

1 April 2009

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Dear Madam/Sir

Exposure Draft of proposed amendments to IAS 24 *Relationships with the State*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft of proposed amendments to IAS 24 *Relationships with the State* (the ED). This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive interpretations/amendments on the issues.

The ED contains proposals for amendments to exempt entities that are controlled, jointly controlled or significantly influenced by a state from the disclosure requirements of IAS 24 in relation to transactions with other state-controlled entities. It also contains amendments to the definition of a related party.

We agree in principle with the amendments proposed, but have a few concerns which we have set out in the appendix to this letter. To summarise:

- Although we welcome the IASB's continued efforts to rationalise IAS 24's definition of a related party, we do not agree fully with the amendments being proposed in this ED that extends the definition beyond that proposed in the previous ED.
- Although we recognise that the IASB is not inviting comment on the definition of 'a State', we have set out in the appendix a number of examples of problems that we believe will arise from its application in practice. We think the definition and supporting material might therefore be in need of some further work. We think that every jurisdiction has its own way of organising state-related activities and organisations, and that a definition needs to be found that achieves broadly the same result (in terms of the scope of the exemption proposed in the ED) regardless of precisely how such activities and organisations are structured. We are not convinced that this is the case with the current definition and supporting material.

We hope that you find our comments helpful. If you wish to discuss them further, please do not hesitate to contact Frederiek Vermeulen or myself.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix

EFRAG's detailed comments on the ED *Relationships with the State*

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?

- 1 We agree that, when two entities are related only because they are controlled, jointly controlled or significantly influenced by the same state, the disclosure required by paragraph 17 of IAS 24 can be extremely onerous. However:
 - (a) under the proposals in the ED, if two entities are related parties of each other for several reasons, only one of which is that they are controlled, jointly controlled or significantly influenced by the same state, transactions between the two entities would fall within the scope of the proposed exemption. We do not believe that is appropriate and think such an exemption would weaken IAS 24 significantly. We prefer the approach proposed in the previous ED, which was that the exemption was available only if the only reason is that the two entities are related because they are controlled, jointly controlled or significantly influenced by the same state.
 - (b) we think that in theory, if one or more material transactions between two related parties are influenced in some way by the existence of the relationship between the parties, that is useful information and should ideally be disclosed in the financial statements. In our view this is the case for all related party transactions and not just those between state-controlled entities. On the other hand, if the transactions are not influenced by the existence of the relationship, there is little informational value in them. We note that, although this was the approach proposed in the previous ED, under the latest proposals it is not relevant whether the transactions have been influenced by the existence of the relationship. We think this is a pity—because it means that potentially useful information will not be disclosed—although we also recognise that our preferred approach raises practical issues that the IASB has concluded cannot easily be addressed without damaging the usefulness of the exemption itself. We therefore accept the proposal in the ED that the exemption should be available regardless of whether the parties or terms of the transactions have been affected by the related relationship.
- 2 The ED proposes extending the exemption that was proposed in the previous ED so that it applies not only to state-controlled entities but also to other relations with the state. EFRAG supports this proposal, which it sees as a logical consequence of the exemption for state-controlled entities.
- 3 Under the current proposal in amended paragraph 17B(b), an entity that is exempt from providing the 'normal' related party disclosures because of the proposed

exemption would have to disclose the types of individually or collectively significant transactions with the state or related party entity involved that have been entered into, together with a qualitative or quantitative indicator of their extent. Our understanding at the time of the 2007 ED was that the main reason for introducing the proposed exemption was to make it unnecessary for reporting entities that are controlled, jointly controlled or significantly influenced by a state to identify entities that are related parties solely because they too are controlled, jointly controlled or significantly influenced by that same state. We think this is a worthy objective. Although the IASB notes in paragraph BC11 that the disclosure requirements of paragraph 17B "do not require the reporting entity to identify every state-controlled entity, nor to quantify in details transactions with such entities, because such a requirement would negate the exemption", we do not think the wording of paragraph 17B(b) reflects that principle. Therefore, if paragraph BC11 correctly reflects the IASB's intention (the "worthy objective" we mentioned earlier), we think the wording of paragraph 17B needs to be reconsidered. On the other hand, if the IASB believes paragraph 17B is correctly worded:

- (a) the statement in paragraph BC11 should be omitted to ensure that the ED is internally consistent; and
- (b) it would mean that the main reason for developing the 2007 ED has not been met. We considered that to be a worthy objective and are disappointed that the IASB has apparently concluded it is not achievable.

