Newsletter

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In this Issue

The Financial and Sustainability Reporting Standards Council (FSRSC) has approved the adoption of Amendments to: PAS 1, Classification of Liabilities as Current or Non-current; PAS 8, Definition of Accounting Estimates; PAS 1 and PFRS Practice Statement 2, Disclosure Initiative – Accounting Policies; and PAS 12, "Deferred tax related to assets and liabilities arising from a single transaction" issued by the International Accounting Standards Board (IASB). These amendments are effective for annual reporting periods beginning on or after January 1, 2023.

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Contents

ADOPTION OF REVISED ACCOUNTING STANDARDS FOR ANNUAL REPORTING PERIODS BEGINNING ON OR AFTER JANUARY 1, 2023 3

TRANSITION AND EFFECTIVE DATE 3

AMENDMENTS TO PAS 1, CLASSIFICATION OF LIABILITIES AS CURRENT OR NON-CURRENT 3

AMENDMENTS TO PAS 8, DEFINITION OF ACCOUNTING ESTIMATES 5

AMENDMENTS TO PAS 1 AND PFRS PRACTICE STATEMENT 2, DISCLOSURE INITIATIVE – ACCOUNTING POLICIES 6

AMENDMENTS TO PAS 12, DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE TRANSACTION 8

Editorial Board 9

PKF

ADOPTION OF REVISED ACCOUNTING STANDARDS FOR ANNUAL REPORTING PERIODS BEGINNING ON OR AFTER JANUARY 1, 2023

The Financial and Sustainability Reporting Standards Council has approved the adoption of the amendments to the following:

- PAS 1, Classification of Liabilities as Current or Non-current;
- PAS 8, Definition of Accounting Estimates;
- PAS 1 and PFRS Practice Statement 2, Disclosure Initiative – Accounting Policies; and
- PAS 12, Deferred tax related to assets and liabilities arising from a single transaction.

TRANSITION AND EFFECTIVE DATE

An entity shall apply these amendments for annual reporting periods ***beginning on or after January 1, 2023,*** retrospectively. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

AMENDMENTS TO PAS 1, CLASSIFICATION OF LIABILITIES AS CURRENT OR NON-CURRENT

Objective

To clarify the classification of a liability as either current or non-current based on the entity's rights at the end of the reporting period.

The amendment also emphasized that classification of 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,
- unaffected by the management's intentions or expectations to settle the liability within twelve months after the reporting period, and
- unaffected by settlement of the liability between the end of the reporting period and the date the financial statements are authorized for issue.

The amendment provides that:

An entity shall classify a liability as current when:

a. it expects to settle the liability in its normal operating cycle;
b. it holds the liability primarily for the purpose of trading;
c. the liability is due to be settled within twelve months after the reporting period; or
d. it does not have the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period.

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

Previous provision in PAS 1 states that an entity that has an unconditional right to delay settlement of a liability for at least 12 months from the end of the reporting period shall classify a liability as non-current, otherwise, should be classified as current. This has been applied differently by preparers; hence, the reason for the amendment. The latest amendment removed reference to 'unconditional' right of settlement deferral to reflect the fact that loans are rarely unconditional because loans have covenants.

Right to Defer for Settlement for at least twelve (12) months

Entity's right to defer settlement of a liability for at least twelve months after the reporting period must:

- have substance; and
- 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 even if the lender does not test compliance until a later date at the end of the reporting period.

Does the entity have a right to refinance an obligation for at least 12 months after the reporting period?

✓ **Non-current** liability regardless of if it would be due within a shorter period.
X **Current** liability.

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 or 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 authorized for issue. *Additional disclosure, however, was required as a non-adjusting event for the settlement of a liability classified as non-current between the end of the reporting period and the date the financial statements are authorized for issue.*

Illustration

Scenario 1

ABC Company entered into a long-term arrangement containing a debt covenant. The specific requirements in the debt covenant must be met on the 31st of December every year. The loan is due in more than 12 months. The entity breaches the debt covenant at or before the end of the reporting period. As a result, the loan becomes payable on demand.

Scenario 2

Same as scenario 1, but the loan arrangement stipulates that the entity has a grace period of 3 months to rectify the breach and during which the lender cannot demand immediate repayment.

