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

Introduction

1. At its meeting in September 2010, the Interpretations Committee discussed clarifying the required disclosures in accordance with IAS 24 *Related Party Disclosures* in cases where a reporting entity hires key management services from a separate management entity. The Committee made a recommendation to the Board to propose an improvement through Annual Improvements.
2. The Board discussed the issue at its meeting in October 2010, at which it asked the staff to perform further analysis.

Purpose of this paper

3. This paper:
 - (a) provides background information on the issue;
 - (b) provides further analysis as requested by the Board;
 - (c) makes a recommendation for
 - (i) a proposed amendment to IAS 24 as presented in Appendix A;

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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- (ii) an assessment of the proposed amendment against the criteria for inclusion in Annual Improvements; and
- (d) asks the Board whether they agree with the recommendation.

Background information and issue raised

4. The submission received presented the case of mutual funds that do not have employees and therefore hire ‘key management’ services from a separate management entity. Throughout this paper and for ease of reference, the ‘mutual fund’ will be referred to as the ‘**reporting entity**’ and the entity providing management personnel as the ‘**management entity**’.
5. 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?
6. The analysis that was first presented to the Interpretations Committee at the meeting in September 2010 was set out in agenda paper 11, which is available on the public website¹.

¹ <http://www.ifrs.org/NR/rdonlyres/7DE0A16A-84EB-4595-B1A1-A688F153742A/0/1009obs11.pdf>

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Board's directions from the meeting in October 2010

7. At its meeting in October 2010, the Board discussed the Interpretations Committee's recommendation set out in agenda paper 3C that the issue should be addressed through Annual Improvements².
8. The Interpretations Committee's recommendation was to propose that the Board should consider amending IAS 24 to clarify that, in the context of the submission:
 - (a) the management entity should be considered a related party; and
 - (b) the KMP should not be considered a related-party.
9. As a consequence of the proposed changes, the reporting entity would not apply the requirements in paragraph 17 of IAS 24 to disclose compensation paid to KMP by the management entity. The aim was to have the reporting entity disclose the fee paid for the service rendered by the management entity instead.
10. We reproduce below the IASB update for the October 2010 meeting on this issue:

[...]

The Board expressed concerns about unintended consequences of the proposed improvement to the definition of a related party. They asked the staff to perform further work to ensure consistency of the proposal with the objective of IAS 24 and to bring to the Board examples of the application of the proposed amendment.

Staff analysis***Assessment against the objective in IAS 24***

11. The submission raised the concern that, under current requirements in IAS 24, the reporting entity might fail to disclose appropriate information in circumstances where it is impracticable to access information in relation to compensation of KMP, because such individuals are not directly employed by the reporting entity.

² <http://www.ifrs.org/Meetings/IASB+19+October+2010.htm>

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12. At the meeting in October 2010, some Board members questioned whether not disclosing such information would fail to meet the objective of IAS 24. We reproduce below for ease of reference paragraph 1 of IAS 24 which states the objective of the standard:

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.

13. In addition, we note that paragraph 11 of IAS 24 lists parties that are not related parties, among which parties listed in subparagraph (d) are reproduced below for ease of reference:

[...]

- (d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

14. In the context of the situation described to us in the original submission, we agree that there is a customer/supplier relationship in that the management entity provides services to the reporting entity. However, we also note that the services provided are in the form of KMP and that paragraph 9(a)(iii) of IAS 24 defines a related party in relation to KMP as reproduced below:

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) [...]

- (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

[...]

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15. Consequently, we think that the nature of the relationship is of related parties rather than an economic dependence, specifically from the perspective of the reporting entity.
16. In addition, outreach activities that we had performed before presenting the issue to the Interpretations Committee show that a key indicator of performance for mutual funds in some jurisdictions is the ‘management expense’ ratio, which is a ratio of total expenses charged to the mutual fund by its management entity over the fair value of total assets. Constituents are concerned that while some reporting entities disclose a service fee, others instead disclose compensation paid by the management entity to its employees that act as KMP of the reporting entity; this impairs comparability and the submitter believes it impairs the usefulness of financial information for users.
17. Because KMP services are being provided, we are of the opinion that the issue is one of disclosure of transactions with related-parties. Consequently, we think that addressing the constituents’ concern that disclosure of relevant information may be avoided from the reporting entity’s perspective meets the objective of IAS 24.

