Summary and analysis of the outreach activities

1 Based on the feedback 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 events and respondents;

(b) Summary of respondents' views;

(c) Appendix 1 - detailed analysis of comments received from outreach (meetings and survey).

Summary of events and respondents

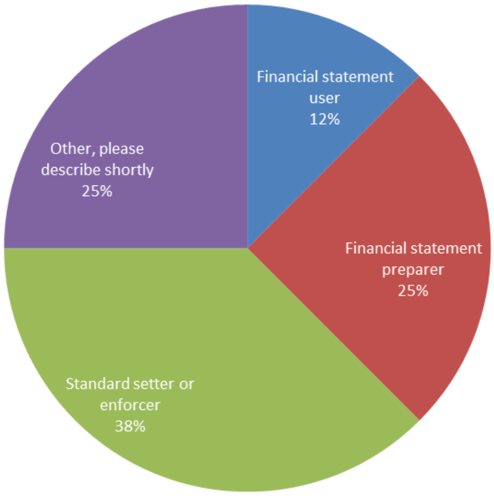
3 EFRAG has undertaken different measures to receive sufficient feedback to decide on the finalization of the comment letter (the "FCL"). EFRAG had the following meetings with working groups after publishing the DCL (draft comment letter):

(a) EFRAG FR TEG-CFSS on 17 February 2022;

(b) EFRAG Academic Panel on 04 March 2022;

4 Moreover, EFRAG Secretariat also held closed meetings with constituents and published a survey. The main messages of the results are summarized below. More details are given in the appendix.

5 EFRAG gave respondents a possibility to answer the questions in EFRAG DCL through an electronic survey. The eight respondents were of the following type:



6 The following respondents submitted the survey:

No.	Type	Geography
1	Auditor	Greece
2	Financial Statement Preparer	Cyprus
3	National Standard Setter	Portugal
4	Financial Statement user	Bulgaria
5	National Standard Setter	Denmark
6	Financial Institution/Preparer	Spain
7	National Standard Setter	Austria
8	Financial Supervision Authority	Romania

Summary of constituents' views

7 The main messages of the outreach activities were as follows.

Classification

8 Although paragraph 72B(b) was generally welcomed constituents and survey respondents (especially half of the survey respondents) raised doubts about classifying liabilities with covenants as non-current when those would be tested shortly after the end of the reporting period.

9 Constituents and survey respondents (67%) stated that the differentiation between paragraph 72B(b) and 72C(b) lacks clarity, but EFRAG's alternative wording for paragraph 72C(b) would lack clarity as well. Constituents suggested to incorporate a probability criterion in the classification model. Users did not assess the classification as an important issue because they would use disclosures to get insights on liquidity risk.

10 Concerns were expressed that a current classification of liabilities with covenants based on the guidance in the proposals (especially paragraph 72C(b)) could further trigger other breaches of covenants (e.g., by cross default).

11 Constituents and more than half of the survey respondents (57%) assessed inconsistencies with regard to the interaction of paragraph 72B(b) and paragraph 75 of IAS 1 which should be clarified or better explained. One survey respondent was concerned about the classification outcome of the interaction between the paragraphs that should actually not differ in his opinion. Another survey respondent stated that if the same cash flow pattern is treated differently it would not be useful for users to understand the uncertainties.

12 Constituents agreed that the main reason for the underlying classification issue is based on the guidance given in paragraph 69(d) of IAS 1 and should probably solved in a broader context (primary financial statements project).

Disclosure

13 Users agreed with the proposals to offer more information on specified conditions and also agreed with getting forward-looking information. More than half of the survey respondents (57%) agreed that the disclosure requirements would be useful.

14 Constituents were split with regard to whether the scope of disclosures should be restricted to a subset of liabilities under paragraph 72B(b). Users had the opposite view and required as much audited information as possible (as this would be less of a problem than too little information). Most survey respondents (83%) stated that they would support give disclose on liabilities with specified conditions where the entity expects to comply in the future although one respondent commented that he would actually not favour disclosures in circumstances where the entity would expect to comply with the conditions but would consider it as a compromise instead of separate presentation.

15 One constituent stated that they were undecided about the forward-looking information whereas another constituent noted that such kind of information would already be required by other standards (e.g., disclosures on liquidity risk or going concern) and would be welcomed. Other constituents noted that they would regard forward-looking information either as a problem in the context of local laws and regulation or as information that would potentially be boilerplate.

16 There was support for EFRAG's positions to not require disclosures on how an entity will comply with the requirements. Survey respondents had split views (50%) regarding whether entities should be required to disclose "how" they comply with the specified conditions.

