

2% Extra-Credit Assignment

Will long-term borrowings will be reclassified into short-term borrowings?

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Summary

No, not exactly. However, long-term borrowings will be reclassified into current liabilities (not exactly short-term borrowings) upon a certain date, using the concepts of

- Current Maturity of Long-Term Debt
- Current Portion of Long-Term Debt

Explanation

The current maturity of a company's long-term debt refers to the stage when a long-term debt (or a portion of it) is due within the next 12 months.

Current Portion of Long-Term Debt (CPLTD) refers to the portion of liabilities that have gone through current maturity of long-term debt. It can be less than or equal to the Long-term Debt (LTD).

$$0 \leq \text{CPLTD} \leq \text{LTD}$$

This means that portion of long-term debt that is to be paid within a year is reclassified from a non-current liability to a current liability.

Why?

This is to accurately analyze the liquidity of a company, since CPLTD must be paid within the coming year; liquidity is a company's ability to convert assets to cash or acquire cash—through a loan or money in the bank—to pay its liabilities/obligations within the current year.

$$\begin{aligned}\text{Current Ratio} &= \frac{\text{Current Assets}}{\text{Current Liabilities}} \\ &= \frac{\text{Current Assets}}{\text{Short-Term Borrowings} + \text{CPLTD}} \\ \text{Quick Ratio} &= \frac{\text{Current Assets} - \text{Inventories}}{\text{Current Liabilities}} \\ &= \frac{\text{Current Assets} - \text{Inventories}}{\text{Short-Term Borrowings} + \text{CPLTD}} \\ \text{Cash Ratio} &= \frac{\text{Cash \& Cash Equivalent} + \text{Short-Term Investments}}{\text{Current Liabilities}} \\ &= \frac{\text{Cash \& Cash Equivalent} + \text{Short-Term Investments}}{\text{Short-Term Borrowings} + \text{CPLTD}}\end{aligned}$$

As you can see in all forms of liquidity analysis, we need to include CPLTD to ensure an accurate analysis.

References

- [1] "Current Maturity Definition," *Investopedia*. <https://www.investopedia.com/terms/c/currentmaturity.asp> (accessed Apr. 30, 2023).
- [2] "What Is the Current Portion of Long-Term Debt (CPLTD)?," *Investopedia*. <https://www.investopedia.com/terms/c/currentportionlongtermdebt.asp> (accessed Apr. 30, 2023).