

Issues Paper

Related Party Transactions — Recognition and Measurement

Prepared by:
Public Sector Accounting Board

October 2011

Comments are requested by November 14, 2011

PSAB

Commenting on this Issues Paper

This Issues Paper is issued by the Public Sector Accounting Board. The members of the Board are drawn from government, public accounting practice, business and academe. All members serve as individuals, not as representatives of their governments, employers or organizations.

This Issues Paper presents key principles that the Board expects to include in a future exposure draft.

Individuals, governments and organizations are invited to send written comments to the Board on this Issues Paper. Comments are most helpful if they clearly identify the preferred alternative supported by their reasoning.

All comments received will be available on the website at www.psab-ccsp.ca shortly after the comment deadline, unless confidentiality is requested.

For your convenience, a PDF [response form](#) has been posted with this document that can be downloaded here. You can save the form both during and after completion for future reference. You are not restricted by the size of the interactive comment fields in the response form and there is also a general comments section.

Alternatively, you may send written comments by e-mail in Word format to:
ed.psector@cica.ca

To be considered, comments must be received by November 14, 2011, addressed to:

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Highlights

The Public Sector Accounting Board (PSAB) proposes, subject to comments received on this Issues Paper and following its due process, to expose a proposed new Section on related party transactions. The Section would apply to governments and those government organizations that base their accounting policies on the CICA Public Sector (PSA) Handbook.

This Issues Paper seeks your views on recognition and measurement of related party transactions in separate financial statements of public sector entities. You are asked to consider and comment on the issues identified. In order to assist PSAB understand the nature and breadth of related party transactions encountered by public sector entities, you are also asked to provide specific practical examples of related party transactions as well as current accounting practice in regard to their recognition and measurement in separate financial statements.

This Issues Paper should be read in conjunction with the Invitation to Comment, “Related Party Transactions — Definition and Disclosure.” The Invitation to Comment seeks comments from stakeholders on PSAB’s preliminary views on the definition of related parties and the disclosure of related party relationships and transactions.

Main features

The main features of this Issues Paper are as follows:

- Issues of recognition and measurement generally arise when related party transactions occur between entities that are part of the same reporting entity.
- Related party transactions would be recognized when they involve the transfer of an asset or liability between related parties in order that financial statements provide an accounting of the assets that a public sector entity controls or obligations that will result in future sacrifice of economic resources.
- Two approaches have been considered for a standard on related party transactions:
 - exclude measurement standards, which would mean transactions would be reported at whatever value is determined by government policy or the related parties unless there is a specific existing standard that stipulates how such transactions should be measured; or
 - include measurement standards, taking a similar approach to RELATED PARTY TRANSACTIONS, Section 3840 of the CICA Handbook – Accounting.

Comments requested

PSAB welcomes comments on all aspects of the Issues Paper. Comments are most helpful if they relate to a specific issue, paragraph or group of paragraphs and, when expressing an opinion as to a preferred accounting and reporting alternative, an explanation of how it is consistent with the application of the concepts described in FINANCIAL STATEMENT CONCEPTS, Section PS 1000 and objectives described in OBJECTIVES OF FINANCIAL STATEMENTS, PS 1100.

PSAB is also seeking information as to how those affected related parties currently account for related party transactions. To aid PSAB in gaining this understanding, readers are asked to provide specific examples of related party transactions involving either the exchange of goods and services or the transfer of assets and liabilities. It would also be helpful if readers describe the current accounting practices related to recognition and measurement of the transactions in separate financial statements.

