
Project	<i>Annual Improvements Project – 2009-2011 cycle</i>
Topic	<i>IAS 24 Related Party Disclosures – Key Management Personnel</i>

Introduction

1. A request has been received asking whether key management personnel (KMP), as defined in *IAS 24 Related Party Disclosures*, can include an entity as opposed to individuals. The issue arises from concern over divergent disclosures. The submission asks for the issue to be addressed within *Annual Improvements*.
2. The submission is reproduced in full in Appendix A.

Objective

3. The objective of this paper is to:
 - (a) provide background information on the situation highlighted in the submission;
 - (b) provide an analysis on the issue;
 - (c) highlight a need for improvement to IAS 24;
 - (d) recommend that the Interpretations Committee (the Committee) recommend that the Board amend IAS 24 through the *Annual Improvements* cycle for 2009-2011; and
 - (e) ask whether the Committee agrees with the staff's recommendation.

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

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 IFRS Interpretations Committee or 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.

Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in *IASB Update*.

IASB Staff paper

Issue presented in the submission and existing diversity***Fact pattern***

4. The submission presents the case of mutual funds that do not have employees and therefore hire ‘key management’ services from a separate servicing entity. Further in 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 ‘**servicing entity**’.
5. In some jurisdictions, the servicing entity would typically perform the role of the trustee and of the manager. Management duties would usually comprise:
 - (a) administrative services, such as processing distributions to unit holders, servicing the unit holders register and preparing the financial statements;
 - (b) investment management services, such as buying and selling investment assets; and
 - (c) ‘key management’ services relating to planning and directing the activities of the mutual fund.

As remuneration for the services performed, a service fee is paid by the reporting entity to the servicing entity. Both the servicing entity itself and employees of the servicing entity may provide services to several reporting entities.

6. An analysis of the services provided by the service entity, the power it holds in respect of the reporting entity and the benefits that the service entity receives from the reporting entity will lead to one of the following assessments of the relationship between the service entity and the reporting entity:
 - (a) the service entity controls or jointly controls the reporting entity;
 - (b) the service entity does not control or jointly control but has significant influence over the reporting entity; or
 - (c) the service entity does not control, jointly control or have significant influence over the reporting entity.

IASB Staff paper

7. In the staff's view, when paragraph 6 (a) or paragraph 6 (b) apply, the service entity is a related party of the reporting entity, based on the definitions in IAS 24 paragraph 9(b) and information about the relationship and transactions between the reporting entity and the service entity must be disclosed in accordance with IAS 24.
8. This paper does not address whether or not the servicing entity is a related party as a result of having control, joint control or significant influence. Instead, this paper is focused on what related party disclosures may or may not be required as a consequence of KMP services being provided.
9. As a result, this agenda paper is written on the assumption that paragraph 6 (c) applies.
10. In addition, there is an underlying presumption in the submission that KMP services may be provided by another entity (in this case, the servicing entity) and that the employees of that other entity who provide those services may qualify as KMP of the reporting entity. The staff agrees with that underlying presumption.

Existing diversity

11. The submitter notes that there is significant diversity in practice with respect to the application of disclosure requirements in IAS 24 in circumstances when the KMP services are provided by employees of another entity. Typically the reporting entity discloses either the:
 - (a) service fee paid to the servicing entity; or
 - (b) compensation paid by the servicing entity to its employees who provide the KMP services to the reporting entity.
12. In reporting in accordance with paragraph **Error! Reference source not found.**, the submitter points out practical difficulties arising when the servicing entity manages several funds, identifying that compensation paid to individual employees may need to be allocated between the reporting entities managed.

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Other information

13. The staff presents below other information gathered via informal outreach that the staff thinks is important for a complete understanding of the issue.

In practice key management may be either individuals or entities

14. The staff is aware that in some jurisdictions KMP refers to individuals, when in other jurisdictions the body acting as KMP has to be a legal entity – also called ‘legal person’.

Useful information to users with respect to mutual funds’ management

15. 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 servicing entity over the fair value of total assets.
16. If some mutual funds disclose the service fee while others disclose the compensation paid by the servicing entity to its employees that act as managers of the mutual funds, comparability and usefulness of financial information for users is at stake.
17. The submitter believes that there is a need for improving the consistency of disclosures given for KMP services.

