

List of Submissions to ED 214 *Extending Related Party Disclosures to the Not-for-Profit Public Sector*

- 1 Representatives of the Australian Accounting Profession
(CPA Australia, The Institute of Chartered Accountants in Australia and Institute of Public Accountants)
- 2 Ernst & Young
- 3 Hayes Knight
- 4 Australasian Council of Auditors-General
- 5 Tasmanian Audit Office
- 6 KPMG
- 7 HoTARAC

20 December 2011

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
Level 7
600 Bourke Street
Melbourne VIC 3000

By email: kstevenson@asb.gov.au

Dear Kevin

Exposure Draft - ED 214 Extending Related Party Disclosures to the Not-for-Profit Public Sector

CPA Australia, the Institute of Chartered Accountants in Australia and the Institute of Public Accountants (the Joint Accounting Bodies) are pleased to respond to the Australian Accounting Standards Board's exposure draft on *Extending Related Party Disclosures to the Not-for-Profit Public Sector*.

The Joint Accounting Bodies represent over 190,000 professional accountants. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

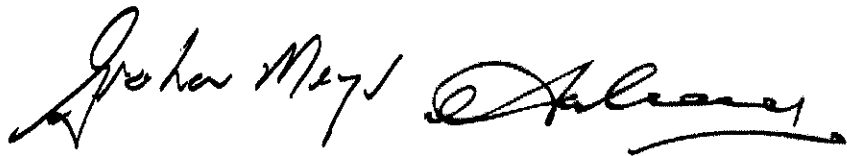
The Joint Accounting Bodies support the proposal to delete paragraph Aus1.3 and thereby remove the current scope exception that not-for-profit public sector entities do not apply paragraphs 1 to 28 of AASB 124 Related Party Disclosures. Our response to matters on which specific comment is requested is included in the Attachment.

If you require further information on any of our views, please contact Mark Shying, CPA Australia by email mark.shying@cpaaustralia.com, Kerry Hicks, the Institute of Chartered Accountants by email kerry.hicks@charteredaccountants.com.au or Tom Ravlic, the Institute of Public Accountants by email tom.ravlic@publicaccountants.org.au.

Yours sincerely



Alex Malley
Chief Executive Officer
CPA Australia Ltd



Graham Meyer
Chief Executive Officer
Institute of Chartered
Accountants in Australia

Andrew Conway
Chief Executive Officer
Institute of Public Accountants

Representatives of the Australian Accounting Profession



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Attachment: Comments in response to AASB questions

1. Is extending AASB 124 (December 2009) to the NFP public sector appropriate?

Yes, the Joint Accounting Bodies support the extension.

2. Are there any amendments that should be made to the proposed disclosure requirements (both Tier 1 and Tier 2) in respect of application by NFP public sector entities?

No, the Joint Accounting Bodies are not aware of any additional amendments that should be made.

3. Are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?

Not to our knowledge.

4. Overall, would the proposals result in financial statements that would be useful to users?

Yes, we believe the proposals would result in financial statements that would be useful to users.

5. Are the proposals in the best interests of the Australian economy?

Yes, we consider the proposals are in the best interests of the Australian economy.

6. Unless already provided in response to specific matters for comment 1 – 5 above, are the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative?

We consider the cost and benefits of the proposals are appropriate relative to the current requirements.



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30 January 2012

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Vic 8007
AUSTRALIA

Dear Chairman

Exposure Draft AASB ED 214 *Extending Related Party Disclosures to the Not-for-Profit Public Sector*

The Australian firm of Ernst & Young is pleased to submit our comments on Exposure Draft AASB ED 214 *Extending Related Party Disclosures to the Not-for-Profit Public Sector*.

Overall, we support the proposals in ED 214 on the basis that it promotes harmonisation with International Financial Reporting Standards and supports transaction neutrality.

We note that adoption of ED 214 may give rise to application issues for affected agencies. Determining who are Key Management Personnel ('KMP') of the agency and attributing KMP/Ministerial income to individual agencies within a portfolio under the responsibility of a particular Minister may be problematic. We therefore recommend that the AASB consider including additional guidance and examples to assist implementation by the Australian NFP public sector. We recommend that the AASB reach out to Treasuries to develop suitable guidance and examples in this regard.

In addition, we note that no transitional provisions are currently proposed in ED 214 and therefore comparatives for related party disclosures would be required when the revised AASB 124 is first applied by NFP public sector entities for reporting periods beginning on or after 1 July 2013, ie comparatives would be required for periods beginning on or after 1 July 2012. We recommend that the AASB provide relief from the requirement to provide comparative information in the first year of application. Alternatively, the Board could extend the application of the revised standard by at least one year to enable sufficient time for affected entities to implement systems, processes and controls to track and capture the required related party information.

Our responses to the specific questions are provided in Appendix A to this letter.

We would be pleased to discuss our comments further with you. Please contact Georgina Dellaportas on (613) 9288 8621 if you wish to discuss any of the matters raised in this response.

Yours sincerely

A handwritten signature in cursive script that reads 'Ernst & Young'.

Ernst & Young

Appendix A - Specific Matters for Comment

1. Whether extending AASB 124 (December 2009) to NFP public sector is appropriate

We support extending AASB 124 to NFP public sector entities on the basis that it promotes harmonisation with International Financial Reporting Standards and supports transaction neutrality. We note that the previous reason for providing an exemption to NFP public sector entities from compliance with AASB 124 which was on the basis that such disclosure was impracticable due to the number of related party transactions that would be required to be disclosed by such entities no longer applies following the changes made to IAS 24 by the International Accounting Standards Board to require only aggregated related party disclosures for government owned entities.

