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**International  
Accounting Standards  
Board**

*This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

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

### **INFORMATION FOR OBSERVERS**

**Board Meeting:** 18 September 2008, London

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

**Subject:** Redeliberations: Follow-up issues – definition of a related party (Agenda paper 13D)

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### **INTRODUCTION**

1. The **purpose of this paper** is to discuss follow-up issues about the definitions of a related party in the ED and IAS 24, and ask the Board to make a decision about them. Those follow-up issues are as follows:
  - (a) Whether two entities are related parties of each other,
    - (i) when a member of the key management personnel of one entity has significant influence over the other entity.
    - (ii) when a person has joint control over one entity and significant influence (or joint control) over the other entity.
    - (iii) when the reporting entity is under the control, joint control or significant influence of a close family member of key management personnel of the other entity.
  - (b) Can an entity be a member of key management personnel?
  - (c) Multi-employer plans.

2. For information, this paper introduces the alternative definition of a related party as approved in March 2008 by the International Auditing and Assurance Standards Board (IAASB) in ISA (International Standards on Auditing) 550 (Revised and Redrafted) "*Related Parties*".
3. The staff originally addressed the issues outlined in paragraph 1 above in a paper for the January 2008 Board meeting – Agenda paper 8D, but deferred discussion of them. This paper is updated in two parts from the previous version. One is the issue ‘Can an entity be a member of key management personnel?’ and the other part is Section 3 ‘Introduction of the alternative definition of a related party as approved by IAASB’.
4. The staff’s recommendations on those issues listed above focus on principles, rather than detailed wording. The staff will work on the wording in drafting the final Standard.
5. This paper divides into three sections:
  - (a) Section 1: Overview of the definition of a related party
  - (b) Section 2: Detailed discussion of issues
  - (c) Section 3: Introduction of the alternative definition of a related party as approved by IAASB

Appendix: Extracts of the definitions of a related party from the ED and IAS

## **SECTION 1: OVERVIEW OF THE DEFINITION OF A RELATED PARTY**

6. This section provides an overview of the definition of a related party as a reminder of the context for the detailed discussion of issues in section 2. This overview summarises the following regarding the definition of a related party:
  - (a) The existing definition in IAS 24 (paragraph 7)
  - (b) Reasons for amending (paragraph 8)
  - (c) The changes proposed in the ED (paragraphs 9-12)

### **The existing definition in IAS 24**

7. Broadly speaking, the existing definition in IAS 24 includes the following as related parties of a reporting entity:
  - (a) A person or an entity that has control, joint control or significant influence over the reporting entity.
  - (b) An entity that is controlled, jointly controlled, or significantly influenced by the reporting entity.
  - (c) An entity that is under common control, common joint control or common significant influence with the reporting entity.
  - (d) Key management personnel, close family members of related parties, post-employment benefit plans.

### **Reasons for amending**

8. This project is a short term project with a limited scope and was not intended to fundamentally reconsider IAS 24. The ED proposes amending the existing definition of a related party in IAS 24 to clarify the intended meaning and to remove some inconsistencies.

### **The changes proposed in the ED**

9. The ED proposed amending the definition of a related party in IAS 24, for four reasons. First, the Board considered the relationship between an associate and a subsidiary of an entity that has significant influence over the associate ('the investor'). IAS 24 requires disclosure in the financial statements of the

associate, but not in the financial statements of the subsidiary. The ED proposed to change the definition of a related party so that an associate and a subsidiary of an entity are related parties of each other for their individual, or separate, financial statements. Similarly, the ED proposed that if the investor is a person who significantly influences one entity and controls another entity, those entities are related parties of each other.

10. 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, if a person significantly influences one entity and a close member of that person's family significantly influences another entity, those entities are currently related parties of each other. The Board proposed to amend the definition of a related party to exclude such entities, thereby ensuring consistent treatment of all associates.
11. Thirdly, IAS 24 treats some investees\* of the key management personnel of a reporting entity as related to the reporting entity. However, the definition in IAS 24 does not include the reciprocal of this—i.e. in the financial statements of the investee, the other entity (i.e. the entity managed by the key management personnel) is not a related party. The ED proposed to define the entities as related parties in both sets of financial statements.

