Summary and analysis of the comment letters received

1 Based on the comments received, the EFRAG Secretariat has developed a revised draft EFRAG final comment letter that is presented as agenda paper 04.04 Non-Current Liabilities with Covenants (b) – TEG 23.03.2022.

Structure of the paper

2 This comment letter analysis contains:

(a) Summary of respondents;

(b) Summary of respondents' views;

(c) Appendix 1 - detailed analysis of responses in comment letters received.

Summary of respondents

3 At the time of writing, 6 comment letters in final version and 4 letters in draft version have been received; the draft versions have been considered for the present summary of feedback but are not published to EFRAG's website.

4 The final letters received have been uploaded to EFRAG's Website (here).

5 The letters are summarised below by type and geography of respondents:

By geography		**By type**	
Europe	3	National Standard Setter	5
Germany	2	Preparer Organisation	3
Sweden	1	Professional Organisation	1
France	1	Regulator	1
Spain	1		
Italy	1		
UK	1		
Total	**10**	**Total**	**10**

6 The following respondents submitted a comment letter:

No.	Name	Type	Geography
1	SFRB	National Standard Setter	Sweden
2	ESBG	Preparer Organisation	Europe
3	GDV	Preparer Organisation	Germany
4	ICAC	National Standard Setter	Spain

5	ICAEW	Professional Organisation	UK
6	ESMA	Regulator	Europe
7	OIC (draft)	National Standard Setter	Italy
8	BusinessEurope (draft)	Preparer Organisation	Europe
9	ASCG (draft)	National Standard Setter	Germany
10	ANC (draft)	National Standard Setter	France

7 In this document the EFRAG Secretariat has adopted the following convention for the classification of the answers:

Term Extent of response among respondents	
All/Almost all	90% to 100%
Most	71% to 89%
Majority	51% to 70%
Many, significant	31% to 50%
Some, others	21% to 30%
One/A few	10% to 20%

Summary of respondents' views

Overall

8 All the respondents shared the concerns that were raised by respondents to the IFRS IC tentative agenda decision as the outcomes fail to faithfully represent an entity's financial position at the reporting date.

Classification

General approach

9 Most respondents explicitly agreed that conditions with which an entity must comply within twelve months after the reporting period shall not affect classification of a liability as current or non-current.

10 One respondent questioned whether this would always result in fair presentation (e.g., a breach of a condition shortly after the reporting date or a foreseeable breach).

11 Some respondents also stated that the proposed guidance for classification would not be sufficient to indicate when a liability would be ultimately repayable.

Paragraph 72C(b)

12 Respondents thought that the classification approach proposed by the IASB in paragraph 72C(b)

(a) is not compatible with principle based standard setting (most respondents);

(b) would introduce a new concept in the IFRS literature (few respondents).

13 Therefore, all respondents suggested to reconsider the wording in paragraph 72C(b):

(a) it was suggested to use a more principles-based perspective (most respondents) or

(b) it was suggested to better explain the interaction with paragraph 72B(b) (probably develop further guidance; some respondents).

(c) it was suggested to eliminate insurance liabilities as an example in paragraph 72C(b) as it would not be appropriate to generally classify insurance liabilities as current because this requirement would lack economic substance [many respondents] as insurance liabilities are held in a portfolio where the payment profile is very predictable extent (one respondent).

14 Many respondents were concerned that the notion “unaffected by the entity’s future actions” might be misleading and would not help to clearly differentiate the conditions which could result in diversity in practice. Therefore,

(a) one respondent proposed to remove paragraph 72C(b), extend paragraph 72B to all conditional settlement terms and retain the exception specified in paragraph 72C(a) rephrased as the “right to defer settlement of a liability beyond 12 months that does not exist when the counterparty has the enforceable right, at the reporting date, to call the liability within 12 months after that date unconditionally”.

(b) one respondent proposed to incorporate a probability threshold for deciding whether a liability should be classified as current or non-current.

(c) a few respondents suggested to transfer paragraph BC20 to the main body of IAS 1 to give some helpful explanation of how paragraph 72C(b) is intended to work.

(d) one respondent agreed to the alternative wording proposed by EFRAG for paragraph 72C(b).

<u>Other comments</u>

15 One respondent suggested to clarify the term “substance”[1] as stated in the proposed paragraph 72A as the term would cast significant doubt about whether the term implies a restriction of the guidance in paragraph 72B(b). The respondent proposed to avoid the term substance to not undermine the convention (rule) set by the guidance.

