

AASB Exposure Draft

ED 323
March 2023

Disclosure of Non-current Liabilities with Covenants – Proposed Amendments to Tier 2

Comments to the AASB by 22 May 2023



Australian Government

**Australian Accounting
Standards Board**

Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by 22 May 2023.

Formal Submissions

Submissions should be lodged online via the “Current Projects – Open for Comment” page of the AASB website (www.aasb.gov.au/current-projects/open-for-comment) as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: standard@aaasb.gov.au

Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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Introduction

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) develops, issues and maintains Australian Accounting Standards. The AASB is a Commonwealth entity under the *Australian Securities and Investments Commission Act 2001*. AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of Australian Accounting Standards.

Exposure Drafts

The publication of an Exposure Draft is part of the due process the AASB follows before making a new Australian Accounting Standard or amending an existing one. Exposure Drafts are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

Why we are making these proposals

The amendments proposed in this Exposure Draft clarify the criteria for classifying a liability as either current or non-current. The amendments also propose additional disclosures to improve the information disclosed in financial statements about certain non-current liabilities with covenants.

The proposed amendments are consistent with amendments already made to AASB 101 *Presentation of Financial Statements* by AASB 2020-1 *Amendments to Australian Accounting Standards – Classification of Liabilities as Current or Non-Current* and AASB 2022-6 *Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants*.

The proposed amendments are necessary to ensure there is consistency in the terminology and presentation requirements in Australian Accounting Standards, to minimise the risk of interpretation and application differences.

What we are proposing

This Exposure Draft proposes amendments to AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* to:

- (a) clarify that a liability is classified as non-current if an entity has the right at the reporting date to defer settlement of the liability for at least twelve months after the reporting date;
- (b) clarify the reference to settlement of a liability by the issue of equity instruments in classifying liabilities; and
- (c) require the disclosure of information that enables users of the financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months.

Application date

It is proposed that the amendments would apply to annual periods beginning on or after 1 January 2024, with earlier application permitted. This is the application date of the substantive amendments set out in AASB 2020-1 and AASB 2022-6.

What happens next

The AASB will consider feedback on this Exposure Draft at future meetings and, based on the information received, will determine whether the proposals should be implemented, with or without amendment. Depending on the nature and extent of the feedback, the AASB may publish a Fatal-Flaw Review Draft to enable further consultation with stakeholders.

We need your feedback

Comments are invited on any of the proposals in this Exposure Draft by 22 May 2023. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposals, as a whole, are supported and that this opinion be supplemented by detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue (whether an issue specifically identified below or another issue).

Specific matters for comment

The AASB would particularly value comments on the following:

1. Do you agree with the proposed amendments to AASB 1060? If you disagree, please explain why.
2. Do you agree that the proposed new disclosure requirements in paragraph 47A:
 - (a) are relevant to Tier 2 entities; and
 - (b) deliver benefits for financial statement users that outweigh any costs incurred by preparers?
3. Do you expect any significant challenges for entities in complying with the disclosure requirements proposed in paragraph 47A? If so, please explain why and what alternative you suggest instead.
4. Do you have any other comments on the proposals?

General matters for comment

The AASB would also particularly value comments on the following general matters:

5. Whether the *AASB For-Profit Entity Standard-Setting Framework* and the *AASB Not-for-Profit Entity Standard-Setting Framework* have been applied appropriately in developing the proposals in this Exposure Draft?
6. Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals?
7. Whether the proposals create any auditing or assurance challenges and, if so, an explanation of those challenges?
8. Whether, overall, the proposals would result in financial statements that would be useful to users?
9. Whether the proposals are in the best interests of the Australian economy?
10. Unless already provided in response to specific matters for comment above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative? In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

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PREFACE

**[DRAFT] ACCOUNTING STANDARD
AASB 2023-X AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS – DISCLOSURE OF
NON-CURRENT LIABILITIES WITH COVENANTS: TIER 2**

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[DRAFT] BASIS FOR CONCLUSIONS

[Draft] Australian Accounting Standard AASB 2023-X *Amendments to Australian Accounting Standards – Disclosure of Non-current Liabilities with Covenants: Tier 2* is set out in paragraphs 1 – 6. All the paragraphs have equal authority.