In particular, respondents are requested to provide responses to the following questions, including reasons for agreeing or disagreeing:

1. Considering the nature and extent of the issues, should a standard on related party transactions include guidance concerning recognition and measurement of related party transactions?
2. Do you agree that when there is a policy of central management of assets and liabilities, only the provider organization would recognize the assets and liabilities?
3. Do you agree that when there is a policy of decentralized management, the recipient organization would only recognize the assets and liabilities for which it is responsible?
4. Do you agree that if a related party transaction involves the transfer of an asset or liability, both the provider and recipient organization would recognize the transaction in their separate financial statements?
5. Do you agree that when a transaction involves the provision of services by one party to a related party and there is a policy of allocating costs:
 - (a) the provider organization accounts for the assets and liabilities and recognizes all revenues and expenses associated with the provision of a good or service on a gross basis; and
 - (b) the recipient organization would identify and report the expense at gross amounts in its separate financial statements?
6. Should contributed goods and services be recognized in separate financial statements and, if so, how should they be reported?
7. Should the standard on related party transactions include measurement standards? If so, should the standard adopt a similar approach to Section 3840, in that transactions would be reported at carrying amount unless they occur in the normal course of operations or have commercial substance?

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PURPOSE

- .01 The purpose of this Issues Paper to seek feedback on the recognition and measurement of transactions that occur between related parties using the CICA Public Sector (PSA) Handbook as their primary source of generally accepted accounting principles. PSAB has concurrently issued an Invitation to Comment, “Related Party Transactions — Definition and Disclosure”. That document should be read in conjunction with this Issues Paper. Any proposals that result from this Issues Paper would apply to those entities that, for the purposes of their financial reporting, are required or choose to base their accounting policies on the PSA Handbook. It does not apply to government business enterprises or other entities that adhere to the standards applicable to publicly accountable enterprises in Part I of the CICA Handbook – Accounting.
- .02 Entities produce many kinds of financial reports in addition to general purpose financial reports. These reports may be prepared by individual entities to comply with legislation or to measure and report on the performance of individual funds, programs and activities. They may be special purpose reports designed to meet particular needs of specific users.
- .03 The PSA Handbook does not discuss objectives of the applicable financial reporting framework for the preparation and presentation of special purpose financial statements or other financial reports published by an entity. The standards in the PSA Handbook are designed to apply to the general purpose financial statements of all public sector entities. General purpose financial statements are financial statements designed to meet the common information needs of external users of financial information about a government. Nevertheless, an entity preparing a special purpose report is not precluded from applying these proposals.

NEED FOR A STANDARD

- .04 Governments establish individual policies regarding related party arrangements that reflect policy objectives, accountability structures and budgetary practices. These related party arrangements often result in the control, accounting and benefit/loss related to an item to occur in separate entities. This raises a question of whether an item should be recognized by the recipient entity. For example, one government department may provide accommodation for other departments and agencies at cost, below cost or without charge.
- .05 A related party transaction is defined as a transfer of economic resources or obligations between related parties, or the provision of services by one party to a related party. Therefore, exchanges of these types are related party transactions whether or not there is an exchange of consideration or transactions have been given accounting recognition. The issue that arises is the extent to which these types of related party transactions are recognized in the separate financial statements of both the providing and recipient entities.

- .06 Other authoritative standard setters do not require recognition in financial statements of related party transactions that have not been given accounting recognition. Their objective is to ensure that an entity's financial statements contain the disclosures necessary to draw the attention of users to the possibility that its reported financial position and performance may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties.
- .07 Disclosure in notes or schedules of related party transactions that occur, and the terms and conditions on which they were conducted, may achieve the common objective of a standard on related party transactions (i.e., providing users with relevant information they need to assess the impact of those transactions on the financial position and performance of an entity). However, PSAB questioned whether disclosure of information about the nature of transactions and the fact that no consideration has been received or paid was useful to explain the effect of the transactions on the reporting entity's financial position and performance. Should the value of the benefit received be included in disclosures and, if so, how should they be measured? If such transactions can be measured for disclosure purposes, the question then becomes, should they not be given accounting recognition?
- .08 PSAB has considered the various arguments against a requirement to recognize related party transactions.
- (a) There are limitations on what a financial reporting standard setter should recommend regarding related party allocations of costs and revenues given that such allocations are an issue of government structure and policy.
 - (b) Standards should not influence the way governments are organized nor dictate policy objectives, accountability structures and budgetary practices.
 - (c) An entity should report expenses in its separate financial statements only when charged for goods and services by the provider and the expenses should be recognized at the exchange amount.
 - (d) If a public sector entity does not pay for goods and services, it should not recognize those transactions in its financial statements. Disclosure tells users of financial statement where to look for additional costs (for example, if accommodation costs are not allocated, then readers know that the costs are not reported and they can go to the statements of the central agency for the information).
- .09 Others have argued that the objective is to report all of an entity's assets, liabilities, revenues and expenses. Without recognition of all related party transactions, expenses reported would not represent the total of resources consumed in delivering government goods and services in the period.
- .10 However, another contrary argument is made that users of separate financial statements are not able to rely on them as relevant information may be missing.

