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EXPOSURE DRAFT

Relationships with the State

Proposed amendments to IAS 24

Comments to be received by 13 March 2009



International
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Exposure Draft

RELATIONSHIPS WITH THE STATE

(Proposed Amendments to IAS 24)

Comments to be received by 13 March 2009

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Introduction

- 1 In February 2007 the International Accounting Standards Board published *State-controlled Entities and the Definition of a Related Party* (an exposure draft of proposed amendments to IAS 24 *Related Party Disclosures*). In that document the Board proposed an exemption from the disclosure requirements in IAS 24 for entities that are controlled, jointly controlled or significantly influenced by a state ('state-controlled entities') in relation to transactions with other state-controlled entities. The proposed exemption would have applied (a) if neither entity actually influenced the other entity and (b) if the state did not actually influence either entity with regard to transactions between them.
- 2 The comment period ended on 25 May 2007. After considering respondents' comments, the Board now proposes a revised exemption for such entities, rather than finalising the exemption previously proposed. The revised proposal would exempt an entity from disclosing transactions with the state as well as other state-controlled entities, regardless of whether influence actually exists in such relationships. However, the proposal would require an entity to disclose information necessary to draw attention to such transactions.
- 3 The previous exposure draft also proposed amendments to the definition of a related party. Respondents generally supported the new definition and the Board intends to adopt a definition based on it, after seeking comment on one further amendment. That amendment would treat two entities 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. This proposal would reinstate one case inadvertently omitted by the previous exposure draft and eliminate various minor inconsistencies.

Invitation to comment

The International Accounting Standards Board invites comments on the amendments proposed in this exposure draft, particularly on the questions set out below. Comments are most helpful if they:

- (a) comment on the questions as stated,
- (b) indicate the specific paragraph or group of paragraphs to which they relate,
- (c) contain a clear rationale, and
- (d) if applicable, include an alternative the Board should consider.

The Board is not seeking comments on matters in IAS 24 other than those set out in this exposure draft.

Respondents should submit comments in writing so as to be received no later than **13 March 2009**.

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?

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?

Question 3

Do you have any other comments on the proposals?

Proposed amendments to IAS 24 *Related Party Disclosures*

Definitions

In paragraph 9 the definition of a related party is replaced by the following.

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).

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- (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.

Disclosure

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.**

20 The following are examples of transactions that are disclosed if they are with a related party:

- (a) purchases or sales of goods (finished or unfinished);
- (b) purchases or sales of property and other assets;
- (c) rendering or receiving of services;
- (d) leases;
- (e) transfers of research and development
- (f) transfers under licence agreements;
- (g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);
- (h) provision of guarantees or collateral; and
- (i) settlement of liabilities on behalf of the entity or by the entity on behalf of another party.

Participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities is a transaction between related parties (see paragraph 34B of IAS 19).

[Draft] Illustrative examples

The following [draft] examples [would] accompany, but [would not be] part of, IAS 24. They illustrate:

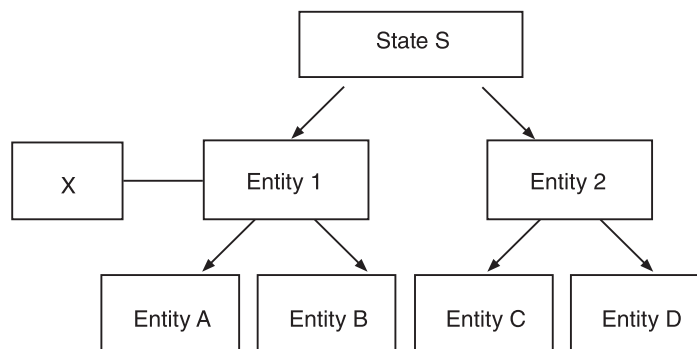
- the proposed exemption for state-controlled entities
- how the proposed definition of a related party would apply when a person or another entity has joint control, significant influence or significant voting power in the reporting entity and in a third party.

[Note for readers of the exposure draft: The exposure draft *State-controlled Entities and the Definition of a Related Party*, published in 2007, contained examples illustrating other aspects of the definition. The IASB staff have updated those examples and posted them on the IASB's Website (www.iasb.org).]

