

SECTION PS 4260

disclosure of related party transactions by not-for-profit organizations

Basis for Conclusions

FOR FUTURE UPDATES TO THIS SECTION, see Section PS 2200.

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PURPOSE AND SCOPE

- .01 This Section establishes disclosure standards for related party transactions in the financial statements of not-for-profit organizations. The measurement of related party transactions is not dealt with in this Section.
- .02 This Section does not apply to management compensation arrangements, including employee future benefits accounted for in accordance with RETIREMENT BENEFITS, Section PS 3250, and POST-EMPLOYMENT BENEFITS, COMPENSATED ABSENCES AND TERMINATION BENEFITS, Section PS 3255, expense allowances and other similar payments to individuals in the normal course of operations.

DEFINITIONS

- .03 The following definitions have been adopted for the purposes of this Section. (Further discussion of the definitions of control, significant influence and economic interest is presented in REPORTING CONTROLLED AND RELATED ENTITIES BY NOT-FOR-PROFIT ORGANIZATIONS, Section PS 4250.)
- (a) **Not-for-profit organizations** are entities, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. A not-for-profit organization's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.
 - (b) **Control** of an entity is the continuing power to determine its strategic operating, investing and financing policies without the co-operation of others.
 - (c) **Joint control** of an economic activity is the contractually agreed sharing of the continuing power to determine its strategic operating, investing and financing policies.
 - (d) **Significant influence** over an entity is the ability to affect the strategic operating, investing and financing policies of the entity.
 - (e) An **economic interest** in another not-for-profit organization exists if
 - (i) the other organization holds resources that must be used to produce revenue or provide services for the reporting organization; or
 - (ii) the reporting organization is responsible for the liabilities of the other organization.

- (f) **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. Two not-for-profit organizations are related parties if one has an economic interest in the other. Related parties also include management and immediate family members (see paragraph .04).
- (g) 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. 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.
- (h) **Fair value** is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties, who are under no compulsion to act.

IDENTIFICATION OF RELATED PARTIES

- .04 The most commonly encountered related parties of a reporting organization include the following:
 - (a) an entity that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the reporting organization;
 - (b) an individual who directly, or indirectly through one or more intermediaries, controls the reporting organization;
 - (c) an entity that, directly or indirectly, is significantly influenced by the reporting organization or has significant influence over the reporting organization or is under common significant influence with the reporting organization;
 - (d) the other organization when one organization has an economic interest in the other;
 - (e) management: any person(s) having authority and responsibility for planning, directing and controlling the activities of the reporting organization. (Management would include the directors, officers and other persons fulfilling a senior management function.)
 - (f) An individual that has either significant influence or joint control over the reporting organization;
 - (g) members of the immediate family of individuals described in paragraphs (b), (e) and (f). (Immediate family comprises an individual's spouse and those dependent on either the individual or the individual's spouse.);
 - (h) the other party, when a management contract or other management authority exists and the reporting organization is either the managing or managed party; and
 - (i) any party that is subject to joint control by the reporting organization (In this instance a party subject to joint control is related to each of the venturers that share that joint control. However, the venturers themselves are not related to one another solely by virtue of sharing of joint control.)
- .05 The degree of influence which one party may exert on another is a major factor in determining whether they are related. In some cases, the degree of influence may be so remote that they need not be considered related. For example, two organizations may be unrelated even though one director serves on the board of each; in such a case, the degree of influence exercised by the director over the strategic policies of each organization determines whether the organizations are related.
- .06 Management would 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 organization. When management has identified circumstances indicating that the other party to a transaction may be related, management has a responsibility to ascertain whether that party is, indeed, related.

DISCLOSURE

- .07 *An organization should disclose the following information about its transactions with related parties:*
 - (a) *a description of the relationship between the transacting parties;*
 - (b) *a description of the transaction(s), including those for which no amount has been recorded;*
 - (c) *the recorded amount of the transactions classified by financial statement category;*
 - (d) *the measurement basis used for recognizing the transaction in the financial statements;*
 - (e) *amounts due to or from related parties and the terms and conditions relating thereto;*
 - (f) *contractual obligations with related parties, separate from other contractual obligations;*
 - (g) *contingencies involving related parties, separate from other contingencies.* [JAN. 2012]
- .08 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.
- .09 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 party transactions, the qualitative as well as the quantitative characteristics of materiality are considered.

Description of relationship

- .10 Terms such as affiliate, associate and related entity are insufficiently precise to describe relationships. With additional explanation, the effect of the related party relationship on the organization is more understandable. Terms such as controlled organization, significantly influenced organization, common control organization, organization in which the reporting organization has an economic interest, management, member of the immediate family of management, and director, describe the relationships better.
- .11 An explanation of how significant influence, joint control or control is exercised between the reporting organization and a related party clarifies the nature of their relationship. It is desirable for such an explanation to include, for example, the extent of representation on the board of directors of either party, or details of management contracts between the parties, depending upon the factor which establishes the relationship.