- .11 The PSA Handbook contains a number of principles that could be referenced to address measurement of transactions between related entities. The table in the Appendix to this Issues Paper contains a listing of those existing principles. This list is not exhaustive; the standards include other principles that apply to accounting for acquisitions and divestitures, as well as accounting for gains and losses prior to and subsequent to such events.
- .12 These principles, to a large extent, address the measurement of transactions between entities that are part of the public sector reporting entity and apply when a government is preparing its own consolidated financial statements. They do not necessarily address recognition and measurement of related party transactions in the separate financial statements of individual related entities.

Question 1

Considering the nature and extent of the issues, should a standard on related party transactions include guidance concerning recognition and measurement of related party transactions?

RECOGNITION

- .13 PSAB reviewed five broad policy options common to related party transactions:
- (a) central management of assets and liabilities;
 - (b) decentralized management of assets and liabilities;
 - (c) transfers of assets and liabilities
 - (d) cost allocation; and
 - (e) contributed goods and service.

Central management of assets and liabilities

- .14 A public sector entity may be subject to a policy whereby the government or another organization provides for central management of assets and liabilities used for, or as the result of, the provision of services of the reporting entity. For example, one government organization may be responsible for the provision of accommodation to other departments and agencies. The providing organization is responsible for the management of real property and assumes the benefits and risks associated with the assets.
- .15 In this case, the provider organization recognizes the assets and liabilities in its separate financial statements when an item satisfies the definitions and meets the recognition criteria. This is because the provider organization controls the economic resources from which future economic benefits are expected to be obtained. Similarly, the provider organization would also recognize the centrally managed liabilities when and if that organization issues its own financial statements.

- .16 The recipient organization would only recognize those assets and liabilities meeting the definitions of them in its separate financial statements. The assets under central management are not controlled by the recipient organization even though the organization may receive future economic benefits from them. Similarly, centrally managed liabilities are not present obligations of a recipient organization.
- .17 For example, the recipient organization's employees may participate in a multiemployer defined benefit pension plan sponsored by the government. The plan is administered by a central agency of the government. The recipient organization would not account, and report obligations, for employee retirement benefits in its own financial statements.
- .18 The expense recorded in the statement of operations of the recipient entity, given the pension plan is a multiemployer plan, is the required contribution of the accounting period. A liability would be recorded in the statement of financial position of the recipient for the difference between the amount of the required contribution and the amount that was contributed to the financial statement date in accordance with RETIREMENT BENEFITS, Section PS 3250.

Question 2

Do you agree that when there is a policy of central management of assets and liabilities, only the provider organization would recognize the assets and liabilities?

Decentralized management of assets and liabilities

- .19 A public sector entity may be subject to a government policy that provides for decentralized management of assets and liabilities. In such cases, the reporting entity would determine whether it has an asset or liability that satisfies the definitions and recognition criteria. In the case of an asset, it would also assess whether it has assumed all the benefits and risks of ownership. Similarly, it would assess whether it has assumed a present obligation. In both cases, it would report any related asset and liability in its own financial statements.

