

Issues Paper Related Party Disclosures in the Not-for-Profit Public Sector

- Decisions made from this Issues Paper may be processed and incorporated into a Exposure Draft, pending possible further research as directed by the Board. This Issues Paper starts off with a summary on the nature of related party disclosures currently being made by NFP public sector entities (which can be found in Agenda Paper 5.3). Subsequently, staff have identified some issues with applying AASB 124 to NFP public sector entities. Lastly, staff suggest areas for possible improvement to AASB 124 with regards to application by the NFP public sector entities.

Nature of related party disclosures currently being made by NFP public sector entities

- Agenda Paper 5.3 details the related party disclosure requirements for public sector entities in addition to AASB 124. The findings are summarised below:

Table 1: Summary of public sector related party disclosures required in addition to AASB 124

Commonwealth, States or Territories	Disclosure requirements applying to all public sector entities		NFP specific public sector entity disclosure requirements	
	KMP remuneration disclosures	Related party transaction disclosures	KMP remuneration disclosures	Related party transaction disclosures
Commonwealth			x	
ACT				
NSW	x			
NT				
QLD	x			
SA	x	x	x	
TAS				
VIC	x			
WA	x	x		

- All jurisdictions except Australian Capital Territory, Northern Territory and Tasmania have KMP remuneration disclosure requirements for public sector entities (both for-profit and NFP). The Commonwealth and South Australia have specific NFP public sector entity KMP remuneration disclosure requirements. South Australia and Western Australia have related party transaction disclosure requirements for their public sector entities.

4. Specific NFP public sector remuneration disclosure requirements fall within two broad categories – salary banding (for example, practised by the Commonwealth Government) and specific individual KMP remuneration disclosures (for example, practised by New South Wales). Salary banding requirements stipulated by jurisdictions fall into two subsets – jurisdictions that require salary banding for all specified personnel (for example, Western Australia’s TI 952 *Remuneration of Senior Officers* requires disclosure of the number of senior officers whose remuneration for the financial year falls within each band of income of \$10,000) and salary banding for specified personnel whose remuneration is above a predetermined amount (for example, Queensland’s *Financial Reporting Requirements for Queensland Government Agencies* requires disclosure of the aggregate remuneration of all senior executive officers whose remuneration for the financial year is \$100,000 or more, within each band of income of \$20,000).

Issues with applying AASB 124 to NFP public sector entities

5. Staff have identified the following paragraphs from AASB 124 that might raise issues in relation to NFP public sector entities.

The use of the term ‘business’ in paragraph 5 of AASB 124

6. Paragraph 5 of AASB 124 states that:

Related party relationships are a normal feature of commerce and business. For example, entities frequently carry on parts of their activities through subsidiaries, joint ventures and associates. In those circumstances, the entity has the ability to affect the financial and operating policies of the investee through the presence of control, joint control or significant influence.

7. This paragraph seems to imply that related party relationships are only relevant for commerce and business. AASB 3 defines ‘business’ as:

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

8. NFP public sector entities differ from for-profit entities in that their primary objective generally is to provide goods or services for community or social benefit. The FRSB has an alternative definition of ‘business’ for its public benefit entities (PBEs) in NZ IFRS 3 *Business Combinations* which reads:

In the context of this standard, “business” also includes an integrated set of activities that is capable of being conducted or managed for the primary objective of providing goods or services for community or social benefit, rather than a financial return.

9. The AASB decided that an alternative definition of ‘business’ (for example, FRSB’s definition for its PBEs) for private sector NFP entities is not necessary when it issued AASB 3 *Business Combination* in March 2008. This is because the Board decided that the term ‘business’ can be read broadly. In particular, the phrase “lower costs or other economic benefits directly to investors or other owners, members or participants” in the

definition of ‘business’ in AASB 3 is broad and can be seen to apply to NFP public sector entities.

Staff Recommendation

Staff recommend that no change to AASB 124 is needed in this instance.

Question for the Board

Does the Board agree with staff’s recommendation?

Related party transactions with Ministers who have no direct responsibility for the entity

10. The framework for Australian government is set out in the Constitution, with Commonwealth functions separated broadly into legislative, judicial and executive. Executive power is vested primarily in the Governor-General acting with the advice of the Federal Executive Council. The Constitution provides that all ministers are Executive Councillors. As members of Parliament, ministers also take part in the exercise of legislative power, including in the introduction of proposed legislation to Parliament for consideration.
11. Acting on advice, the Governor-General appoints ministers, establishes departments, then formally allocates executive responsibility among ministers through the Administrative Arrangements Order published in the *Commonwealth Gazette*. The Order specifies the matters dealt with by each department of state and the legislation administered by each minister of state administering a department. In accordance with the Administrative Arrangements Order, most of the general executive powers of the Commonwealth are exercised by ministers or their departments without the direct involvement of the Governor-General or Executive Council. Many enactments also vest decision-making powers directly in ministers. However, some important powers, such as regulation-making and many appointments, are vested in the Governor-General in Council*.
12. Paragraph 9 and Paragraph 25 of AASB 124 respectively read:
 - 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.
 - ...

