

## **The costs and benefits of implementing the revised IAS 24 *Related Party Disclosures***

### **Introduction**

- 1 Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of the amendments to the revised IAS 24 *Related Party Disclosures* (the Amendments)
- 2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. (The results of the consultations EFRAG has carried out seem to confirm this.) Therefore, as explained more fully in the main sections of this report, the approach EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the amendments in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

### **EFRAG's endorsement advice**

- 3 EFRAG also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB and IFRIC against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

### **A summary of the Amendments**

#### *Background*

- 4 Related party relationships are a common feature of commercial and business activities and include relationships that involve transactions with subsidiaries, joint ventures and associates as well as key management personnel of such entities. A related party relationship could have an effect on the financial performance and position of an entity because of the influence that a related party can exercise over transactions with an entity. It follows that information on an entity's related party

## ***EFRAG's Endorsement Advice Letter on the revised IAS 24 Related Party Disclosures***

transactions, including outstanding balances, commitments, and relationships with related parties is important to users. IAS 24 defines a “related party” and sets out the information that an entity must provide when it engages in transactions with parties that are considered to be related.

- 5 The definition of a “related party” in IAS 24 has been the subject of some criticism because some believe it to be inherently inconsistent and too complex to apply in practice because, in their view, it is asymmetrical, lacks clarity and includes multiple cross-references that are difficult to interpret.
- 6 IAS 24 applies to all entities including entities that are government-related – i.e. entities controlled, jointly controlled or significantly influenced by the government. Concerns have been raised that in environments where government control is pervasive, compliance with the disclosure requirements in IAS 24 can be burdensome because of difficulties in identifying when the same government controls, jointly controls or significantly influences both parties to a transaction. In addition, concerns have been raised about the cost/benefit implications of voluminous disclosures about transactions that are unlikely to have been influenced by related party relationships in these situations.
- 7 The IASB therefore set out to amend IAS 24 to address the concerns described above. In particular, the Amendments set out to:
  - (a) simplify the definition of a “related party” while eliminating some internal inconsistencies and to make it symmetrical; and
  - (b) provide relief for government-related entities in relation to the amount of information such entities need to provide in respect to related party transactions.

*What has changed?*

### Related party definition

- 8 As explained above, the objective of IAS 24 is to provide information to users about the existence and possible effect of related party transactions on the financial performance and position of an entity. The definition of a “related party” is therefore an integral concept in this standard.
- 9 The Amendment made to the definition of a related party can be illustrated as follows:
  - (a) associates are regarded as related parties of subsidiaries of a common investor, and vice versa. Previously associates considered subsidiaries of their controlling investor as related parties, but those subsidiaries did not consider the associates as related parties in their separate financial statements;
  - (b) entities in which key management personnel invests (investees) and the entity managed by said key management personnel are regarded as related parties of one another. Previously an entity managed by such individuals considered the investees of that individual as related parties, but the investees did not regard the entity managed by the key management personnel as a related party in their separate financial statements;
  - (c) where an individual investor has significant influence over one entity and control or joint control over another entity, these two entities are regarded as related

## ***EFRAG's Endorsement Advice Letter on the revised IAS 24 Related Party Disclosures***

parties of one another. Previously such entities were not regarded as related to each other; and

- (d) where an individual investor has joint control over a reporting entity and a close member of that individual's family has joint control or significant influence over the other entity, these two entities are regarded as related parties of one another. Previously the entity under joint control of an individual investor considered another entity under joint control or significant influence of that individual's close family member as a related party, but this relationship was not regarded as a related party relationship from the perspective of investees of the close family member.
- 10 The amended definition also results in the exclusion of situations where a person has significant influence over an entity and a close member of that person's family has significant influence over another entity. In the past these were regarded as related parties.
- 11 The amendment also clarified that if an individual is part of the key management personnel in one entity and has significant influence over another entity, these two entities are not regarded as related parties of one another.
- 12 Accordingly, the practical implication of the Amendment to the definition of a related party is that more entities are considered related parties. As a result, the volume of disclosures in the financial statements is likely to increase for entities that fall within the amended definition.

The revised standard contains illustrative examples of the amendments.

### Exemption for government-related entities

- 13 The requirements in existing IAS 24 also apply to, amongst others, entities that are related to a government through control, joint control or significant influence. The "exemption" Amendment to IAS 24 aims to provide relief to such entities from certain disclosure requirements.
- 14 "Government", for the purposes of the exemption, refers to government, government agencies and similar bodies whether local, national or international. This is the same definition used in other IFRSs such as IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.
- 15 The Amendment exempts a reporting entity from the "normal" disclosure requirements in relation to related party transactions and outstanding balances, including commitments, in respect to so-called government-related entities with:
- (a) a government that has control, joint control or significant influence over the reporting entity; and
  - (b) another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

It is important to note that the exemption applies only to entities and not to individuals.

