such plans from the definition.

Inconsistency related to key management personnel in paragraph 9(b)(vii)

80. Several respondents note that paragraph 9(b)(vii) of the definition does not include a close family member of key management personnel of the entity. 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, entity B is a related party of entity A if entity A is the reporting entity based on paragraph 9(b)(vi) whereas entity A is not a related party of entity B if entity B is the reporting entity, 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).

Other comments

81. A few respondents ask the Board to consider the following editorial amendments:

(a) the term ‘reporting entity’ is used consistently throughout the revised Standard, including those paragraphs not amended by the ED;

(b) clarify that it does not matter whether control, joint control or significant influence is held directly or indirectly. This could be achieved to via a general paragraph or within each relevant section of the Standard. One respondent supports the retention of the wording ‘directly or indirectly through one or more intermediaries’ in the paragraph 9(a) of the existing IAS 24;

(c) clarify whether an associate and a joint venture also include subsidiaries of the associate or the joint venture respectively; and

(d) although paragraph IE5 states that in parent’s consolidated financial statements, associates are related to the Group, clarify that the relationship does not extend to the associate’s group.

82. A few respondents urge the Board to reconsider the revised definition and articulate it in plain English. This is especially important considering the fact that IFRS is translated into many languages and therefore believe that it is crucial that all ambiguities in the definition are removed.

Question 3 – Definition of related party transactions

83. The ED also proposes amending the definition of a related party transaction to clarify the intended meaning and adds the following example of a related party transaction: transactions or commitments to do something if a particular event occurs or does not occur in the future.

> *Do you agree with the proposal to clarify the definition of a related party transaction?*
>
> *If not, why? What changes would you propose and why?*

84. All the respondents to Q3 except for one agree with the proposal above. However, while agreeing with the proposal, many respondents comment on the new example in the ED and other aspects of the definition of a related party transaction.

‘Transactions or commitments to do something’ in the proposed paragraph 20(j)

85. Many respondents expressed concerns about paragraph 20(j) of the ED as follows:

(a) it is difficult to understand the Board’s intention to require the disclosure set out in paragraph 20(j) of the ED;

(b) practical difficulties in complying with this requirement because many commitments of the type described in paragraph 20(j) may not be the subject of written contracts;

(c) the wording of paragraph 20(j) is more akin to a contingency, not a commitment, and has the potential to scope in all executory contracts including normal routine transactions such as sales order placed at year end with future delivery dates;

(d) all the other examples in paragraph 20 refer to what the entity has done in the past, whereas (j) is worded to include future transactions, which is inconsistent and not beneficial to users or investors;

(e) the addition of 'future commitments' to the list of transactions is problematic as they are not generally recognised in financial statements or disclosed in the notes;

(f) paragraph 20(j) would not encompass the same transactions as the description in paragraph BC23 of the Basis for Conclusions ("situations in which an entity entered into a contract to do something in the future, but there has not yet been a transfer of resources);

(g) the information as required in paragraph 20(j) is already captured by existing requirements, such as those in respect of post balance sheet events and narrative reporting;

(h) in the IAS 37 revision, the Board is in the course of eliminating the need to disclose information related to conditional rights and obligations. Stand ready obligations are to be captured as liabilities and those commitments would be part of the outstanding balances referred to in paragraph 17. All other forms of commitments are therefore conditional obligations;

(i) the burden of preparing related party disclosures is already quite heavy. Any additional request, especially for transactions which are not recognised in the financial statements, is particularly costly. The compliance cost far outweighs the benefit obtained from the disclosure; and

(j) it is not clear what it means or what it is meant to cover and no due process appears to have taken place for this and it goes beyond the stated objectives of the ED.

86. Respondents make the following suggestions:

(a) explain the objective and scope of paragraph 20(j) in the Basis for Conclusions;

(b) give examples of the type of transactions that would be disclosed under 20(j);

(c) clarify that paragraph 20(j) refers to ‘commitments at non-market rates’ and ‘any future transactions that are not entered into in the ordinary course of business’, along with the focussing of the disclosure principle on transactions which have been influenced;

(d) limit paragraph 20(j) to ‘unrecognised contractual commitment’ as required in IAS 1;

(e) disclose such information as non-financial information;

(f) revise paragraph 20(j) to describe future transactions or commitments that are unconditional on the occurrence or non-occurrence of a future event; and

(g) amend the paragraph 20(j) to read simply “financial commitments to a related party”.

87. One respondent notes that the wording of paragraph 20(j) appears to be inaccurate and therefore not easy to translate and interpret in other languages. A transaction is a past event and as such may not refer to the future. The respondent understands that the Board implies that not only commitments to do something if a particular event occurs or does not occur in the future but also transactions resulted from them should be disclosed. Therefore, the respondent proposes to change the wording of paragraph 20(j) as follows:

(j) *~~transactions or~~ commitments to do something if a particular event occurs or does not occur in the future <u>or transactions resulted from such commitments.</u>*

Proposed definition of ‘related party transaction’

88. One respondent asserted that definition is prescriptive as it includes only a transfer of resources, services or obligations between related parties but does not include the potential future transfer of such items or the potential for third party involvement in a related party transaction. The respondent also notes that the definition does not deal with situations in which an entity does not transact with a related party but has been influenced by that party to act or not

to act. The respondent suggests that the definition be amended to deal with these issues as follows:

A related party transaction <u>*includes*</u> ~~*is*~~ *a transfer of resources, services or obligations* <u>*involving*</u> ~~*between*~~ *a reporting entity and a related party, regardless of whether a price is charged.*

Question 4 – Others

89. The ED also asked respondents for any other comments on the proposals in the ED.

Do you have any other comments on the proposals?

