



## **MATERIALITY OF KEY MANAGEMENT PERSONNEL RELATED PARTY TRANSACTIONS OF NOT-FOR-PROFIT PUBLIC SECTOR ENTITIES**

### **Issue**

In March 2015, the AASB issued *AASB 2015-6 Amendments to Australian Accounting Standards – Extending Related Party Disclosures to Not-for-Profit Public Sector Entities*, extending the scope of AASB 124 *Related Party Disclosures* to include application by not-for-profit public sector entities. Since issue of the amendments, concerns have been raised with the AASB about the operationalisation of the Standard in the public sector. The concerns primarily relate to assessment of the materiality of transactions with a key management personnel (KMP) related party. Consequently, the AASB considered the issue of whether a transaction with a KMP related party that did not occur as part of a public services provider/taxpayer relationship is always material for disclosure in general purpose financial statements.

### **Reasons for Not Adding the Issue to the AASB’s Agenda**

The objective of AASB 124 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. It is not for the purpose of assessing governance or probity issues. The AASB observed that information required to meet other objectives may differ from those necessary to satisfy the objective of AASB 124, and noted it was considering the issue having regard to only the objective of general purpose financial statements and AASB 124. However, the AASB also observed that a large amount of information is already collected in the public sector that relates to KMP conflicts of interest and related party transactions for other purposes, and that material KMP related party disclosures may be captured already by such processes.

The AASB observed that AASB 101 *Presentation of Financial Statements* contemplates that an entity need not provide a specific disclosure required by an Australian Accounting Standard if the information resulting from that disclosure is not material; that is, the absence of the disclosure could not influence the economic decisions that users make on the basis of the financial statements. The AASB noted it expects those parties assuming responsibility for the general purpose financial statements to apply professional judgement in making an assessment about the materiality of a related party disclosure.

The Board observed when preparing general purpose financial statements, a preparer is likely to first identify the types of related party transactions that may have occurred; then assess, of that population, the types of transactions that:

- are not material or will likely always be immaterial for disclosure in general purpose financial statements;
- could potentially be material for disclosure in the entity’s general purpose financial statements; and
- will likely always be material for disclosure in the entity’s general purpose financial statements.

A not-for-profit public sector entity then applies judgement in determining the extent of information it needs to collect to meet the objective of AASB 124. As noted in AASB 2015-6 paragraph BC17, the Board considers there is little value in an entity incurring significant costs to obtain data that is immaterial for disclosure, and accordingly, the Board does not expect information to be collected unless it could be material for disclosure.

The Board observed that AASB 124 paragraphs IG9 and IG11 indicate that the following criteria are relevant when assessing materiality for disclosing transactions between an entity and its KMP related parties:

- (a) the potential effect of the relationship on the financial statements (i.e. not materiality of the transaction to the KMP); and
- (b) whether the transaction occurred as part of a public service provider relationship with a taxpayer on terms no different to that of a transaction with the general public (eg collection of rates, taxes, use of public service facilities – see paragraph IG11 and examples 7 and 8) or whether part of an ordinary operational transaction (eg purchase of property, plant and equipment, hiring employees) on normal commercial terms and conditions. Both these types of transactions should not be presumed to be material by nature of the transaction alone (that is, qualitatively material because the transaction is with a related party), but could be qualitatively material where the KMP can exert undue influence over the outcomes, or quantitatively material for disclosure where the effect on the financial statements could influence the economic decisions that users make on the basis of the financial statements.

The Board also noted that, when establishing the significance of a transaction, other relevant factors to consider outlined in AASB 124 paragraph 27 are whether it is:

- (a) significant in terms of size;
- (b) outside normal day-to-day business operations, such as the purchase and sale of businesses;
- (c) disclosed to regulatory or supervisory authorities;
- (d) reported to senior management;
- (e) subject to shareholder approval (in this context, ministerial approval).

The key assessment is whether knowledge of the relationship and terms and conditions could influence a user's understanding of the impact on the financial statements. Where the impact on the financial statements is not material the transaction is not required to be disclosed.

For example, the materiality assessment applied to a transaction with a KMP related party that has been through the entity's procurement processes which require several independent quotes to be obtained is unlikely to differ to that which would apply to the same transaction undertaken with an unrelated party, where the KMP has no influence over the transaction. Similarly, an entity may determine that disclosure of the employment of KMP close family members where recruited in the same manner, and subject to the same terms and conditions as those offered to other public service employees performing similar roles, to be material only where disclosure of the employment of employees who are unrelated to the entity, made under the same conditions, is material.

The Board thinks that existing guidance in Australian Accounting Standards is sufficient to address the issue of whether a transaction with a KMP related party that did not occur as part of a public services provider/taxpayer relationship is always material for disclosure in general purpose financial statements. The Board also observed that it may develop guidance on materiality as part of a forthcoming Practice Statement. The Board does not expect that significantly divergent interpretations would arise in practice. Consequently, the AASB decided not to add this issue to its work program.