European Financial Reporting Advisory Group

Summary and analysis of the comment letters received on the EFRAG draft comment letter on the Classification of Liabilities as Current or Non-current and its Deferral of Effective Date, Amendment to IAS 1

1 Based on the comments received, the EFRAG Secretariat has developed an EFRAG proposals to finalise the endorsement advice that is presented as agenda paper 07-04.

Structure of the paper

2 This comment letter analysis contains:

(a) Background;

(b) Summary of respondents' views;

(c) Main positions in EFRAG's proposed final comment letter;

(d) Appendix 1– list of respondents; and

(e) The comment letters can be found using the following link.

Background

3 Paragraph 69 of IAS 1 *Presentation of Financial Statements* requires an entity to classify a liability as current if the entity 'does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period'. Paragraph 73 requires an entity to classify a liability as non-current if the entity 'expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility'.

4 The IFRS Interpretations Committee (IFRS IC) received two requests for guidance on the relationship between these two requirements. The IFRS IC proposed new guidance as part of the Annual Improvements to IFRSs 2010–2012 Cycle but, after considering feedback from respondents, decided not to recommend finalising the guidance. At its March 2013 meeting the IASB accepted that recommendation and decided to reconsider the issue.

5 At its meeting in September 2013, the IASB tentatively decided to develop clarifications applying a principle that the classification of a liability as current or noncurrent should reflect the rights existing at the end of the reporting period. In February 2015, the IASB published its proposals in the Exposure Draft Classification of Liabilities.

6 On 24 September 2019 the IASB met to finalise the Amendments and decided:

(a) not to re-expose the amendments; and

(b) that the amendments should apply for annual reporting periods beginning on or after 1 January 2022.

7 The Amendment to IAS 1 was issued in January 2020, effective for annual reporting periods beginning on or after 1 January 2022. The Amendments improve existing requirements and could result in companies reclassifying some liabilities from current to non-current, and vice versa; this could affect a company's loan covenants. However, in response to the covid-19 pandemic, the IASB provided entities with more time to implement any classification changes resulting from the Amendments by deferring the effective date by one year to annual reporting periods beginning on or after 1 January 2023.

8 EFRAG TEG discussed the Amendment to IAS 1 and the draft comment letter in its meeting on March 2020. EFRAG TEG considered that the Amendment to IAS 1 would remove diversity in practice and meet the endorsement criteria, which means the qualitative characteristics of relevance, reliability, comparability, and understandability required to support economic decisions and the assessment of stewardship, raise no issues regarding prudent accounting, and that they are not contrary to the true and fair view principle; and are conducive to the European public good.

9 EFRAG published a draft comment letter on the Amendments on 6 November 2020. In the draft comment letter, EFRAG supports the proposed amendments.

Summary of respondents' views

10 At the time of writing, eight comment letters have been received. Respondents views expressed on their letters are summarised below.

11 Six respondents concurred with EFRAG's initial assessment. The Amendments meet the *technical criteria* for endorsement. In other words, the Amendments are not contrary to the principle of true and fair view and meet the criteria of understandability, relevance, reliability, comparability, and lead to prudent accounting.

12 Six respondents agreed with EFRAG assessment of the impact of the Amendments on the European public good as the Amendments are an *improvement over current requirements* across the areas which have been subject to changes.

13 Six respondents agreed with EFRAG's initial assessment that the Amendments will not result in increased *costs* and that it is likely to be cost neutral. Furthermore, users are likely to benefit from the Amendments as the information resulting from it will remove inconsistency and increase comparability between entities and therefore enhance their analysis.

14 Six respondents concurred with the assessment that the benefits to be derived from implementing the Amendments in the EU are likely to outweigh the costs involved.

15 However, in December 2020 the IFRS IC provided additional insights into how the amendments would apply in different circumstances. A Tentative Agenda Decision analysed three fact patterns. The consultation period is open for comments until 15 February 2021.

16 Two respondents considered that beforementioned the IFRS IC tentative conclusions should be investigated further. The IFRS IC tentatively concluded that the entity had no right to defer settlement of the loan for at least twelve months after

the reporting period in case two[1] and case three[2] and the entity should classify the loan as current at the reporting date.

17 The IFRS IC considered that paragraph 72A of IAS 1 should apply for those cases and states that *'if the right to defer settlement is subject to the entity complying with specified conditions, the right exists at the end of the reporting period only if the entity complies with those conditions at the end of the reporting period. The entity must comply with the conditions at the end of the reporting period even if the lender does not test compliance until a later date'*.

