

STAFF PAPER

March 2013

IASB Meeting

Project	Annual Improvements 2010-2012 Cycle (ED May 2012) Comment Letter Analysis		
Paper topic	IAS 24 <i>Related party Disclosures</i> —Key management personnel services		
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Introduction

1. The Exposure Draft (ED) of the proposed *Annual Improvements to IFRSs 2010–2012 Cycle* published in May 2012 includes a proposal to amend IAS 24 *Related Party Disclosures* to clarify the requirements about key management personnel (KMP) services that are provided by an entity rather than by an individual. The original submission presented the case of a mutual fund that typically does not have employees and therefore obtains KMP services from a separate management entity. The issue arose from concerns over divergent disclosures.

Objective of this paper

2. The objective of this paper is:
 - (a) to provide background information on the issue;
 - (b) to provide an analysis of the comment letters received on the proposals to amend IAS 24;
 - (c) to summarise the changes that the Interpretations Committee recommends for finalisation in response to comments received; and

- (d) to ask you to approve the revised, proposed amendments to IAS 24 for inclusion in the final improvements to IFRSs that is expected to be issued in 2013.

Structure of the paper

- 3. This paper is organised as follows:
 - (a) background;
 - (b) the IASB's proposals to address the concerns raised;
 - (c) comment letter analysis;
 - (d) Question 1: proposal to amend IAS 24;
 - (e) Question 2: transitional provisions and effective date; and
 - (f) Basis for Conclusions.
- 4. There are two appendices to this paper:
 - (a) Appendix A shows the final proposed amendments to IAS 24, as recommended to you for finalisation by the Interpretations Committee; and
 - (b) Appendix B shows the changes made to the proposals exposed in May 2012, as a result of comments received, in markup.

Background

- 5. In 2010 the Interpretations Committee received a request asking whether key management personnel, as defined in IAS 24 *Related Party Disclosures*, could include an entity or whether it could only apply to individuals. This issue was originally referred to the Interpretations Committee because it is common in some industries, such as mutual fund management, that key management personnel 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 otherwise non-related reporting entities.
6. It is clear in IAS 24 that KMP employed directly by the reporting entity, or through a related-party KMP service provider, are identified as a related party. The concerns about the identification of KMP costs arise in situations in paragraph 5(c) and 5(d), in which KMP services to the reporting entity are provided by entities that do not otherwise meet the definition of a related party provider. For convenience, these entities are referred to as ‘the management entity’ throughout this paper.
7. Because of a the lack of consistency in the basis of identification of these KMP service providers as related parties of the reporting entity, there has been wide diversity about whether these transactions have been disclosed and about what form that disclosure has taken.

The IASB’s proposals to address the concerns raised

8. The IASB addressed these concerns by proposing three amendments to IAS 24:
- (a) The management entity providing KMP services should be identified as a related party of the reporting entity by inserting a new clause into the definition of related party in paragraph 9 of IAS 24:

9(b)(viii) The entity, or members of its group, provides key management personnel services to the reporting entity.
 - (b) An exemption should be granted from the detailed disclosure requirements in paragraph 17 of IAS 24 in respect of KMP services provided by a management entity :

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.

- (c) Payments made to a management entity in respect of KMP services should be separately disclosed by extending the disclosure requirements in paragraph 18 of IAS 24:

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

Comment letter analysis

9. The IASB received 84 comment letters on the ED. These letters were analysed in total in Agenda Paper 10, which was presented at the November 2012 Interpretations Committee meeting. The IASB received 64 comment letters about the proposed amendment to IAS 24. For a detailed analysis of the comments received in respect of the proposed amendment to IAS 24, you should refer to Agenda Paper 15E, which was presented to the Interpretations Committee at its January 2013 meeting. A copy of each of these papers will be provided with this month's agenda papers.
10. The invitation to comment contained two questions in relation to IAS 24:
- i. Do you agree with the Board's proposal to amend the Standard as described in the Exposure Draft? If not, why and what alternative do you propose?
 - ii. Do you agree with the proposed transitional provisions and effective date for the issue as described in the Exposure Draft? If not, why and what alternative do you propose?
11. Responses to these two questions are analysed separately.

