

International Accounting Standard IAS 24

Related Party Disclosures

January 2012

(incorporating amendments from IFRSs issued up to 31 December 2011, including those with an effective date after 1 January 2012)

BASIS FOR CONCLUSIONS

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Basis for Conclusions on IAS 24 *Related Party Disclosures*

This Basis for Conclusions accompanies, but is not part of, IAS 24.

Introduction

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 24 *Related Party Disclosures* in 2003 and 2009. Individual Board members gave greater weight to some factors than to others.
- BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of standards, including IAS 24. The project was undertaken in the light of queries and criticisms raised in relation to the standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within existing standards, to deal with some convergence issues and to make other improvements. In May 2002 the Board published its proposals in an exposure draft of *Improvements to International Accounting Standards* (the 2002 ED), with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the exposure draft. After reviewing the responses, the Board issued a revised version of IAS 24 in December 2003.
- BC3 In February 2007 the Board published an exposure draft *State-controlled Entities and the Definition of a Related Party* (the 2007 ED), proposing:
- (a) an exemption from the disclosure requirements in IAS 24 for transactions between entities that are controlled, jointly controlled or significantly influenced by a state ('state-controlled entities'¹); and
 - (b) amendments to the definition of a related party.
- BC4 The Board received 72 comment letters on the 2007 ED. After considering those comments, in December 2008 the Board published revised proposals in an exposure draft *Relationships with the State* (the 2008 ED). The 2008 ED:
- (a) presented revised proposals for state-controlled entities; and
 - (b) proposed one further amendment to the definition of a related party.
- BC5 The Board received 75 comment letters on the 2008 ED. After reviewing the responses, the Board issued a revised version of IAS 24 in November 2009.
- BC6 Because the Board's intention was not to reconsider the fundamental approach to related party disclosures established by IAS 24, this Basis for Conclusions discusses only the following requirements in IAS 24:
- (a) management compensation (paragraphs BC7–BC10);
 - (b) related party disclosures in separate financial statements (paragraphs BC11–BC17);

¹ In finalising the revised version of IAS 24 in 2009, the Board replaced the term 'state' with 'government'.

- (c) definition of a related party (paragraphs BC18–BC32);
- (d) government-related entities (paragraphs BC33–BC48); and
- (e) other minor changes made in 2009 (paragraph BC49).

Management compensation

- BC7 The version of IAS 24 issued by the Board's predecessor in 1984 had no exemption for the disclosure of key management personnel compensation. In developing the 2002 ED, the Board proposed that the disclosure of management compensation, expense allowances and similar items paid in the ordinary course of business should not be required because:
- (a) the approval processes for key management personnel compensation in some jurisdictions remove the rationale for related party disclosures;
 - (b) privacy issues arise in some jurisdictions where accountability mechanisms other than disclosure in financial statements exist; and
 - (c) requiring these disclosures placed weight on the determination of 'key management personnel' and 'compensation', which was likely to prove contentious. In addition, comparability of these disclosures would be unlikely until measurement requirements are developed for all forms of compensation.
- BC8 However, some respondents to the 2002 ED objected to the proposed exemption because they were concerned that information relating to management compensation is relevant to users' information needs and that an exemption based on 'items paid in the ordinary course of business' could lead to abuse. Establishing a disclosure exemption on such a criterion without a definition of the terms could lead to exempting other transactions with management from being disclosed, because they could all be structured as 'compensation paid in the ordinary course of an entity's operations'. Respondents argued that such an exemption could lead to abuse because it could potentially apply to any transactions with management.
- BC9 The Board was persuaded by the respondents' views on the 2002 ED and decided that the Standard should require disclosure of key management personnel compensation because:
- (a) the principle underpinning the requirements in IAS 24 is that transactions with related parties should be disclosed, and key management personnel are related parties of an entity.
 - (b) key management personnel compensation is relevant to decisions made by users of financial statements when it represents a material amount. The structure and amount of compensation are major drivers in the implementation of the business strategy.
 - (c) the benefit of this information to users of financial statements largely outweighs the potential lack of comparability arising from the absence of recognition and measurement requirements for all forms of compensation.

