

AASB Exposure Draft

ED 214
July 2011

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

Comments to AASB by 31 January 2012



Australian Government

**Australian Accounting
Standards Board**

Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by 31 January 2012.
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All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chairman of the AASB agrees to those submissions being treated as confidential. The latter will only occur if the public interest warrants such treatment.

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This Exposure Draft is available on the AASB website: www.aasb.gov.au.
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AASB 2012-X EXTENDING RELATED PARTY DISCLOSURES TO
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[Draft] Australian Accounting Standard AASB 2012-X <i>Extending Related Party Disclosures to the Not-for-Profit Public Sector</i> is set out in paragraphs 1 – 5. All the paragraphs have equal authority.
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PREFACE

Background

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards, including Interpretations, to be applied by:

- (a) entities required by the *Corporations Act 2001* to prepare financial reports;
- (b) governments in preparing financial statements for the whole of government and the General Government Sector (GGS); and
- (c) entities in the for-profit or not-for-profit private or public sectors that are reporting entities or that prepare general purpose financial statements.

AASB 1053 *Application of Tiers of Australian Accounting Standards* establishes a differential reporting framework consisting of two tiers of reporting requirements for preparing general purpose financial statements:

- (a) Tier 1: Australian Accounting Standards; and
- (b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 1 requirements incorporate International Financial Reporting Standards (IFRSs), including Interpretations, issued by the International Accounting Standards Board (IASB), with the addition of paragraphs on the applicability of each Standard in the Australian environment.

Publicly accountable for-profit private sector entities are required to adopt Tier 1 requirements, and therefore are required to comply with IFRSs. Furthermore, other for-profit private sector entities complying with Tier 1 requirements will simultaneously comply with IFRSs. Some other entities complying with Tier 1 requirements will also simultaneously comply with IFRSs.

Tier 2 requirements comprise the recognition, measurement and presentation requirements of Tier 1 but substantially reduced disclosures requirements in comparison with Tier 1.

Australian Accounting Standards also include requirements that are specific to Australian entities. These requirements may be located in Australian

Accounting Standards that incorporate IFRSs or in other Australian Accounting Standards. In most instances, these requirements are either restricted to the not-for-profit or public sectors or include additional disclosures that address domestic, regulatory or other issues. These requirements do not prevent publicly accountable private sector for-profit entities from complying with IFRSs. In developing requirements for public sector entities, the AASB considers the requirements of International Public Sector Accounting Standards (IPSASs), as issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants.

Exposure Drafts

The publication of an Exposure Draft is part of the due process that the AASB follows before making a new Australian Accounting Standard or amending an existing one. Exposure Drafts are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

Reasons for Issuing this Exposure Draft

AASB 124 *Related Party Disclosures* does not apply to general purpose financial statements of not-for-profit (NFP) public sector entities.

Following requests from its constituents to review IAS 24 *Related Party Disclosures*, the IASB made amendments to simplify the definition of 'related party' and provide a partial exemption from the disclosure requirements for entities that are related by virtue of being controlled, jointly controlled or significantly influenced by the same government. The AASB incorporated the revised IAS 24 into AASB 124 (December 2009). The AASB noted that this version of AASB 124 provides a more appropriate basis for application by NFP public sector entities than earlier versions, as transactions between government-related entities of the same jurisdiction are exempted partially from disclosure. Therefore, in furtherance of its policy of promulgating transaction-neutral Standards to the extent feasible, the AASB is issuing this Exposure Draft to seek comments on its proposal to require NFP public sector entities to apply AASB 124.

Main Features of this Exposure Draft

This Exposure Draft proposes the deletion of paragraph Aus1.3 in AASB 124 (December 2009). This is the paragraph that exempts NFP public sector entities from applying the Standard. Therefore, it is proposed that paragraphs 1-28 of AASB 124 apply to general purpose financial statements of NFP public sector entities – the AASB is not proposing any amendment of the disclosure requirements. It is also proposed that Tier 2 NFP public sector

entities would not be required to comply with the disclosure requirements that do not apply to entities preparing general purpose financial statements under Australian Accounting Standards – Reduced Disclosure Requirements.

Application Date

It is proposed that this Standard be applicable to annual reporting periods beginning on or after 1 July 2013 with early adoption permitted for annual reporting periods beginning on or after 1 January 2005 but before 1 July 2013.

No transitional provisions are proposed and therefore comparatives for related party disclosures would be required when AASB 124 is first applied by NFP public sector entities.

Reduced Disclosure Requirements

AASB 124 has been amended by AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements* with effect from 1 July 2013 to identify the disclosure requirements that Tier 2 entities need not comply with. The analysis of disclosure requirements considered by the AASB when developing AASB 2010-2 was prepared in the context of AASB 124 not being applicable to NFP public sector entities. It is proposed that the conclusions in that analysis also apply in the context of the proposals in this Exposure Draft. Accordingly, the reduced disclosure requirements currently specified for AASB 124 are proposed to also apply to Tier 2 NFP public sector entities.

