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EFRAG's Draft Comment Letter on the IASB's Exposure Draft Non-current liabilities with Covenants

Objective

1 The objective of the session on ED/2021/9 Non-current Liabilities with Covenants (Proposed amendments to IAS 1) (the ED) is to:

(a) provide an update on the content of the ED;

(b) discuss the EFRAG Secretariat proposal to finalise EFRAG's Draft Comment Letter on the ED (the DCL); and

(c) recommend EFRAG' Draft Comment Letter to the EFRAG Board for approval.

Background of the ED

2 The IASB intends to:

(a) retain the classification of current and non-current based on the obligation of the borrower to pay and the control of the borrower to avoid payments based on the situation as of the end of the reporting period for the 12-month period after the end of the reporting period;

(b) propose a separate presentation within the non-current heading of the balance sheet to highlight the information that some non-current liabilities due to contractual conditions may become current within the 12-month period after the end of the reporting period;

(c) clarify that certain liabilities that may become payable within the 12-month period after the end of the reporting period is to be classified as current; and

(d) provide disclosure requirements for non-current financial liabilities that may become repayable within twelve months.

Feedback received from the outreaches

3 The EFRAG Secretariat have received limited feedback from the EFRAG TEG Working Groups (EFRAG FIWG and EFRAG user panel). The main messages were:

FIWG

(a) Members considered that the ED would be directed into the right direction.

(b) Members were also concerned about the proposals to split the liabilities on the face of the financial statements based on the missing definitions (e.g., *specified condition*) and a possible broad scope. The same situation would exist for the disclosures required by the ED. A member suggested just to show those separately that will potentially not comply in the future.

(c) Members also found the word affect in paragraph 72C(b) to be misleading as change of control clauses are not uncommon in loan contracts.

User panel is taken minutes

(d) Member noted that insights into covenants was something that investors keenly sought, but one member was not sure whether the way to put that on the face of the financial statements was right. User would be more interested in the key covenants and the company's actual audited performance on those covenants. The member agreed that the approach probably solved the issue of clear guidance about whether to present as current or non-current. The user also agreed with not taking more information beyond 31 December. It did raise the question of when to include a subsequent event, as new information that could cause a liability to accelerate was something that might need to be mentioned in the subsequent event.

(e) Member also mentioned that Financial Institutions might have hundreds of bonds and debts outstanding that were subject to certain covenants. There would be a need for judgment in selecting which ones were material to present in a meaningful way. The ED's approach on presentation seemed to be too broad.

(f) One member stated that all information should be taken into account when the annual report was finalised, so if covenants would be breached in the future and a loan became repayable then that would be a current liability at year-end. The member also questioned whether there are any loans without such specified conditions.

(g) One member supported the IASB's alternative, as anything that could be accelerated into current should be called current. Companies should be under an obligation to explain their refinancing strategies when it was evident they had many current liabilities. But whether the granularity met users' information usefulness test was a different question.

(h) One member thought that with 72B there was a right and with 72C there was not a right, and with those two all possible forms of bonds should be covered. But the member also noted that EBITDA was also dependent on what competitors did. Companies were always dependent on society as a whole.

EFRAG Secretariat`s recommendation

4 The EFRAG Secretariat proposals regarding EFRAG's Draft Comment Letter are presented in agenda paper 05-02 EFRAG's Draft Comment Letter.

Question 1

5 EFRAG in general supports the IASB's efforts to address the concerns that have emerged in the context of the IFRS Interpretations Committee's agenda decision (para. 9-11 of AP 05-02).

6 EFRAG agrees with paragraph 72B and the subparagraphs (a) and (b) of the ED (para. 12 of AP 05-02).

7 However, EFRAG has concerns

(a) about the relationship of the paragraphs 72B(b) and 72C(b) of the ED (para. 13 of AP 05-02).

(b) about the wording in 72C(b) '*unaffected by the entity's future actions*'. (para. 14 - 17 of AP 05-02)

8 EFRAG agrees with the direction of the proposed disclosure requirements, but has some concerns related to the targeted scope of the disclosure requirements: (para. 20 - 21 of AP 05-02)

(a) The proportion of liabilities subject to specified conditions will be very significant compared to liabilities not subject to such conditions.

(b) Such a broad population contains a risk that disclosure requirements will become boilerplate.

(c) EFRAG proposes that the disclosure requirements in 76ZA(b)(i) and (iii) should only be applicable for certain liabilities with covenants and that 76ZA(b)(ii) will be deleted.

9 EFRAG highlights that some information may already be required as part of IFRS 7. (para. 22 of AP 05-02)

Question 2

10 EFRAG disagrees with the requirement to separately present on the face of the balance sheet the liabilities classified as non-current (where compliance with specified conditions is required within twelve months after the reporting period). (para. 28 - 29 of AP 05-02)

11 EFRAG also has reservations about the scope of liabilities that will have to be presented separately for the same reason as stated in paragraph 8(a) above. (para. 30 - 32 of AP 05-02)

Question 3

12 EFRAG supports the IASB efforts to improve the guidance with regard to the current and non-current classification of liabilities with specified conditions. Nevertheless as explained above, EFRAG finds it challenging to distinguish between 72B(b) and 72C(b). (para. 39 of AP 05-02)

13 EFRAG supports the proposed retrospective application with earlier application permitted and also agrees to the proposed date of first-time application. (para. 40-41 of AP 05-02)

Questions for EFRAG TEG members

14 Do you have comments on EFRAG's Draft Comment Letter proposed by the EFRAG Secretariat?

15 Do you recommend EFRAG's Draft Comment Letter for the EFRAG Board to approve?

Agenda Papers

16 In addition to this issues paper, the following papers have been provided for the session:

(a) Agenda Paper 05-02 – Draft Comment Letter ED/2021/9.

(b) Agenda Paper 05-03 – IASB's Exposure Draft Non-Current Liabilities with Covenants.

(c) Agenda Paper 05-04 – Snapshot – ED/2021/9.