Scenario 3

Same as scenario 1, but the lender agreed not to demand repayment as a consequence of the breach. The entity obtains this waiver:

a. at or before the period end and the waiver is for a period of more than 12 months after the period end;
b. at or before the period end and the waiver is for a period of less than 12 months after the period end;
c. after the period ends but before the financial statements are authorized for issue.

PAS 1 requires certain disclosures of refinancing and rectification of loan agreement breaches which happen after the end of the reporting period and before the accounts are authorized for issue.

The table below sets out whether debt is to be presented as current or non-current and whether the above disclosures are required.

	Scenario				
	1	**2**	**3(a)**	**3(b)**	**3(c)**
Does the entity have a right to defer the settlement of the liability for at least 12 months at the end of the reporting period?	X	X	✓	X	X
Classification	current	current	non- current	current	current
Disclosures required under PAS 1?	X	X	X	X	✓

Our View:

Most of the entities might find themselves in compliance with the amendments; however, some entities might still be affected by these amendments particularly those entities that considered management's intentions in classifying its liabilities and those entities that have existing long-term loan agreements; moreover, this has an impact on certain loan covenants requiring certain ratios. Therefore, all entities are advised to reconsider the classification of their existing liabilities to determine whether any changes are required as changes to its classification shall be subjected to reclassification since the application of the amendment is retrospective.

References: ***Amendments to PAS 1; Classification of Liabilities as Current or Non-current***

AMENDMENTS TO PAS 8, DEFINITION OF ACCOUNTING ESTIMATES

Objective

To clarify how reporting entities should distinguish changes in accounting policies from changes in accounting estimates.

The amendment provided a definition for accounting estimate which states that "*accounting estimates are monetary amounts in financial statements that are subject to measurement uncertainty.*" Previously, no definition was provided; hence preparers find it difficult to differentiate what accounting estimate is against accounting policy.

In addition, the amendment clarified that "*an accounting policy may require items in financial statements to be measured in a way that involves measurement uncertainty—that is, the accounting policy may require such items to be measured at monetary amounts that cannot be observed directly and must instead be estimated. In such a case, an entity develops an accounting estimate to achieve the objective set out by the accounting policy. Developing accounting estimates involves the use of judgements or assumptions based on the latest available, reliable information.*"

Illustration

- Fair value of an investment property

  An entity which applies the fair value model in PAS 40 Investment Property and has elected to change its valuation technique consistent with the income approach to one consistent with the market approach due to a change in market conditions as permitted by PFRS 13 Fair Value Measurement. The example states that the fair value of the investment property is an accounting estimate because:

  - the fair value of the investment property is a monetary amount in the financial statements that is subject to measurement uncertainty;
  - the fair value of the investment property is an output of a measurement technique used in applying the accounting policy; and
  - in developing its estimate of the fair value of the investment property, the entity uses judgements and assumptions.

  The change in the valuation technique is a change in the measurement technique applied to estimate the fair value of the investment property. The effect of this change is a change in accounting estimates because the accounting policy (i.e. to fair value investment property) has not changed.

- Cash-settled share-based payment liability

  An entity that changes the estimate of the expected share price volatility in its option pricing model for its previously issued share appreciation rights, because of changes in the market conditions. The example states that the fair value of the liability is an accounting estimate because:

  - the fair value of the liability is a monetary amount in the financial statements that is subject to measurement uncertainty;

- the fair value of the liability is an output of a measurement technique used in applying the accounting policy; and
- to estimate the fair value of the liability, the entity uses judgements and assumptions.

The change in the expected volatility of the share price is a change in an input used to measure the fair value of the liability. The effect of this change is a change in accounting estimates because the accounting policy (i.e. to measure the liability at fair value) has not changed.

Our View:

The amendment provides greater clarity on the distinction between changes in accounting estimates, accounting policies and correction of errors which has an impact on whether the change will be effected prospectively or retrospectively on its financial statements. Thus, entities are encouraged to assess any changes that have been made within the entity to ensure consistency with the amended standard.

