Summary of ASPE 3840 – Related Party Transactions
Scope

This section applies to the measurement and disclosure of related party transactions in the financial statements of profit-oriented enterprises.

This section does not apply to management compensation arrangements, including employee future benefits (ASPE 3461), expense allowances and other similar payments, including loans and receivables, to individuals, in the normal course of operations.

Key definitions

**Related parties** exist when one party has the ability to exercise, directly or indirectly, control, joint control or significant influence over the other. Two or more parties are related when they are subject to common control, joint control or common significant influence. Related parties also include management and immediate family members.

*A related party transaction* is a transfer of economic resources or obligations between related parties or the provision of services by one party to a related party regardless of whether any consideration is exchanged.

Note: The parties to the transaction are related prior to the transaction. When the relationship arises as a result of the transaction, the transaction is not one between related parties.

*An ownership interest* in an item transferred or the benefit of a service provided exists when an enterprise has the right and ability to, directly or indirectly, obtain future economic benefits from the item transferred or the service provided.

Identification of related parties

Management shall make reasonable efforts to identify all related parties. Circumstances that might indicate the existence of related parties include abnormal terms of trade or transactions not normally entered into by the reporting enterprise.

Examples of the most commonly encountered related parties of a reporting enterprise:

- An enterprise that directly, or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, the reporting enterprise;

- An individual who directly, or indirectly through one or more intermediaries, controls the reporting enterprise;

- Management: any person(s) having authority and responsibility for planning, directing and controlling the activities of the reporting enterprise

The section includes more examples of the most commonly encountered related parties of a reporting enterprise, these can be found in S3840.04.
Measurement

Related party transactions are measured at either:

- **Exchange Amount** = The amount of consideration paid or received as established and agreed to by related parties.
- **Carrying amount** = The amount of an item transferred, or cost of services provided, as recorded in the accounts of the transferor, after adjustment, if any, for amortization or impairment in value.

A monetary related party transaction or a non-monetary related party transaction is measured at the carrying amount, UNLESS:

- The transaction has commercial substance AND:
  - Occurs in the normal course of operations EXCEPT:
    - a non-monetary related party transaction that is an exchange of a product or property held for sale in the normal course of operations for a product or property to be sold in the same line of business, to facilitate sales to customers other than parties to the exchange, is measured at the carrying amount of the asset given up adjusted by the fair value of any monetary consideration received or given.

- Does NOT occur in the normal course of operations AND:
  - The change in ownership interests in the item transferred or the benefit of a service provided is substantive; and
  - The exchange amount is supported by independent evidence.

See the diagram at the end of this publication for a graphical summary of the measurement rules.

**Carrying Amount**

*Recording differences between carrying amounts of items exchanged*

When related party transactions are measured at carrying amount, any differences between the carrying amounts of items exchanged, together with any tax amounts related to the items transferred, shall be included as a charge or credit to equity.

Example:

Entity A transfers an investment portfolio at its carrying amount of $1,000, to related party, B, in exchange for property carried at $700 in Entity B’s records. Entity A records the property received at $700 and Entity B records the investment portfolio received at $1,000. The difference is accounted for in equity, as noted above. A net credit is a capital contribution and is credited to contributed surplus. A net debit is an equity distribution and is charged against any existing credit balance in contributed surplus arising from previous related party transactions, with any excess charged against retained earnings.
The journal entries recorded would be:

<table>
<thead>
<tr>
<th>Debit (Dr)</th>
<th>Credit (Cr)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property</td>
<td>$700</td>
</tr>
<tr>
<td>Contributed Surplus</td>
<td>$300</td>
</tr>
<tr>
<td>Investments</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

*Recording the transaction in Entity A’s records*

<table>
<thead>
<tr>
<th>Debit (Dr)</th>
<th>Credit (Cr)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments</td>
<td>$1,000</td>
</tr>
<tr>
<td>Contributed Surplus</td>
<td>$300</td>
</tr>
<tr>
<td>Property</td>
<td>$700</td>
</tr>
</tbody>
</table>

*Recording the transaction in Entity B’s records*

**Why are transactions not recognised at fair value?**

Fair value measurement assumes that transaction amounts are arrived at by parties dealing at arm’s length. As related parties do not deal at arm’s length, a transaction between related parties cannot be presumed to have been at fair value.

**Exchange Amount**

Key Concepts = “Commercial Substance” and “In the normal course of operations”

**Commercial Substance**

When non-monetary related party transaction occurs, it is measured at the exchange amount when it has commercial substance. A non-monetary asset has commercial substance when the entity’s future cash flows are expected to change significantly as a result of the transaction.

The assessment of whether the entity’s future cash flows are expected to change significantly can be made using either quantitative or qualitative factors. Quantitative factors include:

- Changes in the configuration (risk/timing/amount) of the future cash flows;
- Entity-specific value of asset received differs from entity-specific value of asset given up. Entity-specific values are different from fair values as an entity-specific value captures the value of an item in the context of the reporting entity rather than the use assumed by market participants.

**In the Normal Course of Operations**

A related party transaction is presumed to NOT be in the normal course of operations when it is not of a type that is usually or frequently undertaken by the enterprise for the purpose of generating revenue.

