

Exposure Draft

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Proposed Amendments to AASB 124 *Related Party Disclosures* – State- controlled Entities and the Definition of a Related Party

Prepared by the
Australian Accounting Standards Board



Australian Government

**Australian Accounting
Standards Board**

Commenting on this Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 7 May 2007. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 25 May 2007. Comments should be addressed to:

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A copy of all non-confidential submissions to the AASB will be placed on public record on the AASB website: www.aasb.com.au.

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PREFACE

Background

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards to be applied by:

- (a) entities required by the *Corporations Act 2001* to prepare financial reports;
- (b) all reporting entities engaged in either for-profit, not-for-profit or public sectors; and
- (c) any other entity that prepares general purpose financial reports.

Australian Accounting Standards that apply to annual reporting periods beginning on or after 1 January 2005 include Australian equivalents to International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB).

Although IFRSs are developed to apply to for-profit entities, the AASB has decided to continue to make transaction-neutral accounting standards as between for-profit, not-for-profit private and not-for-profit public sectors. Accordingly, Australian Accounting Standards (including Australian equivalents to IFRSs) generally require the same accounting treatment for similar transactions occurring in both for-profit and not-for-profit entities, including public sector entities. An Australian equivalent to an IFRS uses the corresponding IFRS as the “foundation” Standard to which the AASB adds material detailing its scope and applicability in the Australian environment. Additions are made, where necessary, to broaden the content of the Australian equivalent to an IFRS to cover domestic, regulatory or other issues. In addition to making accounting standards that are Australian equivalents to IFRSs, the AASB also continues to make other Australian Accounting Standards that are specific to the not-for-profit sector, including public sector entities, or that are purely of a domestic nature.

Exposure Drafts

The adoption of IFRSs is an ongoing process. Whenever the IASB issues new or amended IFRSs, the AASB must also consider making new or amended Australian equivalents to those IFRSs.

In developing a new or amended IFRS, the IASB releases an Exposure Draft of the proposed Standard or amendments for public comment. The AASB generally follows a similar due process prior to making or amending Australian Accounting Standards. In the case of changes proposed by the IASB to IFRSs, the AASB also releases an Exposure Draft containing those proposed changes and specifically invites comments from Australian constituents on, among other things, whether the implementation of the proposals in an Australian equivalent to an IFRS may be affected by the Australian environment (including the legal and regulatory environment) and whether the proposals are in the best interests of the Australian economy.

Purpose of this Exposure Draft

The purpose of this Exposure Draft is to invite comments from Australian constituents on proposed amendments to AASB 124 *Related Party Disclosures*, which is the Australian equivalent to IAS 24 *Related Party Disclosures*.

These proposed amendments are contained in the Exposure Draft of Proposed Amendments to IAS 24 *Related Party Disclosures* – State-controlled Entities and the Definition of a Related Party that was issued by the IASB in February 2007. If these amendments are approved by the IASB, and subsequently by the AASB, they are expected to be applicable from the time that the IASB amendments become effective. The IASB has not yet specified an effective date.

Summary of Main Changes to AASB 124

The Exposure Draft proposes to eliminate the disclosure requirements in paragraph 17 of AASB 124 for some entities that are controlled or significantly influenced by a state in relation to transactions with other entities controlled or significantly influenced by that state. The IASB has used an indicator approach to establish when an entity can apply the exemption.

The proposed indicators of circumstances in which the relationship should not be exempt include:

- the presence of common members of the board;
- the existence of direction or compulsion by a state;
- related parties transacting business at non-market rates;
- related parties sharing of resources; and
- related parties undertaking economically significant transactions.

The Exposure Draft proposals would mean that, in the absence of the above indicators, state-controlled entities (that is, entities controlled by a national, regional or local government) would not need to undertake the exercise of investigating whether it had a transaction that might need to be disclosed with any other state-controlled entity. In the Australian context, the relief as proposed in this Exposure Draft would only apply to for-profit public sector entities, because AASB 124 does not apply to not-for-profit public sector entities.

