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11 March 2009

Dear Sir David,

## **Exposure Draft, Relationships with the State - Proposed amendments to IAS 24**

Deloitte Touche Tohmatsu is pleased to respond to the Exposure Draft, *Relationships with the State - Proposed amendments to IAS 24* (the "2008 exposure draft").

We agree that state-controlled entities may have difficulties in identifying all entities controlled, jointly controlled or significantly influenced by the same state. However, we are concerned that the proposed exemption as set out in the 2008 exposure draft is too broad. In addition, we have a number of concerns in relation to the revised definition of a related party. Our detailed responses to the invitation to comment questions are included in Appendix A.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0) 207 007 0907.

Yours sincerely,



**Ken Wild**  
**Global IFRS Leader**

## **Appendix A: Invitation to Comment**

### **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.*

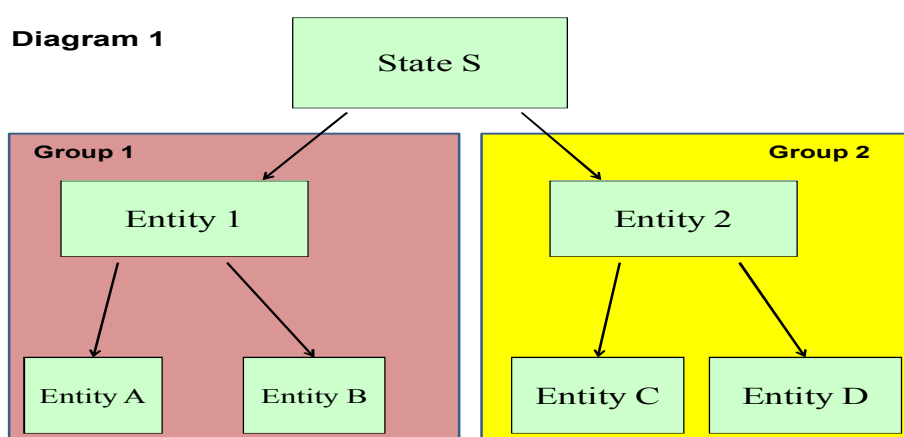
*Do you agree with the proposed exemption, and with the disclosures that entities must provide when the exemption applies? Why or why not? If not, what would you propose instead and why?*

We concur with the Board's view that, in practice, it may be difficult to determine whether there is actual influence by the state over transactions between state-controlled entities<sup>1</sup>. However, we believe that the proposed exemption as set out in the 2008 exposure draft is too broad.

Paragraph 17A of the Exposure Draft states: "*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."*

IE 1 in the 2008 exposure Draft illustrates the exemption (see Diagram 1 below that is based on the example provided in IE 1).



*Note: State S directly or indirectly controls Entity 1, Entity 2, Entity A, Entity B, Entity C and Entity D.*

<sup>1</sup> The term "state-controlled entities" in this comment letter refers to entities that are controlled, jointly controlled or significantly influenced by a state.

As illustrated in IE 1, the exemption is so broad that Entity A, in its individual financial statements, would not be required to make the disclosures set out in paragraph 17 for transactions with Entity B and Entity 1. Likewise, we believe that the proposal would suggest that Entity 1 and Entity B would not be required to make the disclosures set out in paragraph 17 for transactions with Entity A and Entity B, and transactions with Entity 1 and Entity A respectively. We do not believe that the Board's justification for this exemption is adequately explained in the Basis for Conclusions.

We note that, in practice, the main difficulty for state-controlled entities seeking to comply with the disclosure requirements in paragraph 17 is that it may not be feasible for them to identify **all** entities that are controlled, jointly controlled or significantly influenced by the state. Therefore, it is often difficult to perform a completeness test as to whether the reporting entity is in compliance with the requirements in IAS 24.

Therefore, we can understand why Entity 1, Entity A and Entity B in Group 1 should be exempted from the related party disclosures for transactions with Group 2.