Inclusion of 'best endeavours clause' in IAS 24

90. Two respondents believe that including 'best endeavours' clause to obtain the necessary information on relationships would better align the standard with reality.

Definition of 'individual financial statements'

91. Several respondents pointed out that the term 'individual financial statements' is introduced to paragraph 3 and is also used in a few other standards (for example, paragraph 15 of IAS 40 and BC 11 of IFRS7) but this term is not defined anywhere in IFRS.

Retention of paragraph 14 in the existing IAS 24

92. Two respondents believe that an appropriate listing and description of significant investments in subsidiaries, associates and jointly controlled entities is important information for users. Therefore, these respondents suggest that instead of deleting paragraph 14 as proposed in the ED, it should be retained although the reference to IAS 27, 28 and 31 should be deleted, or be reworded to clarify what information to be disclosed.

Disclosure of key management personnel compensation

93. Some respondents questioned how to measure or what to disclose regarding the following items:

(a) Post-employment benefits, in particular, actuarial gains and losses, final salary schemes. For example, is this disclosure intended to refer only to current service cost and past service costs? Or does it include interest costs and a share of actuarial gains and losses?

(b) Corridors and past service costs, and values of share awards.

(c) The disclosure requirements of key management personnel of the subsidiary's parent company where a subsidiary is a reporting entity.

(d) Although IAS 24 assumes that 'key management personnel' are natural persons, in case a key management personnel is an entity (for example, investment fund).

(e) Two respondents doubt whether the guidance on compensation in IAS 19 *Employee Benefits* is sufficient to enable entities to disclose the relevant information as described in paragraph BC7 of IAS 24. Furthermore, one of them indicates that no reference is made in IAS 24 to IFRS 2 *Share-based Payment* in this connection. Therefore, some respondents believe that it would be helpful to clarify the intended disclosures under this paragraph and to provide some guidelines on it.

(f) Two respondents indicated that it is not clear whether key management personnel compensation that should be disclosed in accordance with paragraph 16 of IAS 24 is the amounts paid or payable during the period or the amounts recognised as an expense during the period.

Categories for disclosures in paragraph 18 of the current IAS 24

94. One respondent thinks that based on experience, the current categorisation for disclosures in paragraph 18 is not very useful to users of the financial statements and in particular, it seems that users do not understand why transactions with parties having control over the reporting entity should not be disclosed separately. Therefore, the respondent recommends that the categories be divided up in a more logical way to make them more beneficial to users of the financial statements. Furthermore, the respondent recommends that paragraph 18 should include some guidelines for cases where a related party is a member of more than one category.

Relief for subsidiaries

95. A few respondents strongly recommend that some relief be provided for subsidiaries whose parents prepare consolidated financial statements that are available for public use. For example, the subsidiaries that the group controls 90 per cent or more of their voting rights, or wholly owns. The reasons given by them are as follows:
    (a) The information disclosed in the subsidiaries' stand-alone statements would just be a repeat of the information included in the consolidated accounts.
    (b) There is a clear need for a cost/benefit analysis to be undertaken as the lack of an exemption imposes onerous burdens on groups.

Inclusion of some materiality guidelines

96. Two respondents recommend that the standard should explicitly state that disclosure is required of material related party transactions and give more guidance on materiality in the context of such transactions, with particular reference to materiality from the perspective of either related party and the qualitative considerations that are arguably more important than quantitative factors in these cases.

Effective date

97. Two respondents propose that the Board expedite the finalization of the proposed amendment so that they can be available for entities to early adopt particularly for reporting periods ending on 31 December 2007.

Transitional provision

98. One respondent notes that the ED is not clear on whether the proposed amendments, particularly the test on 'influence' indicators shall apply to all past transactions when an indicator is discovered, and it also has not provided guidance on whether a related party could avail itself to the exemption when the indicator ceased to exist.

Consequential amendment to IFRS 8

99. Several respondents observed that in paragraph BC58 of IFRS 8 Operating Segments, the Board indicated that its proposals to amend IAS 24 with regard to state-controlled entities might result in a consequential amendment to IFRS 8 but no such amendment has been proposed in the ED. Therefore, some of them suggest that the board should clarify whether, where entities under common state control are exempt from the related party disclosures, those exempt entities should be regarded as a single customer by a supplier of services to those entities as required in paragraph 34 of IFRS 8. Two of them suggest that the Board should consequently amend the disclosure requirement of IFRS 8.34 along with the amendment to IAS 24 and thus provide similar relief from disclosure requirement to state-controlled entities because they might encounter the same difficulties in applying IFRS 8.34.

Interaction with IFRS 3 – common control transaction

100. One respondent recommends the Board to consider whether the principle in the ED should be used to establish whether transactions involving state-controlled entities should be treated as common control transactions which are exempt from the requirements in IFRS 3. For example, consider the situation where one state-controlled entity acquires another state-controlled entity in an arm’s length transaction (i.e. there are no indicators of state influence in the relationship).

Other recommended rewording and clarifications

101. Many respondents also provided editorial suggestions.