State-controlled entities

Example 1—Exemption from disclosures

IE1 State S, directly or indirectly, controls Entities 1 and 2 and Entities A, B, C and D. Person X is a member of the key management personnel of Entity 1.



IE2 In Entity A's financial statements, the exemption in paragraphs 17A and 17B would apply to:

- transactions with State S; and
- transactions with Entities 1 and 2 and Entities B, C and D.

However, that exemption would not apply to transactions with Person X.

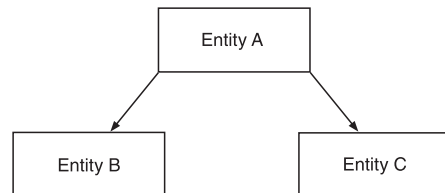
IE3 In Entity A's financial statements^{*}, an example of disclosure to comply with paragraphs 17A and 17B could be:

[Example] State S, directly or indirectly, owns 80 per cent of the company's outstanding shares. The company's significant transactions with State S and other entities controlled, jointly controlled or significantly influenced by State S are [a large portion of its sales of goods and purchases of raw materials] [about 50 per cent of its sales of goods and about 35 per cent of its purchases of raw materials]. The company also benefits from guarantees by State S of the company's bank borrowing (see note X [of the financial statements] for details [to comply with other relevant IFRSs]). Those transactions are related party transactions as defined in IAS 24 *Related Party Disclosures*. However, as permitted by IAS 24, the related party disclosures in note Y do not include disclosure about transactions with those related parties.

Definition of a related party

Example 2—Entity with joint control

IE4 Entity A (a) has joint control over Entity B and (b) has joint control or significant influence over Entity C.



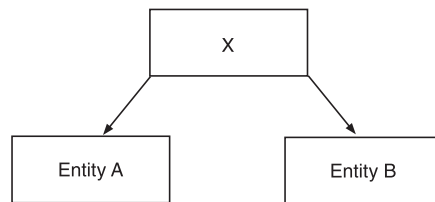
IE5 For Entity B's financial statements, Entity C is related to Entity B. [paragraph 9(b)(iii) and (iv)]

IE6 Similarly, for Entity C's financial statements, Entity B is related to Entity C. [paragraph 9(b)(iii) and (iv)]

* In examples 1-4, 'financial statements' means the individual, separate or consolidated financial statements.

Example 3—Person with joint control

IE7 Person X (a) has joint control over Entity A and (b) has joint control or significant influence over Entity B or significant voting power in it.

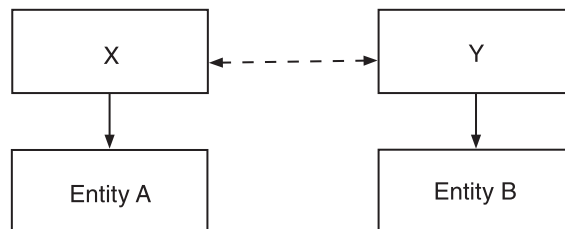


IE8 For Entity A's financial statements, Entity B is related to Entity A. *[paragraph 9(b)(vi) and (ix)]*

IE9 Similarly, for Entity B's financial statements, Entity A is related to Entity B. *[paragraph 9(b)(vi)]*

Example 4—Close member of the family of person with joint control

IE10. Person X is a close member of Person Y's family. Person X has joint control over Entity A and Person Y has joint control or significant influence over Entity B or significant voting power in it.



IE11 For Entity A's financial statements, Entity B is related to Entity A. *[paragraph 9(b)(vi) and (ix)]*

IE12 Similarly, for Entity B's financial statements, Entity A is related to Entity B. *[paragraph 9(b)(vi)]*

**Approval by the Board of *Relationships with the State*
(proposed amendments to IAS 24) published in
December 2008**

Relationships with the State (proposed amendments to IAS 24 *Related Party Disclosures*) was approved for publication by the thirteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Stephen Cooper	
Philippe Danjou	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
John T Smith	
Tatsumi Yamada	
Wei-Guo Zhang	

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed amendments to IAS 24.