The AASB's conclusions in relation to proposed Tier 2 disclosure requirements in this Exposure Draft have been reached after applying its usual approach to analysing the proposed disclosures – application of the 'Tier 2 Disclosure Principles'. Those principles and the analysis of the proposed disclosure requirements are available on the AASB website under [Work in Progress/Reduced Disclosure Requirements](#).

Request for Comments

Comments are invited on the proposals in this Exposure Draft by 31 January 2012. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposal, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the major issues. The AASB regards supportive and critical comments as essential to a balanced review of the issues and will consider all submissions, whether they address all specific

matters, additional issues or only one issue. The AASB will consider the possibility of roundtables in due course.

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;
- 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;
- 3 whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals;
- 4 whether, overall, the proposals would result in financial statements that would be useful to users;
- 5 whether the proposals are in the best interests of the Australian economy; and
- 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.

ACCOUNTING STANDARD AASB 2012-X
EXTENDING RELATED PARTY DISCLOSURES
TO THE NOT-FOR-PROFIT PUBLIC SECTOR

Objective

- 1 The objective of this Standard is to extend the scope of paragraphs 1-28 of AASB 124 *Related Party Disclosures* to not-for-profit public sector entities.

Application

- 2 **This Standard applies to:**
- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the *Corporations Act 2001* and that is a reporting entity;
 - (b) general purpose financial statements of each other reporting entity; and
 - (c) financial statements that are, or are held out to be, general purpose financial statements.
- 3 **This Standard applies to annual reporting periods beginning on or after 1 July 2013.**
- 4 **This Standard may be applied to annual reporting periods beginning on or after 1 January 2005 but before 1 July 2013. If an entity applies this Standard to such an annual reporting period, it shall disclose that fact.**

Amendment to AASB 124

- 5 Paragraph Aus1.3 is deleted.

BASIS FOR CONCLUSIONS

This Basis for Conclusions accompanies, but is not part of, AASB 2012-X.

Background

- BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in the Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- BC2 The first version of AASB 124, AASB 124 *Related Party Disclosures* (July 2004), applied explicitly to general purpose financial statements of companies and other for-profit entities. IAS 24 *Related Party Disclosures*, which it replicated, continues to have this scope. The December 2005 and subsequent versions of AASB 124 specifically exempt not-for-profit (NFP) public sector entities from applying AASB 124. This was on the grounds of practicability, including the number of intra-government transactions.
- BC3 The AASB has received representations from constituents that the disclosure of relevant related party information is a critical element of accountability in the public sector. A key example is information relating to key management personnel (KMP) of public sector entities, the disclosure of which is not required under current Australian Accounting Standards.
- BC4 Following requests from its constituents to review IAS 24, the IASB made amendments to simplify the definition of 'related party' and, to ease concerns about practicability, provide a partial exemption from the disclosure requirements for entities that are related by virtue of being controlled, jointly controlled or significantly influenced by the same government. The AASB incorporated the revised IAS 24 into AASB 124 (December 2009). The AASB noted that this version of AASB 124 provides a more appropriate basis for application by NFP public sector entities than the previous versions, as transactions between government-related entities of the same jurisdiction are exempted partially from disclosure, as explained further in paragraph BC6.
- BC5 Therefore, in furtherance of its policy of promulgating transaction-neutral Standards to the extent feasible, the AASB initiated a project to consider issues relating to extending the scope of AASB 124 (December 2009) to NFP public sector entities. In deciding to propose that NFP public sector entities be required to apply

paragraphs 1-28 of AASB 124 unamended, the AASB addressed a range of issues, including the possibility of:

- (a) exempting such entities from disclosing certain related party transactions with Ministers;
- (b) amending the definition of ‘key management personnel’ for such entities;
- (c) inserting an alternative definition (to that in Appendix A of AASB 3 *Business Combinations*) for the term ‘business’ in paragraph 5 of AASB 124; and
- (d) incorporating additional disclosure requirements concerning the remuneration of KMP.

Each of these issues and the outcome of the AASB’s considerations are noted below. References to AASB 124 hereafter are references to the December 2009 version of that Standard.

Significant Issues

Exemption for entities from disclosing certain related party transactions with Ministers

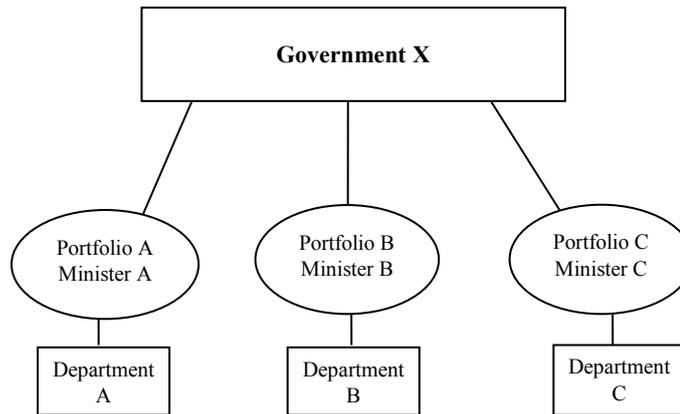
BC6 The definition of ‘related party’ in AASB 124 separately addresses persons related to the reporting entity and entities related to the reporting entity. Although, as noted in paragraph BC4 above, the IASB has introduced a partial exemption from the disclosure requirements for government-related entities, this exemption applies only in relation to those entities specified in paragraphs 25(a) and 25(b) and not to persons who are related parties covered by paragraph 17 (KMP compensation) or paragraph 18 (transactions during the periods covered by the financial statements).