17 Constituents noted that the forward-looking information should consider events up to the date of the publication date while another constituent was of a different view due to the general guidance in IAS 10 for events after the balance sheet date.

Presentation

18 Almost all participants agreed that no separate presentation should be required. Respondents to the survey fully agreed (100%) to not separately present liabilities in the scope of paragraph 72B(b).

Other aspects

19 The two amendments (2020 and 2021) should be applied simultaneously with no option to early application just for the 2020 amendments.

Appendix 1 - detailed analysis of comments received from outreach (meetings and survey)

Question 1

> 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 constituents' comments

<u>Views expressed on classification in the meetings</u>

20 Constituents confirmed that the differentiation between paragraph 72B(b) and .72C(b) would lack clarity. Constituents also pointed out that the guidance for classification does not lead to useful information for users as it does not give insights about the probability that repayment would be required within 12-month after the reporting period end. Constituents suggested to incorporate a probability criterion in the classification model (similar to recognition and measurement). Constituents also

noted that the alternative proposal in EFRAG's DCL would also lead to question with regard to the definition set up in paragraph 15 ("discrete event").

21 Constituents agreed that the main reason was based on the guidance given in paragraph 69(d) of IAS 1. A member proposed to state in 69(d) that the classification should be based on the facts and circumstances as of the reporting period end not looking into the future.

22 Constituents did not support the alignment of classification and measurement as part of this narrow scope amendment but suggested to highlight that this could be part of the broader primary financial statement project.

23 One constituent highlight that a current classification of liabilities with covenants based on the guidance in the proposals could further trigger other breaches of covenants (e.g., by cross default) and therefore have severe economic consequences. A current classification based on the existence of a change of control clause would not be appropriate.

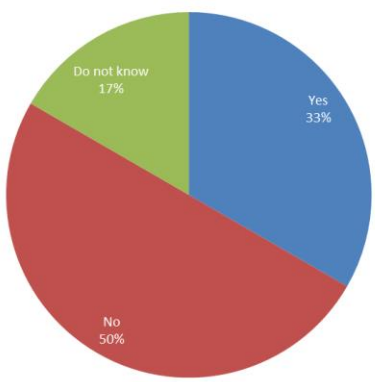
24 Constituents assessed inconsistencies with regard to paragraph 72B(b) and paragraph 75 of IAS 1 which leads to the outcome that a rule-based solution/approach is not suitable in all circumstances. Member also struggled with the wording in paragraph 75 of IAS 1.

25 Constituents suggested to limit the requirement to liabilities in the scope of IFRS 7.

26 Constituents noted that the classification requirement of the proposals would not be important for users because they would require information that shows the economic substance (how is the entity from breaching or how much liquidity risk exists), so information from the notes would take precedence over information based on separate presentation (e.g., when the covenant is probably breached but the liability is still being classified as non-current or when a liability is classified current as a result of a change of control clause). Even if a breach would occur the liability would still be deemed non-current in the analysis if the entity was sure to receive a waiver by the lender.

<u>Views expressed on classification in the survey</u>

27 Half of the respondents (50%) stated that covenants to be complied with based on data shortly after the end of the reporting period should not be presented as non-current.

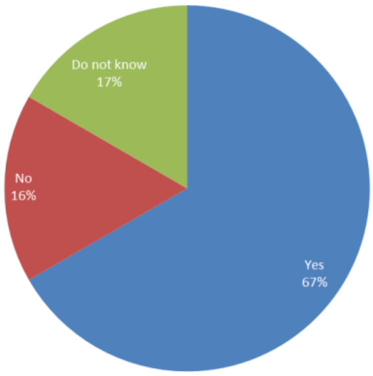


Do you agree that covenants to be complied with based on data (even shortly) after the end of the reporting period should be presented as non-current?

28 One respondent that agreed to the classification as non-current stated that otherwise there would be discretion for the entity to argue what is close enough to the reporting period end. One respondent that answered 'do not know' noted that

the rules-based classification would make it difficult to give meaningful information in all circumstances.

29 Majority of respondents (67%) stated that the distinction between paragraph 72B(b) and 72C(b) is not clear with respect to the differentiation in which situations the liability would be classified as current or non-current.

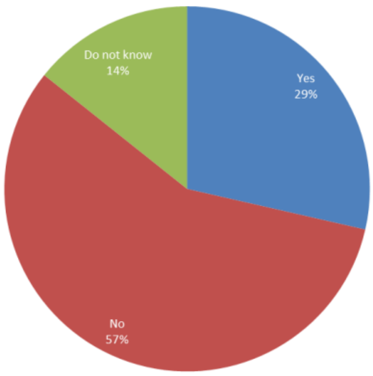


Do you agree with regard to the distinction between paragraph 72B(b) and 72C(b).

