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IASB proposes amendments for related party disclosures

On 22 February 2007, the International Accounting Standards Board (IASB) published an Exposure Draft (ED) which would amend IAS 24 **Related Party Disclosures**. The principal change proposed is to reduce disclosure requirements under IAS 24 for some entities that are related only because they are controlled or significantly influenced by the same state. In addition, the ED proposes a number of changes in the detail of the definition of related party, and takes the opportunity to restructure that definition and to improve the language of the Standard generally.

The IASB has requested comments on the proposals by 25 May 2007.

Ken Wild, Deloitte's global IFRS leader, says:

"In principle, I welcome these proposals to amend IAS 24 – particularly as regards removing its blanket coverage of state-controlled entities. We have raised this question with the IASB in the past, and are pleased that they are responding to a very real practical issue for jurisdictions where state-controlled and state-influenced entities play a major role. Similarly, I am pleased to see the Board addressing the numerous quirks in the definition of related party – which are a constant torment for those applying the Standard. But ... the devil is in the detail. An initial reading of the proposals does not bring a very warm feeling. The wording seems woolly in places – and it is important to identify and remove any ambiguities at this stage, so that the revised Standard does result in a real improvement. I and my team will be spending time during the exposure period examining the detail in order to assist the Board in producing the best Standard possible."

State-controlled entities

The Board's primary objective in issuing this ED is to address the question of related party disclosures for state-controlled entities. Note that, for this purpose, the term 'state' refers to a national, regional or local government.

The current version of IAS 24 contains no special provision for state-controlled entities, and therefore is seen as quite burdensome in jurisdictions where state-controlled entities play a major role. The ED proposes to reduce this burden by introducing the following exemption:

A reporting entity is exempt from the disclosure requirements of paragraph 17 [of IAS 24] in relation to an entity if:

- (a) the entity is a related party only because the reporting entity is controlled or significantly influenced by a state and the other party is controlled or significantly influenced by that state; and
- (b) there are no indicators that the reporting entity influenced, or was influenced by, that entity.

Essentially, therefore, transactions between entities that are related only because of their being subject to control or significant influence by the same state would not be disclosable provided that the transactions are unaffected by the relationship.

Indicators of influence

Paragraph 17B of the ED lists the following as indicators of the influence referred to above:

- the related parties transact business at non-market rates (otherwise than by way of regulation); or
- the related parties share resources; or
- the related parties engage in economically significant transactions with each other.

In addition, paragraph 17C of the ED suggests that the following **may** indicate such influence:

- the existence of direction or compulsion by a state for related parties to act in a particular way; or
- the presence of common members on the boards of the entities.

The Board considers that, in the circumstances described in paragraph 17B (see above), it will be difficult to refute that transactions have been influenced by the relationship between the entities. The circumstances described in paragraph 17C, however, are not as clear-cut and more judgement will be required to determine whether influence exists.

The indicators listed above are not intended to be exhaustive.

Transactions that do not qualify for exemption

Where factors or circumstances exist indicating that transactions between state-controlled or state-influenced entities have been affected by the relationship, then those transactions are disclosable in the normal way.

Note also that the exemption extends only to transactions **between** entities controlled or influenced by a state. It does not apply to transactions between such entities and the state itself (i.e. the relief is granted for 'horizontal' transactions but not for 'vertical' transactions).

Disclosures required

Where an entity wishes to avail of the proposed exemption, the ED would require a statement to the effect that there are no indicators that the reporting entity influenced, or was influenced by, any other entity controlled or significantly influenced by the state.

Proposed revised definition of related party

The definition of related party proposed in the ED is set out on the next page.

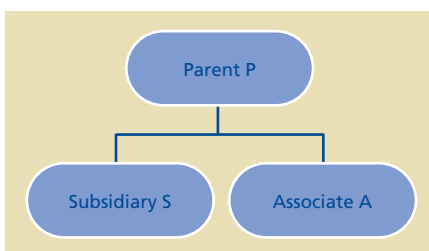
This definition has been completely rewritten – with a view to improving its clarity. In addition, a limited number of substantive changes are proposed regarding the status of:

- an associate of a subsidiary's controlling investor;
- two associates of a person; and
- investments of members of key management personnel.

An associate of a subsidiary's controlling investor

Under IAS 24's current definition, in S's individual financial statements A would not be identified as a related party, because A is not controlled by P.

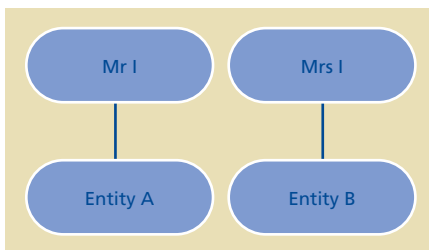
The Board has concluded that the definition of related party should be amended so as to correct this omission. Similarly, under the revised definition, if the investor is a person (rather than an entity) who has significant influence over one entity and control over another entity, then the two investees are related for the purposes of their individual financial statements.



Proposed revised definition of related party

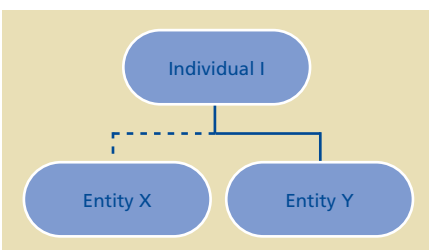
A related party is a person or entity that is related to an entity that is preparing its financial statements (in this Standard [draft revised IAS 24] referred to as the 'reporting entity').

- (a) A person or a close member of the family of that person is related to a reporting entity if either person:
- (i) is a member of the key management personnel of the reporting entity or 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.
- (b) An entity is related to a reporting entity if:
- (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 entity is an associate or joint venture of the entity (or of a member of a group of which the 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);
 - (iv) 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;
 - (v) the entity is controlled by a person identified in (a);
 - (vi) the entity is one in which a person identified in (a)(i) or (a)(ii) holds significant voting power or has joint control or significant influence; or
 - (vii) a member of the key management personnel of the entity, or a parent of the entity, has control, joint control or significant influence over, or significant voting power in, the reporting entity.

**Two associates of a person**

In the example, Mrs I is a close family member of Mr I. Mr I has significant influence over Entity A, and Mrs I has significant influence over Entity B. Under IAS 24's current definition, A and B would be identified as related parties in each other's financial statements. The entities would not fall within the definition of related parties if they were linked only because Mr I had invested directly so as to give him significant influence in both. Neither would they be related for the purposes of their individual financial statements where an investor that is an entity has significant influence over both.

The Board has concluded that having common significant influence through a person and a close member of the family of that person does not result in a related party relationship and proposes to amend the definition of related party to that effect.

**Investments of members of key management personnel**

Under IAS 24's current definition, where I is a member of the key management personnel of Entity X, and he also controls, jointly controls, significantly influences or holds significant voting power in Entity Y, then in X's financial statements Y would be identified as a related party. However, in Y's financial statements, X would not be identified as a related party.

The Board has concluded that the possibility of I influencing transactions is just as relevant in the financial statements of Entity Y as it is for Entity X. Therefore, the proposals would result in both sets of financial statements (X and Y) identifying the other as a related party.

The next steps

This ED has a 90 day (rather than the more usual 120 day) comment period – with comments requested by 25 May 2007. The Board's intention is to have the revised Standard in place for 2007 year ends. While it is clear that they intend to permit application for 2007 year ends, they have not yet indicated whether such application will be required – it may be that the revisions are considered to be 'major' (as contemplated in the Board's policy statement issued in July 2006) and, therefore, that mandatory application will not be required until 2009 accounting periods.

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