

Local Government - Accounting for Related Party Disclosures

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Photo credit

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Accounting for Related Party Disclosures

The purpose of this guidance material is to assist preparers of local government financial statements in the compilation of the information to be disclosed in relation to related parties and senior officers.

For periods commencing on 1 July 2016 the requirements of Australian Accounting Standards Board 124 *Related Party Disclosures* (AASB 124) will apply to financial statements prepared by local governments within Victoria. Given the initial application of AASB 124 this guidance has been prepared and supersedes the Department's previous guidance note on *Related Party Disclosures* that was issued in May 2015.

Introduction

AASB 124 requires local governments to make specific disclosures in relation to transactions and balances (including commitments) with related parties. While local governments have been required to make disclosures broadly in line with the requirements of AASB 124 for a number of years, the application of the standard to the sector for the first time warrants the updating of guidance material to both refresh and reiterate accounting standard requirements as well as to clarify expectations to ensure consistency across the sector.

The implementation of AASB 124 provides councils with an opportunity to review and improve the existing systems and processes in place to identify related parties and capture required information regarding transactions with related parties. Note that

comparative information is not required on initial adoption of AASB 124.

Important definitions

Critical to the application of the standard is the understanding of key terms used throughout the standard. These are detailed in the following paragraphs.

Related parties

There are four types of related parties that council need to consider, these are:

1. Entities related to council;
2. Key Management Personnel (KMP);
3. Close family members of Key Management Personnel; and
4. Entities that are controlled or jointly controlled by either 2 or 3 above.

Entities related to council

This classification will include any entity that is either controlled, jointly controlled or which a council has significant influence over. In determining whether an entity is related to a council the criteria outlined in AASB 10 *Consolidated Financial Statements* (AASB 10), AASB 11 *Joint Arrangements* (AASB 11) and AASB 128 *Investments in Associates and Joint Ventures* (AASB 128) are to be applied.

These entities will, typically, have been identified as part of the financial statement preparation process and will be disclosed in the notes relating to investments in joint ventures, associates and subsidiaries.

All subsidiaries as well as investments in Regional Library Corporations will meet the definition of a related party.

Key Management Personnel

AASB 124 defines Key Management Personnel (KMP) as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly.

AASB 124 (Aus 9.1) specifically includes Councillors as part of the definition of KMP.

Within a council it is expected that Key Management Personnel would normally include:

- All councillors;
- The Chief Executive Officer; and
- The next level of management (Directors/General Managers).

Notwithstanding these categories it is possible that lower levels of management in councils to be included. This would be the case where it is demonstrated that they are responsible for planning, directing and controlling the activities of council. Each council must make an assessment for all their staff based on the definition in AASB 124.

In determining what members of management are to be included as KMP consideration should be given to the organisational structure, level of delegation, position descriptions and responsibilities.

Close family member of a member of KMP

A family member of a KMP, who may be expected to influence or be influenced by that KMP, is also a related party to a council. These individuals are referred to as Close Family Members.

Close Family members include:

- *A KMP's children and spouse or domestic partner;*
- *children of a KMP's spouse or domestic partner; and*
- *dependants of a KMP or that person's spouse or domestic partner.*

Note that the above list is not exhaustive and that other, more distant family members would meet the definition of a related party (of council) if it is reasonable to expect that they may influence or be influenced by the KMP. In many cases this could be

expected to capture the parents, siblings and other relatives of the KMP.

A spouse or child of a KMP, employed, in a completely arm's length process, by council, would meet the definition of a related party. Accordingly, their remuneration, and associated leave balances would meet the definition of related party transactions and balances.

It is expected that councils will be required to provide all KMP with sufficient information, including training where appropriate, regarding the definition of a related party to enable informed disclosures to be made. In addition, councils would be expected to critically review disclosures of related parties by KMP and where uncertainty existed make appropriate enquiries of KMP to satisfy themselves of the completeness of information provided.

Entities controlled or jointly controlled by a KMP or their close family members

Any entity, regardless of legal form or purpose, that is controlled or jointly controlled by a KMP or Close Family Member of a KMP is a related party (of council). The control and joint control criteria detailed in AASB 10 and AASB 11 are to be applied in determining whether an entity is a related party of council.

Entities are not limited to corporate or business activities and can include clubs, associations and sporting groups. Careful consideration will need to be given to other positions held by KMP and their close family members to determine if they have the ability to control or jointly control the entity (business, club, association, etc).

Membership of a governing board of a club or association by a KMP or close family member of a KMP would not in itself be evidence of control or joint control of that club. It would need to be demonstrated that the KMP (or close family member) had the ability to control, or jointly control the club or association prior to concluding it was a related party of council.

Importantly, this test is not equivalent to the existence of an interest in a club or association. The employment of a KMP or close family member of a KMP by an entity that transacts with council does not in itself result in those transactions meeting the definition of a related party transaction. For this to occur the KMP (or close family member) needs to

be employed in a position that has control or joint control of the entity.

For example, if the Chief Executive Officer's (CEO) spouse is employed as a salesperson in a large hardware store that provides building material to council, the hardware store is unlikely to be a related party as the CEO's spouse would not have the ability to control or jointly control the entity. In contrast if the CEO's spouse owned and operated a local newsagent then the newsagent would most likely be a related party of council as the spouse would have the ability to control the operations of the newsagent.

Senior Officers

A senior officer is an employee of council who has management responsibilities and reports directly to the CEO **or** whose total annual remuneration package is in excess of \$142,000 and **is not** a KMP.

Note that it is the total annual remuneration that determines if an officer is a senior officer, regardless of the actual remuneration paid in the period.