## ***EFRAG's Endorsement Advice Letter on the revised IAS 24 Related Party Disclosures***

- 16 However, when the exemption in the Amendment is used, the reporting entity is required to disclose:
- (a) the name of the government and the nature of its relationship with the reporting entity (i.e. control, joint control or significant influence) for transactions and related outstanding balances referred to above;
  - (b) information about the nature and amount of each individually significant transaction in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements. For other transactions that are collectively, but not individually, significant a qualitative or quantitative indication of their extent shall also be disclosed.
- 17 These disclosures are intended to inform users that related party transactions have occurred and to provide an indication of their nature and the amounts involved. The intention, however, is not to require the reporting entity to identify every single government-related entity, nor to quantify in detail every transaction with such entities, because such a requirement would negate the relief provided by the exemption.

### **EFRAG's initial analysis of the costs and benefits of the amendments**

- 18 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing the Amendments, both in year one and in subsequent years. The results of EFRAG's initial assessment can be summarised as follows. The implementation in the EU of the Amendments is likely to:
- (a) involve a decrease in preparation costs for those preparers affected by the exemption while those affected by the revised definition will incur additional costs;
  - (b) involve users in additional but insignificant analysis costs; and
  - (c) likely to result in an improvement in the quality of the information provided about certain related party transactions that were previously not disclosed while some (not all) information about government-related entities will be lost.
- 19 EFRAG published its initial assessment and supporting analysis on 20 November 2009. It invited comments on the material by 10 January 2010. In response, EFRAG received eight comment letters. Six respondents agreed with EFRAG's assessment of the benefits of implementing the Amendments and the associated costs involved for users and preparers. The other respondents did not comment specifically on EFRAG's initial assessment of the costs and benefits of implementing the Amendments in the EU, but supported EFRAG's recommendation that the Amendments be adopted for use in Europe.

### **EFRAG's final analysis of the costs and benefits of the amendments**

- 20 Based on its initial analysis and stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of the Amendments is presented in the paragraphs below.

## ***EFRAG's Endorsement Advice Letter on the revised IAS 24 Related Party Disclosures***

### *Costs for preparers*

- 21 The Amendments make two changes to IAS 24: they widen the definition of a related party and they provide some relief to entities that are controlled, jointly controlled or significantly influenced by a common government (government-related entities). EFRAG has carried out an assessment of the additional work the Amendments are likely to create (or what work they might save) preparers.
- 22 The application of the amended definition of a related party would result in more disclosures for some entities that are likely to require some time and effort to compile, at least in the first year of application. Those preparers affected are likely to incur some incremental year-one and ongoing costs. For some preparers those costs will be insignificant.
- 23 Many government-related entities thought that the detailed disclosure requirements in existing IAS 24 imposed unnecessary burden on them, which is not necessarily offset by a perceived benefit to users. The Amendments address this issue because the revised standard will require less granular disclosures than at present. In EFRAG's view, this will reduce the burden to those preparers affected and save those preparers significant time and effort. EFRAG's assessment is that the cost saving involved for those preparers is likely to be significant in year-one and on an ongoing basis.

### *Costs for users*

- 24 EFRAG has also carried out an assessment of the implications of the Amendments for the costs incurred by users of the financial statements.
- 25 Prior to the Amendments, there was some uncertainty as to which entities might be considered to be related to each other. The Amendment removes this uncertainty, and provides a clearer basis for including particular relationships in the definition of a related party. The outcome will be information that is more meaningful and understandable and as a result is likely to generate cost savings to users.
- 26 Regarding the exemption, EFRAG concluded that there could be an increase in costs to supplement the loss of some information. However, the revised IAS 24 requires some disclosures when the exemption is applied, which in EFRAG's view, appear to be sufficient to inform users of the occurrence of significant related party transactions. In addition, the disclosure requirements of other standards, such as IAS 20, will continue to apply. This increase in costs to users is therefore likely to be insignificant.
- 27 Users are also expected to incur some incremental costs to incorporate the additional information resulting from the revised definition into their analysis – again this is not likely to be significant.
- 28 Overall, EFRAG's assessment is that the Amendments combined will not result in increased costs to users.

### *Benefit for preparers and users*

- 29 Finally, EFRAG assessed the benefits that are likely to arise from the Amendments. EFRAG's initial assessment is that the Amendments will result in a significant benefit for some preparers who were previously subjected to onerous disclosure requirements. The benefit for preparers resulting from the application of the exemption comes at the cost of users who may lose some, but not all, relevant information. It is however unlikely that this loss of information is more significant than the benefit to preparers.

***EFRAG's Endorsement Advice Letter on the revised IAS 24 Related Party Disclosures***

- 30 In contrast, users are likely to benefit from the increased disclosures resulting from the application of the amended definition of a related party while preparers will be burdened with disclosure requirements. In EFRAG's view, the benefit for users is likely to outweigh the cost for preparers.

*Conclusion*

- 31 EFRAG's overall assessment is that implementing the Amendments:
- (a) is likely to involve a decrease in preparation costs for those preparers affected by the exemption while those affected by the revised definition will incur additional cost;
  - (b) is likely to involve users in additional but insignificant analysis costs; and
  - (c) is also likely to result in an improvement in the quality of the information provided about certain related party transactions that were previously not disclosed while some (not all) information about government-related entities will be lost.
- 32 EFRAG's assessment is that the benefits to be derived from adopting the Amendments are likely to outweigh the costs involved.

Stig Enevoldsen  
**EFRAG, Chairman**  
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