Question 1: Proposal to amend IAS 24

12. Of the 64 respondents who commented on the IASB's proposal to amend IAS 24, 43 agreed with little or no further comment. These respondents agree with all three aspects of the proposed changes and think that the amendments proposed will result in improved reporting of related party transactions. Those respondents

who provided more detailed responses to the IASB's proposal to amend IAS 24 raised some topics for further consideration:

- (a) KMP compensation disclosure;
- (b) symmetry in the identification of related parties;
- (c) disclosures about the nature of KMP services provided; and
- (d) sundry drafting suggestions.

Key management personnel compensation disclosure

13. The topic most frequently raised for detailed discussion was the proposed exemption from the detailed disclosure requirements in paragraph 17, granted to management entities. Nine of the 21 detailed responses, representing a cross-section of types of respondent, included comments on this aspect of the proposals.

14. 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.

15. In proposing an exemption from this disclosure, we acknowledged that the fee structure that is payable by the reporting entity may not mirror the compensation that is paid to the employees of the management entity.

16. In the proposed amendment, the amount disclosed in respect of these arrangements is the 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. This was proposed because it may not be possible, in many cases, for the reporting entity to identify the

employees of the management entity who are involved in the provision of KMP services or provide the information in the form required by paragraph 17 of IAS 24. The IASB suggested in their discussions that information provided in that form would not be useful in achieving the objective of IAS 24.

17. Some respondents to the ED were concerned about the loss of valuable information about how KMPs are remunerated. They were also concerned that some KMPs would choose to contract through a management entity in order to avoid providing the detailed disclosures required by paragraph 17 of IAS 24. Other respondents think that we should distinguish between the two types of management entities affected by these proposals and define the type of management entity that should be excluded from the disclosure requirements.
18. One respondent thinks that we should employ a ‘comply or explain’ approach whereby the reporting entity is required to provide the disclosures required by paragraph 17 for payments made for KMP services through another entity unless it is impracticable to access the detailed information, in which case this should be stated and explained.
19. In our view there is no easy way to resolve these concerns:
 - (a) Defining the type of entity that qualifies for this exemption is only feasible when two extreme types of entity are considered. For any other entity it will always be difficult to draw that line and any attempt to do so could give rise to structuring possibilities.
 - (b) We are attracted to the ‘comply or explain’ suggestion, but think that in practice this would result in boilerplate disclosures because the majority of entities would not be able to comply. The onus in reporting this disclosure is on the reporting entity, so any concerns about the non-disclosure of information provided by another entity, ie the management entity, cannot be enforced in this way.
20. This disclosure relates to the management fee that has been paid or is payable by the reporting entity. At the heart of this dilemma is the point that when a reporting entity pays a fee to a management entity there is rarely a direct correlation between the fee paid by the reporting entity and the remuneration package of individual employees of the management entity:

- (a) If the individual employees of the management entity providing the services could be identified, and their services could be apportioned between various customers, how would the profit component of these services (which would be needed to reconcile the management entity's costs with its fee income) be disclosed?
 - (b) Is information about how a management entity structures its employees' remuneration relevant information for the investors in the reporting entity?
 - (c) In the specific case of a vehicle set up by an individual KMP to provide his or her services to the reporting entity, there may be no correlation between the fee paid by the reporting entity each year and how the KMP chooses to draw value from their captive management entity—whether as remuneration (however structured), capital accumulation or distributed capital.
21. In the Interpretations Committee's view, it is rarely possible, or meaningful, to analyse the fee payable by the reporting entity into the format required by paragraph 17. They therefore recommend that the exemption for the management entity from these disclosures proposed in the May 2012 ED should be affirmed.

Symmetry in the identification of related parties

22. The next most frequently discussed aspect of the proposed amendment (raised by 6 of the 21 respondents providing detailed comments) related to the asymmetry of the revision to the definition of related parties. The definition of 'related party' had been extended in the proposed amendment, as follows, to include:
- 9(b)(viii) The entity, or members of its group, provides key management personnel services to the reporting entity.
23. The respondents who raised this topic, principally accounting firms or accounting bodies, expressed concern that the relationship between the KMP service-providing entity and the reporting entity was not symmetrical. The management entity is a related party of the reporting entity, but the reporting

entity is not a related party of the management entity except as a result of another relationship.

