

Financial Reporting Standard During Bankruptcy Proceedings: Preventive Settlement or Financial Reorganization

Accounting Standards Committee

**Saudi Organization for Chartered and Professional Accountants
(SOCPA)**

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Introduction

According to the Bankruptcy Law, an entity may enter into a preventive settlement or financial reorganization proceeding if it is more likely to suffer financial difficulties leading to distress; if distressed; or if bankrupt.¹ The characteristics and benefits of each proceeding are different in many aspects including, for example, management of the proceeding, appointment of a bankruptcy officeholder, claim moratorium, handling of contracts, etc. The main difference between preventive settlement or financial reorganization proceedings and bankruptcy proceedings is the business continuity during the former. As persons for whom preventive settlement or financial reorganization proceedings (the “Proceeding”) are implemented may be entities subject to the Companies Law and the Capital Market Authority’s requirements for the preparation of interim and annual financial statements, this Standard that stipulates additional presentation and disclosure requirements is developed to assist such entities in the preparation of their financial statements during the Proceeding’s period. The requirements of this Standard supplement, and are not contrary to, those of full IFRS Standards and the IFRS for SMEs. Hence, this Standard shall be read in the context of IFRS Standards as well as other supplemental standards and pronouncements adopted in the Kingdom of Saudi Arabia.

Objective

- 1 This Standard is designed to provide useful information for users of financial statements of entities under preventive settlement or financial reorganization proceedings stipulated in the Saudi Bankruptcy Law and its implementing regulations. Despite of the fact that entering into a preventive settlement or financial reorganization proceeding under the Saudi Bankruptcy Law does not change an entity’s position as a going concern that shall implement IFRS Standards as endorsed in the Kingdom of Saudi Arabia, such an event is so

¹ Bankruptcy Law, Articles 13 and 42

significant that it changes information needs of users of the financial statements and, therefore, creates a need to set additional presentation and disclosure requirements supplemental to those of IFRS Standards.

Scope

- 2 The Standard stipulates additional requirements for the financial statements to be prepared by entities that enters into the preventive settlement or financial reorganization Proceeding, as a going concern, under related articles of the Saudi Bankruptcy Law and its implementing regulations. It applies to all entities except government entities and agencies.
- 3 The Standard shall be applied prospectively as from the beginning of the financial year during which a petition for the Proceeding is filed.
- 4 The Standard shall cease to apply as from the beginning of the year following the year during which a court orders the termination of the Proceeding.
- 5 If a petition to enter into a preventive settlement or financial reorganization Proceeding is filed, or a court orders the commencement of the Proceeding, after the end of the financial year but before the financial statements are authorized for issue, such an event shall be disclosed as required by IAS 10, or Section 32 of the IFRS for SMEs, as applicable.
- 6 The Standard shall not apply to a restructuring procedure, including debt rescheduling or negotiations, to the extent that the procedure is not implemented according to the bankruptcy proceedings of the Saudi Bankruptcy Law and its implementing regulations. The entity shall apply requirements of IAS 37, or Section 21 of the IFRS for SMEs, as applicable, to restructuring procedures that are implemented outside the scope of the Bankruptcy Law.

Presentation

Financial reporting during the preventive settlement or financial reorganization proceeding

- 7 For the presentation of financial changes in an entity during the preventive settlement or financial reorganization Proceeding under the related articles of the Saudi Bankruptcy Law and its implementing regulations, the financial statements for financial periods from the commencement of the Proceeding to its end shall distinguish transactions and events that are directly related to the Proceeding from ongoing business activities.

