



## Debt Classification

The guidance for what constitutes a current asset or a current liability is included in Accounting Standards for Private Enterprises (ASPE) Section 1510 *Current Assets* and *Current Liabilities*. For an overview of the differences in the classification of current assets and current liabilities, refer to our [Clear-Cut ASPE: Balance Sheet Presentation](#).

The purpose of this document is to provide a more in-depth overview of the requirements for presenting and classifying debt, callable debt and in addressing debt covenant violations.

### *Debt Classification*

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 the entity has to the counterparty. In other words, if the liability is due to be paid within one year, it should be presented as a current liability regardless of the entity's intentions or the expected outcome.

Current liabilities must include only the portion of long-term debt obligations payable within one year from the date of the balance sheet. The remaining balance would typically be presented as long-term debt unless there are factors which would suggest that the debt is current in its entirety.

Non-current classification of debt is based on facts existing at the balance sheet date rather than on expectations regarding future refinancing or renegotiation. If the creditor has at that date, or will have within one year from that date, the unilateral right to demand immediate repayment of any portion or all of the debt under any provision of the debt agreement, the obligation is classified as a current liability unless:

- a) the creditor has waived, in writing, or subsequently lost, the right to demand payment for more than one year from the balance sheet date;
- b) Or, the obligation has been refinanced on a long-term basis before the balance sheet is completed;
- c) Or, the debtor has entered into a non-cancellable agreement to refinance the short-term obligation on a long-term basis before the balance sheet is completed and there is no impediment to the completion of the refinancing.

*Note: The guidance above is not just for bank debt and third party loans. It also applies to related party loans. For more information on this topic refer to our [Clear-Cut ASPE: Classification of Related Party Balances](#).*

## The Clear-Cut: ASPE Debt Classification

### Debt Covenant Violations

Long-term debt with a measurable covenant violation is classified as a current liability unless:

- a) the creditor has waived, in writing, or subsequently lost, the right, arising from violation of the covenant at the balance sheet date, to demand repayment for a period of more than one year from the balance sheet date;
- b) Or, the debt agreement contains a grace period during which the debtor may cure the violation and contractual arrangements have been made that ensure the violation will be cured within the grace period;
- c) And, a violation of the debt covenant giving the creditor the right to demand repayment at a future compliance date within one year of the balance sheet date is not likely.
- d) Disclosure of Covenant Violations

There is also a disclosure requirement related to violations of debt covenants but it is not found in Section 1510 but rather Section 3856 *Financial Instruments*.

Entities are required to disclose whether any financial liabilities were in default or in breach of any term or covenant during the period that would permit a lender to demand accelerated repayment. Furthermore, there must also be disclosure of whether the default was remedied, or the terms of the liability were renegotiated, before the financial statements were completed.

### Presentation of Callable Debt

The illustrative guidance included in Section 1510 provides an example of the presentation of callable debt with scheduled minimum cash repayments. In this example, the entity has a debt payable to a bank, or other lender, of \$330,000. The terms of the debt agreement provide for repayment of the debt over five years but also give the lender the right to call for repayment at any time. At the end of 20X8 the entity believes the lender will not call for repayment of the debt before the end of the five-year period.

	20X8	20X7
<b>Liabilities</b>		
Current:		
Accounts payable and accrued liabilities	\$ 613,000	\$ 530,000
Scheduled cash repayments for long-term debt (Note X)	410,000	410,000
Current liabilities before callable debt	1,023,000	940,000
Callable debt (Note X)	330,000	440,000
Total current liabilities	1,353,000	1,380,000
Non-current:		
Long-term debt (Note X)	15,000	315,000
Total liabilities	\$ 1,368,000	\$ 1,695,000

## The Clear-Cut: ASPE Debt Classification

As you can see from the above example the current liability section of the balance sheet has been essentially broken down into two categories: current liabilities that are expected to be paid within twelve months, and liabilities that meet the definition of current liabilities but are not necessarily expected to be paid within twelve months.

It is important that the user understands that both of these two sub-classifications are indeed current liabilities. One of the ways the example illustrated above does this is by specifically stating “total current liabilities” in the subtotal line. It is often the case that financial statement templates as well as software that help prepare financial statements do not include specific wording for subtotals and totals on the balance sheet and thus could result in the presentation being misleading.

In this example, the related note disclosure might look like this:

Note X: Debt	20X8	20X7
Callable bank loans, interest at prime plus 1.75% per annum, principal repayable over 60 months, secured by certain equipment	\$ 330,000	\$ 440,000
Promissory notes payable, interest at prime plus 2% per annum, repayable in monthly installments of \$25,000 plus interest, secured by a general security agreement over all assets of the company, principal due 20Y0	425,000	725,000
<b>Total debt</b>	<b>755,000</b>	<b>1,165,000</b>
Less current portion:		
Cash repayments required within 12 months	(410,000)	(410,000)
Callable debt	(330,000)	(440,000)
<b>Current debt</b>	<b>(740,000)</b>	<b>(850,000)</b>
<b>Total long-term debt</b>	<b>\$ 15,000</b>	<b>\$ 315,000</b>
Management does not believe that the demand features of the callable debt will be exercised in the current period. Assuming payment of the callable debt is not demanded, regular principal payments required on all long-term debt for the next five years are due as follows:		
20X9	\$ 410,000	
20Y0	235,000	
20Y1	110,000	
	<u>\$ 755,000</u>	