* *A Guide on Key Elements of Ministerial Responsibility (Prime Minister, Canberra) December 1998*

25 A reporting entity is exempt from the disclosure requirements of paragraph 18 in relation to related party transactions and outstanding balances, including commitments, with:

- (a) a government that has control, joint control or significant influence over the reporting entity; and
- (b) another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

13. The revised definition of ‘related party’ separately considers persons related to the reporting entity and entities related to the reporting entity. The paragraph 25 relief applies only to entities that are related to the reporting entity.
14. Under the revised definition of ‘related party’, Ministers would be considered KMP of the Australian Government. Therefore, under subparagraph 9(a)(iii) of the definition of ‘related party’, Ministers would be related parties of the Australian Government and also to each of the entities that form part of the Australian Government.
15. This means that entities would have to disclose related party transactions with Ministers who have no direct responsibility for them. Most of these transactions are likely to be of a domestic and trivial nature. This may result in voluminous disclosures of no relevance to users.
16. Staff identify the following solutions:

- Adopting FRSB’s approach

The FRSB has inserted a paragraph in NZ IAS 24 that requires a reporting entity to disclose related party transactions according to paragraph 18 of NZ IAS 24 only for Ministers of the Crown who have portfolio responsibility for the reporting entity (are effectively members of the KMP of the reporting entity itself).

- Adopting IPSAS 20 definition of related party for (not-for-profit) public sector entities

The definition of ‘related party’ IPSAS 20 *Related Party Disclosures* is as follows:

Related party — parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control. Related parties include:

- (a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the reporting entity;
- (b) Associates (see International Public Sector Accounting Standard (IPSAS) 7, “Accounting for Investments in Associates”);
- (c) Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;

- (d) Key management personnel, and close members of the family of key management personnel; and
- (e) Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.

This definition solves the issue of which Ministers are relevant as it has a narrower scope than AASB 124 since subparagraph (d) of ‘related party’ in IPSAS 20 explicitly omits KMP of the parent entity. KMP of the parent entity are only related where the individual has the authority and responsibility for planning, directing and controlling the activities of the reporting entity.

- Introducing a specific exemption for domestic and trivial related party transactions involving Ministers

Paragraph 10.5 of the now superseded AASB 1046 *Director and Executive Disclosures by Disclosing Entities* provided relief for transactions between the disclosing entity and specified directors when certain conditions are met. This paragraph states:

Transactions with and amounts receivable from or payable to the *specified directors* and *specified executives* are excluded from the requirements of paragraphs 10.1 to 10.4 when:

- (a) they occur within a normal *employee*, customer or supplier relationship on terms and conditions no more favourable than those that it is reasonable to expect the entity would have adopted if dealing at arm’s length with an unrelated individual; and
- (b) information about them does not have the potential to affect adversely decisions about the allocation of scarce resources made by users of the financial report, or the discharge of accountability by the *director* or *executive*; and
- (c) they are trivial or domestic in nature.

Staff also note that AASB 1031 *Materiality* may also exclude domestic and trivial transactions.

Staff recommendation

Staff recommend adopting FRSB’s approach on the following basis:

- (a) Under IPSAS 20, the KMP of the parent entity are only considered to be related to the reporting entity where the individual has the authority and responsibility for planning, directing and controlling the activities of the reporting entity. Under AASB 124, the KMP of the parent entity are all considered to be related to the reporting entity by virtue of being included in the definition of a related party. Staff consider that under AASB 124 this has the effect of ensuring that all transactions between a member of the KMP of the parent entity and the reporting entity are assessed to determine whether

disclosure is necessary, whereas, under IPSAS 20 only a sub-set of these transactions are assessed – those relating to the member of the KMP of the parent entity who also directs the activities of the reporting entity. Staff consider that this inclusion of all KMP of the parent entity in the definition of a related party is more robust than that under IPSAS 20. It appears that IPSAS 20 assumes that KMP outside of the direct reporting line do not significantly influence the reporting entity. In limited circumstances staff consider that this will not be the situation and thus prefer the AASB 124 approach.

