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Dear Stig,

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 EFRAG's draft comment letter on the IASB's Exposure Draft of Proposed Amendments to IAS 24 Related Party Disclosures – State-controlled Entities and the Definition of a Related Party (the "DCL"). This letter represents the view of the German Accounting Standards Board.

As a result of our considerations we support EFRAG's proposal except for the following issues:

- We do not support EFRAG's proposal (see par 2 in DCL) to provide a general exemption for transactions which have not been influenced. The distinction whether or not a transaction has been influenced is very difficult in many cases. Hence, we do not think that is a real improvement in sense of a simplification.
- Regarding the definition of related parties we propose to limit related party relationships generally to those relationships having control character.
- Accordingly, we support by all means the idea to propose an alternative principles-based definition (see par 11 in DCL), but it should be adjusted to our comments on the definition of related parties.

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

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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 IASB's 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.



For the same reasons we doubt if EFRAG's proposal is an appropriate solution:

To apply the proposed exemption, the reporting entity has to identify the other related party and to assess whether or not a transaction with this party has been influenced. The assessment of being influenced or not is very difficult in many cases due to the lack of comparable transactions with other market participants. Diversity in practice will be the result. The advantage of current IAS 24 is that this distinction does not have to be made.

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 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 IASB's 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.

In addition to EFRAG's DCL we suggest to note that presumably other so far undetected inconsistencies will arise when applying the new provisions.

To avoid inconsistencies and to make the definition simpler to read and to understand, we propose the following re-drafted principles-based definition:



- a) *An entity or a person is a related party to the reporting entity if the direct relationship between both is of control character.*
- b) *If the entity or the person referred to in a) has only an indirect relationship to the reporting entity, they are also related parties to the reporting entity, if any relationship in between (upwards or downwards) is of control character.*
- c) *For purposes of identifying a related party relationship a member of the key management personnel is equivalent to a person having control over an entity.*

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 EFRAG's comments in the DCL.

Question 4

Do you have any other comments on the proposals?

Although we support the idea to limit the definition of close family members, we are not in favour of a best efforts-solution as proposed in the DCL, par 13. The understanding what best efforts means can vary widely. Therefore it is not an appropriate solution from our point of view.

Rather, we prefer a limitation to a smaller group of dependants and refer to our comments on question 2 (d).