IASB Meeting | Agenda reference **2B**

Staff Paper | Date **July, 2009**

Project **Related Party Disclosures**

Topic **Comment Letter Analysis: Exemption proposal and required disclosure when the exemption applies**

Purpose of this paper

1. This paper deals with the proposed exemption from disclosure requirements in IAS 24 *Related Party Disclosures* for transactions with the state and state-controlled entities[1]. The exemption was proposed in exposure draft (ED) *Relationships with the State*[2].

2. This paper addresses:

   (a) the scope of the exemption (paragraphs 27-49) and

   (b) the disclosure requirements where the exemption applies (paragraphs 50-79).

3. Appendix A contains relevant extracts from the first ED *State-controlled Entities and the Definition of a Related Party* issued in February 2007[3] and ED 2008.

[1] We use the word "state" to mean a state that has control, joint control or significant influence over the reporting entity. The phrase "state-controlled entities" refers to entities that are controlled, jointly controlled or significantly influenced by a common state.
[2] Referred to as ED 2008 in this paper.
[3] Referred to as ED 2007 in this paper.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

Summary of staff recommendations

4. Staff recommend:

   (a) no change to the application scope of the exemption in ED 2008 (paragraphs 39-48).

   (b) the following for disclosure requirements where the exemption applies:

      (i) no additional specific disclosures for transactions with entities that are related parties because they are members of the same group[4] (paragraphs 62 and 63).

      (ii) separate disclosure of the nature and extent of individually significant transactions (paragraphs 64-68).

      (iii) additional wording on the level of disclosure required to meet the objective of IAS 24 (paragraphs 69-79).

5. Staff believe that (a) retaining the scope of the exemption proposal, combined with (b) strengthening the disclosure requirements where the exemption applies enhances the proposals in ED 2008 and meets the objectives of IAS 24. Staff do not expect that these amendments will require re-exposure.

ED 2008 Exemption proposal

Background

6. The original version of IAS 24, issued in 1984, did not require state-controlled entities to disclose transactions with other state-controlled entities. The revised version of IAS 24 issued in December 2003 and applicable from 1 January 2005 removed that exemption. At the time the Board concluded that the disclosure requirements would not be a burden for state-controlled entities.

[4] Such related party relationships are those that exist in a vertical group structure between a parent, subsidiaries and affiliates. For the purpose of this paper we refer to these as **direct** related party relationships to distinguish them from related party relationships that arise only as a result of common state control.

7. In subsequent practice concerns were raised that where state control is pervasive:

   (a) it may not be possible to identify other state-controlled entities and provide complete related party disclosures.

   (b) the cost of meeting the requirements of IAS 24 may not be offset by the benefit of increased information to users.

   (c) often transactions between state-controlled entities are likely to be conducted as if they are unrelated parties.

8. As a result, ED 2007 proposed an exemption for entities that are controlled, jointly controlled or significantly influenced by a state for transactions with other state-controlled entities. The proposed exemption would have applied:

   (a) if neither entity influenced the other and

   (b) if the state did not influence either entity.

9. After considering respondents' comments, the Board proposed a revised exemption in ED 2008 that would apply regardless of whether influence actually exists in such relationships. The revised proposal also clarified that the exemption would apply to transactions with the state itself and not just to other state-controlled entities.

10. Whereas the exemption proposal in ED 2007 would have applied to entities that are related due to common state control only, the proposal in ED 2008 extended the exemption to entities that are also related for reasons other than common state control.

11. The proposal in ED 2008 would require an entity to disclose information necessary to draw attention to related party transactions.

Overview of respondents' views

12. ED 2008 asked constituents the following question:

> **Question 1-State-controlled entities**
>
> This exposure draft proposes an exemption from disclosures in IAS 24 for entities controlled, jointly controlled or significantly influenced by the state in specified circumstances.
>
> Do you agree with the proposed exemption, and with the disclosures that entities must provide when the exemption applies? Why or why not? If not, what would you propose instead and why?

Views of respondents in support of the proposal in ED 2008

13. Most respondents supported the exemption proposal in ED 2008. In summary, they highlighted the following benefits:

    (a) It overcomes the obstacle of entities being required to identify when transaction counterparties are controlled by a common state, which:

        (i) is particularly problematic in jurisdictions where there are a large number of such entities.

        (ii) may lead to incomplete disclosure if entities are not aware of transactions with other state-controlled entities.

    (b) It meets the objective of IAS 24 without imposing unnecessary burden by recognising that the cost of meeting the requirements is not always offset by the benefit of increased information for users of financial statements. By focusing on disclosure of transactions that are affected by a related party relationship, the requirements:

        (i) reduce cost by not requiring extensive disclosure for transactions that may be unaffected by the relationship.

