30 April 2024

ISCA Financial Reporting Bulletin 3 (Revised April 2024)

FRB 3 (Revised April 2024): 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 adoption of the equivalent amendments to IAS 1 in 2022

About the Institute of Singapore Chartered Accountants

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Established in 1963, ISCA is an advocate of the interests of the profession. Complementing its global mindset with Asian insights, ISCA leverages its regional expertise, knowledge, and networks with diverse stakeholders to contribute towards the advancement of the accountancy profession.

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

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ISCA's Financial Reporting Committee (FRC) 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 guidances.

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.

Note:

- ***This FRB has been updated from FRB 3 (issued on 30 October 2020) to incorporate the amendments to SFRS(I) 1-1 Presentation of Financial Statements on 14 December 2022 which resulted from the adoption of the equivalent amendments to IAS 1 Presentation of Financial Statements, effective for annual reporting periods beginning on or after 1 January 2024.***

- *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 April 2024. References made to SFRS(I)s and IFRSs are accurate as at the date of issuance of this FRB. Members are strongly advised to refer to the respective standards or pronouncements for any subsequent updates.*

Contents

1. Background

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

The 2020 amendments are intended to clarify the requirements on determining whether a liability is current or non-current so as to promote consistency in application. These amendments to IAS 1 were adopted in Singapore on 29 May 2020 and 23 July 2020, which has consequently resulted in amendments to SFRS(I) 1-1 *Presentation of Financial Statements*.

In October 2022, IASB issued further clarifications ("2022 amendments") on the 2020 amendments and deferred the effective date of both 2020 and 2022 amendments to annual reporting periods beginning on or after 1 January 2024.[2] These amendments to SFRS (I) 1-1 were adopted in Singapore on 14 December 2022.

The 2020 and 2022 amendments (collectively as "the Amendments") are to be applied together for annual reporting periods beginning on or after 1 January 2024 retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and earlier application is permitted.

ISCA has issued this FRB to assist members in understanding the amendments and their application to commonly encountered scenarios in Singapore.

Where the term "loan" is used in this FRB, the accounting classification is considered from the perspective of the entity with the borrowings (i.e., the classification of financial liabilities as current or non-current).

[1] IASB's Project Page on Classification of Liabilities as Current or Non-current (Amendments to IAS 1)

[2] IASB's Project Page on Non-current Liabilities with Covenants

2. Summary of the Amendments to SFRS(I) 1-1 and Other Accounting Requirements

The following is a summary of the Amendments and other related accounting requirements:

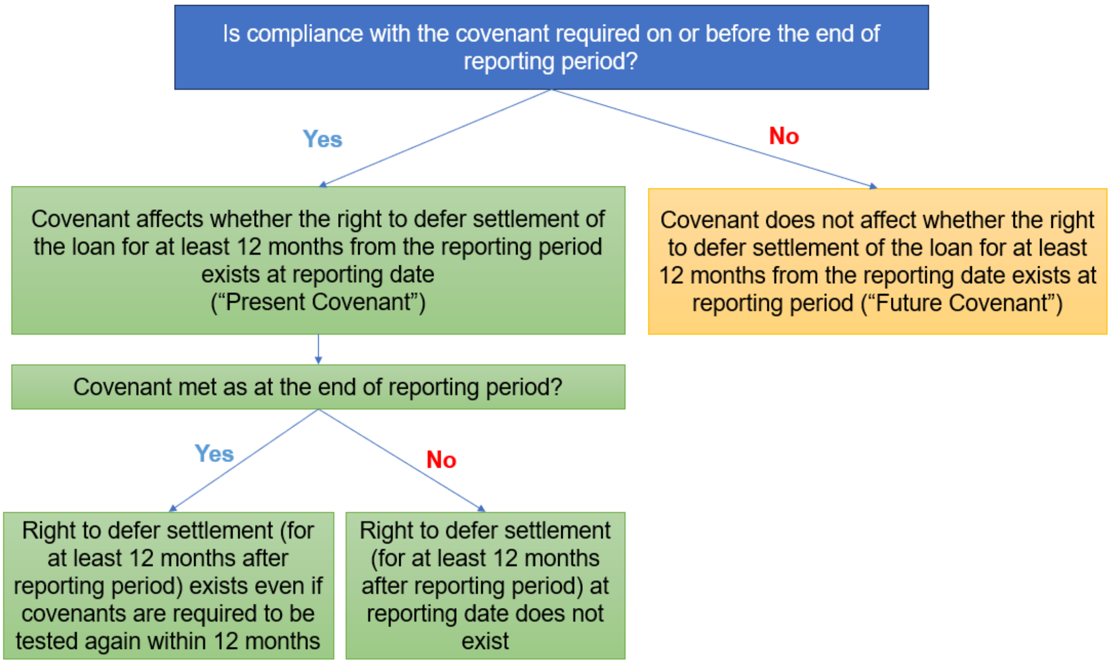
A. Amendments to SFRS(I) 1-1: Right to defer settlement must exist at the end of the reporting period[3] and must have substance[4]

