

# IFRS Accounting Standards in Practice 2024/2025

## Classification of Loans as Current or Non-current

2024/2025

February 2024

# Contents

1. INTRODUCTION .....	3
2. REQUIREMENTS OF IAS 1 RELATED TO THE CLASSIFICATION OF LIABILITIES AS CURRENT OR NON-CURRENT .....	4
3. CLASSIFICATION OF LOANS WITH COVENANTS .....	5
4. IMPLICATIONS OF A BREACH OF COVENANT .....	6
5. RIGHT TO ROLL OVER AN OBLIGATION .....	7
6. CLASSIFICATION FLOW CHART .....	8
7. EXAMPLES.....	10
A. COMPLIANCE WITH COVENANT REQUIRED AT THE END OF OR AFTER THE REPORTING PERIOD .....	10
B. COMPLIANCE WITH COVENANT REQUIRED PRIOR TO THE END OF THE REPORTING PERIOD .....	16
C. COMPLIANCE WITH COVENANT REQUIRED QUARTERLY OR PERIODICALLY .....	20
D. RIGHT TO ROLL OVER AN OBLIGATION .....	23
E. OTHER COMMON ISSUES.....	29
8. DISCLOSURE REQUIREMENTS .....	31
9. EFFECTIVE DATE AND FIRST TIME APPLICATION .....	33

## 1. INTRODUCTION

IAS 1 *Presentation of Financial Statements* includes the requirements for the classification of liabilities as current or non-current.

In January 2020, the International Accounting Standards Board (IASB) issued amendments to IAS 1 *Classification of Liabilities as Current or Non-current* (the 2020 Amendments), which introduced certain requirements related to the determination of the existence of a right at the end of the reporting period to defer settlement of a liability for at least twelve months after the reporting period. One of the requirements prescribed by the 2020 Amendments related to the classification of liabilities subject to covenants (e.g. a bank loan where the lender may demand accelerated repayment if financial covenants are not met). The 2020 Amendments provided that if an entity's right to defer settlement for at least twelve months is subject to the entity complying with specified conditions within that period (e.g. a covenant test six months after the reporting date), the right to defer settlement for twelve months exists at the end of the reporting period only if the entity complies with those conditions at the end of the reporting period. Several concerns were raised about the outcome of these requirements. In order to address these concerns, in October 2022, the IASB issued further amendments to IAS 1 *Non-current Liabilities with Covenants* (the 2022 Amendments).

The 2022 Amendments modified the requirements introduced by the 2020 Amendments and now require that covenants that need to be complied with only after the reporting period do not affect whether the right to defer settlement for a period of at least twelve months after the reporting period (referred to as 'the right to defer settlement for at least twelve months' for brevity in this publication) exists at the end of the reporting period. A covenant affects whether the right to defer settlement for at least twelve months exists at the end of the reporting period only if the entity is required to comply with the covenant on or before the end of the reporting period.

The 2022 Amendments have brought clarity to several issues related to the classification of loans with covenants as current or non-current. However, there are many complexities in this determination. Preparers need to consider the interaction of different paragraphs of IAS 1 to conclude on the appropriate classification of liabilities with covenants.

This BDO IFRS® *Accounting Standards In Practice* provides an overview of the requirements of IAS 1 related to the classification of loans as current or non-current, as amended by the 2022 Amendments. It also includes a flow chart to help in determining the classification of loans with covenants, along with application of the flow chart to multiple scenarios.

The focus of this publication is on the classification of loans with covenants as current or non-current. It does not address the classification of other liabilities.

The term 'the Amendments' is used in this publication to refer to the cumulative effect of the 2020 and 2022 Amendments. The Amendments are effective for annual reporting periods beginning on or after 1 January 2024, with earlier application permitted - see [section 9](#) for further information.

## 2. REQUIREMENTS OF IAS 1 RELATED TO THE CLASSIFICATION OF LIABILITIES AS CURRENT OR NON-CURRENT

IAS 1.69 requires an entity to classify a liability as current when any of the following criteria are met:

- 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 is required to classify all other liabilities as non-current.

The flow chart and the examples in this publication assume that conditions (a) to (c) above are not met, unless stated otherwise. Therefore, the focus of the subsequent discussion is on the assessment of whether the condition in IAS 1.69(d) is met i.e. whether the right to defer settlement of the liability for at least twelve months exists at the end of the reporting period.

IAS 1.72A requires the right to defer settlement of the liability for at least twelve months to have substance. The flow chart and the examples in this publication assume the right to defer settlement to have substance, unless stated otherwise.



### 3. CLASSIFICATION OF LOANS WITH COVENANTS

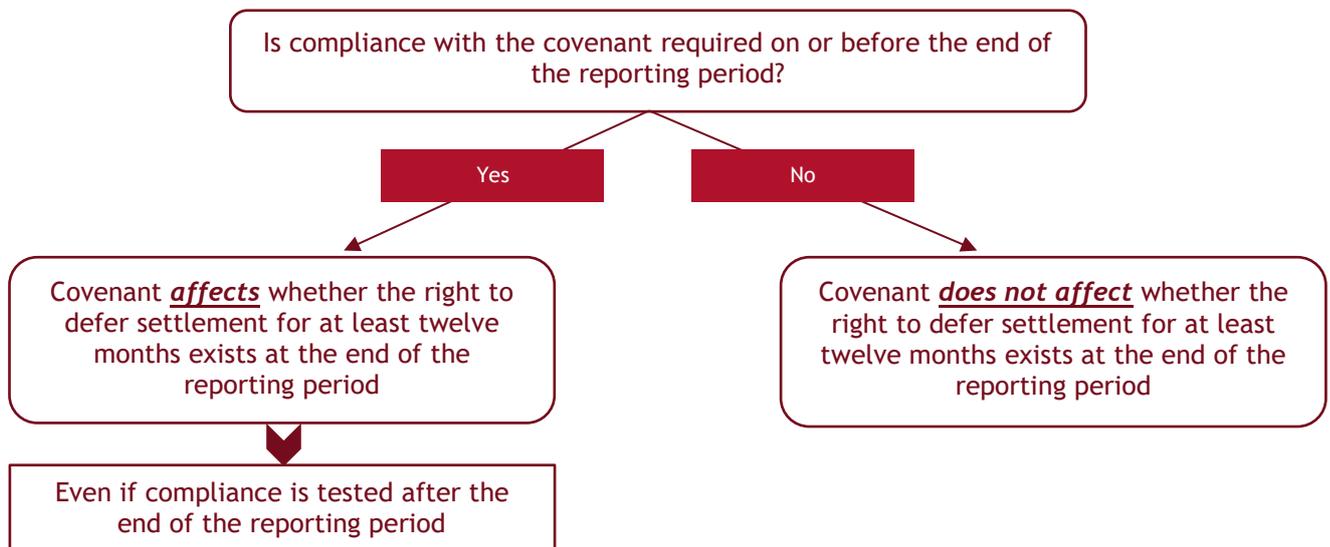
IAS 1.72B, introduced by the 2022 Amendments, provides the core requirement for the determination of the right to defer settlement of liabilities arising from loan arrangements for at least twelve months subject to compliance with conditions (referred to as ‘covenants’).

#### IAS 1.72B (*emphasis added*)

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).

The following diagram depicts the requirements of IAS 1.72B:



IAS 1.76ZA sets out the disclosure requirements for situations where an entity classifies liabilities arising from loan arrangements as non-current when the entity’s right to defer settlement of those liabilities for at least twelve months is subject to the entity complying with covenants within twelve months after the end of the reporting period (refer to [section 8](#) for further discussion).