        (ii) provide more relevant and meaningful information to users.

        (iii) ensure that relevant disclosure is not obscured by excessive information about unaffected transactions.

(c) It considers corporate governance issues ie that many state-controlled entities operate independently of each other like unrelated parties.

(d) It does not require the reporting entity to assess whether actual influence exists which may be difficult in practice. ED 2007 would have required such an assessment.

Respondents' concerns about proposal in ED 2008

14. Many respondents from China commented that state-controlled entities should be excluded altogether from the definition of a related party either (a) unconditionally or (b) if transactions fully conform to the market mechanism[5]. They observed that state-controlled entities typically transact with each other on 'normal business terms'. The Board considered this issue in reviewing responses to ED 2007 and concluded that entities controlled by the same state are indeed related parties.

15. Non Chinese respondents focused more on the scope of the exemption proposal. Some were concerned that it was too broad and resulted in loss of information that is potentially valuable to users of financial statements. However, of this subset of respondents, a large number nevertheless agreed that the ED 2008 proposal provided a workable solution.

16. Respondents raised specific concerns about the exemption proposals in the context of the financial crisis which the staff analyse below.

The financial crisis

Respondents' concerns

17. Respondents were concerned about the implications of the increase in the number of state-controlled entities in environments where state control is not

[5] Under Chinese GAAP enterprises are not regarded as related parties simply because they are under common control of the State, if no other related party relationship exists between them.

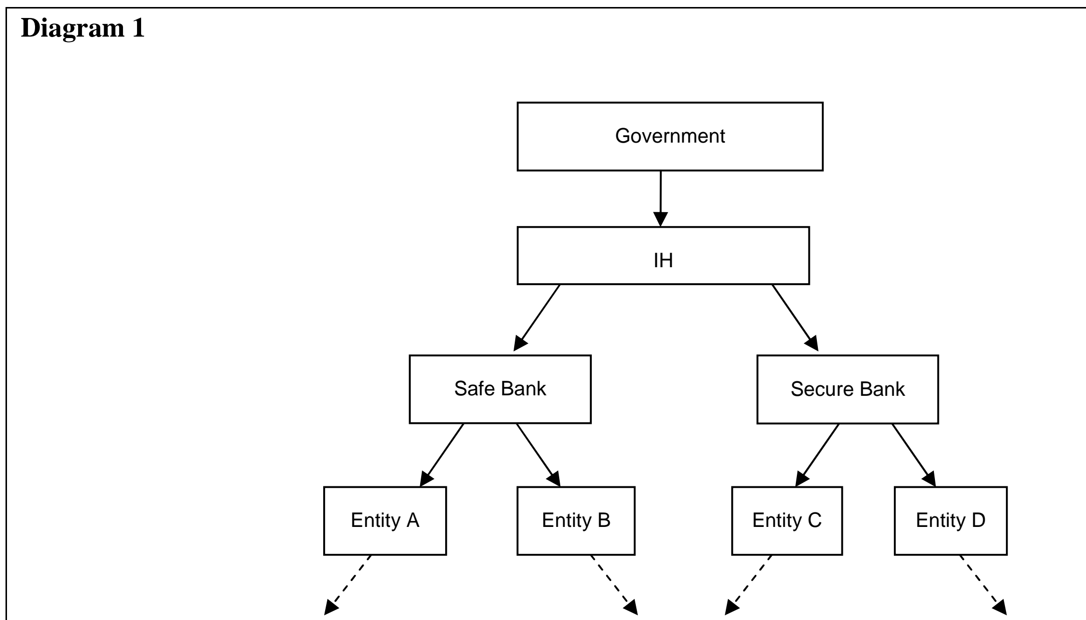
pervasive during the financial crisis, as a result of governments taking significant and sometimes controlling stakes in financial institutions.

18. The exemption proposal in ED 2008 would extend to such financial institutions and respondents questioned whether the significant financial assistance provided by governments would be adequately disclosed. One respondent thought that entities should be required to provide full[6] IAS 24 disclosure for 'other than customary' transactions, but apply the exemption for 'customary' transactions.

Case study

19. Staff examined this issue in the context of a government taking stakes in two lenders, Safe Bank and Secure Bank. The arrangement is temporary. An investment holding company, Investments Holding Co (IH), was set up to manage the government's 40% stake in Safe Bank and 60% stake in Secure Bank as illustrated below.