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

12. Lastly, in response to comments that the definition of a related party is difficult to understand and interpret, the ED proposed to restructure it. The restructuring is not intended to change the meaning of a related party except for the changes described in paragraphs 9–11 above.

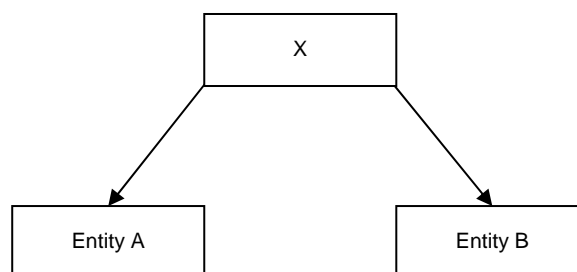
## SECTION 2: DETAILED DISCUSSTION OF ISSUES

### Are two entities related parties of each other?

13. This issue deals with whether two entities are related parties of each other in the following three cases:
- (a) when a member of the key management personnel of one entity has significant influence over the other entity.
  - (b) when a person has joint control over one entity and significant influence (or joint control) over the other entity.
  - (c) when the reporting entity is under the control, joint control or significant influence of a close family member of key management personnel of the other entity.

*When a member of the key management personnel (KMP) of one entity has significant influence over the other entity*

14. The staff uses the following diagram to help the Board's understanding of this issue when giving examples in the following paragraphs.



Comments received on the ED

15. Some respondents indicated that paragraph 9(b)(vii)<sup>1</sup> of the ED assumes that each member of KMP always has at least significant influence. However, arguably, this is not always the case, for example, where a majority shareholder controls the board.

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<sup>1</sup> See appendix for extracts from the ED.

16. Some respondents asserted that there appears to be an anomaly with respect to KMP. For example, based on the above diagram:

- (*case 1*) when X has significant influence over both Entity A and Entity B, Entity A and Entity B are *not* related parties;
- (*case 2*) When X is a member of KMP of both Entity A and Entity B, Entity A and Entity B are *not* related parties; and
- (*case 3*) when X is a member of KMP of Entity A and has significant influence over Entity B, Entity A and Entity B are related parties.

These respondents assert that case 2 implicitly treats KMP as having influence that is significant but no more, whereas case 3 treats KMP as having influence that is stronger than significant influence.

#### The staff's analysis

17. The ED proposed that the relationship between associates of an investor should not fall within the definition of a related party relationship. This is because there is insufficient influence through the common investment in two associates to warrant concluding that they are related. Thus, if X (a person or an entity) significantly influences Entity A and Entity B, Entity A and Entity B would not be related to each other. This is the basis for case 1 above.
18. According to paragraph 11(a)<sup>23</sup> of IAS 24, two entities with a director or other member of KMP in common are not necessarily related parties of each other. For example, if X is a member of KMP of both Entity A and Entity B, Entity A and Entity B are not necessarily related to each other. This is the basis for case 2 above.

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<sup>2</sup> IAS 24.11 In the context of this Standard, the following are not necessarily related parties:

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

(b)-(d) ... .

<sup>3</sup> For reference, according to the alternative definition of a related party by the IAASB in paragraph 54 of this paper, two entities that have common key management are considered related parties of each other, unlike IAS 24.

19. To provide further background, the table below compares IAS 24 (reformatted 1994) with IAS 24 (revised 2003) and the ED in relation to KMP. (emphasis added)

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

20. On the other hand, the ED proposed in its paragraph 9(b)(vii) that, to remove an inconsistency, when a member of KMP of one entity has significant influence over the other entity, those two entities are related to each other. Thus, if X is a member of KMP of Entity A and significantly influences Entity B, Entity A and Entity B would be related to each other. This is the basis for case 3 above.
21. Considering paragraphs 17, 18 and 20, the staff also observes an inconsistency as pointed out by some respondents in paragraph 16. That is, paragraph 11(a) of IAS 24 considers that a member of KMP could have influence that is significant but no more, whereas paragraph 9(b)(vii) of the ED seems to imply that a member of KMP always has influence that is stronger than significant influence.