## 4. IMPLICATIONS OF A BREACH OF COVENANT

IAS 1.74-75 provide the requirements for the classification of a liability subject to compliance with a covenant when an entity breaches the covenant. There were no substantial changes made to IAS 1.74-75 by the Amendments.

### IAS 1.74 (*emphasis added*)

When an entity breaches a covenant 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.

### IAS 1.75 (*emphasis added*)

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.

### Waiver of a breach of covenant

In some cases, the lender provides a waiver for a breach of a covenant. A waiver would be different from a period of grace referred to in IAS 1.75.

IAS 1 does not define a period of grace. The term 'waiver' is not used in IAS 1.

#### **BDO Comment:**

In our view, a waiver would refer to the lender surrendering the rights related to the breach of covenant. For example, the lender surrenders its right to demand immediate repayment, which arises from a breach.

A period of grace would refer to a time period provided by the lender during which the lender agrees not to demand immediate repayment of the loan due to the breach. At the end of the time period, the lender regains the right to demand immediate repayment resulting from the breach.

Thus, in our view, a waiver would be a complete surrender of the rights, whereas a period of grace is a suspension of the rights for a specified period of time.

The requirement in IAS 1.75 of a minimum period of twelve months after the reporting period for classification of the liability as non-current would apply to a period of grace, but not to a waiver, as the waiver is a complete surrender of the rights of the lender related to the breach. In substance, a waiver is permanent and not for a particular period of time.

In our view, a waiver effectively modifies the terms of the loan arrangement, removing the covenant that is waived from the contractual terms of the liability.

Sometimes, the assessment of the modification of the contractual terms may involve legal interpretation to ascertain the precise nature of the rights surrendered or retained by the lender.

## 5. RIGHT TO ROLL OVER AN OBLIGATION

Often, loan arrangements provide entities with a right to roll over an obligation when it is due for repayment. IAS 1.73 sets out the requirements related to the classification of liabilities with a right to roll over as current or non-current.

### IAS 1.73 (*emphasis added*)

If an entity has the right, at the end of the reporting period, to 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. If the entity has no such right, the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

### **BDO Comment: Interaction between IAS 1.73 and IAS 1.72B(b)**

Loan arrangements may provide the borrower with a right to roll over an obligation subject to the entity complying with a covenant on the date of the roll over. If an entity has such a right to roll over an obligation after the end of the reporting period, a question arises as to how the related covenant test should be treated, i.e. whether IAS 1.72B(b) applies to such a covenant test.

IAS 1 does not provide explicit guidance on the interaction between IAS 1.73 and IAS 1.72B(b).

In our view, IAS 1.73 and IAS 1.72B(b) are complementary. Therefore, if the right to roll over an obligation is subject to a covenant test and the entity is required to comply with the covenant only after the end of the reporting period, that covenant will not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period. As a result, considering the requirements of IAS 1.73, the liability will be classified as non-current at the end of the reporting period.

Therefore, if an entity has the right to roll over an obligation for at least twelve months after the reporting period, the obligation will be classified as non-current irrespective of whether such a right to roll over is subject to a covenant or not.

However, the analysis may differ if the entity is required to comply with another covenant on or before the end of the reporting period and failure to meet that covenant would result in the lender obtaining the right to demand immediate repayment (refer to [section 6](#) - Classification Flow Chart and [section 7 - example D\(II\)](#)).

## 6. CLASSIFICATION FLOW CHART

The flow chart in this section summarises the requirements of IAS 1 related to the classification of loans as current or non-current. The following points should be noted in using the flow chart:

1. The flow chart is for the assessment of the classification of loans as current or non-current. It does not address the classification of other liabilities.
2. As the flow chart is applicable only to loan arrangements, the assessment of the criteria in IAS 1.69(a)-(b) is not applicable. If the loan is due to be settled within twelve months after the reporting period (IAS 1.69(c)), the answer to Question 2 will be 'Yes'. The answers to Questions 3-6 will then determine the classification of such loans.

If the answer to Question 2 is No, i.e. the loan is not scheduled to be settled within twelve months after the reporting period, Questions 7-11 assess whether the entity has the right to defer settlement of the liability for at least twelve months after the reporting period.

3. Questions 9 and 10 ask whether the lender has provided a waiver or a period of grace for the covenant violation before the end of the reporting period. It should be noted that for a non-current classification, the waiver or period of grace should be provided **by the end of the reporting period**. If it is received after the end of the reporting period, the loan will be classified as current. This is because the classification of the liability depends on whether the entity had a right to defer settlement for at least twelve months at the end of the reporting period. If the breach of covenant occurred on or before the end of the reporting period and the waiver or period of grace was received after the end of the reporting period, the entity would not have a right to defer settlement for at least twelve months at the end of the reporting period.
4. The flow chart is applicable to annual as well as interim reporting period ends.
5. Question 3 states that even if the right to roll over the obligation is subject to the entity complying with a covenant, answer 'YES'. Question 4 asks whether the entity is required to comply with a covenant on or before the end of the reporting period. If the answer to Question 4 is 'YES', the flow chart further assesses compliance with the covenant. Such a scenario may arise if the entity is required to meet covenant tests more than once during the year and the right to roll over the obligation is subject to one of the covenant tests (refer to [section 7 - Example D\(II\)](#)).
6. The flow chart considers the classification requirements of IAS 1 for loan arrangements only in the context of settlement of the loans being in cash. It is possible for 'settlement' to mean the transfer of other economic resources, such as the entity's own equity instruments. In certain cases, loans may be classified as current liabilities despite there being a right to defer settlement of the liability in cash for twelve months. This would be the case if an entity issued a convertible note repayable in cash in 5 years' time with an American-style conversion option exercisable at the option of the counterparty at any time, with the option resulting in the issuance of a variable number of the entity's own equity instruments. Such a conversion feature would typically result in the entire loan being classified as a current liability because the conversion feature is not classified as an equity instrument and it may result in the settlement of the loan within twelve months (see IAS 1.76A-76B).



## 7. Examples

In the following examples, we analyse various fact patterns using the classification flow chart discussed in section 6. The examples include multiple variations of several base fact patterns.

### A. COMPLIANCE WITH COVENANT REQUIRED AT THE END OF OR AFTER THE REPORTING PERIOD

#### Base fact pattern A:

Entity A obtains a loan from Bank B on 1 January 20X0. The loan is repayable in full after five years. Entity A's annual reporting period end is 31 December. The loan arrangement requires Entity A to have a working capital ratio above 1.1 at every annual period end i.e. 31 December. Failure to meet the covenant test of the working capital ratio results in Bank B having the right to demand immediate repayment of the loan.

The following scenarios analyse the assessment of the classification of the loan at 31 December 20X1.

#### Example A1: Covenant met at the end of the reporting period

Entity A's working capital ratio as at 31 December 20X1 is 1.3 and it therefore meets the covenant test at the end of the reporting period.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable four years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant at the end of the annual reporting period. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A has met the covenant test as at 31 December 20X1. Therefore, the answer to **Question 8** is 'Yes'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

#### Example A2: Covenant not met at the end of the reporting period

Entity A's working capital ratio as at 31 December 20X1 is 1. Therefore, it does not meet the covenant at the end of the reporting period. There is no waiver of the breach of covenant from Bank B, nor did Bank B provide a period of grace for the covenant violation.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable four years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant at the end of the annual reporting period. The covenant test was not waived prior to the point at which the covenant was to be tested. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A did not meet the covenant test as at 31 December 20X1. Therefore, the answer to **Question 8** is 'No'.