Illustrative diagram 1



[6] As required by paragraph 17

Exemption scope

20. The exemption proposal in ED 2008 applies to transactions between:

    (a) IH and the government

    (b) Safe Bank or Secure Bank (or their subsidiaries) and the government

    (c) Safe Bank or Secure Bank (or their subsidiaries) and IH

    (d) Safe Bank and Secure Bank

    (e) A subsidiary of Safe Bank and a subsidiary of Secure Bank

    (f) Safe Bank and its subsidiary (or Secure Bank and its subsidiary)

    (g) Two subsidiaries of Safe Bank (or two subsidiaries of Secure Bank).

Disclosure requirements

21. Each of those entities would nevertheless be required to disclose:

    (a) summarised information about their relationship and individually and collectively significant transactions with the government and each other as required by paragraph 17B of ED 2008.

    (b) information about the receipt of government grants and assistance as required by IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, including

        (i) the accounting policy for government grants and the nature and extent of government grants recognised in the financial statements and

        (ii) the nature, extent and duration of government assistance.

22. Paragraph 3 of IAS 20 defines government grants as:

    > assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

23. The definition of government grants excludes some forms of government assistance, eg those which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal

trading transactions of the entity. The standard defines government assistance as:

> action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.[7]

24. Prominent transactions between governments and financial institutions during the current financial crisis have included capital injections, guarantees of bank deposits, provision of liquidity facilities and arrangements to buy distressed debt for which no third party buyer can be found. In some cases, those transactions have been made available to all banks meeting specified criteria in a country, and have not been limited to state-controlled banks.

25. It may be uncertain whether IAS 20 applies when the government is not acting as the government, but rather in its capacity as a majority shareholder (parent). The financial crisis presented a different set of circumstances from environments where state control is pervasive. Some respondents thought it inappropriate that these newly state-controlled financial institutions should be exempt from the disclosure requirements in IAS 24. Staff conclude that the disclosure requirements in IAS 20 along with those in paragraph 17B of ED 2008 address respondents' concerns about the lack of transparency arising from the application of the ED 2008 exemption proposal to financial institutions that have been the recipients of significant government assistance.

26. In the next section staff analyse respondents' broader concerns about loss of information to users that has arisen as a result of the widening of the application scope of the exemption proposal in ED 2008.

[7] IAS 20 paragraph 3

Scope of the exemption

Overview of respondents' views

27. Some respondents thought the application scope of the exemption proposal was too narrow. They thought that a similar exemption should be provided for non-state controlled entities. They indicated that such entities could face problems similar to those that motivated the Board to propose the exemption for state-controlled entities (difficulty of identifying all related parties, excessive disclosure of transactions that are not affected by the relationship). However, that issue is beyond the scope of this project and this paper does not discuss it further.

28. Many respondents, notably accounting firms and standard setters, had particular concerns about the exclusion of the word 'only', which was in ED 2007 but not in ED 2008. This exclusion extends the exemption to instances where two entities are related not only because they are controlled by the same state, but also because they are related for another reason.

The significance of the word 'only'

29. ED 2007 limited the exemption to cases when state-controlled entities are related **only** because the same state has control, joint control or significant influence over both the reporting entity and the other entity. ED 2008 deleted **only**. We use diagram 2 below to discuss three issues relating to the inclusion or exclusion of **only**:

    (a) If **only** is included, how does that affect disclosures about transactions within a sub-group owned by the state? For example, suppose the state controls Entity 1, and Entity 1 controls entity A. Does the exemption apply to transactions between 1 and A (because the state controls both 1 and A, and 1 has no independent capacity to control A)? Or should 1 and A be regarded as related for another reason (1's control of A)?

(b) If **only** is included, what is the boundary between the state and entities owned by the state? In the example in (a), suppose the view is taken that Entity 1 and A are related for another reason (1's control of A). It then becomes important to determine whether 1 is an entity controlled by the state (in which case the exemption would **not** apply) or part of the state (in which case the exemption **would** apply). This may be easily answered if 1 is a normal company incorporated under normal company law, that simply happens to have the state as a controlling shareholder. The answer may be much less clear if 1 is, for example, an agency or department.

(c) If **only** is excluded, does that bring any other types of related party relationship within the scope of the proposed exemption (paragraphs 35-37)?