Reference: *Amendments to PAS 8; Definition of Accounting Estimates*

AMENDMENTS TO PAS 1 AND PFRS PRACTICE STATEMENT 2, DISCLOSURE INITIATIVE – ACCOUNTING POLICIES

Objective

To provide guidance on how to apply the concept of materiality to accounting policy disclosures.

The amendments to PAS *1 replaced the required disclosure from significant accounting policies into material accounting policy information*. In relation to the amendments, PFRS Practice Statement 2, Making Materiality Judgements was also amended to explain and demonstrate the application of the 'four-step materiality process' to accounting policy disclosures.

Disclosure of Accounting Policy Information

An entity is likely to consider accounting policy information material to its financial statements if that information relates to material transactions, other events or conditions and:

a. the entity changed its accounting policy during the reporting period which resulted in a material change to the information in the financial statements;
b. the entity chose the accounting policy from one or more options permitted by PFRSs;
c. the accounting policy was developed in accordance with PAS 8 in the absence of an PFRS that specifically applies;
d. the accounting policy relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy, and the entity discloses those judgements or assumptions; or.
e. the accounting required for them is complex and users of the entity's financial statements would otherwise not understand those material transactions, other events or conditions—such a situation could arise if an entity applies more than one PFRS to a class of material transactions.

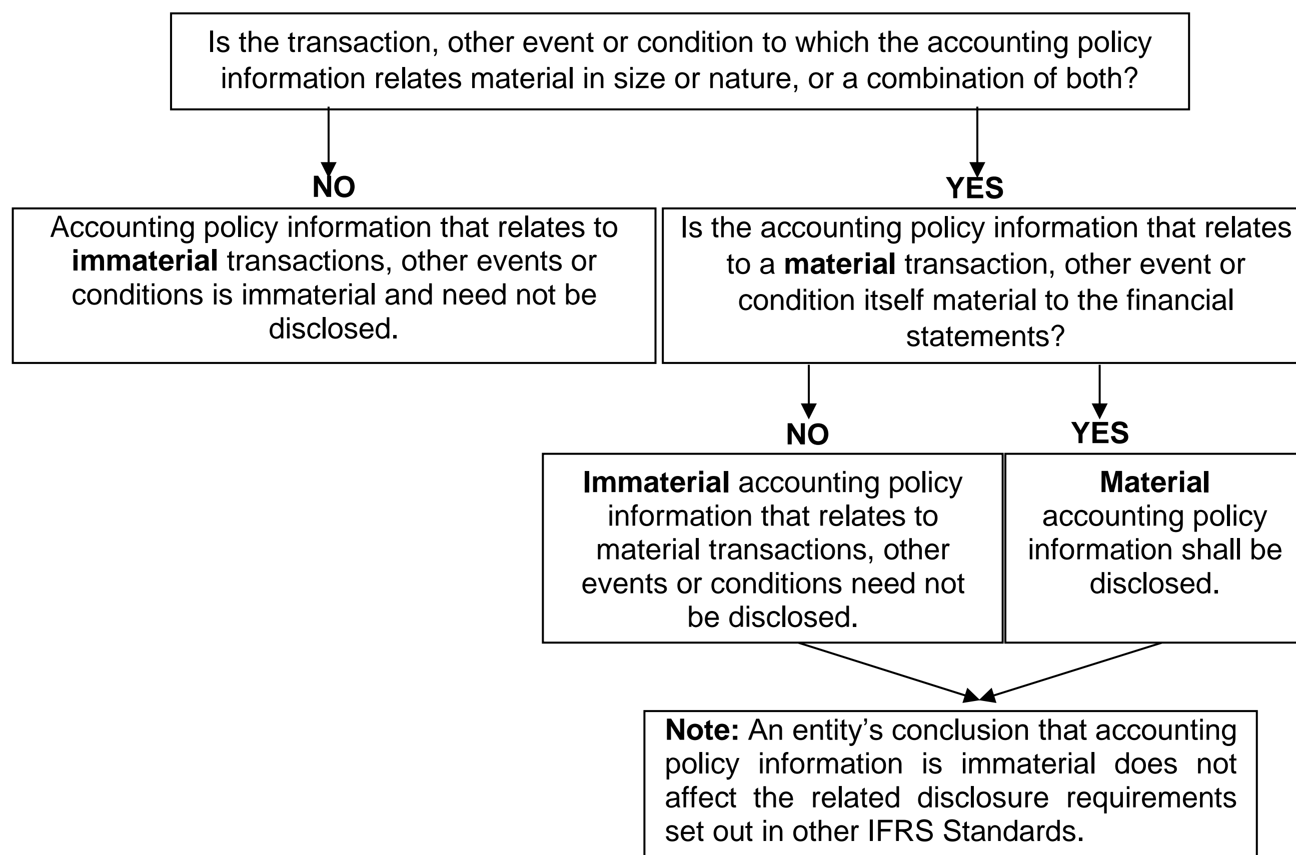
Note: *Not all accounting policy information relating to material transactions, other events or conditions is material itself.*