2. Whether any amendments should be made to the proposed disclosure requirements (both Tier 1 and Tier 2) in respect of application by NFP public sector entities

We do not believe that amendments to disclosure requirements are necessary for Tier 1 or Tier 2 reporters. However, we recommend that additional Australian specific application guidance and examples be included to assist implementation by the Australian NFP public sector and promote consistency and comparability between agencies within a jurisdiction as well between jurisdictions. This guidance and illustrative examples should deal with:

- Determining who are Key Management Personnel ('KMP') of the agency
- How income of KMP/Ministers is to be attributed to individual agencies within a portfolio under the responsibility of a particular Minister.

3. Whether any regulatory or other issues arising in the Australian environment that may affect the implementation of the proposals

No transitional provisions are currently proposed in ED 214 and therefore comparatives for related party disclosures would be required when the revised AASB 124 is first applied by NFP public sector entities for reporting periods beginning on or after 1 July 2013, ie comparatives would be required for periods beginning on or after 1 July 2012.

We recommend that the AASB provide relief from the requirement to provide comparative information in the first year of application. Alternatively, the Board could extend the application of the revised standard by at least one year to enable sufficient time for affected entities to implement systems, processes and controls to track and capture the required related party information.

4. Whether, overall, the proposals would result in financial statements that would be useful to users

Related party information is a critical element of accountability in the public sector and therefore is considered useful information for users. The fact that most Treasuries do mandate some form of disclosure of remuneration for key management personnel supports the view that there is a need for users to be provided with remuneration information. In addition, we believe that users are interested in material transactions with KMP where those transactions have been conducted on terms not normally faced by citizens, ie not on arm's length.

5. Whether the proposals are in the best interests of the Australian economy

We believe the proposals are in the best interests of the Australian economy. Refer to comments at questions 1 and 4 above.

6. Unless already provided in response to specific matters for comment 1-5 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative

The public sector NFP's will likely incur additional costs in order to comply with the proposals in ED 214 in that there will be a need to have systems, processes and controls in place to capture and record related party information. In addition, the process of attributing KNP/Ministerial remuneration to individual agencies could be time consuming and involve significant judgement. However, such systems and implementation issues are consistent with those faced by private sector entities, particularly entities that are part of a large group of companies. We do not believe that costs of implementing the proposals outweigh the benefits to users in providing such information. As noted above, related party information is a critical element of accountability in the public sector and therefore is considered important information for users.



Hayes Knight

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25 January 2012

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
MELBOURNE VIC 8007
By email: standards@asb.gov.au

Dear Kevin,

**RE: EXPOSURE DRAFT – ED214
EXTENDING RELATED PARTY DISCLOSURES TO THE NOT-FOR-PROFIT ENTITIES**

Hayes Knight is pleased to provide comments in relation to the above Exposure Draft.

We support the proposal for deletion of paragraph AU51.3 and hence the application of paragraphs 1 to 28 to general purpose financial statements of not-for-profit public sector entities.

We further support the amendments made to simplify the definition of business and provide a partial exemption from the disclosure requirements for entities that are related by virtue of being controlled, jointly consolidated or significantly influenced by the same government.

We have provided responses to specific matters attached in appendix 1.

Please do let me know if you require any further information

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'Pran Rathod'.

Pran Rathod FCPA
Director – Audit Services

1. Is extending the AASB 124 (December 2009) to the NFP public sector appropriate?
We support the extension.
2. Are there any amendments that should be made to the proposed disclosure requirements (both Tier 1 and Tier 2) in respect of application by NFP public sector entities?
We do not consider the need for any further additional amendments.
3. Are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?
We are not aware of any regulatory or other issues affecting the implementation of the proposal.
4. Overall, would the proposals result in financial statements that would be useful to users?
Yes, we believe the proposals would provide useful information in the financial statements.
5. Are the proposals in the best interests of the Australian economy?
We consider the proposals as being in the best interest of our economy.
6. Unless already provided in response to specific matters for comment 1-2 above, are the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative?
We believe that in the first year of application, the public sector entities may face the issue in determining which parties meet the definition of a related party.

However, we believe the cost and benefits are appropriate considering the requirements.

31 January 2012

Mr Kevin Stevenson
The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

Dear Mr Stevenson

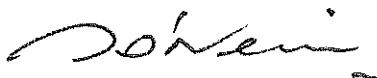
ED 214 Extending Related Party Disclosures to the Not-for-Profit Public Sector

Attached is the Australasian Council of Auditors-General (ACAG) response to the Exposure Draft referred to above. The views expressed in this submission represent those of all Australian members of ACAG.

While ACAG supports the principle of disclosing related party information in the financial reports of not-for-profit public sector entities, ACAG believes there are a number of practical issues associated with the proposed application of AASB 124 *Related Party Disclosures* that require further consideration.

I trust you will find the attached comments useful.

Yours sincerely



Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

ED 214 Extending Related Party Disclosures to the Not-for-Profit Public Sector

1. Whether extending AASB 124 (December 2009) to the NFP public sector is appropriate.

ACAG supports the principle of requiring NFP public sector entities to disclose related party information. ACAG believes, however, there are a number of issues that may arise in the proposed application of AASB 124 to NFP public sector entities.

2. Whether any amendments should be made to the proposed disclosure requirements (both Tier 1 and Tier 2) in respect of application by NFP public sector entities.

ACAG believes there are a number of practical issues that may arise on the application of AASB 124 to NFP public sector entities as proposed by the exposure draft.

The *Basis for Conclusions* section of the exposure draft discusses a number of potential issues relating to the application of the standard to Ministers. ACAG believes that this aspect of the standard would give rise to a number of significant practical application issues.

Application of Key Management Personnel definition to Ministers of Government:

If the definition of Key Management Personnel (KMP) was to include government Ministers, a number of issues arise relating to how this would be applied at an agency and Whole of Government (WhOG) level. This is particularly relevant given that Ministers will generally have direct and indirect roles with numerous government agencies (departments, statutory bodies and government owned corporations) and their related entities. Likewise, certain agencies may have more than one Minister to whom they are accountable.

