Hong Kong Institute of Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK

Update No. 243

(Issued 14 August 2020)

This Update relates to issuance of *Classification of Liabilities as Current or Non-current* (Amendments to HKAS 1 *Presentation of Financial Statements*). The amendments clarify how to classify debt and other liabilities as current or non-current.

The amendments aim to promote consistency in applying the requirements by helping companies determine whether, in the statement of financial position, debt and other liabilities with an uncertain settlement date should be classified as current (due or potentially due to be settled within one year) or non-current. The amendments include clarifying the classification requirements for debt a company might settle by converting it into equity.

The amendments clarify, not change, existing requirements, and so are not expected to affect companies' financial statements significantly. However, they could result in companies reclassifying some liabilities from current to non-current, and vice versa; this could affect a company's loan covenants.

The amendments are effective for annual periods beginning on or after 1 January 2023 retrospectively. Earlier application is permitted.

Document Reference and Title	***Instructions***
VOLUME II	
Contents of Volume II	Discard existing page i and replace with revised page i.
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)	
HKAS 1 (Revised) *Presentation of Financial Statements*	Replace the cover page and pages 2, 4 and 58 with revised cover page and revised pages 2, 4 and 58. Insert pages 55L–55N after page 55K and pages 91G–91J after page 91F.

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to August 2020)

HKAS 1 (Revised)
Revised ~~July 2019~~August 2020

Effective for annual periods
beginning on or after 1 January 2009

Hong Kong Accounting Standard 1 (Revised)

Presentation of Financial Statements

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Hong Kong Accounting Standard 1 *Presentation of Financial Statements* (HKAS 1) is set out in paragraphs 1–140 and Appendices A &~~C~~D. All the paragraphs have equal authority. HKAS 1 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting.* HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

This revised Standard was issued in December 2007 and revised in ~~January 2019~~ August 2020. It supersedes HKAS 1, issued in 2004, as amended in 2005.

Appendix D

Amendments to Classification of Liabilities as Current or Non-current

The following sets out amendments required for this Standard resulting from amendments to HKAS 1 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted.

Paragraphs 69, 73, 74 and 76 are amended. Paragraphs 72A, 75A, 76A, 76B and 139U are added. Paragraph 139D is deleted. Headings are added before paragraphs 70, 71, 72A and 76A. Paragraphs 70, 71, 72 and 75 are not amended, but are included for ease of reading. New text is underlined and deleted text is struck through.

Structure and content

...

Statement of financial position

...

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 ~~an unconditional~~ <u>the</u> right <u>at the end of the reporting period</u> to defer settlement of the liability for at least twelve months after the reporting period ~~(see paragraph 73). 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~~.**

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

<u>*Normal operating cycle (paragraph 69(a))*</u>

70 Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period. The same normal operating cycle applies to the classification of an entity's assets and liabilities. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months.

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 HKFRS 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 74 and 75.

72 An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if:

(a) the original term was for a period longer than twelve months; and

(b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are authorised for issue.

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 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.

73 If an entity ~~expects, and~~ has the ~~discretion,~~ right, at the end of the reporting period, to ~~refinance or~~ roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. ~~However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing)~~ If the entity has no such right, the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

74 When an entity breaches a ~~provision~~ 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 ~~an unconditional~~ 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.

75A Classification of a liability is unaffected by the likelihood that the entity will exercise its right to defer settlement of the liability for at least twelve months after the reporting period. If a liability meets the criteria in paragraph 69 for classification as non-current, it is classified as non-current even if management intends or expects the entity to settle the liability within twelve 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. However, in either of those circumstances, the entity may need to disclose information about the timing of settlement to enable users of its financial statements to understand the impact of the liability on the entity's financial position (see paragraphs 17(c) and 76(d)).

76 ~~In respect of loans classified as current liabilities, if~~ If the following events occur between the end of the reporting period and the date the financial statements are authorised for issue, those events are disclosed as non-adjusting events in accordance with HKAS 10 *Events after the Reporting Period*:

(a) refinancing on a long-term basis of a liability classified as current (see paragraph 72);

(b) rectification of a breach of a long-term loan arrangement classified as current (see paragraph 74); ~~and~~

(c) the granting by the lender of a period of grace to rectify a breach of a long-term loan arrangement ~~ending at least twelve months after the reporting period.~~ classified as current (see paragraph 75); and

(d) settlement of a liability classified as non-current (see paragraph 75A).

