



Project	Related Parties
Topic	Revised definition of a related party

Introduction

1. This paper analyses the responses to the exposure draft *Relationships with the State*¹ dealing with the definition of a related party.
2. This paper does not provide a quantitative review of the comments received or attribute comments to individual respondents.
3. In ED 2008 respondents were asked the following question:

Question 2 - Definition of a related party

The exposure draft published in 2007 proposed a revised definition of a related party. The Board proposes to amend that definition further to ensure that two entities are treated as related to each other whenever a person or a third entity has joint control over one entity and that person (or a close member of that person's family) or the third entity has joint control or significant influence over the other entity or has significant voting power in it.

Do you agree with this proposal? Why or why not? If not, what would you propose instead and why?

4. The Board did not seek comments on other aspects of the definition as the Board regarded the revised definition developed in 2008 as final. Agenda paper 2E discusses respondents' comments on other aspects of the definition.
5. The staff recommend the following:
 - (a) To retain the requirements relating to relationships with joint control as proposed in ED 2008 (paragraph 21).

¹ Referred to as ED2008.

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.

- (b) To remove the term ‘significant voting power’ from the definition (paragraph 37).

Background

- 6. In February 2007 the Board published the exposure draft *State-controlled Entities and the Definition of a Related Party*² which included some amendments to the definition of a related party to eliminate some inconsistencies and to restructure the definition to improve its readability.
- 7. For further background on the decisions leading up to the publication of ED 2007 refer to Appendix D.
- 8. After analysing responses to ED 2007, the Board decided to retain the definition of a related party and related guidance as exposed in ED 2007.
- 9. The responses to ED 2007 brought some additional issues to the attention of the Board including a case relating to joint control that was in the current IAS 24 *Related Party Disclosures* definition but was omitted from the ED 2007 definition. In September 2008 the Board discussed some follow up issues and tentatively decided to amend the definition to include the case omitted and to eliminate some additional inconsistencies (further details included in the analysis below).
- 10. While the Board considered most aspects of the definition to be final, the Board re-exposed the particular amendments discussed below as they included cases not previously included in the current IAS 24 or ED 2007 definitions.

Figures and tables

- 11. Note: The analysis below refers to figures and tables included in Appendix A.

Issues raised in comment letters

- 12. The staff have prepared an analysis of responses and recommendations for the following issues:
 - (a) Joint control (paragraphs 13 to 21)

² Referred to as ED 2007.

- (b) Principle based definition (paragraphs 22 to 25)
- (c) Access to and availability of information (paragraphs 26 to 29)
- (d) Significant voting power (paragraphs 30 to 37)

Joint control

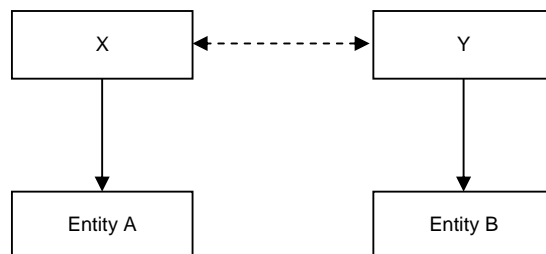
Analysis of comment letters

13. Many respondents approved of the proposed treatment of joint control and thought that it provided clarification and eliminated inconsistencies in the previous ED. They agreed that a joint venture relationship increases the likelihood that transactions may have terms different from the market and that users should have access to information with which they can assess the reporting entity's operation.
14. Whilst most respondents supported the Board's efforts to eliminate inconsistencies and lack of clarity, others felt that each new amendment widened the scope, increasing the burden on preparers. This is illustrated in Table 1 in Appendix A. Others felt the proposal was inappropriate since joint control means that more than one party (and in some cases several parties) can exercise a similar extent of influence over the same entity; no one party has control. One respondent elaborated stating that joint control would not be sufficient to affect a transaction because logically a venturer would not accept non-arm's-length conditions in transactions with a party that is not related to that venturer, but is related to another venturer.
15. One respondent commented that the proposal would lead to excessive disclosure in the oil and gas industry, which often conducts operational activities through jointly-controlled entities.
16. One respondent commented that the requirements could cause practical difficulties for the individual financial statements of a jointly controlled entity or associate. For example the definition means that reporting entities will have to identify and disclose transactions with every other jointly controlled entity or associate of any of its shareholders who have joint control or control of the reporting entity.