Issues associated with applying AASB 124 to Ministers would include:

(a) Identification of KMP

As Ministers would appear to be KMP at the WhOG and General Government Sector (GGS) level, disclosure of their remuneration and related party transactions would be required in the financial statements prepared under AASB 1049. While ACAG believes that this information is relevant to users of the financial statements, practical issues could also arise on the disclosure of this information.

- ACAG requests clarification on whether heads of individual government agencies could also be considered as KMP for the purpose of the WhOG and or GGS financial reports.
- Clarification may also be required in relation to the definition of KMP in relation to the role of Cabinet and Executive Council which generally includes Ministers, the Governor, and in certain jurisdictions, possibly a Director-General who may act as a secretary.

These bodies can have a broad policy, planning and decision making function across all entities within WhOG. As a result of these bodies having such functions, guidance as to whether/how to include such individuals in AASB 124 disclosures would be beneficial.

(b) *KMP remuneration*

(i) Agency financial report

Ministers are generally remunerated through the Parliament via a central agency. Accordingly, where Ministers are not remunerated by individual agencies for which they are KMP, how would their remuneration be disclosed, if at all, in the financial reports of individual agencies? It is unclear how the allocation of “paid...by, or on behalf of the entity” and “includes such consideration paid on behalf of a parent of the entity” as included in the definition of compensation will affect such disclosures.

Apportionment of a Minister’s remuneration between agencies would require the application of considerable judgement and may be impractical. It would require an arbitrary apportionment of Minister’s parliamentary, party political, electorate and constituent responsibilities. Further, the inclusion of a small portion of a Minister’s salary in KMP disclosures at the agency level would provide little information to a user in interpreting the aggregate KMP compensation disclosures.

One jurisdiction remunerates Ministers through nominated agencies which report the remuneration as administered items. Again, these Ministers may have responsibility for other agencies which may give rise to apportionment issues. ACAG suggests clarification of treatment would be helpful in this circumstance.

Some jurisdictions query the need to disclose Ministerial remuneration in agencies’ financial reports where reference could be made to other published financial materials which already includes this information.

Suggested amendments that could be considered in relation to the application of the standard to Ministers of government could include:

- limiting KMP remuneration disclosures for Ministers of government to the WhOG level only; or
- exempting the disclosure of KMP remuneration for Ministers in the agency’s accounts in circumstances where the required information is publicly available and the financial report discloses where that information can be located.

ACAG Offices support limiting KMP remuneration disclosures for Ministers to the WhOG level only.

(ii) WhOG/GGS financial report

At the WhOG/GGS level, is there a need to give KMP disclosures for both the WhOG financial report and the GGS financial report? This would create another level of complexity in the compilation and readability of the disclosures and the apportionment issues noted above remain.

If the AASB does not consider it appropriate to change the proposed application of AASB 124 to Ministers, ACAG recommends that further clarity be provided in the standard relating to:

- the definition of KMP as applicable to NFP public sector entities, specifically taking into account the role of Ministers at both WhOG/GGS level and at an agency level. For example, if it is the AASB's intention that Ministers are always KMP of the Government, it would be helpful to state this.
- allocation of remuneration where the Minister is responsible for a number of entities within their portfolio e.g. whether apportionment of remuneration should be made based on services rendered regardless of who paid the remuneration.

(c) *Transactions with KMP of the entity or entity's parent*

Since the nature of transactions vary greatly e.g. purchases/sales of various types of goods or property, rendering and receiving of various types of services, lease or rent income/expense, ACAG suggests guidance be included on the level of detail required. This may also be of relevance to non-Ministerial KMP/related parties. Where there is a transition of Government, guidance would be useful on what transactions should be disclosed.

Related Party Transactions

Ministers as related parties

Even where a Minister is not KMP of a particular agency, it appears that they (and potentially their family members) would be captured as a related party (assuming the Minister is a KMP of the Government). The broader nature of activities undertaken by the government sector will likely involve more transactions between government entities and related parties than in a typical private sector context. The time taken to prepare disclosures may be significant and may pose difficulties in agencies meeting their statutory obligations to prepare financial statements by a given date.

Most ACAG Offices would like transactions with Ministers disclosed at the agency level, however, there are other Offices which are of the view that related party transactions should be aggregated at the WhOG level only.

WhOG and GGS financial reports

ACAG seeks clarification as to whether related party disclosures are required in both the WhOG financial report and the GGS financial report. To reduce complexity and duplication, ACAG recommends exempting the GGS financial report from complying with AASB 124.

Transactions between government entities

By virtue of the definition of related party (b)(i), all government entities will be related parties of each other. Although such entities are provided with exemption from application of paragraph 18, paragraph 26 requires disclosure of specific significant inter-government entity transactions and significant aggregate information. The costs of compliance with paragraph 26 are likely to be significant in the time and resources taken to compile the information given agency reporting timeframes.

General application of AASB 124 to NFP public sector entities

ACAG also recommends that consideration be given to including a public sector perspective for the section titled "Purpose of Related Party disclosures" within AASB 124 (paragraphs 5 to 8). Similarly, paragraph 27 of AASB 124 identifies that in assessing the significance of a related party transaction, consideration would be given as to whether they are carried out on "non-market terms." Since many government agency transactions are non-commercial (particularly those classified as NFP), ACAG suggests a broader sector neutral approach would be to refer to "transactions outside the normal course of business or on terms not available to non-related parties" as in Australian Auditing Standard ASA 550 *Related Parties*.

ACAG acknowledge the examples in AASB 124 at IE1-IE3, however, it is suggested additional guidance be considered for other types of transactions, e.g.:

- various types of fees/charges
- appropriations
- tax equivalent amounts
- amounts collected on behalf of another agency (as an agent).

In relation to these matters, ACAG believes that further consideration is required as to the exact nature and extent of the intended disclosures from the application of AASB 124 to NFP public sector entities. The application of AASB 124 to NFP public sector entities should provide for disclosure of information relevant to users of the report in a manner that does not significantly increase the cost of gathering the information required and is not so extensive that it potentially reduces the overall readability and usefulness of the financial report. This also avoids unnecessary duplication of information.

3. Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

ACAG is not aware of any regulatory or other issues.

4. Whether, overall, the proposals would result in financial statements that would be useful to users.

Subject to the points raised above, ACAG believes that related party information is useful to the users of the financial reports of NFP public sector entities. The proposals, with some adjustment, have the potential to help promote standardisation and comparability of related party disclosures across jurisdictions.

5. Whether the proposals are in the best interests of the Australian economy.

ACAG supports the disclosure of related party information on the basis of sector neutrality. ACAG does not believe there are significant economic impacts, positive or negative, associated with the proposed requirements.

6. Unless already provided in response to specific matters for comment 1–5 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.

ACAG believes significant additional costs may occur in the understanding and capture of relevant information. However, in some instances, these may be offset by the benefits of accountability and transparency in the long term.

31 January 2012

Mr Kevin Stevenson
The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

Dear Mr Stevenson

ED 214 Extending Related Party Disclosures to the Not-for-Profit Public Sector

In addition to the Australasian Council of Auditors-General (ACAG) response to the Exposure Draft referred to above, which the offices listed below support, I also wish to raise a matter not addressed by the proposed Exposure Draft.

This relates to the remuneration disclosures covered by paragraphs 1 to 28 of AASB 124. These paragraphs currently apply to for-profit public sector entities resulting in these entities disclosing KMP remuneration in aggregate. It is our view that for-profit government businesses should be regarded as disclosing entities being at least as, if not more than, publicly accountable. Therefore, consideration should be given to amending AASB 124 to require government businesses to comply with paragraph Aus29 of this standard.

The view expressed in this letter represents that of the following audit offices:

- Tasmanian Audit Office
- Queensland Audit Office

Yours sincerely



H M Blake
Auditor-General



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Our ref AASB Submission ED 214

Mr Kevin Stevenson
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West VIC 8007

6 February 2012

Dear Kevin

Exposure Draft 214 Extending Related Party Disclosures to the Not-for-Profit Public Sector

We are pleased to have the opportunity to provide our comments on Exposure Draft 214: *Extending Related Party Disclosures to the Not-for-Profit Public Sector* ("ED 214") issued by the Australian Accounting Standards Board.

Overall, we support extending related party disclosures to the not-for-profit public sector, and believe the proposals will result in financial statements that are useful and will further improve financial reporting in this sector.

However, having said this, we acknowledge that there may be a number of practical application issues arising as public sector entities implement the proposed standard. In particular, we believe there are two fundamental interpretation challenges ahead for public sector entities, as follows:

- Firstly, identifying related party entities. Public sector governance arrangements are complex and determining whether an entity controls or is in fact, controlled by another entity, is challenging. We recommend the AASB give consideration to aligning the effective date of this amended standard with the work that is being undertaken on "control" in the public sector or at least, providing illustrative examples to assist application.
- Secondly, identifying key management personnel. Again, this can be challenging in the public sector where we see a variety of Ministerial arrangements. Identifying which Ministers are related to which entities may not be as straight forward as one would think. We recognise there is a risk that illustrative public sector specific examples may be used more widely than originally intended, however, given the importance of consistency across the public sector, we think such illustrative examples would be helpful.

* * * * *



*Australian Accounting Standards Board
Exposure Draft 214 Extending Related Party
Disclosures to the Not-for-Profit Public Sector
6 February 2012*

We would be pleased to discuss our comments with members of the AASB or its staff. If you wish to do so, please contact me on (02) 9335 7963.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'ND' followed by a stylized flourish.

Nicola Davis
Partner



Department of Treasury and Finance

Contact: Peter Gibson
Phone: 02 6215 3551
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Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
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Dear Mr Stevenson *Kevin*

ED 214 Extending Related Party Disclosures to the Not-for-Profit Public Sector

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the Exposure Draft: *Extending Related Party Disclosures to the Not-for-Profit Public Sector*.

HoTARAC appreciates what the AASB is aiming to achieve and generally agrees with the principle behind extending AASB 124 *Related Party Disclosures* to the not-for-profit (NFP) public sector. HoTARAC is also supportive of following a transaction-neutral approach, where feasible; and acknowledges that amendments have been made to AASB 124, which does make it *more* suitable for the NFP public sector than earlier versions. However, the basic philosophy behind AASB 124 is based on the structures and accountabilities relevant to for-profit entities (particularly in the private sector). In particular:

- The concept of control (and hence the concept of a related party) is a more complex issue for the NFP public sector, as evidenced by the additional explanatory guidance in the existing AASB 127 *Consolidated and Separate Financial Statements* and the current project on the AASB work program;
- Remuneration of many key management personnel (KMP) in the NFP public sector – including all Ministers - is not set by the entity, but by parliament on recommendation of an independent body such as a tribunal, so the accountabilities are different;
- The relationships between Ministers and entities is often more complex than the relationships between for-profit entities and their KMP (and the latter *may* be better defined through other means such as the Corporations Act and explicit legal precedent);
- The KMP of NFP public sector entities – and their relatives - are also citizens, and thus may tend to have much more extensive dealing with the entity itself and other government entities on an 'average citizen' basis. The majority of 'average citizen' transactions are not important for accountability in the public sector.

HoTARAC acknowledges that some of these issues are considered in the Basis for Conclusions. However, HoTARAC believes that the proposals are not adequately

addressed in the Standard. Consequently, HoTARAC cannot support the proposed extension of AASB 124 (December 2009), in its proposed unamended form, to the NFP public sector, due to HoTARAC's significant concerns.

