30 October 2020

ISCA Financial Reporting Bulletin 3 (Revised)

FRB 3 (Revised):
Classification of liabilities as Current or Non-current (Amendments to SFRS(I) 1-1)

Revised to incorporate the amendments to SFRS(I) 1-1 which resulted from the Accounting Standards Council Singapore (ASC) adopting the equivalent amendments to IAS 1

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ISCA is the Designated Entity to confer the Chartered Accountant of Singapore – CA (Singapore) – designation.

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ISCA's Financial Reporting Committee (FRC) is chaired by Mr Reinhard Klemmer and comprises representatives from legal and accounting firms, corporate, regulators and academia in the financial reporting eco-system. FRC's terms of reference include monitoring policy and implementation issues relating to the development of accounting standards internationally and in Singapore, and to identify, understand and address accounting issues faced by professional accountants in Singapore, and provide support through the issuance of guidance.

The terms of reference are executed through FRC with the support of two Sub-Committees, namely the Core Sub-Committee and the Valuation Sub-Committee. The FRC Core Sub-Committee is the technical accounting arm of FRC and comprises various technical accounting subject matter experts from accounting firms. The Core Sub-Committee engages in technical deliberations on emerging accounting issues in Singapore and new or revised accounting developments proposed by the international accounting standards setter.

Note:

- ***This FRB has been updated from FRB 3 (issued on 15 April 2020) to incorporate the following amendments to SFRS(I) 1-1 Presentation of Financial Statements which resulted from the Accounting Standards Council Singapore (ASC) adopting the equivalent amendments to IAS 1 Presentation of Financial Statements:***

  - ***Amendments to SFRS(I) 1-1, effective for annual reporting periods beginning on or after 1 January 2022, as announced by the ASC on 29 May 2020****

  - ***Deferment of the effective date of the amendments to SFRS(I) 1-1 by one year (i.e. to annual reporting periods beginning on or after 1 January 2023) as announced by the ASC on 23 July 2020****

  It is important to note that there is no change to the views and guidance (from that shared in FRB 3 issued on 15 April 2020) as a result of the above.

- *Although this FRB makes references to SFRS(I) 1-1, the guidance in this FRB is also applicable to entities applying FRS 1 Presentation of Financial Statements.*

- *This FRB is based on publicly available information as at 30 October 2020. References made to ASC and IASB websites are accurate as at the date of issuance of this FRB. Members are strongly advised to refer to the respective websites for any subsequent updates.*

* https://www.asc.gov.sg/current-news

Contents

1. Background

On 23 January 2020[1], the International Accounting Standards Board (IASB) issued amendments to IAS 1 *Presentation of Financial Statements*.

The amendments are intended to clarify the requirements on determining whether a liability is current or non-current so as to promote consistency in application. The amendments shall be applied for annual reporting periods beginning on or after 1 January 2023[2] retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and earlier application is permitted.

The amendments to IAS 1 may affect the classification of liabilities in situations such as where long-term loans are classified as current due to the lack of an unconditional right to defer settlement or where management's expectations or intentions regarding the settlement of liabilities are considered to determine the classification of the liability. Hence, all entities should reconsider the existing classification of their liabilities and determine if changes are required in light of the amendments.

The aforementioned amendments to IAS 1 have been adopted by the ASC on 29 May 2020 and 23 July 2020, which has consequently resulted in amendments to SFRS(I) 1-1.

ISCA has issued this FRB to assist members in understanding and applying the amendments to certain common scenarios in Singapore.

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[1] https://www.ifrs.org/projects/2020/classification-of-liabilities/#final-stage

[2] The effective date of the amendments to IAS 1 (issued on 23 January 2020) was subsequently deferred by one year to annual reporting periods beginning on or after 1 January 2023. The IASB explained that this was in response to the COVID-19 pandemic and to provide companies with more time to implement any classification changes resulting from those amendments.

Refer to IASB's announcement at:
https://www.ifrs.org/news-and-events/2020/07/iasb-defers-the-effective-date-of-amendments-to-ias-1/

2. Summary of the amendments to SFRS(I) 1-1

In summary, the amendments clarify the following:

A. Substantive right to defer settlement must exist at the end of the reporting period

Under the existing SFRS(I) 1-1 requirements, a liability is classified as non-current if the entity has an unconditional right to defer settlement of that liability for at least 12 months after the reporting period.