- BC10 The Board believes that although some jurisdictions have processes for approving compensation for key management personnel in an attempt to ensure an arm's length result, it is clear that some jurisdictions do not. Furthermore, although approval processes for management compensation may involve other parties such as shareholders or investors, key management personnel may still have a significant input. In addition, the Board noted that disclosing key management personnel compensation would improve transparency and comparability, thereby enabling users of financial statements to make a better assessment of the impact of such compensation on the entity's financial position and profit or loss. The Board also noted that the definition of key management personnel and the guidance on compensation in IAS 19 *Employee Benefits* are sufficient to enable entities to disclose the relevant information.

Related party disclosures in separate financial statements

- BC11 The version of IAS 24 issued by the Board's predecessor in 1984 exempted disclosures about related party transactions in:
- (a) parents' financial statements when they are made available or published with the consolidated statements; and
 - (b) financial statements of a wholly-owned subsidiary if its parent is incorporated in the same country and provides consolidated financial statements in that country.
- BC12 In the 2002 ED the Board proposed to continue exempting separate financial statements of parents and financial statements of wholly-owned subsidiaries from disclosures about any related parties in specified circumstances. It proposed that disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or the financial statements of a wholly-owned subsidiary would not be required, but only if those statements were made available or published with consolidated financial statements for the group.
- BC13 The Board proposed to retain this exemption so that entities that are required by law to produce financial statements available for public use in accordance with International Financial Reporting Standards (IFRSs) in addition to the group's consolidated financial statements would not be unduly burdened. The Board noted that in some circumstances, users can find sufficient information for their purposes regarding a subsidiary from either its financial statements or the group's consolidated financial statements. In addition, the users of financial statements of a subsidiary often have, or can obtain access to, more information. The Board also noted that users should be aware that amounts recognised in the financial statements of a wholly-owned subsidiary can be affected significantly by the subsidiary's relationship with its parent.
- BC14 However, respondents to the 2002 ED objected to this exemption, on the grounds that disclosure of related party transactions and outstanding balances is essential information for external users, who need to be aware of the level of support provided by related parties. The respondents also argued that financial

statements prepared in accordance with IFRSs could be presented on a stand-alone basis. Therefore, financial statements prepared on the basis of this proposed exemption would not achieve a fair presentation without related party disclosures.

- BC15 The Board was persuaded by those arguments and decided to require the disclosure of related party transactions and outstanding balances in separate financial statements of a parent, investor or venturer in addition to the disclosure requirements in IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates*² and IAS 31 *Interests in Joint Ventures*.³
- BC16 The Board noted that the financial statements of an entity that is part of a consolidated group may include the effects of extensive intragroup transactions. Indeed, potentially all of the revenues and expenses for such an entity may derive from related party transactions. The Board concluded that the disclosures required by IAS 24 are essential to understanding the financial position and financial performance of such an entity and therefore should be required for separate financial statements presented in accordance with IAS 27.
- BC17 The Board also believed that disclosure of such transactions is essential because the external users need to be aware of the interrelationships between related parties, including the level of support provided by related parties, to assist external users in their economic decisions.

Definition of a related party

- BC18 The definition of a related party in IAS 24 was widely considered to be too complex and difficult to apply in practice. The Board noted that the existing definition of a related party had weaknesses: it was cumbersome and included several cross-references that made it difficult to read (and to translate). Therefore, the 2007 and 2008 EDs proposed revised definitions.
- BC19 In revising the definition, the Board adopted the following approach:
- (a) When an entity assesses whether two parties are related, it would treat significant influence as equivalent to the relationship that exists between an entity and a member of its key management personnel. However, those relationships are not as close as a relationship of control or joint control.
 - (b) If two entities are both subject to control (or joint control) by the same entity or person, the two entities are related to each other.
 - (c) If one entity (or person) controls (or jointly controls) a second entity and the first entity (or person) has significant influence over a third entity, the second and third entities are related to each other.
 - (d) Conversely, if two entities are both subject to significant influence by the same entity (or person), the two entities are not related to each other.

² In May 2011, the Board amended IAS 28 and changed its title to *Investments in Associates and Joint Ventures*.

³ IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31.

- (e) If the revised definition treats one party as related to a second party, the definition should also treat the second party as related to the first party, by symmetry.

BC20 The new definition was not intended to change the meaning of a related party except in the three respects detailed in paragraphs BC21–BC26. The 2008 ED proposed other amendments to the definition for one additional case that had been inadvertently omitted from the 2007 ED and the elimination of further inconsistencies (paragraphs BC27–BC29). In finalising the amendments in 2009, the Board also removed the term ‘significant voting power’ from the definition of a related party (paragraphs BC30 and BC31).