Preface

Standards amended by AASB 2023-X

This [draft] Standard makes amendments to AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (March 2020).

Main features of this Standard

Main requirements

AASB 2020-1 *Amendments to Australian Accounting Standards – Classification of Liabilities as Current or Non-Current* and AASB 2022-6 *Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants* amended AASB 101 *Presentation of Financial Statements* 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 (often referred to as 'covenants').

Consistent with the amendments made by AASB 2020-1 and AASB 2022-6, this [draft] Standard amends AASB 1060 to:

- (a) clarify that a liability is classified as non-current if an entity has the right at the reporting date to defer settlement of the liability for at least twelve months after the reporting date;
- (b) clarify the reference to settlement of a liability by the issue of equity instruments in classifying liabilities; and
- (c) require the disclosure of information that enables users of the financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months.

Application date

This [draft] Standard applies to annual periods beginning on or after ... [1 January 2024], with earlier application permitted.

[Draft] Accounting Standard AASB 2023-X

The Australian Accounting Standards Board makes Accounting Standard AASB 2023-X *Amendments to Australian Accounting Standards – Disclosure of Non-current Liabilities with Covenants: Tier 2* under section 334 of the *Corporations Act 2001*.

Dated ... [date]

Keith Kendall
Chair – AASB

[Draft] Accounting Standard AASB 2023-X *Amendments to Australian Accounting Standards – Disclosure of Non-current Liabilities with Covenants: Tier 2*

Objective

- 1 This Standard amends AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (March 2020) to:
- (a) clarify that a liability is classified as non-current if an entity has the right at the reporting date to defer settlement of the liability for at least twelve months after the reporting date;
 - (b) clarify the reference to settlement of a liability by the issue of equity instruments in classifying liabilities; and
 - (c) require the disclosure of information that enables users of the financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months.

These amendments reflect the issuance of AASB 2020-1 *Amendments to Australian Accounting Standards – Classification of Liabilities as Current or Non-Current* (March 2020) and AASB 2022-6 *Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants* (December 2022).

Application

- 2 The amendments set out in this Standard apply to entities and financial statements in accordance with the application of AASB 1060 set out in AASB 1057 *Application of Australian Accounting Standards*.
- 3 This Standard applies to annual periods beginning on or after ... [1 January 2024]. This Standard may be applied to annual periods beginning before ... [1 January 2024].
- 4 This Standard uses underlining, striking out and other typographical material to identify the amendments to AASB 1060, 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. Amended paragraphs are shown with deleted text struck through and new text underlined.

Amendments to AASB 1060

- 5 Paragraph 40 is amended and paragraph 47A is added. Deleted text is struck through and new text is underlined.

Statement of Financial Position³

...

Current liabilities

- 40 An entity shall classify a liability as current when:
- (a) it expects to settle the liability in the entity's 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 date; or
- (d) the entity does not have ~~the an unconditional right at the reporting date~~ to defer settlement of the liability for at least twelve months after ~~the~~ reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by ~~the issue of equity instruments do not affect its classification~~ the transfer of the entity's own equity instruments do not affect its classification as current or non-current if, applying AASB 132 *Financial Instruments: Presentation*, the entity classifies the option as an equity instrument, recognising it separately from the liability as an equity component of a compound financial instrument.

[Based on *IFRS for SMEs* Standard paragraph 4.7]

...

Information to be presented either in the statement of financial position or in the notes

...

47A In applying paragraph 40, 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 date. 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 date, 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 – 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 reporting date.

Commencement of the legislative instrument

6 For legal purposes, this legislative instrument commences on ... [31 December 2023].

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, AASB 2023-X Amendments to Australian Accounting Standards – Disclosure of Non-current Liabilities with Covenants: Tier 2.