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 specified conditions (commonly known as "covenants").

If an entity's right to defer settlement of the liability may be subject to the entity complying with covenants, the entity has the right to defer settlement of the liability at the end of the reporting period if it complies with those covenants that an entity is required to comply with on or before the end of the reporting period (i.e. present covenants).[5] Covenants that an entity is required to comply with only after the reporting period (i.e., future covenants) do not affect an entity's right to defer settlement of the liability at the end of the reporting period.

Refer to the diagram below for an illustration of this amendment.



[3] SFRS(I) 1-1 Paragraph 69(d)

[4] SFRS(I) 1-1 Paragraph 72A

[5] Paragraphs BC48D and BC48EC(a) of Basis for Conclusions on IAS 1

In the event that an entity has breached a covenant of a non-current liability on or before the end of the reporting period, the entity can continue to classify the liability as non-current if:

- the lender has agreed by the end of the reporting period to provide a grace period of at least 12 months after the reporting period, within which the entity can rectify the breach; and
- the lender cannot demand immediate repayment during the grace period.[6]

B. Amendments to SFRS(I) 1-1: Additional disclosures for covenants to be complied with within 12 months after reporting period[7]

An entity is required to provide disclosures when it classifies a liability arising from a loan arrangement as non-current and the right to defer settlement is subject to the entity complying with covenants within twelve months after the reporting period.

The entity must disclose information in the notes to enable users of financial statements to understand the risk that the liability could become repayable within twelve months of the reporting period, including:

(a) information about the covenants (including the nature of the covenants and when the entity is required to comply with them) and the carrying amount of related liabilities; and

(b) facts and circumstances, if any, that indicate the entity may have difficulty complying with the covenants. Such facts and circumstances could also include the fact that the entity would not have complied with the covenants based on its circumstances at the end of the reporting period.

Refer to Appendix 1 for an illustration of the disclosures required for liabilities arising from loan agreements.

C. Amendments to SFRS(I) 1-1: Classification of a liability is unaffected by whether the entity exercises its right to defer settlement after the reporting period[8]

It has been clarified that events occurring 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.

[6] SFRS(I) 1-1 Paragraph 75

[7] SFRS(I) 1-1 Paragraph 76ZA

[8] SFRS(I) 1-1 Paragraph 75A

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, SFRS(I) 7 *Financial Instruments: Disclosures* paragraph B10A states that if the outflows of cash (or another financial asset) included in the summary quantitative data about its exposure to liquidity risk could either (a) occur significantly earlier than indicated in the data or (b) be for significantly different amounts from those indicated in the data, the entity shall state that fact and provide quantitative information that enables users to evaluate the extent of this risk unless that information is included in the contractual maturity analyses required by paragraph 39(a) or (b).

D. Amendments to SFRS(I) 1-1: Meaning of settlement of a liability[9]

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.

