AASB Standard

AASB 2022-6
December 2022

Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants

[AASB 101 and AASB Practice Statement 2]

Australian Government

Australian Accounting Standards Board

Obtaining a copy of this Accounting Standard

This Standard is available on the AASB website: www.aasb.gov.au.

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AVAILABLE ON THE AASB WEBSITE
IASB Basis for Conclusions – Amendments

Australian Accounting Standard AASB 2022-6 *Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants* is set out on pages 5 – 8. All the paragraphs have equal authority.

Preface

Standards amended by AASB 2022-6

This Standard makes amendments to AASB 101 *Presentation of Financial Statements* (July 2015) and AASB Practice Statement 2 *Making Materiality Judgements* (December 2017).

These amendments arise from the issuance of International Financial Reporting Standard *Non-current Liabilities with Covenants* (Amendments to IAS 1) by the International Accounting Standards Board (IASB) in October 2022.

Main features of this Standard

Main requirements

This Standard amends AASB 101 to improve the information an entity provides in its financial statements about liabilities arising from loan arrangements for which the entity's right to defer settlement of those liabilities for at least twelve months after the reporting period is subject to the entity complying with conditions specified in the loan arrangement.

The Standard also amends an example in Practice Statement 2 regarding assessing whether information about covenants is material for disclosure.

Application date

This Standard applies to annual periods beginning on or after 1 January 2023. Earlier application is permitted, provided AASB 2020-1 *Amendments to Australian Accounting Standards – Classification of Liabilities as Current or Non-current* is also applied at the same time.

Accounting Standard AASB 2022-6

The Australian Accounting Standards Board makes Accounting Standard AASB 2022-6 *Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants* under section 334 of the *Corporations Act 2001*.

Dated 15 December 2022	Keith Kendall Chair – AASB

Accounting Standard AASB 2022-6
Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants

Objective

This Standard amends AASB 101 *Presentation of Financial Statements* (July 2015) and AASB Practice Statement 2 *Making Materiality Judgements* (December 2017) as a consequence of the issuance of International Financial Reporting Standard *Non-current Liabilities with Covenants* (Amendments to IAS 1) by the International Accounting Standards Board in October 2022.

Application

The amendments set out in this Standard apply to entities and financial statements in accordance with the application of AASB 101 set out in AASB 1057 *Application of Australian Accounting Standards.*

This Standard applies to annual periods beginning on or after 1 January 2023.

This Standard may be applied to annual periods beginning before 1 January 2023, provided AASB 2020-1 *Amendments to Australian Accounting Standards – Classification of Liabilities as Current or Non-current* is also applied to the period. When an entity applies this Standard to such an annual period, it shall disclose that fact.

This Standard uses underlining, striking out and other typographical material to identify the amendments to AASB 101 and AASB Practice Statement 2, in order to make the amendments more understandable. However, the amendments made by this Standard do not include that underlining, striking out or other typographical material. Ellipses (…) are used to help provide the context within which amendments are made and also to indicate text that is not amended.

Amendments to AASB 101 *Presentation of Financial Statements*

Paragraphs 60, 71, 72A, 74 and 139U are amended. Paragraphs 72B and 139W are added. Paragraph 76ZA is added immediately after paragraph 76. New text is underlined and deleted text is struck through. Paragraphs 69 and 75 are not amended but have been included for ease of reference.

Structure and content

...

Statement of financial position

...

Current/non- current distinction

60 **An entity shall present current and non- current assets, and current and non- current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 66–76B ~~76~~ except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, an entity shall present all assets and liabilities in order of liquidity.**

...

Current liabilities

69 **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 after the reporting period.

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

...

Held primarily for the purpose of trading (paragraph 69(b)) or due to be settled within twelve months (paragraph 69(c))

71 Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading. Examples are some financial liabilities that meet the definition of held for trading in AASB 9, bank overdrafts, and the current portion of non-current financial liabilities, dividends payable, income taxes and other non-trade payables. Financial liabilities that provide financing on a long-term basis (ie are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting period are non-current liabilities, subject to paragraphs 72A–75 ~~74 and 75~~.

...

Right to defer settlement for at least twelve months (paragraph 69(d))

72A An entity's right to defer settlement of a liability for at least twelve months after the reporting period must have substance and, as illustrated in paragraphs 72B–75 ~~73 – 75~~, must exist at the end of the reporting period. ~~If the right to defer settlement is subject to the entity complying with specified conditions, the right exists at the end of the reporting period only if the entity complies with those conditions at the end of the reporting period. The entity must comply with the conditions at the end of the reporting period even if the lender does not test compliance until a later date.~~

72B An entity's right to defer settlement of a liability arising from a loan arrangement for at least twelve months after the reporting period may be subject to the entity complying with conditions specified in that loan arrangement (hereafter referred to as 'covenants'). For the purposes of applying paragraph 69(d), such covenants:

(a) affect whether that right exists at the end of the reporting period – as illustrated in paragraphs 74 –75 – if an entity is required to comply with the covenant on or before the end of the reporting period. Such a covenant affects whether the right exists at the end of the reporting period even if compliance with the covenant is assessed only after the reporting period (for example, a covenant based on the entity's financial position at the end of the reporting period but assessed for compliance only after the reporting period).