Question 3

Do you agree that when there is a policy of decentralized management, the recipient organization would only recognize the assets and liabilities for which it is responsible?

Transfers of assets and liabilities

If a related party transaction involves the transfer of an asset or liability, both the provider and recipient organization should recognize the transaction. This is consistent with FINANCIAL STATEMENT OBJECTIVES, Section PS 1100, that states

financial statements should provide an accounting of the full nature and extent of the financial affairs and resources that the entity controls.

- .20 The provider organization derecognizes the asset or the liability. The recipient organization recognizes an asset or liability. An asset is recognized by the recipient and derecognized by the provider when control of the economic resources and substantially all the benefits and risks of ownership have been transferred to the recipient. A liability should be recognized by the recipient and derecognized by the provider when the recipient has assumed a present obligation to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits.

Question 4

Do you agree that if a related party transaction involves the transfer of an asset or liability, both the provider and recipient organization would recognize the transaction in their separate financial statements?

Cost allocation

- .21 A related party transaction may involve a provision of services by one party to a related party. For example, a central agency may be responsible for provision of information services to other organizations. The organization may be subject to a government a policy of allocating the costs of services to recipient organizations.
- .22 In this case, the provider organization accounts for the assets and liabilities. Among other things, it recognizes all revenues and expenses associated with the provision of information services.
- .23 One related issue is whether the revenues and expenses of the provider organization would be reported gross or on a net recovery basis. Showing the gross revenues and costs of providing goods or services helps users to understand the full extent of the providing organization's operations.
- .24 Whether the reporting is to be done on a gross or net basis can be a matter of professional judgment and would consider whether the organization acts as principal as opposed to an agent or broker in the transactions; has benefits and risks of ownership; and is primarily responsible for providing the good or service required by the recipient organization.
- .25 A strong indicator that the entity acts as an agent or broker is if a supplier or other third party entity is responsible for providing the good or service desired by a recipient organization. In such a case, net reporting may be appropriate.
- .26 The recipient organization would recognize the expense in its separate financial statements. Expenses would be identified and reported at gross amounts in arriving at surplus or deficit for the period.

Question 5

Do you agree that when a transaction involves the provision of services by one party to a related party and there is a policy of allocating costs:

- (a) the provider organization accounts for the assets and liabilities and recognizes all revenues and expenses associated with the provision of a good or service on a gross basis; and
- (b) the recipient organization would identify and report the expense at gross amounts in its separate financial statements?

Contributed goods and services

- .27 It is not unusual for government to establish a policy that certain activities are undertaken by central organizations to support the activities of other departments and agencies. For example, a central agency may be responsible for the debt management, pension administration, procurement and other administrative services that apply across all government organizations with the objective of achieving efficiencies.
- .28 The government may have a policy of funding the expenses related to these common services through appropriations or other revenue sources and not allocating the costs to individual organizations within the public sector reporting entity. However, contributed goods or services between government organizations are a related party transaction whether or not the transactions have been given accounting recognition.
- .29 The provider organization accounts for assets and liabilities and related expenses. Two options have been considered for reporting by the recipient organization in its separate financial statements as follows:
 - (a) disclosure only without recognition of the expense; or
 - (b) recognition of the expense.
- .30 FINANCIAL STATEMENT CONCEPTS, Section PS 1000, states that elements of financial statements include assets, liabilities, revenues and expenses. Revenues and expenses are linked to and measure the change in assets and liabilities for a period. The Section does not specifically address contributed goods and services. Nevertheless, as contributed goods and services would not result in a change in assets or liabilities, they would not meet the definition of revenues or expenses under the Section.
- .31 There is existing GAAP that, while not dealing specifically with non-reciprocal transfers of assets, provides an accounting model that is consistent with the objectives of financial statements. CONTRIBUTIONS – REVENUE RECOGNITION, Section PS 4210, states that an organization may choose to recognize contributions of materials and services, but it should only do so when a fair value can be reasonably estimated and when the materials and services are used in the normal course of the organization's operations and would otherwise have been

purchased. The US Financial Accounting Standards Board's Statement of Financial Accounting Standards (FAS) 116, "Accounting for Contributions Received and Contributions Made," is similar to Section PS 4210, except that it applies to all entities (not-for-profit organizations and business enterprises) that receive or make contributions.