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

- 4 EFRAG welcomes the IASB's continued efforts to rationalise IAS 24's definition of a related party. However, we do not agree with the amendment being proposed in this case.
 - (a) We think paragraphs 9(b)(iii) and 9(b)(iv) – and the related IE4-6 (and possibly also IE7-9) – could cause practical difficulties for the individual financial statements of a jointly controlled entity or associate. For example, using the example in IE4-6, we think the definitions mean that Entities B and C would have to identify and disclose transactions with every other jointly controlled entity or associate of any of its shareholders. That is very onerous indeed.
 - (b) We suggest that the wording of paragraph 9(b)(ix) would be clearer were '(A)' replaced with 'both' and '(B)' with 'also'.
 - (c) As we stated in our comment letter on the 2007 ED, we think it can be extremely difficult for an entity to comply with a disclosure requirement that is based on an

expectation that it will have significant amounts of information about the private lives and private affairs of individuals. In many cases the reporting entity will need to rely on the co-operation of others to obtain the information it needs to provide the disclosures, but in some cases it will be difficult to require the right disclosures from those persons. In some other cases such requirements could involve privacy infringement.

Question 3 – *Do you have any other comments on the proposals?*

The definition of 'a State'

- 5 Paragraphs 9 and 11A of the 2007 ED explain that 'a state' is a national, regional or local government, and the term is being used to refer to any governing jurisdiction that has statutory or regulatory powers of government. Although the IASB is not inviting comment on the definition of 'a State', we are worried about the practical application of this definition. For example:
- (a) Judging by the position in Europe, a number of different structures are used to control (or influence) entities that are in effect state-controlled (or state-influenced) entities. We are concerned that not all of those structures will result in those entities being called state-controlled or state-influenced under the definitions in the ED. For example, in some countries the entities are not controlled or influenced by the government directly, but by an agency established on the basis of, and given a special purpose (to invest...) by an Act making the agency strictly speaking neither a governmental body nor a private sector body. We think such entities should fall within the scope of the exemption proposed in the ED but are not sure that they do.
 - (b) We note that supranational governments (such as the European Union) are not 'states' as currently defined. Is that really the intention?
 - (c) We think that the proposed definition might also cause difficulties in practice when applied to existing structures when several governments are working together. Those will not always fall under the definition of 'joint control'. For example, a group or co-operation of municipalities holds (partially) a company. We think that, as long as they have not transferred their statutory or regulatory powers, they are not covered by the exemption. We think they should be.
 - (d) We think that the definition of a government as a governing jurisdiction with statutory or regulatory competences might in certain jurisdictions also apply to certain regulators that comprise market participants (as is sometimes the case in, for example, the energy market). Was it in the intention that such entities should be within the scope of the definition?
 - (e) The fact that the definition refers to 'any governing jurisdiction that has statutory or regulatory powers of government' might need some clarification to ensure that the exemption applies to all relations with that government and not only when the government is actually using its statutory or regulatory powers.

(f) We also assume that it is not the IASB's intention that the existence of state-regulation would bring an entity within the scope of the term, yet as currently drafted that appears possible.

6 In view of these examples of practicality issues that arise in applying the definition of 'a State', we think the definition and supporting material might need some further work. Every jurisdiction has its own way of organising state-related activities and organisations, and we think a definition needs to be found that achieves broadly the same results (in terms of the scope of the exemption) regardless of precisely how such activities and organisations are structured.

'Significant' voting power / transactions

7 We note that the proposal seems to be that the term 'significant voting power' although not defined in IAS 24, is to be used more widely in the new definition of a 'related party' than hitherto. We think it would be necessary to provide some additional guidance on this notion to ensure consistent application in practice. The IASB could perhaps address this topic in the context of the proposals in ED10 *Consolidated Financial Statements*.

8 Similarly we note that proposed paragraph 17B introduces the term 'significant transactions'. We would welcome further clarification.