Introduction

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in the exposure draft *Relationships with the State*. Individual Board members gave greater weight to some factors than to others.
- BC2 In February 2007 the Board published *State-controlled Entities and the Definition of a Related Party* (an exposure draft of proposed amendments to IAS 24 *Related Party Disclosures* (the 2007 ED)). The 2007 ED proposed an exemption from the disclosure requirements in paragraph 17 of IAS 24 for entities controlled, jointly controlled or significantly influenced by a state ('state-controlled entities'). It also proposed to amend the definition of a related party to clarify the intended meaning and to remove some inconsistencies.
- BC3 In developing the 2007 ED, the Board noted the following:
- (a) It can be difficult to identify other state-controlled entities, particularly in jurisdictions with a large number of such entities.
 - (b) The cost of meeting the requirements in IAS 24 is not always offset by the benefit of increased information for users of financial statements. More specifically:
 - (i) extensive disclosures are required for transactions that are unaffected by the relationship;
 - (ii) if some entities are not aware that their transactions are with other state-controlled entities, the disclosures provided will be incomplete; and
 - (iii) transactions that are affected by the relationship might well be obscured by excessive disclosures about unaffected transactions.
 - (c) Some states establish subsidiaries, joint ventures and associates to compete with each other. In this case, transactions between such entities are likely to be conducted as if they are unrelated parties.
- BC4 The 2007 ED proposed that the exemption would apply if:
- (a) entities are related simply because of control, joint control or significant influence by the same state;

- (b) neither entity actually influences the other entity; and
- (c) the state does not actually influence either entity with regard to transactions between them.

To support this principle, the 2007 ED proposed various indicators that would suggest that actual influence might have occurred.

- BC5 The comment period for the 2007 ED ended on 25 May 2007. The Board received 72 comment letters. Respondents generally supported an exemption for state-controlled entities. However, respondents expressed concerns about the complexity of the specific proposal in the 2007 ED and asked the Board to clarify various aspects of it. The Board attempted to address those concerns, but concluded that this would make the exemption so complex that it would not achieve its purpose.
- BC6 After considering the comments received, the Board now proposes a revised exemption for those entities (see paragraphs BC7–BC11). In addition, the Board proposes one further amendment to the definition of a related party (see paragraphs BC12–BC17).

State-controlled entities

- BC7 The revised proposal would exempt state-controlled entities from the disclosure requirements in paragraph 17 of IAS 24 in relation to the state and other state-controlled entities. However, the proposal would require those entities to disclose some information necessary to draw attention to such relationships and transactions.
- BC8 More specifically, the Board's revised proposal has the following features:
- (a) As proposed in the 2007 ED, other state-controlled entities would still be treated as related to the reporting entity, but the reporting entity would be exempt from the requirement to disclose transactions with those entities. (If both entities are significantly influenced by the state, but not controlled or jointly controlled by it, they would not be related parties).
 - (b) Unlike in the 2007 ED, the revised exemption would not require the reporting entity to assess whether actual influence existed (see paragraph BC9).
 - (c) Unlike in the 2007 ED, the revised exemption would extend to transactions with the state itself (see paragraph BC10).
 - (d) The 2007 ED would have required the reporting entity to disclose the fact that it was exempt from the disclosure requirements of

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paragraph 17 of IAS 24. The reporting entity would have been required to state that there is no indication that it influenced or was influenced by other state-controlled entities, nor that the state influenced either entity with regard to transactions between it and other state-controlled entities. The revised proposal would require more specific disclosure: the name of the state, the nature of its relationship with the reporting entity and some information about the types and extent of significant transactions with the state or other state-controlled entities (see paragraph BC11).