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s considerations in reaching the conclusions in this Exposure Draft. It sets out the reasons why the Board developed the Exposure Draft, the approach taken to developing the Exposure Draft and the bases for the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

Reasons for proposing these amendments

BC2 The Board issued AASB 2020-1 *Amendments to Australian Accounting Standards – Classification of Liabilities as Current or Non-Current* in March 2020 and AASB 2022-6 *Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants* in December 2022. These Standards amended AASB 101 *Presentation of Financial Statements* 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 (often referred to as ‘covenants’). AASB 2022-6 also amended an example in AASB Practice Statement 2 *Making Materiality Judgements* regarding assessing whether information about covenants is material for disclosure.

BC3 The amendments made by AASB 2020-1 and AASB 2022-6 principally affect the classification and disclosure of current and non-current liabilities for entities applying Tier 1 reporting requirements.¹ It is appropriate for the Board to consider making similar amendments to the Tier 2 Standard AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* to ensure consistency in the terminology and presentation requirements across Australian Accounting Standards.

Relevance of the amendments to AASB 1060

BC4 The AASB *For-Profit Entity Standard-Setting Framework* and the AASB *Not-for-Profit Entity Standard-Setting Framework* outline the approach adopted by the Board for considering whether to add to or amend disclosure requirements in AASB 1060 when the IASB makes amendments to full IFRS Standards.

BC5 Applying this approach, this Exposure Draft proposes that in relation to the amendments made by AASB 2020-1 and AASB 2022-6 to AASB 101:

- (a) where AASB 1060 contains a corresponding paragraph, AASB 1060 should be updated in a similar manner. If the corresponding paragraph in AASB 1060 (paragraph 40) is not updated, entities may interpret and apply the requirements of AASB 1060 differently from the corresponding requirements in AASB 101;
- (b) AASB 1060 should be updated in relation to the new disclosure requirements added to AASB 101 if the disclosure is of particular relevance in the Australian environment or addresses a matter of public policy since the amendments to AASB 101 do not introduce significant recognition and measurement differences. The rationale for adding paragraph 47A to AASB 1060 is further detailed in paragraph BC6; and
- (c) where guidance paragraphs were added to AASB 101, these paragraphs are not added to AASB 1060. When developing AASB 1060, the Board was aware that replacing certain Standards with sections in AASB 1060 also removed some of the guidance included in those Standards, where such guidance was also not included in the *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs Standard)*. However, to maintain the simplicity of the disclosure requirements in AASB 1060, the Board considered this preferable to considering on a case-by-case basis which guidance should be included and which could be omitted.² Although the

¹ AASB 1053 *Application of Tiers of Australian Accounting Standards* outlines that Australian Accounting Standards consist of two tiers of reporting requirements for preparing general purpose financial statements:

- (a) Tier 1: Australian Accounting Standards; and
- (b) Tier 2: Australian Accounting Standards – Simplified Disclosures.

² AASB 1060 paragraph BC55.

Board was unable to follow that approach in this case as the *IFRS for SMEs* Standard was last updated by the IASB in 2015, prior to the 2020 and 2022 amendments, on balance the Board considered that including the additional guidance paragraphs in AASB 1060 was not necessary. The Board noted that AASB 1060 paragraph 2 permits an entity applying AASB 1060 to refer to the guidance in other Australian Accounting Standards (including AASB 101) when helpful.

- BC6 When applying the approach outlined in paragraph BC5(b) to proposed paragraph 47A (corresponding to AASB 101 paragraph 76ZA), the Board considered that the required disclosures would provide useful information to the users of Tier 2 financial statements because it would allow them to understand the nature of the entity's covenants and the risk that a liability classified as non-current could nonetheless be repayable within twelve months. The Board considers that users of the financial statements of Tier 2 entities are particularly interested in information about an entity's short-term cash flows and obligations, commitments or contingencies, whether or not recognised as liabilities, and liquidity and solvency.³
- BC7 No changes to AASB 1060 are required in relation to the amendments made to AASB Practice Statement 2. This is because AASB Practice Statement 2 provides non-mandatory guidance to all entities on making materiality judgements when preparing general purpose financial statements in accordance with Australian Accounting Standards. Therefore, AASB 1060 does not include any guidance corresponding explicitly with that in AASB Practice Statement 2.

³ AASB 1060 paragraph BC41.