The Exposure Draft also proposes to amend and clarify the definition of a related party to remove inconsistencies and improve readability. The AASB's preliminary view is to support these proposals. The main amendments to the definition are:

- the inclusion, in the definition of a related party, of the relationship between a subsidiary and an associate of the same entity, in the individual or separate financial statements of both the subsidiary and the associate;
- the removal, from the definition of a related party, of situations in which two entities are related to each other because a person has significant influence over one entity and a close member of the family of that person has significant influence over the other entity. The IASB concluded that the definition of IAS 24 does not include two associates of the same entity as related to each other. Therefore, when the investor is a person and a close member of the family of that person, the same conclusion should apply; and
- the inclusion, within the definition of a related party, of two entities where one is an investee of a member of key management personnel (KMP) and the other is the entity managed by the person that is a member of KMP. At present, investees of KMP are related to the entity that the KMP managed but AASB 124 does not include the reciprocal of this.

Request for Comments

Comments are invited on any of the proposals in the Exposure Draft, including the questions on the proposed amendments to IAS 24 as listed in the Invitation to Comment sections of the IASB Exposure Draft.

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 7 May 2007. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 25 May 2007. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB

regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Specific Matters for Comment

In addition, the AASB would value comments on:

- (a) any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
 - (i) not-for-profit entities; and
 - (ii) public sector entities;
- (b) whether the proposals are in the best interests of the Australian economy.

Exposure Draft of Proposed
AMENDMENTS TO
IAS 24 *RELATED*
PARTY DISCLOSURES
STATE-CONTROLLED ENTITIES
AND THE DEFINITION OF A
RELATED PARTY

Comments to be received by 25 May 2007

This Exposure Draft of proposed Amendments to IAS 24 Related Party Disclosures—State-controlled Entities and the Definition of a Related Party is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form as amendments to IAS 24. Comments on the Exposure Draft and the Basis for Conclusions should be submitted in writing so as to be received by **25 May 2007**.

Respondents are asked to send their comments electronically to the IASB Website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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PROPOSED AMENDMENTS TO IAS 24 *RELATED PARTY DISCLOSURES*

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BASIS FOR CONCLUSIONS

Introduction

- 1 This exposure draft contains proposals by the International Accounting Standards Board to amend IAS 24 *Related Party Disclosures*. The amendments would eliminate the disclosure requirements in paragraph 17 of IAS 24 for some entities that are controlled or significantly influenced by a state in relation to transactions with other entities controlled or significantly influenced by that state. The exemption does not apply when influence exists in such relationships.
- 2 The exposure draft also proposes amending the definition of a related party, for four reasons. First, the Board considered the relationship between an associate and a subsidiary of an entity ('the investor'). IAS 24 requires disclosure of transactions between an associate and a subsidiary of the investor in the individual or separate financial statements of the associate but not in the individual or separate financial statements of the subsidiary. The Board proposes to change the definition of a related party to ensure that an associate and a subsidiary of an entity are related parties for the purposes of their individual, or separate, financial statements. Similarly, the Board proposes that when the investor is a person, an entity that is significantly influenced by that person and another entity that is controlled by that person are related parties.
- 3 Secondly, the Board considered the relationship between associates of the investor. IAS 24 does not define associates as related to each other if the investor is an entity. However, an entity that is significantly influenced by a person, and another entity that is significantly influenced by a close member of the family of that person, are related parties. The Board proposes to amend the definition of a related party to exclude such entities, thereby ensuring consistent treatment of all associates.
- 4 Thirdly, IAS 24 treats some investees* of the key management personnel of an entity preparing its financial statements (in this exposure draft referred to as the 'reporting entity') as related to the reporting entity. However, the definition in IAS 24 does not include the reciprocal of this—ie in the financial statements of the investee, the reporting entity is not a related party. The Board proposes to amend the definition to ensure that in both sets of financial statements the entities are defined as related parties.
- 5 Lastly, in response to comments that the definition of a related party is difficult to understand and interpret, the Board proposes to restructure it. The restructuring is

* Investees include entities controlled, jointly controlled or significantly influenced by an investor or in which the investor holds significant voting power.

not intended to change the meaning of a related party except for the changes described in paragraphs 2–4 above.