Settlement (paragraphs 69(a), 69(c) and 69(d))

76A For the purpose of classifying a liability as current or non-current, settlement refers to a transfer to the counterparty that results in the extinguishment of the liability. The transfer could be of:

(a) cash or other economic resources—for example, goods or services; or

(b) the entity's own equity instruments, unless paragraph 76B applies.

76B Terms of a liability that could, at the option of the counterparty, result in its settlement by the transfer of the entity's own equity instruments do not affect its classification as current or non-current if, applying HKAS 32 *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.

...

Transition and effective date

...

139D [Deleted]

...

139U *Classification of Liabilities as Current or Non-current*, issued in August 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 2023 retrospectively in accordance with HKAS 8. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

APPENDICES

Amendments to the Basis for Conclusions on other IFRSs

Amendments to the Basis for Conclusions on Definition of Material

Amendments to the Basis for Conclusions on Classification of Liabilities as Current or Non-current

DISSENTING OPINIONS

GUIDANCE ON IMPLEMENTING

IAS 1 *PRESENTATION OF FINANCIAL STATEMENTS*

Appendix

Amendments to the Basis for Conclusions on Classification of Liabilities as Current or Non-current

This appendix contains amendments to the Basis for Conclusions on IAS 1 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted.

Paragraphs BC38L–BC38P and the heading above paragraph BC38L are deleted. The heading above paragraph BC39 is replaced by a new heading and sub-heading. Paragraphs BC48A–BC48H are added and headings are added above paragraphs BC48A and BC48F. After paragraph BC105F, a new heading and paragraphs BC105FA–BC105FC are added. New text is underlined and deleted text is struck through.

Statement of financial position

...

~~Classification of the liability component of a convertible instrument (paragraph 69)~~

BC38L–BC38P [Deleted]

~~Effect of events after the reporting period on the classification of liabilities (paragraphs 69–76)~~

Current liabilities (paragraphs 69–76B)

Effect of events after the reporting period (paragraphs 69–76)

BC39 ...

Right to defer settlement for at least twelve months (paragraphs 69(d) and 72A–76)

BC48A Paragraph 69(d) specifies that, to classify a liability as non-current, an entity must have the right to defer settlement of the liability for at least twelve months after the reporting period. In January 2020, the Board amended aspects of this classification principle and related application requirements in paragraphs 73–76. The Board made the amendments in response to a request to reconcile apparent contradictions between paragraph 69(d)—which required an 'unconditional right' to defer settlement—and paragraph 73—which referred to an entity that 'expects, and has the discretion, to' refinance or roll over an obligation.

BC48B The Board added to the classification principle in paragraph 69(d) and the example in paragraph 73 clarification that an entity's right to defer settlement must exist 'at the end of the reporting period'. The need for the right to exist at the end of the reporting period was already illustrated in the examples in paragraphs 74 and 75 but was not stated explicitly in the classification principle.

BC48C The Board also observed that the classification principle requires an assessment of whether an entity has the right to defer settlement of a liability and not whether the entity will exercise that right. Accordingly:

(a) the Board amended paragraph 73, which discusses liabilities an entity has a right to roll over for at least twelve months after the reporting period. The Board deleted from paragraph 73 a suggestion that to classify such a liability as non-current, an entity must not only have the right to roll over the liability but also expect to exercise that right. The Board also aligned the terminology by replacing 'discretion' with 'right' in paragraph 73.

(b) the Board added paragraph 75A, which explicitly clarifies that classification is unaffected by management intentions or expectations, or by settlement of the liability within twelve months after the reporting period.

