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Le Président

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N°358

**The IAS 24 Project Manager**

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## **EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 24 RELATED PARTY TRANSACTIONS**

Dear Sir/Madam,

I am writing on behalf of the CNC to give you our comments on the above-mentioned Exposure Draft (ED).

Our detailed comments are set out in the Appendix.

We welcome the proposed amendments to the definition of related parties and related party transactions, which help improve the consistency of financial reporting.

We also support the objective of exempting state-controlled entities from the disclosure requirements of §17 of IAS 24 where the cost of producing the information outweighs its relevance to users of financial reporting.

We are not, however, convinced that this objective will be achieved by the proposed approach which bases exemption on the absence of indicators of influence, and therefore requires to identify (if not disclose) the related parties and related party transactions and to assess whether indicators of influence exist.

It is our understanding that a state-controlled entity will have to disclose all transactions with another state-controlled entity where a relationship of influence exists, even if this influence has no actual impact on the financial statements.



Our suggestion would be to limit disclosure to those situations of influence, which actually impact the financial statements, either because the transactions are economically significant and/or are not transacted at market rates.

We hope you find these comments useful and would be pleased to provide any further information you might require.

**Yours sincerely,**



Jean-François Lepetit

# APPENDIX

## AMENDMENTS TO IAS 24 *RELATED PARTY DISCLOSURES*

### Question 1 – State-controlled entities

(a) Do you agree with the proposal to provide, in the circumstances described?

in this exposure draft, an exemption for entities controlled or significantly influenced by the state?

If not, why? What would you propose instead and why?

(b) Do you agree:

(i) that an indicator approach is an appropriate method for identifying when the exemption should be provided for entities controlled or significantly influenced by the state; and

(ii) that the proposed indicators are appropriate?

If not, why? What would you propose instead and why?

### CNC's Reply

#### Preliminary remark

We presume that the terms “controlled or significantly influenced by the state” as stated in question 1 and paragraph 17A (a) correspond to the definitions of control and significant influence in IAS 27 and IAS 28 respectively.

The term “joint control” as defined by IAS 31 is not explicitly mentioned in Q1 nor in paragraph 17A (a), although considering the general definition of a related party, we believe it is intended to be included. We therefore suggest that entities under “joint control” be added explicitly in paragraph 17A (a) and in to the scope of Question 1. .

We further suggest that explicit reference should be made to the definition of controlled, jointly controlled or significantly influenced entities as stated in standards IAS 27, 31, and 28 respectively.

Question 1(a): We agree in principle with the proposal to exempt entities controlled, jointly controlled or under significant influence of a state from the disclosure requirements of IAS 24.

In this respect, we understand from BC 11 to BC 14 that the principal grounds for proposing the exemption are the practical difficulties of identifying potential related parties and the excessive cost of providing such disclosures as compared to the benefit of the information obtained (“excessive disclosures about unaffected transactions”).

However, we believe the wording of para. 17A(a) should be clarified as it suggests that entities that are both under the significant influence of a state are necessarily related parties, which is not consistent with the definition of a related party as proposed in the revised definition. (See BC6)

Question 1(b)(i): In theory, an indicator approach might be an appropriate method of determining when exemption should be provided.

However, in practice it is difficult to define indicators, which are not costly and complicated to apply. In order to determine whether indicators of influence exist as set out in 17B it may require considerable research. There is the risk that this research might be as lengthy as actually preparing the information for the disclosures and this might cancel out any benefits derived from exemption i.e. it might be in contradiction with the cost benefit objective set out in BC 14

Question 1. (b) (ii)

- **Influence**

Para.17A (b) stipulates that in order to obtain an exemption from disclosures there should be no indicator of “influence” affecting state-controlled related parties.

We have several comments on this statement:

- We believe “influence” should be defined as there is a confusion whether it has the same meaning as “significant influence” in IAS 28;
- Our suggestion is to ask that “influence” be assessed by reference to the objective of IAS 24 which states: “The objective of this Standard is to ensure that an entity’s financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.”

We suggest that the ED should clarify whether disclosure applies to situations of “influence” irrespective of whether such situations actually affect the financial statements. i.e. the disclosure of all significant transactions is required if and when there is an indication of influence regardless of whether this influence had an effect on the financial statements.

Presumably, as stated in section 17, the user is interested in the “potential effect of the relationship on the financial statements”. The use of the term “potential” suggests that it is not necessary to establish whether there is an actual effect on the financial statements.

However, the wording of 17 A (b) suggests that exemption is dependent on whether influence was actually exercised. This could be interpreted to mean whether the relationship actually had an effect on the financial statements.

In our view, it would be more relevant to limit disclosure to transactions where influence actually has an effect on the financial statements.

- **Clarification of structure and wording**

We also wish to comment on para.17B, 17C and 17D with respect to the clarification of the structure and wording.

We think it should be made clear in the wording of para.17B that the indicators are only examples of situations that could indicate influence, except for the indicator of “business at non-market rates” in para. 17B(a) since it gives rise to a stronger presumption of influence than the other indicators, as it impacts the financial statements.

