



**Review of the application of accounting standard requirements in
respect of the disclosure of key management personnel
compensation by Irish equity issuers**

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MISSION

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1. Introduction

Compensation arrangements for key management personnel ('KMP') is a subject that generates considerable interest. Given that information about such arrangements may be relevant to users' understanding of the financial report, and, in the interests of transparency and comparability, IAS 24 *Related Party Disclosures* requires disclosure of such compensation.

During the course of its first cycle of reviews undertaken between 2007 and 2012, IAASA corresponded with 11 equity issuers included in this review in respect of their key management personnel disclosures, among other matters. A number of instances of non-compliance with the relevant financial reporting requirements were identified and our annual observations documents include a summary of the issues identified¹.

As a follow-up to these incidences of non-compliance, IAASA decided to perform a thematic review of Irish equity issuers' application of the requirements of IAS 24 *Related Party Disclosures* in respect of the disclosure of KMP compensation in their annual financial reports. This document provides details of the results of that thematic review.

2. Background to IAASA's activities

IAASA's financial reporting supervision role is to examine the annual and half-yearly financial reports of equity, debt and fund issuers – whose securities are admitted to trading on a regulated market within the European Union and whose home member state is Ireland – for compliance with the relevant reporting framework. The nature of an examination undertaken by IAASA can be broad in scope ('full scope review'), focused on a limited number of matters in respect of a particular issuer ('focused review') or on a specific financial reporting topic across a range of issuers ('thematic review').

Further details about IAASA and its activities can be obtained on our website at www.iaasa.ie and, in particular, on our publications page at www.iaasa.ie/publications/index.htm.

3. Summary observations

In general, the standard of compliance with the key management personnel compensation disclosure requirements of IAS 24 was good, with the majority of issuers meeting the substantive requirements of IAS 24.17. This is unsurprising given the likely focus on such disclosures by preparers in the knowledge of their scrutiny by users, as well as the fact that the requirements of the Standard are relatively straightforward. Moreover, as noted above, IAASA had previously received undertakings for improvements from 11 issuers in relation to deficiencies in their KMP disclosures and these improvements were reflected in the findings of this review. However, despite the good quality disclosures of many issuers, there are a number of areas where improvement is warranted and these are discussed below in the context of the principal findings.

4. Recommendations

Arising from the results of this thematic review, IAASA intends to correspond with a number of issuers in respect of their disclosures of KMP compensation and to secure improvements to future disclosures where necessary. Furthermore, IAASA considers that it would be useful for all issuers, including entities applying IFRS that are outside of IAASA's financial reporting review remit, to take account of the following matters when preparing their disclosures in respect of KMP compensation:

¹ Item 5 in the *Observations* document published in January 2011 in respect of 31 December 2010 year-ends, Item 2.4 in the *Observations* document published in January 2010 in respect of 31 December 2009 year-ends, and Item 7 in the *Observations* document published in January 2009 in respect of 31 December 2008 year-ends.

- whether the composition of KMP is appropriate, in particular whether there are individuals who are not directors but who have authority and responsibility for planning, directing and controlling the entity's activities and who should be classified as KMP;
- whether there is sufficient clarity in the narrative disclosures as to the basis for the composition of KMP, in particular in respect of members of executive management included. Where the issuer's management team/committee are considered KMP it may be necessary and/or beneficial for users' understanding, to disclose the composition of that team/committee;
- whether all categories of compensation (in particular, share-based payment expense) have been disclosed and included in the total of KMP compensation;
- where certain categories of compensation are not relevant in a given financial year, whether a statement to that effect (or inclusion with a 'nil' balance) would add clarity for users;
- whether employee benefits are appropriately categorised (e.g. short-term, post-employment or other long-term) according to the definitions in IAS 24 *Related Party Disclosures* and IAS 19 *Employee Benefits*;
- whether there are other transactions with KMP which require disclosure (e.g. dividend payments); and
- whether there is any further information relating to KMP compensation that users might consider relevant and which should, therefore, be disclosed.