Staff analysis and recommendation

17. The proposals in ED 2008 addressed the following three issues :

(a) Case 1



According to paragraphs 9(a)(iii), (e) and (f) of the current IAS 24, when person X has joint control over reporting entity A and person Y is a close member of X's family and has joint control or significant influence over, or has significant voting power in, entity B, entity B is related to the reporting entity A. The definition proposed in ED 2007 did not include this case.

(b) Case 2 - The existing definition in IAS 24 is inconsistent as it does not define the reciprocal of the case referred to above as a related party. That is, if entity B was the reporting entity, entity A is not a related party under the current definition.

(c) Case 3 - The existing definition in IAS 24 does not define two entities as related parties when a person or an entity has joint control over one entity and **the same person or entity** has joint control or significant influence over, or has significant voting power in, the other entity. However, as noted in Case 1, it does define them as related when a person has joint control over one 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. For example (referring to Figure 1 in Appendix A), 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 then Entities A and B are not related parties of each other (in both the existing definition and the proposal in ED 2007).

18. In coming to its conclusions for ED 2008 the Board noted that the definition in ED 2007 (due to the exclusion of Case 1) did not capture the same set of related parties as the existing IAS 24 definition. This contradicted the stated intention of ED 2007 to limit the changes to specified cases, not including this one. As a

result, in September 2008, the Board decided to amend the definition proposed to capture this particular case inadvertently omitted from ED 2007 and remove inconsistencies by including the other two cases listed above.

19. The Basis for Conclusions of ED 2008 states the following:

BC15 The 2007 ED proposed that two associates of a person or of a third entity are not related to each other because there is insufficient influence in such relationship to warrant concluding that they are related. The Board confirmed this amendment in finalising the new definition. The Board then considered whether two entities should be regarded as related if the same entity has joint control over both entities. The defining characteristic of an associate is significant influence. The Board noted that joint control is generally regarded as influence that is stronger than significant influence. ...

20. In essence, that reasoning lead to a conclusion that significant influence is 'weaker' than control and joint control. The Board used that reasoning in concluding that two parties are:

- (a) related if both are subject to control by the same third party.
- (b) related if both are subject to joint control by the same third party.
- (c) not related if both are subject to significant influence by the same third party.

21. The staff believe that the responses to ED 2008 didn't object to removing the anomalies noted above, however some had concerns that joint control is being treated equivalently to control (for instance when a third party has joint control over one entity and significant influence in another, the two entities are related to each other). As a fundamental reconsideration of the issue is beyond the scope of this project, the staff believe that the Board can choose to align the treatment of joint control either with the treatment of control or with the treatment of significant influence.

Staff recommendation

The staff recommend that the Board proceed with ED 2008's proposal that two entities are related to each other whenever a person or a third entity has joint control over one entity and that person (or a close member of that person's family) or the third entity has joint control or significant influence over the other entity. Does the Board agree?

Principle based definition

Analysis of comment letters

22. A number of respondents mention their preference for a more principle based approach to the definition. One respondent prefers the first sentence to articulate a principle, rather than what appears to be a circular definition: “A *related party* is a person or entity that is related to the entity that is preparing its financial statements.” They believe the application of the standard would improve if practitioners and users are able to determine the basis from which the current listing of related parties is derived.
23. Some respondents noted that without a principle, there is no clear basis for including or excluding particular relationships from the definition of a related party. Some respondents would prefer a more principle-based definition. Some refer to the definition the International Auditing and Assurance Standards Board (IAASB) has developed (and which is reproduced in Appendix B) as an example of a more principle-based definition. However this definition is not without its own inconsistencies (as illustrated in Table 3 of Appendix B) and still lacks an overall principle to justify the inclusion/exclusion of relationships from the definition.
24. Some respondents believe that the only way to draft a simpler definition is to base it on a set of underlying principles. For example they refer to part (b) (iv) and (b) (ix) and believe they describe a similar situation and therefore a simpler form of drafting should be sought.