Remuneration

Under AASB 124 remuneration is classified as either:

- Short-term employee benefits;
- Post-employment benefits;
- Other long-term benefits;
- Termination benefits; and
- Share-based payment.

It is not expected that KMP of council (or senior officers) would receive post-employment benefits or share based payment. Notwithstanding this, preparers should familiarise themselves with the definitions of these payments under AASB 124.

Short-term benefits include wages, salaries, councillor allowances (not reimbursements), paid annual leave and paid sick leave, employer funded superannuation contributions, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as housing, cars and free or subsidised goods or services).

Long-term benefits include long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are

not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation.

Termination benefits include any other payment made on termination in relation to the position.

Acting and Part Year Appointments

This guidance adopts a person based approach to the disclosure of KMP and senior officers.

In relation to management positions (including the CEO) disclosures required relate to persons and not positions. Nevertheless, if more than one person holds a specific position during the period it is expected that, where this has a significant impact on the disclosure, appropriate narrative would be included to explain the situation.

Generally, if a person is acting in a position that is currently filled (i.e. covering a period of annual leave) they are not to be included as a KMP or senior officer. An exception to this is where the officer in the acting role is doing so because the nominal holder of the position is acting in a vacant position. If a person is acting in a vacant position that person is generally to be included (for the period of acting). Professional judgement should be exercised when assessing acting arrangements and factors such as the types of decisions the person can make while acting (eg. the power to sign major contracts) should be considered.

All personnel holding KMP positions, whether acting or not, are to be considered when determining related parties. Where a person (management or councillor) is not a KMP for the full period, related parties are only considered during the period that they hold a KMP position.

Note that where Councillors occupy their role for only a portion of the financial year (for example during an election year) appropriate processes are required to capture the relevant related party information.

Example

Large City Council has a CEO and 3 directors. Along with 6 councillors this makes a total of 10 KMP positions.

During the year the following events occurred:

- A general election was held on 22 October resulting in 4 councillors being returned and 2 new councillors being elected;
- The CEO resigned on 1 January;
- The Director Corporate and Community Services acted in the CEO role until an external appointment was made on 1 March; and
- A senior officer acted in the role of Director Corporate and Community Services for the period 1 January – 1 March.

These events would result in the following numbers of KMP being disclosed:

- Councillors (detailed by name) 8, being 6 at start of year and 2 newly elected;
- Non-Councillors 6, being 4 at start of year, new CEO and Acting Director.

Although the position the Acting Director held was filled by another officer, the Acting Director is included in KMP as the reason for the acting was the vacant CEO position.

Total remuneration paid to all 14 individuals would be disclosed in aggregate and by bands of \$10,000.

Disclosure requirements – Related Parties

The following disclosure is required for related parties:

Details of Parent, Subsidiaries and Associates

Details of the parent along with a list of each subsidiary and associate, along with a cross reference to where details of the subsidiaries and associates are disclosed are to be disclosed.

Details of KMP

A table detailing (by name) each Councillor and their period of office along with the number of management personnel included in the KMP classification.

Remuneration of KMP

A table detailing in aggregate remuneration, classified as short-term employee benefits, long-term employment benefits and termination benefits. Further a table detailing the individual total remuneration for each KMP, in increments of \$10,000, is to be included.

Transactions with related parties

This section is to disclose two groups of transactions. The first are, to the extent that they are not detailed in other subsidiary or joint venture disclosures, details of transactions with subsidiaries and other jointly controlled operations. The second are those related to transactions between council and:

1. *Key Management Personnel;*
2. *Close family members of Key Management Personnel; and/or*
3. *Entities controlled or jointly controlled by 1 or 2.*

Details of all material transactions (revenue and expenditure) between council and related parties, grouped by transaction type, are to be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of council.

The threshold for separate disclosure of a transaction (or group of transactions) is significant, not material. Given this it is likely that relatively low value transactions could be deemed significant if they were deemed of public interest.

Materiality must be considered in terms of both the nature and value of the transactions. This guidance takes the view that any related party transaction, other than those detailed in the following paragraph, is material and evidence would need to be provided to rebut the assumption that the disclosure of such transactions is of importance to the users of the financial report.

Transactions between council and related parties that are typical to any citizens and undertaken in the normal course of council operations and at arm's length, such as payment of rates or other fees and charges, do not require disclosure as related party transactions.

Outstanding balances

All balances (receivable or payable) relating to transactions with related parties are to be disclosed. As with transactions any individually significant balances will require separate disclosure.

Loans and commitments

If any loans have been made to or received from a related party, or if a council has entered into contractual commitments with a related party, these must also be disclosed.

Disclosure requirements – Senior Officers

A senior officer is not a KMP and therefore the related party disclosure requirements do not apply. Nevertheless, a note is to be included in the financial report detailing the number of senior officers summarised in bands of \$10,000.

References

AASB 124 Related Party Disclosures Public Sector Not-For-Profit Entities (CPA Australia) available at

https://www.cpaaustralia.com.au/~/_media/corporate/allfiles/document/professional-resources/public-sector/aasb-124-related-party-disclosure-questionnaire-for-the-personal-sector.pdf?la=en

Australian Accounting Standard AASB 124 *Related Party Disclosures* available at

http://www.aasb.gov.au/admin/file/content105/c9/AA_SB124_07-15.pdf

Australian Accounting Standard AASB 10 *Consolidated Financial Statements* available at

<http://www.aasb.gov.au/Pronouncements/Current-standards.aspx>

Australian Accounting Standard AASB 11 *Joint Arrangements* available at

<http://www.aasb.gov.au/Pronouncements/Current-standards.aspx>

Australian Accounting Standard AASB 128 *Investments in Associates and Joint Ventures* available at

<http://www.aasb.gov.au/Pronouncements/Current-standards.aspx>

