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Project	Annual Improvements—2010–2012 cycle		
Topic	IAS 24 <i>Related Party Disclosures</i>—Key Management Personnel		

Objective of this paper

1. In 2010 a request was received by the IFRS Interpretations Committee asking whether key management personnel (KMP), as defined in IAS 24 *Related party Disclosures*, could include an entity or could only apply to individuals. The original submission presented the case of mutual funds that typically do not have employees and therefore hire KMP services from a separate servicing entity. The issue arose from concerns over divergent disclosures.
2. At its meeting in September 2010, the IFRS Interpretations Committee discussed clarifying the disclosures required in accordance with IAS 24 in cases where a reporting entity hires key management services from a separate service entity. The Committee made a recommendation to the Board to propose an improvement through Annual Improvements.
3. The Board discussed the issue at its meeting in October 2010 and again in September 2011. This paper will address the Board's concerns raised in those discussions.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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Structure of this paper

4. This paper is organised as follows:
 - (a) Background;
 - (b) identification of key management personnel costs;
 - (c) disclosure of key management personnel costs;
 - (d) comparison of structuring examples with the revised IAS 24;
 - (e) existing key management personnel compensation disclosure; and
 - (f) staff summary and recommendation

Background

5. The submission received by the Interpretations Committee presented the case of a mutual fund that does not have employees and therefore hires key management services from a separate management entity. Throughout this paper, the mutual fund will be referred to as the reporting entity and the entity providing key management personnel services will be referred to as the management entity.
6. Two questions were asked in the context of the submission:
 - (a) Can key management personnel (KMP) as defined in IAS 24 include an entity as opposed to individuals? and
 - (b) Should the reporting entity disclose:
 - (i) the remuneration paid by the management entity to the individuals providing the KMP services, or
 - (ii) the service fees paid by the reporting entity to the management entity for the KMP services?

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7. The Board have discussed this issue twice, once in October 2010 and again in September 2011.
8. At its meeting in October 2010, the Board discussed the Interpretations Committee's recommendation that:
 - (a) the management entity should be considered a related party; and
 - (b) persons providing KMP services to the reporting entity should be excluded from the definition of a KMP if they are not employed by the reporting entity.
9. At its meeting in September 2011, the Board discussed the staff's recommendation that:
 - (a) the management entity should be considered a related party; and
 - (b) fees paid by the management entity to its employees should be excluded specifically from the disclosure requirements relating to KMP compensation.
10. In these discussions, the Board members raised a number of concerns:
 - (a) that all costs relating to key management services, however they are structured, should be identified;
 - (b) that disclosure of these costs should provide useful information to users and support the objective of IAS 24;
 - (c) that unintended consequences of any proposed changes to definitions should be avoided; and
 - (d) that structuring possibilities should be reduced.

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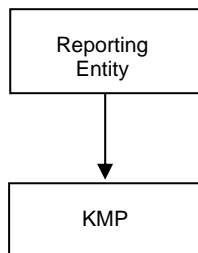
Identification of key management personnel costs

11. This issue was originally referred to the Interpretations Committee because it is common in some industries, such as mutual fund management, that key management services can be provided in a variety of ways:

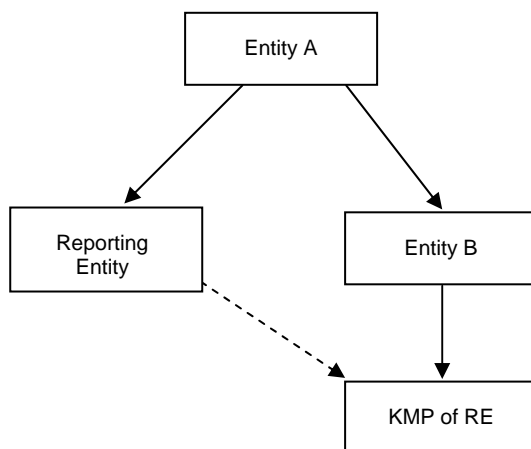
- (a) by a specific KMP, employed directly by the reporting entity;
- (b) by a related-party KMP-service provider entity that employs one or more personnel to service one or more related entities;
- (c) by a specific KMP, employed through the KMP's own company; and
- (d) by an unrelated, professional KMP-service provider that employs one or more personnel to service a number of non-related reporting entities.