16 One respondent was concerned about the missing definition for the term ‘specified conditions’ which could result in diversity in practice.

17 Some respondents agreed that paragraph 72C(a) is a good **example** for a situation where no right to defer the payment for at least 12-months after the reporting period end exists.

18 One respondent raised concern about the original root cause in paragraph 69(d) of IAS 1 as it would already require a forward-looking perspective. Although – on an overall basis – the amendment would be acceptable, it does not solve the original problem.

19 One respondent expressed the view that the interaction of paragraph 72B and paragraph 75 of IAS 1, although not being under debate in this project, is not sufficiently clear and may lead to discrepancy in outcomes that may not reflect useful information. It also seemed contradictory to get a waiver in advance to the expected breach and classify the liability as non-current while disclosing a potential breach of the covenant at the reporting period end (76ZA(b) (ii)).

[1] *An entity’s right to defer settlement of a liability for at least twelve months after the reporting period must have substance and, as illustrated in paragraphs 72B–75, must exist at the end of the reporting period.*

Disclosures

General approach

20 Many respondents did support the proposals to enable users to understand the risk that a liability may become repayable with twelve months after the reporting period end. One respondent did not support the proposed disclosures as targeted changes to the IFRS 7's existing liquidity risk disclosures should be made instead. One respondent also raised questions about the interaction of IAS 1 and IFRS 7. Meanwhile disclosures about maturities under IFRS 7 follow a different concept than the requirement for classification in non-current and current, disclosures under IAS 1 overlap with the disclosure requirements of IFRS 7.

Scope of the disclosure

21 Many respondents raised concerns about the proposals. They did not support the proposed scope of the disclosures and suggested to only disclose information where:

(a) significant doubt or uncertainties about premature payment within the next 12-months exists to prevent information overload and obscured information (many respondents) or

(b) where the risk of breaching the specified condition is more than remote (one respondent).

(c) One respondent that acknowledged the idea of materiality as highlighted in paragraph BC 26 stressed the difficulties of differentiating between relevant and non-relevant information.

Forward looking disclosure

22 Many respondents did not support forward looking information in general in line with the argument given by the IASB's alternative views in the proposals (paragraph AV5 of IAS 1). Respondents specifically stated that:

(a) commercial and litigation issues would exist. Those suggested to make a statement based on a probability criterion and on evidence as at the reporting period end (some respondents).

(b) a statement "whether" compliance would be given in the future could trigger a self-accelerating process due to cross-default. The respondent also opined that a disclosure about "how" to comply with covenants would probably be boilerplate. The respondent stated that disclosures about behavioural aspects would not be appropriate as the focus on stewardship would go beyond the purpose of financial statements and the respondent also expected challenges of auditing and enforcing such statements (one respondent).

23 A few respondents supported EFRAG's proposal to consider information regarding forward looking information that is based on facts and circumstances known at the date of issuance of the financial statements whereas a few respondents did not support this proposal. One respondent specifically pointed to the guidance in IAS 10.

Other comments

24 One respondent proposed to not require a hypothetical assessment of the covenant at the reporting period end (76ZA(b)(ii)). While another respondent was cognisant of the weaknesses of the disclosure requirement (e.g., where seasonality exists) it was noted that where structuring occurs, or a grace period is given the disclosure requirement could give important information to the users.

25 One respondent suggested additional disclosures for covenants where changes in the arrangement occurred during the reporting period (e.g., renegotiation) as this would unveil potential critical conditions.

26 One respondent proposed to clarify that disclosures are not required under the order of liquidity presentation as paragraph 76ZA(b) specifically refers to the non-current and current classification. IFRS 17 also already requires specific disclosures about liquidity risk.

Presentation

27 None of the respondents support a separate presentation of non-current financial liabilities on the face of the statement of financial position for the following reasons:

(a) Many respondents did not see more useful information. Many respondents mentioned that information usefulness would not increase when most liabilities will have to be reclassified under this item.

(b) One respondent further noted that this requirement would relate to all liabilities and should thus be investigated more deeply.

(c) One respondent stated that a narrow-scope amendment would not fulfil a high threshold for separate presentation.

(d) One respondent proposed to not require an additional line item when entities apply the alternative presentation using the order of liquidity.

28 One respondent suggested to have only one non-current line item that is called '(non-current) financial liabilities (including financial liabilities with covenants)'.

Other aspects

29 Many respondents supported the proposed retrospective application and the deferral of the effective date of the amendments to IAS 1 published in 2020.

