Current Vs Non-current for Conditions in Force

In practical life, the classification of something between current or non-current is far more important than the understanding of a layman. The differences may be alike whether you fail to drive your car from location A to location B, and then you will not able to eat your dinner at location B or you will miss a date or you will be in a traffic jam for hours, etc. For a business, the management between the balance between current and non-current means whether the business can survive or not. A highly profitable business is not able to survive, if it does not have a health management between current and non-current, we called it "liquidity". Bad liquidity management will likely result in borrowing monies at extremely high interest rates, doing risky transactions without option, and instantly turn the profitable business status to great loss status.

In accounting, an entity shall classify a liability as current when it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. And the unconditional right must be in force as of the reporting date (i.e. the end of the financial statements date according to prevailing interpretation). Therefore, if an entity wishes to satisfy liquidity test for its financial statements, it needs to assure the completion of necessary conditions for non-current liability classification before the end of the financial statements date, instead of during auditing nor during directors' approval. All actions taken or waiver obtained after the said ended date are irrelevant and will not be accepted in audit test for the purposes of classification.

Some entities may have term loans facilities with their banker, an original loan with more than one-year term of repayment will be classified as non-current at the beginning date. However, the classification of this term loan in subsequent reporting date will rely on the conditions in force. If a term loan will be due on a date within one year from the reporting date but there is continuous financing arrangement with the same banker to roll-over the term loan to more than one-year term, the term loan will be still classified as non-current liability. Otherwise, the term loan will be classified as current liability. In case the entity has plan or intention (showing in management documents) to cease within one year the roll-over under the renewed banking facilities, the term loan is also required to be classified as current liability.

Except for the intention of the entity, auditor needs also pay attention to other trigger factors of which will lead to the classification of a more than one-year term loan to current liability. Most of the banking facilities will have acceleration clauses, other than the repayment on demand clause, to enable the bank to call the loan before due date based on certain happenings, e.g. pledged assets be damaged, lost or impaired, failure to repay loan installments, etc. If these trigger factors happened, the term loan will be classified as current liability, unless waiver is obtained from the banker, again before the reporting date. Furthermore, auditor needs to know the fact in legal viewpoint that waiver is not an intention letter, and the intention of an entity (as an audit client) and the intention of banker will be treated totally in different ways.

If an entity obtained a banker letter to support its classification of a term loan, subject to repayment on demand clause or trigger factors of acceleration clauses, as non-current liability before the reporting date, the entity should not be too early to happy. The wordings in the waiver of banker must be very clear and straightforward and legal binding, any vague and ambiguous description in the waiver will be rejected by auditor to accept the non-current liability classification, including wordings of intent, contemplate, prepare, consider, etc. I hope, from the above, auditor and client can find out the bottom line in non-current classification.

Presley Chang, HK 18 August 2012