

5 July 2007

Comment Letters  
Amendment to IAS 24  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
UK

Dear Sir/Madam,

**Re: IASB Exposure Draft of Proposed Amendments to IAS 24 *Related Party Disclosures: State-controlled Entities and the Definition of a Related Party***

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the IASB Exposure Draft of Proposed Amendments to IAS 24 *Related Party Disclosures: State-controlled Entities and the Definition of a Related Party*. This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive amendment.

The ED proposes to amend IAS 24 *Related Party Disclosures*:

- to eliminate some disclosure requirements that would otherwise apply to entities that are controlled or significantly influenced by a state in relation to transactions with other entities that are controlled or significantly influenced by that state. The exemption does not apply when influence exists in such relationships; and
- to tidy up some of the definitions in the standard and in particular to amend the definition of a related party to eliminate certain inconsistencies and generally to make the definition easier to understand and apply.

We welcome the IASB's initiative. The disclosure requirements that the ED is proposing to amend are currently proving burdensome and resulting in disclosures that appear to be of little value, and the definition of related party is in need of improvement and simplification. However, in our view the proposed amendment, which currently applies only to state-controlled and state-influenced entities, should apply to all entities. Furthermore, further improvements in the definition of a related party are needed. Our detailed comments are set out in the appendix to this letter.

If you would like further clarification of the points raised in this letter, Paul Ebling or I would be happy to discuss the letter with you further.

Yours sincerely,

Stig Enevoldsen  
EFRAG, Chairman

## Appendix

### Question 1 – State-controlled entities

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

1 We agree that, when two entities are related only because they are both controlled/significantly influenced by the state, the disclosures required by paragraph 17 of IAS 24 can be both extremely onerous and not particularly useful if the reporting entity is not actually influenced by, or does not actually influence, the other entity. We therefore support the proposal.

2 Having said that, we are not convinced that there are any circumstances in which the benefits that arise from the disclosures required by paragraph 17 will be significant enough to justify the cost of producing them when there is no influence. For that reason, we think the IASB should consider extending the scope of the exemption proposed so that it applies to all entities. In other words, we think the IAS 24 should be amended so that the principle that applies to the paragraph 17 disclosures is that disclosures about transactions between related parties need to be given only if one or other party influences the other—the paragraph 17 disclosures would not need to be given about transactions between related parties when neither party has influenced the other.

- We think our proposal will reduce the amount of clutter in the financial statements by not requiring the disclosure of information that is of little value to users (ie details of transactions between related parties where neither party has influenced the other).
- In our view it would also make the standard more robust and more principle-based, because there would be a single, universally applied principle. Under the ED's proposals, there would be a (different) principle, and an exception to that principle for certain entities.
- Our proposal would also mean that the principle underlying paragraph 17 would be more in line with the stated objective of IAS 24 as set out in paragraph 1 of the standard.
- Finally, we think our proposal overcomes a major weakness in the ED, which is that the exemption as set out in the ED would grant an advantage in economic competition to state-controlled or state-influenced entities in comparison with other entities.

3 Such a change could perhaps be supported by a requirement for entities to state that related party transactions not disclosed were undertaken with entities that neither influence nor are influenced by the reporting entity.

4 We also have some more detailed comments about the exemption proposed:

- (a) The ED proposes that the exemption should apply when both related parties are related parties only because they are *controlled* or *significantly influenced* by a state. However, the Basis does not explain why the exemption is not

available when *joint control* by a state is involved. We think either it should explain the omission or the exemption should be extended to joint control.

- (b) We wondered whether it might be possible to read paragraph 13 as being inconsistent with the proposed exemption from the requirements of paragraph 17. Paragraph 12 talks clearly about parent-subsidiary relationships, but paragraph 13 talks more vaguely about related party relationships where "control exists" and could perhaps therefore be read as applying to relationships that would fall within the proposed exemption. We believe that if a relationship falls within paragraph 17A, it should not be required to provide the paragraph 12 and 13 disclosures.