- 6 The exposure draft also proposes to improve the wording of the standard.

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 **27 May 2007**.

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?

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?

- (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?

- (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?

- (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?

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?

Question 4

Do you have any other comments on the proposals?

Proposed Amendments to IAS 24 *Related Party Disclosures*

Scope

In the Standard, paragraph 3 is amended as follows. New text is underlined.

- 3 This Standard requires disclosure of related party transactions and outstanding balances in the consolidated and separate financial statements of a parent, venturer or investor presented in accordance with IAS 27 *Consolidated and Separate Financial Statements*. This Standard also applies to individual financial statements.

Definitions

In the Standard, paragraph 9 is amended by replacing the definition of a *related party* as shown below. The existing definition is reproduced for ease of reference.

Proposed revised definition

A *related party* is a person or entity that is related to an 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 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.

Existing definition

Related party A party is related to an entity if:

- (a) directly, or indirectly through one or more intermediaries, the party:
- (i) controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
 - (ii) has an interest in the entity that gives it significant influence over the entity; or
 - (iii) has joint control over the entity;
- (b) the party is an associate (as defined in IAS 28 *Investments in Associates*) of the entity;
- (c) the party is a joint venture in which the entity is a venturer (see IAS 31 *Interests in Joint Ventures*);

- (d) **the party is a member of the key management personnel of the entity or its parent;**
- (e) **the party is a close member of the family of any individual referred to in (a) or (d);**
- (f) **the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or**
- (g) **the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.**

In the Standard, paragraph 9 is amended by revising the definitions of a *related party transaction* and *close members of the family of an individual* and introducing the definition of a *state*. New text is underlined and deleted text is struck through. Paragraph 11A is added.

A *related party transaction* is a transfer of resources, services or obligations between a reporting entity and a related partyies, regardless of whether a price is charged.

***Close members of the family of an individual person* are those family members who may be expected to influence, or be influenced by, that individual person in their dealings with an entity and ~~—They may include:~~**

- (a) **theat ~~individual's~~ person's domestic partner (such as a husband or wife or equivalent) and children;**
- (b) **children of theat individual's ~~person's~~ domestic partner; and**
- (c) **dependants of theat individual ~~person~~ or theat individual's ~~person's~~ domestic partner.**

A state is a national, regional or local government.

11A The term *state* in this Standard refers to any governing jurisdiction that has statutory or regulatory powers of government, whether that state is at a national, regional or local level.

In the Standard, paragraph 14 is deleted and paragraphs 12 and 17 are amended. New text is underlined and deleted text is struck through.

Disclosures

- 12 **Relationships between a parents and its subsidiaries shall be disclosed irrespective of whether there have been related party transactions ~~between those related parties~~. An entity shall disclose the name of the entity's ~~its~~ parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.**
- 14 ~~[deleted] The identification of related party relationships between parents and subsidiaries is in addition to the disclosure requirements in IAS 27, IAS 28 and IAS 31, which require an appropriate listing and description of significant investments in subsidiaries, associates and jointly controlled entities.~~
- 17 **~~If there have been~~ an entity has related party transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions, ~~and~~ outstanding balances and commitments necessary for ~~an users to~~ understanding of the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to the requirement in paragraph 16 to disclose key management personnel compensation. At a minimum, disclosures shall include:**
 - (a) **the amount of the transactions;**
 - (b) **the amount of the outstanding balances and:**
 - (i) **their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and**
 - (ii) **details of any guarantees given or received;**
 - (c) **provisions for doubtful debts related to the amount of outstanding balances; and**
 - (d) **the expense recognised during the period in respect of bad or doubtful debts due from related parties.**

In the Standard, after paragraph 17 paragraphs 17A–17E are added.