- The lender has not provided a waiver for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 9** is 'No'.
- The lender has not provided a period of grace for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 10** is 'No'.

Therefore, the loan is classified as '**Current**' as at 31 December 20X1.

#### Example A3: Waiver of breach received after the end of the reporting period.

Entity A's working capital ratio as on 31 December 20X1 is 1. Therefore, it does not meet the covenant on 31 December 20X1. Entity A's financial statements for the year ended 31 December 20X1 are authorised for issue on 20 February 20X2. Entity A receives a waiver of the breach from Bank B on 15 January 20X2.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable four years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant at the end of the annual reporting period. The covenant test was not waived prior to the point at which the covenant was to be tested. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A did not meet the covenant test as at 31 December 20X1. Therefore, the answer to **Question 8** is 'No'.
- The lender has not provided a waiver for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 9** is 'No'.
- The lender has not provided a period of grace for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 10** is 'No'.

Therefore, the loan is classified as '**Current**' as at 31 December 20X1.

In this example, the waiver of the breach is received after the end of the reporting period, although before the financial statements are authorised for issue. For the purpose of classification of a liability as non-current, the existence of the right to defer settlement for at least twelve months after the end of the reporting period must exist at the end of the reporting period (IAS 1.69(d)). In this case, Entity A does not have such a right to defer settlement at the end of the reporting period. Therefore, the liability is classified as current.

#### BDO Comment:

A waiver of the breach received after the end of the reporting period is a non-adjusting event in accordance with IAS 10 *Events After the Reporting Period*. IAS 10.21 requires disclosure of the following for each material category of non-adjusting event after the reporting period:

- a. the nature of the event; and
- b. an estimate of its financial effect, or a statement that such an estimate cannot be made.

Depending on the facts and circumstances, the entity should evaluate the applicability of the disclosure requirements of IAS 10.21.

#### Example A4: Waiver of an expected breach received before the end of the reporting period

At the beginning of December 20X1, Entity A expects the working capital ratio at the end of the reporting period to be 0.9. Therefore, it approaches Bank B for a waiver of the expected breach of covenant. On 15 December 20X1, Bank B provides a waiver from the expected breach.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable four years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant at the end of the annual reporting period. However, the covenant test was waived prior to the point at which the covenant was to be tested i.e. 31 December 20X1. Therefore, the answer to **Question 7** is 'No'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

#### BDO Comment:

In this example, the covenant test was waived prior to the point of testing. In our view, such a waiver effectively modifies the contractual terms to remove the covenant test from the terms of the loan arrangement. Therefore, in our view, the assessment of the classification of the loan as current or non-current will consider the loan to not have a covenant test as at 31 December 20X1. Therefore, the loan is classified as non-current.

#### Example A5: Anticipated breach is waived; the lender inserts a new covenant test

At the beginning of December 20X1, Entity A expects the working capital ratio at the end of the reporting period to be 0.9. Therefore, it approaches Bank B for a waiver of the expected breach. On 15 December 20X1, Bank B provides a waiver from the expected breach. However, it inserts a new covenant test based on Entity A's financial position as at 31 March 20X2. If the covenant is not met in the 31 March 20X2 test, Bank B will have the right to demand immediate repayment of the loan.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable four years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant at the end of the annual reporting period. However, the covenant test was waived prior to the point at which the covenant was to be tested i.e. 31 December 20X1. Therefore, the answer to **Question 7** is 'No'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

**BDO Comment:**

Similar to Example A4, the waiver received prior to the testing of the covenant has modified the contractual terms of the loan arrangement and the classification of the loan as current or non-current will be assessed considering the loan as not having a covenant test on 31 December 20X1.

In this example, at the time of the waiver, the lender has inserted a new covenant, which will be tested after the end of the reporting period, which has also modified the contractual terms of the loan arrangement. In our view, IAS 1.72B(b) will apply to the new covenant inserted as compliance with the covenant is required after the end of the reporting period (see [Section 3](#)). Therefore, this new covenant does not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period.

As a result, the loan is classified as non-current. Disclosures will be required in accordance with IAS 1.76ZA because there is a covenant test within twelve months after the reporting date, which could result in the loan becoming repayable (see [Section 8](#)).

**Example A6: Period of grace provided for expected covenant violation**

At the beginning of December 20X1, Entity A expects the working capital ratio at the end of the reporting period to be 0.9. On 15 December 20X1, on Entity A's request, Bank B agrees that it will not exercise its right to demand the loan until 30 June 20X2. As part of this agreement to not demand repayment, Bank B introduces a working capital ratio covenant test as on 30 June 20X2.

The working capital ratio as at 31 December 20X1 was 0.9, as expected.

After 30 June 20X2, Bank B will reconsider the loan based on the new working capital ratio covenant. From 1 July 20X2, Bank B has the right to demand repayment of the loan with respect to the 31 December 20X1 covenant violation. Bank B has this right irrespective of whether Entity A meets the new covenant on 30 June 20X2.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable four years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant at the end of the annual reporting period. The covenant test was not waived prior to the point at which the covenant was to be tested. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A did not meet the covenant test as at 31 December 20X1. Therefore, the answer to **Question 8** is 'No'.
- The lender has not provided a waiver for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 9** is 'No'.
- The lender has provided a period of grace for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 10** is 'Yes'.
- The period of grace ends on 30 June 20X2 i.e. before twelve months from the end of the reporting period. Therefore, the answer to **Question 11** is 'No'.

Therefore, the loan is classified as '**Current**' as at 31 December 20X1.

**BDO Comment:**

The fact pattern in Example A6 may appear similar to that in Example A5.

However, in the fact pattern in Example A5, the lender provided a complete waiver from the breach of covenant, whereby all the rights related to the breach of covenant were surrendered by the lender.

In Example A6, the lender has provided a period of grace in respect of the covenant to be tested as at 31 December 20X1. Effectively, the lender has retained the rights related to the breach of covenant that was expected to (and did) occur as at 31 December 20X1.

In both the examples, there is a covenant which will be tested within twelve months of the end of the reporting period.

In Example A5, if the covenant is met in March 20X2, the lender does not obtain a right to demand immediate repayment. If the covenant is not met, the lender obtains the right to demand immediate repayment. This right arises from the breach of the future covenant that will be tested in March 20X2 and not the original breach that was expected to occur on 31 December 20X1. Therefore, IAS 1.72B(b) applies to the covenant to be complied with in March 20X2 in Example A5 and the covenant does not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period. Therefore, the loan is classified as non-current in Example A5.

In Example A6, although the lender has added a new covenant to be tested in June 20X2, the lender regains the right to demand immediate repayment, irrespective of the outcome of the covenant test in June 20X2. This right arises from the original breach of covenant that was expected to (and did) occur as at 31 December 20X1 and not a breach of the new covenant. Therefore, the requirements of IAS 1.75 apply in this case. In the fact pattern in Example A6, the period of grace is less than twelve months from the end of the reporting period. Therefore, the criterion in IAS 1.75 is not met and the loan is classified as current.

**Example A7: Covenant required to be met after the end of the reporting period**

Consider a similar base fact pattern as 'Base fact pattern A' above, except that the covenant is to be tested based on the working capital ratio as at 31 January 20X2. At the end of the reporting period i.e. 31 December 20X1, Entity A expects the working capital ratio to be 0.9 on 31 January 20X2. Thus, the covenant is expected to be breached after the end of the reporting period.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable four years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant after the end of the annual reporting period. Therefore, the answer to **Question 7** is 'No'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

As required by IAS 1.72B(b), if compliance with a covenant is required only after the end of reporting period, that covenant does not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period. However, in such situations, IAS 1.76ZA requires entities to 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 (refer to [Section 8](#)).