Transactions with related parties that are in the normal course of operations usually occur within a normal business relationship and on terms and conditions that are similar to those of transactions with unrelated parties. Generally, items exchanged in the normal course of operations by related parties are subsequently transferred to unrelated parties within a normal operating cycle and therefore the exchange amount is confirmed.
However, when the transaction is not in the normal course of operations, it is only measured at the exchange amount when:

- The change in ownership interests in the item transferred or the benefit of a service provided is substantive; and
- The exchange amount is supported by independent evidence.

<table>
<thead>
<tr>
<th>Change in ownership interests</th>
<th>Independent Evidence</th>
</tr>
</thead>
</table>

- A change in ownership interests in the item transferred or service provided must be substantive;
- When there is a change in ownership interests, the ability to obtain future economic benefits also changes and in order to justify recognition of the transaction at the exchange amount, there must be a change in the continuity of influence over the item transferred or the beneficial interests of a service provided.
- The greater the change in ownership interests, the more likely the change is substantive.
- Independent evidence in support of the use of an exchange amount includes at least one of the following:
  - Independent appraisals, valuations or approvals, by appropriately qualified parties not related to the enterprise;
  - Comparable recently quoted market prices in an open and unrestricted market;
  - Comparable independent bids on the same transaction; or
  - Comparable amounts of similar transactions actually undertaken with unrelated parties.

Change in the continuity of influence occurs when:

- The nature of the relationship of the transferor to the item transferred changes – for example from control to joint control; or
- The residual equity ownership interest of the item transferred changes by at least 20%.

Examples – transfers between entities under common control:

1. Changes in legal title

An item is transferred between two subsidiary companies, both wholly-owned by the same parent;

Although legal title to the item transferred may have changed, there has been no change in the ownership interests in the item transferred and, accordingly, the transfer is accounted for at the carrying amount of the item transferred.

2. Transfer of a business

   a) If the required criteria of the transaction being a substantive change supported by independent evidence are met, then the transaction is measured at the exchange amount and the business combination is accounted for in accordance with S1582.
   b) If the above criteria are not met, the acquiring enterprise records assets and liabilities acquired at their carrying amount and, if appropriate, recognizes a non-controlling interest. Changes in non-controlling interests are recognized as equity transactions, in accordance with S1602.
Gains and losses

Any gain or loss resulting from a related party transaction measured at the exchange amount is included in income for the period, unless another section requires an alternative treatment.

Non-monetary related party transactions without commercial substance and not in the normal course of business

Non-monetary related party transactions that do not have commercial substance and are not in the normal course of operations are measured at the carrying amount regardless of whether the transaction results in a substantive change supported by independent evidence.

Specific Considerations

Consolidation and equity accounting

- Gains and losses arising in combining entities as a result of a business combination between related parties are reversed on consolidation.

- A transaction between a parent and a subsidiary resulting in a difference between carrying amount in the subsidiary and the amount at which the item or service received is measured requires adjustment on consolidation so as to reflect any non-controlling share of the difference.

- Similarly, a transaction between an investor and its significantly influenced investee requires adjustment, when the equity method of accounting is used, of the investor’s equity for the difference between the investee’s carrying amount and the amount at which the item or service received is measured in the investee.

Financial instruments

When a financial instrument as defined is created or transferred in a related party transaction, the transaction is measured at either the carrying amount or at the exchange amount, dependent on the conditions of the transaction (refer above), with the exception of a transaction between an entity and a person or an entity whose sole relationship with the entity is in the capacity of management (accounted for in accordance with section 3856, Financial Instruments).
Disclosure

An enterprise shall disclose the following information about its transactions with related parties:

- a description* of the relationship between the transacting parties;
- a description* of the transaction(s), including those for which no amount has been recognized;
- the recognized amount of the transactions classified by financial statement category;
- the measurement basis used;
- amounts due to or from related parties and the terms and conditions relating thereto;
- contractual obligations with related parties, separate from other contractual obligations; and
- contingencies involving related parties, separate from other contingencies.

*Descriptions must be in sufficient detail so as to accurately convey the nature of the relationship and the significance of the transaction to the reporting enterprise.

Related party transactions may be entered into on the same terms as if the parties were unrelated, or they may be entered into on terms differing from those that might have prevailed if the parties had been unrelated to one another. Without disclosure of information about related party transactions, financial statement readers would be justified in assuming that the transactions reported in the financial statements took place at prices bargained with unrelated parties.

Information about related party transactions is often of more significance to a financial statement user than information about unrelated party transactions, regardless of the size of such transactions. When considering disclosure of related

Further resources

Detailed examples are included in the Handbook section which cover:

- Accounting for related party transactions
  - Tax Aspects of related party transactions:
  - Transactions without special tax elections
- Transactions with section 85 rollover election
- Application of disclosure requirements
- Measurement of financial assets and financial liabilities arising from related party transactions
Tying it all together – illustrative decision tree

A - Carrying amount is used for both monetary and non-monetary transactions in these circumstances.

B - In rare circumstances, when the carrying amount of the item received is not available, a reasonable estimate of the carrying amount, based on the transferor’s original cost, may be used to measure the exchange.
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