The staff's conclusion and recommendation

22. The staff concludes that there is an inconsistency between paragraph 11(a) of IAS 24 and paragraph 9(b)(vii) of the ED in treating what level of influence a member of KMP could have.
23. The staff notes the following two definitions in IAS 24.
- Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity including any director (whether executive or otherwise) of that entity.*
- 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.*
24. The staff recommends that the Board should amend paragraphs 9(b)(vi)-(vii)<sup>4</sup> of the ED and paragraph 11(a)<sup>5</sup> of IAS 24 to state the following:
- Two entities are not related parties simply because a member of key management personnel of one entity has significant influence over the other entity.*
25. The reasons for the staff's recommendation include the following:
- (a) There may be cases where a member of KMP has influence that is significant but no more, particularly when KMP is a director;
  - (b) During the Improvements in 2003, two entities were deleted in the definition of a related party when they have a member of KMP in common, as further explained in paragraph 11(a) of IAS 24; and
  - (c) After all, like cases 1 and 2 in paragraph 16 above, the relationship between those two entities in case 3 is not also sufficient to warrant concluding that they are related.
26. ***Does the Board agree with the staff's recommendation in paragraphs 24?***

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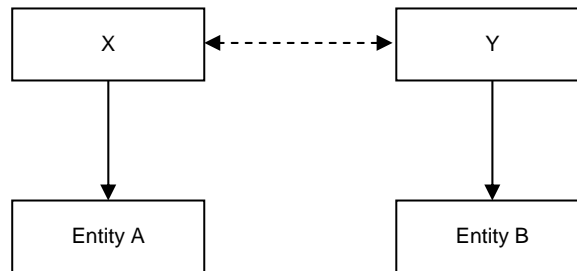
<sup>4</sup> See appendix for extracts from the ED.

<sup>5</sup> See footnote 2 of this paper.



*When a person has joint control over one entity and significant influence (or joint control) over the other entity*

27. The staff uses the following diagram to help the Board's understanding of this issue when giving examples in the following paragraphs.



Comments received on the ED

28. Two respondents refer to cases when a person has joint control<sup>6</sup> over a reporting entity and a close member of that person's family jointly controls or significantly influences, or has significant voting power in, the other entity. They note that under paragraphs 9(a)(iii), (e) and (f) of IAS 24, the other entity is a related party of the reporting entity, whereas the definition proposed in the ED would not capture this. These respondents assert that the definition proposed in the ED does not capture the same related parties as the existing IAS 24<sup>7</sup>.
29. For example, when X (a person) has joint control over Entity A (a reporting entity) and Y (a close member of X's family) has joint control or significant influence over, or has significant voting power in, Entity B, Entity B is related to Entity A under IAS 24 but *not* under the ED.

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<sup>6</sup> IAS 24.9 *Joint control* is the contractually agreed sharing of control over an economic activity. IAS 31.3 *Joint control* is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

<sup>7</sup> The ED stated explicitly that the Board's intention was to capture the same set of related parties as IAS 24 at present except for three amendments explicitly proposed in the ED.

## The staff's analysis

30. As two respondents mentioned in paragraph 28, according to paragraphs 9(a)(iii), (e) and (f) of IAS 24, when a person has joint control over the reporting entity and a close member of that person's family has joint control or significant influence over, or has significant voting power in, the other entity, the other entity is related to the reporting entity. However, the definition proposed in the ED does not capture this.
31. However, the staff notes the following other points in the existing definition of a related party in IAS 24:
- (a) It does not define the reciprocal of the case referred to in paragraph 28 as related parties. That is, Entity A is not related to Entity B in the example of paragraph 29.
  - (b) It does not define two entities as related parties when a person or an entity has joint control over one entity and that person (*not* a close member of the family of that person) or the entity has joint control or significant influence over, or has significant voting power in, the other entity. For example, when X (a person or an entity) has joint control over Entity A and has joint control or significant influence over, or has significant voting power in, Entity B, Entity A and Entity B are not related parties of each other.