24. This point was discussed by the IASB in November 2011 when finalising the proposed amendments. The IASB thought that this asymmetry is appropriate. The KMP-service provider is a related party of the reporting entity; the KMP services it provides will affect the activities, financial position and profit or loss of the reporting entity. However, in the case of a professional management entity, the reporting entity is merely a customer of the management entity, and is often only one among numerous customers. The customer, ie the reporting entity, will be unable to affect the management entity's activities, financial position and profit.
25. We do not think that the reporting entity is a related party of the management entity solely because of the provision of KMP services. The Interpretations Committee recommends that the IASB should reaffirm its decision that the related party relationship in this instance is not symmetrical, but that this decision should be explained in the Basis for Conclusions. (See paragraphs 33-37.)

Disclosures about the nature of services provided

26. A few respondents suggested that the disclosure requirements should be extended to provide information about the nature and extent of the KMP services provided. They thought that this information would be useful to investors and others in assessing the effect of the management entity on the reporting entity.
27. The Interpretations Committee think that there is merit in adding this disclosure requirement to the proposed amendments, because providing investors with an understanding of what the KMP services consist of will enable them to assess both the amount of the management fee that is recognised in the financial statements and the degree of influence that is exerted by the management entity.
28. They recommend the following should be added to the proposed amendments to paragraph 18 of IAS 24:

Information should also be disclosed about the nature and extent of the key management personnel services provided by such an entity.

Sundry drafting suggestions

29. A few respondents provided detailed drafting suggestions:
- (a) One respondent suggested that describing the reporting entity as ‘hiring’ KMP services from another entity was confusing. They suggested that ‘hires’ be replaced by ‘obtains’, in paragraph 17A. We agree with this suggestion.
 - (b) One respondent suggested that use of the phrase ‘amounts recognised as an expense’ would not apply in some instances when the cost may be capitalised as part of an asset. They suggested that the words ‘recognised as an expense’ be replaced with the word ‘incurred’. We accept that this could help to prevent confusion and agree with this suggestion.
 - (c) A few respondents were concerned that in extending the related party definition to include management entities that provide KMP services to the reporting entity, we had omitted including management entities that provide KMP services to the parent of the reporting entity. We accept this comment and recommend amending paragraph 9(b)(iii) accordingly to include a reference to services provided to the entity’s parent.
 - (d) One respondent thinks that because the proposed amendment to the Basis for Conclusions discusses the need to clarify disclosures, it could be interpreted that it was not the IASB’s intention to extend the identification of related parties. In our view, the IASB intended to extend the definition of related parties to include providers of KMP services because information about the related party cannot be disclosed until that relationship is identified. The Interpretations Committee recommends that the description of the objective of the amendments in the Basis of Conclusion should be revised to include ‘identification’ as well as ‘disclosure’.

Recommendation of the Interpretations Committee

30. On the basis of this analysis, the Interpretations Committee recommends to the IASB the following amendments to the proposal:

- (a) add the following to paragraph 18 regarding additional disclosures about the nature of KMP services provided:

Information should also be disclosed about the nature and extent of the key management personnel services provided by such an entity.

- (b) revise the wording in the May 2012 ED to include the drafting suggestions that were recommended in paragraph 29.

Question to the IASB

Does the IASB agree with the Interpretations Committee's recommendation to revise the proposed amendment to IAS 24 by:

- (a) adding a requirement to disclose information about the nature and extent of KMP services provided; and
(b) including the drafting suggestions recommended in paragraph 29?

Question 2: Transitional provisions and effective date

32. The ED proposes that the amendments to IAS 24 shall apply for annual periods beginning on or after 1 January 2014. Of the 61 respondents who commented on these proposals, 59 (97 per cent of respondents) agreed with the proposed requirements. The Interpretations Committee recommends that the transitional provisions and effective date as exposed in the ED should be retained with respect to IAS 24.

Question 2 to the IASB

Does the IASB agree with the Interpretations Committee's recommendation to reaffirm the transition provisions and effective date in the 2012 ED?

Basis for Conclusions

33. The original IAS 24 did not include a Basis for Conclusions. The current Basis for Conclusions for IAS 24 summarises the IASB's considerations in reaching its conclusions on revising IAS 24 in 2003 and 2009.

