

# FRS Alert

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Malaysia**

## Disclosure of Key Management Personnel Compensation

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This FRS Alert provides guidance on the following aspects of the FRS 124.16 requirement to disclose key management personnel (KMP) compensation:

- disclosure in the financial statements of a subsidiary for which the KMP are paid by the parent; and
- application of the disclosure requirement when management services are provided by another entity.



### Guidance

#### **Disclosure in the financial statements of a subsidiary for which the KMP are paid by the parent**

FRS 124.16's requirements should be applied on the basis of the compensation provided to the KMP for their services to the subsidiary, even if the compensation is paid by the parent or another entity. When the same individual provides key management services to more than one subsidiary (but is paid by one entity), the compensation disclosed should be determined based on a reasonable allocation of the total compensation. We recommend that the basis of the allocation should be disclosed.

If a reasonable allocation of the total compensation is impractical, we consider that the total compensation payable to the KMP should be disclosed along with an explanation of the arrangement.

#### **Application of the requirements when management services are provided by another entity**

When an entity is managed by another entity (e.g. an investment fund that is managed by a corporate fund manager), we consider that the management entity should be treated as a related party if it carries out the functions normally associated with key management. Hence management fees payable should be disclosed along with information concerning the nature of the arrangement (FRS 124.12 and 17).

Some arrangements have the legal form of a contract between the reporting entity and a management entity but in substance relate to the services of an individual. Such arrangements should be evaluated in accordance with their substance. Accordingly, if the services of an individual who acts as a member of the KMP are procured through a contract with an entity, amounts payable should be disclosed as KMP compensation under FRS 124.16. By contrast, when the substance is for the provision of the services of the management entity, we do not consider it necessary to "look through" that entity to identify the KMP of the reporting entity.

## Discussion

### General

FRS 124.9 defines KMP 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.”

KMP are specified to be related parties (FRS 124.9). FRS 124.16 requires that:

“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.”

### Disclosure in the financial statements of a subsidiary for which the KMP are paid by the parent

It is common in groups of companies that:

- the same individual (or individuals) is a director (or otherwise a member of the KMP) of more than one group entity; and
- these individuals are paid by one group entity.

At a group level, this situation does not present any difficulties. Normally, the KMP of the parent entity are regarded as the group KMP and the compensation disclosed is their total compensation for services to the group. However, an issue arises in the financial statements of individual entities when the KMP are paid by another group entity. FRS 124 does not address the issue of how much compensation should be disclosed in the individual financial statements.

The definition of compensation at FRS 124.9 makes it clear that the relevant amount is the benefits payable to the KMP in exchange for the services to the entity in question. Compensation is therefore disclosable even if another entity pays the KMP. This applies whether or not the parent or other paying entity recharges the cost by way of a management fee or similar.

When the same individuals are KMP of several group entities but are paid by the parent (or another entity), the FRS 124.9 approach requires an allocation of their total compensation on the basis of the services provided to each entity. Such an allocation could be made based on the estimated time spent on each entity's affairs or another reasonable basis. When there is no reasonable basis for an allocation we recommend that each entity should disclose:

- the total compensation for each member of its KMP;
- an explanation that this total amount is for services to more than one entity; and
- a description of any recharge arrangements.

An alternative approach is to disclose the fact that key management is compensated by the parent with no disclosure of the amount. This is not our preferred approach and is acceptable only if there is no reasonable basis to make an apportionment.

### Management services provided by another entity

Some entities that prepare FRS financial statements are managed by another entity (usually for a fee). For example, certain types of investment funds do not have executive directors (or equivalent) but are instead managed by an investment management entity. This gives rise to a number of issues including:

- whether the investment management entity should be regarded as a member of the KMP of the fund; and
- whether the KMP of the management entity are also KMP of the fund.

We consider that KMP are individuals (i.e. people) rather than entities. Moreover, a management fee is not normally an employee benefit and does not therefore meet the definition of compensation in FRS 124.9. Nonetheless, if an entity carries out the functions of key management we believe it should be regarded as a related party.

Some management contracts are, in substance, arrangements to provide the services of specific individuals to a managed entity. If so, the individuals concerned would be KMP of the entity if they perform a key management role.

When the contract is a genuine “entity to entity” arrangement, we would not regard the KMP of the management entity as KMP of the fund (managed entity). There is therefore no need to “look through” the management entity to identify the KMP of the fund.

## Examples

### Example 1 - parent pays compensation to KMP of subsidiary

An executive director of a subsidiary is compensated directly by the parent on behalf of the subsidiary. The director works 100% for the subsidiary and does not receive any compensation from the subsidiary. The subsidiary pays a management fee to the parent, which contains an element for the key management personnel’s compensation, among other things. The management fee is disclosed as related party transactions in the subsidiary’s financial statements.

How should the key management compensation be disclosed in the **subsidiary’s separate financial statements** ?

#### Analysis

FRS 124.16 requires the disclosure of key management compensation. FRS 124.9 is also clear that consideration paid to the director on behalf of the subsidiary should be disclosed. Accordingly, the director’s remuneration should be disclosed in the subsidiary’s separate financial statements. We recommend a statement is also included that the compensation is paid at the parent’s level, and it is recharged as part of the management fee. In any case, the management fee is a related party transaction and is disclosable under FRS 124.17.

### Example 2 - parent pays compensation to KMP of several subsidiaries

An individual is an executive director of a parent entity and each of its 10 subsidiaries. The director is paid RM 250,000 by the parent for services to the group as a whole. The time spent by the director on each subsidiary’s affairs is not tracked and varies from one day to the next.

How should the key management compensation be disclosed in each subsidiary’s **separate financial statements** ?

#### Analysis

In principle the RM 250,000 should be allocated amongst the subsidiaries. In this case it appears that no reasonable basis of allocation could be derived and justified. The total compensation should therefore be disclosed by each entity, together with a statement that this is paid by the parent.

## Applicability

FRS 124 is applicable to an entity that:-

- Is not a private entity as defined in Section 15(1) of Companies Act, 1965; in this case Private Entity Reporting Standards (PERS) are to be applied
- Is required to prepare or lodge any financial statements under any law administered by Securities Commission or Bank Negara Malaysia; or
- Is a subsidiary or associate of, or joint venture controlled by, an entity which is required to prepare or lodge any financial statements under any law administered by Securities Commission or Bank Negara Malaysia.

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