Settlement using the entity's own equity instruments (e.g. convertible debt settled by conversion into the entity's own shares) also affects the current and non-current classification of the liability, except where the conversion option is classified as an equity instrument under SFRS(I) 1-32.

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 after the reporting period) affects the current or non-current classification of the host liability. To illustrate this, consider the following example:

> Illustrative example
>
> 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 for 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.

[9] SFRS(I) 1-1 Paragraphs 76A and 76B

- 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.

E. Others: Going concern assumption for breaches of loan covenants

The breach of a loan covenant may indicate the existence of issues with a borrower's financial health. While all breaches may give rise to repayment issues, when a breach remains unremedied and the lender has obtained a right to demand immediate or accelerated repayment of the loan, this may have a more pressing impact on a borrower's ability to continue as a going concern.

In accordance with SFRS(I) 1-1 paragraph 25, management is required to consider the impact of covenant breaches and other relevant events and conditions and assess whether there are material uncertainties that may cast significant doubt over the entity's ability to continue as a going concern. Even though a breach (or other relevant event) may not occur until after the reporting period, this must still be considered. If the breach of a loan covenant results in material uncertainties that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties.

Occasionally, the impact of a covenant breach could be so severe that the going concern assumption is no longer appropriate. When this happens, an entity is required to prepare its financial statements on a basis other than going concern. Selecting an appropriate basis will require the exercise of professional judgement and the basis selected will need to be disclosed. The fact that the entity does not prepare the financial statements on a going concern basis and the reason why the entity is not regarded as a going concern will also need to be disclosed.

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

A. Term loans with callable clauses

Some term loan agreements may include a 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 as at the end of the reporting period. 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.

However, if one of the events of default occurred during the reporting period but the lender agreed to provide a grace period of at least 12 months after the reporting period for the entity to rectify the breach during which the lender cannot demand immediate repayment, the entity classifies the liability as non-current. Additional disclosures of the default and remediation of the default of the loan liability would be required under SFRS(I) 7 paragraphs 18 and 19.

Notwithstanding that there is no impact on the classification of the borrowing at the end of the reporting period, the entity should ensure appropriate disclosures are made in the financial statements if one of the events of default occur subsequent to the end of the reporting period. Such disclosures may include those required under SFRS(I) 1 paragraph 76ZA as well as those relating to non-adjusting events under SFRS(I) 1-10 paragraph 21.

B. Loans with rollover facilities

Some 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 facility that was fully drawn down on 1 May 2023 contains the option to roll it over on 1 May every year thereafter until 30 April 2030. The ability to roll over the loan is at the discretion of the entity and conditional on the entity complying with a specified debt-to-equity ratio (D/E ratio) on 30 April. The entity's financial year-end is 31 December.

Q: Should such term loan be classified as a current or non-current liability as at 31 December 2024?

The borrower's right to defer settlement of the loan is conditional upon the entity complying with the specified D/E ratio.

The entity classifies the liability as non-current if it complies with the D/E ratio on 30 April 2024 for the financial year ended 31 December 2024. The fact that the borrower must assess its compliance with the D/E ratio within the next 12 months after the reporting period (i.e., on 30 April 2025) does not affect the classification of the loan as at 31 December 2024.

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 as noted in Section 2B for liabilities arising from loan agreements with covenants required to be complied with within 12 months after the reporting period.

C. Loan covenants

Loan covenants can take many forms and usually the breaching of a loan covenant is contractually an event of default. A typical example is a requirement in the agreement for a borrower to maintain one or more financial ratios (such as working capital or debt-to-equity ratio) above or below a specified benchmark. When the borrower breaches a covenant on or before the end of the reporting period, the loan should be classified as current if the borrower does not have the right to defer settlement for at least 12 months after the reporting period.