Structuring opportunities

18. At the meeting in October 2010, some Board members expressed concerns that the proposed amendment would open the door to structuring opportunities, in that reporting entities may outsource their KMP with the sole purpose of avoiding disclosing compensation paid to those individuals.
19. In response to that concern, we note that a key feature of the situation described in the submission is that the KMP arrangement does not lead the management entity to control, to jointly control or to have significant influence over the reporting entity, nor are those entities controlled by the same ultimate parent. We think that in situations where the reporting and management entities reach that degree of independence, structuring opportunities are reduced.

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20. Consequently, and given the existing diversity in practice in some jurisdictions, we continue to think that clarifying the disclosure requirements for the reporting entity in the situation described in the submission is an improvement to IAS 24.

Review of the original proposed amendment

Identifying the related-parties

21. As a result of applying the original proposed amendment in the specific fact pattern described in the submission, the persons providing the KMP services were not to be identified as a related-party to the reporting entity. The intention was not to require that the reporting entity should disclose compensation to persons providing the KMP services; rather, it was to require the disclosure of the fees paid to the management entity, which was to be identified as a related-party.
22. Further to the discussions at the meeting in October 2010, some Board members pointed out that excluding the identification of the persons providing the KMP services as a related party to the reporting entity would entail that no information would be disclosed with respect to any other transactions that might take place between the persons providing the KMP services and the reporting entity, other than compensation. Such transactions could, for example, be in the form of commitments or loans directly from the reporting entity to the person that is KMP of the reporting entity.
23. We note that allowing the reporting entity to not disclose financial information about such transactions was not the original intention. We also think that those transactions would have to be disclosed to meet the objective of IAS 24. Consequently, we are of the opinion that the exception proposed to be introduced in subparagraph 9(a)(iii) of IAS 24 for the persons providing the KMP services in the draft wording for the amendment presented in October 2010 should not be carried forward.
24. We therefore recommend that the Board should proceed with an amendment to paragraph 9(b) of IAS 24 that would require the management entity to be

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identified as a related-party as well. Such an amendment would require the reporting entity to identify both the management entity and the persons providing the KMP services as related-parties. Consequently, it would require the reporting entity to disclose the service fee paid to the management entity.

25. However, we note that this does not fully address the question of whether the reporting entity should disclose compensation to the persons providing the KMP services hired from the management entity.

Disclosure of compensation to KMP

26. We note that on this last issue, two views exist:
- (a) View A: the reporting entity should be required to provide the information on compensation to the persons providing the KMP services even though the individuals are not on its payroll;
 - (b) View B: the reporting entity should not be required to provide information on compensation to the persons providing the KMP services.
27. Proponents of view A argue that the service fee paid to the management entity is based on the KMP individuals' compensation and other costs (ie salary, pension costs, travel expenses, etc.). Consequently, they believe that the reporting entity can only assess that the service fee paid is appropriate for the service rendered if it obtains a relevant breakdown between the different types of cost that have been incurred by KMP.
28. We note that IAS 24 does not require that compensation information should be provided on an individual basis; rather, the requirements in paragraph 17 of IAS 24 permit that the information can be given in total for the KMP as a group, though by category of benefits. Because advocates of view A rely on this requirement that only an aggregate number should be disclosed by category of

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benefits, they expect all reporting entities to be able to provide the required information on compensation to the persons providing the KMP services paid by the management entity.

29. Proponents of view B argue that because there is no direct link between the persons providing the KMP services and the reporting entity, the compensation to the persons providing the KMP services by the management entity should not be required to be disclosed. They also claim that, in some cases, it is impracticable for the reporting entity to obtain information on compensation paid by the management entity to the persons providing the KMP services.
30. We believe that view B would provide appropriate relief to reporting entities and would provide for a practical solution to concerns expressed by constituents on comparability of amounts reported.