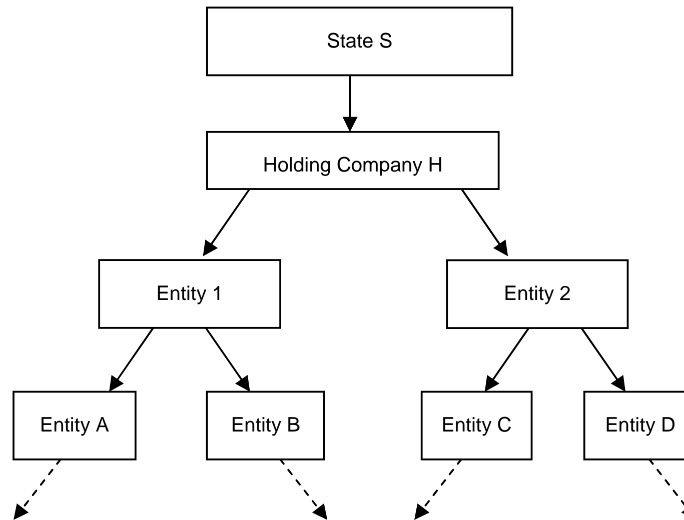
Illustrative diagram 2

30. The analysis below assumes that entity 1 is viewed as having independent capacity to control entity A. The following diagram illustrates the effect of inserting or omitting 'only':

Diagram 2

State S, directly controls Holding Company, H.
H directly or indirectly, controls Entities 1 and 2 and Entities A,B,C and D.

Assume that A is the reporting entity.



Sub-group 1-comprises Entities 1, A and B (direct related party relationships of A)
Sub-group 2-comprises Entities 2,C and D (related to A through common control of the State)

'Only' included and H is part of S

31. In Entity A's separate financial statements, the exemption in paragraph 17A of ED 2008 would apply to transactions with:

    (a) H /S and

    (b) other state-controlled entities that are related only because of common state control ie Entities 2, C and D.

32. The exemption would **not** apply to transactions with Entity 1 and B because the entities that make up sub-group 1 are related parties because of their relationship to one another, irrespective of their relationship to their ultimate parent, the State. Entity A would be required to comply with the disclosure requirements in IAS 24 for related party transactions with Entities 1 and B.

‘Only’ included and H is not part of S

33. The exemption would not apply at all and H would be regarded as the parent in a direct vertical group comprising Entities 1,2,A,B,C, and D. Entity A would be required to provide full IAS 24 disclosure for transactions with Entities 1,2,B,C and D.

‘Only’ is omitted

34. In Entity A’s separate financial statements, the exemption would apply to transactions with:

    (a) H/S and

    (b) Entities 1 and 2 and Entities B, C and D.

Instances of other related party relationships

35. The staff has identified only one case, other than direct related party relationships in a vertical structure, when a state-controlled entity and the state (or other state-controlled entities) are related to each other for reasons other than control, joint control or significant influence by the state.

36. Assume the state controls entity X and entity Y, and entity Y is a post employment benefit plan of entity X. In its ED 2007 deliberations, the Board defined the sponsoring employer as a related party of a post-employment benefit plan.

37. By omitting ‘only’ from ED 2008, entity X would be provided relief from IAS 24 disclosure requirements in relation to its transactions with entity Y since it is a state-controlled entity. However, the main transactions between a defined benefit plan and the sponsoring employer are (a) employer contributions and (b) investments by the plan in the employer or in assets used by the employer. Paragraph 120(e)(iv) of IAS 19 *Employee Benefits* requires an entity (ie the sponsoring employer) to disclose contributions by the employer. Paragraph 120(k) of IAS 19 requires disclosure of the amount included in the fair value of plan assets for (i) each category of the entity’s own financial instruments and (ii)

any property occupied by, or assets used by, the entity. Thus, the existing requirements of IAS 19 already require a sponsoring employer to disclose most, if not all, of the information that IAS 24 would require without the proposed exemption.

Respondents' views on 'only' being excluded in ED 2008

38. A large number of respondents preferred the exemption proposal in ED 2007 which included 'only'. They gave the following reasons for this preference:

    (a) Since a state-controlled business is often structured in the same way as a non state-controlled business, eg through the use of a parent, subsidiaries and affiliates, many respondents thought it inappropriate for transactions and relationships between the various entities to be exempt from disclosure simply because the parent is controlled by the state. This, they asserted, may deny users of the financial statements information that may be relevant, irrespective of whether the controlling shareholder of the parent entity is the state.

    (b) Using diagram 2 above, respondents could understand why Entity 1, Entity A and Entity B in sub-group 1 should be exempted from related party disclosures for transactions with sub-group 2 (Entities 2, C and D) because of the difficulties they face in identifying **all** entities that are controlled, jointly controlled or significantly influenced by the state. However, they did not agree that any sub-group 1 entity should be exempted from related party disclosures for transactions with another entity within sub-group 1.

    (c) Respondents did not believe it would be difficult for Entity 1, Entity A and Entity B to identify entities that are controlled, jointly controlled or significantly influenced by Entity 1. Entity 1, Entity A and Entity B are also in a group that contains a parent and subsidiaries and hence Entity 1 would be required to identify all transactions within sub-group 1 for the purposes of preparing consolidated financial statements.

