



**Are your long-term liabilities still  
non-current?**

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At the start of 2020 the requirements to classify a liability as current or non-current were amended. The amendments take effect for annual reporting periods that begin on or after 1 January 2023. This article provides an overview of the amended requirements and some practical challenges that may stem from them.

IAS 1 *Presentation of Financial Statements* deals with, amongst others, the classification of assets and liabilities as current and non-current. The requirements to classify liabilities as current or non-current were amended in 2020. The amendments take effect for annual reporting periods that begin on or after 1 January 2023. This article considers the amendment.

### Current requirements

A liability must be classified as current if:

- The entity expects to settle it in its normal operating cycle or holds it primarily for trading purposes,
- The liability is due to be settled within 12 months after the reporting period, or
- The entity does not have an unconditional right to defer settlement for at least 12 months after the reporting period.

The amendments relate to the last principle. The explanations in the standard currently refer to an entity's expectations and discretion to refinance a loan. This was not consistent with the requirement for an unconditional right to defer settlement.

### Amended principle

The amended classification principle makes it clear that the entity's right to defer settlement must exist at the end of the reporting period. The IASB indicated that examples previously illustrated this, without explicitly stating it. The principle in paragraph 69(d) of IAS 1 now states that an entity should classify a liability as current when:

'... it does not have the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting date' (own underlining)

### Right to defer settlement

The amendments could significantly affect the classification of liabilities in situations where the entity's right to defer settlement is subject to compliance with conditions. These conditions may, for example, arise from loan covenants. The right to defer

settlement only exists at the end of the reporting date if the entity complies with the conditions at the end of the reporting date. This is the case even if the lender does not test compliance until a later date. The challenges that the practical application of this requirement may pose become clear from an example.

An entity has a March reporting period. The terms of a loan that the entity party to require compliance with covenant ratios annually at the end of June. If the entity does not comply with the covenant ratios at the end of March (the reporting date), the liability cannot be classified as non-current. This is the case even though the entity should only measure compliance with the covenants at the end of June and may historically have a pattern of compliance at that time of its business cycle.

It may be relatively straightforward to determine whether the entity complies with the condition at the end of the reporting date for balance sheet covenants, such as gearing or own capital ratios. It is less clear how an entity assesses compliance with performance conditions (for example, based on profit or EBITDA) for a period beyond the reporting date. The IASB decided not to prescribe a specific method. Each entity must identify a method that is appropriate in its particular circumstances. Entities who are party to agreements with such performance conditions (or any other types of conditions measured over time) should develop a basis for this assessment before the amendments take effect.

### Entity's expectation

The amendments clarify that the likelihood that the entity will settle the liability within 12 months, despite having a right to defer payment, does not affect the liability's classification. The classification of the liability depends on the entity's rights at the end of the reporting period. An entity should provide disclosure if it expects to settle the liability within 12 months despite having the right to defer settlement.