30 One respondent expressed concerns about the significant complexity with regard to the classification so more time would be required to renegotiate contract terms thus an extension to 2025 would be more appropriate.

Question to EFRAG FR TEG

31 Does EFRAG FR TEG has comments or questions on this summary *of responses in comment letters* received (Detailed responses presented in appendix 1)?

Appendix 1 - Detailed analysis of responses in comment letters received

Question 1 – Classification and disclosure

The Board proposes to require that, for the purposes of applying paragraph 69(d) of IAS 1, specified conditions with which an entity must comply within twelve months after the reporting period have no effect on whether an entity has, at the end of the reporting period, a right to defer settlement of a liability for at least twelve months after the reporting period. Such conditions would therefore have no effect on the classification of a liability as current or non-current. Instead, when an entity classifies a liability subject to such conditions as non-current, it would be required to disclose information in the notes that enables users of financial statements to assess the risk that the liability could become repayable within twelve months, including: (a) the conditions (including, for example, their nature and the date on which the entity must comply with them); (b) whether the entity would have complied with the conditions based on its circumstances at the end of the reporting period; and (c) whether and how the entity expects to comply with the conditions after the end of the reporting period. Paragraphs BC15–BC17 and BC23–BC26 of the Basis for Conclusions explain the Board's rationale for this proposal. Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why

EFRAG's tentative position

EFRAG supports this ED as it addresses the concerns of constituents. **EFRAG suggests to not base the main explanation for differentiation in paragraph 72C(b) on the words "unaffected", but instead to clarify that (a) payments as a consequence of a discrete event occurred after the balance sheet date do not affect the classification; and (b) items such as financial guarantees would be classified as current.** **EFRAG proposes that the interaction of paragraph 61 and paragraph 69(d) of IAS 1 is considered further by the IASB. EFRAG proposes that the IASB should clarify that the guidance in paragraph 72B and 72C does not impact the order of liquidity if presentation by order of liquidity in paragraph 60 and 64 is applied.** **EFRAG has a concern that the rather broad target population for the disclosure requirements contains a risk of the disclosures being boilerplate and proposes to the IASB to elaborate on the application of materiality for such disclosures, especially with regard to the significance of the impact on the entity's liquidity.** **EFRAG suggests to add in paragraph 76ZA(b) that disclosures should be made in case of significant uncertainties on whether conditions are met. EFRAG also proposes to redraft paragraph 76ZA(b)(iii).**

Summary of respondents' comments

32 In general all respondents shared the concerns that were raised by the respondents to the IFRS IC tentative agenda decision as the outcomes fail to faithfully represent an entity's financial position at the reporting date.

Classification

33 One respondent suggested to clarify the term "substance" as stated in the introductory paragraph 72A of IAS 1 of the proposals. The respondents had doubts whether paragraph 72B(b) would also be applicable when the entity would know that it would breach the covenant within 12-month after the reporting period end. The respondent proposed to avoid the term substance to not undermine the convention (rule) set by the guidance.

34 Most respondents explicitly agreed that conditions with which an entity must comply within twelve months after the reporting period shall not affect classification of a liability as current or non-current. One respondent noted that it was questionable whether in some situations a classification as non-current warrants a fair presentation of an entity's financial position (e.g., a breach of a condition shortly after the reporting date or a foreseeable breach).

35 One respondent was concerned about the missing clarity about what is meant by 'specified conditions' and that such lack may lead to diversity in practice unless this term is defined more clearly. It is not clear for example, whether these 'specified conditions' are limited to what are widely regarded as 'covenants'.

36 Some respondent agreed that paragraph 72C(a) is a good **example** for a situation where no right to defer the payment for at least 12-months after the reporting period end exists.

37 Respondents thought that the classification approach proposed by the IASB in paragraph 72C(b)

(a) is not compatible with principle based standard setting (majority of respondents). and that

(b) the proposed concept in paragraph 72C(b) would introduce a new concept in the IFRS literature (one respondent), and that

(c) it would contradict the accruals basis of accounting principle in the conceptual framework (one respondent).