The word 'unconditional' has been deleted as part of the amendments to SFRS(I) 1-1. The rationale is that rights to defer settlement of a loan are rarely unconditional – they are often conditional on compliance with covenants. If an entity's right to defer settlement of the liability is contingent on the entity complying with specified conditions, the entity has the right to defer settlement of the liability at the end of the reporting period if it complies with those conditions at that date. *[Paragraph BC48D[3] of IAS 1]*

B. Classification of a liability is unaffected by whether the entity exercises its right to defer settlement

It has been clarified that events happening after the reporting period (until the date the financial statements are authorised for issue) do not impact the classification of the liability that was determined at the end of the reporting period.

If a liability has been determined to be non-current at the end of the reporting period, it continues to be classified as non-current even if management intends or expects the entity to settle the liability within 12 months after the reporting period or even if the entity settles the liability between the end of the reporting period and the date the financial statements are authorised for issue.

Notwithstanding that there is no impact on the classification of the liability as at the end of the reporting period, the entity should ensure appropriate disclosures are made in the financial statements relating to the settlement of the liability subsequent to the end of the reporting period (for instance, in the liquidity risk management note).

[3] Paragraph BC48D of Basis for Conclusions on IAS 1

C. Meaning of 'settlement' of a liability

It has been clarified that a liability is 'settled' if the liability is extinguished with the transfer of cash, other economic resources (for example, goods or services) or an entity's own equity instruments (see Note).

<u>Note</u>
There is an exception for debt instruments that can be settled in the entity's own shares (e.g. convertible debt).

If the conversion option is classified as equity under SFRS(I) 1-32, the conversion option does not affect the current or non-current classification of the host liability.

If the conversion option is classified as liability under SFRS(I) 1-32, the conversion option (that is, whether the option is exercisable within 12 months) affects the current or non-current classification of the host liability. To illustrate this, consider the following example:

<u>Illustrative example</u>

An entity has issued a foreign currency denominated bond which matures on 30 September 2030. The bond comprises a financial liability and a conversion option (granted to the holder) to convert the bond into the entity's shares at any time before maturity. The entity has assessed and determined that the conversion option is classified as liability under SFRS(I) 1-32 (i.e. it fails the 'fixed-for-fixed' criteria) separately from the host liability.

The host liability is classified as current because of the following reasons:

- The transfer of the entity's own shares is a form of settlement of the host liability in accordance with the amendments to SFRS(I) 1-1.

- As the holder has the option to convert the host liability into the entity's shares at any time before maturity, the entity does not have the right to defer settlement of the liability for at least 12 months after the reporting period.

3. Application of the amendments to commonly encountered scenarios in Singapore

A. Long-term loans with callable clauses

Some term loan agreements may include an overriding repayment on demand clause which gives the lender the right to recall the loan on demand ("callable term loans").

Q: Should callable term loans be classified as current or non-current liabilities?

If the lender has the right to recall the loan on demand at any time and without any cause, the borrowing entity will need to classify its term loan liability as current.

If the lender's right to recall the loan is conditional upon the occurrence of certain events of default, the entity should assess whether the stated events of default have occurred <u>as at the end of the reporting period</u>. Events after the reporting period and the probability of occurrence are disregarded in the assessment.

The entity classifies the liability as non-current if the stated events of default have not occurred as at the end of the reporting period.

Notwithstanding that there is no impact on the classification of the borrowing as at the end of the reporting period, the entity should ensure appropriate disclosures are made in the financial statements <u>if the stated events of default have occurred subsequent to the end of the reporting period</u>.

B. Term loans with rollover facilities

Some term loan agreements may contain rollover clauses which give the borrower the right to roll over the loan at regular intervals. For instance, a 10-year loan facility that was fully drawn down on 1 May 2020 with the option to roll over the loan on 1 May every year thereafter will be the case. The ability to roll over the loan is conditional on the entity complying with specified loan covenants on 30 April. The entity's financial year-end is 31 December.

Q: Should such term loans be classified as current or non-current liabilities?

The borrower's right to defer settlement of the loan is conditional upon the entity complying with specified loan covenants. The entity should assess whether it complies with the covenant tests <u>as at the end of the reporting period</u> (e.g. 31 December 2020), even though the lender does not test compliance until a later date (e.g. 30 April 2021).

The entity classifies the liability as non-current if it meets the covenant tests as at the end of the reporting period.

Notwithstanding that there is no impact on the classification of the borrowing as at the end of the reporting period, the entity should ensure appropriate disclosures are made in the financial statements <u>if the entity has failed the covenant test subsequent to the end of the reporting period</u>.

