IFRS

STAFF PAPER

March 2019

IASB® meeting

Project	**Classification of Liabilities as Current or Non-current (Amendments to IAS 1)**
Paper topic	Lending conditions tested after the reporting period

CONTACT(S)	Kuniyoshi Suzuki	ksuzuki@ifrs.org	+81 (0)3 5205 7289
	Saori Tanabe	stanabe@ifrs.org	+81 (0)3 5205 7289
	Joan Brown	jbrown@ifrs.org	+44 (0)20 7246 6916

Introduction

1. The Exposure Draft *Classification of Liabilities* published in February 2015 (Exposure Draft) proposed amendments to requirements in paragraphs 69-76 of IAS 1 *Presentation of Financial Statements*. Those requirements relate to classification of liabilities as current or non-current.

2. Whether an entity classifies a liability as current or non-current might depend on whether it has complied with conditions in a lending agreement. This paper considers whether and, if so how, the Board should clarify a previous tentative decision on the effect of conditions that will not be tested until after the end of the reporting period.

Background

3. The Exposure Draft proposed that an entity should classify a liability as non-current only if it has a right <u>at the end of the reporting period</u> to defer settlement of the liability for at least twelve months after the reporting period.

4. An entity's right to defer settlement of a loan might be subject to conditions specified in a lending agreement. The lending agreement might also specify dates on which compliance with the conditions will be tested, for example each anniversary of the loan being granted.

5. In February 2016, the Board tentatively decided to clarify that, in assessing an entity's right to defer settlement of a liability, compliance with any conditions in a lending agreement should be assessed as at the reporting date—even if the lender will not test the entity's compliance until a later date. The staff had recommended this approach on the basis that the purpose of the condition is to protect the lender's interests and, to be effective, such protection must be in place continuously. So the entity's right to defer settlement is implicitly conditional on continuous compliance, even if the lender tests compliance only from time to time.

Reason for considering this matter again

6. At the November 2018 Board meeting, a Board member suggested clarifying how to assess compliance at the reporting date for some types of conditions.

7. The Board member noted that, although it should be clear how to assess whether an entity complies at the reporting date with a condition relating to its *financial position* (for example, a gearing ratio), it might be less clear how to assess whether an entity complies at the reporting date with a condition relating to its *financial performance* (for example operating profits or a ratio of EBITDA[1] to net interest-bearing debt) for a period that extends beyond the reporting date.

[1] Earnings before interest, tax, depreciation and amortisation.

Example

8. An entity receives a loan on 1 April X0 that it will not be required to repay until 31 March X5, providing it continues to meet conditions that are tested on 31 March each year. One of the conditions is that a measure of the entity's income for each year ending on 31 March exceeds 12 million currency units (CU).

9. At 31 December X0, the entity's income has been and is forecast to be:

Period	Income (CU)
1 January X0 – 31 March X0	3 million (actual)
1 April X0 – 31 December X0	11 million (actual)
1 January X1 – 31 March X1	5 million (forecast)

10. At the reporting date, the entity's income since 1 April X0 is CU11 million. So it has not yet satisfied the lending condition that will be tested at 31 March X1.

11. However, comparing the entity's income for 9 months and the minimum income required for 12 months is not a useful comparison. More relevant information would be obtained by comparing, for example:

    (a) the minimum income required for the year ending 31 March X1 (CU12 million) with either:

        (i) the income earned by the entity for the year ended 31 December X0 (CU14 million); or

        (ii) the income earned by the entity for the 9 months ended 31 December X0 plus that forecast for the last 3 months (CU16 million); or

    (b) a proportion of the required income attributable to the first 9 months of the assessment period (9/12ths of CU12 million = 9 million) with the actual income of that period (CU11 million).

12. Comparing the minimum income required each year with that earned in the year to 31 December X0 (the comparison described in paragraph 10(a)(i)) could be most consistent with a general requirement to assess compliance as at the reporting date.

Staff analysis

13. This question might not arise frequently in practice—lenders who specify conditions relating to financial performance often specify performance periods that coincide with the entity's financial reporting periods so the conditions can be tested by reference to audited financial statements.

14. If the question does not arise frequently in practice, there may not be a need for prescriptive or comprehensive requirements to address every possible type of condition. However, the general requirement to assess compliance as at the reporting date should be worded so it can be applied to all types of conditions, without implying a need to compare actual performance in the period with a measure of performance required for a longer period.

Staff recommendation

15. The Board has tentatively decided to clarify that, in assessing an entity's right to defer settlement of a liability, compliance with any conditions in a lending agreement should be assessed as at the reporting date—even if the lender will not test the entity's compliance until a later date.

16. The staff recommend adding that, if a condition relates to a measure of financial performance for a period extending beyond the reporting date, an entity would be judged to comply with the condition as at the reporting date if its financial performance for a period of equal length ending on the reporting date indicates it is complying with the condition.

17. This staff recommendation would allow an entity to make a comparison like that described in paragraph 12.

Question for the Board

Conditions tested after the reporting period
Do you agree with the staff recommendation in paragraph 16?