5. Approach to the thematic review

At the time this review was completed there were 24 equity issuers under IAASA's remit (see Appendix 1). The 2012 annual financial reports of all 24 were examined for compliance with the requirements of IAS 24 *Related Party Disclosures* in respect of the disclosure of KMP compensation. The review comprised a desktop review of the published annual financial reports and additional information was not sought from issuers. Therefore, it has been necessary to make certain assumptions in analysing some of the disclosures provided. Furthermore, where this review has established apparent or potential non-compliance, IAASA intends to correspond with the relevant issuers to seek clarification and, where necessary, improvements to KMP disclosures in future annual financial reports.

6. The requirements of the relevant reporting framework

IAS 24 *Related Party Disclosures* specifies a number of disclosure requirements in respect of transactions with KMP, including in respect of their compensation. There are several other sources of disclosure requirements in respect of transactions with company directors, including companies' legislation, the listing rules of the Irish Stock Exchange as well as the UK Corporate Governance Code and Irish Annex. This review is limited to assessing the compliance of issuers' KMP compensation disclosures with the requirements of IAS 24.

Key management personnel ('KMP') are defined in IAS 24.9 as "*those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity*".

Under IAS 24.9, compensation includes all employee benefits (as defined in IAS 19 *Employee Benefits*) which are all forms of consideration paid, payable or provided, in exchange for services rendered. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity.

IAS 24.17 states that an entity shall disclose KMP personnel compensation in total and for each of the following categories:

- (a) Short-term employee benefits (e.g. salaries, social security contributions, paid sick leave, bonuses payable within 12 months);
- (b) Post-employment benefits (e.g. pensions, post-employment life insurance and medical care);
- (c) Other long-term benefits (e.g. sabbatical leave, long-term disability benefits, bonuses not payable wholly within 12 months);
- (d) Termination benefits (e.g. compensation for loss of office, redundancy payments); and
- (e) Share-based payment (e.g. share options).

IAS 24.18 provides for additional disclosures which are also relevant to KMP, including the amount of transactions and any outstanding balances. Thus, where any of the above employee benefits have not been paid by year end, IAS 24 requires disclosure of the remaining balance at that date.

7. Principal observations

The following are the principal observations arising from the review:

7.1 *Composition of KMP*

- A majority of the issuers surveyed (14) considered that KMP comprised the directors (executive and non-executive) as well as members of the issuer's senior management. Most of the remaining issuers limited composition of its KMP to the directors (executive and non-executive) (9). However, in 1 instance non-executive directors were not considered as members of the entity's KMP.
- In the case of the 9 issuers who deemed KMP to comprise the board of directors, there were at least 4 which had executive management teams or divisional heads who were not directors but whose responsibilities suggest that they may meet the definition of KMP. Furthermore, of the 14 cases where employees in addition to directors were deemed to be KMP, 2 added only the company secretary, although there were indications that both had executive management teams with significant responsibilities in respect of controlling the activities of the issuer.
- In the case of 7 of the 14 issuers that included members of senior management in their KMP, there was a lack of clarity about which members of executive management were included. Disclosures such as 'other senior management' were vague and uninformative, in contrast to better quality disclosures such as that KMP included 'the Group's Executive Management Team' with disclosure (elsewhere in the annual report) of the membership of that team. While IAS 24 allows disclosure of KMP in aggregate, transparency as to who is considered KMP provides context to, and enhances the understanding of, the amounts disclosed.
- Arising from these findings, IAASA intends to engage with at least 8 issuers to clarify the composition of KMP, the rationale for that composition, and, in 1 specific case, to establish the rationale for the assessment that the issuer's non-executive directors are not responsible for planning, directing and controlling the activities of the issuer.

