

IFRS in Focus

IASB amends IAS 1 to clarify the classification of liabilities as current or non-current

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This *IFRS in Focus* addresses the recent amendments to IAS 1 *Presentation of Financial Statements* that have been published by the International Accounting Standards Board (IASB). The amendments are titled *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)*.

The amendments to IAS 1:

- clarify 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.
- specify that classification is unaffected by expectations about whether an entity will exercise its right to defer settlement of a liability.
- explain that rights are in existence if covenants are complied with at the end of the reporting period.
- introduce a definition of 'settlement' to make clear that settlement refers to the transfer to the counterparty of cash, equity instruments, other assets or services.
- are effective for annual periods beginning on or after 1 January 2022 with earlier application permitted.
- are applied retrospectively.

Background

The amendments result from a request received by the IASB to clarify the criteria for the classification of a liability as either current or non-current. In particular, the IASB was asked to clarify how having an unconditional right to defer settlement (specified in IAS 1:69(d)) reconciled with having the discretion to refinance or roll over an obligation (specified in IAS 1:73). This is because having an unconditional right to defer settlement was seen as a much higher hurdle than having the discretion to defer settlement.

The IASB decided to address this conflict by proposing amendments to IAS 1 in Exposure Draft ED/2015/1 *Classification of Liabilities*. The IASB decided to finalise these proposals with additional clarifications, but no fundamental changes.

Observation

The amendments affect only the presentation of liabilities as current or non-current in the statement of financial position—not the amount or timing of recognition of any asset, liability, income or expenses, or the information that entities disclose about those items. However, it should be noted that a changed classification may affect an entity's compliance with loan covenants.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

The amendments

The IASB made a number of amendments to clarify the classification criteria for liabilities as current or non-current. The most significant changes are listed below.

1. A clarification has been added to 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'. This was previously illustrated in the examples but not explicitly stated.
2. The IASB specifies 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 has been deleted and a new paragraph has been added to state explicitly that classification is unaffected by management intentions or expectations.
3. The word 'unconditional' has been removed from IAS 1:69 and a new paragraph has been 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.

Observation

The IASB considered, but decided not to clarify, how an entity determines compliance with a condition if that condition relates to the entity's cumulative financial performance for a longer period extending beyond the reporting period.

4. A definition of the word 'settlement' has been added that 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.
5. The IASB also clarifies the scope of when counterparty conversion options affect classification as current or non-current. Applying the amendment, if a liability has terms that could, at the option of the counterparty, result in its settlement by the transfer of the entity's own equity instruments, these terms do not affect its classification as current or non-current if the entity recognises the option separately as an equity instrument applying IAS 32 *Financial Instruments: Presentation*.

Observation

It should be noted that this amendment means in turn that if an obligation to transfer equity instruments issued as part of a convertible instrument is not classified as equity, the transfer of equity instruments would constitute settlement of the convertible instrument for the purpose of classifying it as current or non-current. This might constitute a significant change for entities that, until now, only considered the date at which cash payment is required.

Effective date

An entity applies the amendments to IAS 1 for annual periods beginning on or after 1 January 2022, with early application permitted. The amendments are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Further information

If you have any questions about the amendments to IAS 1 please speak to your usual Deloitte contact or get in touch with a contact identified in this *IFRS in Focus*.

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