



# Staff Paper

<b>Project:</b>	<b>Related Party Disclosures</b>	<b>Meeting</b>	AASB December 2016 (M154)
<b>Topic:</b>	<b>Proposed Tentative Agenda Decision</b>	<b>Agenda Item:</b>	9.1
<b>Contact(s):</b>	Kris Peach <a href="mailto:kpeach@asb.gov.au">kpeach@asb.gov.au</a> (03) 9617 7611 Nikole Gyles <a href="mailto:ngyles@asb.gov.au">ngyles@asb.gov.au</a> (03) 9617 7639	<b>Project Priority:</b> <b>Decision-Making:</b> <b>Project Status:</b>	High High Initial deliberation

## Introduction and objective of this paper

- 1 The objective of this paper is to outline staff analysis of whether a transaction with a key management personnel related party not part of a public service provider/taxpayer relationship is always material, even if on normal terms and conditions. This issue has been raised to AASB staff in relation to related party disclosures for public sector entities.
- 2 The paper includes a proposed tentative agenda decision.

## Summary of staff recommendations

- 3 Staff recommend that the Board issue a tentative agenda decision outlining the reasons why the Board did not take this issue onto its agenda (refer to Appendix A for proposed wording).

## Background

- 4 In March 2015 the AASB released *2015-6 Amendments to Australian Accounting Standards – Extending Related Party Disclosures to Not-for-Profit Public Sector Entities*. 2015-6 extends the scope of AASB 124 to include application by not-for-profit public sector entities. Implementation guidance was also included to assist application of the Standard by not-for-profit public sector entities. 2015-6 applies to annual reporting periods beginning on or after 1 July 2016.
- 5 Since the release of the amendments, AASB staff have attended a number of meetings at forums, including HOTARAC and ACAG meetings, at which concerns have been raised as to the operability of the Standard in the public sector.
- 6 These issues primarily relate to assessing the materiality of transactions, and the satisfaction of audit requirements in relation to materiality. In particular, the issue of whether a transaction with a key management personnel related party not part of a public service provider/taxpayer relationship is always material, even if on normal terms and conditions, has been raised.
- 7 Staff understand that this issue arises because of the AASB 124 definition of close family members. AASB staff understand that, based on discussions with IASB staff, this definition

captures all adult children regardless of dependence, and Ministers needing to do a broad range of enquiries to get information. In many instances this information is potentially subject to freedom of information requests.

## Staff analysis

8 The Australian implementation guidance for not-for-profit public sector entities AASB 124 notes that entities should consider the guidance in AASB 101 *Presentation of Financial Statements* and AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* in assessing whether a related party transaction is material (para. IG11). Further, entities may consider the factors outlined in paragraph 27 of AASB 124 to assist in making the determination. Paragraph 27 states:

27 *In using its judgement to determine the level of detail to be disclosed in accordance with the requirements in paragraph 26(b), the reporting entity shall consider the closeness of the related party relationship and other factors relevant in establishing the level of significance of the transaction such as whether it is:*

*(a) significant in terms of size;*

*(b) carried out on non-market terms;*

*(c) outside normal day-to-day business operations, such as the purchase and sale of businesses;*

*(d) disclosed to regulatory or supervisory authorities;*

*(e) reported to senior management;*

*(f) subject to shareholder approval.*

9 Accordingly, transactions conducted on normal terms and conditions (i.e. as if a member of the general public) with key management personnel related parties are not automatically assessed as material. Conversely, not all such transactions are assessed as not material.

10 Further, staff note that AASB 124 IG9 and IG11 state that, the following criteria are relevant when assessing materiality for disclosing key management personnel related transactions:

- the potential effect of the relationship on the financial statements (i.e. not materiality to the related party); and
- if the terms of the transaction are not any different to that of a transaction with the general public and in a public service provider/ taxpayer relationship, it's not material for disclosure.

11 Further, staff note that AASB 124 IG11 and Examples 7 and 8, highlight that revenues received such as rates and taxes, or expenses paid such as grants, provided in the normal public service provider/ taxpayer relationship are not material. For example:

- if the transaction has been through the entity's normal procurement processes, it is presumed this is at terms no different to those applying to the general public and the assessment of materiality should be consistent with the normal materiality considerations for other disclosure aspects of the financial statements; or
- if KMP close family members are employed through the entity's normal recruitment processes and the terms and conditions are demonstrably consistent with those

offered to other public service employees performing similar roles, normal financial statement materiality disclosure assessments apply.