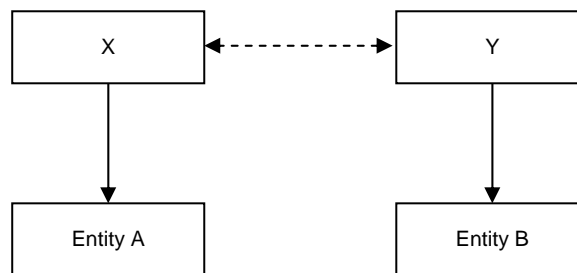
## The staff's conclusion and recommendation

32. The staff concludes that there are three issues involving paragraphs 9(a)(iii), (e) and (f) of IAS 24. The three issues identified are:
- (a) Issue 1: see paragraph 30 (the ED does not capture the same set of related parties as IAS 24).
  - (b) Issue 2: see paragraph 31(a) (the reciprocal of paragraph 9(f) of IAS 24 is not defined as related parties).
  - (c) Issue 3: see paragraph 31(b) (when two entities have a common investor *not through* a close family member).

33. The staff notes the following two objectives that the ED intended regarding the definition of a related party:
- (a) Objective 1: to amend the existing definition in IAS 24 to clarify the intended meaning and to remove some inconsistencies.
  - (b) Objective 2: to capture the same set of related parties as IAS 24 except for three amendments explicitly proposed in the ED.
34. The change indicated by respondents was not explicitly stated in the ED as a change to IAS 24, and it does not seem intentional.
35. The staff considers three possible alternatives to resolve the issues identified above.
- (a) Alternative 1: to maintain the position in IAS 24 and resolve Issue 1.
    - Meets Objective 2 but does not meet Objective 1.
  - (b) Alternative 2: to maintain the position implicit in the ED and resolve Issues 2 and 3.
    - Meets Objective 1 but does not meet Objective 2.
    - May need consultation with constituents.
  - (c) Alternative 3: to maintain the position in IAS 24 but to additionally amend the definition to remove the existing inconsistencies, to resolve Issues 1, 2 and 3.
    - Meets Objectives 1 and 2 but may need consultation with constituents for the additional amendments.
36. The staff recommends that Alternative 1 would logically be most appropriate if re-exposure is not considered, although some inconsistencies still remain in the Standard as a result of Alternative 1. However, the staff would recommend Alternative 3 if re-exposure is considered. ***Does the Board agree?***

*When the reporting entity is under the control, joint control or significant influence of a close family member of key management personnel (KMP) of the other entity*

37. The staff uses the following diagram to help the Board's understanding of this issue when giving examples in the following paragraphs.



Comments received on the ED

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

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

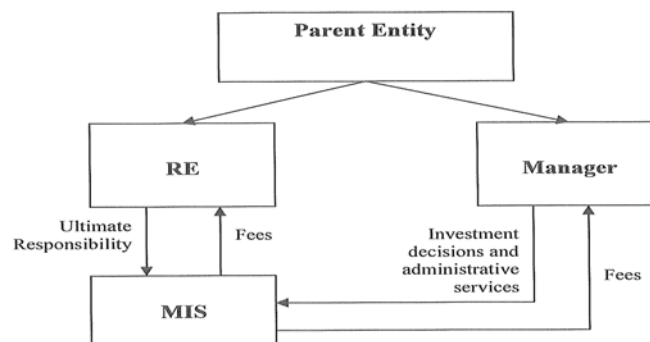
These respondents suggest including a close member of the family of KMP in paragraph 9(b)(vii) of the proposed definition.