Questions raised

18. The submitter asks if KMP can include an entity as well as individuals. The staff thinks that the diversity in practice can be addressed by answering the following question:

When KMP services are provided to the reporting entity via a servicing entity, should IAS 24 require disclosures of:

- (a) remuneration paid by the servicing entity to the individuals providing the KMP services for the reporting entity;

IASB Staff paper

- (b) service fees paid by the reporting entity to the servicing entity for the KMP services; or
- (c) all transactions between the reporting entity and the servicing entity?

Staff analysis

Can KMP definition include entities as well as individuals?

- 19. The staff notes that the KMP definition in paragraph 9 of IAS 24 refers specifically to ‘persons’. In addition, the limited review to IAS 24 published in November 2009 amended the definition of a related party in paragraph 9 of IAS 24. The amendment resulted in a clear distinction between ‘a person’ and ‘an entity’.
- 20. Therefore the staff believes that the intent is that the KMP definition refers to individuals as opposed to an entity. The staff notes that this is consistent with the views expressed in the submission.

What related party disclosures are required?

- 21. The information and staff conclusions reached above can be summarised as follows:
 - (a) KMP services can be provided to the reporting entity by another entity and therefore the staff of another entity.
 - (b) The definition of KMP applies to individuals and not entities.
 - (c) The employees of the servicing entity who provide the KMP services to the reporting entity, may meet the definition of KMP of the reporting entity.

The staff therefore thinks that it is necessary to consider what disclosures are required by IAS 24 in respect of KMP.

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Disclosures required in respect of KMP

22. Paragraph 17 of IAS 24 requires the disclosure of KMP **compensation**. The staff notes that paragraph 9 of IAS 24 defines **compensation** as:

Compensation includes all **employee benefits** (as defined in IAS 19 *Employee Benefits*) including employee benefits to which IFRS 2 *Share-based Payment* applies. Employee benefits are all forms of consideration paid, payable or provided **by the entity, or on behalf of the entity**, in exchange for **services rendered to the entity**. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity. [...] (emphasis added).

23. One view (**view A**) of how this requirement should be applied is that the reporting entity would disclose compensation paid by the servicing entity to the individuals employed by the servicing entity and acting as KMP of the reporting entity.
24. However, the reporting entity may not have access to the employee compensation information required to make this disclosure. Even if the information is available, practical difficulties arise when it comes to disclosing employee benefits for an employee of the servicing entity who services several funds.
25. Another view (**view B**) is that the intent in the definition is to describe compensation as being amounts paid by the entity to its own employees. Proponents of view B argue that paragraph 17 of IAS 24 is not applicable to the situations described in the submission because the amounts are not paid to the reporting entity's own employees.
26. Some proponents of view B also argue that it is only transactions directly between the reporting entity and the related party that require disclosure. This is based on the definition of a related party transaction in paragraph 9 of IAS 24:

A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

27. There is no payment directly from the reporting entity to the employees of the servicing entity, thus some argue, nothing to disclose. The staff disagrees with this argument because there is a service provided by the employees to the reporting entity.

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Other related party relationships

28. The staff thinks that an obvious follow-on question is whether the servicing entity and the reporting entity are automatically related parties because the service entity provides KMP services. Clearly if the power that the servicing entity has includes the power to participate in the financial and operating policy decisions of the investee (but not the power to control or jointly control those policy decisions), then the servicing entity will be a related party because it has significant influence over the reporting entity.
29. Although one might view the decision-making power that is present in KMP as equivalent to significant influence, the definitions of each are different. Therefore the staff's view is that there could be situations where the servicing entity does not qualify as a related party that has significant influence over the reporting entity. Consequently, the staff does not think that the servicing entity automatically meets the definition of a related party under IAS 24 as currently written, although the staff thinks that it would be rare for it not to meet the definition of a related party.

Staff conclusion

30. The staff thinks that the intention of IAS 24 is clear that amounts paid by an entity for KMP services should be disclosed. Usually this disclosure is straight-forward because the disclosure is of amounts paid to the reporting entity's own employees. However, when the amount paid by the reporting entity for KMP services is in the form of a service fee to another entity, it will often not be possible to obtain and disclose the amount paid to the people providing that service.
31. The staff recommends that when payments for KMP services are to another entity, disclosure should be required of the amounts paid to that entity, rather than the amounts paid by the other entity to the person providing the KMP services. This should be required, whether the other entity qualifies as a related party for other reasons or not.

IASB Staff paper

32. The staff thinks that this would be best addressed through amending IAS 24 to specify this requirement. Doing so will make clear what is required and so address the diversity of disclosures that is seen in practice.