## B. COMPLIANCE WITH COVENANT REQUIRED PRIOR TO THE END OF THE REPORTING PERIOD

### Base fact pattern B:

Entity A obtains a loan from Bank B on 1 January 20X0. The loan is repayable in full after five years. Given the seasonal nature of Entity A's business, the loan arrangement requires Entity A to have a working capital ratio above 1.1 as at every 31 October. Failure to meet the covenant test of the working capital ratio results in Bank B having the right to demand immediate repayment of the loan. Entity A's annual reporting period end is 31 December.

The following scenarios analyse the assessment of classification of the loan at 31 December 20X1.

#### Example B1: Anticipated breach is waived; the lender inserts a new covenant test

At the beginning of October 20X1, Entity A expects the working capital ratio at the end of October 20X1 to be 1.0. It approaches Bank B for a waiver in anticipation of a breach of covenant. Bank B provides a waiver of the anticipated breach on 15 October 20X1. Bank B inserts a new debt-equity ratio test based on Entity A's financial position as at 31 March 20X2. If the new covenant is not met in the 31 March 20X2 test, Bank B will get the right to demand immediate repayment of the loan.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable three years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant before the end of the reporting period. However, the covenant test was waived prior to the point at which the covenant was to be tested i.e. 31 October 20X1. Therefore, the answer to **Question 7** is 'No'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

#### Example B2: Waiver received after the breach

Entity A's working capital ratio as at 31 October 20X1 is 1. Therefore, there is a breach of covenant as at 31 October 20X1. Subsequent to the breach, Entity A approaches Bank B for a waiver. Bank B provides a waiver on 15 November 20X1.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable three years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant before the end of the reporting period. The covenant test was not waived prior to the point at which the covenant was to be tested i.e. 31 October 20X1. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A did not comply with the covenant. Therefore, the answer to **Question 8** is 'No'.
- Bank B provided a waiver for the covenant violation before the end of the reporting period i.e. 31 December 20X1. Therefore, the answer to **Question 9** is 'Yes'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

**BDO Comment:**

In this example, the waiver is provided after the breach has occurred, but before the end of the reporting period. By way of waiver, the contractual terms of the loan arrangement are modified such that the lender has surrendered its rights arising from the breach.

As a result, at the end of the reporting period, Entity A has the right to defer settlement of the liability for a period of twelve months after the end of the reporting period. This right is subject to the covenant test that will be performed in October 20X2. However, IAS 1.72B(b) applies to this covenant test and the covenant does not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period.

In our view, Entity A is in the same economic position as at 31 December 20X1 in the fact patterns in Example B1 (where the waiver is received prior to the date on which the covenant test is carried out) and Example B2 (where the waiver is received after the breach has occurred, but before the end of the reporting period). In both the fact patterns, Entity A has the right to defer settlement for at least twelve months as at 31 December 20X1 and the loan is classified as non-current.

In our view, whether the waiver is received prior to the breach or after the breach will not affect the analysis, provided the waiver is received on or before the end of the reporting period.

**Example B3: Breach is waived; the lender demands additional collateral as a condition**

Entity A's working capital ratio as at 31 October 20X1 is 1.0. Therefore, there is a breach of covenant as at 31 October 20X1. Subsequent to the breach, Entity A approaches Bank B for a waiver. Bank B provides a waiver on 15 November 20X1, subject to the provision of Entity A's new factory building as additional collateral. The additional collateral is provided by 30 November 20X1.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable three years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant before the end of the reporting period. The covenant test was not waived prior to the point at which the covenant was to be tested i.e. 31 October 20X1. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A did not comply with the covenant. Therefore, the answer to **Question 8** is 'No'.
- Bank B provided a waiver for the covenant violation before the end of the reporting period i.e. 31 December 20X1. Therefore, the answer to **Question 9** is 'Yes'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

**BDO Comment:**

In this example, the waiver provided is subject to provision of additional collateral. The collateral is provided by the end of the reporting period. Therefore, the waiver is complete by the end of the reporting period and the loan is classified as non-current.

If the collateral were not provided by the end of the reporting period, the waiver of the breach would be incomplete by the end of the reporting period as the condition attached to it would not have been met. In such a scenario, the loan would be classified as current.

**Example B4: Breach is waived; the lender inserts a new covenant test**

Entity A's working capital ratio as at 31 October 20X1 is 1.0. Therefore, it does not meet the covenant on 31 October 20X1. Subsequent to the breach, Entity A approaches Bank B for a waiver. Bank B provides a waiver on 15 November 20X1. It further inserts a new debt-equity ratio test based on Entity A's financial position as at 31 March 20X2. Failure to meet the new covenant test as at 31 March 20X2 would result in Bank B having the right to demand immediate repayment of the loan.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable three years after the end of the reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant before the end of the reporting period. The covenant test was not waived prior to the point at which the covenant was to be tested i.e. 31 October 20X1. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A did not comply with the covenant. Therefore, the answer to **Question 8** is 'No'.
- Bank B provided a waiver for the covenant violation before the end of the reporting period i.e. 31 December 20X1. Therefore, the answer to **Question 9** is 'Yes'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

**BDO Comment:**

In this example, the waiver is provided after the breach has occurred, but before the end of the reporting period. By way of waiver, the contractual terms of the loan arrangement are modified such that the lender has surrendered its rights arising from the breach.

As a result, at the end of the reporting period, Entity A has the right to defer settlement of the liability for a period of twelve months after the end of the reporting period. However, Bank B inserted a new covenant test that will be performed in March 20X2. Therefore, Entity A's right to defer settlement for at least twelve months is subject to the covenant test that will be performed in March 20X2. However, since compliance with the covenant is required only after the end of the reporting period, IAS 1.72B(b) applies to this covenant test and the covenant does not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period.

Therefore, the loan is classified as non-current as at 31 December 20X1.

## Example B5: Period of grace provided by the lender

Fact pattern (*different from the base fact pattern B*):

Entity A has an outstanding loan as at 31 December 20X1, which is repayable after five years. The loan arrangement provides for an annual current ratio covenant test, which is based on the statement of financial position as at every 30 November. A breach of covenant results in the lender having the right to demand immediate repayment of the loan until the next covenant test date i.e. 30 November of the following year.

Entity A breaches the current ratio covenant as at 30 November 20X1. On 15 December 20X1, the lender agrees that it will not exercise its right to demand the loan until 30 June 20X2. As part of this agreement to not demand repayment, the lender introduces a new current ratio covenant test as at 30 June 20X2. After 30 June 20X2, the lender will reconsider the loan based on the new current ratio covenant. From 1 July 20X2, the lender has the right to demand repayment of the loan with respect to the 30 November 20X1 covenant violation. The lender has this right irrespective of whether Entity A meets the new covenant on 30 June 20X2.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable after five years. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant before the end of the annual reporting period. The covenant test was not waived prior to the point at which the covenant was to be tested. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A did not meet the covenant test as at 30 November 20X1. Therefore, the answer to **Question 8** is 'No'.
- The lender has not provided a waiver for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 9** is 'No'.
- The lender has provided a period of grace for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 10** is 'Yes'.
- The period of grace ends on 30 June 20X2 i.e. before twelve months from the end of the reporting period. Therefore, the answer to **Question 11** is 'No'.