Statement of financial position

- 8 The statement of financial position of an entity under the Proceeding shall distinguish prepetition liabilities that are subject to compromise or forgiveness from those that are not (such as fully secured liabilities) and post-petition liabilities. Liabilities that may be affected by the plan (proposal) shall be reported in accordance with the related contractual provisions as required by the related IFRS Standards, even if it is expected to be settled at a different value. If there is a doubt about the sufficiency of a secured claim or its security or about the reduction thereof in the preventive settlement or financial reorganization plan (proposal), the full value of such a claim shall be included in the prepetition claims that are subject to compromise or forgiveness; and it shall be reclassified when, and only when, it is determined subsequently that the claim is not subject to compromise or forgiveness.
- 9 The claims that are identified after the commencement of the Proceeding shall be recognised and reported as required by endorsed IFRS Standards, for example, IAS 37, or Section 21 of the IFRS for SMEs, as applicable.
- 10 The related IFRS Standards as endorsed in the Kingdom of Saudi Arabia require classifying long-term liabilities as current in a classified statement of financial position if, according to their terms, they are, or will be, payable within one year or one operating cycle, whichever is longer, due to non-compliance with a term in the loan contract. An entity shall assess whether the entrance into the Proceeding according to the ratified plan results in a change to the classification of liabilities in accordance with the requirements of endorsed IFRS Standards.

Statement of profit or loss and other comprehensive income (statement of comprehensive income)

- 11 In addition to the requirements of IFRS Standards as endorsed in the Kingdom of Saudi Arabia, this Standard requires the statement of profit or loss to portray business results of the reporting entity for the period during which it was under the preventive settlement or financial reorganization Proceeding under the Saudi Bankruptcy Law, providing users with information distinguishes items related to ordinary activities from those arising from entering into the Proceeding. For this purpose, income and expenses (including professional fees), any realized gain or loss and any provisions for losses arising from the preventive settlement or financial reorganization shall be clearly distinguished as preventive settlement or financial reorganization elements, except as required to report discontinued operations according to IFRS 1 and IFRS 5, or Section 5 and Section 17 of the IFRS for SMEs, as applicable.
- 12 When a debt becomes an approved claim after entering into the Proceeding (for example, by a court judgment) but at a value different from that prior to entering into the Proceeding, gain or loss from the amendment of the recorded debt value to the approved value shall be presented according to endorsed IFRS Standards as preventive settlement or financial reorganization elements in the statement of profit or loss.
- 13 It is not appropriate to defer professional fees and similar expenditures pending the ratification of the plan (proposal) and, then, reduce the gain from the forgiven debt at an amount equal to the expenses that have previously been deferred. It is also not appropriate for professional fees and similar expenditures to accrue upon filing of the petition for the commencement of the Proceeding under the related articles of the Saudi Bankruptcy Law and its implementing regulations. Instead, since the preventive settlement or financial reorganization Proceeding does not result in assets or liabilities, expenses shall be recognised at the time when they are incurred and be reported as preventive settlement or financial reorganization elements.

- 14 Finance expense that is incurred by an entity during a preventive settlement or financial reorganization Proceeding under the Saudi Bankruptcy Law, solely because of entering into the Proceeding, shall be reported as a preventive settlement or financial reorganization element.
- 15 Finance income that is achieved by an entity during a preventive settlement or financial reorganization Proceeding under the Saudi Bankruptcy Law, solely because of entering into the Proceeding, shall be reported as a preventive settlement or financial reorganization element.

Statement of cash flows

- 16 In addition to the requirements of IFRS Standards as endorsed in the Kingdom of Saudi Arabia, this Standard requires cash flows arising from a preventive settlement or financial reorganization Proceeding to be distinguished from other operating, investing and financing activities as preventive settlement or financial reorganization elements. Those elements can be best presented as such under the direct method. IAS 7 (or Section 7 of the IFRS for SMEs, as applicable) provides examples of cash flows from operating activities. Cash flows from preventive settlement or financial reorganization elements shall be identified in more useful detail. For example, received returns can be disaggregated into normal recurring received returns and cash accumulated received returns from the preventive settlement or financial reorganization. A supplemental table to be included in the statement of cash flows or in notes to the financial statements shall disclose in detail operating cash flows received and paid due to the preventive settlement or financial reorganization if the indirect method is used.

Condensed financial statements

- 17 Consolidated financial statements that include one or more subsidiaries that are under a preventive settlement or financial reorganization Proceeding in addition to one or more subsidiaries that are not under such Proceeding shall contain condensed financial statements (for example, in accordance with the requirements of IAS 34 for presenting condensed financial statements) that comply with the

requirements of this Standard for each entity under the preventive settlement or financial reorganization Proceeding.