The staff's conclusion and recommendation

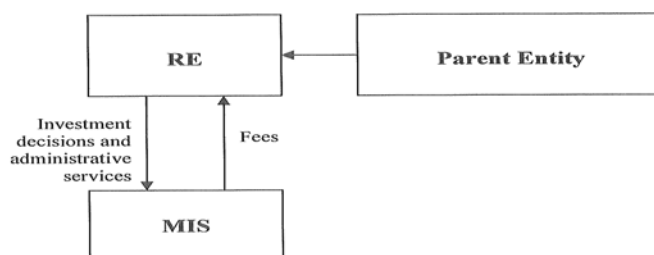
39. The staff concludes that there still remains an extra inconsistency regarding KMP because paragraph 9(b)(vii) of the ED does not include a close member of KMP's family. Therefore, the staff recommends that the Board should amend paragraph 9(b)(vii) of the ED to include a close member of KMP's family, which would remove that extra inconsistency. ***Does the Board agree?***

## Can an entity be a member of key management personnel?

40. A few respondents questioned whether an entity can be a member of key management personnel (KMP).
41. For example, who will be a KMP of a managed investment scheme (MIS) in Australia? MISs are usually in the form of unit trusts. Examples of MIS structures include:
- (a) MISs having two relevant entities – a responsible entity (RE) and a manager. The RE is the entity set up as the trustee for the MIS. The manager of the fund is then a related party to the RE. The manager performs all of the obligations of the RE.



- (b) MISs having just one relevant entity. The RE operates the MIS on a day-to-day basis and makes the investment decisions.



42. In the above example, more specific issues could be as follows:
- (a) Are transactions with the RE related party transactions?
- (b) Can employees and/or directors of the RE be KMP of the MIS?

43. The staff notes the following:
- (a) This project has a limited scope to generally handle some issues explicitly proposed in the ED.
  - (b) It seems that this issue needs to examine cases in practice when an entity can be a member of KMP, which may require time to investigate and resolve.
  - (c) According to the result of that examination in (b), this issue may lead to an amendment to the definition of KMP and thus consultation with constituents.
44. Therefore, the staff recommends that the Board should not deal with this issue in this project with a limited scope. *Does the Board agree?*

### **Multi-employer plans**

#### Comments received on the ED

45. Two respondents questioned 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.

#### The staff's analysis

46. The staff thinks that this issue could separate into two sub-issues as follows:
- (a) Should a multi-employer plan be excluded from the definition of a related party?
  - (b) When a multi-employer plan is a reporting entity, are its sponsoring entities related to that multi-employer plan?
47. IAS 24 and the ED define the following as a related party in the same way:  
*the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity*
48. The above definition in paragraph 47 requires only the condition 'for the benefit of employees of the reporting entity' to identify a post-employment benefit plan as a related party of the reporting entity. In other words, it does not require the condition 'significant influence of the reporting entity over a post-employment benefit plan'. Therefore, a multi-employer plan of which a

reporting entity is one of the sponsoring entities is related to the reporting entity even in cases when the reporting entity cannot have significant influence over the multi-employer plan.

49. At its November 2007 meeting, the Board tentatively decided to amend the definition to include the sponsoring employer as a related party of a post-employment benefit plan. This would remove the inconsistency that a post-employment plan is related to a sponsoring entity but the sponsoring entity is not related to the post-employment plan. However, the staff undertook to investigate whether this decision should also apply to a multi-employer plan.

