CICA handbook accounting and auditing highlight summary no. 85 September 1995

HIGHLIGHT SUMMARY

(Note: New Handbook material or changes in existing material are identified in each HANDBOOK REVISIONS RELEASE.)

Related party transactions, Section 3840

This Section has been revised to establish new measurement standards and enhance existing disclosure standards for related party transactions in the financial statements of profit oriented enterprises.

The main features of revised Section 3840 are:

- A related party transaction should be measured at the carrying amount, except as specified below.
- A monetary related party transaction (or a non-monetary related party transaction that represents the culmination of the earnings process) should be measured at the exchange amount when it is in the normal course of operations.
- A monetary related party transaction (or a non-monetary related party transaction that represents the culmination of the earnings process) that is not in the normal course of operations, should be measured at the exchange amount when:
  (a) the change in the ownership interests in the item transferred or the benefit of a service provided is substantive; and
  (b) the exchange amount is supported by independent evidence.
- Any difference between the carrying amounts of items exchanged in a related party transaction measured at carrying amount, together with any tax amounts related to the items transferred, should be included as a charge or credit to equity.
- Any gain or loss resulting from a related party transaction measured at the exchange amount should be included in income for the period, unless another Handbook Recommendation requires alternative treatment.
- New disclosure requirements include disclosure of:
  — the recorded amount of the transactions classified by financial statement category;
  — the measurement basis used;
  — contractual obligations with related parties; and
  — contingencies involving related parties.

The Recommendations are effective for related party transactions occurring in years beginning on or after October 1, 1995.

The Section also includes an appendix illustrating the effect of using a special tax election such as a Section 85 "rollover".

The Recommendations formerly in Section 3840 continue to apply to non-profit organizations and have been moved to Section 4231 and re-named NON-PROFIT ORGANIZATIONS — RELATED PARTY TRANSACTIONS, DISCLOSURE CONSIDERATIONS. The Recommendations for Economic Dependence, formerly in Section 3840, are now in Section 3841, ECONOMIC DEPENDENCE.

Financial instruments — disclosure and presentation, Section 3860

This new Section prescribes certain requirements for presentation of recognized financial instruments and identifies the information to be disclosed about both recognized and unrecognized financial instruments. The main features of the presentation standards are:

- The issuer of a financial instrument should classify the instrument as a liability or as equity in accordance with the substance of the contractual arrangement on initial recognition and the definitions of a financial liability and an equity instrument. When a financial instrument contains both a liability and an equity element, the component parts should be classified separately.
- Interest, dividends, losses and gains relating to a financial instrument classified as a financial liability should be reported in the income statement. Distributions to holders of a financial instrument classified as an equity instrument should be reported directly in equity.

- A financial asset and a financial liability should be offset and the net amount reported in the balance sheet when an entity has a legally enforceable right to set off the recognized amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The main features of the disclosure standards are:

- For each class of financial instrument, both recognized and unrecognized, an entity should disclose information about:
  - extent and nature, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows;
  - exposure to interest rate risk, including contractual repricing or maturity dates and effective rates;
  - exposure to credit risk, including its maximum credit risk exposure and significant concentrations of credit risk; and
  - fair value.
- An entity should disclose additional information about financial assets carried at an amount in excess of fair value and financial instruments accounted for as a hedge of risks associated with anticipated future transactions.

The Recommendations are effective for fiscal years beginning on or after January 1, 1996 except in the case of life insurance enterprises, for which the effective date is January 1, 1997. The Recommendations are to be applied retroactively, resulting in restatement of comparative information for prior years except when the necessary information is not reasonably determinable.

EIC Abstracts

New

- Income statement presentation of results of a portion of a business segment held for disposal (EIC-63)

Amended

- Reverse takeover accounting (EIC-10)
- Special termination benefits (EIC-23)
- Discontinued operations (EIC-45)
- Liability recognition for costs to exit an activity (including certain costs incurred in a restructuring) (EIC-60)
- Measurement of cost of a business acquisition effected by issuing shares (EIC-62)

Auditing and Related Services Guidelines

- Performance of a review of financial statements (AuG-20)