(d) In some instances, respondents commented, such relationships may have existed prior to the state taking control and questioned why IAS 24 compliant related party disclosures should no longer be required.

(e) Some respondents noted that the Basis for Conclusions did not provide an adequate explanation of why 'only' had been omitted from ED 2008.

Staff analysis and recommendations

'Only' included or excluded?

39. This analysis assumes, as did many respondents to ED 2008, that a controlling state-controlled entity (Entity 1 in diagram 2) has capacity, independent of the state, to control another entity (Entity A). On this view, if two entities are part of a group headed by the state, those entities are related parties of each other not only because they are controlled by the same state but also because they are part of the same group. Should 'only' be re-inserted or should 'only' remain omitted as in ED 2008? Staff have summarized the advantages of both alternatives below:

Include 'Only'	Exclude 'Only'
1. Such disclosure is more likely to benefit users because of the proximity of the relationship. 2. The number of entities for which disclosure is required should not be excessive since the requirements relate to entities within the state-controlled sub-group only. 3. The reporting entity does not need to carry out an extensive search to identify all other state-controlled entities with which it has a direct related party relationship. It should know what these are. 4. The information for such relationships is accessible to the reporting entity since it is required for consolidated financial	1. It eliminates tension around the definition of 'state' and the random disclosure that may result dependent upon how entities are structured and whether or not holding companies are considered to be part of the 'state.' 2. It reduces the burden for entities and auditors of identifying all counterparties controlled by the same state, for disclosures that may be of limited benefit to users. 3. This alternative also achieves a better cost - benefit balance. Disclosure requirements where the exemption applies focus on providing users with information about individually and collectively **significant** transactions

reporting purposes. 5. The exemption still applies for those relationships that exist as a result of common state control, which may be harder to identify and result in voluminous and incomplete disclosure. 6. This approach eliminates in part the inconsistency between state and non state-controlled entities by requiring full IAS 24 disclosure for related party relationships within the state-controlled sub-group.	without overburdening users with excessive disclosure. 4. It eliminates drafting issues of explaining which related party relationships do not qualify for the exemption.

40. Staff believe that omitting 'only' best meets the objective of IAS 24 by requiring the entity to focus on transactions that are most likely to be affected by the related party relationship. It also overcomes the problem of random disclosure dependent on how entities are structured and whether entities are considered to be part of the state or not.

Question 1
For the reasons summarized in paragraphs 39 - 40, staff recommend that 'only' is omitted from the exemption proposal resulting in no change to ED 2008. Does the Board agree?

Additional approaches for dealing with loss of information to users

41. Although some respondents were broadly in favor of omitting 'only' from the exemption proposal, others raised valid concerns about the loss of information to users. The section above explains why the staff do not recommend re-inserting 'only'. Staff have assessed two additional approaches for dealing with this issue:

    (a) Exemption does not apply to transactions between two entities that are part of a group headed by a publicly quoted entity.

(b) Exemption does not apply for transactions with direct owner (ie the entity that immediately controls the entity, not entities higher up the group structure).

42. **Approach (a)** would require IAS 24 disclosure for example for transactions between entities in sub-group 1 (in diagram 2) assuming that Entity 1 is quoted. This approach would have the following advantages:

(a) It captures a narrower subset than if 'only' were re-inserted (entities within a quoted group only) and the information should be available.

(b) It has a well-defined application scope (ie only within the quoted group).

(c) It requires full IAS 24 disclosure where there is likely to be more public interest (entities within the same quoted group).

(d) Disclosure of transactions between entities in different quoted groups is not required.

(e) It goes some way to eliminating inconsistencies with publicly quoted entities in the private sector.

43. However staff do not recommend this approach because:

(a) the disclosure requirements when the exemption applies (paragraph 17B) focus on providing users with information about individually and collectively significant transactions without overburdening users with excessive disclosure.

(b) there may be uncertainty in treatment where, for example, an entity was not quoted in a previous year and is quoted in the current year.

(c) it may result in arbitrary disclosure based on how entities are structured and whether a parent / holding company is considered to be part of the state (exemption applies) or not (exemption does not apply).

44. **Approach (b)** overcomes:

(a) difficulties in identifying all other state-controlled entities. The reporting entity should know who owns it. Full IAS 24 disclosure is required for transactions with direct owner only, other related party relationships would be exempt.

(b) difficulties in obtaining 'downstream' information in large, complex, deep vertical structures.

45. However, staff do not recommend approach (b) because of :

(a) operational difficulties. A reporting entity could, for example, get another agency department to transact on its behalf.