BC7 The AASB considered whether providing a wider exemption for the disclosure of the related party transactions with Ministers illustrated in the following paragraphs was justified by any circumstances unique to the public sector and that may not have been considered by the IASB, whose mandate is limited to for-profit entities. The AASB’s consideration included the role of Ministers in a government and how onerous the disclosures required under AASB 124 might be.

BC8 Ministers may qualify as a related party of a public sector entity under one or more of the criteria set down in paragraph 9(a) of the definition of ‘related party’ in AASB 124. Where they are KMP of

their government, under the definition of ‘related party’, Ministers would also be related parties not only of the government but also of each subsidiary of the government. This would mean that if AASB 124 were to be applied to NFP public sector entities, subsidiary government entities could be required to disclose related party transactions with Ministers who have no responsibility for the entity. Where those transactions are material in amount or nature, the AASB considered that it was appropriate for AASB 124 to apply.

- BC9 The AASB observed that, as is often the case with related party transactions, judgement would be required as to when transactions are material, especially when qualitative assessments are made about the nature of transactions. The AASB considered situations in which Ministers paid taxes, levies or other statutory charges or fees faced generally by citizens. The AASB does not expect, absent unusual circumstances, that disclosure would be required in these situations. However, if commercial contracts, for example, were entered into by Ministers with public sector entities, even if immaterial in amount and not untoward when compared with other similar contracts, the AASB expects that entities would need to consider whether the nature of the relationship and those transactions was such as to require disclosure.
- BC10 The relationship of Ministers to the government and their departments can be illustrated with the aid of the diagram below. For simplicity, assume Government X has only three portfolios, with Ministers A, B and C in charge of their respective portfolios. Because Ministers A, B and C are KMP of the Government, each Minister would be a related party of all departments (see paragraph 9(a)(iii) of the definition of ‘related party’ in AASB 124). For example, Minister A would be a member of the KMP of the Government and a related party to departments A, B and C. This would result in departments B and C applying paragraph 18 of AASB 124 and disclosing material related party transactions with Minister A, despite the Minister having no responsibility for departments B and C.



- BC11 The AASB considered whether any exemption should be given to entities from disclosing related party transactions with all or only certain Ministers. For example, the AASB considered whether to adopt the type of exemption in paragraphs NZ 25.1 and NZ 26.1 of NZ IAS 24 *Related Party Disclosures*, issued by the Financial Reporting Standards Board of the New Zealand Institute of Chartered Accountants.¹ However, the AASB did not consider this was warranted, given the role of materiality and in view of the fact that AASB 124 requires disclosure of aggregated information on related party transactions rather than individual transaction information.
- BC12 The AASB noted that this issue of transactions with Ministers is not relevant to local governments because paragraph Aus17.9(e) of AASB 127 *Consolidated and Separate Financial Statements* indicates that local governments are not controlled by state or territory governments – and therefore state or territory Ministers normally would not be KMP of a parent entity of a local government and thus would not be related parties under that caption. Based on the views in relation to Ministers (as noted above), the AASB also decided that no explicit exemption from disclosing related party transactions with councillors is necessary for local governments or their subsidiaries.

Definition of ‘key management personnel’

- BC13 The AASB considered whether an amendment of the definition of KMP for the NFP public sector would be necessary to facilitate a decision to remove the NFP public sector exemption from AASB 124, but decided that the present definition was suitable. The AASB noted that, in a public sector context, entities should consider the facts and circumstances in assessing whether a person is a member of the KMP, as defined, of the entity.
- BC14 Normally, the determination of KMP is similar for entities in the public sector or the private sector. However, ministerial-type roles do not normally arise in a private sector context. Therefore,

¹ Paragraph NZ 25.1 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. Paragraph NZ 26.1 requires summarised disclosures about transactions exempted under paragraph NZ 25.1.

consideration needs to be given to whether Ministers are KMP in the absence of a private sector analogy. The AASB noted that a Minister would be a member of the KMP of an entity that is in the Minister's portfolio if the Minister has the "authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly".

Alternative definition of 'business'

BC15 The AASB considered whether an alternative definition (to that in Appendix A of AASB 3) for the term 'business' in paragraph 5 of AASB 124 was necessary. The AASB decided that an alternative definition is not required, which is consistent with its previous decision when it reissued AASB 3 in March 2008. In the AASB's view, 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 applied by NFP public sector entities.

Additional KMP disclosures

BC16 The AASB considered requests from some public sector constituents for additional disclosures (such as salary banding disclosures) for KMP in the public sector. The AASB follows a policy of transaction neutrality in the requirements in Standards and therefore decided not to propose any additional remuneration or other disclosure requirements for NFP public sector entities. It could see no NFP public sector specific reason to impose disclosures that exceed the requirements for for-profit entities and NFP private sector entities.