17A A reporting entity is exempt from the disclosure requirements of paragraph 17 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 entity 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.**

17B Indicators that the influence referred to in paragraph 17A(b) exists are when the related parties:

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

17C The existence of direction or compulsion by a state for related parties to act in a particular way could indicate that the influence referred to in paragraph 17A(b) exists. Furthermore, the presence of common members on the boards of the reporting entity and the other entity could lead to the relationship having an effect on the profit or loss and financial position. Entities shall consider whether the existence of direction or compulsion by a state or the existence of common board members indicates that the influence referred to in paragraph 17A(b) exists.

17D The indicators of influence described in paragraphs 17B and 17C are not exhaustive. A reporting entity might identify other factors or circumstances that suggest the reporting entity could influence, or be influenced by, the related party that would require the reporting entity to comply with the requirements in paragraph 17.

17E When there are no indicators that the reporting entity influenced, or was influenced by, any other entity controlled or significantly influenced by the state, as provided by paragraph 17A, the reporting entity shall disclose a statement to that effect. When a reporting entity does not qualify for the exemption in paragraph 17A it shall comply with all the disclosure requirements of this Standard for that related party.

In the Standard, paragraph 20 is amended as follows. New text is underlined and deleted text is struck through.

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

- (a) ...
- (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; and
- (j) transactions or commitments to do something if a particular event occurs or does not occur in the future.

In the Standard, paragraph 23B is added.

Effective date

23B An entity shall apply the [draft] amendments adding paragraphs 11A, 17A–17E and 20(j), deleting paragraph 14 and amending paragraphs 3, 9, 12 and 17 for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies the [draft] amendments for a period beginning before [date to be inserted after exposure], it shall disclose that fact.

Illustrative Examples

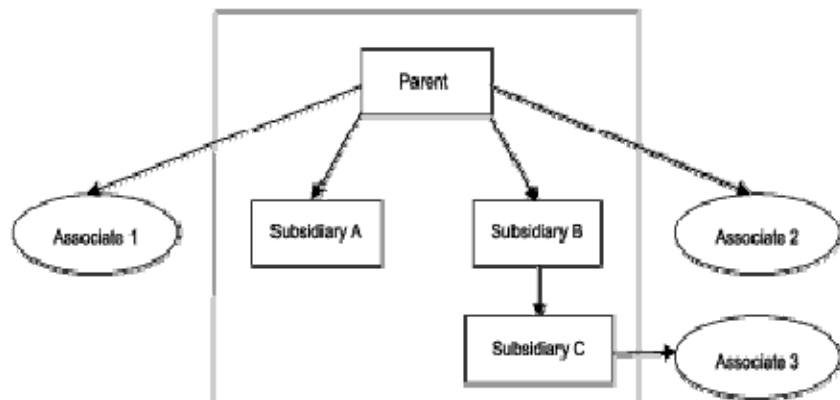
The following illustrative examples are added after the Basis for Conclusions.

IAS 24 Related Party Disclosures Illustrative Examples

These [draft] examples accompany, but are not part of, IAS 24. The references are to subparagraphs of the definition of **related party** in paragraph 9 of IAS 24.

Example 1—Associates and subsidiaries

IE1 Parent entity has a controlling interest in Subsidiaries A, B and C and has significant influence over Associates 1 and 2. Subsidiary C has significant influence over Associate 3.



IE2 In Parent's separate financial statements, Subsidiaries A, B and C, and Associates 1, 2 and 3 are related parties. [(b)(i) and (iii)]

IE3 In Subsidiary A's individual financial statements, Parent, Subsidiaries B and C and Associates 1, 2 and 3 are related parties. In Subsidiary B's separate financial statements, Parent, Subsidiaries A and C and Associates 1, 2 and 3 are related parties. In Subsidiary C's individual financial statements, Parent, Subsidiaries A and B and Associates 1, 2 and 3 are related parties. [(b)(i) and (iii)]

IE4 In the individual financial statements of Associates 1, 2 and 3, Parent and Subsidiaries A, B and C are related parties. Associates 1, 2 and 3 are not related to each other. [(b)(ii)]

IE5 In Parent's consolidated financial statements, Associates 1, 2 and 3 are related to the Group. [(b)(iii)]

Example 2—Key management personnel

IE6 A person, X, has a 100 per cent investment in Entity A and is a member of the key management personnel of Entity C. Entity B has a 100 per cent investment in Entity C.