(b) the disclosure requirements when the exemption applies (paragraph 17B) focus on providing users with information about individually and collectively significant transactions without overburdening users with excessive disclosure.

(c) reservations about whether the disclosure would be of benefit to users. The direct owner, for example, may be a shell holding company.

(d) arbitrary disclosure based on how entities are structured and whether the immediate owner is considered to be part of the state (exemption applies) or not (exemption does not apply).

46. Staff also considered but do not recommend a third approach to limit the exemption under some circumstances, such as where there is a single, dominant and active management team within a group of entities[8] which may suggest that the reporting entity is more likely to influence, or be influenced by, the related party relationship.

[8] The presence of common members on the boards of the reporting entity and the other entity could, for example, lead to the relationship having an effect on the profit or loss and financial position. Different boards of directors with different objectives and goals suggest that transactions are more likely to be conducted as if they are between unrelated parties.

47. Staff conclude that this is an ‘indicator of influence’ approach, which the Board rejected in developing ED 2008[9] for being too complex and unworkable. The Board noted that it might be very difficult, if not impracticable, to assess whether influence actually existed.

48. Staff believe the existing requirements in ED 2008 meet the objectives of IAS 24 without placing an onerous burden on entities providing the information or obscuring meaningful disclosure with excessive detail.

Question 2

For the reasons summarized in paragraphs 41 - 48, staff recommend:

-No change to the exemption scope for transactions between two entities that are part of a group headed by a publicly quoted entity.

-No change to the exemption scope for transactions with direct owner (ie the entity that immediately controls the entity, not entities higher up the group structure).

Does the Board agree?

49. However, as discussed below in paragraphs 50 - 79, staff propose changes to the disclosure requirements in paragraph 17B (b), that would strengthen disclosure of related party transactions when the exemption applies.

[9] ED 2007 included indicators of influence such as when related parties:
- transact business at non-market rates
- share resources or
- engage in economically significant transactions with each other.

Proposed disclosure requirements when exemption applies

50. The objective of IAS 24 is:

> to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.[10]

51. To meet this objective, paragraph 17B of ED 2008 requires the following disclosures when the exemption applies:

    (a) The name of the state and the nature of its relationship with the reporting entity (ie control, joint control or significant influence).

    (b) The types of individually or collectively significant transactions with the state or other state-controlled entities and a qualitative or quantitative indication of their extent.

    (c) Disclosure of the fact that the state or other state-controlled entities are related parties as defined in IAS 24 but, as permitted by paragraph 17A, disclosures about related party transactions do not cover transactions with that state or those entities.

52. The disclosure requirements in paragraph 17B (b) of ED 2008 neither require the reporting entity to identify **every** state-controlled entity, nor to quantify in detail **all** transactions with such entities. Most respondents thought that the disclosure requirements were balanced and workable.

Respondents' concerns

53. Respondents expressing concerns were divided between:

    (a) those that believed the requirements were too onerous (paragraphs 55 and 56) and

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[10] IAS 24 *Related Party Disclosures* paragraph 1.

(b) those that believed the disclosures were inadequate and of limited value to users (paragraphs 57 - 60) .

54. ED 2008 requires information about significant transactions. Some respondents requested more guidance on the meaning of 'significant transactions', including whether it refers to the size or nature of the transaction. Some suggested that more detailed disclosure is required for non-routine transactions that are not at arm's length. [11]

Required disclosure too onerous

55. Some respondents, mainly in China, were concerned that the disclosure requirements were too onerous and negated or greatly reduced the benefit of the exemption. Some requested they be deleted altogether, whereas others thought they should be non-mandatory, but encouraged.

56. The following specific reservations were raised:

(a) It is questionable whether the disclosures are achievable for those entities unable to identify other state-controlled entities (the reason for the exemption in the first place).

(b) Classification and aggregation of transactions is still required in order to provide the disclosures, even for qualitative judgments. This could prove onerous where volumes of state-controlled entities and transactions are high, leading to non-compliance or incomplete information.

(c) It would be problematic and costly to identify, monitor and accurately quantify the extent of transactions.

(d) It may prove difficult to obtain information because of commercial confidentiality.

[11] In January 2008 the Board tentatively decided to clarify that a transaction is on arms' length terms if the same terms, including price, would have applied if it had taken place between unrelated parties.

Disclosure inadequate and of limited value to users

57. A number of respondents questioned whether the information required by ED 2008 would be beneficial to users of financial statements. They thought that disclosure requirements should be restricted to instances where they help users understand the effect of significant related party transactions on financial performance and where they are necessary to prevent the financial statements from being misleading. They believed that disclosure should focus on transactions that are carried out on favourable terms because of the entity's relationship with the state and are 'unusual' in nature or conducted on 'non-market' terms.

