



Project:	Related party disclosures – Tentative Agenda Decision	Meeting	AASB March 2017 (M156)
Topic:	Finalisation of Tentative Agenda Decision	Agenda Item:	4.1
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		Decision-Making:	High
		Project Status:	Redeliberations

Introduction and objective of this paper

- 1 The objective of this paper is to consider feedback received on the Tentative Agenda Decision *Materiality of Key Management Personnel Related Party Transactions for Public Sector Entities*, and to decide how to proceed on the agenda decision.

Attachments

Agenda Paper 4.2 Submissions received on the Tentative Agenda Decision

Background

- 2 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*. AASB 2015-6 extended the scope of AASB 124 to include application by not-for-profit public sector entities. Implementation guidance was also included to assist application of the Standard by not-for-profit public sector entities. AASB 2015-6 applies to annual reporting periods beginning on or after 1 July 2016.
- 3 Since issue of the amendments, AASB staff have attended a number of meetings at forums, including HOTARAC and ACAG meetings, at which concerns have been raised as to the operationalisation of the Standard in the public sector. The concerns primarily relate to assessing the materiality of transactions, and the associated consideration of audit requirements in relation to materiality. In particular, the issue of whether a transaction with a key management personnel (KMP) related party that is not part of a public service provider/taxpayer relationship is always material, even if on normal terms and conditions, has been raised.¹

¹ As noted in [Agenda Paper 9.1 of the AASB December 2016 meeting](#), staff understand that this issue arises in part because of the AASB 124 definition of close family members. AASB staff understand that, based on discussions with IASB staff, this definition captures all adult children regardless of dependence, and

- 4 The Board discussed the concern and its possible response at its December 2016 meeting. The Board decided to respond to the concern by way of issue of an Agenda Decision, rather than amendment to AASB 124 or adopting a ‘Frequently Asked Question’ (or similar) approach. The Agenda Decision approach acknowledged the pervasiveness of the issue, and is subject to a formal public consultation process.
- 5 The Tentative Agenda Decision *Materiality of Key Management Personnel Related Party Transactions for Public Sector Entities* was issued on 21 December 2016 for comment by 8 February 2017.

Feedback on the Tentative Agenda Decision

- 6 The Board received four comment letters on the Tentative Agenda Decision, from:
 - (a) Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC);
 - (b) Australasian Council of Auditors-General (ACAG);
 - (c) CPA Australia; and
 - (d) Institute of Public Accountants.

Staff have not prepared a collation of the comment letters given the small number of responses received and the diverse nature of the responses. The comment letters received are included as Agenda Paper 4.2.

- 7 The Tentative Agenda Decision was also discussed at the Auditing and Assurance Standards Board’s February 2017 meeting. AASB staff² attended the session as observers. In summary:
 - (a) two AUASB members signalled concerns similar to those raised by other respondents to the Tentative Agenda Decision;³
 - (b) AUASB members noted that there is no gap (concerning related parties and materiality) in the Auditing Standards requiring action by the AUASB.
- 8 Respondents generally were supportive of the AASB’s move to respond to constituent concerns in a timely manner, and most broadly support the AASB’s conclusion that transactions with KMP related parties should not be automatically presumed to be material by nature. However, respondents sought the addition of further implementation guidance to AASB 124, and expressed concerns about various aspects of the Tentative Agenda Decision, including:

Ministers needing to do a broad range of enquiries to get information. In many instances, this information is potentially subject to freedom of information requests.

2 Kala Kandiah, Technical Director (a/g), and Evelyn Ling, Senior Project Manager

3 In the main, these members belong to one of the organisations that made a submission.

- (a) clarity of the purpose of the Tentative Agenda Decision and AASB 124, including identification of the users to whom the Tentative Agenda Decision was directed;
- (b) the characterisation of transactions involving grants in many cases as being similar to public services provider/taxpayer transactions; and
- (c) the suggestion that a 'normal procurement process' could always be presumed to be an appropriate indicator of immateriality of a transaction.

Staff recommendations and analysis

- 9 Having regard to the feedback received (see also Agenda Paper 4.2), and noting that the Board decided to issue an agenda decision in part to address constituent concerns in a timely manner, staff recommend the Board:
- (a) finalise the agenda decision, amended to address constituent concerns raised to the extent it is appropriate to address the concern as part of the agenda decision;
 - (b) consider whether to undertake a separate project to add guidance to AASB 124, and the scope of that guidance, as part of its decision-making at its 2-3 May 2017 meeting on its 2017-2019 work program. Staff note that:
 - (i) this may be seen as not being responsive to constituent concerns in a timely manner. However, if staff were to develop proposals for limited amendments to AASB 124 to incorporate similar themes to those conveyed by the agenda decision, (1) this would negate the need for the agenda decision to be finalised; (2) the proposed amendments to AASB 124 would require further due process, which would lengthen the time taken to finalise the amendments and respond to constituent concerns; and (3) further amendments to AASB 124 (for example to add further implementation guidance) may still be required after the Board discusses its 2017-2019 work program; and
 - (ii) resources will likely need to be diverted from the Board's Agenda Consultation project if the Board would like for staff to bring to the next Board meeting analysis and proposals for amendments to AASB 124 to address constituents concerns raised in the comment letters received.
 - (c) consider whether to undertake a separate research project to investigate extending related party disclosures to address a broader objective, as part of its decision-making at its May 2017 meeting on its 2017-2019 work program; and
 - (d) consider whether to add guidance on the application of materiality by public sector entities as part of its decision making on an Australian Practice Statement that incorporates the IASB Materiality Practice Statement. The IASB Materiality Practice Statement is expected to be published within six months.

