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Dear Sir David,

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

We appreciate the opportunity to respond to the International Accounting Standards Board's Exposure Draft of Proposed Amendments to IAS 24 Related Party Disclosures – State-controlled Entities and the Definition of a Related Party. This letter represents the view of the German Accounting Standards Board.

As a result of our considerations we indeed strongly support the Board's efforts to achieve an improved definition of related parties by a general restructuring and by deleting detected inconsistencies. However, we propose to go even further and to limit related party relationships generally to those relationships having control character.

Regarding the IASB's proposal of an exemption for state-controlled entities we do not oppose, but we seriously doubt if the proposed amendment is an appropriate solution to the identified problems.

For the detailed comments we refer to the appendix to this comment letter.

If you want to discuss any aspects of this letter in more detail, please do not hesitate to contact me.

Yours sincerely,

Harald Wiedmann

*President*



## 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?

(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?

We acknowledge the burden entities might have to meet the requirements of current IAS 24. The definition of related parties is far reaching and the disclosure requirements are complex. Therefore we highly appreciate the Board's efforts to simplify the requirements.

Our understanding is that the main reason for the Board to propose the exemption for state-controlled entities is the fact that state-controlled entities suffer from identifying related party relationships, especially in countries with a large number of state controlled entities.

We strongly doubt if the proposed exemption designed as an indicator approach, is an appropriate solution:

Firstly, the reporting entity has to identify other entities potentially controlled or significantly influenced by the state anyway. Only after an assessment whether or not an indicator signals influence, those entities can be deleted from the list of related parties. But this deletion is not forever: year-by-year the assessment has to be repeated because the facts and circumstances could have changed. As a result nothing but the disclosure itself is economised. The identification process has to be done with or without the exemption in the Board's proposed indicator approach.

Secondly, after having gone through the identification process, the reporting entity has to assess whether or not actual influence was executed. In combination with our doubts concerning the indicators itself (see below), we fear that this indicator approach could lead indeed to less disclosures in the end, but the preparation work is much more challenging than it is now: complex and costly assessments have to be made whether or not an indicator exists.



If the indicator approach will be implemented nevertheless, we want to express the following concerns.

Although the proposed design of the indicators is generally welcome as it allows management's judgement whether or not influence exists, a number of application issues will arise:

It should be made clear if the questions of actual influence should be answered on a transaction level or on an entity level. The former would mean extremely many investigations. The latter would mean that the exemption can not be used in regard to a related party in total if only one transaction with this related party was influenced, whereas the rest of the transactions with the same related party were not influenced.

Additionally, it should be clarified, what the term influence in IAS 24.17A (b), 17B, 17C and 17D means. If, for example, a transaction was made under arm's length conditions, but it would not have been made without pressure of the state, shall it be considered as an influenced transaction or as a non influenced transaction because of the arm's length conditions?

Whereas the wording in IAS 24.17C, that the entity shall consider, if influence exists, allows management's judgement, this judgement is obviously not allowed, if an indicator mentioned in IAS 24.17B exists. We do not see the reason why "shared resources" or "significant transactions" should always be regarded as actual influence.

To sum up, we doubt if the proposed exemption is really a simplification for entities suffering from the burden to identify other state-controlled entities and we have serious concerns about the clearness of the proposed indicators.



## 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?

We basically agree with the proposed amendment as it eliminates an inconsistency in the current definition. However, we refer to our comments on part (d) of this question proposing a general limitation to relationships having control character.

(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?

We agree with the proposed amendment as it eliminates an inconsistency in the current definition.

(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?

We basically agree with the proposed amendment as it eliminates an inconsistency in the current definition. However, we refer to our comments on part (d) of this question proposing a general limitation to relationships having control character.



(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?

We support the general restructuring of the existing definition as we find the restructured definition simpler to read and therefore simpler to understand.

In addition, the proposed amendment eliminates the inconsistencies mentioned in the introduction of the exposure draft. However, there are still some other inconsistencies which should be eliminated as well.

For example:

- 1 The wife of entity A's director has significant influence over entity B.

From the perspective of entity A, entity B is a related party to entity A according to proposed IAS 24.9 (b) (vi).

From the perspective of entity B, entity A is not a related party to entity B as no definition applies.

- 2 Entity A controls entity C, entity B has significant influence over entity C.

While entity A's director is a related party to entity C according to proposed IAS 24.9 (a) (i), entity B's director is not, although entity B is a related party to entity C and entity B's director has the same "controlling influence" in entity B as entity A's director has in entity A.

Presumably, other so far undetected inconsistencies will arise when applying the new provisions.

Even more important than that, we suggest reconsidering the current and also the proposed definition of a related party relationship fundamentally.

Both the current and the proposed definition assume that significant influence is enough to influence transaction between the reporting entity and the related party in a way that the transactions would not have entered into or at conditions different from market rates.

We doubt if this is true. Significant influence is defined as the power to participate in the financial and operating policy decisions of an entity but is not control over these policies. We are of the opinion that this power is not enough to influence *transactions* of that entity in the afore mentioned sense.



As a result the definition should be limited to those relationships which are of control character. This would not only lead to a significant alleviation for preparers, it would also increase the explanatory power of the reported disclosures as many irrelevant disclosures would be eliminated. Hence, also users would benefit from this limitation.

Our understanding about the proposed amendment to the definition of close family members is that the definition is extended by deleting the term *may*. We are of the opinion that the same fundamental idea as mentioned above should be applied to the question if all close family members should be regarded as related parties. We believe that the current and even more the proposed definition are much too far reaching. A limitation to a smaller group of dependants, determined on the basis of a clear underlying principle, would be helpful for preparers and users.

### **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?

We support the clarification of the definition in IAS 24.9 regarding related party transactions being transactions between the reporting entity and a related party.

In addition to the proposed example in IAS 24.20 (j), we suggest clarifying whether or not dividend payments are part of related party transactions as this is a frequent question in practice. We are of the opinion that dividend payments do not meet the requirement of being a transfer of resources, services or obligations between the reporting entity and the related party.

### **Question 4**

Do you have any other comments on the proposals?

We have some minor additional proposals:

- We suggest amending the proposed title of the Board's amendment from "state-controlled entities" to "state influenced entities" as this would better reflect the content of the exemption.
- The proposed exemption in IAS 24.17A (a) refers to state-controlled entities and entities significantly influenced by the state. We wonder why jointly controlled entities are not mentioned.
- We also wonder if there is a major application problem caused by the definition of the term state. In many cases, it is not the state itself, but a kind of agency,



who is the shareholder of a state-controlled entity. Another example: if one entity is controlled by Federal Ministry A and another is controlled by Federal Ministry B, is this relationship covered by the proposed exemption? The question is how to deal with these cases.

- Proposed IAS 24.9 (a) (i) refers to a person being “a member of the key management personnel of the reporting entity or a parent of the reporting entity”. Recent discussions have shown that this wording can be misunderstood. The second alternative can be read as follows: the person is a parent of the reporting entity, which was presumably not intended. If the word “of” was inserted after the “or” the following would be clear: “a member of the key management personnel of the reporting entity or of a parent of the reporting entity”, which was presumably intended.