- .32 A standard on recognition could adopt a definition of contributed goods and services that is consistent with that of other standard setters. That is, contributed goods and services are used in the normal course of operations of a recipient and which would otherwise have to be purchased.

Question 6

Should contributed goods and services be recognized in separate financial statements and, if so, how should they be reported?

MEASUREMENT

- .33 An exchange of assets or liabilities between related parties, or the provision of services by one party to a related party, could be accounted for under various bases of measurement. The alternative bases of measurement include:
- (a) the carrying amount;
 - (b) the exchange amount; or
 - (c) fair value.
- .34 Other authoritative standard setters do not include measurement in their standards on related party transactions. Only RELATED PARTIES TRANSACTIONS, Section 3840 of the CICA Handbook – Accounting includes measurement of related party transactions within its scope.
- .35 In the absence of standards, related party transactions may be reported at whatever value is determined by the related parties unless there is a specific existing standard that stipulates how such transactions should be measured. For example, IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, requires that an asset acquired through a non-exchange transaction is initially measured at its fair value as at the date of acquisition.

Carrying amount

- .36 Under Section 3840, generally, transactions between related parties are to be measured at the carrying amount of an item transferred or service provided. The carrying amount is the amount of an item transferred, or cost of services provided, as recorded in the accounts of the transferor, after any necessary adjustments, such as write-downs. Using carrying amount also reduces any consolidation adjustment necessary for producing government-wide summary financial statements.

- .37 The intention of using the carrying amount is that the amount attached to the item transferred or the cost of the service provided is retained. The CICA Accounting Standards Board (AcSB) argues that in a historical cost, transaction-based accounting model, it is generally presumed that a transaction amount arrived at by parties dealing at arm's length initially represents the fair value of the items exchanged. As related parties do not deal at arm's length, a transaction between related parties cannot be presumed to have been entered into at "fair value". Related parties may have flexibility in the price-setting process and may enter into transactions that unrelated parties would not necessarily enter into. Therefore, an item transferred or the cost of the service provided between related parties should be measured at the carrying value which retains the amount attached to the item or the cost of the services provided. Any differences in carrying amounts of the items exchanged would be accounted for in accordance with FINANCIAL CONCEPTS, Section PS 1000.
- .38 The AcSB based the standards in Section 3840 on the premise that when the continuity of interest in an item transferred, or the beneficial interests of a service provided has not changed, the transaction has insufficient substance to justify a change in measurement for financial reporting purposes and, hence, its carrying amount is retained. In a corporate relationship, a related party transaction may result in a change in the legal title of an item exchanged without a substantive change in the equity ownership interests in the item. The continuity of interest over the item transferred is retained and, therefore, the carrying amount is also retained. For example, when an item is transferred between two subsidiary companies, both wholly owned by the same parent, although the 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.

Exchange amount

- .39 According to Section 3840, a change in the carrying amount of the item transferred or service provided is only justified when the transaction is a monetary transaction occurring in the normal course of operations. In such circumstances, it may be measured at the exchange amount. For private sector entities the exchange amount may differ from the carrying amount due to profit taking by the provider. For example, the sale of an inventory item from one related party to another may take place at a cost-plus value. In these situations, it is not necessary, and may be impractical, to record the transactions at carrying amount.
- .40 In the public sector, profit taking is generally not the motive. However, there can be situations where such is the case and, therefore, this approach seems to apply. For example, public utility services may be provided to a related recipient organization on a cost-plus basis to ensure that the provider of the service is generating a return sufficient to repair and replace its own assets. Alternatively, there may be situations where the provider provides services on a below cost

basis. It may be impractical to record such transactions at carrying amount in the public sector and the exchange amount is more appropriate.