IE7 In Entity C's financial statements,² Entity A is related to Entity C because X controls Entity A and is a member of the key management personnel of Entity C. [(b)(v)-(a)(i)]

IE8 In Entity C's financial statements, Entity A is also related to Entity C if X is a member of the key management personnel of Entity B and not Entity C. [(b)(v)-(a)(i)]

IE9 Furthermore, the outcome described in paragraphs IE7 and IE8 will be the same if X has only joint control, significant influence or significant voting power over Entity A. [(b)(vi)-(a)(i)]

² In examples 2-4, 'financial statements' means the individual, separate or consolidated financial statements.

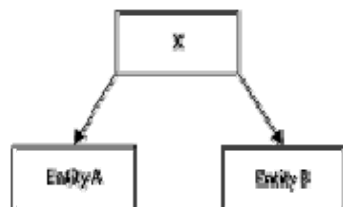
IE10 In Entity A's financial statements, Entity C is related to Entity A because X controls A and is a member of Entity C's key management personnel. [(b)(vii)]

IE11 Furthermore, the outcome described in paragraph IE10 will be the same if X has only joint control, significant influence or significant voting power over Entity A. The outcome will also be the same if X is a member of the key management personnel of Entity B and not Entity C. [(b)(vii)]

IE12 In Entity B's consolidated financial statements, Entity A is a related party of the Group if X is a member of the key management personnel of the Group. [(b)(v)–(a)(i)]

Example 3—Person as investor

IE13 A person, X, has an investment in Entity A and Entity B.

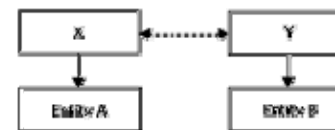


IE14 In Entity A's financial statements,* if X controls Entity A, Entity B is related to Entity A when X has control, joint control or significant influence over Entity B. [(b)(v)–(a)(ii) and (b)(vi) – (a)(ii)]

IE15 Similarly, in Entity B's financial statements, Entity A is related to Entity B. [(b)(v)–(a)(ii) and (b)(v) – (a)(iii)]

Example 4—Close members of the family holding investments

IE16 A person, X, is the domestic partner of Y. X has an investment in Entity A and Y has an investment in Entity B.



IE17 In Entity A's financial statements,* if X controls Entity A, Entity B is related to Entity A when Y has control, joint control or significant influence over Entity B. [(b)(v)–(a)(ii) and (b)(vi) – (a)(ii)]

IE18 Similarly, in Entity B's financial statements, Entity A is related to Entity B. [(b)(v)–(a)(ii) and (b)(v) – (a)(iii)]

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 of Proposed Amendments to IAS 24 Related Party Disclosures—*State-controlled Entities and the Definition of a Related Party*. Individual Board members gave greater weight to some factors than to others.

Extending the definition of a related party

An associate of the subsidiary's controlling investor

BC2 The Board was asked to consider whether an associate and a subsidiary of the same entity are related parties. The Board noted that the definition of a related party includes a party that has significant influence over the entity. Therefore, when an associate prepares individual or separate financial statements, its investor is a related party. If the investor has a subsidiary, that subsidiary is also related to the associate, because the subsidiary is part of the group that has significant influence over the associate. The Board proposes an amendment to ensure that the definition states this more clearly.

BC3 In contrast, when a subsidiary prepares individual or separate financial statements, an associate of the subsidiary's controlling investor is not a related party as defined in IAS 24 *Related Party Disclosures*. The subsidiary does not have significant influence over the associate, nor is it significantly influenced by the associate. This is because the associate is not part of the group as defined in IAS 27 *Consolidated and Separate Financial Statements*.

BC4 The Board decided that, for the same reasons that the parties described in paragraph BC2 are related, the parties described in paragraph BC3 are also related. Thus, the Board proposes to amend IAS 24 to include in the definition of a related party the relationship discussed in paragraph BC3.

