



Classification of Related Party Balances

Appropriate balance sheet classification of related party balances is a common deficiency noted in financial statements prepared in accordance with Accounting Standards for Private Enterprises (ASPE). In general, there are two primary standards that provide guidance on this topic: Sections 1510 *Current Assets* and *Current Liabilities* and 3856 *Financial Instruments*.

Classification of Current Assets and Current Liabilities

Section 1510 applies to all assets and liabilities regardless of whether or not the counterparty to that asset or liability is arm's length or a related party. It is important to ensure that appropriate classification is separately considered for each individual related party balance. The assessment requirements for a balance in an asset position is not the same as a balance in a liability position.

Related Party Assets

The balance sheet classification of all assets depends on when they are ordinarily realizable or on the expected realization of the asset. Therefore, current assets include only those assets ordinarily realizable within one year from the date of the balance sheet or within the normal operating cycle.

One of the most common misclassifications of assets is when a related party loan receivable is classified as current when the expectation is that it will not be realized within one year. Such related party balances should either be split between those that are expected to be realized within one year and those that are long-term or simply presented as long-term assets.

Related Party Liabilities

Unlike assets, the determination of whether a liability is current is not based on when it is ordinarily realizable or when it is expected to be paid. Rather, the classification of a liability is based on the legal obligation that the entity has to the counterparty. In other words, if the liability is due to be paid or may be called within one year, it should be presented as a current liability regardless of the entity's intentions or the expected outcome. For additional information on debt classification refer to our [Clear-Cut ASPE: Debt Classification](#).

The Clear-Cut: ASPE Classification of Related Party Balances

When amounts are owed to related parties, management can decide at any time to repay these amounts. As such, related party liabilities should default to a current classification unless justification supporting long-term classification is evident. Examples would include a formalized shareholder agreement restricting the withdrawal of capital or a formal postponement placed by a third-party lender.

Where there is an absence of an external postponement of the liability, there will need to be some form of documentation supporting long-term classification such as a waiver from the related party creditor. This waiver needs to forgo any repayment of the amount for more than one year.

Note that this waiver is not just a piece of paper documenting what might happen. Where there is evidence that the related party amounts are withdrawn or repaid each year the facts do not support the long-term classification regardless of the existence of the waiver.

Samples of waivers of the right to collect for both related entities and related individuals are included as Appendix A and B.

Offsetting of a financial asset and a financial liability

The guidance for when related party balances may be present net as one line item on the balance sheet is included in Section 3856 *Financial Instruments*.

Netting related party assets and liabilities is only acceptable in certain circumstances. There is a required two-fold test that the entity has a legally enforceable right to settle the amounts net and there is an intention to do so. It is not common for these two tests to be met once tax considerations are applied as rarely are transactions settled on a net basis. Consider as an example when an entity would settle amounts owing to an individual net with amounts owing from a corporation; this would rarely occur.

One example where offsetting would likely be appropriate is where one entity has both sales and purchases with another entity. The related accounts receivable and accounts payable are likely appropriately offset to present as a net balance.

The Clear-Cut: ASPE Classification of Related Party Balances

Appendix A – Related Entities - Sample Waiver of Right to Collect

December 31, 20X7

ABC Company Ltd.
1000 Granville Street
Vancouver, BC
V6Z 1L5

To the Directors of ABC Company Ltd.

Re.: Related Party Loan due to XYZ Corporation Inc.

This letter outlines the terms and conditions of the amounts due to XYZ Corporation Inc. from ABC Company Ltd. which as of December 31, 20X7 totaled \$49,175 (the “Related Part Loan”).

Terms and Conditions [to be tailored for loan specifics]

The Related Party Loan is unsecured, non-interest bearing and has no specific terms of repayment.

Waiver of Right to Demand Repayment

The undersigned, who are the directors of XYZ Corporation Inc., hereby waive the right to call, or otherwise demand repayment, of the Related Party Loan within the twelve month period subsequent to the date of this letter.

Yours truly,

XYZ Corporation Inc.

Director Name

Signature

Director Name

Signature

Director Name

Signature

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Appendix B – Related Individuals - Sample Waiver of Right to Collect

December 31, 20X7

ABC Company Ltd.
1000 Granville Street
Vancouver, BC
V6Z 1L5

To the Directors of ABC Company Ltd.

Re.: Related Party Loan due to XYZ Corporation Inc.

This letter outlines the terms and conditions of the amounts due to Mr. Shareholder from ABC Company Ltd. which as of December 31, 20X7 totaled \$49,175 (the “Related Part Loan”).

Terms and Conditions [to be tailored for loan specifics]

The Related Party Loan is unsecured, bears interest at prime +2% and has no specific terms of repayment.

Waiver of Right to Demand Repayment

The undersigned hereby waive the right to call, or otherwise demand repayment, of the Related Party Loan within the twelve month period subsequent to the date of this letter.

Yours truly,

Mr. Shareholder

Name

Signature