### **Staff recommendations**

- 12 In response to the issue of whether a transaction with a key management personnel related party not part of a public services provider/taxpayer relationship is always material, staff think that, based on the above analysis the guidance in AASB 124 is clear that such transactions are not necessarily material.
- 13 Although staff acknowledge that there appears to be uncertainty expressed by some as to how the guidance is to be interpreted, AASB staff do not expect significant diversity in practice in Australia to arise when considering the materiality of related party transactions for public sector entities. Accordingly, staff recommend that the AASB makes no modification to the requirements of AASB 124.
- 14 Staff considered the format of any announcement to be issued by the AASB or staff in response to the issue. Specifically, staff considered whether a 'Frequently Asked Question' or similar response would be sufficient, rather than any formal AASB Board response.
- 15 However, due to the pervasive nature of the issue, on balance, staff recommend that the Board issue a tentative agenda decision (which includes a formal public consultation process) outlining the reasons why the Board did not take this issue onto its agenda (refer to Appendix A for proposed wording).

### **Questions to the Board**

**Q1** Does the Board agree with the staff recommendation to issue a tentative agenda decision?

**Q2** If so does the Board agree with:

- the wording of the proposed tentative agenda decision in Appendix A to this paper?
- a comment period of approximately 45 days (refer to draft project plan below for timing)?

### **Draft project plan**

December 2016 Issue proposed agenda decision for comment by 8 February 2017

21 February 2017 Discuss comments received at AASB Board meeting

Late February/  
Early March Issue final agenda decision

## **Appendix A: Proposed Agenda Decision**

### Issue

The AASB considered the issue of whether a transaction with a key management personnel related party not part of a public services provider/taxpayer relationship, always material even if it is on normal terms and conditions.

### Reasons for Not Adding the Issue to the AASB's Agenda

In considering this issue the AASB noted that transactions conducted on normal terms and conditions (i.e. as if a member of the general public) with key management personnel related parties are not automatically be assessed as material by nature. Conversely, not all such transactions are assessed as not material.

The Board observed that AASB 124 IG9 and IG11 require that, the following criteria are relevant when assessing materiality for disclosing key management personnel related transactions:

- the potential effect of the relationship on the financial statements (i.e. not materiality to the related party); and
- if the terms of the transaction are not any different to that of a transaction with the general public and in a public service provider/ taxpayer relationship, it's not material for disclosure.

The Board also noted that, when establishing the significance of a transaction, other relevant factors to consider outlined in AASB 124 are whether it is:

- significant in terms of size;
- outside normal day-to-day business operations, such as the purchase and sale of businesses;
- disclosed to regulatory or supervisory authorities;
- reported to senior management;
- subject to shareholder/minister approval. (para. 27)

Further, IG11 and examples 7 and 8, highlight that revenues received such as rates and taxes, or expenses paid such as grants, provided in the normal public service provider/ taxpayer relationship are not material. However, other transactions demonstrably made on normal terms as if with the general public may also not be material using the concepts applied to assessing materiality of other financial statement disclosures. The key assessment is whether knowledge of the relationship and terms and conditions would influence a user's understanding of the impact on the financial statements. Accordingly, if the impact on the financial statements is not material the transaction is not required to be disclosed.

For example, if the transaction has been through the entity's normal procurement processes, it may be presumed that the transaction is at terms no different to those applying to the general public and the assessment of materiality should be consistent with the normal materiality considerations for other disclosure aspects of the financial statements. Similarly, if KMP close family members are employed through the entity's normal recruitment processes and the terms and conditions are demonstrably consistent with those offered to other public service employees performing similar roles, normal financial statement materiality disclosure assessments apply.

The Board thinks that existing guidance in Australian Accounting Standards is sufficient to address the issue of whether a transaction with a key management personnel related party not part of a public services provider/taxpayer relationship, always material even if it is on normal terms and conditions.

The Board does not expect that significantly divergent interpretations would arise in practice. Consequently, the AASB [decided] not to add this issue to its work program.

## **Appendix B: Extract from AASB 124 *Related Party Transactions***

IG9 Paragraph 18 of the Standard requires an entity to disclose information about transactions that have occurred between the entity and its related parties, including transactions between the entity and its key management personnel or key management personnel of the entity's parent that is necessary for users to understand the potential effect of the relationship on the financial statements.