The staff's recommendation and confirmation

50. The staff recommends that a multi-employer plan should remain a related party of its sponsoring entities as defined in IAS 24 and the ED, for the following reasons:
- (a) A change to the definition is required if the Board wishes to exclude a multi-employer plan from the definition of a related party. However, this is beyond the limited scope of this project.
  - (b) If a multi-employer plan is excluded from the definition, the effect of the exclusion is expected to be insignificant because IAS 19 already requires disclosure of most of the items that IAS 24 requires the sponsoring employers to disclose.
51. ***Does the Board agree with the staff's recommendation in paragraph 50?***
52. Also, the staff confirms with the Board that when a multi-employer plan is a reporting entity, its sponsoring entities are related to that multi-employer plan, as decided by the Board for a post-employment benefit plan in its November 2007 meeting. Thus, it would keep consistency in the definition of a related party if a multi-employer plan remains a related party of its sponsoring entities, as recommended in paragraph 50. ***Does the Board confirm this?***

### **SECTION 3: INTRODUCTION OF THE ALTERNATIVE DEFINITION OF A RELATED PARTY AS APPROVED BY IAASB**

53. This section introduces the Board to the alternative/complementary definition of a related party as approved in March 2008 by the International Auditing and Assurance Standards Board (IAASB) of International Federation of Accountants (IFAC) in ISA (International Standards on Auditing) 550 (Revised and Redrafted) "*Related Parties*". This section is just for the Board's information and does not ask the Board to make any decisions.

54. The IAASB developed the following definition of a related party in the revised and redrafted ISA 550:

"Related Party" – A party that is either:

- a. A related party as defined in the applicable financial reporting framework<sup>8</sup>; or
- b. Where the applicable financial reporting framework establishes minimal or no related party requirements:
  - a. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
  - b. Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
  - c. Another entity that is under common control with the reporting entity through having:
    - i. Common controlling ownership;
    - ii. Owners who are close family members; or
    - iii. Common key management.

However, entities that are under common control by a state (i.e. a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

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<sup>8</sup> An applicable financial reporting framework is broadly a set of accounting standards that each jurisdiction adopts and applies. For example, in jurisdictions that use IFRS, IFRS is an applicable financial framework.



55. Comparing the alternative definition by the IAASB (see (ii)a-c as reproduced in paragraph 54) with the ED of amendments to IAS 24, the staff observes the following differences:
- (a) Common investment: the IAASB definition considers only ‘under common control’ that is limited to three specific circumstances, whereas the ED definition considers ‘under common control’ and ‘under control on one side and joint control (or significant influence) on the other side’.
  - (b) Some specified cases: the IAASB definition does not provide any specified cases, whereas the ED definition provides some specified cases such as key management personnel, a close family member and a post-employment benefit plan.
  - (c) The IAASB has attempted to develop a principles-based definition, whereas the ED definition is arguably more rules-based.
  - (d) Unlike the ED definition, the IAASB definition does not consider the notion ‘joint control’ separately.
  - (e) Unlike the ED definition, the IAASB definition treats as related parties entities that have key management in common.
  - (f) Unlike the ED definition, the IAASB definition excludes state-controlled entities except in two cases.
56. The staff reminds the Board that several respondents expressed a preference for a principles-based definition in the comment letters on the ED. For example, the International Organization of Securities Commissions (IOSCO) commented that it cannot tell from what principle the current exhaustive listing of related parties is derived. Also, it believes that the definition of a related party should be sufficiently clear so that the examples merely illustrate the definition, as opposed to being integral to understanding the definition.
57. However, the staff believes that it is beyond the limited scope of this project to try to convert the existing definition into a more principles-based definition.

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

### **THE ED**

#### PROPOSED REVISED DEFINITION

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

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

## IAS 24

### EXISTING DEFINITION

*Related party* A party is related to an entity if:

- (a) directly, or indirectly through one or more intermediaries, the party:
  - (i) controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
  - (ii) has an interest in the entity that gives it significant influence over the entity, or
  - (iii) has joint control over the entity;
- (b) the party is an associate (as defined in IAS 28 Investments in Associates) of the entity;
- (c) the party is a joint venture in which the entity is a venturer (see IAS 31 Interests in Joint Ventures);
- (d) the party is a member of the key management personnel of the entity or its parent;
- (e) the party is a close member of the family of any individual referred to in (a) or (d);
- (f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.