18 One respondent remarked that the fact patterns are rather common and that entities are currently applying the existing requirements in IAS 1 differently when assessing the effects of covenants on the classification of their liabilities. The effects of such a change are far reaching in nature because the classification of liabilities as current or non-current usually affects the assessment of an entity's liquidity and thus,

(a) its ability to access debt; and

(b) the cost of its debt.

19 This respondent concurred with the IFRS IC tentative conclusion that paragraphs 72A and 75 of IAS 1 are clear as regards the classification of liabilities as current or non-current, when the liability is subject to a condition (such as covenants) and the borrower's compliance with the condition is tested at dates after the end of the reporting period.

20 In addition, this respondent mentioned that the amendments provide with a simple approach to how an entity assesses the effects of covenants on the classification of its liabilities at the reporting date and accordingly, that such an approach could result in a consistent implementation of the amendments. However, he noted that simplicity should not be achieved at the expense of useful information.

21 According to the respondent some entities operation in seasonal business usually have a better financial position on 30 June, rather, than on 31 December. Applying paragraph 72A of IAS 1 would lead the liability to be classified as non-current in the interim financial statements and as current in the annual financial statements, even in situations where the probability that the gearing condition will not be met at the next 30 June is remote. He believed that the change of classification of the liability depending on the reporting date is neither relevant nor understandable for users. Such statement was confirmed by another respondent.

22 Finally, those two respondents questioned whether the amendments would result in useful information when applied to the two above-mentioned fact patterns, if the assessment is performed solely based on data observed at the reporting date, and disregards the contractual terms specified in the loan arrangement. One expressed that the respective amendmnt fails to consider the reasons why both lender and the entity have agreed to test the compliance with the conditions at a later date.

[1] The entity's right to defer settlement of the loan for at least twelve months after the reporting period is subject to the entity complying with a specified condition (a working capital ratio above 1.0 at 31 March 20X2).

The entity does not comply with the condition at the end of the reporting period because its working capital ratio is 0.9.

[2] The entity's right to defer settlement of the loan for at least twelve months after the reporting period is subject to the entity complying with two specified conditions (a working capital ratio above 1.0 at 31 December 20X1 and a working capital ratio above 1.1 at 30 June 20X2).

The entity has a working capital ratio of 1.05 at 31 December 20X1. Therefore, the entity complies with the condition tested at that date (a working capital ratio above 1.0) but does not comply with the condition that will be tested at 30 June 20X2 (a working capital ratio above 1.1).

Main positions in EFRAG's proposals to the draft endorsement advice

23 EFRAG has concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability, and understandability required to support economic decisions and the assessment of stewardship and raise no issues regarding prudent accounting.

24 EFRAG has also assessed that the Amendments do not create any distortion in their interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, EFRAG has concluded that the Amendments are not contrary to the true and fair view principle.

25 EFRAG has assessed that the Amendments would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that endorsing the Amendments is conducive to the European public good.

26 In EFRAG's assessment of whether the Amendments would be conducive to the European public good, EFRAG has assessed whether the Amendments would improve financial reporting, would reach an acceptable cost-benefit trade-off, and whether the Amendments could affect economic growth.

27 As explained above, we have concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability, and understandability required to support economic decisions and the assessment of stewardship, that they raise no issues regarding prudent accounting and that they are not contrary to the true and fair view principle. We have also concluded that the Amendments are conducive to the European public good. Therefore, we recommend the Amendments for endorsement without further delay.

Question to EFRAG TEG

28 Does EFRAG TEG agree with EFRAG Secretariat's conclusions in the *proposals to the draft endorsement advice*?

Appendix 1 – List of respondents

Name	**Type of respondent**	**Country**
Allianz	Preparer	Germany
Accounting Standards Committee of Germany (ASCG)	National Standard Setter	National Standard Setter
Autorité des Normes Comptables (ANC)	National Standard Setter	France
Comissão de Normalização Contabilística (CNC)	National Standard Setter	Portugal
Instituto de Contabilidad y Auditoria de Cuentas (ICAC)	National Standard Setter	Spain
Mazars	Auditor	France
Munich Re	Preparer	Germany
Organismo Italiano di Contabilità (OIC)	National Standard Setter	Italy