12. These possible compensation structures are represented diagrammatically below:

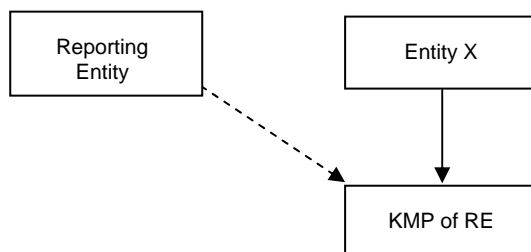
11(a)



11(b)



11(c) and (d)



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13. It is clear in IAS 24 that KMP employed directly by the reporting entity, as described in 11(a), are identified as a related party in accordance with Paragraph 9 (a) (iii) of IAS 24:
- 9 A person or a close member of that person's family is related to a reporting entity if that person:
- [...]
- (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
14. Similarly, the management entity described in 11(b) will be identified as a related party of the reporting entity in accordance with IAS 24.9 (b) (i):
- 9 (b) An entity is related to a reporting entity if any of the following conditions applies:
- (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
15. (The type of structure described in 11(b) is very common in this sector—one subsidiary typically manages the funds held by another subsidiary.)
16. The concerns expressed by the Board about the identification of KMP costs arise in situations 11(c) and 11(d), in which entities that do not otherwise meet the definition of a related party provide KMP services to the reporting entity. The staff recommendation made in both October 2010 and September 2011 was that these management entities should be identified as related parties by amending IAS 24.9 (b) and the staff reaffirm that recommendation.
17. In our view, the relationship disclosed should only be that of the management entity with the reporting entity. We do not believe that the reporting entity is a related party of the management entity. The reporting entity should disclose all transactions with the management entity but the management entity should not disclose its transactions with its KMP clients unless it is a related party for reasons other than providing KMP services.

IASB Staff paper

18. The staff recommend that a clause should be added to paragraph 9 (b), as proposed in October 2010 and September 2011, to include the management entity in the definition of related parties:

(viii) The entity, or members of its group, provides key management personnel services to the reporting entity.

19. Including this clause will ensure that all transactions and balances that the reporting entity has with the management entity should be disclosed by the reporting entity.

Question 1

Does the Board agree with the staff recommendation to amend IAS 24 to include the management entity providing key management services within the definition of related entities?

Disclosure of key management personnel costs

Key management personnel compensation disclosure

20. Paragraph 17 of IAS 24 requires a separate analysis of costs relating to KMP compensation:

17 An entity shall disclose key management personnel compensation in total and for each of the following categories:

- (a) short-term employee benefits;
- (b) post-employment benefits;
- (c) other long-term benefits;
- (d) termination benefits; and
- (e) share-based payment.

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21. This disclosure requirement provides a more detailed disaggregation of the category of expense of KMP compensation than do the disclosure requirements for other transactions with related parties:

18 If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph 17. At a minimum, disclosures shall include:

- (a) the amount of the transactions;
- (b) the amount of outstanding balances, including commitments, and:
 - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
 - (ii) details of any guarantees given or received;
- (c) provisions for doubtful debts related to the amount of outstanding balances; and
- (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

22. Many Board members expressed concern that when KMP services are provided through a management entity, this disaggregated information is lost. Other Board members were concerned that any proposed change to IAS 24 to capture KMP compensation paid through the management entity could result in compensation information relating to the KMP of professional KMP-service providers being disclosed by the reporting entity. In their view, that information would not be relevant to users.
23. In order to prevent the inclusion of potentially misleading information, the Committee proposed in October 2010 that persons providing KMP services to the reporting entity should be excluded from the definition of KMP unless they were employed directly by the reporting entity. Many Board members expressed

IASB Staff paper

concern that removing some KMP from the definition would lead to unintended consequences.

24. Following these discussions, the staff recommended in September 2011 that the definition of a KMP should remain unaltered and that the management entity should be identified as a related party. The staff also recommended that amounts paid by the management entity to its employees should be excluded from KMP disclosures.
25. Some Board members were unhappy with this proposal and suggested that IAS 24 should be revised in some way to both identify the managing entity as a related party yet also require it to make the detailed disclosures relating to KMP compensation that are required by IAS 24.17.
26. The resulting discussions identified a number of practical issues with this latter proposal:
 - (a) If the management entity is a vehicle for employing one or more identifiable KMP it may be possible to obtain the disclosure information required.
 - (b) On the other hand, if the management entity is an independent, professional KPM-service provider it may be difficult to identify the specific personnel who act as KMP to each individual reporting entity if that managing entity services a range of clients.
 - (c) In both cases, the fee structure payable by the reporting entity may not mirror the compensation paid to the employees of the managing entity.
 - (d) Among the practical considerations of disclosing amounts payable by the management entity to the individuals who provide the KMP services to the reporting entity were concerns about privacy and employee confidentiality.
 - (e) Some board members supported the Committee's recommendation that the amount disclosed in respect of these arrangements should be the

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management entity fee that is recognised as an expense by the reporting entity itself, rather than the employee compensation amount that is recognised as an expense by the management entity.