BC5 Furthermore, the Board decided that in the situations described in paragraphs BC2 and BC3, if the investor is a person who has significant influence over one entity and control over another entity, then sufficient influence exists to warrant concluding that the two entities are related.

Two associates of a person

BC6 The Board concluded that the relationship between associates of an entity should not fall within the definition of a related party. This is because there is insufficient influence through the common investment in two associates to warrant concluding that they are related.

BC7 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, subparagraph (f) of the definition of related party in IAS 24 defines those entities as related parties. However, on reconsideration the Board concluded that having common significant influence through a person and a close member of the family of that person does not create sufficient influence to conclude that they are related. Therefore, the Board proposes to amend the definition of a related party to remove situations in which the investor is a person and a close member of the family of that person.

Investments of members of key management personnel

BC8 Subparagraph (f) of the definition of related party states that when a member of the key management personnel of the reporting entity (Entity A) controls, jointly controls or significantly influences, or holds significant voting power in, another entity (Entity B) then Entity B is related to Entity A. The Board decided that this is appropriate because, in this situation, the person could influence transactions between the entities through the management position in Entity A and the ownership interest in Entity B. The Board observed, however, that if Entity B is the reporting entity then Entity A is not currently within the definition of related party of Entity B (in the situation described).

BC9 The Board decided that the possibility of that person influencing transactions is just as relevant in the financial statements of Entity B. Therefore, the Board proposes to amend the definition of a related party to ensure that in both sets of financial statements the entities are defined as related parties.

State-controlled entities

- BC10 Responding to concerns raised by constituents about the ability of entities to meet the requirements of IAS 24, the Board also considered the disclosure requirements for entities controlled by a state. The Board noted that the version of IAS 24 that preceded its revision in 2003 did not require state-controlled entities to disclose in their financial statements transactions with other state-controlled entities. The revised version of IAS 24 issued in 2003 omitted this because at the time the Board concluded that the disclosure requirements would not be a burden for state-controlled entities.
- BC11 In jurisdictions with a large number of state-controlled entities, or entities over which the state has significant influence, it can be difficult to identify other entities that are controlled or significantly influenced by the state. Entities that are controlled or significantly influenced by the state might not even be aware that an entity with which they have transactions is a related party.
- BC12 The cost of meeting the requirements in IAS 24 for entities controlled or significantly influenced by the state is not always offset by the benefit of increased information for users of financial statements. Extensive disclosures are required for transactions that are unaffected by the relationship. If some entities that are controlled or significantly influenced by the state are not aware that their transactions are with a fellow subsidiary or associate, the disclosures provided will be incomplete. Furthermore, transactions that are affected by a related party relationship, and information that is potentially useful to users of the financial statements, might well be obscured by excessive disclosures about unaffected transactions.
- BC13 Some states establish subsidiaries and associates to compete with each other. Moreover, subsidiaries and associates within a state can have different boards of directors with different objectives and goals. In these cases, transactions between such entities are likely to be conducted as if they are unrelated parties.
- BC14 The Board concluded that, for the reasons discussed in paragraphs BC10–BC13, in many situations the cost of complying with the requirement to disclose transactions with entities that are related simply because of control or significant influence by the state will outweigh the benefits obtained from disclosure of the information. Therefore, the Board decided to exempt these entities from the disclosure requirements of paragraph 17.
- BC15 Because of the proposed amendments to the definition of a related party, as discussed in paragraphs BC2–BC4, the exemption for state-controlled entities is extended to include situations in which the state controls one entity and

significantly influences another. The Board concluded that if it provided relief from the requirement to disclose entities under common control, entities that are related simply because the state controls one and significantly influences the other should also be exempt. This is because such a relationship creates the same concerns for the entity as are discussed in paragraphs BC10–BC13.