An associate of a subsidiary’s controlling investor

BC21 First, the Board considered the relationship between an associate and a subsidiary of an investor that has significant influence over the associate. The Board observed that 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. Although the definition in the 2003 version of IAS 24 incorporated such relationships, the Board concluded that the revised definition should state this more clearly.

BC22 In contrast, when a subsidiary prepares individual or separate financial statements, an associate of the subsidiary’s controlling investor was not a related party as defined in the 2003 version of IAS 24. The subsidiary does not have significant influence over the associate, nor is it significantly influenced by the associate.

BC23 However, the Board decided that, for the same reasons that the parties described in paragraph BC21 are related, the parties described in paragraph BC22 are also related. Thus, the Board amended the definition of a related party to include the relationship discussed in paragraph BC22.

BC24 Furthermore, the Board decided that in the situations described in paragraphs BC21 and BC22, if the investor is a person who has significant influence over one entity and control or joint control over another entity, sufficient influence exists to warrant concluding that the two entities are related.

Two associates of a person

BC25 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. This is because there is insufficient influence through the common investment in two associates. However, the Board noted a discrepancy in that if a person significantly influences one entity and a close member of that person’s family significantly influences another entity, those entities were treated as related parties of each other. The Board amended the definition to exclude the entities described in the latter scenario, thereby ensuring a consistent treatment of associates.

Investments of members of key management personnel

- BC26 Thirdly, IAS 24 treats some investees of the key management personnel of a reporting entity as related to that entity. However, the definition in the 2003 version of IAS 24 did not include the reciprocal of this—ie for the financial statements of the investee, the other entity managed by the key management personnel was not a related party. To eliminate this inconsistency, the Board amended the definition so that for both sets of financial statements the entities are related parties.

Joint control

- BC27 Respondents to the 2007 ED pointed out that one case had been 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, the 2003 version of IAS 24 defined the other entity as related to the reporting entity.
- BC28 The Board noted that joint control is generally regarded as influence that is stronger than significant influence. Therefore, the Board concluded that the relationship described in paragraph BC27 should continue to be treated as a related party relationship.
- BC29 The definition in the 2003 version of IAS 24 did not include the reciprocal of the case described in paragraph BC27, nor did it deal with cases when a person or a third entity has joint control or significant influence over the two entities. The definition proposed in the 2007 ED would not have rectified these omissions. The Board decided to include these cases in the definition, to treat similar relationships in a consistent manner. In summary, whenever a person or entity has both joint control over a second entity and joint control or significant influence over a third entity, the amendments described in this paragraph and paragraph BC27 treat the second and third entities as related to each other.

Removal of 'significant voting power'

- BC30 Respondents to the 2007 and 2008 EDs raised concerns about the term 'significant voting power' in the definition of a related party. They identified anomalies in its use such as when significant voting power created a related party relationship only when that power is held by individuals, not when that power is held by an entity. A further anomaly arose because two entities were classified as related to each other when a third person was a member of the key management personnel of one and had significant voting power in the other; however, they were not treated as related when a third person had significant voting power in both entities.
- BC31 In response to these comments, the Board deleted the reference to 'significant voting power' because it was undefined, used inconsistently and created unnecessary complexity. The Board concluded that if the effect of 'significant voting power' was considered to be the same as 'significant influence', its deletion

would have no effect because 'significant influence' is in the definition. On the other hand, if the effect of 'significant voting power' was considered to be different from that of 'significant influence', IAS 24 did not explain what that difference was.

Other minor changes to the definition of a related party

BC32 The revisions to IAS 24 in 2009 included the following other minor changes:

- (a) The definition of a **related party** is amended:
 - (i) to replace references to 'individual' with 'person';
 - (ii) to clarify that an associate includes subsidiaries of an associate and a joint venture includes subsidiaries of the joint venture; and
 - (iii) to clarify that two entities are not related parties simply because a member of key management personnel of one entity has significant influence over the other entity.
- (b) The definition of a **close member of the family** is amended:
 - (i) to replace references to 'individual' with 'person'; and
 - (ii) to delete 'may' from the list of examples to state that close members of a person's family include (rather than 'may include') that person's spouse or domestic partner and children.