**(b) Do you agree:**

- (i) that an indicator approach is an appropriate method for identifying when the exemption should be provided for entities controlled or significantly influenced by the state; and**
- (ii) that the proposed indicators are appropriate?**

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

- 5 We agree in principle with the adoption of an "indicator approach", but have some difficulty with the actual indicators proposed in new paragraph 17B. Our main problem is that we had thought that the principle was set out in paragraph 17A(b)—ie that the reporting entity shall neither influence nor be influenced by its related party—but the indicators set out in paragraph 17B do not seem to be based on that, or indeed any clear, underlying principle. As a result it is difficult to see what the paragraph is trying to get at. For example:
  - (a) it is not clear to us why the existence of "economically significant transactions" undertaken between two parties that are related should necessarily mean that one of the parties is influencing the other.
  - (b) there are a number of arrangements nowadays in which two entities might "share resources", so it is not clear why that should necessarily be an indication that one related party influences the other.
  - (c) although the principle in paragraph 17A(b) seems to be about one entity influencing its related party, paragraph 17C talks about both related parties being directed or compelled by a third party (the state).

One way of addressing these concerns would be to try to articulate more effectively what the underlying principle is; for example, are we looking for influence in respect of a transaction or influence more at the entity-level? The indicators could then be reformulated around that revised general principle. (We think the principle underpinning the material in paragraphs 17B and 17C might, despite paragraph 17A(b), actually be about the extent to which the two entities operate independently of each other.) An alternative might be to adopt an approach similar to that adopted in IAS 36; in other words to describe the indicators as indicators that influence may (ie not will) exist.

- 6 In addition, we think there is a problem with the indicator described in paragraph 17B(a) ("transact business at non-market rates"). This indicator requires reporting entities that might fall within the scope of the exemption to identify all their related entities (including those that are state-controlled or state-influenced) and to study the

terms on which every transaction has taken place. Of course, if the reporting entity soon finds a transaction that has been carried out at non-market rates it can stop studying the terms of the transactions—but will not be able to take advantage of the exemption. However, to take advantage of the exemption the terms of every transaction would need to be studied. We do not think that was the IASB's intention.

- 7 Furthermore, we think it would be useful if paragraph 17C could be clarified to make it clear that the references to “the existence of direction or compulsion by a state” is not intended to bring state-regulated entities within the scope of the paragraph.

## **Question 2 – Definition of a *related party***

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

- 8 EFRAG agrees with both these proposals. The existing definition is clearly inconsistent in treating a subsidiary of an investor and that investor's associate as related parties only if the reporting entity is the investor's associate. It is also inconsistent in treating the relationship between a subsidiary of an investor and that investor's associate differently depending on whether the investor is an entity or an individual. We agree that a subsidiary of an investor and that investor's associate are related parties of each other regardless of whether (a) it is the associate or the subsidiary that is the reporting entity and (b) the investor is an entity or an individual.

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

- 9 Under the existing definition, an entity's associates are not considered to be related parties of each other, yet an entity that is significantly influenced by a person and another entity that is significantly influenced by a close family member of that person are related parties. Again, we agree that this is inconsistent. We also agree that the appropriate way to deal with the inconsistency is to change the definition so that an entity that is significantly influenced by a person and another entity that is significantly influenced by a close family member of that person are no longer related parties.

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

**expanding the definition to encompass both situations. Do you agree with the proposed amendment? If not, why? What would you propose instead and why?**

10 Currently, when a member of the key management team of the reporting entity controls, jointly controls or significantly influences a second entity, the entities are treated as related when the first entity is the reporting entity, but not when the second entity is the reporting entity. We agree that this is inconsistent. We further agree with the proposal to amend the definition so that they are treated as related parties regardless of which of the entities is the reporting entity.

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

11 We agree that the existing definition is complex and difficult to understand and apply. We further agree that the changes and restructuring the IASB is proposing will improve the definition. However, we think the revised definition is also complex and will prove difficult to understand and apply.

