

---

## **INFORMATION BULLETIN FOR LENDERS**

### **OCTOBER 2003**

---

#### **EMERGING ISSUES COMMITTEE REPORT – EIC122**

A recent public practice mailing of the Certified General Accountants Association of BC clarified the new reporting rules relating to Callable Debt Obligations. These rules signify a material change to financial statements for those businesses whose mortgages, term loans and other long-term obligations are subject to demand by the lender.

#### **TERM DEMAND LOANS**

In the past, loan agreements that provided for specific repayment terms were reflected as long-term liabilities, with the anticipated one-year principal reduction segregated to current liabilities. Now, if such loans are subject to demand at the option of the lender, the new rules require the full amount to be included in current liabilities. Working capital calculations will be adversely affected by this change and in many cases, businesses will no longer reflect any long-term liabilities on their balance sheets.

#### **OTHER LONG-TERM DEBT**

Another significant change requires inclusion in current liabilities of the entire amount of long-term debt in the year prior to the year in which the term of the loan matures. This

applies even if no demand feature is in place. For example, a loan agreement that provides for payments over a five-year term with the balance due at the conclusion of the term will now be reflected as a current liability in the fourth and fifth years.



#### **IMPLICATIONS FOR FINANCIAL STATEMENTS**

The emerging issues committee's interpretation of the CICA Handbook rules for callable debt obligations will have significant implications for financial statements. In many cases, companies will no longer report positive working capital, the ratio of current assets to current liabilities will be negative and the traditional interpretation of the current vs. non-current classification in financial statements will no longer apply. Lenders will have to recalculate statements to determine if clients meet their lending guidelines. Details of repayment terms and five-year principal reduction requirements will likely disappear from the notes to financial statements.

## **IMPLICATIONS FOR FINANCIAL STATEMENTS, continued**

The new rules are effective for year-ends that commence on or after January 1, 2002, so most 2003 financial statements should now reflect the changes.

## **QUALIFICATION OF AUDIT AND REVIEW ENGAGEMENT REPORTS**

In some cases, business owners may refuse to comply with these new rules, directing their accountants to continue reflecting term demand loans as long-term debt. In such cases, independent accountants such as Harvey, Lister & Webb Incorporated, will have no option but to qualify the auditors' report or review engagement report.

## **CONCLUSION**

We do not view this as a positive change, but rather an overreaction to the Enron and Sarbanes-Oxley situation in the United States. The new treatment may be a technically correct result of the CICA Handbook rules, but it will make the interpretation of financial statements much more difficult and will certainly reduce their usefulness. If financial statements are prepared without reflecting the new rules, then qualified audit and review engagement reports will become much more prevalent.

For more information, please call or contact **Harvey, Lister & Webb Incorporated** at 250.492.8821, 502 Ellis Street, Penticton, BC V2A 4M3 or email to [info@harveylister.com](mailto:info@harveylister.com).

**Harvey, Lister & Webb Incorporated publishes a series of information bulletins on various subjects and topics of interest to their clients and advisors. If you wish to receive copies of these bulletins or an index of those available, please contact Susan Brooks at [susan@harveylister.com](mailto:susan@harveylister.com).**