However, we do not understand why Entity 1, Entity A and Entity B in Group 1 in their separate or individual financial statements are not be required to make the related party disclosures for transactions with entities within Group 1 for the following reasons:

- The objective of IAS 24 is to provide users with information necessary to draw their attention to the possibility that an 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. We see the exemption proposed by the 2008 exposure draft as a practical solution to address the real difficulties in complying with the disclosure requirements in paragraph 17 for certain state-controlled entities and to avoid unnecessary and impracticable disclosures. However, we do not believe that Entity 1, Entity A and Entity B would have significant difficulties in identifying entities that are controlled, jointly controlled or significantly influenced by Entity 1. Entity 1, Entity A and Entity B are in a group that contains a parent and subsidiaries and hence Entity 1 would be required to identify all transactions with entities within Group 1 for the purposes of the preparation of its consolidated financial statements.
- We are aware of many circumstances where Entity 1 and Entity 2 in Diagram 1 are entities whose equity instruments are traded in a public market. In those situations, Entity 1 and Entity 2 are controlled or significantly influenced directly by the state. In addition, in such circumstances, Entity 1 would usually prepare consolidated financial statements that include the results and financial positions of its subsidiaries (as would Entity 2). In this respect, Entity 1 and Entity 2 are no different from other entities whose equity instruments are traded in a public market (ie listed entities). However, under the proposals outlined in the 2008 exposure draft, listed entities in a group where the parent is not a state-controlled entity would still be required to disclose, in their individual financial statements, transactions with other entities within the same group. We do not understand why entities within a group where the parent is controlled or significantly influenced by the state (eg entities within Group 1 or entities with Group 2) would be

exempted from the disclosures in paragraph 17 in relation to transactions with other entities within the same group.

We believe that the exemption should only apply to situations where two entities are related parties **solely because** they are both controlled, jointly controlled or significantly influenced by the same state.

To illustrate, Entity 1, Entity A and Entity B are related parties by virtue of their relationship to one another, irrespective of their relationship to the state. Likewise, Entity 2, Entity C and Entity D are related parties, irrespective of their relationship to the state. This illustration relies on an assumption that Entity 1 and Entity 2 are not considered to be "the state" for the purposes of applying IAS 24. In the later section relating to the definition of the state, we will discuss that question in more detail.

We, therefore, believe that Entity 1, Entity A and Entity B, in their individual financial statements, should make the disclosures in accordance with paragraph 17 for transactions with other entities within Group 1.

Where entities are related **solely because** they are controlled by the state, we agree that the exemption in relation to paragraph 17 should be given to such transactions, and generic disclosures, as proposed in paragraph 17B, should be made. However, we believe that it is important for the Board to emphasize in the final text of the standard that those generic disclosures should provide users with sufficient information relevant to an understanding of the effect of material related party transactions on the financial performance of the entities. Such a view is consistent with the underlying principle in IAS 1 *Presentation of Financial Statements* that requires entities to provide users with information that is relevant to understanding the financial performance of an entity (see paragraphs 15 and 112 of IAS 1). In determining whether a transaction is material, the size or nature, or a combination of both should be considered.

To address the concerns we have raised, we would propose the following changes to paragraphs 17A and 17B:

- (1) Amending paragraph 17A as follows (new text is underlined and deleted text is struck through):

*"Subject to the requirements of paragraphs 17B, A reporting entity is exempt from the disclosure requirements of paragraph 17 ~~in relation to~~ when it has transactions with: ... (b) another entity that is a related party solely because the same state has control, joint control or significant influence over both the reporting entity and the other entity."*

- (2) Amending paragraph 17B as follows (new text is underlined and deleted text is struck through):

