

**DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON
AMENDMENTS TO IAS 24 *Related Party Disclosures*****INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS**

Comments should be sent to commentletter@efrag.org or
uploaded via our website by 10 January 2010

EFRAG has been asked by the European Commission to provide it with advice and supporting material on the amendment to IAS 24 *Related Party Disclosures*. In order to do that, EFRAG has been carrying out a technical assessment of the amendment against the criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the EU.

A summary of the amendment is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

EFRAG initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions on Appendix 2 and 3.

1 Please provide the following details about yourself:

- (a) Your name or, if you are responding on behalf of an organisation or company, its name:

CNC - Comissão de Normalização Contabilística

- (b) Are you/ls your organisation or company a:

Preparer User Other (please specify)

Public Authority

- (c) Please provide a short description of your activity/the general activity of your organisation or company:

Accounting Standard Setter

(d) Country where you/your organisation or company is located:

Portugal

(e) Contact details including e-mail address:

cecnc@igf.min-financas.pt

2 EFRAG’s initial assessment of the amendment is that it meets the technical criteria for endorsement. In other words, it is not contrary to the true and fair principle and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG’s reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

Yes No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG’s endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the amendment? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No

3 EFRAG is also assessing the costs that will arise for preparers and for users on implementation of the amendment in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment are set out in paragraphs 2-12 of Appendix 3. To summarise, EFRAG’s initial assessment is that:

(a) the Amendment to the related party definition is likely to involve additional year one and ongoing costs for some preparers. For some preparers those costs will be insignificant; and

- (b) the Amendment to provide a partial exemption from the disclosure requirements in IAS 24 for government-related entities is likely to result in year one and ongoing cost savings for the preparers affected. For some of these preparers those cost savings are likely to be significant.

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

- 4 As explained in Appendix 3, EFRAG believes that the Amendments to the related party definition is likely to result in improvements in the quality of the information provided (see Appendix 3, paragraph 6-12) and that the benefits to be derived from that will exceed the costs involved.

However, the Amendment to provide a partial exemption from the disclosure requirements in IAS 24 for government-related entities creates a loss of some information and consequently is likely to result in an increase in costs for users. EFRAG thinks that these additional costs should be insignificant because the disclosure requirements for entities that apply the exemption would allow users to understand the effect of significant related party transactions on the financial position and performance of the reporting entity.

As a result, EFRAG’s overall assessment is that the Amendments will result in net benefits for users.

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG’s endorsement advice?

- 5 Based on the conclusions described in paragraphs 3 and 4 above, EFRAG has tentatively concluded that the benefits to be derived from implementing the Amendments in the EU are likely to exceed the costs involved.

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG’s endorsement advice?

- 6 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the amendment.

Do you agree that there are no other factors?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG’s endorsement advice?

APPENDIX 1 A SUMMARY OF THE AMENDMENT

Background

- 1 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 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.
- 2 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.
- 3 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.
- 4 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

- 5 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.
- 6 The Amendment changes the definition of a related party so that the following relationships are included in the definition:
 - (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 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.

The revised standard contains illustrative examples of the changes from page 33 onward.

- 7 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 treated as related parties.
- 8 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, then these two entities are not regarded as related parties of one another.
- 9 Accordingly, the practical implication of the Amendment to the definition of a related party is that more entities would be 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.

Exemption for government-related entities

- 10 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.
- 11 “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 as used in other IFRSs such as IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

12 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.

13 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.

14 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.

APPENDIX 2

EFRAG’S TECHNICAL ASSESSMENT OF THE AMENDMENT AGAINST THE ENDORSEMENT CRITERIA

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity as a contributor to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as adviser to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.

Does the accounting that results from the application of the Amendments meet the criteria for EU endorsement?

- 1 EFRAG has considered whether the Amendments meet the requirements of the European Parliament and of the Council on the application of international accounting standards, in other words that the Amendments:
 - (a) meet the ‘true and fair principle’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
 - (b) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered whether it would be in the European interest to adopt the Amendments.

Relevance

- 2 According to the Framework, information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.
- 3 EFRAG considered whether the Amendments would result in the provision of relevant information—in other words, information that has predictive value, confirmatory value or both—or whether it would result in the omission of relevant information. EFRAG’s assessment about the Amendments’ relevance is very similar to its assessment of comparability.
- 4 The Amendment to the definition of a related party clarifies certain aspects of the existing definition and eliminates some of its internal inconsistencies. This is achieved by widening the definition of related party transactions to capture relationships that are similar in nature, but which are excluded from the present definition. In EFRAG’s view, the additional disclosure resulting from the wider definition is relevant for users because it concerns information that can affect the

financial performance and position of the reporting entity. By providing information about relationships between related parties that were not previously required by the standard, users will benefit from added transparency concerning the transactions affected by those relationships.

- 5 The Amendment in respect to the exemption provided to government-related entities will result in the loss of some information to users. However, entities that apply the exemption must still provide information about individually and collectively significant transactions with related parties. Therefore, in EFRAG’s view, users will continue to receive most of the relevant information that they receive under the existing standard. In addition, EFRAG thinks that by focusing on significant transactions, the information provided will not be obscured by excessive information about less significant transactions between related entities.
- 6 EFRAG also considered the implications of the increase in the number of government-controlled entities in environments where, as a result of the financial crises, governments have taken significant and sometimes controlling stakes in financial institutions. The exemption in the Amendments would extend to such financial institutions and it could be questioned whether the financial assistance provided by governments would be adequately disclosed. EFRAG thinks it would for two reasons:
 - (a) first, the Amendment requires disclosure of significant transactions in such instances and therefore all significant transactions would be disclosed in terms of paragraph 26 of the amended standard; and
 - (b) the disclosure requirements of other standards, such as IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, will continue to apply to those entities applying the exemption. These standards would require certain disclosures where transactions, not captured by the disclosures noted above, were not at arm’s length and could therefore have affected the financial performance and position of the reporting entity.