- (b) Staff believe that the FRSB’s approach is a relatively direct solution compared to adopting the IPSAS 20’s definition of ‘related party’ or introducing a specific exemption for domestic and trivial related party transactions involving Ministers. The issue is that Ministers would be a related party to the Australian Government and also to each of the entities that form part of the Australian Government under the definition of ‘related party’ in AASB 124, and therefore entities would have to disclose related party transactions of Ministers who have no direct responsibility for them. The FRSB’s approach deals with this issue directly by exempting reporting entities from disclosing related party transactions with Ministers of the Crown who have no direct responsibility for them.
- (c) Adopting the FRSB’s approach would promote convergence efforts with New Zealand.
- (d) The FRSB’s approach involves the least change to AASB 124 and is therefore most consistent with the AASB transaction neutrality policy.

Question for the Board

Does the Board agree with staff’s recommendation?

Areas for improvement to AASB 124 with regard to NFP public sector entities

KMP remuneration disclosures for NFP public sector entities

- 17. In Agenda Paper 8.2 of the February 2010 meeting, staff noted that some public sector constituents have requested that the AASB consider alternative disclosures for KMP in the public sector (such as salary banding disclosures). Looking at Table 1, most jurisdictions have specific public sector remuneration disclosures that go beyond AASB 124. Agenda Paper 5.3 shows that specific NFP public sector remuneration disclosures fall within broad two categories – salary banding (for example, practised by the Commonwealth Government) and specific individual KMP remuneration disclosures (for example, practised by New South Wales).

Should AASB 124 require additional KMP remuneration disclosure for NFP public sector entities?

- 18. An argument for not requiring NFP public sector entities to disclose additional KMP remuneration disclosures is to be more consistent with a transaction-neutral approach to

setting Standards. Currently, AASB 124 only requires reporting entities (other than some disclosing entities) to report up to five categories of KMP remuneration in aggregate.

19. Some would argue that the following points outweigh the transaction-neutral approach:

- (a) Disclosure of information to the Parliament and the public about the performance of Australian Public Sector (APS) activities and functions is essential to sound governance in the APS. An agency's annual report is a principal vehicle by which it publicly reports on its performance. NFP public sector personnel are remunerated from public money and agency heads are accountable to Ministers, the Parliament and the public for the way in this public money and resources are used. Accountability is central to ensuring the Australian Government performs its functions effectively, efficiently, ethically and in the best interests of the Australian community[†].
- (b) Although the location of individual KMP disclosure requirements is currently the subject of debate, disclosing entities in the private sector must make individual KMP disclosures under AASB 124 or Section 300A of the *Corporation Act 2001*. Therefore, it can be argued that individual KMP remuneration disclosures should be required of NFP public sector entities.
- (c) Table 1 depicts that only the Australian Capital Territory, Northern Territory and Tasmania do not have specific KMP remuneration disclosures. Hence there is a divergence of practice which hinders comparison across jurisdictions. This issue could be alleviated by introducing common additional disclosure requirements for individual or banded KMP remuneration for NFP public sector entities.

[†] Australian Public Service Commission Homepage - Foundation of Governance
(<http://www.apsc.gov.au/foundations/accountability.htm#annualreporting>)

Salary banding or specific individual KMP remuneration disclosures for NFP public sector entities?

20. The benefits of incorporating salary banding over specific individual KMP remunerations disclosures in AASB 124 are reduced compliance costs and probably less resistance from preparers given the current requirements they face.
21. Although accountability is essential to the democratic system, it is only one of a number of qualities necessary to an effective system of government. Transparency increases the probability that poor decisions will be exposed and this can help to prevent foreseeable and preventable errors[‡]. Based on the Board's recent thinking on removing individual KMP disclosure requirements from AASB 124 into the law, because they are more a matter of public policy on governance than a standard-setting matter, staff presume the Board would not support adding individual or banded KMP disclosure requirements in respect of NFP public sector entities in the Standard. Furthermore, information about certain KMP is published in various documents required by law. For example, each jurisdiction in Australia provides information about Ministerial salaries and allowance e.g. on the Australian Parliament House website in respect of Commonwealth Ministers.

Question for the Board

Does the Board agree with staff's presumption?

Due process and proposed timeline

22. Pending further research as directed by the Board, an Exposure Draft will be prepared and the comments received from the Board on this Issues Paper will be incorporated into the Exposure Draft. The revised timeline is as follows:

Action	Date
Prepare draft ED, including subcommittee process	May - July 2010
Issue ED for three-month comment period and face-to-face liaison with key constituents	August 2010
Consider comments on ED and prepare/consider draft Standard	November - December 2010
Finalise Standard	January 2010

[‡] APS Commission *Delivering Performance and Accountability*