Government-related entities

Exemption (paragraph 25)

- BC33 The version of IAS 24 that preceded its revision in 2003 did not require 'state-controlled' entities to disclose transactions with other such entities. The revised version of IAS 24 issued in 2003 omitted this exemption because at the time the Board concluded that the disclosure requirements would not be a burden for those entities.
- BC34 Subsequently concerns were raised that in environments where government control is pervasive, compliance with IAS 24 was problematic. To address those concerns, the 2007 ED proposed an exemption from the disclosure requirements now in paragraph 18 of IAS 24 for government-related entities. In developing that proposal, the Board noted the following:
- (a) It can be difficult to identify other government-related entities, particularly in jurisdictions with a large number of such entities. Such entities might not even be aware that an entity with which they have transactions is a related party.
 - (b) For these transactions, the cost of meeting the requirements in IAS 24 was not always offset by the benefit of increased information for users of financial statements. More specifically:
 - (i) extensive disclosures were required for transactions that are unaffected by the relationship;

- (ii) if some entities are not aware that their transactions are with other government-related entities, the disclosures provided would be incomplete; and
 - (iii) transactions that are affected by the relationship might well be obscured by excessive disclosures about unaffected transactions.
 - (c) Some governments 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.
- BC35 Respondents to the 2007 ED generally supported an exemption for government-related entities. However, they expressed concerns about the complexity of the specific proposal and asked the Board to clarify various aspects of it. After considering all comments received, the Board proposed a revised exemption for those entities in the 2008 ED.
- BC36 Respondents to the 2008 ED generally supported the revised proposal, but some argued that the exemption should not apply to transactions:
- (a) between members of a group that is controlled by a government (paragraph BC37); and
 - (b) between government-related entities that are related for a reason in addition to their relationship with the same government (paragraph BC38).
- BC37 Some respondents reasoned that the exemption should not apply to transactions between members of a group that is controlled by a government, for example between a government-related entity and its parent or its fellow subsidiaries. Those respondents noted that the relationship within such a group might sometimes be closer and more influential than between government-related entities in an environment where government control is pervasive. However, for the following reasons the Board concluded that the exemption should also apply within such groups:
- (a) Sometimes, requiring disclosure in such cases would negate the purpose of the exemption and could lead to significant differences in the level of disclosure when the substance of the relationships and transactions could be very similar. For example, suppose one government controls all entities directly but another government has similar entities and controls them all through a single holding company. The entities controlled by the first government would all qualify for the exemption but those controlled by the second government would not.
 - (b) Requiring disclosure in such cases would place considerable pressure on the definition of the boundary between government and entities controlled by the government. For example, suppose a government controls entities through an intermediate institution. It would be necessary to determine whether that institution is an entity controlled by the government (in which case the exemption would not apply) or part of the government (in which case the exemption would apply). This may be answered easily if

the institution is a company incorporated under normal company law that simply happens to have the government as a controlling shareholder. It may be less clear if the institution is, for example, a government agency or department.

- BC38 The Board identified only one case when government-related entities might be related to each other for reasons other than their relationships with the same government: a government might control both a post-employment benefit plan and the sponsoring employer. However, the main transactions between such a plan and the sponsoring employer are (a) employer contributions and (b) investments by the plan in the employer or in assets used by the employer. IAS 19 already requires a sponsoring employer to disclose most, if not all, of the information that IAS 24 would require if the exemption did not apply. Thus the Board concluded that no significant loss of disclosure would arise from applying the exemption in these cases.
- BC39 Paragraph BC34 explains why the Board provided an exemption from the disclosure requirements in paragraph 18 of IAS 24 for government-related entities. It was beyond the scope of the project to consider whether similar exemptions would be appropriate in other circumstances.
- BC40 Some respondents to the 2008 ED noted that many financial institutions had recently become government-related entities when governments took significant and sometimes controlling equity interests in them during the global financial crisis. They queried whether the exemption was appropriate in such cases. In finalising the amendments in 2009, the Board identified no reason to treat such entities differently from other government-related entities. The Board noted that in addition to the disclosure requirements in IAS 24, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* requires the reporting entity to disclose information about the receipt of government grants or assistance.
- BC41 Respondents to the 2008 ED noted that the proposed definition of 'state' was similar to the definition of 'government' in IAS 20. To avoid confusion and provide consistency, the Board adopted the latter definition when finalising the amendments to IAS 24 in 2009. The Board decided that it need not provide a more comprehensive definition or additional guidance on how to determine what is meant by 'government'. In the Board's view, a more detailed definition could not capture every conceivable government structure across every jurisdiction. In addition, judgement is required by the reporting entity when applying the definition because every jurisdiction has its own way of organising government-related activities.