- .41 Similarly, for non-monetary transactions having commercial substance, Section 3840 requires that they too be measured at the exchange amount when they are in the normal course of operations.
- .42 NON-MONETARY TRANSACTIONS, Section 3831 in Part II of the CICA Handbook – Accounting, defines non-monetary transactions as either:
- (a) non-monetary exchanges, which are exchanges of non-monetary assets, liabilities or services for other non-monetary assets, liabilities or services with little or no monetary consideration involved; or
 - (b) non-monetary non-reciprocal transfers, which are transfers of non-monetary assets, liabilities or services without consideration. Non-reciprocal transfers include, but are not limited to, donations of non-monetary assets or services and the distribution of assets to owners in the liquidation of all or part of an entity.
- .43 A non-monetary related party transaction has commercial substance when the entity's future cash flows are expected to change significantly as a result of the transaction. The entity's future cash flows are expected to change significantly when:
- (a) the risk, timing and amount of the future cash flows of the asset received differs significantly from the configuration of the future cash flows of the asset given up; or
 - (b) the entity-specific value¹ of the asset received differs from the entity-specific value of the asset given up and the difference is significant in relation to the exchange amount of the items exchanged.
- .44 The AcSB focuses on projected future cash flows to determine whether a transaction has commercial substance. The AcSB holds that the use of projected cash flows is consistent with the underlying fair value principle; it will produce financial information that more faithfully reflects the economics of the exchange and it will be easier to apply consistently. Cash flow projections are often part of the decision-making process to enter into a transaction. It reflects information required by users of the financial statements. Users are interested in the amount, timing and risk of cash flows generated by the entity. Rather than focusing on the attributes of the assets being exchanged, the financial statements objectively capture the impact of changing cash flow expectations both in measuring the asset received and in recognizing any gain or loss on the asset given up.

¹ Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life, or expects to incur when settling a liability. Entity-specific value, resulting from entity-specific measurement, differs from fair value. It attempts to capture the value of an item in the context of the reporting entity. The entity uses its expectations about its use of the asset rather than the use assumed by marketplace participants.

- .45 The determination of commercial substance is used by other standard setters to determine whether non-monetary exchanges of assets should be measured at fair value. For example, IPSAS 17, *Property, Plant and Equipment*, requires that the cost of an item of property, plant, and equipment acquired in exchange for a non-monetary asset is measured at fair value unless the exchange transaction lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable.
- .46 Under Section 3840, a related party monetary transaction, or non-monetary transaction that has commercial substance, may be measured at the exchange amount when:
- (a) it is in the normal course of operations; or
 - (b) if not in the normal course of operations, the change in the ownership interests in the item transferred or the benefit of a service provided is substantive, and the exchange amount is supported by independent evidence.
- .47 A related party transaction that is in the normal course of operations occurs within a normal business relationship and on terms and conditions that are similar to those of transactions with unrelated parties. Matters to be taken into account when determining whether the operations are normal include: type and scope of operations; characteristics of the industry; operating policies of the enterprise; nature of products and services; and the environment in which the enterprise operates. Whether or not a transaction is in the normal course of operations is a question of fact. A related party transaction is presumed not to be in the normal course of operations when it is not of a type that is usually, frequently or regularly undertaken by the enterprise for the purpose of generating revenue.
- .48 Examples of transactions in the normal course of operations are: the sale or purchase of an inventory item; the provision or receipt of a recurring service including management and administrative services commonly shared by related parties; a lending activity undertaken by a financial institution, a sale or purchase of real estate by an enterprise that is in the business of selling real estate as part of its ongoing activities; and recurring investing activities by an investment company. The sale or purchase of assets that were not acquired for resale would be an example of a transaction not in the normal course of operations.