BC48D The Board considered whether an entity's right to defer settlement needs to be unconditional. The Board noted that rights to defer settlement of a loan are rarely unconditional—they are often conditional on compliance with covenants. The Board decided that if an entity's right to defer settlement of a liability is subject to the entity complying with specified conditions, the entity has a right to defer settlement of the liability at the end of the reporting period if it complies with those conditions at that date. Accordingly, the Board:

(a) deleted the word 'unconditional' from the classification principle in paragraph 69(d); and

(b) added paragraph 72A to clarify that if an entity's right to defer settlement is subject to compliance with specified conditions:

  (i) 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; and

  (ii) 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.

BC48E The Board considered whether to specify how management assesses an entity's compliance with a condition relating to the entity's cumulative financial performance (for example, profit) for a period extending beyond the reporting period. The Board concluded that comparing the entity's actual performance up to the end of the reporting period with the performance required over a longer period would not provide useful information—one of these measures would have to be adjusted to make the two comparable. However, the Board decided not to specify a method of adjustment because any single method could be inappropriate in some situations.

Settlement (paragraphs 76A–76B)

BC48F While developing the amendments discussed in paragraphs BC48A–BC48E, the Board considered whether a liability is 'settled' when it is rolled over under an existing loan facility. The Board concluded that rolling over a liability does not constitute settlement because it is the extension of an existing liability, which does not involve any transfer of economic resources. The Board also observed that a liability is defined as an obligation 'to transfer an economic resource' and that some types of liabilities are settled by transferring economic resources other than cash. For example, performance obligations within the scope of IFRS 15 *Revenue from Contracts with Customers* are settled by transferring promised goods or services. The Board decided it would be helpful to clarify those aspects of the meaning of the term 'settlement' and so added paragraph 76A.

BC48G While considering the meaning of the term settlement, the Board also considered liabilities an entity will or may settle by issuing its own equity instruments or, in other words, by converting the liability to equity. In *Improvements to IFRSs* issued in 2009, the Board had added to paragraph 69(d) a statement that '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 effect of this statement is that a bond that the holder may convert to equity before maturity is classified as current or non-current according to the terms of the bond, without considering the possibility of earlier settlement by conversion to equity.

BC48H The Board concluded that, when it had added the statement about counterparty conversion options in 2009, it had intended the statement to apply only to liabilities that include a counterparty conversion option that meets the definition of an equity instrument and, applying IAS 32 *Financial Instruments: Presentation*, is recognised separately from the host liability as the equity component of a compound financial instrument. The Board further concluded that, in other cases—that is, if an obligation to transfer equity instruments is classified applying IAS 32 as a liability or part of a liability—the transfer of equity instruments would constitute settlement of the liability for the purpose of classifying it as current or non-current. To reflect those conclusions, the Board moved the statement about counterparty conversion options from paragraph 69(d) to new paragraph 76B and clarified its scope.

Transition and effective date

Classification of Liabilities as Current or Non-current (Amendments to IAS 1)

BC105FA In January 2020 the Board issued *Classification of Liabilities as Current or Non-current* for the reasons described in paragraphs BC48A–BC48H. When issued, those amendments had an effective date of annual reporting periods beginning on or after 1 January 2022. Subsequently, the Board noted that the covid-19 pandemic has created pressures that could make it more challenging to implement any changes in classification of liabilities as current or non-current resulting from the application of these amendments. The pressures caused by the covid-19 pandemic could also delay the start and extend the duration of any renegotiation of loan covenants resulting from those changes. Consequently, the Board decided to provide entities with operational relief by deferring the effective date of the amendments by one year to annual reporting periods beginning on or after 1 January 2023. Earlier application of the amendments continues to be permitted.

BC105FB The Board noted that deferring the effective date would delay the implementation of the improvements to the classification of liabilities that the amendments intend to bring about. However, the amendments clarify the requirements for presentation of liabilities instead of fundamentally changing the required accounting; recognition and measurement requirements are unaffected by the amendments. Consequently, the Board concluded that the advantages of a deferral during a time of significant disruption would outweigh the disadvantages.

BC105FC The Board considered whether to introduce disclosure requirements as part of the amendment but concluded that this was unnecessary because an entity is required to comply with paragraph 30 of IAS 8. Application of that paragraph requires disclosure of known or reasonably estimable information relevant to assessing the possible impact of the application of the amendments issued in January 2020 on an entity's financial statements.