Disclosure requirements when the exemption applies (paragraph 26)

- BC42 The Board considered whether the disclosure requirements in paragraph 26:
- (a) met the objective of IAS 24 (paragraphs BC43–BC46); and
 - (b) were operational (paragraphs BC47 and BC48).

IAS 24 BC

- BC43 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, including commitments, with such parties.’ To meet that objective, paragraph 26 requires some disclosure when the exemption applies. Those disclosures are intended to put users on notice that related party transactions have occurred and to give an indication of their extent. The Board did not intend to require the reporting entity to identify **every** government-related entity, or to quantify in detail **every** transaction with such entities, because such a requirement would negate the exemption.
- BC44 Some respondents to the 2008 ED were concerned that qualitative disclosure of individually significant related party transactions alone would not meet the objective of IAS 24 and that combining individually significant transactions with collectively significant transactions would not provide sufficient transparency. The Board concluded that it should require an entity to disclose:
- (a) the nature and amount of each individually significant transaction; and
 - (b) quantitative or qualitative information about other types of transactions that are collectively, but not individually, significant.
- BC45 The Board noted that this requirement should not be too onerous for the reporting entity because:
- (a) individually significant transactions should be a small subset, by number, of total related party transactions;
 - (b) the reporting entity should know what those transactions are; and
 - (c) reporting such items on an exceptional basis takes into account cost-benefit considerations.
- BC46 The Board also noted that more disclosure of individually significant transactions would better meet the objective of IAS 24 because this approach focuses on transactions that, through their nature or size, are of more interest to users and are more likely to be affected by the related party relationship.
- BC47 Some respondents raised concerns about whether the reporting entity would be able to identify whether the counterparty to individually significant or collectively significant transactions is a related party because it is controlled, jointly controlled or significantly influenced by the same government. The problem of identifying all such counterparties was one of the primary reasons for the exemption.
- BC48 However, as discussed in paragraph BC43, it was not the Board’s intention to require the reporting entity to identify every government-related entity, or to quantify every transaction with such entities. Moreover, individually significant transactions are likely to attract more scrutiny by management. The Board concluded that management will know, or will apply more effort in establishing, who the counterparty to an individually significant transaction is and will have, or be able to obtain, background information on the counterparty.

Other minor changes made in 2009

BC49 The revisions to IAS 24 in 2009 included the following other changes:

- (a) The list of examples of **related party transactions** is amended to include in paragraph 21(i) commitments to do something if a particular event occurs or does not occur in the future, including executory contracts. The Board concluded that commitments were one type of transaction, but to avoid doubt decided to make explicit reference to them.
- (b) Paragraph 3 relating to the **scope** of IAS 24 is amended to clarify that the Standard applies to individual, as well as separate and consolidated, financial statements because individual financial statements relate to something different from the defined term in IAS 27.⁴
- (c) Paragraph 34 of IFRS 8 *Operating Segments* is amended. The Board recognised that in applying the requirements in IFRS 8 it may not be practicable or meaningful to regard all government-related entities as a single customer, especially for environments in which government control is pervasive.
- (d) A consequential amendment to the Basis for Conclusions on IAS 19 draws attention to the new definition of a related party. The definition of a qualifying insurance policy in IAS 19 refers to this definition.

⁴ The consolidation guidance was removed from IAS 27 and the Standard was renamed *Separate Financial Statements* by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The definition of separate financial statements was not changed.

Dissenting opinion

Dissent of Robert P Garnett

- DO1 Mr Garnett disagrees with the Board's decision to exempt only government-related entities from the requirements of paragraph 18 to disclose information about all transactions with related parties. He also disagrees with the decision not to require all entities to provide information about each individually significant transaction with a related party as set out in paragraph 26(b)(i).
- DO2 The Basis for Conclusions sets out clearly the need to remove the unnecessary burden of collecting data for all transactions, entered into and priced on normal business terms, because the counterparty was identified as a related party. It also explains the need to inform investors of individually significant transactions with related parties. Mr Garnett agrees with the explanations in paragraphs BC33–BC48.
- DO3 Paragraph 25, however, restricts these changes to entities that are controlled, jointly controlled or significantly influenced by the same government. Mr Garnett sees no reason to make such a distinction, other than to provide limited relief to certain entities.