This objective could be achieved by merging para.17B and para.17D.

Also para.17C is an example of an indicator (common board members) which might be included in the list of examples of indicators that could lead to the existence of influence (proposed revised para.17B).

We would also suggest that the Board makes it clear that the “common board members” mentioned in para. 17C include persons as well as entities. Furthermore, it should be made clear that the definition of “state” will vary according to each jurisdiction and that this will in turn determine whether board members are “common” or not.

However, we wonder whether the existence of common board members is any more than a reflection of the control exercised by the state entity, so that it seems redundant information.

- **Practical application difficulties**

We wish to stress the practical difficulties of applying the indicators of influence set out in para.17B of the ED.

For example, we consider that the identification of business transactions at non-market conditions (other than by way of regulation) as required by para.17B (a) raises considerable difficulties as it requires as a prerequisite to identify all related parties and related party transactions, therefore reducing significantly the benefit in terms of cost of complying of the proposed amendment (in our view, your conclusions in BC12 also apply in the circumstances).

We would also point out that the exemption for “transactions at non-market rates by way of regulation” mentioned in para. 17B(a) should refer to regulation applicable to all market participants. Otherwise, there might be cases where a special regulation applies to specific entities that may not lead to disclosure, which would be inappropriate in our view.

Moreover, the shared resources indicator set out in §17B(b) seems very general and further guidance would be required on what is included in “shared resources” and the circumstances in which it could give rise to the exercise of influence.

## **Question 2 – Definition of a *related party***

(a) The definition of a related party in IAS 24 does not include, for a subsidiary’s individual or separate financial statements, an associate of the subsidiary’s controlling investor. The Board has decided that it should be included, and thus proposes to amend the definition of a related party.

The Board similarly proposes that when the investor is a person, entities that are either significantly influenced or controlled by that person are to be treated as related to each other. Do you agree with this proposed amendment?

If not, why? What would you propose instead and why?

(b) IAS 24 does not define associates of an *entity* as related parties. However, when a *person* has significant influence over an entity and a close member of the family of that *person* has significant influence over another entity, IAS 24 defines those two entities as related parties. The Board proposes to align the definition for both types of ownership by excluding from the

definition of a related party an entity that is significantly influenced by a person and an entity that is significantly influenced by a close member of the family of that person. Do you agree with the proposed amendment?

If not, why? What would you propose instead and why?

(c) IAS 24 defines any entity over which a member of the key management personnel of the reporting entity has control, joint control or significant influence, or in which the member holds significant voting power, as related to the reporting entity. However, the converse is not true. Thus, when the entity that a person controls, jointly controls or significantly influences, or in which the person has significant voting power, is the reporting entity and that person is a member of the key management personnel of another entity, that other entity is not defined as related to the reporting entity. The Board proposes to remove this inconsistency by expanding the definition to encompass both situations. Do you agree with the proposed amendment?

If not, why? What would you propose instead and why?

(d) Do you agree with the proposal to clarify the definition of a related party? Does the wording proposed capture the same set of related parties as IAS 24 at present (except for the amendments described in (a)–(c) above)? Do you agree that the proposed wording improves the definition of a related party?

If not, why? What would you propose instead and why?

## **CNC's Reply**

Question 2(a) We agree.

An associate and a subsidiary of the same entity are related parties because the subsidiary is part of a group that exercises a significant influence over the associate (BC2).

This relationship is not required to be disclosed by IAS 24 in the individual accounts of the subsidiary. IAS 24 does however require disclosure of the subsidiary as a related party in the associate's individual accounts.

We therefore agree that it would be more consistent to make the equivalent disclosure in the subsidiary's individual accounts.

Question 2(b) We agree

Under current IAS 24 definitions, associates with a common investor are not considered related parties where the investor is an entity. Entities significantly influenced by persons who are members of the same family are currently defined as related parties. The proposed amendment excludes such entities from the definition.

We agree that there should be a consistent treatment for persons and entities.

Question 2 (c) We agree.

Investees controlled or significantly influenced by key management personnel of a reporting entity are related parties of the reporting entity. Currently this relationship is disclosed in the reporting entity's financial statements but not in those of the investee.

We agree on grounds of consistency of disclosure.

Question 2 (d) We agree.

We believe the new definition captures the same related parties (subject to above amendments) and that the structure and wording of the definition are clearer.

**Question 3 – Definition of *related party transactions***

Do you agree with the proposal to clarify the definition of a related party transaction?

If not, why? What changes would you propose and why?

**CNC's Reply**

Question 3. We agree.

**Question 4**

Do you have any other comments on the proposals?

**CNC's Reply**

We believe it would be helpful to better define and give examples of the type of transactions that would be disclosed under 20(j) “transactions or commitments to do something if a particular event occurs or does not occur in the future”.

Question 2 (c) refers to “significant voting power” with respect to the interest of key management personnel in investees. We recommend that the term “significant voting power” should be defined.