Question to Board members

Q1 Do Board members agree with staff recommendations as set out in paragraph 9?

Constituent concerns addressed in proposed revisions to the Tentative Agenda Decision

10 In paragraph 9(a), staff recommended the Board finalise the agenda decision, amended to address constituent concerns raised to the extent it is appropriate to address the concern as part of the agenda decision. Staff's response to constituent concerns raised are set out in the following paragraphs:

Clarity of the purpose of the Tentative Agenda Decision and AASB 124, including identification of the users to whom the Tentative Agenda Decision was directed

- 11 The feedback reflects that different stakeholders hold different views as to the objective of related party disclosures in financial statements. There is a view that disclosures should act as an accountability mechanism to provide a complete picture to users about governance, transparency and identification of conflicts of interest. In this regard, one respondent observed that the materiality of a related party transaction should be assessed with reference to the materiality of the transaction to the KMP; rather than materiality to the financial statements.
- 12 The discussion on materiality in the *Framework for the Preparation and Presentation of Financial Statements*, AASB 101 and AASB 108 do not contemplate materiality of related party transactions being subject to a different materiality objective to that of other information included in the financial statements. Accordingly, staff concur with the Board's position implicitly set out in the Tentative Agenda Decision that materiality and the purpose of related party disclosures in financial statements is considered with respect to the existing objectives of AASB 124 and general purpose financial statements.
- 13 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. Accordingly, the objective of the standard is clear that the purpose of the disclosures is to assess the impact or possible impact on the financial statements of related party transactions, so materiality cannot be from the perspective of the KMP. However, in response to the constituent concern, staff think it would be useful to add text to the Agenda Decision to clarify this.
- 14 In addition, staff received informal feedback that it would be useful for the Board to clarify in the agenda decision that the Board is responding to a concern relating to the preparation of financial statements, rather than the audit of those financial statements. Having regard to the background to the development of the agenda decision, staff concur, and have proposed text to be included in the Agenda Decision in this regard.

The characterisation of transactions involving grants as being similar to public service provider/taxpayer transactions

- 15 A respondent (ACAG) was concerned that the agenda decision suggests that all transactions involving grant distributions to related parties are akin to public service provider/ taxpayer transactions. Another respondent noted the apparent extension of AASB 124.IG11 to expenses such as grant distributions but expressed implicit support for the proposal.
- 16 Staff concur that not all transactions involving grant distributions to related parties may be similar to public service provider/ taxpayer transactions. Staff think the concern expressed by ACAG can be addressed through revisions to the wording of the agenda decision without changing the Board's conclusions exposed.

The suggestion that a 'normal procurement process' could always be presumed to be an appropriate indicator of immateriality of a transaction

- 17 A respondent (ACAG) was concerned that the Tentative Agenda Decisions suggests that 'normal procurement process' could always be presumed to be an appropriate indicator of immateriality of a transaction. Staff concur with the contention put forth in the ACAG submission that normal procurement processes are of varying standard. Staff think the concern expressed by ACAG can be addressed through revisions to the wording of the agenda decision without changing the Board's conclusions exposed.

Other constituent concerns addressed

- 18 A respondent (CPA Australia) suggested that the final Agenda Decision acknowledge that the issue arises in part due to operationalisation of the Standard to close family members of a KMP.
- 19 Staff note that providing context as to why the Board has considered the issue is consistent with the Board's practice in its past Agenda Decisions. Accordingly, staff recommend the Agenda Decision be amended in this regard, as marked up in Appendix A. However, staff do not think it is necessary for the Agenda Decision to refer specifically to 'close family members'.
- 20 Appendix A sets out staff's proposed amendments to the wording of the Tentative Agenda Decision.

Question to Board members

- Q2 Do Board members agree with the proposed wording of a final Agenda Decision, as marked up in Appendix A?

Next steps

- 21 The next steps are dependent on the Board's decisions at this meeting, including whether to finalise the Tentative Agenda Decision.

APPENDIX A Proposed final Agenda Decision

(marked up from the Tentative Agenda Decision to respond to constituent concerns. New text is underlined and deleted text is struck through)

MATERIALITY OF KEY MANAGEMENT PERSONNEL RELATED PARTY TRANSACTIONS

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 key management personnel (KMP) related party, ~~who~~ that ~~is~~ did not occur as part of a public services provider/taxpayer relationship, is always material ~~even if it is on normal terms and conditions~~ 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.

