



## iGAAP in Focus

### Financial reporting

## IASB issues amendments to IAS 1 regarding the classification of liabilities with covenants

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This *iGAAP in Focus* outlines the amendments to IAS 1 *Presentation of Financial Statements* titled *Non-current Liabilities with Covenants*, published by the International Accounting Standards Board (IASB) in November 2022 (the 2022 amendments).

- The IASB amends IAS 1 to specify that only covenants an entity must comply with on or before the reporting period should affect classification of the corresponding liability as current or non-current
- An entity is required to disclose information in the notes that enables users of financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months
- The amendments are applied retrospectively (applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) and are effective for annual reporting periods beginning on or after 1 January 2024. Earlier application is permitted
- The amendments defer the effective date of the amendments to IAS 1 titled *Classification of Liabilities as Current or Non-current* published in January 2020 (the 2020 amendments) by one year to annual reporting periods beginning on or after 1 January 2024

#### Background

In 2020, the IASB issued amendments to IAS 1 titled *Classification of Liabilities as Current or Non-current*. In the 2020 amendments, among other changes, the IASB clarified that the classification of liabilities as current or non-current is based on rights that are in existence at the end of the reporting period.

The 2020 amendments specified how an entity assesses whether it has the right to defer settlement of a liability when that right is subject to compliance with specified conditions (in the amendments referred to as 'covenants') within twelve months after the reporting period. Stakeholders have since expressed concerns about the outcome of applying the 2020 amendments to such covenants. The IASB decided to address these stakeholder concerns.

**For more information please see the following websites:**

[www.iasplus.com](http://www.iasplus.com)

[www.deloitte.com](http://www.deloitte.com)

### The 2022 amendments

The 2022 amendments specify that only covenants that an entity is required to comply with on or before the end of the reporting period affect the entity's right to defer settlement of a liability for at least twelve months after the reporting date (and therefore must be considered in assessing the classification of the liability as current or non-current). Such covenants affect whether the right exists at the end of the reporting period, even if compliance with the covenant is assessed only after the reporting date (e.g. a covenant based on the entity's financial position at the reporting date that is assessed for compliance only after the reporting date).

The IASB also specifies that the right to defer settlement is not affected if an entity only has to comply with a covenant after the reporting period. However, if the entity's right to defer settlement of a liability is subject to the entity complying with covenants *within twelve months* after the reporting period, an entity discloses information that enables users of financial statements to understand the risk of the liabilities becoming repayable within twelve months after the reporting period. This would include information about the covenants (including the nature of the covenants and when the entity is required to comply with them), the carrying amount of related liabilities and facts and circumstances, if any, that indicate that the entity may have difficulties complying with the covenants.

#### Observation

In the Exposure Draft (ED) preceding the 2022 amendments, the IASB proposed to require an entity to present non-current liabilities with covenants separately in the statement of financial position. The main reason for this proposal was to avoid users of financial statements being misled by a non-current classification without any indication that the liability could become repayable within twelve months.

However, feedback on the ED suggested that users of financial statements would not be misled if the conditionality of non-current liabilities were explained in the notes instead of through separate presentation of these liabilities in the statement of financial position. Therefore, the IASB decided not to finalise this proposal.

### The 2020 amendments

As a reminder, the key changes introduced by the 2020 amendments that are unaffected by the most recent amendments include:

- A clarification was added in both IAS 1:69 and 73 to emphasise that for a liability to be classified as non-current, the entity's right to defer settlement must exist 'at the end of the reporting period'
- The IASB specified that for a liability to be non-current an assessment is required of whether an entity has the right to defer settlement of a liability and not whether the entity will exercise that right. The reference to an entity's expectations in IAS 1:73 was deleted and a new paragraph was added to state explicitly that classification is unaffected by management intentions or expectations
- The word 'unconditional' was removed from IAS 1:69 and a new paragraph was added to clarify that if the right to defer settlement is conditional on the compliance with covenants the right exists if the conditions are met at the end of the reporting period, even if the lender does not test compliance until a later date
- A definition of the word 'settlement' was added and states "For the purpose of classifying a liability as current or non-current, settlement refers to a transfer to the counterparty that results in the extinguishment of the liability." This transfer could be of cash, goods and services or the entity's own equity instruments
- The circumstances when counterparty conversion options affect classification as current or non-current were clarified

### Transition and effective date

The 2022 amendments are applied retrospectively in accordance with IAS 8 for annual reporting periods beginning on or after 1 January 2024. Earlier application of the 2022 amendments is permitted. If an entity applies the 2022 amendments for an earlier period, it is also required to apply the 2020 amendments early.

At the same time, the IASB aligns the effective date of the 2020 amendments to 1 January 2024. An entity that applies the 2020 amendments after the publication of the 2022 amendments is required to also apply the 2022 amendments for that period.

### Further information

If you have any questions about the classification of liabilities with covenants, please speak to your usual Deloitte contact or get in touch with a contact identified in this *iGAAP in Focus*.

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