Staff analysis

25. Respondents to ED 2007 generally noted that the restructuring of the definition had made it clearer and easier to use. Accordingly the Board decided in September 2008 to proceed with a definition structured along those lines and not to attempt to develop a more principle-based definition. The staff see no reason to re-open that decision.

Access to and availability of information

Analysis of comment letters

26. Some respondents argued that the costs of providing information would outweigh the benefits to stakeholders. In some international groups the number of joint ventures and associated companies can be extensive. To keep track of all transactions with joint ventures and associates will require significant resources.
27. Some respondents believe that it would be difficult to obtain the information an entity would be required to provide in relation to individuals and would require private information, which may be difficult to access and involve issues of privacy infringement. In addition, the preparer will need inside information on the private lives of the people potentially concerned by this requirement. For these reasons, this requirement may be difficult to apply.

Staff analysis and recommendation

28. The Board has discussed in previous meetings whether entities can obtain the necessary information to identify and disclose related party transactions. In October 2007 the Board discussed whether to include in the standard a 'best endeavours clause' that would not require disclosure if an entity has been unable to obtain the necessary information in spite of using its best endeavours. The Board decided not to include such a clause as it would be very subjective and could result in minimal disclosure.
29. Regarding access to individuals' private information, the existing definition in IAS 24 also requires a similar level of access. The proposal in ED 2008 might increase the amount of information required from an individual. However the staff believe that an entity would still be required to have the same access under the existing definition.

Significant voting power

Analysis of comment letters

30. Some respondents expressed concern with the use of ‘significant voting power’ in the 2008 ED as there is no definition in IAS 24. These respondents suggested the Board should either define it or delete it.
31. Respondents argue that including the term in the definition implies something different to control, joint control and significant influence. Respondents requested further clarification of what level of influence it implies compared to the others in order to prevent a divergence in practice. For instance respondents note that paragraph 9(b)(vii) indicates that an entity is related to a reporting entity where a person who is a member of key management personnel of the reporting entity has significant voting power in the entity. In comparison if the person has significant influence in the entity it is not a related party. This implies that significant voting power is ‘stronger’ than significant influence. However respondents also note that if a person has significant voting power in both entities they are not related parties.
32. One respondent was concerned about terms being used inconsistently in this standard and in IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*. Since ‘significant voting power’ is not defined in any of these standards the respondent suggested that the term should be defined in the context of ED 10 *Consolidated Financial Statements*.
33. Some respondents noted that the term is only used in connection with individuals and not other entities. They do not understand why a related party arises if a **person** had significant voting power in another entity but does not if an **entity** had significant voting power in another entity.

Staff analysis and recommendation

34. The staff note the following anomaly regarding key management personnel and those with significant voting power in the ED 2008 proposal (refer to Figure 1 and Table 2 in Appendix A):

IASB Staff paper

- (a) Case 1 - If person X is a member of key management personnel of entity A and has significant voting power in entity B, then entities A and B are related parties of each other.
 - (b) Case 2 - If person X has significant voting power in both entities, then entities A and B are **not** related parties of each other.
 - (c) Case 3 - If person X is a member of key management personnel of both entities, then entities A and B are **not** related parties of each other.
35. Understandably the responses to ED 2008 expressed confusion over the level of influence indicated by significant voting power due to the above. The Board has already concluded that the level of influence indicated by membership of key management personnel is equivalent to significant influence. This together with Case 1 implies that significant voting power is a higher level of influence, as it, in conjunction with a key management personnel relationship, gives rise to a related party. However Case 3 goes against this logic.
36. The staff see four alternatives to address the anomaly:
- (a) Alternative 1 – Stick with the ED 2008 definition. Referring to Table 2 it can be seen that part of the anomaly exists in IAS 24 and part was introduced in ED 2007 proposals. In relation to significant voting power, the ED 2007 proposals attempted only to capture the reciprocal circumstances of IAS 24.
 - (b) Alternative 2 – Include Case 2 in the definition of a related party. This will imply that significant voting power has a higher level of influence than both key management personnel and significant influence.
 - (c) Alternative 3 – Exclude Case 1 from the definition of a related party. Excluding Case 1 would impose the same requirements for significant voting power as for key management personnel and significant influence. This will imply that significant voting power has an equivalent level of influence to both key management personnel and significant influence. However this will be a departure from the existing definition of IAS 24.
 - (d) Alternative 4 – Delete all references to significant voting power. Entities will then have to rely on the remaining terms to determine whether their voting power gives rise to a related party relationship (ie whether it is significant influence, joint control etc).
37. The staff considered the following in developing a recommendation:

IASB Staff paper

- (a) Significant voting power is not defined.
- (b) Significant voting power must imply something other than significant influence. Otherwise, the notion would be redundant.
- (c) Anomalies exist in the ED 2008 definition regarding the use of significant voting power.
 - (i) Paragraphs 9(b)(viii) and (x) highlight one anomaly. They both define two entities as related parties of each other when a third person is key management personnel of one and has significant voting power in the other. However if a third person has significant voting power in both entities they are not related parties.
 - (ii) Another anomaly exists in both the existing and current definitions. Significant voting power creates a related party relationship only when that power is held by individuals, not when that power is held by an entity.
- (d) In reviewing the responses to ED 2007, the Board noted that the existing references to the undefined notion of significant voting power created some anomalies and lack of clarity. However, the Board came to the conclusion that removing the existing references to significant voting power was beyond the scope of the proposals in ED 2007. Therefore, the Board retained this notion in the definition.
- (e) We need to bring this project to a timely conclusion. Thus, it is not worth making changes that would require re-exposure.
- (f) The references to the undefined notion of significant voting power are marginal components of the definition as a whole but increase its complexity and generate anomalies. These factors suggest that deleting the notion would not require re-exposure.

Staff recommendation and questions to the board

The staff recommends deleting references to significant voting power (Alternative 4). Does the Board agree?

The staff believes Alternative 4 does not require re-exposure. Does the Board agree?

Appendix B: Reminder of the Alternative Definition of a Related Party as Approved by the IAASB

- A6. This appendix reminds the Board of the definition of a related party 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". This section is just for the Board's information and does not ask the Board to make any decisions.
- A7. The IAASB developed the following definition of a related party in the revised and redrafted ISA 550:

"Related Party" – A party that is either:

- (i) A related party as defined in the applicable financial reporting framework³; or
- (ii) 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.

³ 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.

- A8. 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 observe 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.
- A9. The staff remind 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.
- A10. However, the staff believe that it is beyond the limited scope of this project to try to convert the existing definition into a more principles-based definition.

A11. Applying the definition of the IAASB to figure 1 of Appendix A will result in the following:

Table 3

		Entity/Family X's level of influence over Entity B		
		C	KMP	SI
Entity/Family X's level of influence over Entity A	C	Yes – (c)(i)&(ii)	Not related	Not related
	KMP	Not related	Yes – (c)(iii)	Not related
	SI	Not related	Not related	Not related

Appendix C: Definition of a related party in the 2008 ED

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

- (a) A person or a close member of that person’s family is related to a reporting entity if that person:
 - (i) is a member of the key management personnel of the reporting entity or of 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 or has significant voting power in it.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
 - (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) either entity is an associate or joint venture of the other entity (or of a member of a group of which the other entity is a member).
 - (iii) both entities are joint ventures of a third party.
 - (iv) either entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) 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. If the reporting entity is itself such a plan, the sponsoring employers are also related to the plan.
 - (vi) the entity is controlled or jointly controlled by a person identified in (a).
 - (vii) a person identified in (a)(i) has significant voting power in the entity.
 - (viii) a person identified in (a)(ii) has significant influence over the entity or significant voting power in it.
 - (ix) a person or a close member of that person’s family (A) has significant influence over the entity or significant voting power in it and (B) has joint control over the reporting entity.
 - (x) a member of the key management personnel of the entity or of a parent of the entity, or a close member of that member’s family, has control or joint control over the reporting entity or has significant voting power in it.

Appendix D: Extracts of relevant introductory paragraphs in ED 2007

2. The exposure draft 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 a significantly influenced by that person and another entity that is controlled by that person are related parties.
3. 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.
4. Thirdly, IAS 24 treats some investees⁴ 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.
5. 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 2–4 above.

⁴ Investees include entities controlled, jointly controlled or significantly influenced by an investor or in which the investor holds significant voting power.