7.2 *Disclosure of compensation by category*

- 20 issuers disclosed details of KMP compensation in the 5 categories required by IAS 24.17 noted in section 6 above. Of the 4 issuers who failed to provide the requisite details, a mitigating factor in respect of 3 of these cases was that since KMP comprised the directors, the information provided in the notes to the financial statements combined with that provided in the Directors' Remuneration Report provided reasonable transparency about KMP compensation. However, in the case of 1 other issuer where the KMP included individuals other than directors, it was not possible to establish the amounts attributable to each category.
- Long-term benefits were not a feature of the KMP disclosures, with only 1 issuer reporting consideration in this category. IAASA intends to engage with a number of issuers to clarify

whether long-term benefits (e.g. deferred bonuses) are a feature of their KMP compensation, and if so, how these amounts have been classified and disclosed.

- Arising from these findings, IAASA intends to engage with the 4 issuers noted above as failing to provide the requisite information in respect of the relevant categories of compensation.

7.3 Location of KMP disclosures

- In all but 2 instances, disclosures in respect of KMP compensation were presented within the audited financial statements. In those 2 cases, the directors were deemed to be the KMP and information about directors' compensation was cross-referenced to the Directors' Remuneration Report, which was included in the Annual Report in the context of Stock Exchange requirements.
- While such an approach is understandable in the context of attempting to avoid the duplication of information in respect of directors' remuneration, several issues of potential non-compliance can arise:
 - firstly, the information may not be presented according to the categories specified by IAS 24, or certain information may be omitted. For example, in the course of its review activity IAASA has noted that the share-based payments expense is sometimes omitted from directors' remuneration tables;
 - secondly, where the information has been presented outside of the financial statements, it may not be apparent that the information has been audited.
- In the case of 1 of these issuers, IAASA has already, in the context of a recent full scope review, brought the matter to the attention of the directors and obtained an undertaking for full compliance with the requirements of IAS 24 in future annual financial reports. Arising from these findings, IAASA also intends to correspond with the other issuer concerned.

7.4 Other observations

- All 22 issuers who provided KMP compensation disclosures in the audited financial statements did so in tabular form and in aggregate rather than by individual as permitted by IAS 24.24. Also, in accordance with IAS 24, all issuers provided a total amount for KMP compensation, although 1 issuer excluded the share-based payment amount from the table, disclosing the amount in the narrative below the table instead.
- Comparatives were provided for all KMP amounts reported in the current year, although it was noted that 3 issuers had restated their KMP comparatives. In 2 instances the rationale for the restatement was not apparent and IAASA intends to correspond with the issuers concerned to clarify the approach adopted.
- The Finance Act 2006 introduced a limit on the value of an individual's pension fund which may attract tax relief and the Finance Act 2011 reduced the maximum allowable amount. It was noted that 14 issuers paid taxed cash allowances in lieu of pension benefits to directors. In 5 cases it was unclear how the cash allowances had been categorised in the KMP disclosures.
- Although other transactions with KMPs were not the focus of this review, it was noted that the disclosure of distributions to KMP was made in only 3 instances despite the prevalence of dividends.
- Where certain categories of compensation were not relevant, several issuers made an explicit statement to that effect, for example, '*no payments were made in relation to compensation for loss of office*' or including a NIL balance in the table of KMP compensation. We consider that such statements add value to the KMP disclosures, providing additional clarity for users of financial reports.

Equity issuers under IAASA's remit and included in this review

1. Aer Lingus Group plc
2. Aminex plc
3. Arysza AG
4. Bank of Ireland
5. C&C Group plc
6. CRH plc
7. Datalex plc
8. DCC plc
9. Dragon Oil plc
10. Elan Corporation plc
11. FBD Holdings plc
12. Glanbia plc
13. Grafton Group plc
14. Greencore Group plc
15. Irish Continental Group plc
16. IFG Group plc
17. Independent News & Media plc
18. Kenmare Resources plc
19. Kerry Group plc
20. Kingspan Group plc
21. Paddy Power plc
22. Ryanair Holdings plc
23. Smurfit Kappa Group plc
24. United Drug plc