(b) do not affect whether that right exists at the end of the reporting period if an entity is required to comply with the covenant only after the reporting period (for example, a covenant based on the entity's financial position six months after the end of the reporting period).

...

74 When an entity breaches a covenant ~~condition~~ of a long- term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial

statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have the right to defer its settlement for at least twelve months after that date.

75 However, an entity classifies the liability as non- current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

...

76ZA In applying paragraphs 69–75, an entity might classify liabilities arising from loan arrangements as non-current when the entity's right to defer settlement of those liabilities is subject to the entity complying with covenants within twelve months after the reporting period (see paragraph 72B(b)). In such situations, the entity shall disclose information in the notes that enables users of financial statements to understand the risk that the liabilities could become repayable within twelve months after 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.

(b) facts and circumstances, if any, that indicate the entity may have difficulty complying with the covenants – for example, the entity having acted during or after the reporting period to avoid or mitigate a potential breach. Such facts and circumstances could also include the fact that the entity would not have complied with the covenants if they were to be assessed for compliance based on the entity's circumstances at the end of the reporting period.

...

Transition and effective date

...

139U AASB 2020-1 *Amendments to Australian Accounting Standards – Classification of Liabilities as Current or Non-current*, issued in March 2020 amended paragraphs 69, 73, 74 and 76 and added paragraphs 72A, 75A, 76A and 76B. An entity shall apply those amendments for annual reporting periods beginning on or after 1 January 2024 ~~1 January 2023~~ retrospectively in accordance with AASB 108. Earlier application is permitted. If an entity applies those amendments for an earlier period after the issue of AASB 2022-6 *Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants* (see paragraph 139W), it shall also apply AASB 2022-6 for that period. If an entity applies AASB 2020-1 ~~those amendments~~ for an earlier period, it shall disclose that fact.

...

139W AASB 2022-6, issued in December 2022, amended paragraphs 60, 71, 72A, 74 and 139U and added paragraphs 72B and 76ZA. An entity shall apply:

(a) the amendment to paragraph 139U immediately on issue of AASB 2022-6.

(b) all other amendments for annual reporting periods beginning on or after 1 January 2024 retrospectively in accordance with AASB 108. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall also apply AASB 2020-1 for that period. If an entity applies AASB 2022-6 for an earlier period, it shall disclose that fact.

Amendments to AASB Practice Statement 2 *Making Materiality Judgements*

The following amendment is a consequence of the amendments to AASB 101.

Example P is amended. New text is underlined.

Information about covenants

...

Example P—assessing whether information about covenants is material
Background An entity has rapidly grown over the past five years and recently suffered some liquidity problems. A long-term loan was granted to the entity in the current reporting period. The loan agreement includes a clause that requires the entity to maintain a ratio of debt to equity below a specified threshold, to be measured at each reporting date (the covenant). According to the loan agreement, the debt-to-equity ratio has to be calculated on the basis of debt and equity figures as presented in the entity's Australian-Accounting-Standards financial statements. If the entity breaches the covenant, the entire loan becomes payable on demand. The disclosure of covenant terms in an entity's financial statements is not required by any local laws or regulations. **Application** Paragraph 31 of AASB 7 *Financial Instruments: Disclosures* requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risk arising from financial instruments to which the entity is exposed at the end of the reporting period. <u>Paragraph 76ZA of AASB 101 requires an entity to disclose, in specified circumstances, information in the notes that enables users of financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months after the reporting period.</u> In the preparation of its financial statements, the entity assesses whether information about the existence of the covenant and its terms is material information, considering both the consequences and the likelihood of a breach occurring. In these circumstances, the entity concluded that, considering its recent liquidity problem, any acceleration of the long-term loan repayment plan (the consequence of the covenant breach occurring) would affect the entity's financial position and cash flows in a way that could reasonably be expected to influence primary users' decisions. The entity also considered the likelihood of a breach occurring. **Scenario 1—the lender defined the covenant threshold on the basis of the three-year business plan prepared by the entity, adding a 10 per cent tolerance to the forecast figures** In this scenario, even though the entity has historically met its past business plans, it assessed the likelihood of a breach occurring as higher than remote. Therefore, information about the existence of the covenant and its terms was assessed as material and disclosed in the entity's financial statements. **Scenario 2—the lender defined the covenant threshold on the basis of the three-year business plan prepared by the entity, adding a 200 per cent tolerance to the forecast figures** In this scenario, the entity assessed the likelihood of a breach occurring as remote, on the basis of its historical track record of meeting its past business plans and the magnitude of the tolerance included in the covenant threshold. Therefore, although the consequences of the covenant breach would affect the entity's financial position and cash flows in a way that could reasonably be expected to influence primary users' decisions, the entity concluded that information about the existence of the covenant and its terms was not material.

Commencement of the legislative instrument

For legal purposes, this legislative instrument commences on 31 December 2022.