IG10 Ministers, councillors and other senior public servants may qualify as a related party of a public sector entity under one or more of the criteria set down in paragraph (a) in the definition of 'related party' in AASB 124. For example, a Minister who is a member of the key management personnel of the Commonwealth or State government is, under the definition of 'related party', a related party not only of the Commonwealth or State government consolidated entity but also of each controlled entity of that government (see Example 2 in paragraph IG6). In such instances, the Standard requires the controlled government entity to disclose related party transactions with that Minister which are necessary to meet the objective noted in paragraph 1 of the Standard, whether or not the Minister has responsibility for the entity.

IG11 A related party transaction is a transfer of resources, services or obligations between an entity and its related party, regardless of whether a price is charged. In the not-for-profit public sector, many entities are likely to engage frequently with persons who are a related party of that entity in the course of delivering the entity's public service objectives, including the raising of funds (for example, rates and taxes) to meet those objectives. These related party transactions often occur on terms and conditions no different to those applying to the general public (for example, the Medicare rebate or public school fees). A not-for-profit public sector entity may determine that information about related party transactions occurring during the course of delivering its public service objectives and which occur on no different terms to that of the general public is not material for disclosure in its general purpose financial statements and accordingly need not be disclosed. Guidance relevant to an entity's assessment of the materiality of a disclosure to its general purpose financial statements is included in AASB 101 *Presentation of Financial Statements* and AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. The factors described in paragraph 27 of the Standard may also assist an entity in making this determination. IG12 Examples 7–8 describe different types of related party transactions that may occur between not-for-profit public sector entities and their related parties:

### **Example 7**

Councillor P is a member of the key management personnel of the LMN local government (the Council). The Council's functions include raising revenue to fund its functions and activities, and planning for and providing services and facilities (including infrastructure) for the local community. In carrying out its functions, the Council undertakes a wide range of activities including the imposition of rates and charges upon constituents, and the provision without charge of services such as parks and roads. Councillor P is a ratepayer residing within the Council's constituency. As such, Councillor P takes advantage of the availability of free public access to local parks and libraries. Councillor P also used the swimming pool at the Council's Recreation Centre twice during the financial year, paying the casual entry fee applicable to the general public each time. The recreation centre has approximately 20,000 visitors each financial year. All of the transactions described above between the Council and Councillor P are related party transactions of the Council considered for disclosure in the Council's general purpose financial statements. Based on the facts and circumstances described, the Council may determine that these transactions are unlikely to influence the decisions that users of the Council's financial statements make having regard to both the extent of the transactions, and that the transactions have occurred between the Council and Councillor P within a public service provider/ taxpayer relationship.

## Example 8

Minister Z, the State Minister for Planning, has responsibility for a range of functions and, in certain circumstances, has the power to intervene on matters associated with planning and heritage processes. Minister Z is a member of the key management personnel of State Government H. Entity MED is a controlled entity of State Government H, and operates within the State Health sector. Entity MED is currently seeking State development approval for a potentially contentious new building. Around this time, Entity MED enters into a contract with Entity STU, an entity wholly-owned and controlled by a close member of Minister Z's family for Entity STU to provide cleaning services at various current and future Entity MED locations, including the new building when completed. The cleaning contract was won by Entity STU in an open tender. Minister Z has declared information about the contract to provide cleaning services to Cabinet and it is included as part of the Minister's Register of Members' Interests. During the reporting period, Entity STU rendered services of \$50,000 to Entity MED. No amounts remain outstanding at Entity STU's reporting date. Entity MED assesses the cleaning services rendered to be a material component of its total operating expenses. Entity STU is a related party of Entity MED in accordance with the definition of a related party in paragraph 9 of the Standard. The provision of \$50,000 cleaning services by Entity STU to Entity MED described above is a related party transaction of Entity MED as there has been a transfer of services and resources between Entity MED and Entity STU. Based on the facts and circumstances described, management of Entity MED may determine that information about the transaction is material for disclosure in its general purpose financial statements as there has been a transfer of resources occurring other than as a result of a public service provider/ taxpayer relationship between related parties and the amount of the transaction is material to Entity MED. The provision of \$50,000 cleaning services by Entity STU to Entity MED described above is also a related party transaction of State Government H as Minister Z is a member of the key management personnel of State Government H and Entity MED is a controlled entity of State Government H. State Government H should separately assess whether the related party transaction is material for disclosure in the whole-of-government financial statement