Fair value

- .49 Generally, other standard setters require that non-monetary transactions are recognized at fair value. IPSASB in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, states that measurement of a non-exchange transaction at its fair value is appropriate to reflect the substance of the transaction and its consequences for the recipient. Fair value most faithfully represents the actual value the public sector entity accrues as a result of the

transaction. It is consistent with the value that would accrue to an entity in an arm's length transaction between unrelated parties.

- .50 NON-MONETARY TRANSACTIONS, Section 3831 of the CICA Handbook – Accounting, establishes standards for the measurement and disclosure of non-monetary transactions. It requires an entity measure an asset exchanged or transferred in a non-monetary transaction at the more reliably measurable of the fair value of the asset given up and the fair value of the asset received, unless:
- (a) the transaction lacks commercial substance (see previous comments on indicators of commercial substance in paragraphs 44-45);
 - (b) the transaction is an exchange of a product or property held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange;
 - (c) neither the fair value of the asset received or given up is reliably measurable; or
 - (d) the transaction is a non-monetary non-reciprocal transfer to owners that represents a spin-off or other form of restructuring or liquidation.

An entity measures an asset exchanged or transferred in a non-monetary transaction that is not measured at fair value at the carrying amount (after reduction, when appropriate, for impairment) of the asset given up adjusted by the fair value of any monetary consideration received or given. An entity should recognize any gain or loss resulting from a non-monetary transaction in net income for the period.

- .51 International Financial Reporting Standards, issued by the International Accounting Standards Board, have similar requirements for an asset exchanged or transferred in a non-monetary transaction. IAS 16 *Property, Plant and Equipment* requires that when items of property, plant and equipment are acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost is measured at fair value unless the exchange transaction lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable. An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction.

- .52 GOVERNMENT TRANSFERS, Section PS 3410, works in tandem with TANGIBLE CAPITAL ASSETS, Section PS 3150, to require that the revenue and an asset transferred are both recognized at fair value by the recipient.

Analysis of alternative approaches

- .53 A standard on measurement of related party transactions could take one of two approaches:
- (a) include measurement standards based on an approach similar to the AcSB in Section 3840; or

- (b) exclude standards on measurement of related party transactions.

Exclude standards on measurement

- .54 Under this approach, related party transactions may be reported at whatever value is determined by government policy or the related parties unless there is a specific existing standard in the PSA Handbook that stipulates how such transactions should be measured. For example, if the transaction involved the transfer of a tangible capital asset, it would be reported at fair value by the recipient as a contributed asset in accordance with TANGIBLE CAPITAL ASSETS, Section PS 3150.
- .55 This approach may complicate the process for preparing and presenting financial statements. If transactions are reported at fair value, it may require the tracking of assets to the extent that assets transferred between entities within the reporting entity are still on hand at the reporting date in order to eliminate and gains and losses associated with the transfer of assets.

Include measurement standards

- .56 In support of this approach, it can be argued that when a transaction between public sector entities that are under the common control of the same government involves the transfer of an asset or liabilities, a substantive change in the consolidated interest in the item does not occur. This lack of change does not justify a change in measurement for financial reporting purposes and, hence, the carrying amount should be retained.
- .57 For example, the transfer of a tangible capital asset does not result in a substantive change to the extent that the consolidated government reporting entity can benefit directly from the asset to provide future net cash flows or to provide goods and services. The service potential that is its output or service capacity to the overall economic entity does not substantively change as a result of the transfer to justify a change in the carrying amount of the asset.
- .58 However, there may be circumstances when a change in the carrying amount of an asset or liability is justified. Similar to Section 3840, a measurement standard could provide the option that a related party transaction that involves the transfer of an asset be initially measured at the greater of carrying amount or exchange amount if the transaction has commercial substance. An entity determines whether a related party transaction has commercial substance by considering whether the recipient entity's future cash flows or service potential is expected to change significantly as the result of the transaction.
- .59 For example, a local government may transfer a parking facility to a parking authority. The parking authority will charge commercial rates for parking. In this case, a change in the value of the facility is justified since it will significantly

change the risk, timing and amount of the future cash flows associated with the asset received.