C. Amounts due from related parties – classification and asymmetrical treatment by lender and borrower

In practice, it is common for a parent company (or a lender entity within the group) to provide advances to its subsidiary (or the borrower entity within the group). These advances typically do not have stated repayment dates and are callable by the lender entity on demand.

The following questions arise:

(i) Should such receivables be classified as current or non-current assets in the lender entity's financial statements?

(ii) If the receivables are classified as current assets, should the payables be correspondingly classified as current liabilities in the borrower entity's financial statements and vice versa?

<u>Lender entity's financial statements</u>

Paragraph 66 of SFRS(I) 1-1 states that:

"An entity shall classify an asset as current when:

(a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;

(b) it holds the asset primarily for the purpose of trading;

(c) it expects to realise the asset within twelve months after the reporting period; or

(d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

An entity shall classify all other assets as non-current."

In the situation where there is no stated repayment date for the receivable amount and the amount is callable by the lender entity on demand, the lender entity is required to assess whether the receivable fulfils the criteria in paragraph 66 of SFRS(I) 1-1 to determine the appropriate classification of the receivable. When doing so, the entity needs to pay attention to the underlying substance and economic reality and not merely the legal form. In other words, the lender entity is required to consider its expectations in relation to the receivable amount. The classification of a financial asset is based on whether the entity **expects** to convert it into cash or consume it in the business within one year/the normal operating cycle. Typically, if the advances are intended for longer term financing of the borrower entity by the lender entity, they would be classified as non-current receivables.

Borrower entity's financial statements

Paragraph 69 of SFRS(I) 1-1 states that:
"An entity shall classify a liability as current when:
(a) it expects to settle the liability in its normal operating cycle;
(b) it holds the liability primarily for the purpose of trading;
(c) the liability is due to be settled within twelve months after the reporting period; or
(d) it does not have the right at the end of the reporting period to defer settlement of the liability for at least twelve months.

An entity shall classify all other liabilities as non-current."

In the situation where there is no stated repayment date for the amount payable and the advance is callable by the lender entity on demand, paragraph 69(d) of SFRS(I) 1-1 would require the borrower entity to classify the amount as a current liability as it "does not have the right to defer settlement of the liability for at least twelve months after the reporting period". In other words, the borrower entity is required to consider its contractual obligation in relation to the payable amount. The default classification of a financial liability is current unless the entity's **right** to defer settlement of the liability for at least 12 months after the financial reporting date has substance[4].

It should also be noted that the current/non-current classification of the advance will be assessed independently for the receivable and the payable; there is no symmetry as the criteria are different for the asset and liability classification.

Because the non-current classification for a financial liability is based on hard evidence of a right to defer settlement which has substance, often an amount due to a related entity fails to meet the requirement for such classification. On the other hand, as the current classification of a financial asset is based on expectations, often it is quite apparent that the intragroup balance is not expected to be settled within 12 months. Hence, we have a current liability classification by one entity and a non-current asset classification by another entity.

[4] Paragraph 72A of SFRS(I) 1-1 (effective 1 January 2023 with earlier application being permitted)

For reference: ISCA Financial Reporting Codification Framework

In November 2019, ISCA issued the ISCA Financial Reporting Codification Framework (Framework). The Framework establishes a formalised categorisation, degrees of authority and a due process for future issuance of ISCA's technical documents. It provides credence to ISCA's technical content, promulgates ISCA's views on the application of accounting standards as well as promotes quality, consistency and best practices in financial reporting.

The Framework is summarised in the table below.

Category	Nature	Degree of authority	Due Process	Highest level of approval
1. Financial Reporting Practice (**FRP**)	Recommended best practices for financial reporting for specific industries, sectors or transactions	Expected to apply	Public consultation required	ISCA Council
2. Financial Reporting Guidance (**FRG**)	Technical guidance, views and insights on specific financial reporting issues for specific industries, sectors or transactions	Expected to follow or explain departures	Public consultation required	ISCA Financial Reporting Committee (FRC), with authority delegated by the ISCA Council
3. Financial Reporting Bulletin (**FRB**)	Technical bulletin containing discussions and highlight of emerging topical financial reporting issues	For information and educational purposes	Public consultation not required	ISCA FRC

For more details on the Framework and the guidance issued under the Framework, please refer to the following:

- Framework – https://isca.org.sg/tkc/fr/financial-reporting-codification-framework/
- FRG – https://isca.org.sg/tkc/fr/financial-reporting-guidances/
- FRB – https://isca.org.sg/tkc/fr/financial-reporting-bulletins/

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