Reliability

- 7 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 8 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness. In EFRAG’s view, the Amendments do not raise any significant issues concerning freedom from material error and bias.
- 9 Reliability concerns should not arise when entities report the additional information due to the change in the definition of a related party; entities should have access to the information about transactions with each other within the same group. In complex organisational structures it may be more difficult to collect all the relevant information, creating some reliability concerns. EFRAG considered these situations and noted that similar information is already required for some of the entities within such structures and such entities are able to obtain the information to meet the

existing requirements. Therefore, the amended definition does not create any new reliability concerns in EFRAG’s view.

- 10 Some argue that the reporting entity will need the co-operation of others to obtain information required about the private affairs of key management personnel. In some cases, it may be difficult to obtain the right information from those persons; and in other cases, disclosing such information could involve privacy infringement. EFRAG considered these situations, and noted that the existing definition of a related party in IAS 24 already requires a certain level of disclosure about individual persons, and that the Amendment should not create any new concerns involving privacy infringement.
- 11 EFRAG understands that currently some preparers are concerned that the existing requirements in IAS 24 are too cumbersome and sometimes difficult to apply in relation to government related entities, and as a result may lead to incomplete or unreliable disclosures being provided. In EFRAG’s view, the relief provided by the Amendment will address concerns about obtaining reliable information concerning relationships and transactions involving a common government, and therefore strengthen the reliability of the information disclosed.

Comparability

- 12 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 13 EFRAG has considered whether the Amendments have been scoped in a way that results in transactions that are economically similar being accounted for differently, or transactions that are economically different being accounted for as if they are similar.
- 14 EFRAG believes that the Amendment to the definition of a related party will enhance the comparability of information as it makes the definition of a related party more symmetrical. This is because the Amendment includes relationships between entities that can exercise a similar extent of influence over each other by virtue of its relationship with a third entity, and which are similar to other relationships that meet the existing definition of a related party.
- 15 EFRAG notes that the consistent application of the exemption will result in comparable information where entities with similar levels of government involvement provide the required disclosures. However, the exemption may result in similar entities disclosing information for similar activities in differing levels of detail where one entity is government related while the other is not. Some may argue that such situations would not result in comparable disclosures. Notwithstanding this concern, as noted above, under our assessment of relevance of information, EFRAG believes that the additional disclosure requirements for entities that use the exemption is sufficient to inform users of the occurrence of significant related party transactions. Therefore, it should not affect the comparability of information in any significant way.

Understandability

- 16 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of

business and economic activity and accounting and the willingness to study the information with reasonable diligence.

- 17 Although there are a number of aspects to the notion of ‘understandability’, EFRAG believes that most aspects are covered by the discussion above about relevance, reliability and comparability (because, for example, information that represents something as similar when it is in fact dissimilar is not comparable, and that lack of comparability will mean it is also not understandable). As a result, EFRAG believes that the main additional issue it needs to consider in assessing whether the information resulting from the application of the Amendments is understandable and whether that information will be unduly complex. In EFRAG’s view, the Amendments do not introduce any new complexities that may impair understandability. In fact, the clarification of the definition of a related party and reduction of information that is not relevant for entities applying the exemption in respect of government-related entities may improve the understandability of the disclosures resulting from this standard.

True and Fair

- 18 EFRAG has also concluded that there is no reason to believe that the information resulting from the application of the Amendments would be contrary to the true and fair view principle.

European Interest

- 19 EFRAG has considered whether the benefits of implementing the Amendments in the EU exceed the costs of doing so. Its initial assessment (as explained more fully in Appendix 3) is that, although implementation of the Amendments would involve some costs, they are likely to be outweighed by the benefits.

Conclusion

- 20 EFRAG’s overall conclusion is that the Amendments satisfy the criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

APPENDIX 3

EFRAG’S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENT

- 1 EFRAG has also considered whether, and if so to what extent, implementing the Amendments in the EU might involve preparers and/or users incurring incremental costs, and whether those costs are likely to be exceeded by the benefits to be derived from their adoption.

Costs for preparers

- 2 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 initial assessment of the additional work the Amendments are likely to create (or what work they might save) preparers.
- 3 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.
- 4 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 amended 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 initial 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

- 5 EFRAG has also carried out an initial assessment of the implications of the Amendments for the costs incurred by users of the financial statements.
- 6 As explained in Appendix 1, prior to the Amendments, there was some uncertainty as to which entities might be considered to be related to each other. The Amendment eliminates 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.
- 7 Regarding the exemption, EFRAG concluded that there could be an increase in costs to supplement the loss of some information. However, the amended 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.

- 8 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.
- 9 Overall, EFRAG initial assessment is that the Amendments combined will not result in increased costs to users.

Benefits for preparers and users

- 10 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.
- 11 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

- 12 EFRAG’s overall assessment is that:
 - (a) implementing the Amendments 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) the Amendments are likely to involve users in additional but insignificant analysis costs; and
 - (c) the Amendments are 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.