Earnings per share

- 18 In case that equity shares are likely to be issued by the plan (proposal), the effect of these additional shares shall be considered in calculating diluted earnings per share as required by IAS 33.

Disclosure

- 19 In addition to the disclosures required by IFRS Standards as endorsed in the Kingdom of Saudi Arabia, this Standard requires from an entity that enters into a preventive settlement or financial reorganization Proceeding to provide additional disclosures when it applies IFRS Standards or the IFRS for SMEs, as applicable.
- 20 The entity's title, whenever mentioned, shall be accompanied by “Under a Preventive Settlement Proceeding” or “Under a Financial Reorganization Proceeding.”
- 21 An entity under a preventive settlement or financial reorganization Proceeding under the Saudi Bankruptcy Law and its implementing regulations shall provide the following disclosures. Such disclosures shall include all the available information until the financial statements are authorized for issue.
- (a) A classification of creditors, according to either their nature or their similar rights.
 - (b) Claims that are not based on a reasonable estimation as required by IAS 37 Provisions, Contingent Liabilities and Contingent Assets, or Section 21 Provisions and Contingencies of the IFRS for SMEs, as applicable.
 - (c) Key categories of claims that are subject to compromise or forgiveness.
 - (d) Information about the bankruptcy officeholder (according to the type of the Proceeding), including its name and contact information.

- (e) Information about the creditors' committee (if any), including their names and contact information.
 - (f) A summary of the court's order to commence the Proceeding.
 - (g) A summary of the proposal filed with the court, whether creditors have voted thereupon and the court has ratified it, and any subsequent amendments thereto.
 - (h) A summary of terminated contracts with a description of the financial effect of its termination.
 - (i) Any other relevant information that may be necessary for users to understand the entity's financial condition during the Proceeding.
- 22 Intragroup receivables and payables between entities that are under a preventive settlement or financial reorganization Proceeding shall be disclosed in the condensed financial statements. In addition, any effects on such amounts caused by the entrance of one or more group entities into the preventive settlement or financial reorganization proceeding shall be disclosed.
- 23 The equity shares or its equivalent that may be issued, including their amount and number and the corresponding liability that will be settled, shall be disclosed.

Effective Date

- 24 This Standard shall be effective for preventive settlement or financial reorganization proceeding that commences after its issuance. Earlier application is permitted for proceedings which have commenced before the issuance of the Standard and still outstanding.

(End of the Standard)

Appendix A

Defined Terms

This appendix is an integral part of this Standard.

For definitions of the terms used in this Standard, refer to the Bankruptcy Law.

Existing liabilities that are subject to compromise or forgiveness

Include all of the liabilities that are existing prior to the date when the petition for the commencement of the Proceeding is filed, except those that cannot be reduced by the Proceeding.

For example, claims whose securities are greater than their value.

Appendix B

Basis for Conclusions

This appendix accompanies, but is not part of, this Standard.

Introduction

B1 Below is a summary of the Accounting Standards Committee’s (the “Committee”) considerations in reaching the conclusions related to this Standard. This appendix provides the reasons for accepting some approaches and refusing some others. The Committee’s members have given more weight to some factors than others.

Background information

B2 Due to the promulgation of the Bankruptcy Law and its legal provisions regulating entities that are more likely to suffer financial difficulties leading to distress, entities that are distressed or bankrupt, and their liabilities to their creditors, a need has arisen to provide users of financial statements with additional information that enables them to take decisions about their dealings with entities that enter into a preventive settlement or financial reorganization Proceeding. Therefore, SOCPA’s Accounting Standards Committee has issued this Standard to bridge a gap in local practices relating to the preparation of financial statements during the preventive settlement or financial reorganization Proceeding. Since an entity that enters into a preventive settlement or financial reorganization Proceeding is in its nature a going concern, it is still subject to the requirements of the international standards as endorsed in the KSA as well as other local standards and pronouncements adopted by SOCPA. This Standard is supplemental to those standards and it aims at providing the additional information required when an entity enters into any such proceedings.