38 Therefore, a majority of respondents suggested to reconsider the wording in paragraph 72C(b) using a more principles-based perspective or better explain the interaction (probably develop further guidance; some respondents). Many respondents were concerned that the notion "unaffected by the entity's future actions" might be misleading, would also be applied for protective clauses (like force majeure cases), and would not help to clearly differentiate the conditions which could result in diversity in practice. Therefore,

(a) one respondent proposed to remove paragraph 72C(b) and extend paragraph 72B to all conditional settlement terms. The right to defer settlement of a liability beyond 12 months would exist at the reporting date if no conditional settlement term, assessed on the basis of facts and circumstances existing at that same date, would

(i) require the entity to settle the liability within 12 months or

(ii) give the counterparty the right to require it;

and - retaining the exception specified in paragraph 72C(a) rephrased as the "right to defer settlement of a liability beyond 12 months that does not exist when the counterparty has the enforceable right, at the reporting date, to call the liability within 12 months after that date unconditionally, and

(b) one respondent proposed to incorporate a probability threshold for deciding whether a liability should be classified as current or non-current, and

(c) some respondents suggested to transfer paragraph BC20 to the main body of IAS 1 to give some helpful explanation of how paragraph 72C(b) is intended to work.

39 Many respondents also proposed to the eliminate insurance liabilities as an example in paragraph 72C(b) as it would not be appropriate to generally classify insurance liabilities as current because this requirement would lack economic substance. One respondent specifically highlighted that insurance liabilities are held in a portfolio where payments for different periods are predictable to a very large extent. Those insurance liabilities should be classified in accordance with the specific disclosure requirement of paragraph 132 of IFRS 17. Another respondent pointed to the risk that the proposal could lead to diversity in practice.

40 One respondent agreed to the alternative wording proposed by EFRAG for paragraph 72C(b).

41 Some respondents also stated that the proposed guidance for classification would not be sufficient to indicate when a liability would be ultimately repayable.

42 One respondent raised concern about the original root cause in paragraph 69(d) of IAS 1 as it would already require a forward-looking perspective. So, although – on an overall basis – the amendment would be acceptable, it does not solve the original problem.

43 One respondent expressed the view that the interaction of paragraph 72B and paragraph 75 of IAS 1 is not sufficiently clear and may lead to discrepancy in outcomes that may not reflect useful information. Although, paragraph 75 is not under debate of the narrow scope amendment is seems that the amendment results in a conclusion that is counterintuitive. Moreover, it seems contradictory that an entity that got a waiver in advance to the expected breach would be classified as non-current but would still have to disclose a hypothetical breach at the reporting period end based on the disclosures to be made under paragraph 76ZA(b) (ii).

Disclosures

44 Many respondents did support the proposals to enable users to understand the risk that a liability may become repayable with twelve months after the reporting period end.

45 One respondent stated that the relationship between the disclosure requirements of IAS 1 on the classification of long-term debt with covenants and the disclosure requirements of IFRS 7 remains unclear in several respects:

(a) Disclosures about maturities under IFRS 7 follow a different concept than the requirement for classification in non-current and current.

(b) Disclosures under IAS 1 overlap with the disclosure requirements of IFRS 7 (remedied defaults or renegotiation of covenants after end of reporting period).

46 The majority of respondents did not support the proposal with regard to the scope of the disclosures, instead respondents suggested to only disclose information about liabilities where significant doubt or uncertainties about premature payment within the next 12-months exists (e.g., if the condition at the reporting date indicates future non-compliance or if a risk non-compliance exists) to prevent information from being obscured. One respondent specifically proposed to only disclose liabilities where the risk of breaching the specified condition is more than remote to set a filter to avoid that a large number of entities that do not face liquidity issues provide unnecessary information.

47 One respondent was of the view that targeted changes to the IFRS 7's existing liquidity risk disclosures and/or supporting guidance should be made. These requirements already require entities to provide an analysis of liabilities based on contractual maturities. Information about the risks and uncertainties relating to possible non-compliance with covenants could be added to this existing information when it is considered material.

48 One respondent that acknowledged the idea of materiality as highlighted in paragraph BC 20 stressed the difficulties of differentiating between relevant and non-relevant information.

49 One respondent suggested to reconsider the wording in paragraph 76ZA(b) and another respondent proposed to not require a hypothetical assessment of the covenant at the reporting period end (76ZA(b)(ii)). One respondent noted that requiring entities to disclose information as to whether they comply at the reporting date with conditions that must be tested at a later date would be unlikely to provide useful information when the timing for the covenants has been set to reflect the entity's specific circumstances but would nevertheless give important information in other cases, where structuring my occur or a grace period was granted to test after the reporting period end.

50 Many respondents did not support forward looking information in general in line with the argument given by the IASB's alternative views in the proposals (paragraph AV5 of IAS 1).

(a) Few respondents explicitly pointed to commercial and litigation issues, instead the respondents suggested to make a statement based on a probability criterion and on evidence as at the reporting period end.