12 For example, we think the revised definition continues to contain inconsistencies. Assume that Entity A is a post-employment benefit plan for the benefit of employees of either Entity B or an entity (Entity C) related to Entity B. Under paragraph (b)(iv) of the definition, Entity A will be a related party of Entity B. However, Entity B does not appear to be a related party of Entity A. Or, to take another example, according to (b)(vi), if a man is a member of the key management personnel of Entity D and his wife has significant influence over Entity E, then Entity E is a related party of Entity D if Entity D is the reporting entity. However, if Entity E is the reporting entity, Entity D does not appear to be a related party of Entity E. If this is right, the definition remains flawed. And if it is not right, our error shows the definition is still too difficult to understand.

13 For that reason we suggest that further efforts are made to simplify the definition and, in doing so, bring out the underlying principles. For example one suggestion that has been made to us is that part (a) of the definition proposed in the ED can be simplified as follows:

- “(a) A person is a related party of a reporting entity if that person:
  - (i) is a member of Key Management Personnel ...
  - (ii) has control over the reporting entity ...
  - (iii) has joint control over the reporting entity ...; or
  - (iv) is a close member of the family of any person in (i)-(iii) above.
- (b) An entity is a related party of a reporting entity if ...”

14 We will also give the matter some further thought and, if we come up with a better definition in the next few weeks, we will let you have it.

**Question 3 – Definition of related party transactions: Do you agree with the proposal to clarify the definition of a related party transaction? If not, why? What changes would you propose and why?**

- 15 We have no problem with the proposed change to the definition of a related party transaction.

**Question 4: Do you have any other comments on the proposals?**

- 16 We are concerned about one of the changes proposed to the definition of ‘close members of the family’. The proposed change we are concerned about is the one highlighted below:

Close members of the family of person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and ~~They may~~ include:

- (a) that person’s domestic partner (such as a husband or wife or equivalent) and children;
- (b) children of that person’s domestic partner; and
- (c) dependants of that person or that person’s domestic partner.

On the one hand, we recognise that there are practical difficulties in applying the unamended definition because it is not realistic to expect an entity to be able to form a judgement as to whether one family member “may be expected to influence, or be influenced by” another family member. As a result, entities inevitably have to apply broad rules of thumb. The amendment highlighted above seems to us to be an attempt to incorporate just such a rule of thumb into the definition (ie a person is influenced by or influences their partner, their or that partner’s children, and their or that partner’s other dependents).

On the other hand, although the effect of the proposed change is to bring all the persons listed in (a)-(c) within the definition regardless of whether they may be expected to influence, or be influenced by, that person in their dealings with the entity:

- (a) we are not sure that was the intention (because if it was the intention the words “may be expected to influence, or be influenced by, that person in their dealings with the entity” would be redundant); and
- (b) we think it would be extremely difficult to comply with such a requirement, because it is not realistic to expect entities to have this amount of information about the private lives and private affairs of individuals. In many cases the reporting entity will need to rely on the co-operation of others to obtain the information it needs to provide the disclosures, and in some cases that could involve privacy infringement. Amending the requirement to include a 'best efforts/best endeavours' clause would help to address this concern.

We therefore believe a rethink is needed.

- 17 Paragraphs 9 and 11A explain that ‘a state’ is a national, regional or local government, and the term is being used to refer to any governing jurisdiction that has statutory or regulatory powers of government. Judging by the position in Europe, a number of different structures are used to control (or influence) entities that are in

effect state-controlled (or state-influenced) entities. We are worried that not all those structures will result in those entities being called state-controlled or state-influenced under the definitions in the ED. For example, in some countries the entities are not controlled or influenced by the government directly, but by an agency that is neither strictly speaking a governmental body nor a private sector body. We think such entities should fall within the scope of the exemption proposed in the ED but are not sure that they do.

On the other hand, we assume it is not the intention that the existence of state-regulation would bring an entity within the scope of the term, yet as currently drafted that appears possible.

We think therefore that the definition and supporting material might need some further work.