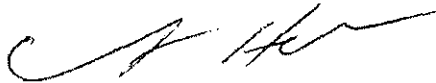
If the ED is to proceed, HoTARAC has the following recommendations:

- Ministerial compensation should only be centralised to whole-of-government or the relevant Department of Premier/Prime Minister and Cabinet to prevent potential duplication of information across departments, in particular for Ministers with multiple portfolio responsibilities.
- The exemption from disclosing most 'average citizen' transactions as related party transactions for Ministers should be included in the body of AASB 124, rather than in the Basis for Conclusions.
- The AASB should provide specific guidance on which Ministers are KMP and which transactions should be disclosed.
- The AASB should reconsider the relevance of IPSAS 20 *Related Party Disclosures* in developing any related guidance.

Comments by HoTARAC on questions from the exposure draft are attached, and include detailed discussion in the context of the issues raised above.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on 02 6215 3551.

Yours sincerely



Grant Hehir
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY
COMMITTEE

∩ February 2012

Encl

HoTARAC Response to AASB ED 214 *Extending Related Party Disclosures to the Not-for-Profit Public Sector*

Specific Matters for Comment

The AASB would particularly value comments on the following:

1. whether extending AASB 124 (December 2009) to the NFP public sector is appropriate;

As proposed - no.

HoTARAC regards disclosure of related party information to be a critical element of accountability and transparency in the public sector. HoTARAC appreciates amendments have been made to AASB 124 *Related Party Disclosures* (AASB 124), specifically:

- amendments to simplify the 'related party' definition; and
- a partial exemption from disclosure requirements for 'government-related entities'.

These amendments now make it a *more* appropriate basis for application to the public sector than earlier versions.

HoTARAC supports the furtherance of the AASB's transaction-neutrality policy, to the extent feasible. HoTARAC also observes that applying the AASB 124 principles to the Not-For-Profit (NFP) public sector, if appropriate modifications are made to address the complexities in the public sector, would bring greater alignment with the practices in New Zealand noting the Trans-Tasman Convergence Project between the AASB and the NZ Financial Reporting Standards Board (FRSB). HoTARAC has provided further comments on the New Zealand practice in the response to Specific Matter for Comment 2.

However, despite AASB 124 (December 2009) being *more* appropriate than earlier versions, HoTARAC does not consider it to be appropriate under its current form without some public sector-specific modifications.

HoTARAC believes there are significant issues surrounding the proposed extension. These issues are discussed further in this response. Overall, HoTARAC would also like to stress that, in many ways one can argue that the application of AASB 124 by the public sector is different and more onerous than for the private sector.

HoTARAC observes that there is considerable work still to be done on Control in the Public Sector. HoTARAC would therefore recommend that the AASB delay the proposed extension of AASB 124 until further progress has been made. The concept of control is important in the application of AASB 124 and is something that could potentially impact on the extent of the disclosures required by AASB 124 for the public sector. The project would hopefully re-examine the relationship between individual public sector entities and government as a

whole, including the boundaries of reporting entities in the public sector. This is indirectly connected with the issues of identifying who the KMP are in the public sector and the entities that would have related party transactions.

HoTARAC recommends that the AASB provide additional guidance in AASB 124 to assist both preparers and auditors with the new AASB 124 requirements. This guidance should include focusing on how to determine which related party transactions should, and should not, be disclosed given the 'uniqueness' and breadth of many activities in public sector entities and taking into account the objective of AASB 124¹.

Also, HoTARAC is uncertain where the material in the Basis for Conclusions to ED 214 will ultimately be located, assuming the proposed amendment goes ahead. However, note that HoTARAC does not support the current proposal included in ED 214.

HoTARAC notes that the AASB has suggested that HoTARAC field test the application of AASB 124 in a public sector context (AASB Board Meeting Minutes – February 2011). HoTARAC would welcome the opportunity to engage further with the AASB on this proposal.

Objective of related party disclosures

The objective of related party disclosures is a fundamental issue that needs to be re-considered in a not-for-profit public sector context. The current objective paragraph of AASB 124 suggests that an entity only needs to disclose those related party transactions that may have impacted on its financial position and profit or loss.

On that basis, for those related party transactions that have been entered into on 'arm's length' terms, one school of thought is that such transactions need not be disclosed. However, there is another school of thought that higher levels of accountability should apply to public sector entities, and that such transactions should be disclosed (even if conducted on arm's length terms) where there may arise perceptions that the related party received a preferential benefit from the transaction.

HoTARAC notes that IPSAS 20 *Related Party Disclosures* has an arguably broader objective, which is considered by HoTARAC to better acknowledge the different circumstances in the not-for-profit public sector.

Application of the KMP definition to Ministers

HoTARAC notes that KMP 'are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly' (AASB 124.9). The models applying in some Australian jurisdictions suggest that Ministers

¹ The objective of this Standard is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility *that its financial position and profit or loss may have been affected* by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties. (AASB 124.1 with added emphasis)

may not be KMP, but in circumstances where they are, HoTARAC raises the following questions in relation to the potential application of this definition to Ministers:

- Would a portfolio or non-portfolio Minister be a KMP of a subsidiary of a department or a statutory body? Ultimately, all public sector entities are 'indirectly' controlled by a Minister – while the responsibility for planning, directing and controlling may be delegated to management, Ministers may ultimately be responsible for the entities, and therefore always be a KMP.
- Would a portfolio or non-portfolio Minister be a part of the KMP of a statutory government owned corporation? If so, would the KMP include the voting shareholding Ministers, the portfolio Minister, or both? HoTARAC has further comments (in one of the following sections) on the application to for-profit public sector entities.
- Which Ministers would be a part of the KMP of the total general government sector? Only Cabinet Ministers/Senior Ministers? The example in Basis for Conclusions paragraph BC10 seems to assume all Ministers are KMP of Government, HoTARAC believes this would not be appropriate, given the cabinet system/government decision making process operating in Australian jurisdictions. HoTARAC also recommends that such an example - if that is how the definition of KMP is to be interpreted - should be provided within the draft AAS rather than the separate Basis for Conclusions. Aus guidance paragraphs in applying the definition would be useful to prevent differing interpretations, for example between management and auditors and application between jurisdictions. This will also assist jurisdictions comparability, HoTARAC refers the AASB to *IPSAS 20 Related Party Disclosures* (discussed in the Other Comments section at the end of this response)

Ministers as 'related parties'

Paragraph BC9 uses the example of a Minister entering into a commercial contract with an entity. HoTARAC would also recommend consideration be given to the scenario where a Minister is involved in a related party transaction that is not an 'average citizen' transaction with another portfolio. A hypothetical example would be a company owned by a close relative of a Minister (and hence a related party) obtaining industry development grants provided by a Government department operating under a different portfolio to the Minister. If there were evidence that the company's grant application was the subject of consultation between the two Ministers, and the grant is subsequently approved, even though the company was not highest on the eligibility criteria, there would appear a need for an assessment under the 'related parties' disclosure requirement. HoTARAC acknowledges there may be some practical difficulty and sometimes it may even be impossible to identify these types of transactions.