Usually, the borrower would have requested for a grace period (commonly known as "cure period") from the lender. This would allow the borrower to rectify the breach while the lender cannot demand immediate repayment during the cure period. The assessment of whether a long-term loan should be classified as current or non-current is based on the "condition" of the loan at the end of the reporting period as illustrated below.

For example, Entity A has a long-term bank loan which is subject to certain financial covenants. These covenants will be assessed at the end of each quarter. If the covenants are breached, the loan will be repayable immediately (i.e., **the breach of the covenant is an event of default**). Entity A has a financial year end of 31 December.

Q1: Entity A determines that it is in compliance with the covenants as at 31 December 2024. Should the long-term loan be classified as current or non-current?

The long-term loan should be classified as non-current at the end of the reporting period of 31 December 2024. The fact that Entity A must assess its compliance with the covenants within the next 12 months does not change the classification of the loan at 31 December 2024. This is the case even if Entity A expects that it is likely that the loan covenants will be breached in the following quarter but additional disclosures will be required as mentioned in Section 2B. Appropriate disclosure of a non-adjusting event should also be provided if the breach occurred subsequent to the end of the reporting period but before the financial statements are authorised for issue[10].

Q2: Entity A determines that it has breached the covenants on 30 September 2024 and has been granted a grace period before 31 December 2024 for the rectification of the breach by the lender.

a) Should the long-term loan be classified as current or non-current as at 31 December 2024 if the breach has been rectified on or before 31 December 2024?

   The long-term loan should be classified as non-current as the breach has been rectified on or before 31 December 2024.

b) Should the long-term loan be classified as current or non-current if the breach has not been rectified before 31 December 2024 but was given a grace period to rectify the breach?

   If the grace period is less than 12 months after 31 December 2024, the loan should be classified as current as the lender has the right to demand repayment after the grace period (i.e. within the next 12 months). However, if the grace period is more than 12 months after 31 December 2024, the loan should then be classified as non-current. Notwithstanding this, the borrower is required to disclose the details of the breach of the covenant in accordance with paragraph 19[11] in SFRS(I) 7.

[10] SFRS(I) 1-10 paragraph 21

[11] SFRS(I) 7 paragraph 19 requires the disclosure of breaches of loan agreement terms other than those described in paragraph 18 where those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).

D. 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 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?

Lender entity's financial statements

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 12 months/the normal operating cycle after the reporting period. 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 reporting period has substance.[12]

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 <u>no symmetry</u> 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 after the reporting period. Hence, we have a current liability classification by one entity and a non-current asset classification by another entity.

[12] Paragraph 72A of SFRS(I) 1-1 (effective 1 January 2024 with earlier application being permitted)

Appendix 1: Illustrative disclosures as required by the Amendments to SFRS(I) 1-1

(This is for illustration purposes only and to be tailored according to the specific facts and circumstances of the reporting entity.)

Note to Financial Statements: Bank borrowings

	2024	2023
Current:	$'000	$'000
Bank borrowings	XX	XX
Non-Current:		
Bank borrowings	XX	XX
	XXX	XXX

Current
The bank borrowings are secured by the Company's fixed deposits. The weighted average effective interest rate is XX% (2023: XX%) per annum.

Non-current
This bank borrowing is for a term of 5 years commencing XXX and is repayable in one lump sum on XXX. It is unsecured and subjected to a financial covenant that is tested semi-annually on 30 June and 31 December each year. The covenant requires the Company to have a working capital (WC) ratio of at least 1.4 in 2024 and 1.5 from 2025 onwards.

The Company complied with this covenant with a WC ratio of 1.45 as at 31 December 2024. Hence, the loan is classified as non-current. However, assuming the Company continues with its current financial position, the Company would have a WC ratio lower than 1.5 as at 30 June 2025 which will be in breach of the covenant for WC ratio based on the WC ratio of 1.45 as at 31 December 2024. This would result in the loan being repayable on demand if a waiver is not obtained. [The Company may describe measures undertaken to address the situation and any material uncertainties relating to going concern.]

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 (link)
- FRG (link)
- FRB (link)