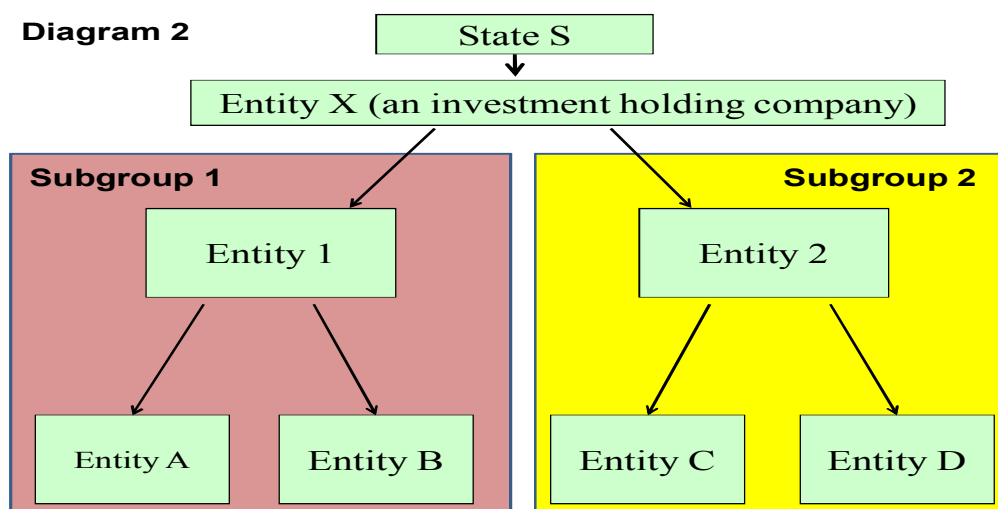
Paragraph 17B "However, a reporting entity that is exempt from the disclosure requirements of paragraph 17 shall disclose the following information about transactions with the state or other entities referred to in paragraph 17A if they are individually or collectively material significant:"

- (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. The entity shall disclose information that enables users of financial statements to understand the effect of material related party transactions on the financial performance of the entity; 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 as required by paragraph 17 do not cover transactions with the state or with those entities referred to in paragraph 17A.

**Definition of "state"**

If the Board agrees with our comments above (that is, the exemption should not be provided to transactions between entities within the same group), we believe that the Board should also clarify the meaning of state in the situation below.

*Whether Entity X would be considered as the "state" for the application of IAS 24 purposes*



*Note: State S directly or indirectly controls Entity X, Entity 1, Entity 2, Entity A, Entity B, Entity C and Entity D.*

Entity X is an investment holding company acting in accordance with instructions from State S.

If Entity X is not considered to be the state, our proposal above would suggest that entities within subgroup 1 would not be exempted from the disclosures in paragraph 17 in relation to transactions with subgroup 2. Alternatively, if Entity X is considered to be the state, entities within subgroup 1 would be exempted from the disclosures in paragraph 17 in relation to transactions with subgroup 2.

In our view, whether Entity X should be considered as the state should be based on the specific facts and circumstances of each case. In a situation where Entity X is "in substance" merely an extension of the state, we believe that Entity X should be considered as the state for the purposes of applying IAS 24. We believe that it is important for the Board to clarify this in the final Standard. The Board should develop the parameters to help practitioners make this assessment. For example, we do not believe that a reporting entity whose equity instruments are publicly traded can be considered to be the state for the purposes of applying IAS 24.

In addition, we believe that the Board should clarify whether supra-national governing bodies (such as the European Union) are considered to be the state for the purposes of applying IAS 24. Since the Exposure Draft covers "relationships with the state", the definition of the state should be unquestionably clear.

### **Other comments**

In addition, we believe that the Board should clarify whether information about outstanding balances with the state or other state-controlled entities is required to be disclosed in the same level of detail as transactions are disclosed. It appears that paragraph 17B does not require state-controlled entities to make any disclosures relating to outstanding balances with the state or other state-controlled entities at the end of a reporting period. However, paragraph BC 11 states: "*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.*" [**Emphasis added**]. As currently drafted, it is not clear whether the proposed exemption extends to outstanding balances with the state or other state-controlled entities.

### **Question 2 – Definition of 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 party has joint control over one entity and that person (or a close member of that person's family) or the third party 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?*

We note that the 2008 exposure draft proposes the following main amendments to the definition of a related party as previously set out in the 2007 exposure draft:

- a) A person is a related party to the reporting entity when the person (or a close family member of the person) has significant voting power in the reporting entity (see paragraph 9(a)(iii));

- b) Two entities are related parties when one entity in which Person A has significant voting power and another entity is controlled or jointly controlled by Person A (see paragraph 9(a)(iii) and paragraph 9(b)(vi));
- c) Two entities are related parties when one entity is a joint venture of a third entity and the other entity is an associate of the third entity (see paragraph 9(b)(iv)); and
- d) Two entities are related parties when both entities are jointly controlled by a party (see paragraph 9(b)(iii)).