Proposed amendment to address the issue

33. The staff is of the opinion that IAS 24 should specify that a servicing entity that provides KMP services to a reporting entity is a related party. This could be done by adding a subparagraph to paragraph 9(b) of IAS 24.
34. As a consequence of this change, the staff believes that the reporting entity should not apply paragraph 17 of IAS 24 on disclosures of employee benefits but rather paragraph 18 of IAS 24. The reporting entity would then disclose the service fee paid to the servicing entity among other information about transactions with the servicing entity.
35. In addition, the staff considered whether the revised definition of a related party should only apply to the servicing entity or also to its parent, subsidiaries and fellow subsidiaries. Because the servicing entity could cause the reporting entity to enter into transactions with the servicing entity's parent or subsidiaries, the staff believes that the parent, subsidiaries and fellow subsidiaries of the servicing entity should also be identified as related parties of the reporting entity. Therefore the reporting entity would also be required to disclose transactions with other members of the servicing entity's group.
36. The amendment would therefore be to clarify that:
- (a) a servicing entity that provides KMP services to a reporting entity is deemed to be identified as the relevant related party in respect of those KMP services;
 - (b) the parent of the servicing entity and its subsidiaries and fellow subsidiaries are also related parties of the reporting entity; and

IASB Staff paper

- (c) the individuals who are employees of the servicing entity and are acting as KMP of the reporting entity are not to be identified as a related party (unless they qualify for other reasons).

Corresponding guidance in US GAAP

- 37. Under US GAAP, related party disclosures are addressed in Topic 850 *Related Party Disclosures*. Overall, unlike IFRSs, management compensation is not required to be disclosed in the financial statements. Rather it is a regulatory requirement for SEC registrants. The staff notes that ‘management’ under US GAAP is considered to be equivalent to the IFRS notion of ‘key management personnel’. In addition, as in IFRSs the definition of ‘management’, Topic 850 refers to ‘persons’. The staff did not find further US GAAP guidance specific to the situation included in the submission.

Staff recommendation

Amendment to IAS 24 through Annual Improvements

- 38. The staff recommends that IAS 24 be amended as proposed in paragraph 33 to 36 above.
- 39. The staff notes that amending IAS 24 would reduce diversity. It would also address the practicability issue of allocating relevant employee benefits to the reporting entity in cases where the employees manage several mutual funds.
- 40. The staff assesses the proposed amendment as being non-urgent but necessary. Therefore it meets the current criteria for inclusion in the *Annual Improvements* cycle for 2009-2011.
- 41. Appendix B to this paper proposes wording for the amendment.

IASB Staff paper

Transition requirements

42. The staff is 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

43. The staff reviewed the proposed change in relation to other existing IFRSs. The staff did not identify consequential amendments to other standards.

Questions for the Committee

Question 1 – Staff recommendation

Does the Committee agree with the staff recommendation to amend IAS 24?

Question 2 – Annual improvements issue

Does the Committee agree that this issue should be included within the next *Improvements to IFRSs* exposure draft?

Question 3 – Transition requirements and draft wording

Does the Committee agree with the proposed retrospective transition requirements?

Does the Committee have any comments on the draft wording for the amendment presented in Appendix B to the paper?

**IASB Staff paper
Appendix A**

Appendix A – Request for *Annual Improvement*

Key Management Personnel

Our purpose in writing is to seek to have the IASB address the issue of whether key management personnel (KMP) as defined in IAS 24 *Related Party Disclosures* can include an entity as opposed to individuals. The issue could potentially be addressed in a number of ways, including as part of annual improvements.

This issue is relevant in many jurisdictions, including Australia and New Zealand in respect of investment entities, and is particularly relevant to investment entities such as some mutual funds that have no employees. Investment entities pay a fee to a separate entity to utilise its services, including ‘key management’ services. There is diversity in practice in many jurisdictions – some investment entities apply paragraph 16 of IAS 24 in the context of the separate entity (i.e. the entity manager) and make disclosures about compensation paid to the entity manager, and others ‘look through’ the entity manager and identify the compensation paid to the individuals who provided the services.

The issue was recently considered at the National Standard-Setters (NSS) meeting held in Seoul on 14-15 April 2010. NSS members expressed a general view that the definition of KMP relates only to people, but that it would be impracticable and inappropriate in many cases to identify the compensation paid to KMP employed by another entity. Furthermore, it was noted that a possible principle underlying the disclosure framework is that the information disclosed should be about the entity reporting, not information about other entities. Accordingly, in relation to entities that pay a fee to another entity that has the relevant KMP, it would be best to require disclosure of the fees paid to the other entity as “compensation”.