58. For transactions conducted on 'non-market' terms, many respondents thought that full IAS 24 disclosure should be mandatory, since they believed that the reporting entity would have access to the information and this information may interest users.

59. One respondent raised this in the context of the current financial crisis which was discussed in paragraphs 17 - 26 and commented that the significant financial assistance that some governments have provided to financial institutions they regulate would not be adequately disclosed pursuant to the requirements in paragraph 17B[12].

60. Some respondents stated that qualitative disclosure about individually material transactions alone would not meet the objective of the IAS 24 and combining individually significant transactions with other collectively significant transactions would reduce transparency and relevance.

Staff analysis and recommendations

61. Staff analysed respondents' concerns about the disclosures required by paragraph 17B of ED 2008, and make recommendations in relation to:

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[12] As discussed earlier, staff note that IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* requires disclosure of Government grants and assistance provided to an entity.

(a) additional disclosure of direct related party relationships in vertical group structures (paragraphs 62 and 63).

(b) separate disclosure of individually significant transactions (paragraphs 64 - 68).

(c) varying levels of disclosure dependent on:

  (i) proximity of related party relationship and

  (ii) nature of the transaction (paragraphs 69 - 79).

Additional disclosure for direct related party relationships

62. Additional disclosure of direct related party relationships[13] may benefit users because of the proximity of the relationship. The reporting entity will most likely be able to identify such relationships and have access to information about transactions.

63. However, staff do not propose additional disclosure for such relationships because:

(a) the required disclosures in paragraph 17B of ED 2008 are sufficient to meet the objective of IAS 24.

(b) staff could not identify additional disclosures that:

  (i) would be of benefit to users

  (ii) would be no more onerous than what is currently required by paragraph 17 of IAS 24

  (iii) do not negate the benefit of the exemption.

[13] Such related party relationships are those that exist in a vertical group structure between a parent, subsidiaries and affiliates. For the purpose of this paper we refer to these as **direct** related party relationships to distinguish them from related party relationships that arise as a result of common state control.

(c) paragraph 12 of IAS 24 requires disclosure of relationships between a parent and its subsidiaries irrespective of whether there have been related party transactions.

(d) other IFRSs require disclosure of these relationships: IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.

> **Question 3**
>
> For the reasons summarized in paragraphs 62 and 63 staff do not recommend that the reporting entity be required to disclose additional information about direct related party relationships in vertical group structures.
>
> Does the Board agree?

Separate disclosure of nature and extent of individually significant transactions

64. Paragraph 17B(b) of ED 2008 requires an entity to disclose individually or collectively significant transactions **either** qualitatively or quantitatively. Whilst staff recognise that judgment is required in determining what is 'significant' (see paragraphs 69 – 78), staff recommend that:

    (a) the wording in the standard is amended to capture disclosure of the nature and extent of individually significant transactions **separately**.

    (b) entities may disclose either qualitative or quantitative information about transactions that are not individually significant (as proposed in ED 2008).

65. Staff suggest that the wording in paragraph 17B be amended as follows:

    (b) (i) a description of the nature and extent of each individually significant transaction with the state or state-controlled entities and (ii) for each type of other ~~the types of~~ ~~individually or~~ collectively significant transactions with the state or ~~such entities~~ state-controlled entities, ~~and a~~ qualitative or quantitative ~~indication~~ disclosure of their extent. Types of transactions include those listed in paragraph 20;

66. This amendment is not intended to require quantitative disclosure of **every** transaction, because that would defeat the objective of the exemption proposal and would go against the Board's intention as expressed in paragraph BC 11. BC 11 states:

> To meet that objective [as in IAS 24], paragraph 17B proposes disclosure requirements for cases when the proposed exemption applies. They do not require the reporting entity to identify every state-controlled entity, nor to quantify in detail transactions with such entities, because such a requirement would negate the exemption.

67. This recommendation has the following benefits:

    (a) It requires the reporting entity to provide quantitative disclosure about individually significant transactions **only**. The volume of such transactions should be a small subset of total transactions and the entity should know what they are.

    (b) Disclosing such items on an exceptional basis is less onerous for the reporting entity in terms of practicability and cost.

    (c) It focuses on information that, through its nature or size, may be more meaningful to users.

68. If the Board accepts this recommendation, the staff will develop revised wording for the example in IE3 that was published with ED 2008 so that it includes an illustration of the quantitative / qualitative disclosures that an entity (Entity A) must provide if it enters into an individually significant transaction, with for example, its immediate Parent (Entity 1).