HoTARAC again refers the AASB to KPMG Reporting Update 11RU-014 (second question on page 8) as KPMG raises an interesting interpretation issue not addressed by the AASB. When is a Minister acting in a 'collective capacity', where the Minister is not part of the

KMP of Government? It is recommended that the AASB ensure this matter be clarified to ensure jurisdictions correctly apply AASB 124.25(a). Would transactions with Ministers who are related parties, acting in their collective government capacity, be assessed as being with the government and eligible for the paragraph 25 and 26 partial exemption?

HoTARAC also notes that where a Minister is a KMP, their close family members are also related parties. As indicated in response to Specific Matter for Comment 6 under the heading 'The public sector's area of influence', the broad nature of public sector transactions and the sole use of the 'materiality' concept applied to close family members (as related parties) could potentially hinder the usefulness of related party disclosures and be unduly onerous.

'For-profit' public sector entities

HoTARAC observes that for-profit public sector entities in most jurisdictions do not disclose Ministers as part of their KMP or as related parties. HoTARAC is of the view that the AASB's interpretation (in the Basis for Conclusions of ED 214) of the definitions in AASB 124 (December 2009) mean that these entities would need to reconsider whether they should treat their Ministers as part of the KMP and/or as related parties? HoTARAC is of the view that this interpretation will have consequential impacts and is seeking confirmation that this is what the AASB intended.

HoTARAC believes that the AASB should further consider the requirements of the relevant International Public Sector Accounting Standard (IPSAS), specifically IPSAS 20 *Related Party Disclosures*. This could prove useful in identifying appropriate guidance for inclusion in AASB 124 to make it more appropriate for application by NFP public sector entities. Further discussion on this issue is in our 'Other Comments' section at the end of the response.

2. whether any amendments should be made to the proposed disclosure requirements (both Tier 1 and Tier 2) in respect of application by NFP public sector entities;

Yes.

HoTARAC notes that the AASB considered whether or not to include an exemption paragraph similar to that of New Zealand's NZ IAS 24 paragraphs NZ 25.1 and NZ 26.1. The NZ paragraphs limit related party disclosure to only Ministers of the Crown who have portfolio responsibility for the reporting entity. HoTARAC notes, however, that the NZ exemption does not fully resolve issues relating to extending AASB 124 to the NFP public sector because the NZ exemption:

- a. assumes that portfolio Ministers are KMPs of all entities that are under his/her portfolio;
- b. does not explicitly exempt entities from disclosing routine transactions for portfolio Ministers; and

- c. ignores related party transaction between non-portfolio Ministers and government entities.

Nevertheless, HoTARAC is strongly of the view that an Aus paragraph exempting entities from disclosing certain Minister-related transactions, such as average citizen transactions, is warranted because of reasons detailed throughout this paper (e.g. uniqueness and breadth of activities assumed by public sector entities) and consideration of the usefulness of the disclosures from the users' perspective.

Therefore, HoTARAC recommends that the AASB reconsiders the following exemptions in Agenda Paper 4.2 tabled at its February 2011 board meeting:

- insert an Aus paragraph into AASB 124 stating that only non-routine Minister-related transactions are required to be disclosed and utilising paragraph 21 of AASB 124 to illustrate examples of non-routine transactions.
- insert an Aus paragraph based on deleted paragraph Aus29.9.3 in AASB 124.

KMP compensation for Ministers

HoTARAC notes the definition of 'compensation' in AASB 124 incorporates 'in respect of the entity'. It is common for some public sector entities to be responsible to multiple Ministers and vice versa. Where a Minister is determined to be a KMP of a public sector entity, HoTARAC notes that KMP compensation disclosures would be required in that entity's financial statements even though the entity does not recognise the Minister's 'compensation' because the Minister is not an employee. Additionally, a Minister's responsibilities may be much wider than his/her responsibilities relating to the individual entity; hence, the reliable measurement of his/her 'compensation' (in respect of that entity) may prove to be difficult and not cost-efficient. Alternatively, there may be multiple identical KMP disclosures (reflecting total remuneration for all entities) across multiple entities' financial statements, which similarly increases the costs for each of those entities. In both cases, what would be disclosed would be of questionable usefulness to users and potentially open to misinterpretation.

Further, in some jurisdictions, a large part of the compensation received by Ministers is provided for their services as members of parliament – such as constituency and committee work – and is not related to services performed for any specific reporting entity or group of reporting entities.

On the basis of these issues, HoTARAC is uncertain how the disclosures required by AASB 124.17 could effectively be complied with.

Therefore, HoTARAC suggests centralising the Minister-related disclosures to the financial statements of either the whole-of-Government or the relevant Department of Premier/Prime Minister and Cabinet. This would not diminish the requirements for disclosure but would reduce the burden on numerous individual entities, and to a lesser extent, it would remove numerous duplications, with uncertain usefulness to the users particularly in the scenario

where an entity is responsible to multiple Ministers. A statement could be provided by individual entities that such disclosures can be found in the relevant 'central' financial statements.