We have the following concerns in relation to the proposed definition:

- a) Impracticability in identifying related parties – A reporting entity may have difficulty in identifying related parties in some situations. For example, where a reporting entity is merely an associate or a jointly controlled entity of another entity, the reporting entity may not be able to identify entities jointly controlled or significantly influenced by the latter entity (unless the latter entity willingly provides the reporting entity with the full list of its related parties). Likewise, a reporting entity in which a party has significant voting power may not be able to identify entities controlled or jointly controlled by that party.

To resolve this issue, we believe that the Board should require related party disclosures in accordance with paragraph 17 **only when** the transactions are individually or collectively material.

- b) What is meant by significant voting power – Although existing IAS 24 does have the term "significant voting power" (see IAS 24 paragraph 9(f)), this term is not a commonly understood term. The term "significant voting power" is not defined in IAS 24 or in other IFRSs. We do not believe that the Board equates the term "significant voting power" with the term "significant influence". We suggest the Board deleting the term "significant voting power" in IAS 24. However, if the Board insists keeping such a term, the Board should define what is meant by significant voting power to avoid unnecessary divergence in practice".
- c) Editorial comments on paragraph 9(b)(iii) – Paragraph 9(b)(iii) states: "both entities are joint ventures of a third party". We believe that paragraph 9(b)(iii) should be drafted as "both entities are joint ventures of the same third ~~party~~ entity."
- d) Editorial comments on paragraph 9(b)(iv) to avoid confusion – "either entity should be replaced with "either of the entities".

### Question 3

*Do you have any other comments on the proposals?*

We have the following comments on the proposals (other than those specifically raised in the 2008 exposure draft):

a) Clarification on whether the entities/parties below are related parties:

- A reporting entity in which an entity has significant voting power. Paragraph 9(a)(iii) only deals with a situation where a person has significant voting power.
- An entity whose parent is either jointly controlled or significantly influenced by the reporting entity.
- A member of the key management personnel of an entity that jointly controls or significantly influences the reporting entity.

In addition, regarding subparagraphs 9(b)(ii), (iii) and (iv), the Board should clarify whether the requirements would cover indirect relationships. For example, we wonder whether paragraph 9(b)(ii) should be changed to "either entity (or the parent of either entity) is an associate of or joint venture of the other entity ..."

Moreover, IAS 24 paragraph 9(b)(x) suggests that an entity is a related party of the reporting entity when 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. However, we note that the proposed definition does not require an entity to be considered as a related party of the reporting entity when the key management personnel of the entity or of the parent of the entity has significant influence in the reporting entity. It is not clear to us what the difference between "significant influence" and "significant voting power" is. We do not understand why the requirement in paragraph 9(b)(x) is not applicable to the "significant influence" situation. We believe that the Board should clarify this.

b) The definition of related party is still very complex. To help users understand and apply the definition, we believe that it would be helpful for the Board to include a diagram that illustrates all related parties of a reporting entity (see Appendix B for details).

In addition, the 2008 exposure draft does not mention anything about the effective date and transitional provisions. We note that the 2007 exposure draft proposes retrospective application - no transitional provisions were proposed. The 2008 exposure draft proposes to include other parties as related parties (see Question 2). IAS 1 requires comparative information to be disclosed in respect of the previous period for all amounts reported in the financial statements, unless another IFRS permits or requires otherwise. We are concerned that entities may not be able to quantify the amounts of transactions with "new" related parties for previous periods. We, therefore, believe that entities should not be required to disclose comparative information in relation to transactions with "new" related parties when they apply the amendment for the first time.



The diagram below shows all related parties of a reporting entity based on our understanding of paragraph 9 of IAS 24 as set out in the 2008 exposure draft except for related parties set out in paragraph 9(b)(v) in relation to post employment benefit plans (ie the diagram may not cover all related parties intended to be covered by the Board).

In addition, the diagram below has not yet taken into account our suggestions set out in our responses to Questions 2 and 3.

Boxes in blue – The parent entity of the reporting entity and its related parties.

Boxes in green - A person that has significant voting power over the reporting entity and the related parties.