A separate section

34. One respondent was concerned that the lack of symmetry (referred to in paragraphs 22-25 of this paper) contravened the IASB's stated approach used in 2003 and 2009 to identify related parties. This approach is recorded in the current Basis for Conclusions:

BC19(e) If the revised definition treats one party as related to a second party, the definition should also treat the second party as related to the first party, by symmetry.

35. If the proposed amendments were integrated throughout the 2003 and 2009 Basis for Conclusions, paragraph BC19(e) would need to be revised. The Interpretations Committee think that this could result in the IASB's earlier thoughts relating to the 2003 and 2009 amendments being lost.
36. In the view of the Interpretations Committee, this is a self-contained amendment on the topic of 'KMP Services' and they recommend adding a separate section with that heading after the existing paragraph BC49. They do not recommend altering the 2003 and 2009 Basis for Conclusions for proposed changes in the development of the 2012 ED. Treating the 2012 considerations as a separate section in the Basis for Conclusions will preserve the thinking of the IASB at the time of the 2003 and 2009 amendments, while still providing information about the Basis for Conclusion for the narrow-focus amendments proposed in the 2012 ED.

Basis for Conclusions to explain reasons for asymmetry

37. The Interpretations Committee further recommend that the reason for the asymmetry in the related-party relationship should be explained by inserting the following sentence into the wording of the May 2012 exposure draft:

In discussing these proposals, the IASB acknowledged that the relationship between the management entity and the reporting entity is not symmetrical. The reporting entity is not a related party of the management entity solely as a consequence of being a customer of the management entity. The reporting entity cannot affect the management's

entity's activities, financial position or profit except through some other relationship.

Question 3 to the IASB

Does the IASB agree with the Interpretations Committee's recommendation to finalise the amendment Basis for Conclusions to IAS 24 by:

- (a) including a section that explains the asymmetry of the related party relationship between the management entity and the reporting entity; and
- (b) presenting the proposed revisions to the Basis for Conclusions as a separate section from the 2003 and 2009 Basis for Conclusions?

Appendix A

Changes for finalising the amendment

Proposed amendment to IAS 24 *Related Party Disclosures*

Paragraph 9 is amended and paragraphs 17A, 18A and 28B are added. New text is underlined. Paragraph 17 has been included for ease of reference but is not proposed for amendment.

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) ...

(b) An entity is related to a reporting entity if any of the following conditions applies:

(i) ...

(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 any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

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 obtains key management personnel services from another entity (‘the management entity’), it is not required to apply the requirements in paragraph 17 to the compensation paid or payable by the management entity to the management entity’s employees or directors.

18 ...

18A Amounts incurred by the entity for the provision of key management personnel services that are provided by a separate management entity shall be separately disclosed. Information shall also be disclosed about the nature and extent of the key management personnel services provided by such an entity.

Effective date and transition

28B Annual Improvements to IFRSs 2010–2012 Cycle issued in [date] amended paragraph 9 and added paragraphs 17A and 18A. An entity shall apply that amendment for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

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

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

Key management personnel services

- BC50 The IASB was asked to address the identification and disclosure of related party transactions that arise when a management entity provides key management personnel services to a reporting entity. The IASB understands that divergence exists because some reporting entities do not identify this as a related party transaction. Of those who do identify this as a related party transaction, some reporting entities would disclose the compensation paid by the management entity to those employees or directors of the management entity that act as key management personnel of the reporting entity. Other reporting entities would disclose the service fee that is paid or payable to the management entity, which is incurred by the reporting entity.
- BC51 The IASB noted that IAS 24 is unclear as to what information to disclose for key management personnel when those persons are not employees of the reporting entity. To address the diversity in disclosures that has arisen from IAS 24 being unclear, the IASB decided to amend the definition of a 'related party'. The amendment clarifies that a management entity that provides key management personnel services to a reporting entity is deemed to be a related party of the reporting entity. In discussing these proposals, the IASB acknowledged that the relationship between the management entity and the reporting entity is not symmetrical. The reporting entity is not a related party of the management entity solely as a consequence of being a customer of the management entity. The reporting entity cannot affect the management's entity's activities, financial position or profit except through some other relationship. Consequently, the reporting entity is required to disclose the amount incurred for the service fee paid or payable to the management entity that employs, or has as directors, the persons that provide the key management personnel services. As a result of identifying the management entity as a related party of the reporting entity, the reporting entity is also required to disclose other transactions with the management entity, for example loans, under the existing disclosure requirements of IAS 24 with respect to related parties.
- BC52 The IASB was informed of concerns that it is impracticable to access the detailed information that is required in paragraph 17 when compensation is paid to a separate management entity as fees. The IASB therefore decided to provide relief so that the reporting entity is not required to disclose the components of compensation to key management personnel that is paid through another entity. Instead, amounts incurred in respect of key management personnel compensation or key management personnel services, paid or payable to another entity, is separately disclosed in accordance with paragraph 18A.