Description of transaction

- .12 A clear description of a related party transaction that sets out the significance of the transaction to the operations of the organization clarifies the effects of the transaction on the organization. Such a description includes information about the nature of the items exchanged.
- .13 A contribution or exchange of goods or services between related parties that has not been given accounting recognition, is also a related party transaction. For example, an organization may provide a related party with management services or the use of premises without receiving consideration in exchange. An explanation of the nature of such a transaction and the fact that no consideration has been received or paid is useful to explain the effect of the transaction on the organization.

Amount of transactions

- .14 To convey the extent of related party transactions, the recorded amounts of such transactions are disclosed. Disclosure of information aggregated by financial statement item (for example: contributions, purchases, administrative expenses, interest expense or income, and management fee income or expense) and nature of relationship is more useful than disclosure of individual transactions with related parties, except for individually significant transactions.

Measurement basis

- .15 Disclosure of the basis used to recognize related party transactions in the financial statements (for example, carrying amount, fair value at the date of contribution or nominal value) assists in evaluating the effect of related party transactions on the reporting organization.

Amounts due to or from related parties

- .16 When amounts are due to or from related parties disclosure includes the relationship of the parties. It is desirable to disclose the nature of the transaction(s) giving rise to the balances.

Consolidated financial statements

- .17 In consolidated financial statements, inter-entity transactions are eliminated and disclosure of such transactions is normally not required. However, when an organization participates in transactions with a controlled or significantly influenced profit-oriented enterprise accounted for by the modified equity method, the profit or loss is eliminated from the financial statements but the transactions themselves are not. Therefore, disclosure is required of related party transactions between the reporting organization and a controlled or significantly influenced enterprise accounted for using the modified equity method.

Contractual obligations and contingencies

- .18 Information about the organization's contractual obligations and contingencies would be disclosed in accordance with FINANCIAL STATEMENT PRESENTATION, paragraphs PS 1201.071-.074, CONTINGENT LIABILITIES, Section PS 3300, and CONTRACTUAL OBLIGATIONS, Section PS 3390. Contractual obligations and contingencies involving related parties may have different characteristics than those involving unrelated parties. Therefore, information about contractual obligations and contingencies involving related parties would be disclosed separately.

SUPPLEMENT

This supplement sets out the previous wording of paragraphs that have been amended substantially as a consequence of withdrawing DISCLOSURE OF RELATED PARTY TRANSACTIONS BY NOT-FOR-PROFIT ORGANIZATIONS, Section PS 4260.

REPORTING CONTROLLED AND RELATED ENTITIES BY NOT-FOR-PROFIT ORGANIZATIONS, Section PS 4250

- .02 The following terms are used in this Section with the meanings specified:

- (a) **Not-for-profit organizations** are entities, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. A not-for-profit organization's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.
- (b) **Control** of an entity is the continuing power to determine its strategic operating, investing and financing policies without the co-operation of others.

- (c) **Joint control** of an economic activity is the contractually agreed sharing of the continuing power to determine its strategic operating, investing and financing policies.
 - (d) A **joint venture** is an economic activity resulting from a contractual arrangement whereby two or more venturers jointly control the economic activity.
 - (e) **Significant influence** over an entity is the ability to affect the strategic operating, investing and financing policies of the entity.
 - (f) An **economic interest** in another not-for-profit organization exists if:
 - (i) the other organization holds resources that must be used to produce revenue or provide services for the reporting organization; or
 - (ii) the reporting organization is responsible for the liabilities of the other organization.
- .39 An organization may enter into a joint venture with other entities. (GOVERNMENT PARTNERSHIPS, Section PS 3060, provides guidance on different types of joint ventures and how they may be identified.) A situation when the reporting organization's proportionate share of assets, liabilities, revenues or expenses related to the jointly controlled activity is not determinable would not be considered to meet the definition of a joint venture for purposes of this Section. The organization would instead consider whether such a situation would be reported as one of significant influence or economic interest. A reporting organization has joint control over the joint ventures in which it has an interest. In order to provide information about all the economic resources under its control, the reporting organization would report its interest in a joint venture in accordance with paragraph PS 4250.36. An organization may follow different policies for reporting different interests in joint ventures. The organization's accounting policies with respect to reporting joint ventures would be disclosed. Interests in similar joint ventures may be grouped together for purposes of disclosure.
- .48 It is expected that reasonable efforts would be made to obtain the financial information required by paragraphs PS 4250.22, PS 4250.32 and PS 4250.38 for financial reporting periods that substantially coincide with that of the reporting organization. However, in cases where this is not possible, the exclusion of the financial information about the controlled or jointly controlled entity would not be justified. Financial information for the other entity's most recent reporting date would be disclosed. Details of events or transactions in the intervening period would include the magnitude of their effect on any of the financial information disclosed about the controlled or significantly influenced entity.

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