27. In our view, it may not be possible in many cases for the reporting entity to identify the personnel involved in the provision of KMP services or to provide the information in the form required by IAS 24.17. We are also not persuaded that information provided in that form would be useful in achieving the objective of IAS 24.
28. Throughout the discussions, Board members have expressed the intention that any proposed disclosure should support the objective of IAS 24:
 1. 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, including commitments, with such parties.
29. The principal objective of IAS24 is to disclose the existence of the related party and to indicate the extent of the possible effect of that relationship by explaining the transactions with the related party. We think that applying that objective to the topic of KMP compensation means the disclosure should draw attention to the amounts paid for KMP services, whether received as personal compensation or as fees to an entity.
30. Equally important is the need for disclosure of other transactions that are effected between the reporting entity and the management entity because such transactions may have been made at the direction of the management entity as a result of its position of influence.
31. It is important, therefore, that any relationship should be separately identified as being for the provision of key management personnel services in order that users of the financial statements are aware of the possible influence of that related party. In our view, it is more important to disclose the total amount paid to the management entity for the provision of KMP services than it is to try to devise a

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methodology to otherwise disaggregate the components of that payment into the format required for KMP compensation in IAS 24.17. (The characteristics of KMP compensation disclosure is discussed separately in paragraphs 44-50.)

32. We recommend that the disclosure requirements of IAS 24.18 should be extended to identify separately fees paid in respect of KMP or key management services by the inclusion of a separate paragraph:

18 A Amounts payable for the provision of key management personnel services, paid to a separate management entity, should be separately disclosed.

33. The staff recommend that:
- (a) the management entity should be identified as a related party of the reporting entity as proposed in paragraph 18 above; and
 - (b) payments made to a management entity in respect of KMP services should be separately disclosed by extending the disclosure requirements of IAS 24.18 as proposed in paragraph 32 above.

Unintended consequences of a change in definition of KMP

34. There is a risk that amounts paid to KMP through a management entity could be double counted in disclosure—once as KMP compensation in accordance with IAS 24.17 and again as the fee payable to the management entity in accordance with IAS 24.18.
35. In our view, it will not always be possible to disclose the fees paid to the managing entity in the KMP compensation form required by IAS 24.17 for the reasons noted in paragraph 26 above. Consequently, the disclosure relating to KMP compensation should be excluded to prevent double counting.
36. In order to achieve this, the Interpretations Committee recommended in October 2011 that the definition of KMP should be amended in IAS 24.9 (a) (iii) to exclude KMP not employed by the reporting entity, ie those paid through a management entity.

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37. Following the discussions with the board in October 2010, we do not recommend revising the definition in IAS 24.9 (a) to exclude KMP not employed by the reporting entity from the *definition* of related parties, because their exclusion from related parties might have unintended consequences, such as the non-disclosure of loans made to KMP not employed by the reporting entity. Instead, we propose that their compensation, paid as fees, should be specifically excluded from the *disclosure* requirements relating to KMP compensation listed in IAS 24.17. We recommend that this exclusion should be in a form similar to that proposed in the September 2011 agenda paper:

17A If an entity hires key management personnel services from another entity (the management entity) then the entity is not required to apply the requirements in paragraph 17 to compensation paid by the management entity to its employees or directors.

38. The staff also propose that the amounts paid as fees to the management entity should be included in the extended disclosure proposed for IAS 24.18, as described in paragraph 32 above.
39. These proposals would ensure that KMP, however remunerated, are still identified as related parties so that other transactions (such as loans) would continue to be required to be disclosed in accordance with IAS 24.18.

Comparison of structuring examples with the revised IAS 24

40. In their discussions, the Board have expressed concerns that there might be unintended consequences to revising IAS 24 and that some transactions with KMP would not be identified or disclosed.
41. Examples of some common compensation structures are illustrated below to indicate how each related party transaction would be identified and disclosed in accordance with the proposed revisions to IAS 24:

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Employment structure	Related party	Identify related party	Disclose KMP costs
KMP is an employee of the reporting entity	KMP	9 (a) iii KMP	17 KMP disclosures - pay by component
KMP is an employee of a service entity that only provides the services of that individual	Management entity	Inserted 9(b) viii	Inserted 18A – service fee
KMP is (a) an employee of the reporting entity	Management entity	Inserted 9(b) viii	Inserted 18A – service fees
(b) also paid directly by reporting entity	KMP	9 (a) iii KMP	17 KMP disclosures- pay by component
KMP services are provided by a professional KPM-service provider that services a number of clients	Management entity	Inserted 9 (b) viii	Inserted 18A - service fee
KMP services are provided by a KPM-service provider, related for reasons other than providing KMP services, that services one or more group entities	Management entity	9 (b) (i)	Existing related party disclosure 18 plus inserted 18A –service fee
KMP enters into a non-compensation transaction with the reporting entity, eg receives a loan: As a KMP of reporting entity	KMP	9 (a) (iii)	17 KMP disclosures- pay by component
Through a management entity	Management entity	Inserted 9 (b) (vii)	Existing related party disclosures in 18