Therefore, the loan is classified as '**Current**' as at 31 December 20X1.

The analysis for this example is similar to that in Example A6.

## C. COMPLIANCE WITH COVENANT REQUIRED QUARTERLY OR PERIODICALLY

### Base fact pattern C:

Entity A obtains a loan from Bank B on 1 January 20X0. The loan is repayable in full after five years.

Entity A's annual reporting period end is 31 December. It prepares quarterly interim financial statements.

The loan arrangement requires Entity A to have a current ratio of at least 1.5 as at 31 March, 30 June, 30 September and 31 December. Failure to meet the covenant test of the working capital ratio results in Bank B having the right to demand immediate repayment of the loan up to the date of the next covenant test.

The following scenarios analyse the assessment of classification of the loan at the end of various interim reporting periods.

#### Example C1: Anticipated breach is waived; covenant is not expected to be met for the subsequent interim period

At the beginning of March 20X1, Entity A expects to have a current ratio of 1.4 as at 31 March 20X1. It approaches Bank B for a waiver of the anticipated breach. Bank B provides a waiver of the anticipated breach on 15 March 20X1. Entity A expects the current ratio to be 1.45 as on 30 June 20X1.

The current ratio as at 31 March 20X1 is 1.4, as expected.

The analysis of classification of the loan as at 31 March 20X1 is as below:

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is not scheduled to be repaid within twelve months from the end of the interim reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant at the end of the interim reporting period. However, the covenant test was waived prior to the point at which the covenant was to be tested i.e. 31 March 20X1. Therefore, the answer to **Question 7** is 'No'.

Therefore, the loan is classified as '**Non-current**' as at 31 March 20X1.

The next covenant testing is on 30 June 20X1 and the management does not expect to meet the covenant. Thus, in less than twelve months after the end of the reporting period (interim reporting period in this case), a breach of covenant is expected and Bank B would then get the right to demand immediate repayment of the loan.

However, as required by IAS 1.72B(b), if compliance with a covenant is required only after the end of reporting period, that covenant does not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period. Therefore, the loan would still be classified as non-current as at 31 March 20X1 since, due to the waiver of the anticipated breach of covenant received on 15 March 20X1, Entity A is effectively not required to meet a covenant on or before the end of the reporting period. However, in such situations, IAS 1.76ZA requires entities to 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 (see [Section 8](#)).

### Example C2: Breach is waived; the covenant is expected to be met in the subsequent interim period

Consider a fact pattern similar to the base fact pattern, except that the covenant testing is required as of 28/29 February, 31 May, 31 August and 30 November.

Entity A's current ratio is 1.45 as at 28 February 20X1. Therefore, there is a breach of covenant. In March 20X1, Entity A approaches Bank B for a waiver of the breach. Bank B provides a waiver of the breach on 15 March 20X1. Entity A expects the current ratio to be 1.6 on 31 May 20X1.

The analysis of classification of the loan as at 31 March 20X1 is as below:

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is not scheduled to be repaid within twelve months from the end of the interim reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant before the end of the reporting period. The covenant test was not waived prior to the point at which the covenant was to be tested i.e. 28 February 20X1. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A did not comply with the covenant. Therefore, the answer to **Question 8** is 'No'.
- Bank B provided a waiver for the covenant violation before the end of the reporting period i.e. 31 March 20X1. Therefore, the answer to **Question 9** is 'Yes'.

Therefore, the loan is classified as '**Non-current**' as at 31 March 20X1.

Similar to Example B2, in our view, whether the waiver is received prior to the breach or after the breach will not affect the analysis, provided the waiver is received on or before the end of the reporting period.

### Example C3: Covenant is breached in the current interim reporting period and is met in the subsequent interim reporting period

Entity A's current ratio is 1.4 as at 31 March 20X1, resulting in a breach of covenant. There is no waiver of the breach of covenant as at 31 March 20X1 nor a period of grace. Entity A's current ratio is 1.6 as at 30 June 20X1.

The analysis of classification of the loan as at 31 March 20X1 and 30 June 20X1 is as below:

Analysis using the classification flow chart:

Classification of the loan as at 31 March 20X1:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is not scheduled to be repaid within twelve months from the end of the interim reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant at the end of the interim reporting period. The covenant test was not waived prior to the point at which the covenant was to be tested. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A did not meet the covenant test as at 31 March 20X1. Therefore, the answer to **Question 8** is 'No'.

- The lender has not provided a waiver for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 9** is 'No'.
- The lender has not provided a period of grace for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 10** is 'No'.

Therefore, the liability is classified as '**Current**'.

Classification of the loan as at 30 June 20X1:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is not scheduled to be repaid within twelve months from the end of the interim reporting period. Therefore, the answer to **Question 2** is 'No'.
- Entity A is required to comply with a covenant at the end of the interim reporting period. Therefore, the answer to **Question 7** is 'Yes'.
- Entity A has met the covenant test as at 30 June 20X1. Therefore, the answer to **Question 8** is 'Yes'.

Therefore, the loan is classified as '**Non-current**'.

**BDO comment:**

If the covenant is breached in one interim reporting period and met in a subsequent interim reporting period, the classification of the loan can fluctuate between current and non-current from one interim reporting period to another. The classification of the loan at the end of a particular reporting period will be affected only by those covenants that are required to be complied with on or before the end of that interim reporting period. Management's expectations about compliance with a covenant (or covenants) in subsequent interim reporting periods will not affect the classification of the loan at the end of the current reporting period.



## D. RIGHT TO ROLL OVER AN OBLIGATION

### Example D(I): Right to roll over an obligation

On 1 July 20X1, Entity A obtained a loan, repayable in full after three years i.e. on 30 June 20X4. At the end of the term of three years i.e. on 30 June 20X4, the loan arrangement provides Entity A the right to roll over the loan with the same lender for a period of another three years.

The analysis of the classification of the loan as at 31 December 20X3 is as below:

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable within twelve months from the end of the reporting period. Therefore, the answer to **Question 2** is 'Yes'.
- At the end of the reporting period, Entity A has a right to roll over the obligation for at least twelve months after the end of the reporting period. Therefore, the answer to **Question 3** is 'Yes'.
- Entity A is not required to comply with a covenant on or before the end of the reporting period, with failure to comply resulting in the lender having the right to demand repayment. Therefore, the answer to **Question 4** is 'No'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X3.

### Base fact pattern D(II):

Entity A has a loan from Bank B. The loan is a short-term facility that includes an annual roll over on 30 June. The loan arrangement requires Entity A to have a current ratio of at least 1.5 on 30 June and 31 December. Failure to meet the covenant on either date provides the lender with the right to demand immediate repayment of the loan.

The roll over on 30 June is subject to Entity A meeting the current ratio test. Entity A's annual reporting period-end is 31 December.

Following scenarios analyse the assessment of classification of the loan at 31 December 20X1.

### Example D(II)-1: Covenant at the end of the reporting period is met

Entity A's current ratio as at 31 December 20X1 is 1.7. Therefore, the covenant is met on 31 December 20X1. The current ratio is expected to be 1.75 on 30 June 20X2.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable within twelve months from the end of the reporting period. Therefore, the answer to **Question 2** is 'Yes'.
- At the end of the reporting period, Entity A has a right to roll over the obligation (subject to a covenant test) for at least twelve months after the end of the reporting period. Therefore, the answer to **Question 3** is 'Yes'.