(b) One respondent was concerned disclosures about statements "*whether*" an entity would comply with covenants could trigger a self-accelerating process due to cross-default clauses that are common in practice. Also, the respondent expressed the view that a description of "how" to comply with covenants would probably result in boilerplate information.

(c) One respondent stated that the proposed disclosure focus on the entity's expectations or intentions (behavioural components), which puts a very strong focus on stewardship that may go beyond the purpose of financial statements. The respondent also saw challenges of auditing and enforcing a detailed statement of how the entity expects to comply with the conditions after the reporting period.

51 Some respondents supported EFRAG's proposal to consider information regarding forward looking information that is based on facts and circumstances known at the date of issuance of the financial statements. Some respondents did not support this proposal and one of them specifically pointed to the guidance in IAS 10.

52 In addition, one respondent proposed that significant amendments to covenant arrangements that occurred during the reporting period should be explained in the notes as additional disclosures (e.g., information about a waiver obtained during the reporting period, or renegotiations of the conditions the entity must comply with) as this would unveil potential critical conditions.

53 One respondent proposed to EFRAG to recommend to the IASB to clarify that no disclosures are required when the financial statement is presented in the order of liquidity as paragraph 76ZA(b) specifically refers to paragraph 72B(b) of IAS 1 which deals with classification in non-current and current. Moreover IFRS 17 already requires specific disclosures about liquidity risk.

54 One respondent noted that EFRAG's suggestion to elaborate on the application of materiality for such disclosures could give the impression that the relevance of materiality and its application could vary from standard to standard but the concept of materiality is pervasive to the financial statements as a whole.

Question 2 Presentation

The Board proposes to require an entity to present separately, in its statement of financial position, liabilities classified as non-current for which the entity's right to defer settlement for at least twelve months after the reporting period is subject to compliance with specified conditions within twelve months after the reporting period. Paragraphs BC21–BC22 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, do you agree with either alternative considered by the Board (see paragraph BC22)? Please explain what you suggest instead and why.

EFRAG's tentative position

EFRAG disagrees with the separate presentation on the face of the balance sheet of the liabilities classified as non-current for which the entity's right to defer settlement is subject to compliance with specified conditions within twelve months after the reporting period.

Summary of respondents' comments

55 All respondents do not support a separate presentation of non-current financial liabilities on the face of the statement of financial position.

(a) Many respondents specifically stated that such proposal would not result in more useful information and would undermine the differentiation between current and non-current liabilities. One respondent further noted that this requirement would relate to all liabilities and should thus be investigated more deeply.

(b) Many respondents mentioned that specific disclosures in the notes would be sufficient to assess the liquidity risk and that information usefulness would not exist when most liabilities will have to be reclassified under this item.

(c) One respondent mentioned that the 'threshold' for specifying separate presentation of items should be high in terms of information value which would not be fulfilled in case of a narrow-scope amendment and that IAS 1 would already provide guidance for disaggregation if necessary.

56 One respondent proposed to EFRAG to suggest to the IASB that no additional line item should be presented in the statement of financial position when entities apply the alternative presentation using the order of liquidity.

57 In case the IASB should continue with the proposal one respondent suggested to have only one non-current line item that is called '(non-current) financial liabilities (including financial liabilities with covenants)'.

Question 3 Other aspects of the proposals

The Board proposes to:

(a) clarify circumstances in which an entity does not have a right to defer settlement of a liability for at least twelve months after the reporting period for the purposes of applying paragraph 69(d) of IAS 1 (paragraph 72C);

(b) require an entity to apply the amendments retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, with earlier application permitted (paragraph 139V); and

(c) defer the effective date of the amendments to IAS 1, Classification of Liabilities as Current or Non-current, to annual reporting periods beginning on or after a date to be decided after exposure, but no earlier than 1 January 2024 (paragraph 139U).

Paragraphs BC18–BC20 and BC30–BC32 of the Basis for Conclusions explain the Board's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

EFRAG's tentative position

EFRAG supports the other aspects of the ED.

Summary of respondents' comments

58 Many respondents supported the proposed retrospective application and the deferral of the effective date of the amendments to IAS 1 published in 2020.

59 However, if the requirements in paragraph 72C(b) were to significantly restrict the applicability of the approach in paragraph 72B of the ED or lead entities not to apply paragraph 72B to common or 'vanilla' conditions, many entities may need to reclassify significant amounts on their statement of financial statement and therefore more time to renegotiate the terms of the agreements which would require an extension of the period to prepare for the amendment (until 2025).