Tier 2

While it is unlikely at this stage that HoTARAC jurisdictions will early adopt the Reduced Disclosure Requirements (RDR), HoTARAC undertakes a high level review to determine whether the AASB Tier 2 proposals may create particular difficulties or concerns for HoTARAC jurisdictions in future. Comments below are made on this basis.

HoTARAC recognises that AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements* paragraph 36, when it comes into effect², will result in Tier 2 entities being excluded from applying specific disclosure requirements³. HoTARAC also acknowledges the scope of the ED's extension applies to paragraphs 1-28 of AASB 124 (December 2009) and is aware of the July 2011 removal by the AASB of its Aus paragraphs on disaggregated KMP disclosures by AASB 2011-4 *Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements*⁴.

3. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals;

Yes.

Whilst HoTARAC is generally supportive of the partial exemption provided in AASB 124 (December 2009) for government-related entities, HoTARAC also notes that the concept of 'significant' transactions has been used in paragraphs 26 and 27. HoTARAC acknowledges that this was implemented through IASB changes; however, in the Australian environment, AASB 124 is subjected to AASB 1031 *Materiality* (AASB 124.Aus1.8). The application of both the concept of 'significant' and the concept of 'material' to transactions is somewhat bewildering. As well as the partial exemption creating an inconsistency between disclosure for related entities and related individuals, there is a further inconsistency with related individuals in terms of which threshold should be used. For example, how does one apply both the 'materiality' threshold and the 'significant' transactions threshold (both of which are required to be applied to transactions with government-related entities)?

² Same effective date as the ED's proposed effective date.

³ Including:

- The disaggregation of key management personnel compensation by category (AASB 124.17(a)-(e)).
- The reference to see paragraph 34B of AASB 119 *Employee Benefits* in relation to certain participation in defined benefit plans as related party transactions (AASB 124.22).
- For government-related entities, the requirements of AASB 124 paragraph 26 and the guidance provided in AASB 124 paragraph 27.

⁴ Same effective date as the ED's proposed effective date.

If the AASB does not provide a specific exemption for individuals (e.g. Ministers)⁵, regarding the materiality issue raised above, in AASB 124, HoTARAC considers that there may also be a disconnect in the disclosure requirements between related party entities and related party individuals, as disclosure for individuals could potentially be more onerous. Disclosure of significant related party transactions for government-related entities would be subjected to paragraph 26 of AASB 124, but disclosure of material related party transactions for individuals would be based on paragraph 18 of AASB 124.

Furthermore, HoTARAC notes that individual jurisdictions may have their own legislative and/or policy requirements for public sector entities to comply with in relation to related party and/or key management personnel disclosures, and in defining KMP.

4. whether, overall, the proposals would result in financial statements that would be useful to users;

HoTARAC understands the intent of what the AASB is aiming to achieve and that the proposals potentially result in useful information for 'users'. Also, disclosure of related party information is a critical element of accountability and transparency in the public sector.

HoTARAC regards the benefits for users would, to some extent, include greater transparency and be a more transaction-neutral standard in line with the AASB's policy.

However, HoTARAC is concerned about various issues that negatively impact on the proposal's 'usefulness'.

HoTARAC considers the sole use of AASB 1031 *Materiality* by the AASB to argue that the 'average citizen' transaction by a Minister should be excluded might not be sufficient. HoTARAC agrees the 'average citizen' transactions would not be considered 'useful' information. A statement by the AASB in the Basis for Conclusions (BC9) highlighting this may be inappropriate. Actual paragraphs of intent need to be provided within the Standard itself and not within the Basis for Conclusions because, as clearly stated by the AASB within the ED, the Basis for Conclusions 'accompanies, but is not part of, AASB ...'. Auditors may not accept such rationale as a reason for exclusion as it is not found in the Standard.

Other significant issues considered in determining whether the proposals would be useful include:

- The lack of public sector specific guidance given the broad nature of transactions and relationships within the public sector.
- Other issues raised by HoTARAC elsewhere throughout this response.

Unless such issues are addressed by the AASB, HoTARAC questions the usefulness of extending the requirements.

⁵ Although noting the issue highlighted in our 'other comments' section in relation to Ministers as related parties and the KPMG Reporting Update, which requires clarification.

5. whether the proposals are in the best interests of the Australian economy;

HoTARAC suggests that the current proposals are premature and require refinement through deliberations as part of the AASB's 'Control in the Public Sector' project.

Disclosure of related-party transactions as described in ED 214 appears beneficial for the transparency and accountability of acquittal for taxpayer's funds. However, the tension and uncertainty regarding Ministers' role and between the application of significant transactions and material transactions must be resolved prior to mandating disclosures in order to ensure usefulness to users, improve comparability and appropriately set the disclosure bar so that the incremental benefits of disclosure do not come at disproportionate cost.

Likewise, disclosures for remuneration of Ministers as KMP require additional consideration. In many Australian jurisdictions, the Minister responsible for the agency is paid from an unrelated department and the remuneration contains a significant component for services as a Parliamentarian that are unrelated to their responsibilities as a member of KMP for an agency or agencies.

6. unless already provided in response to specific matters for comment 1 – 5 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.

The costs, especially in implementation of AASB 124 in its current form, could potentially outweigh the perceived benefits.

HoTARAC believes that the proposed effective date and retrospective application provides insufficient time for ensuring that relevant information is collected as of now (effective from being annual reporting periods beginning on or after 1 July 2013). Therefore, HoTARAC does not support such a short lead time without the provision of transitional assistance. HoTARAC considers it to be unreasonable for the AASB to expect that NFP public sector entities would already have systems or other mechanisms in place to easily identify all 'related party' transactions. This information is unlikely to be sourced from the financial reporting IT system.

HoTARAC notes there would be additional ongoing costs, including time and resources spent, in gathering, and determining, the relevant information for disclosures. For example, additional information collection mechanisms and clerical processes will certainly be required for related party transactions as not all financial systems will be able to readily identify these transactions, let alone if the counter-party is a company 'controlled' by a related party. Some of the required information may be more effectively collected at a Whole-of-Government level through direct enquiry of Ministers etc, rather than at an individual entity level.