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Question 2

Does the Board agree with the staff recommendations:

- (a) to exclude compensation relating to KPM not employed by the entity from the disclosure requirements of IAS 24.17 related to KMP compensation;
- (b) to extend IAS 24.18 to require that transactions with related parties for the compensation of KMP or the provision of KMP services are disclosed separately;
- (c) to retain the existing definition of KMP to prevent any unintended consequences of excluding them from related parties?

Annual Improvements criteria assessment

42. We have assessed the issue against the Annual Improvements criteria below:

- (a) *The proposed amendment clarifies or corrects existing IFRSs.*

The change proposed is a clarification, which intends to clarify the appropriate disclosure relating to KMP services in the situation described. The proposed change does not introduce a new principle or amend an existing principle. It provides clarification in accordance with the existing principles of IAS 24.

- (b) *The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.*

The proposed change is limited to disclosures in well-defined situations in which the reporting entity hires key management personnel services from a separate entity.

- (c) *It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach a conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.*

Because the Interpretations Committee reached a conclusion on a timely basis on the issue, it is likely that the Board will also reach a conclusion on a timely basis.

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- (d) *If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.*

There is no current or planned Board project to review IAS 24.

43. In our opinion, the issue satisfies the Annual Improvements criteria.

Existing key management personnel compensation disclosure

44. The amount of compensation paid to KMP, disaggregated as required by IAS 24.17, is useful information for users. KPM compensation is relevant to users because the structure and amount of compensation are major drivers in the implementation of business strategy. The disclosure required by IAS24.17 improves transparency, thereby allowing users to make a better assessment of the impact of KMP compensation on the reporting entity's financial position and profit and loss.
45. In the staff's view, however, the categories of expenses disclosed are not all that is needed to achieve the objective of IAS 24, as noted in paragraph 28 above.
46. Applying the objective of IAS 24 to KMP compensation would give a disclosure objective of enabling users to assess when the financial position or profit and loss of the reporting entity has been affected by the KMP's relationship with the reporting entity. This relationship would be likely to have the greatest effect on the reporting entity when the KMP's behaviour is affected by the compensation or fees that they have received. In our view, the component of KMP compensation that is most likely to affect their behaviour is not the categories required by paragraph 17 but is instead any *variable* component of their compensation and, in particular, performance-related bonuses. We believe some Board members hold a similar view, because the subject of bonuses, and their disclosure, was raised in the Board's discussions.

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47. At present, paragraph 17 of IAS 24 does not require the separate disclosure of these variable amounts. Annual bonuses would be included within short-term benefits and payments arising from the maturity of long-term incentive plans would be included within long-term benefits. In our view, disclosing these amounts separately would give users transparency on a significant driver of the behaviour of KMPs.
48. For example, if the financial statements disclosed a large variable payment to KMP from the maturity of a long-term incentive plan, this might cause users to scrutinise the assumptions and judgements made in the preparation of the financial statements more carefully than otherwise.
49. Variable payments are equally significant as a component of the fee paid to the management entity. A significant component of that fee is typically structured as a variable amount based on a calculation of the increase in market value of the funds under management. Disclosing this component separately would allow users to assess the quality of the fund management services provided.
50. The separate disclosure of variable amounts, whether paid as KMP compensation or as fees paid to a managing entity, would draw attention to the possibility that the reporting entity's financial position and profit and loss may have been affected by the KMP's behaviour.
51. We recommend that input on this topic is sought from the Committee and that any proposed amendment to require separate disclosure of variable amounts paid to related parties, and any proposed wording, should be brought back to a future meeting.

Question 3

Does the Board agree with the staff analysis?

Does the board agree with the staff recommendation to seek further input on variable payments to related parties and consider any proposal to make such an amendment as part of the 2011-2013 annual improvements project?

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Staff summary and recommendations***Proposed changes to IAS 24***

52. The changes proposed to IAS 24 in paragraphs 16, 32 and 37 above are summarised below:
- (a) The definition of a related party is extended to include management entities.
 - (b) The disclosure requirements of IAS 24.18 are extended to require the separate disclosures of transactions for the provisions of KMP services.
 - (c) The KPM compensation provided through managing entities is excluded from the disclosure requirements of IAS 24.17 to prevent duplication.
53. These changes to IAS 24 are noted in Appendix A.