- Entity A is required to comply with a covenant at the end of the reporting period, with failure to comply resulting in the lender having the right to demand repayment. Therefore, the answer to **Question 4** is 'Yes'.
- Entity A complied with the covenant at the end of the reporting period. Therefore, the answer to **Question 5** is 'Yes'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

IAS 1.72B(b) will apply to the covenant to be tested on 30 June 20X2. Therefore, this covenant will not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period i.e. 31 December 20X1. Classification of the loan as current or non-current at the end of the reporting period is not affected by the expectation about the compliance with a future covenant.

**Example D(II)-2(a): Covenant at the end of the reporting period not expected to be met; covenant on the date of the roll over is expected to be met**

Entity A's current ratio is expected to be 1.3 as at 31 December 20X1. Therefore, the covenant is expected to be breached. At the beginning of December 20X1, Entity A approaches Bank B for waiver of the anticipated breach. Bank B provides a waiver of the anticipated breach on 15 December 20X1. Entity A expects the current ratio to be 1.6 on 30 June 20X2.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable within twelve months from the end of the reporting period. Therefore, the answer to **Question 2** is 'Yes'.
- At the end of the reporting period, Entity A has a right to roll over the obligation (subject to a covenant test) for at least twelve months after the end of the reporting period. Therefore, the answer to **Question 3** is 'Yes'.
- Entity A is required to comply with a covenant at the end of the reporting period, with failure to comply resulting in the lender having the right to demand repayment. However, the covenant test was waived prior to the point at which the covenant was to be tested i.e. 31 December 20X1. Therefore, the answer to **Question 4** is 'No'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

IAS 1.72B(b) will apply to the covenant to be tested on 30 June 20X2. Therefore, this covenant will not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period i.e. 31 December 20X1. Classification of the loan as current or non-current at the end of the reporting period is not affected by the expectation about the compliance with a future covenant.

Example D(II)-2(b): Covenant at the end of the reporting period not expected to be met; covenant on the date of roll over is not expected to be met

Entity A's current ratio is expected to be 1.3 as at 31 December 20X1. Therefore, the covenant is expected to be breached. At the beginning of December 20X1, Entity A approaches Bank B for waiver of the anticipated breach. Bank B provides a waiver of the anticipated breach on 15 December 20X1. Entity A expects the current ratio to be 1.4 on 30 June 20X2, and therefore, anticipates a breach of covenant on 30 June 20X2 as well.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable within twelve months from the end of the reporting period. Therefore, the answer to **Question 2** is 'Yes'.
- At the end of the reporting period, Entity A has a right to roll over the obligation (subject to a covenant test) for at least twelve months after the end of the reporting period. Therefore, the answer to **Question 3** is 'Yes'.
- Entity A is required to comply with a covenant at the end of the reporting period, with failure to comply resulting in the lender having the right to demand repayment. However, the covenant test was waived prior to the point at which the covenant was to be tested i.e. 31 December 20X1. Therefore, the answer to **Question 4** is 'No'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

**BDO comment:**

IAS 1.72B(b) will apply to the covenant to be tested on 30 June 20X2. Therefore, this covenant will not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period i.e. 31 December 20X1. In Example D(II)-2(a), the covenant to be tested in June 20X2 is expected to be met, whereas in Example D(II)-2(b), the covenant is expected to be breached. In either case, it will not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period i.e. 31 December 20X1.

However, as required by IAS 1.76ZA, when the entity's right to defer settlement for at least twelve months of a liability classified as non-current is subject to compliance with covenants after the reporting period, the entity needs to 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. In our view, this disclosure requirement applies to situations involving roll over rights subject to compliance with covenant after the reporting period - see Examples D(II).

### Example D(II)-3: Anticipated breach of the covenant to be complied with prior to the end of the reporting period is waived

Consider a similar fact pattern as in base fact pattern D(II), except that the covenant is to be tested on 30 November and 31 May.

Entity A's current ratio on 30 November 20X1 is 1.3. Therefore, the covenant is breached on 30 November 20X1. In December 20X1, Entity A approaches Bank B for a waiver. Bank B provides a waiver of the breach on 15 December 20X1. The current ratio is expected to be 1.7 on 31 May 20X2, the date of the next covenant test.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable within twelve months from the end of the reporting period. Therefore, the answer to **Question 2** is 'Yes'.
- At the end of the reporting period, Entity A has a right to roll over the obligation (subject to a covenant test) for at least twelve months after the end of the reporting period. Therefore, the answer to **Question 3** is 'Yes'.
- Entity A is required to comply with a covenant before the end of the reporting period, with failure to comply resulting in the lender having the right to demand repayment. Therefore, the answer to **Question 4** is 'Yes'.
- Entity A did not comply with the covenant. Therefore, the answer to **Question 5** is 'No'.
- The lender provided a waiver for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 6** is 'Yes'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

Similar to Example B2, in our view, whether the waiver is received prior to the breach or after the breach will not affect the analysis, provided the waiver is received on or before the end of the reporting period.

### Base fact pattern D(III)

#### **Annual roll over subject to covenant testing:**

Entity A has a short-term loan which includes an annual roll over every 30 September. The roll over is subject to Entity A having a current ratio of at least 1.5 on the date of the roll over.

Entity A's annual reporting period end is 31 December.

The following scenarios (Example D(III)-1 and 2) analyse the assessment of classification of the loan as at 31 December 20X1.

#### Example D(III)-1: Covenant for annual roll over is met

Entity A's current ratio as at 30 September 20X1 is 1.7. Therefore, the covenant is met on 30 September 20X1 and the loan is rolled over for one year. The next covenant test is on the subsequent date of the roll over i.e. 30 September 20X2.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable within twelve months from the end of the reporting period. Therefore, the answer to **Question 2** is 'Yes'.
- At the end of the reporting period, Entity A has a right to roll over the obligation (subject to a covenant test) for at least twelve months after the end of the reporting period. Therefore, the answer to **Question 3** is 'Yes'.
- Entity A is required to comply with a covenant before the end of the reporting period (i.e. on 30 September 20X1). Therefore, the answer to **Question 4** is 'Yes'.
- Entity A complied with the covenant. Therefore, the answer to **Question 5** is 'Yes'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

#### Example D(III)-2: Breach of covenant for annual roll over is waived

Entity A's current ratio as at 30 September 20X1 is 1.3. Therefore, the covenant is breached on 30 September 20X1. Subsequent to the breach, Entity A approaches the lender for a waiver. The lender provides a waiver of the breach on 31 October 20X1. The next covenant test is on the subsequent date of roll over i.e. 30 September 20X2.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable within twelve months from the end of the reporting period. Therefore, the answer to **Question 2** is 'Yes'.
- At the end of the reporting period, Entity A has a right to roll over the obligation (subject to a covenant test) for at least twelve months after the end of the reporting period. Therefore, the answer to **Question 3** is 'Yes'.
- Entity A is required to comply with a covenant before the end of the reporting period. Therefore, the answer to **Question 4** is 'Yes'.
- Entity A did not comply with the covenant. Therefore, the answer to **Question 5** is 'No'.
- The lender provided a waiver for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 6** is 'Yes'.

Therefore, the loan is classified as '**Non-current**' as at 31 December 20X1.

**BDO comment:**

Entity A breached the covenant on 30 September 20X1. However, it received a waiver from the breach before the end of the reporting period.

IAS 1.73 requires a right to roll over an obligation for at least twelve months after the reporting period under an existing loan facility to be classified as non-current. In this case there is a covenant test nine months after the reporting period. However, in our view, IAS 1.72(B)(b) applies to the covenant that is required to be complied with in September 20X2. Therefore, this covenant does not affect whether Entity A has the right to defer settlement for at least twelve months as at 31 December 20X1. Considering Entity A's right to roll over the liability in September 20X2, the loan is classified as non-current as at 31 December 20X1.