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.

In considering this issue, the AASB noted that AASB 124 paragraph IG11 conveys that transactions between an entity and its KMP related parties conducted on ~~normal~~ terms and conditions (~~i.e. as if a no different to those applied to other~~ members of the general public) ~~with KMP related parties~~ should

not automatically be assessed as material by nature.⁴ The Board ~~reiterated the comments made~~ ~~noted its view expressed~~ in AASB 2015-6 ~~Amendments to Australian Accounting Standards—~~ ~~Extending Related Party Disclosures to Not-for-Profit Public Sector Entities~~ ~~paragraph BC17 and BC18~~ that it does not expect, absent unusual circumstances, that the application of materiality would result in disclosure in many ~~of these~~ situations ~~involving transactions between an entity that is a public services provider and a taxpayer who is also a related party to the entity.~~ Similarly, it does not expect disclosure in many situations involving related parties where the transactions are conducted on terms and conditions applied to the general public. Accordingly, a not-for-profit public sector entity would apply judgement in determining the extent of information it needs to collect to meet the objective of AASB 124.⁴ ~~As noted in 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 is likely to be material for disclosure.

Question to Board members:
Board members are asked whether the highlighted sentence should be retained in a final Agenda Decision. Staff have mixed views as to whether it is appropriate for the Agenda Decision to make this statement. Some staff consider the sentence captures the sentiment of para BC17; other staff think the sentence could be seen as an interpretation of AASB 124 that applies also to for-profit entities.

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 transactions~~:

- (a) the potential effect of the relationship on the financial statements (i.e. not materiality of the transaction to the KMP) ~~when assessing the quantitative aspects~~; and
- (b) whether the transactions which 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, and in a public service provider/ taxpayer relationship, are not likely to be qualitatively material for disclosure.
These types of transactions ~~are should~~ not be presumed to be material by nature of the transaction alone, but could be material for disclosure where the effect of the relationship 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:

⁴ Paragraph IG 11 of AASB 124 states “A related party transaction is a transfer of resources, services or obligations between an entity and its related party, regardless of whether a price is charged. In the not-for-profit public sector, many entities are likely to engage frequently with persons who are a related party of that entity in the course of delivering the entity’s public service objectives, including the raising of funds (for example, rates and taxes) to meet those objectives. These related party transactions often occur on terms and conditions no different to those applying to the general public (for example, the Medicare rebate or public school fees). A not-for-profit public sector entity may determine that information about related party transactions occurring during the course of delivering its public service objectives and which occur on no different terms to that of the general public is not material for disclosure in its general purpose financial statements and accordingly need not be disclosed. Guidance relevant to an entity’s assessment of the materiality of a disclosure to its general purpose financial statements is included in AASB 101 *Presentation of Financial Statements* and AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. The factors described in paragraph 27 of the Standard may also assist an entity in making this determination”.

- (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/minister approval. ~~(para. 27)~~

Further, ~~paragraph IG11 and examples 7 and 8,~~ highlight that ~~revenues received transactions~~ such as rates and taxes ~~paid (similarly for expenses paid such as grants), which are~~ transacted in the normal public service provider/taxpayer relationship may not be material. ~~However, o~~Other transactions ~~between an entity and its related parties~~ demonstrably made on ~~normal~~ terms ~~no different to those that would have applied to, as if with~~ the general public, may also not be material using the concepts applied to assessing materiality of other financial statement disclosures. ~~Such transactions could include expenses such as grant distributions from a public sector entity to a KMP related entity.~~ The key assessment is whether knowledge of the relationship and terms and conditions would influence a user's understanding of the impact on the financial statements. ~~Accordingly, if Where~~ the impact on the financial statements is not material the transaction is not required to be disclosed.

For example, ~~if the~~where a transaction has been through the entity's ~~normal~~ procurement processes ~~which require several independent quotes to be obtained and the KMP has no influence over the decision-making process in respect of that transaction,~~ ~~it may be presumed that the transaction is on terms no different to those applying to the general public and~~ the assessment of ~~the~~ materiality ~~of the transaction should~~ is unlikely to differ to that which would apply to the same transaction undertaken with a party that is not a KMP related party~~be consistent with the normal materiality considerations for other disclosure aspects of the financial statements (likely to be a quantitative assessment).~~ Similarly, ~~if an entity may determine that disclosure of the employment of~~ KMP close family members ~~where recruited in the same manner, are employed through the entity's normal recruitment processes and subject to the same~~ terms and conditions ~~are demonstrably consistent with as~~ those offered to other public service employees performing similar roles, ~~to be material only where disclosure of the employment of other employees, who are not KMP close family members, made under the same conditions is material,~~ normal financial statement materiality disclosure assessments apply.

The Board thinks that existing guidance in Australian Accounting Standards is sufficient to address the issue of whether a transaction with a KMP related party, ~~who is that did~~ not ~~occur as~~ part of a public services provider/taxpayer relationship, is always material ~~for disclosure in general purpose financial statements even if it is on normal terms and conditions.~~

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