Question 4
For the reasons summarized in paragraphs 64 – 68 staff recommend that the reporting entity be required to disclose the nature and extent of individually significant transactions separately, as articulated in paragraph 65. Does the Board agree?

Level of disclosure required

69. Some respondents thought that a contradiction existed between the requirements in paragraph 17B (b) and the statement in paragraph BC 11 of ED 2008 that there is no requirement to identify every state-controlled entity, nor to quantify in detail transactions with such entities since this would negate the exemption.

70. Staff recommend inclusion of the following text in paragraph 17 B to address concerns about the level of disclosure required.

> <u>(d) The entity shall disclose information that enables users of financial statements to understand the effect of material related party transactions on the financial performance of the entity. An entity decides, according to its circumstances, how much detail it provides to satisfy the requirements of this IFRS. The level of detail would depend on (i) the proximity of the related party relationship and (ii) the nature of the transaction, eg whether it is conducted on 'non-market' terms or whether it is significant in terms of size.</u>

71. The entity is required to exercise judgement when determining what is 'significant'. For example, the Post Office selling stamps to the Ministry of Defence may not be a 'significant' transaction in this context, whereas the MOD selling land to a state-controlled utility company at below market rates would be considered 'significant' because of the 'unusual' nature of the transaction.

72. Similarly, the state providing a state-controlled utility company with a loan that represents 50% of its funding may be considered 'significant' due to its size alone, assuming that such assistance was within the state's usual sphere of intervention.

73. It is of course possible to have a small and 'unusual' transaction, and a large and 'usual' transaction. The reporting entity applies judgement in deciding what and how much information to disclose. We intend to include examples, such as those in paragraphs 71 and 72 in the illustrative examples that will accompany the amendments to IAS 24.

74. The wording in paragraph 70 is consistent with IAS 1 *Presentation of Financial Statements* which requires entities to provide information that is relevant to users' understanding of the financial performance of an entity. It is also

consistent with the principles-based approach adopted in IFRSs where the reporting entity is required to apply its judgement in complying with disclosure requirements.

75. It is also consistent with the following guidance in IFRS 7 *Financial Instruments: Disclosures*:

> An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics.[14]

76. Existing IFRSs provide some guidance on materiality. IAS 1 *Presentation of Financial Statements* notes:

> that omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements.[15]

77. In May 2009 the Board discussed materiality in relation to disclosures in IAS 19 when it tentatively decided not to provide additional guidance in individual standards but to consider the issue in a broader context, perhaps as part of the Conceptual Framework project.

78. Staff do not recommend providing additional guidance on materiality. In its ED 2007 deliberations the Board tentatively decided not to include specific materiality guidance for related party transactions.

79. Staff recommend expanding the discussion in BC11 to explain more fully how the disclosures required by 17B meet the objectives of IAS 24.

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[14] IFRS 7 paragraph B3.
[15] IAS 1 Definitions paragraph 7.

Question 5

For the reasons summarized in paragraphs 69 - 79 staff recommend that the revised standard includes wording that captures the level of disclosure required to meet the objectives of IAS 24 (as in paragraph 70).

In addition staff recommend that BC 11 of the Basis for Conclusions is expanded to explain more fully how the disclosures required by paragraph 17B meet the objectives of IAS 24.

Does the Board agree?

Appendix A Extracts from Exposure Drafts

Extracts from ED 2007

In the Standard, after paragraph 17 paragraphs 17A–17E are added.

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

(a) the entity is a related party only because the reporting entity is controlled or significantly influenced by a state and the other entity is controlled or significantly influenced by that state; and

(b) there are no indicators that the reporting entity influenced, or was influenced by, that entity.

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

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

(b) share resources; or

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

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

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

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

Extracts from ED 2008

In the Standard, after paragraph 17 paragraphs 17A and 17B are added. Paragraph 20 is not proposed for amendment but is included here for ease of reference.

17A A reporting entity is exempt from the disclosure requirements of paragraph 17 in relation to:

(a) a state that has control, joint control or significant influence over the reporting entity; and

(b) another entity that is a related party because the same state has control, joint control or significant influence over both the reporting entity and the other entity.

17B However, a reporting entity shall disclose the following information about transactions with the state or other entities referred to in paragraph 17A:

(a) the name of the state and the nature of its relationship with the reporting entity (ie control, joint control or significant influence);

(b) the types of individually or collectively significant transactions with the state or such entities and a qualitative or quantitative indication of their extent. Types of transactions include those listed in paragraph 20; and

(c) the fact that the state or such entities are related parties as defined in IAS 24 but, as permitted by paragraph 17A, disclosures about related party transactions do not cover transactions with that state or those entities.