**Example D(IV): Negotiations for a waiver of the breach are ongoing at the end of the reporting period**

Entity A has a long-term loan that is due for repayment on 31 December 20X1, which is the end of the annual reporting period. The loan arrangement provides Entity A with a right to roll over the loan for a period of five years if a working capital covenant is met as at 31 December 20X1. Entity A does not meet the covenant as at 31 December 20X1.

At the end of the reporting period, Entity A and the lender are negotiating whether to extend the loan for a period of 2 years, however, discussions have not yet concluded.

Analysis using the classification flow chart:

- The liability arises from a loan arrangement. Therefore, the answer to **Question 1** is 'Yes'.
- The loan is repayable within twelve months from the end of the reporting period. Therefore, the answer to **Question 2** is 'Yes'.
- At the end of the reporting period, Entity A has a right to roll over the obligation (subject to a covenant test) for at least twelve months after the end of the reporting period. Therefore, the answer to **Question 3** is 'Yes'.
- Entity A is required to comply with a covenant at the end of the reporting period. Therefore, the answer to **Question 4** is 'Yes'.
- Entity A did not comply with the covenant. Therefore, the answer to **Question 5** is 'No'.
- The lender has not provided a waiver for the covenant violation by the end of the reporting period. Therefore, the answer to **Question 6** is 'No'.

Therefore, the loan is classified as '**Current**' as at 31 December 20X1.

The fact that Entity A and the lender are negotiating an extension of the loan at the end of the reporting period does not affect the analysis. Even if the lender agrees to extend the loan after the end of the reporting period, but before the financial statements are authorised for issue, the loan will be classified as current as at 31 December 20X1, as Entity A did not have a right to defer settlement of the loan for at least twelve months at the end of the reporting period.

## E. OTHER COMMON ISSUES

### Example E(I): Cross-default liabilities

Entity A has two term loans from Bank B - term loan I and term loan II. Term loan II requires Entity A to meet a working capital covenant at the end of the annual reporting period. Failure to meet the covenant would result in Bank B having the right to demand immediate repayment of both term loan I and term loan II.

#### Analysis:

The assessment for cross-default liabilities would be similar to that of other loan arrangements. The conclusion as to the classification of the loan would apply to all the loans covered by the cross-default terms, unless there are other terms applicable to any one or more particular loans in the group of loan arrangements.

### Example E(II): Multiple covenant breaches and waivers

Entity A has a term loan from Bank B. The loan is repayable after five years. The loan arrangement includes a working capital ratio test at the end of the annual reporting period i.e. 31 December and at every calendar quarter (March, June, September). Failure to meet the covenant provides Bank B with the right to demand immediate repayment of the loan during the period up to the next covenant test.

During the year 20X1, the covenant test was not met for Q1, Q2 or Q3, however, for each breach of covenant, Bank B waived its right to demand repayment until the next quarterly covenant test. The 31 December 20X1 covenant test was met. However, Entity A does not expect to meet the covenant test in for Q1 20X2.

Does the fact that there were multiple covenant breaches and waivers received affect the classification of the loan as current or non-current as at 31 December 20X1?

#### Analysis:

The fact that there were multiple covenant breaches and waivers received does not affect the classification of the loan as current or non-current as at 31 December 20X1. The classification will depend, among other criteria, on whether, **at the end of the reporting period**, the entity has the right to defer settlement of the liability for at least twelve months after the reporting period.



### Example E(III): Two-stage covenant test

Entity A has a loan which provides for a covenant test to be performed semi-annually on 30 June and 31 December. The covenant requires Entity A to have an interest coverage ratio of at least 8. If the covenant is not met, Entity A is required to deposit cash in a designated bank account within one month.

The amount of cash required to be deposited is the amount, which, if added to the net income, would result in the interest coverage ratio to be at least 8. If the cash is not deposited in the bank account within a month, the bank obtains the right to demand immediate repayment of the loan.

As at 31 December 20X1, Entity A's interest coverage ratio is 6. Therefore, the first covenant is not met. Entity A has sufficient funds to deposit in the designated bank account by 31 January 20X2.

How should Entity A classify the loan in its statement of financial position as on 31 December 20X1?

#### Analysis:

In this case, the covenant is tested in two stages:

- i. Stage 1 is the test of the interest coverage ratio, which was breached before the end of the reporting period.
- ii. Stage 2 is the requirement to deposit cash in a designated bank account. The due date for the compliance with this requirement is after the end of the reporting period.

IAS 1 does not provide any specific requirements for such cases.

In our view, the covenant will be breached only when Entity A fails to comply with the test in its entirety i.e. it fails to deposit the required funds in the designated bank account by 31 January 20X2. As the second stage of the covenant test is required to be complied with after the reporting period, IAS 1.72B(b) will apply and the covenant will not affect whether the right to defer settlement for at least twelve months exists at the end of the reporting period. Therefore, the liability is classified as non-current as at 31 December 20X1.

Entity A would need to provide the disclosures as required by IAS 1.76ZA (see [section 8](#)).



## 8. DISCLOSURE REQUIREMENTS

The Amendments have introduced paragraph 76ZA, which sets out the disclosure requirements for situations where an entity classifies liabilities arising from loan arrangements as non-current and the entity's right to defer settlement of those liabilities for at least twelve months is subject to the entity complying with one or more covenant(s) within twelve months after the reporting period. In such situations, IAS 1.76ZA requires the entity to 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. 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.

### **Example:**

Entity A has a bank loan repayable after 5 years. The loan arrangement requires Entity A to have a working capital ratio above 1.2 as at every 30 June, failing which the loan becomes repayable on demand.

Entity A's annual reporting period end is 31 December.

Entity A met the covenant test on 30 June 20X1. On 31 December 20X1, Entity A's working capital ratio is 1.15.

The covenant test on 30 June 20X2 is after the reporting period and does not affect whether Entity A has the right to defer settlement for at least twelve months as at 31 December 20X1.

The liability is classified as non-current on 31 December 20X1.

The following are some illustrative disclosures as required by IAS 1.76ZA:

### **Illustrative disclosure 1**

#### **Note XX Loans and borrowings (extract):**

Entity A's loan from Bank B (20X1: CU950,000; 20X0: CU935,000) is repayable on 31 December 20X5. The contract includes a covenant that requires a working capital ratio above 1.2 on 30 June every year. The loan will be repayable on demand if the covenant is not met.

Entity A's working capital ratio on 30 June 20X1 was 1.25 and the covenant requirement was complied with. Therefore, as on 31 December 20X1, the loan is not repayable on demand and is classified as non-current.

Entity A's working capital ratio on 31 December 20X1 is 1.15 which does not meet the covenant requirement of the working capital ratio above 1.2.

Historically, Entity A has experienced the highest turnover during the first 6 months of the year. Entity A will need to meet expected sales targets over this period next year in order to comply with the future covenant test as at 30 June 20X2. If the entity does not comply with the covenant test as at 30 June 20X2, the loan will become repayable on demand.

At the time these financial statements are authorized for issue, Entity A has met its expected sales target and its working capital ratio has increased to 1.18.