30 One respondent that answered 'do not know' stated that the term affected/unaffected should be better explained. The same respondent pointed to the missing link with regard to IAS 10. Two respondents specifically commented that they would agree with the wording suggested by EFRAG.

31 One respondent specifically stated that in paragraph 72C(b) no reference should be made to insurance liabilities.

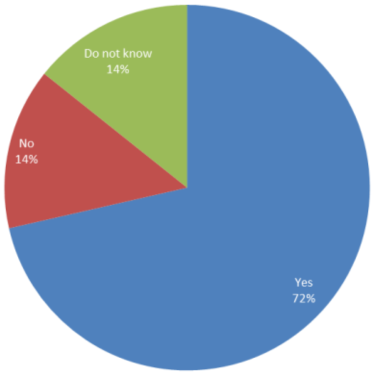
32 A majority of the respondents (57%) noted that they would not support the outcome of the interaction between paragraph 72B(b) and paragraph 75.



Do you agree to the outcome of the interaction of paragraph 72B(b) and 75?

33 One respondent was concerned about the outcome of the interaction between the paragraphs. The history should not determine the accounting, therefore breaching a covenant and getting a grace period (would lead to current classification) while a test with an original test date after the reporting period end would be classified as non-current. The classification outcome should not be different as at the reporting period end. Another respondent stated that if the same cash flow pattern is treated differently it would not be useful for users to understand the uncertainties.

34 A majority of respondents (72%) agreed that the amendment shall only clarify but not amend the principle in paragraph 69(d) of IAS 1.



Do you support that the amendment shall only clarify but not amend the principle in paragraph 69(d) of IAS 1?

Views expressed on disclosures in the meetings

35 User constituents - especially from credit rating agencies - agreed with the proposals to offer more information on specified conditions and also agreed with getting forward-looking information. The entities performance with regard to the covenant should be clearly explained.

36 Constituents were split with regard to whether the scope of disclosures should be restricted to a subset of liabilities under paragraph 72B(b). One user constituent noted that a restriction of the scope of the disclosures would not be required from his point of view. One constituent stated that it should be taken into account that financial information is going to be used digitally therefore an information overload (due to increased volume of disclosures) was not expected.

37 One constituent stated that they were undecided about the forward-looking information whereas another constituent noted that such kind of information would already be required by other standards (e.g., disclosures on liquidity risk or going concern). Constituents

(a) noted that they would regard forward-looking information either as a problem in the context of local laws and regulation or as information that would potentially be boilerplate. Other constituents concurred on the importance of having forward looking information about the risk of a breach of a covenant.

(b) User constituents noted that forward-looking information should not be a problem as entities would already use such information in other publications. Consequently, it would be necessary to know whether a waiver or a period of grace was granted be the lender.

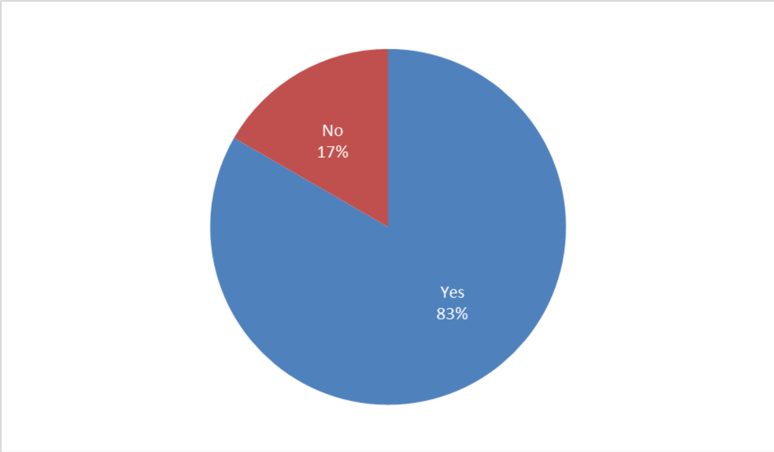
(c) User constituents would find it particular useful to have audited information as management normally provides unaudited information about their covenants/specified conditions. Normally less information would be a problem for user, but more is better except for potential boilerplate information which would never be useful.

(d) Forward-looking disclosure requirements are supported and will not create issues. Nevertheless, EFRAG's positions was supported to not require disclosures on how an entity will comply with the requirements.

38 Constituents noted that the forward-looking information should consider events up to the date of the publication date while another constituent had split views about this requirement due to the general guidance in IAS 10 for events after the balance sheet date.

