Financial Reporting Department

FEDERAL BANK
YOUR PERFECT BANKING PARTNER

FRD/ICAI/01/2023

15 February 2023

To

The Secretary, Accounting Standards Board,
The Institute of Chartered Accountants of India,
ICAI Bhawan, Post Box No. 7100,
Indraprastha Marg,
New Delhi – 110 002

Dear Sir,

Sub: Exposure Draft ED/ Ind AS 1/2022/2 Classification of Liabilities as Current or Non-current and Non-current Liabilities with Covenants – Amendments to Ind AS 1

We appreciate the opportunity to comment on the Accounting Standards Board's (the Board) Exposure Draft Exposure Draft ED/ Ind AS 1/2022/2 Classification of Liabilities as Current or Non-current and Non-current Liabilities with Covenants – Amendments to Ind AS 1 (the ED). This letter represents the views of The Federal Bank Limited.

We feel that the proposed amendments will improve the information an entity provides when its right to defer settlement of a liability is subject to compliance with conditions within twelve months after the reporting period.

We agree with the amendments proposed to Ind AS 1, however we do not agree with the removal of the carve-out which is presently included as para 74 of Ind AS 1. In the annexure to this letter, we have provided elaborate answers to the question raised in the ED.

Please contact at fr@federalbank.co.in if you wish to discuss any of the contents of this letter.

Yours Sincerely,

Venkatraman Venkateswaran
Chief Financial Officer
The Federal Bank Limited

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Annexure

Proposed amendments to Ind AS 1

We agree to the amendments in the exposure draft

- To clarify that the classification of liabilities as current or non-current should be based on rights that are in existence at the end of the reporting period and align the wording in all affected paragraphs to refer to the "right" to defer settlement by at least twelve months and make explicit that only rights in place "at the end of the reporting period" should affect the classification of a liability. (Para 69 (d) of Ind AS 1)
- Only covenants with which an entity is required to comply on or before the reporting date affect the classification of a liability as current or non-current. (Para 72B of Ind AS 1)
- To clarify that classification is unaffected by expectations about whether an entity will exercise its right to defer settlement of a liability; (Para 73 of Ind AS 1)
- An entity must disclose information in the notes that enables users of financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months (Para 75A of Ind AS 1)
- To make clear that settlement refers to the transfer to the counterparty of cash, equity instruments, other assets or services. (Para 76A and 76B of Ind AS 1)

Removal of a Carve-out (Para 74 of Ind AS 1)

Where there is a breach of a material provision 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 on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach. Under Ind AS 1, a carve-out was made in paragraph 74 of Ind AS 1 prescribing that an entity does not classify such a liability as current. As compared to this, IAS 1 requires such a liability to be classified as current because, at the end of the reporting period, the entity does not have the right to defer its settlement for at least twelve months after that date.

The ASB considered the said carve-out and is proposing to remove the same.

Question for respondents:

Do you agree with removal of the carve-out made in paragraph 74 of Ind AS 1? If not, why?

Response from Federal Bank

Rationale for removal of carve-out as given in Exposure draft	Our Views
The Standard prescribes the classification of liabilities as current or non-current on the basis of whether it has right at the end of the reporting period to defer settlement of the liability for at least twelve months after the	• We agree with the amended prescription of classification of non-current liabilities with covenants, based on the existence of right to defer settlement of liability for at least twelve

reporting period (paragraph 69(d)). This principle has been further clarified in the proposed amendments that classification of a liability will depend on existence of the right at the end of the reporting date. Subsequent events, such as, intention or expectation of the management to settle the liability within twelve months after the reporting period or actual settlement between the end of the reporting period and the date the financial statements are approved for issue, will not affect the classification. However, the entity may need to disclose information about the timing of settlement to enable users of its financial statements to understand the impact of the liability on the entity's financial position. Accordingly, in view of the proposed amendments, the existing carve-out is not conceptually aligned with the other prescriptions of the Standard for classification of liabilities as current or non-current.	months. However, we feel that the establishment of such a right by the borrower cannot happen on or before the reporting date, and practically it can happen only after the reporting date but before the approval of financial statements for issue, as many lenders keep the covenants based on reporting date position for ease of verification, which is addressed presently by the presence of the carve-out. Eg: Maintenance of current ratio of 1.33:1 on the reporting date, 31-03-2023, is the loan covenant. The actual current ratio can be computed by the entity only after the business hours of 31-03-2023, getting the right of deferral from the lender by reporting date will be practically difficult. • We also agree that subsequent events, such as, intention or expectation of the management to settle the liability within twelve months after the reporting period or actual settlement between the end of the reporting period and the date the financial statements are approved for issue, will not affect the classification, however, **a firm agreement between lender and the borrower on condonation of the breach actually determines whether the liability is current or non-current**, which is a paramount factor to be considered in classification. The agreement entered between the lender and borrower, is moreover an adjusting event, which had firmed up a position (whether the lender will demand the loan or not due to the breach of covenant) which was not conclusive on the reporting date. • We agree with the disclosures proposed, which is in the best of interest of the users of financial statements.
While certain carve-outs were made to smoothen the transition to Ind AS, it was intended that since the objective is to achieve	In the Indian context, this carve-out still have a great relevance and removal of the same will have the following impacts:

convergence with IFRS Accounting Standards over a period of time, the carve-outs shall be reviewed from time-to-time once Ind AS implementation gets stabilised in India. Accordingly, since 6 years of Ind AS implementation have already elapsed, the ASB considered it appropriate to remove this carve-out.	• Fluctuation in the current and non-current liabilities year on year, due to the subsequent condonation of breach by the lenders. • Fluctuations in the ratios prescribed by the RBI, prescribed as per the Board approved policies of the lenders etc., • This will negatively affect the fresh working capital needs of the borrowers, as the Banks will assess the short term needs based on the classification (Current or non-current) in the Financial statements, however in substance this is a non-current liability.
Removal of the carve-out will be a step towards bringing greater financial discipline amongst the entities since a breach of a loan covenant even if subsequently condoned by a lender signifies an inherent weakness in the financial condition of an entity	While we may agree that this may be an indicator of inherent weakness in the financial condition of an entity. We cannot be conclusive that a breach of a loan covenant poses an increased a credit risk. The breach may be due to various reasons like seasonality of business, macro-economic environment, sector specific stress etc., which all are temporary in nature. Hence the lenders, after the breach, reassess the limits of the entity and enter into agreements for condonation of the breach, which has to be given due weightage in the classification of the liability into current or non-current also. Hence, again the carve-out addresses this concern for the Banking industry.

On the background of the above explained reasons, we do not agree on the removal of the carve-out present in Ind AS 1.