Scope

B3 The government entities and agencies have been excluded from this Standard because they are subject to different control and supervision regulations that may include special financial reporting requirements. It is also difficult to apply IFRS

Standards and other local standards and pronouncements adopted in the KSA to such entities. The Bankruptcy Law requires a regulated entity to obtain a favorable decision from the competent authority to apply for the initiation of a bankruptcy proceeding. The Bankruptcy Law provides definitions for a regulated entity and competent authority and enumerates competent authorities.

- B4 During discussions with stakeholders, inquiries received about when to apply the Standard and whether it is more relevant to start applying it when a petition for the commencement of the Proceeding is filed, the court accepts such a petition or a plan is ratified. After considering each option, the Committee decided that the filing of a petition for the commencement of the Proceeding has consequential effects on an entity, including for example, suspension of claims. Therefore, the Standard shall be applied as from such event.

Non-publicly accountable entities (small and medium-sized entities)

- B5 Inquiries received about whether small and medium-sized entities may apply this Standard. The Committee decided that an entity of any kind may apply the Standard. References are made to the relevant sections of the IFRS for SMEs whenever references are made to full IFRS Standards. It is noteworthy that the Bankruptcy Law is applicable to all entities, but it lays down special legal requirements related to what it called the “small debtors”.

When to start applying the Standard

- B6 The Committee deliberated the time at which an entity shall start to apply the Standard, and decided to raise this issue in the round table discussions. Views of the attendees were divided between the application prospectively from the date at which a decision to implement the proceeding is taken or from the beginning of the financial year during which such a decision is taken. To facilitate the application of the Standard, the Committee adopted the view that the Standard shall be applied from the beginning of the financial period or year during which a petition for the Proceeding is filed.

Consolidation of financial statements when a group component is under a preventive settlement or financial reorganization Proceeding

B7 One or more of group components may enter into a preventive settlement or financial reorganization Proceeding. The Committee is of the opinion that users of financial statements may need more information about such components in addition to the information required by IFRS 12 *Disclosure of Interests in Other Entities*. Therefore, the Committee decided to include a requirement to provide condensed financial statements in accordance with this Standard for each group component enters into a preventive settlement or financial reorganization Proceeding.

Appendix C

Application Guidance

This appendix provides guidance and examples for application and is not part of the Standard.

Guidance material

The following examples illustrate when an entity shall apply the *Financial Reporting Standard During Bankruptcy Proceedings: Preventive Settlement or Financial Reorganization*. They are not intended to provide an exhaustive list of all cases in which the Standard shall be applied.

Preventive Settlement or Financial reorganization

AG1 The board of directors of entity A decided to apply to a court for a financial reorganization proceeding due to the entity's default. The financial reorganization petition was filed on 25 October 2X20 under the Saudi Bankruptcy Law and the court ordered to commence the proceeding on 10 December 2X20. The entity's financial year-end is 31 December every calendar year.

Analysis: The *Financial Reporting Standard During Bankruptcy Proceedings: Preventive Settlement or Financial Reorganization* shall be applied as from the beginning of the financial year that will end on 31 December 2X20.

AG2 The board of directors of entity B decided to apply to a court for a financial reorganization proceeding due to the entity's default. The financial reorganization petition was filed on 25 October 2X20 under the Saudi Bankruptcy Law and the court ordered to commence the proceeding on 10 February 2X21. The entity's financial year-end is 31 December every calendar year.

Analysis: The *Financial Reporting Standard During Bankruptcy Proceedings: Preventive Settlement or Financial Reorganization* shall be applied as from the beginning

of the financial year that will end on 31 December 2X21. The entity shall disclose in its financial statements for the financial year ended 31 December 2X20 that it has applied for the commencement of the Proceeding and that the court has ordered to commence the Proceeding.

AG3 The court has ordered the termination of the financial reorganization proceeding for entity C on 25 October 2X20. The entity's financial year-end is 31 December every calendar year.

Analysis: The *Financial Reporting Standard During Bankruptcy Proceedings: Preventive Settlement or Financial Reorganization* shall be applied to the financial statements for the financial year ended 31 December 2X20 and shall cease to apply to financial statements for subsequent years.

(End of Appendices)