Views expressed on disclosures in the survey

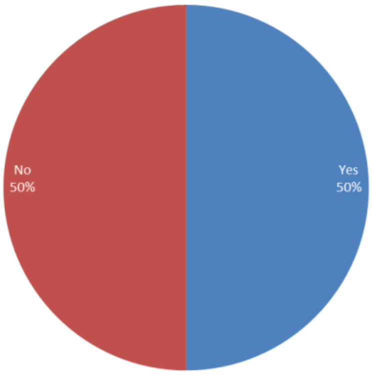
39 Most respondents (83%) stated that they would support to disclose liabilities with specified conditions where the entity expects to comply in the future.



Should the proposed new disclosures be required in cases where the entity expects to comply with the conditions in the future?

40 One respondent opined that the disclosure requirements are a compromise to avoid separate presentation, but the respondent indicated that he would actually not favour disclosures in circumstances where the entity would expect to comply with the conditions. Another respondent stated that the disclosures should represent the managements' expectation with regard to the uncertainty.

41 The respondent's views were split (50%) regarding whether entities should be required to disclose how they comply with the specified conditions.

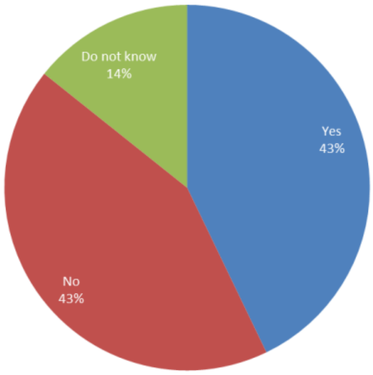


Do you agree that entities should not be required to disclose how they expect to comply with the specified conditions in the future?

42 One respondent had concerns about disclosing forward-looking information. One respondent agreed to disclose "how" the entity expects to comply with the specified condition if significant uncertainties regarding material changes in the liquidity position would exist.

43 Respondents fully agreed that disclosure requirement about future compliance should be based on the knowledge gained up to the date of issuance of the financial statements.

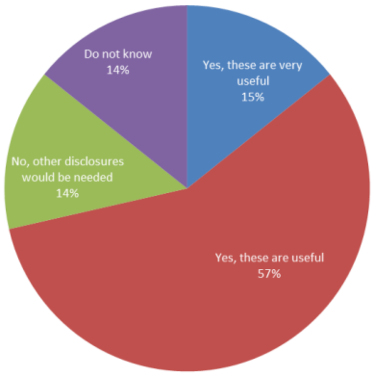
44 Respondents were split with regard to the question whether forward-looking information should be disclosed in the notes or whether this would be inappropriate.



Do you agree with the concern raised regarding the use of forward-looking information?

45 One respondent stated that they would regard disclosures of whether and how they expect to comply with a covenant as a problem because of ever increasing risk of litigation.

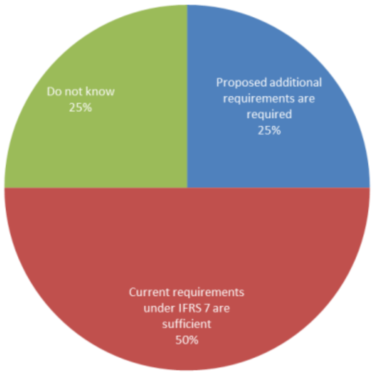
46 A majority of respondents agreed that such disclosure requirement would be useful.



Do you agree with the usefulness of the proposed new disclosure requirements?

47 One respondent commented that disclosures should be based on contractual terms and conditions and should reflect management´s expectation on cash flows and connected uncertainties.

48 Fifty percent of the respondents agreed that current disclosure requirements under IFRS 7 are sufficient and that additional disclosure requirements in IAS 1 with regard to liabilities with specified conditions to be tested within 12 months after the end of are not required.



What are your views on additional disclosure requirements in IAS 1 with regard to liabilities with specified conditions to be tested within 12 months after the end of the reporting period? Do you think that IFRS 7 already require similar disclosures?

49 One respondent stated that additional disclosure requirements of IAS 1 may be provided as a supplement to the requirements of IFRS 7.

50 Moreover, with regard to the question whether liquidity risk disclosures under IFRS 7 would be provided for other liabilities than financial liabilities more than half of the respondents (60%) did not know while the rest (40%) did disclose such information.

Question 2

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 constituents' comments

51 Almost all constituents in the meetings agreed that no separate presentation should be required.

52 Respondents to the survey fully agreed (100%) to not separately present liabilities in the scope of paragraph 72B(b). Instead, one respondent indicated that the information should be disclosed in the notes.

Question 3

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 constituents' comments

53 Constituents noted that the two amendments (2020 and 2021) should be applied simultaneously with no option to early application just for the 2020 amendments.