Transition provisions

54. Because the proposed changes relate to the disclosure of financial information, we are of the opinion that transition provisions should follow the general principles in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and entities should apply the amendment retrospectively.

Consequential amendments

55. We reviewed the proposed change in relation to other existing IFRSs. We did not identify consequential amendments to other standards.
56. Specifically, we believe that no consequential amendment is needed to IFRS 1 *First-Time Adoption of International Financial Reporting Standards*.

Question 4

Does the Board agree with the wording for the proposed amendments as set out in Appendix A?

Appendix A—Draft amendment to IAS 24 *Related Party Disclosures*

This appendix includes the draft of the proposed amendment. It is based on the text included in the most recently issued standards. New text is underlined and deleted text is struck through.

Proposed amendment to IAS 24 *Related Party Disclosures*

Paragraph 9 is amended (new text is underlined) and paragraphs 17A, 18A and 29 are added.

Definitions

9 The following terms are used in this Standard with the meanings specified:

A related party is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the ‘reporting entity’).

- (a) A person or a close member of that person’s family is related to a reporting entity if that person:
- (i) has control or joint control over the reporting entity;
 - (ii) has significant influence over the reporting entity; or
 - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
- (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
 - (iii) Both entities are joint ventures of the same third party.
 - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
 - (vi) The entity is controlled or jointly controlled by a person identified in (a).
 - (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
 - (viii) The entity, or members of its group, provides key management personnel services to the reporting entity.

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Appendix A**Disclosures**

All entities

- 17 **An entity shall disclose key management personnel compensation in total and for each of the following categories**
- (a) **short-term employee benefits;**
 - (b) **post-employment benefits;**
 - (c) **other long-term benefits;**
 - (d) **termination benefits; and**
 - (e) **share-based payment.**
- 17A If an entity hires key management personnel services from another entity (the management entity) then the entity is not required to apply the requirements in paragraph 17 to compensation paid by the management entity to its employees or directors.
- 18 **If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph 17. At a minimum, disclosures shall include:**
- (a) **the amount of the transactions;**
 - (b) **the amount of outstanding balances, including commitments, and:**
 - (i) **their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and**
 - (ii) **details of any guarantees given or received;**
 - (c) **provisions for doubtful debts related to the amount of outstanding balances; and**
 - (d) **the expense recognised during the period in respect of bad or doubtful debts due from related parties.**
- 18A Amounts payable for the provision of key management personnel services, paid to a separate management entity should be separately disclosed.

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Appendix A**

Effective date and transition

- 29 *Improvements to IFRSs* issued in [date] amended paragraphs 9 and 17 and added paragraph 17A. An entity shall apply this amendment for annual periods beginning on or after 1 July 2013. Earlier application is permitted.

Basis for Conclusions on proposed amendment to IAS 24 *Related Party Disclosures*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Definition

- BC1 The Board was asked to address unclear wording with respect to disclosures of related party transactions that are identified when a management entity provides key management personnel services to a reporting entity in the specific circumstances where the management entity does not control, jointly control or have significant influence over the reporting entity. The constituents pointed out that divergence exists, because some reporting entities would disclose the compensation paid by the management entity to its employees or directors acting as key management personnel of the reporting entity. Other reporting entities instead disclose the service fee paid by the reporting entity to the management entity with respect to the key management personnel services rendered.
- BC2 The Board noted that IAS 24 *Related Party Disclosures* is unclear as to what information to disclose with respect to key management personnel when those persons are not employees of the reporting entity. To address the diversity in disclosures that arises from IAS 24 being unclear, the Board proposes to amend the definition of a related party. The amendment would clarify that a management entity that provides key management services to a reporting entity is deemed to be a related party. As a result of the change, the reporting entity would be required to disclose the service fee paid to the management entity that employs, or has as directors, the persons that provide the key management services.
- BC3 The Board also noted that because key management personnel would still be identified as a related-party, the reporting entity would be required to disclose compensation to key management personnel by category of benefits in accordance with paragraph 17, along with other direct transactions between key management personnel and the reporting entity as required in paragraph 18. The Board was informed that constituents are concerned about the impracticability of accessing the detailed information that is required in paragraph 17 when compensation is paid to separate managing agent as fees. The Board therefore proposes to provide relief in that the reporting entity would not be required to disclose compensation to key management personnel paid through another entity. Instead payments in respect of KMP compensation or KMP services payable to another entity would be separately disclosed in accordance with IAS 24.18.