

Related party disclosures – Amendments to IAS 24

Background

Identifying related party relationships can be a challenging and costly exercise particularly for large multinational organisations. It requires the ability to identify and evaluate all types of relationships up and down the organisational chart including those among and between subsidiaries, associates, investees and any other entities that might be influenced by a common set of owners or key management (or close family members thereof).

Reporting entities in some jurisdictions, such as China, face particular challenges where transactions between entities that are controlled, jointly-controlled, or significantly influenced by the same government (hereinafter referred to as “government-related entities”) are common and represent related party transactions that are subject to disclosure under IFRS. In addition, as a result of the increase in the number of government ‘bail-outs’ of businesses that has taken place during the past several years, the number of related party relationships that are to be identified, quantified and disclosed will have substantially increased for some entities.

In some respects, the definition of what a related party relationship represents, as set out in the current IAS 24 *Related Party Disclosures*, has not helped matters due the complex and cumbersome structure of the definition itself. In response to these issues, the IASB has amended IAS 24 in an effort to simplify the identification of such relationships and re-balance the extent of disclosures of transactions between related parties based on the costs to preparers and the benefits to users in having this information available in financial statements.

Summary of key changes

Definition of a related party

The IASB’s intention was to clarify the definition of related parties, but without reconsidering the fundamental approach to related party disclosures. In revising the definition, the Board adopted the following approach:

- ▶ When an entity assesses whether two parties are related, it will 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.
- ▶ 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.



- ▶ 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.
- ▶ 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.
- ▶ 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.

The following related party relationships were affected by the change in the definition:

- ▶ An associate of a subsidiary's controlling investor:
 - ▶ Clarified that where an investor controls a subsidiary and has significant influence over an associate, both the investor and the subsidiary are related parties to the associate.
 - ▶ Changed the definition to include a similar scenario where an investor controls a subsidiary and has significant influence over an associate, both the investor and associate are related parties to the subsidiary.
- ▶ Two associates of a person:
 - ▶ The definition has always stated that where an entity invests in two associates, the associates are not regarded as related parties as there is insufficient influence.

- ▶ However, the amended standard changed the definition to address the scenario where a person (or a close member of that person's family) significantly influences two entities, the entities are not related due to insufficient influence.
- ▶ Investments of members of key management personnel:
 - ▶ Currently in IAS 24, where the key management personnel of an entity held an investment which resulted in control or joint control, the investee was treated as a related party of the entity. The amendment provides that the reciprocal of this is also treated as a related party (i.e., from the standpoint of the investee, the entity is a related party of the investee).
- ▶ Joint control:
 - ▶ The current definition states that 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 another entity, the other entity is related to the reporting entity.
 - ▶ This definition, however, does not include the reciprocal of this relationship (i.e., from the standpoint of the other entity, the reporting entity is treated as a related party), nor does it deal with cases when a person or a third entity has joint control or significant influence over the two entities. The amended definition includes these cases, to treat similar relationships in a consistent manner.



Partial exemption for government-related entities

The current IAS 24 does not provide an exemption for disclosure of related party transactions among government-related entities. As set out in the introduction, reporting entities in certain jurisdictions such as China face particular challenges in identifying and reporting related party transactions. In many instances, the government does not exert sufficient influence, whether by choice or, unknowingly, by circumstance, to impact the economic outcomes of transactions between government-related entities as well as with the government itself. This is despite the fact that the government could exert such influence based on its ownership interest. In other instances, the reporting entity is not aware (or is not able to identify) that its counterparties are also government-related entities.

The IASB addressed these issues by amending IAS 24 to provide for a partial exemption of related party disclosures for transactions between government-related entities as well as with the government itself. For these entities, the general disclosure requirements of IAS 24 (e.g., disclosing the amount of the transactions, the amount of outstanding balances, including commitments, provisions for doubtful debts, expenses in respect of bad or doubtful debt or commitments with related parties) will not apply. Instead, alternative disclosures have been included that require:

- ▶ The name of the government and the nature of its relationship with the reporting entity (i.e., control, joint control or significant influence).
- ▶ The nature and amount of each individually significant transaction.
- ▶ A qualitative or quantitative indication of the extent of other transactions that are collectively, but not individually, significant. Types of such transactions are included in Box 1.

Box 1: Types of collectively significant transactions to be disclosed if they are with a related party

- ▶ Purchases or sales of goods (finished or unfinished)
- ▶ Purchases or sales of property and other assets
- ▶ Rendering or receiving services
- ▶ Leases
- ▶ Transfers of research and development
- ▶ Transfers under licence agreements
- ▶ Transfers under finance arrangements (including loans and equity contributions in cash or in kind)
- ▶ Provision of guarantees or collateral
- ▶ Commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognised and unrecognised)
- ▶ Settlement of liabilities on behalf of the entity or by the entity on behalf of that related party

In determining the level of detail of information to be disclosed, the reporting entity should consider the closeness of the related party relationship and other factors relevant in establishing the level of significance of the transaction. These factors are summarised in Box 2.

Box 2: Relevant factors for assessing the significance of related party transactions

- ▶ Significant in terms of size
- ▶ Carried out on non-market terms
- ▶ Outside normal day-to-day business operations, such as the purchase and sale of businesses
- ▶ Disclosed to regulatory or supervisory authorities
- ▶ Reported to senior management
- ▶ Subject to shareholder approval

Disclosure requirements for commitments

The amendment also added explicit disclosure requirements for commitments (including executory contracts) with related parties. Although some reporting entities may have already been providing disclosures about commitments based on the existing requirements of IAS 24, the amendment makes this disclosure requirement explicit.

Consequential amendments to other IFRS

IFRS 8 *Operating Segments* has also been revised in respect of determining the revenue arising from significant customers who are under common control. The amendment points out that judgment will be required to assess whether a government, including government agencies and similar bodies (whether local, national, or international), and entities known to the reporting entity to be under the control of that government, are considered a single customer for purposes of disclosing revenue from single customers under common control as prescribed by paragraph 34 of IFRS 8.

Effective date and transition

The amendments become effective for annual periods beginning on or after 1 January 2011 and should be applied retrospectively. However, early application is permitted for either the partial exemption for government-related entities (without adopting the other revisions resulting from the amendment) or for the entire revised standard.

Business impact

Identifying and disclosing related party transactions may continue to be a timely and costly exercise (even under the amended standard). Financial statement preparers need to ensure that they work with the right groups within their organisations to capture the necessary information. This will apply to all members within the group reporting structure (including key management personnel), as well as associates or other investees who are influenced by the reporting entity. The holdings of influential investors may also need to be evaluated in order to determine whether the reporting entity is doing business with such affiliates as these types of relationships may meet the definition of a related party relationship.

For those organisations who are subject to control or some significant level of influence by a government (or government agency or similar party), a substantial amount of work may need to be done in order to identify related party relationships with other similar government-related entities (as well as with the government itself).

However, the level of disclosure for transactions between government-related organisations (or with the government itself) may be limited based on the exemption from full disclosure. In order for such entities to take advantage of this exemption in the current year, the process needs to begin now.

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