Consequences of applying view B, ie of providing relief

31. We note that as a result of applying our recommendation set out in paragraph 24 of this paper and the current paragraph 9(a)(iii), the management entity and the persons providing the KMP services are identified as related-parties.
32. As a result, applying the requirements in paragraph 18 of IAS 24 to both the management entity and KMP would lead to the disclosure of:
 - (a) the fee paid by the reporting entity to the management entity; and
 - (b) the aggregate amount of direct transactions between the persons providing the KMP services and the reporting entity (ie transactions other than compensation paid by the management entity to the persons providing the KMP services).
33. In addition, applying view B would allow the reporting entity to not disclose information on compensation to KMP as set out in paragraph 17 of IAS 24.
34. We note that applying the requirements in paragraph 18(a) of IAS 24 to the service fee paid results in disclosing a single figure, irrespective of the number of

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transactions at stake and irrespective of the nature of service costs covered by the fees (eg salary, travel costs, bonuses, pension costs, etc.). In contrast, applying view A would lead to the disclosure of the aggregate amount of compensation to KMP by category of benefits.

35. The consequences of applying view B are consistent with the intention to provide practical relief for reporting entities.

Conclusion

36. Given the extent of the diversity in practice that has been reported to us and the need expressed by constituents to enhance comparability, we recommend that IAS 24 should be amended to clarify that:

- (a) the management entity should be identified as a related-party; and
- (b) the reporting entity should not be required to disclose compensation to the persons providing the KMP services in the circumstances discussed in this paper.

Annual Improvements criteria assessment

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

- (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*

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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.

- (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.

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

Transition provisions

39. Because the proposed changes relate to 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

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

Staff's recommendation

42. As proposed in paragraph 36 of this paper, we recommend that the Board should proceed with considering an amendment to IAS 24 that would clarify that, in the specific context of the submission:

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- (a) a management entity that provides KMP services to a reporting entity is deemed to be identified as a relevant related party in respect of those KMP services;
 - (b) the persons providing the KMP services are related-parties; but the reporting entity is not required to disclose compensation paid by the management entity to the persons providing the KMP services; and
 - (c) the parent of the management entity and its subsidiaries and fellow subsidiaries are also related parties of the reporting entity.
43. The proposed wording of the amendment is included in Appendix A.

Questions to the Board**Question 1—Committee recommendation on the need for the amendment**

Does the Board agree with the staff recommendation to amend IAS 24 as proposed in paragraph 42?

Question 2—Staff assessment of the proposed amendment against the criteria for inclusion in Annual Improvements

Does the Board agree with the inclusion of the proposed amendment to IAS 24 in the Annual Improvements cycle for 2010-2012?

Question 3—Wording for the proposed amendment

Does the Board agree with the wording for the proposed amendment 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*

Paragraphs 9 and 17 are amended (new text is underlined) and paragraphs 17A 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, except when paragraph 17A applies:**
- (a) short-term employee benefits;
 - (b) post-employment benefits;
 - (c) other long-term benefits;
 - (d) termination benefits; and
 - (e) share-based payment.
- 17A Circumstances may exist where an entity hires key management personnel services from another entity (the management entity) and that management entity does not control, jointly control or have significant influence over the entity. In those circumstances, and only in those circumstances, the entity is not required to apply the requirements in paragraph 17 to compensation paid by the management entity to directors or employees of the management entity. However, the entity is required to apply the other requirements in this IFRS, and specifically paragraph 18, to any persons providing key management personnel services.

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

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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 in the specific circumstances where the management entity does not control, jointly control or have significant influence over the reporting entity. The Board therefore proposes to provide relief in that the reporting entity would not be required to disclose compensation to key management personnel. However, other disclosure requirements with respect to key management personnel would apply, for example, to other transactions between the reporting entity and the persons providing the KMP services.
- BC4 In addition, because the management entity can cause the reporting entity to enter into related party relationships with the management entity's parent or its subsidiaries, the Board proposes that the parent, subsidiaries and fellow subsidiaries of the management entity should also be identified as related parties of the reporting entity.