The NSS view is consistent with the inherent meaning of KMP in IAS 19 *Employee Benefits*. IAS 19 makes five separate references to KMP (paragraphs 23, 47, 124, 131 & 143) and one reference to ‘management personnel’ (paragraph 6), which in context can only be referring to employees. For example, paragraph 143 of IAS 19 states “Where required by IAS 24 an entity discloses information about termination benefits for key management personnel.” Although the term ‘employee’ is not defined in IAS 19, it is implicit in IAS 19 that employees are people.

We acknowledge that as a consequence of the NSS view about the existing definition, in complying with paragraph 16, it could be argued that it would be necessary to ‘look through’ the entity manager and identify the compensation paid to the people who provided the services. This ‘look through’ approach is particularly problematic and inappropriate when an entity manager provides services to many investment entities. For example, if the entity manager provides services to ten investment entities, this may suggest that each investment entity should disclose 10% of the compensation paid by the entity manager to its KMP.

**IASB Staff paper
Appendix A**

However, this may not provide useful information necessary to address the purpose of related party disclosures. Alternatively trying to reliably determine the relevant compensation of KMP that should be allocated to each investment entity would be impracticable.

We note our previous correspondence on the topic. In 2007, the AASB asked the IFRIC to address the issue and it was decided to include the issue in an IASB staff paper connected with the review of IAS 24 in relation to state-controlled entities. Consistent with this, in June 2008, the then Chairman of the [...] wrote to David Tweedie to seek to have the IASB consider the issue again when it considered the submissions on the Exposure Draft of Proposed Amendments to IAS 24 Related Party Disclosures – State-controlled Entities and the Definition of a Related Party (ED). However, at its September 2008 discussion of responses to the ED, the IASB decided not to consider this issue in this project as reported in the IASB Update. In July 2009 we wrote a joint letter to Wayne Upton seeking advice as to the best way to have this issue addressed, and whether he would recommend that we send it to the IFRIC or to the IASB for consideration as part of the revision of IAS 24.

Given the views expressed at the Seoul NSS meeting we consider that the issue would need to be dealt with by the IASB (rather than the IFRS Interpretations Committee) because the preferred solution goes beyond interpretation. If the issue were considered as part of annual improvements we note that it:

- ✓ would clarify wording in IAS 24;
- ✓ has a narrow and well defined purpose;
- ✓ is not the subject of any current or planned IASB project; and
- ✓ addresses a non-urgent but necessary amendment to IFRS.

If you have any queries regarding this letter, please contact us or [contact information omitted].

Yours sincerely

Kevin Stevenson
AASB Chairman

Joanna Perry
FRSB Chairman

IASB Staff paper
Appendix B

Appendix B – Draft amendment to IAS 24 *Related Party Disclosures*

Proposed amendment to IAS 24 *Related Party Disclosures*

Paragraph 9 is amended (new text is underlined) and paragraph 29 is 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. If the persons providing the key management personnel services to the reporting entity are not its employees or employees of its group, then the persons concerned are not key management personnel for the purposes of applying this standard, unless they meet the conditions in (a)(i) or (a)(ii).
- (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.

**IASB Staff paper
Appendix C**

Effective date and transition

- 29 *Improvements to IFRSs* issued in [date] amended paragraph 9. An entity shall apply this amendment for annual periods beginning on or after 1 January 2012. 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 Constituents pointed out that divergence exists in the disclosures of related party transactions identified when a servicing entity provides key management personnel services to a reporting entity. The divergence is that some reporting entities would disclose the compensation paid by the servicing entity to its employees acting as management personnel of the reporting entity. Other reporting entities disclose the service fee paid by the reporting entity to the servicing 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 servicing entity that provides key management services to a reporting entity is deemed to be the related party rather than the persons that are the key management personnel. As a result of the change, the reporting entity would be required to disclose the service fee paid to the servicing entity that employees the KMP persons, and would not be required to disclose employee benefits of those persons. In addition, because the servicing entity can cause the reporting entity to enter into related party relationships with the servicing entity's parent or its subsidiaries, the Board proposes that the parent, subsidiaries and fellow subsidiaries of the servicing entity be also identified as related parties of the reporting entity.