**EFRAG Secretariat:**
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# IASB ED/2021/09 Non-current Liabilities with Covenants - Proposed amendments to IAS 1
# Cover Note

## Objective

1 The objective of the session is to:

(a) provide the EFRAG Board with a summary of the main proposals contained in the IASB's Exposure Draft ED/2021/9 *Non-current Liabilities with Covenants* (the 'ED');

(b) explain the initial input received from the EFRAG FIWG, the EFRAG User Panel and the summary of the EFRAG TEG discussion and its advice to the EFRAG Board; and

(c) discuss and approve a draft comment letter on the ED.

## Background of the IASB project

2 IAS 1 Presentation of Financial Statements specifies that, for an entity to classify a liability as non-current, the entity must have the right, at the end of the reporting period, to defer settlement of the liability for at least twelve months after the reporting period according to paragraph 69 (d) of IAS 1.

3 In January 2020, the IASB Board issued Classification of Liabilities as Current or Non-current (2020 amendments), which clarified aspects of how entities classify liabilities when the right to defer settlement is subject to compliance with specified conditions after the reporting period.

4 The IFRS IC received a submission about applying the above amendments from 2020 and published a tentative agenda decision explaining how to apply the amendments to particular fact patterns. It was concluded that there is no right to defer settlement for at least twelve months when compliance with specified condition based on its circumstances at the end of the reporting period does not exist, even if compliance with such conditions were required only after the reporting period.

5 Respondents to the tentative agenda decision raised concerns about the outcomes and potential consequences of the 2020 amendments in some situations when compliance is required after the reporting period end and e.g., seasonality influences the achievement of compliance. The IFRS IC reported the feedback to the IASB Board.

6 The IASB Board decided to propose amendments to IAS 1 so that conditions with which an entity must comply after the reporting period would not affect classification of a liability as current or non-current. Instead, entities would present separately, and disclose information about, non-current liabilities subject to conditions within twelve months after the reporting period.

**Summary of the IASB's proposals on the project**

7 In the Exposure Draft 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**

8 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 was heading into the right direction.

(b) Members were 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*

(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 TEG discussion and advice to the EFRAG Board**

*EFRAG Draft Comment Letter*

9 EFRAG TEG discussed the ED/2021/9 at its 16 December 2021 meeting.

*Question 1*

10 EFRAG TEG members generally agreed the IASB's amendment was an improvement of the current drafting of IAS 1, however it was questioned how the ED would interact with paragraph 60 of IAS 1, especially when the balance is presented in order of liquidity. In general, no issue was recognized regarding possible duplicate disclosures under IFRS 7.

11 EFRAG TEG members noted that the wording "affect" was something new and subject to possibly different interpretations. The relation between para. 72B(b) and 72C(b) should be clarified or better rephrased because it would be unclear how to draw a line (e.g., change of control). The difference would be the nature of the agreement (scheduled payments vs. no scheduled payments beyond 12 months).

12 One EFRAG TEG member suggested to use a phrase like "discrete events after the balance sheet date" should not affect the classification, so such an event should trigger non-current classification. The para. 72C(b) would have to be moved to 72B. Insurance liabilities would be classified as non-current. The problem originates in the wording in para. 69(d) of IAS 1, so this paragraph should be redrafted.

13 One EFRAG TEG members noted that the accounting for a period of grace under the ED was said to be questionable, leading to diversity in practice; the IASB should clarify that covenants that are not tested during a grace period would trigger the classification as current.

14 The scope by referring to elevated risks in para. 20 (b) should not be narrowed but admitted that the number of liabilities in scope would be too high. There was disagreement with possible forward-looking information (also from a legal risk perspective). There should be a materiality assessment for disclosures under the requirements in para. 76ZA(b) of the ED introduced as it would not be clear how the preparers "expectation" would be defined.

15 It was highlighted by EFRAG TEG members that materiality should point to the impact on liquidity of the entity. The "and how" (in para. 76ZA(b)(iii)) should be deleted, "based on management's best estimate and facts and circumstance at the reporting date" should be inserted.

16 In addition, EFRAG TEG members noted that disclosures should be made if significant uncertainty would exist. If a high level of uncertainty would be expected, it should be mentioned under IAS 1.

*Question 2*

17 EFRAG TEG members did not agree with separate presentation in the ED. For the same reasons as stated for disclosures (vast population in scope). There should also be no mention of an alternative as referred to in para. 31 of the proposed DCL,

which should be deleted. The presentation would not lead to useful information and also contradict paragraph 60 of the ED.

*Question 3*

18 EFRAG TEG members agreed with the suggestions in the proposed draft comment letter.

*Written input*

19 One member not attending the meeting highlighted – by written notice - that the interaction of the proposals with entities that present their balance sheet based on the order of liquidity IAS 1.60 and the disclosure as currently required by IAS 1.61 was less clear and should be clarified. The member concluded that the proposed disclosures should also be required for these entities, but that would not be explicit.

*EFRAG TEG advice to the EFRAG Board*

20 EFRAG TEG advises the EFRAG Board to approve the Draft Comment Letter on the ED/2021/9.

## Note to the EFRAG Board on the format of the Draft Comment Letter

21 To reduce the length of [Draft] Comment Letters EFRAG secretariat has as of January 2022 made changes to the use of "black boxes". [Draft] Comment Letters of less than 10 pages will no longer include "black boxes". For the ease of reading a condensed content of longer [Draft] Comment Letters, the content of the "black boxes" will be included in an appendix.

22 Due to its short length the Draft Comment Letter on ED/2021/9 contains no "black boxes".

**Questions for EFRAG Board**

23 Does EFRAG Board agree with the drafting of the cover note to the EFRAG DCL on IASB's ED *Non-Current Liabilities with Covenants*? Does EFRAG Board agree with the drafting of the EFRAG's response to the questions included in the IASB's ED *Non-Current Liabilities with Covenants*?

24 Does EFRAG Board agree to include Appendix 2 to the EFRAG DCL on IASB's ED N*on-Current Liabilities with Covenants*?

## Next steps

25 The IASB exposure period for ED/2021/9 is short and ending on 21 March 2022. It is largely overlapping the exposure period for ED/2021/10 Supplier Finance Arrangements which is ending on 28 March 2022. Both coincides with the Christmas holiday period and the busy reporting season. To facilitate constituency feedback and TEG and Board administration. EFRAG secretariat is planning for a parallel work on the finalisation of the two Comment Letters.

26 EFRAG Secretariat is planning to present the constituents feedback from the Draft Comment Letter and discuss a draft version of the EFRAG final comment letter ('FCL') with EFRAG TEG on 22 March 2022.

27 In order to secure a speedy process, EFRAG Secretariat is planning to submit to EFRAG Board the EFRAG FCL for approval through a written procedure between 23 March and 26 March 2022.

**Agenda Papers**

28 In addition to this cover note, agenda paper 02-02 – *Draft Comment Letter ED/2021/9* – has been provided for the session. In addition to this cover note and the main paper, the following background paper is provided:

(a) Agenda paper 02-03 – Snapshot – ED/2021/9 (for background only).