Appendix B

Changes from the Exposure Draft published in May 2012 following our recommendations in this paper

Proposed changes to the proposals in the May 2012 ED are in red:

Appendix A

Changes for finalising the amendment

Proposed amendment to IAS 24 *Related Party Disclosures*

Paragraph 9 is amended and paragraphs 17A, 18A and 28B are added. New text is underlined. Paragraph 17 has been included for ease of reference but is not proposed for amendment.

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) ...

(b) An entity is related to a reporting entity if any of the following conditions applies:

(i) ...

(ix) 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).

(x) The entity, or any member of its a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

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 obtains key management personnel services from another entity (‘the management entity’), it is not required to apply the requirements in paragraph 17 to the compensation paid or payable by the management entity to the management entity’s employees or directors.

18 ...

- 18A Amounts incurred by the entity payable for the provision of key management personnel services, ~~recognised as an expense by the entity,~~ that are provided by a separate management entity shall ~~should~~ be separately disclosed. ~~Information shall also be disclosed about the nature and extent of the key management personnel services provided by such an entity.~~

Effective date and transition

- 28B *Annual Improvements to IFRSs 2010–2012 Cycle* issued in [date] amended paragraph 9 and added paragraphs 17A and 18A. An entity shall apply that amendment for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

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.

Key management personnel **services**

- BC50 The IASB Board was asked to address the disclosure of related party transactions that arise when a management entity provides key management personnel services to a reporting entity. The IASB Board understands that divergence exists because some reporting entities **do not identify this as a related party transaction**. Of those who do identify this as a related party transaction, some reporting entities would disclose the compensation paid by the management entity to those employees or directors of the management entity that act as key management personnel of the reporting entity. Other reporting entities would disclose the service fee that is paid or payable to the management entity, which is **incurred** recognised as an expense by the reporting entity.
- BC2 The IASB Board noted that IAS 24 is unclear as to what information to disclose for key management personnel when those persons are not employees of the reporting entity. To address the diversity in disclosures that has arisen from IAS 24 being unclear, the IASB Board **proposed** ~~proposed~~ **decided** to amend the definition of a 'related party'. The amendment ~~would~~ **clarifies** that a management entity that provides key management **personnel** services to a reporting entity is deemed to be a related party of the reporting entity. ~~As a result of that change,~~ **In discussing these proposals, the IASB acknowledged that the relationship between the management entity and the reporting entity is not symmetrical. The reporting entity is not a related party of the management entity solely as a consequence of being a customer of the management entity. The reporting entity cannot affect the management's entity's activities, financial position or profit except through some other relationship. Consequently, the reporting entity is would be required to disclose the amount incurred recognised as an expense for the service fee paid or payable to the management entity that employs, or has as directors, the persons that provide the key management personnel services. As a result of identifying the management entity as a related party of the reporting entity, t**The reporting entity is also ~~would be~~ required to disclose other transactions with the management entity, for example loans, under the existing disclosure requirements of IAS 24 with respect to related parties.
- BC3 The IASB Board was informed of concerns that it is impracticable to access the detailed information that is required in paragraph 17 when compensation is paid to a separate management entity as fees. The IASB Board therefore **decided** ~~proposes~~ to provide relief so that the reporting entity **is not would** ~~not be~~ required to disclose **the components** of compensation to key management personnel that is paid through another entity. Instead, amounts **incurred** ~~recognised as an expense~~ in respect of key management personnel compensation or key management personnel services, paid or payable to another entity, ~~is would be~~ separately disclosed in accordance with paragraph 18A.