- BC16 When considering the effect of a complete exemption from the requirements in paragraph 17 of IAS 24, the Board noted that, in some circumstances, influence from the state or the related party might affect the transactions entered into by, or the actions of, the entity. This is because the nature of the relationship that exists between the two entities can affect the financial position or profit or loss of the entity. The Board concluded that in those situations the disclosure requirements of paragraph 17 should apply.
- BC17 The proposed amendment to IAS 24 sets out a general principle of when an entity can apply the exemption. Indicators to distinguish situations in which the exemption is not appropriate support this principle. This is intended to capture situations discussed in paragraph BC16. The indicators proposed in the exposure draft are not exhaustive, but suggest examples of the types of situation that could give rise to the need to disclose the related party transactions.
- BC18 In some circumstances, it will be difficult to refute that transactions are influenced by the relationship, for example, transactions at non-market rates or the sharing of resources (ie the indicators included in draft paragraph 17B). In other situations, it might not be as clear and an entity will need to assess whether influence exists—such as when the entities have common board members, or when there is direction or compulsion from the state. Draft paragraph 17C is intended to reflect this type of indicator.
- BC19 If an entity qualifies for the exemption, the Board concluded that the entity should confirm that there are no transactions or circumstances that would give rise to the requirement to disclose any of those transactions as being with related parties. The Board decided to include this requirement to ensure that entities affirm their assessment of all known facts. If the exemption does not apply in relation to a related party then full disclosures must be made in accordance with IAS 24.

Other minor amendments

Clarification of the definition of a related party transaction

- BC20 The Board was asked to consider the definition of a related party transaction and whether it might cause confusion when translated from English into other languages. IAS 24 states that a related party transaction is ‘a transfer of resources, services or obligations between related parties regardless of whether a price is charged’.
- BC21 However, on translation, the definition can be interpreted as requiring the disclosure of transactions between two of an entity’s related parties. This could mean, for example, that if an entity has an investment in an associate and an investment in a joint venture, any transactions between the associate and the joint venture must be disclosed in the entity’s financial statements.
- BC22 Such an interpretation was not the Board’s intended meaning—the definition was intended to include only those transactions between the reporting entity and its related parties. Therefore, the Board proposes amending the definition of a related party transaction.
- BC23 The Board also discussed whether the definition of a related party transaction included situations in which an entity entered into a contract to do something in the future, but there has not yet been a transfer of resources. The Board decided that this was a transaction that should be disclosed because it could affect decisions of financial statement users. The Board proposes to add a sentence to paragraph 20 to clarify this.

Restructured definition of a related party

- BC24 The Board noted that the definition of a related party has weaknesses other than those noted in paragraphs BC2–BC9: it is cumbersome and includes several cross-references that make it difficult to read (and to translate). Therefore, the Board decided to take this opportunity to clarify the intended meaning and to simplify the structure of the definition. The redrafting included replacing the word ‘individual’ with ‘person’. As a consequence, the Board proposes, for consistency, to amend the definition of close member of the family of a person.
- BC25 The Board also proposes supplementing the standard with implementation guidance to highlight some situations in which entities are related parties.

- BC26 Changes to the structure of the definition of a related party are not intended to alter the meaning in IAS 24, except for the other amendments proposed in this exposure draft.

Improvements project amendments

- BC27 In December 2003 the Board amended IAS 27 and IAS 28 *Investments in Associates* as part of its Improvements project. Those amendments reduced or eliminated alternatives, redundancies and conflicts within existing standards, and dealt with some convergence issues and made other improvements.
- BC28 Unfortunately, as a consequence of those amendments, paragraph 14 of IAS 24 refers to disclosure requirements in IAS 27 and IAS 28 that were withdrawn. The Board therefore proposes removing paragraph 14 because it does not provide useful and accurate information. Even though the disclosure requirements of IAS 31 *Interests in Joint Ventures* were not removed during the Improvements project, deleting paragraph 14 does not conflict with the IAS 31 requirements.

Scope of IAS 24

- BC29 The Board notes that paragraph 3 of IAS 24 could be interpreted incorrectly because it does not specify whether the standard applies in consolidated and individual financial statements. To remove the confusion, the Board proposes to amend paragraph 3 to clarify that IAS 24 applies to individual, separate and consolidated financial statements.