- .60 When a transaction involves the transfer of an item or provision of a service in the normal course of operations, it is not necessary, or practical, to record the amount of a transaction at the carrying amount. A related party transaction that is in the normal course of operations occurs within a normal business relationship and on terms and conditions that are similar to those of transactions with unrelated parties. In such cases, it is likely that the exchange amount would approximate fair value that would have been arrived on an arm's length basis. The accompanying Invitation to Comment proposes that disclosure of information about related party transactions that occur in the normal course of operations is not required.
- .61 Under this approach, when a transaction between public sector entities under the common control of the same public sector entity that is not in the normal course of operations involves a provision of goods or services by one entity to another, the transactions could be measured at the amount determined under the cost allocation business model. This business model reflects the existing accountability framework for a public sector entity and the way in which operations are managed. The entity's financial reporting system would normally be the starting point for identifying the cost of a good or service.
- .62 A contribution of goods and services between related parties may not be given accounting recognition. Often, contributed goods and services are not recorded because of valuation difficulties. If contributed goods and services are recognized, their valuation would reflect management's best estimate.
- .63 This approach would simplify the process for preparing and presenting government reporting entity financial statements. Specifically, using carrying amount reduces the need for any consolidation adjustments.

Question 7

Should the standard on related party transactions include measurement standards? If so, should the standard take a similar approach to Section 3840 in that related party transactions would be recorded at carrying amount unless they occur in the normal course or operations or have commercial substance?

APPENDIX

EXISTING PSA HANDBOOK MEASUREMENT STANDARDS

Paragraph(s)	Summary of principle
PS 1300.35	Account for government business enterprises by the modified equity method.
PS 2500.06	Inter-governmental ² unit transactions are eliminated.
PS 2500.15	Inter-governmental unit gains and losses arising on the sale or transfer of assets remaining within the government reporting entity should be eliminated.
PS 2510.45	When a governmental unit becomes a government business enterprise, the change cannot create revenue or result in reporting tangible capital assets that would improve net financial position.
PS 2510.51	When a government's net investment balance increases or decreases because of a change in the status of a governmental unit to a government business enterprise, the amount of the increase or decrease is accounted for as an adjustment to the opening balance of accumulated surplus/deficit.
PS 2700.30	Inter-segment transfers should be measured on the basis that the government used to price those transfers.
PS 3060.29	Recognize the government's interest in government partnerships, except for government business partnerships, using the proportionate consolidation method.
PS 3060.32	Account for the government's share of government business partnerships by the modified equity method.
PS 3070.29	Inter-organizational transactions ³ and balances are not eliminated under the modified equity method.
PS 3070.34	The transfer or sale of a tangible capital asset from a governmental unit to a government business enterprise should not improve the net results or net financial position of the government reporting entity.
PS 3070.35-.39	Accounting for inter-organizational bond holdings.
PS 3070.48-.56	When an organization no longer meets the definition of a government business enterprise.
PS 3150.14	The cost of a contributed asset is considered equal to its fair value at the date of contribution.
PS 3230.06-.14	Circumstances where debt issued by a government and loaned to a government business enterprise may be offset.

² Paragraph PS 2500.04 defines a governmental unit as “a government organization that is not a government business enterprise”. A government organization is defined as “an organization that is controlled by the government”. Inter-governmental entities are those that a government controls and consolidates.

³ This has the effect that transactions between a government business enterprise and a government or governmental unit is not eliminated. Further, transactions between two government business enterprises controlled by the same government are not eliminated.