Materiality – qualitative aspects

It is HoTARAC's view that the determination of material related party transactions can be problematic for the public sector. This is because transactions in the public sector usually involve the use of 'public resources' and therefore the qualitative aspect of materiality may have an equal or higher importance than the quantitative aspect. This may result in entities having to consider materiality for every transaction (apart from, perhaps, "average citizen" transactions), regardless of how quantitatively insignificant the transaction may be.

As a consequence, HoTARAC fears that this may lower the bar for disclosing material transactions. The concept of qualitative materiality in the public sector has always been problematic and the subject of debate. In contrast for the private sector, it is arguable that, in practice, the quantitative aspect of materiality for most related party transactions would be given more prominence.

It is HoTARAC's view that the AASB should also reconsider the application of AASB 1031 by public sector entities for the purposes of AASB 124. Paragraph 12(b)(i) of AASB 1031⁶ is particularly confusing as it seems to indicate that all related party transactions in the public sector could be material, and may, as mentioned earlier, lower the "bar" for material related party transactions to be disclosed. In contrast, for the private sector, it is arguable that materiality for most related party transactions is judged primarily on a quantitative basis.

HoTARAC believes there should be further consideration of how materiality/immateriality impacts on the type of relationships or transactions that lead to disclosure. For example, while AASB 1031 applies to AASB 124, HoTARAC notes that commercial contracts that are immaterial in amount are nevertheless expected to be disclosed (paragraph BC9), and also the concept of 'significant' transactions as discussed in response to Specific Matter for Comment 3. In the absence of AASB guidance on this matter, each jurisdiction may need to develop policies and guidance to ensure consistency for its entities in application of the AASB 124 disclosure requirements; this may reduce comparability between jurisdictions.

The public sector's area of influence

HoTARAC notes that for the private sector, the universe of related party disclosures for individuals (e.g. KMPs) to an entity is likely to be limited to transactions of the related party with the entity's business. For example, it is expected that the nature of related party disclosures for the KMPs of Coca-Cola could be limited to transactions with the Coca-Cola businesses.

⁶ AASB 1031 paragraph 12 (extract):

In deciding whether an item or an aggregate of items is material, the size and nature of the omission or misstatement of the items usually need to be evaluated together. In particular circumstances, either the nature or the amount of an item or an aggregate of items could be the determining factor. For example:

- (a) ...
- (b) it may be necessary to treat as material an item or an aggregate of items which would not be judged material on the basis of the amount involved, because of their nature. This may apply when:
 - (i) transactions occur between an entity and parties who have a fiduciary responsibility in relation to that entity, such as those transactions outlined in AASB 124 *Related Party Disclosures* and AASB 1046 *Director and Executive Disclosures by Disclosing Entities*; or ...

On the other hand, the public sector provides a broad range of goods and services to the public, and the area of influence is potentially significantly wider than that for a private sector entity. For example, at the Whole of Government level, Ministers may be considered KMP of the Whole of Government reporting entity, and therefore related parties for all its subsidiaries (e.g. departments and other public sector entities). Thus, if a KMP Minister were to use any services provided by public sector entities, e.g. public transport and public healthcare, the number of impacted entities and the amount of disclosure could be numerous. This issue is compounded by the fact that AASB 124 includes close family members of the KMP as related parties as well. This is the ‘average citizen’ issue raised earlier.

While HoTARAC acknowledges that certain routine transactions *might* not be disclosed according to the AASB’s ‘expectation’ in paragraph BC9 of ED 214, the process to identify and track these potential transactions is unduly onerous.

HoTARAC regards the benefits for users would, to some extent, include greater transparency and be a more transaction-neutral AAS in-line with the AASB’s policy. However the disclosure requirements need to be appropriate to the public sector environment, in particular regarding the role of Ministers and the ‘average citizen’ transactions.

Other Comments (including Practical Difficulties)

IPSAS 20 Related Party Disclosures

IPSAS 20 provides public sector specific guidance to clarify the applicability of the IPSAS to accounting by public sector entities. This includes a discussion on Ministers and their relationship with entities/government. HoTARAC recommends that the AASB gives further consideration of IPSAS 20, as it could prove useful in the AASB’s deliberation of AASB 124 for application in the not-for-profit public sector whilst still upholding the policy of transaction-neutral standards.

Related Party Disclosures for Agreements between Layers of Government

HoTARAC recommends the AASB consider the additional complexities arising in respect to related party disclosures where State and Commonwealth jurisdictions enter into joint venture arrangements. For example, a joint venture for a Port Authority might include two State Ministers and their Federal counterparts. There may be considerable additional complexity in the KMP disclosures as the joint venture in relation to KMP compensation (as discussed in the HoTARAC response to Specific Matter for Comment 2), which would be determined under both State and Federal regimes.

In developing this response, HoTARAC identified the following matters that the AASB may wish to consider:

- The definition of “compensation” in AASB 124 will not exactly align with the distinction between “short-term employee benefits” and “other long-term employee benefits” under the revised AASB 119. HoTARAC has not identified any decision by the IASB to execute such a consequential amendment; and

- AASB 1031 paragraph 12(b)(i) refers to a standard that no longer exists – AASB 1046 *Director and Executive Disclosures by Disclosing Entities*.

Location of Related Party Disclosures

Finally, at least one jurisdiction believes that there is an issue of the appropriate location of related party disclosures in the public sector. In at least some jurisdictions, information is already publicly available about KMP remuneration and some related party transactions through existing transparency mechanisms that are not present to the same extent in the private sector. HoTARAC notes that the AASB have considered similar issues in the past for directors' remuneration, and decided that this was more appropriately left to the companies' legislation regime. Similar issues apply to disclosures in the public sector – should all these disclosures be located in accounting standards or should they be elsewhere?