- BC9 As noted in paragraph BC4, the exemption proposed in the 2007 ED would have applied if there were no actual influence between the entities or between the entities and the state. In developing this revised proposal for the current exposure draft, the Board noted that it might be very difficult, if not impracticable, to assess whether influence actually existed. Thus, the exemption does not require such an assessment.
- BC10 Furthermore, the proposed exemption extends to transactions between the reporting entity and the state itself, for the following reasons:
- (a) Paragraph BC3 describes reasons why the Board proposes an exemption for transactions between state-controlled entities. Those reasons are equally valid for transactions between the reporting entity and the state.
 - (b) It may be difficult to distinguish between a state and entities controlled by that state. For example, are departments and agencies part of the state or are they entities controlled by the state?
 - (c) If the exemption were available for transactions with state-controlled entities but not for transactions with that state, the resulting disclosure would be arbitrary and of limited benefit to users. One state might conduct many transactions directly, leading to disclosure of those transactions, whereas another state might conduct most transactions through state-controlled entities, leading to a lower level of disclosure, even though the substance of the relationships and transactions could be very similar.
- BC11 The objective of IAS 24 is to provide 'disclosures necessary to draw attention to the possibility that [the entity's] 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.' To meet that objective, 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.

Additional amendments to the definition of a related party

- BC12 The 2007 ED proposed to restructure the definition of a related party in IAS 24. The restructuring was not intended to change the meaning of a related party except in three respects described explicitly in the 2007 ED. Respondents generally supported the restructured definition and the Board intends to adopt it.
- BC13 The Board is taking the opportunity provided by this exposure draft to propose one further amendment to the definition of a related party, as discussed in paragraphs BC14–BC16. The Board invites comment on this aspect of the definition. The Board regards all other aspects of the definition as final and seeks no further comment on them. For the convenience of respondents, the appendix to this document contains a marked up copy of the definition, showing the changes from the version proposed in the 2007 ED.
- BC14 Some respondents pointed out one aspect that was excluded from the restructured definition without being explicitly stated as a change to IAS 24. When a person has joint control over a reporting entity and a close member of that person’s family has joint control or significant influence over the other entity or has significant voting power in it, IAS 24 defines the other entity as related to the reporting entity. However, this case was omitted from the definition proposed in the 2007 ED.
- 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. Therefore, the Board proposed that the

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relationship described in paragraph BC14 should remain a related party relationship. Paragraphs BC16 and BC17 explain how the revised definition of a related party would deal with this point and two other anomalies.

- BC16 The existing definition in IAS 24 does not include the reciprocal of the case described in paragraph BC14, nor does it deal with cases when a person or a third entity has joint control, significant influence or significant voting power in two entities. The definition proposed in the 2007 ED would not have rectified those omissions. The Board now proposes to include those cases in the definition, to treat similar relationships in a consistent manner. In summary, the Board's revised proposals would treat two entities 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 significant voting power in it.
- BC17 The proposed amendments discussed in paragraphs BC14–BC16 are reflected in the revised definition of a related party as follows:
- (a) Case when a third entity has joint control over one entity and that third entity has joint control or significant influence over the other entity: paragraph 9(b)(iii) and (iv) of the revised definition.
 - (b) Case when a person has joint control or significant influence over the reporting entity or has significant voting power in it and that person (or a close member of that person's family) has joint control over the other entity: paragraph 9(a)(iii) and (b)(vi) of the revised definition.
 - (c) The reciprocal of the case in (b) above: paragraph 9(b)(ix) of the revised definition.

Appendix

For the convenience of respondents, this appendix shows the changes made to the definition of a related party, as proposed in the exposure draft published in 2007, to arrive at the definition proposed now. New text is underlined and deleted text is struck through. Except as indicated in paragraphs BC12–BC17, the Board regards these changes as final and does not seek comment on them.

Revised definition of a related party

A *related party* is a person or entity that is related to ~~an~~ 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 ~~the~~ that person’s family ~~of that person~~ is related to a reporting entity if ~~either~~ 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) ~~the reporting~~ 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) ~~the entity is an associate or joint venture of the reporting entity (or of a member of a group of which the reporting 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.
 - (iv)(v) ~~the~~ 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.
 - (v)(vi) ~~the~~ the entity is controlled or jointly controlled by a person identified in (a) ;

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- ~~(vi)~~(vii) ~~the entity is one in which a person identified in (a)(i) or (a)(ii) has holds significant voting power or has joint control or significant influence in the entity;~~
~~or~~
- (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.
- ~~(vii)~~(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 significant influence over, or has significant voting power in, the reporting entity it;