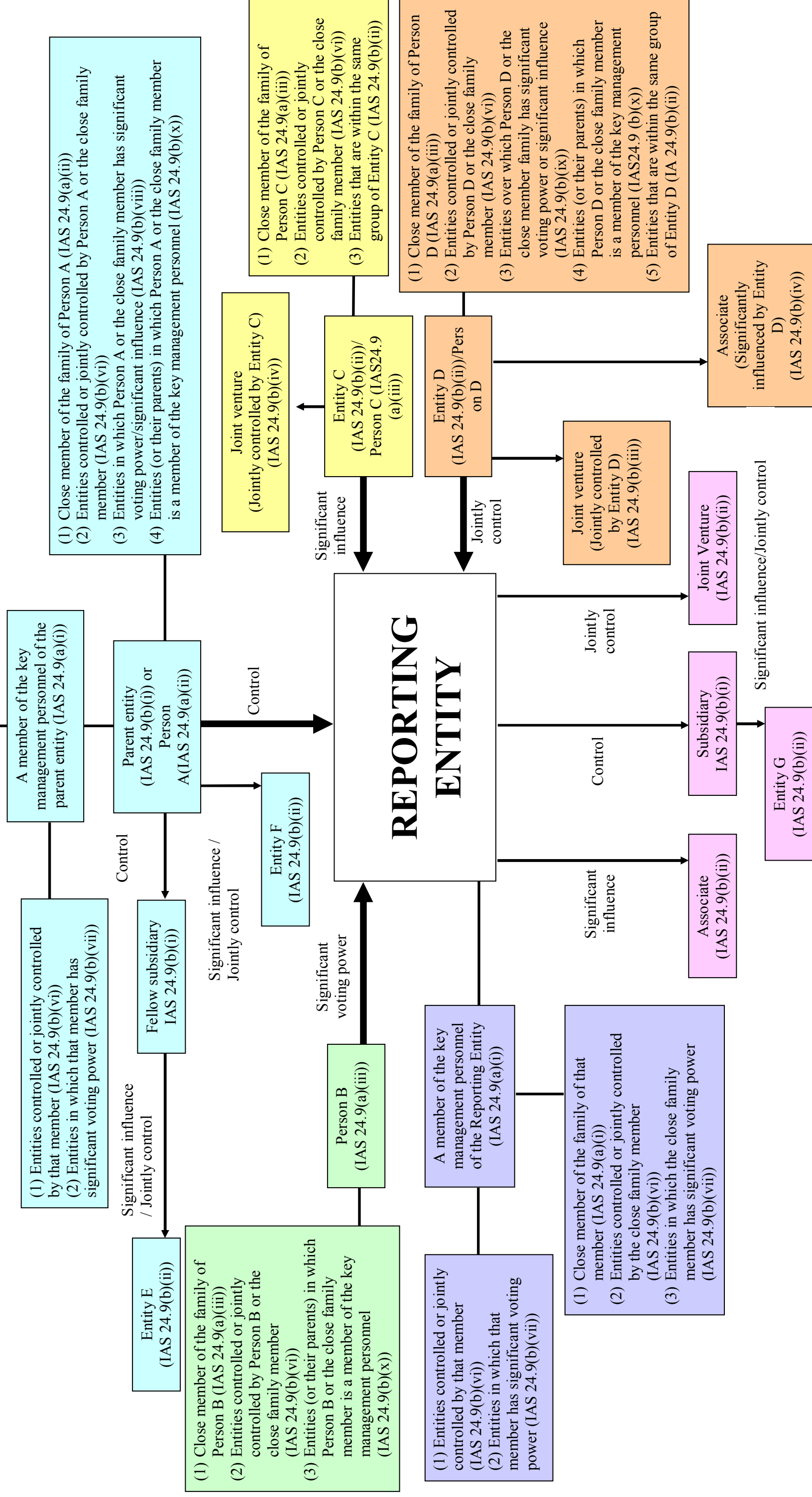
Boxes in yellow – Entity or person that has significant influence over the reporting entity and the related parties.

Boxes in orange – Entity or person that has joint control over the reporting entity and the related parties.

Boxes in purple – Entities controlled, jointly controlled or significantly influenced by the reporting entities.

Boxes in dark blue – The key management personnel of the reporting entity and their related parties.

- (1) Close member of the family of that member (IAS 24.9(a)(i))
- (2) Entities controlled or jointly controlled by the close family member (IAS 24.9(b)(vi))
- 3) Entities in which the close family member has significant voting power (IAS 24.9(b)(vii))



**Appendix B: Diagram illustrating the definition of related party**