## Illustrative disclosure 2

### Note XX Loans and borrowings (extract):

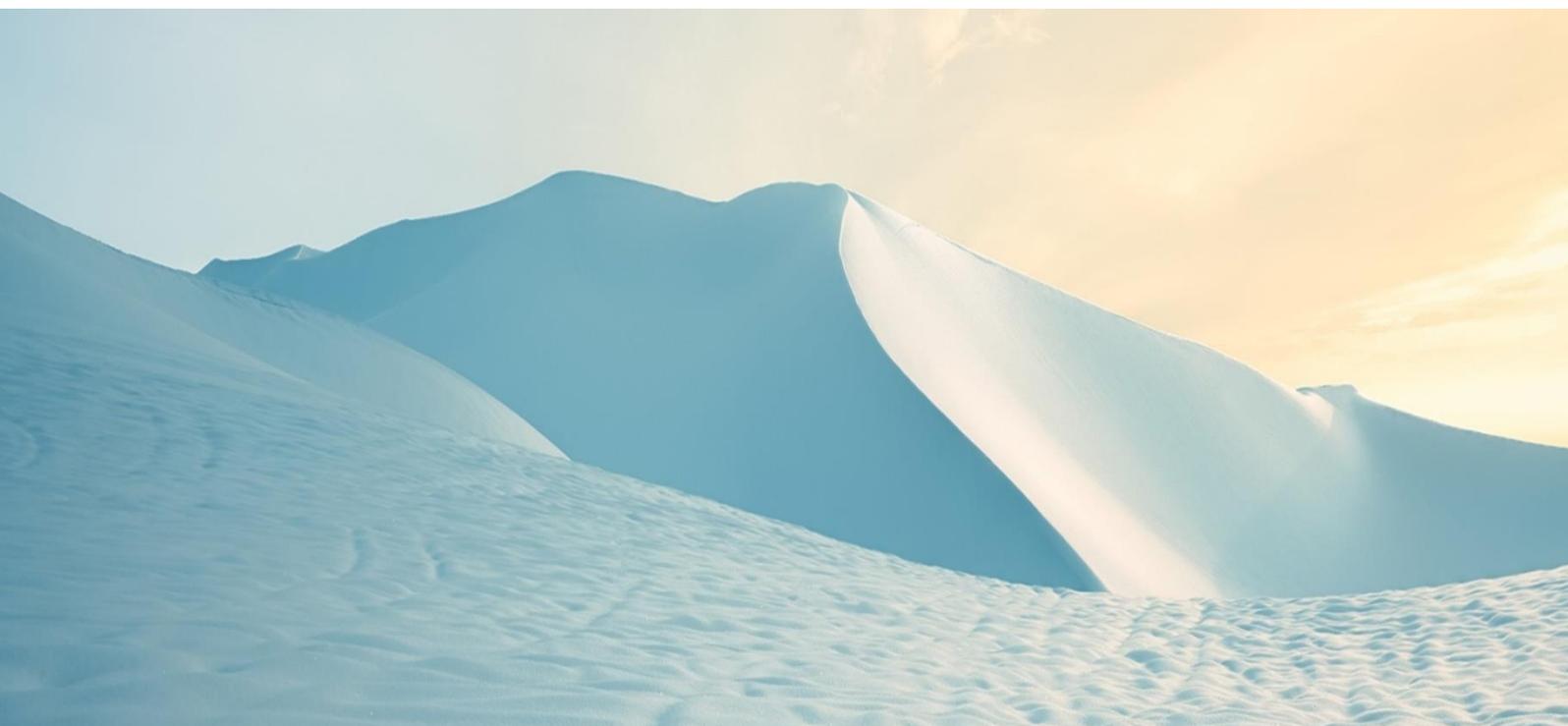
Entity A's loan from Bank B (20X1: CU950,000; 20X0: CU935,000) is repayable on 31 December 20X5. The contract includes a covenant that requires a working capital ratio above 1.2 on 30 June every year. The loan will be repayable on demand if the covenant is not met.

Entity A's working capital ratio on 30 June 20X1 was 1.25 and the covenant requirement was complied with. Therefore, as on 31 December 20X1, the loan is not repayable on demand and is classified as non-current.

Entity A's working capital ratio on 31 December 20X1 is 1.15 which does not meet the covenant requirement of the working capital ratio above 1.2.

At the time these financial statements are authorised for issue, Entity A's working capital ratio has declined to 1.10 due to a reduction in demand in jurisdiction Z. Entity A has approached Bank B for a waiver of the potential breach of covenant and negotiations for waiver are at an advanced stage. However, if Entity A does not comply with the covenant test as at 30 June 20X2 and the breach of covenant is not waived by Bank B, the loan will become repayable on demand.

Based on the facts and circumstances, some of the disclosure requirements of IFRS 7 *Financial Instruments: Disclosures* (e.g. IFRS 17.18-19 on defaults and breaches, disclosures on capital management) and IAS 1 *Presentation of Financial Statements* (e.g. IAS 1.25 related to going concern) may apply. The above examples do not address these disclosure requirements.



## 9. EFFECTIVE DATE AND FIRST TIME APPLICATION

The Amendments are effective 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*. Earlier application is permitted.

If an entity applies the 2022 Amendments for an earlier period, it shall also apply the 2020 Amendments for that period. If an entity applies the 2020 Amendments for an earlier period after the issue of the 2022 Amendments, it shall also apply the 2022 Amendments for that period. If an entity applies the Amendments for an earlier period, it shall disclose that fact.

The Amendments were endorsed for use in the European Union on 19 December 2023.

### Classification of loans for the comparative period in the first year of application of the Amendments

The Amendments would be applicable to the classification of loans for the comparative period also in the first year of application.

For example, consider an entity that applies the Amendments for the first time for annual reporting periods beginning on or after 1 January 2024. The entity had a loan outstanding on 31 December 2023, which required compliance with a covenant. Failure to meet the covenant on the designated date would result in the loan becoming repayable on demand. The loan was classified as current in the financial statements for the years ended 31 December 2023 and 2022. In accordance with the requirements of the Amendments, the loan would be classified as non-current as at 31 December 2023. In the financial statements for the year ended 31 December 2024, the entity would be required to classify the loan as non-current for the comparative period i.e. 31 December 2023.

In addition, the entity would be required to present a third statement of financial position at the beginning of the preceding period in accordance with IAS 1.40A, which requires a third statement of financial position as at the beginning of the preceding period (i.e. 1 January 2023) if the retrospective application of the Amendments has a material effect on the information in the statement of financial position at the beginning of the preceding period.



FOR MORE INFORMATION:

[BDO's IFRS Policy Committee](#)

[BDO's IFRS Country Leaders](#)

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Neither BDO IFR Advisory Limited, and/or any other entity of BDO network, nor their respective partners, employees and/or agents accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

The BDO network (referred to as the 'BDO network' or the 'Network') is an international network of independent public accounting, tax and advisory firms which are members of BDO International Limited and perform professional services under the name and style of BDO (hereafter 'BDO member firms'). BDO International Limited is a UK company limited by guarantee. It is the governing entity of the BDO network.

Service provision within the BDO network in connection with corporate reporting and IFRS Accounting Standards (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board and IFRS Sustainability Disclosure Standards as issued by the International Sustainability Standards Board, is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BV, a limited liability company incorporated in Belgium.

Each of BDO International Limited, Brussels Worldwide Services BV, BDO IFR Advisory Limited and the BDO member firms is a separate legal entity and has no liability for another entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BV, BDO IFR Advisory Limited and/or the BDO member firms. Neither BDO International Limited nor any other central entities of the BDO network provide services to clients.

BDO is the brand name for the BDO network and for each of the BDO member firms.

© 2024 BDO IFR Advisory Limited, a UK registered company limited by guarantee. All rights reserved.

[www.bdo.global](http://www.bdo.global)