An entity shall disclose, along with material accounting policy information or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

Making Materiality Judgements

Materiality assessment for accounting policy information should follow the same guidance that applies to materiality assessments applicable to other information, that is to consider both qualitative and quantitative factors. The diagram below illustrates how an entity should assess its accounting policy information and determine if material, therefore should be disclosed.

Determining whether accounting policy information is material:



Users generally find information about the characteristics of an entity's transactions, other events or conditions—entity-specific information—more useful than disclosures that only include standardized information, or information that duplicates or summarizes the requirements of the PFRS Standards. Entity-specific accounting policy information is particularly useful when that information relates to an area for which an entity has exercised judgement—for example, when an entity applies an PFRS standard differently from similar entities in the same industry.

Although entity-specific accounting policy information is generally more useful, material accounting policy information could sometimes include information that is standardized, or that duplicates or summarizes the requirements of the PFRS Standards. Such information may be material if, for example:

a. users of the entity's financial statements need that information to understand other material information provided in the financial statements.
b. an entity reports in a jurisdiction in which entities also report applying local accounting standards.
c. complex accounting is required by the PFRS and such shall be able to understand by the users of financial statements.

<u>Our View:</u>

The amendment may impact the accounting policy disclosures of entities as PAS 1 requires that an accounting policy information should be disclosed based on its materiality rather than on its significance. Furthermore, the amendment is intended to reduce boiler template disclosures. This may require greater use of judgment because not all significant information can be material. Thus, entities should revisit their accounting policy information disclosures to assess whether such information should still be disclosed and should focus on providing accounting policy information that is entity specific to enhance the usefulness of the financial statements.

Reference: ***Amendments to PAS 1 and PFRS Practice Statement 2; Disclosure of Accounting Policies***

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AMENDMENTS TO PAS 12, DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE TRANSACTION

Objective

To reduce diversity in the reporting of deferred tax on leases and decommissioning obligations.

Recognition of Deferred Tax Liabilities and Deferred Tax Assets

Taxable temporary differences

A deferred tax liability shall be recognized for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

a. the initial recognition of goodwill; or
b. the initial recognition of an asset or liability in a transaction which:
   i. is not a business combination;
   ii. at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and
   iii. at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

Initial Recognition of an Asset or Liability

A transaction that is not a business combination may lead to the initial recognition of an asset and a liability and, at the time of the transaction, affect neither accounting profit nor taxable profit. For example, at the commencement date of a lease, a lessee typically recognizes a lease liability and the corresponding amount as part of the cost of a right-of-use asset. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of the asset and liability in such a transaction.

Deductible Temporary Differences

A deferred tax asset shall be recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

a. is not a business combination;
b. at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and
c. at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

Our View:

The amendment clarifies that the recognition of deferred tax is required for temporary differences which arose from the initial recognition of a lease and subsequently. In the presentation of deferred taxes in the statement of financial position, entities would typically just offset these deferred tax assets and liabilities, however the applicable tax law should be considered. There are some cases that the amendment might lead to the recognition of unequal amounts of deferred tax assets and liabilities despite the gross deductible and taxable temporary differences being equal, the entity should therefore account for the difference between the deferred tax asset and liability in profit or loss.

Reference: ***Amendments to PAS 12; Deferred Tax related to Assets and Liabilities arising from a Single Transaction***

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Comments and suggestions are welcome.

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