11 February 2021

Ms Sue Lloyd
Chair
IFRS Interpretations Committee
IFRS Foundation
7 Westferry Circus
Canary Wharf
London

Via website: www.ifrs.org

Dear Sue

Tentative Agenda Decision – Classification of Debt with Covenants as Current or Non-current (IAS 1)

As the representatives of over 200,000 professional accountants in Australia, CPA Australia and Chartered Accountants Australia and New Zealand (CA ANZ) thank you for the opportunity to comment on the above Tentative Agenda Decision (TAD) of the IFRS Interpretations Committee (IFRIC).

CPA Australia and CA ANZ are concerned that the conclusion arrived at in Case 3 of the TAD may not reflect the outcomes that the amendments made to IAS 1 *Presentation of Financial Statements* (IAS 1), issued in January 2020, sought to achieve. We believe that, if the TAD interpretation is applied as proposed, this could result in inappropriate presentation that fails to mirror the economic substance of the loan agreements entities have entered into. We are also concerned that the TAD introduces a rules-based, rather than evidence based, approach to interpreting the amendments to IAS 1 that pre-empts the experience that will gained from practical application of these amendments ahead of their 1 January 2023 application date.

The reasons for our concerns are set out below:

Application of the requirements to Case 3
In Case 3 of the TAD, the fact pattern specifies that the entity is required to meet two specified conditions for the right to defer settlement of the liability by at least 12 months:

- a working capital ratio above 1.0 at 31 December 20X1 (the reporting period end); and
- a working capital ratio above 1.1 at 30 June 20X2 (6 months after the reporting period end)

The entity has a working capital ratio of 1.05 at 31 December 20X1.

Having considered the amendments to IAS 1, IFRIC concludes that the entity does not have the right to defer settlement of the liability for at least 12 months at the reporting period end. This is because it considers that the wording of IAS 1 requires the entity to comply with both the current and future working capital measures at the reporting period end.

We believe that, in reaching this conclusion, IFRIC has not adequately considered the context in which variable covenants may be imposed by lenders over time. Feedback received from our members is that such variability in covenants generally reflect an acknowledgement by the lender that different economic circumstances may be relevant at the later date (e.g. to allow for

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seasonal trading or an impending business restructure or acquisition). Variable covenant thresholds allow for these future circumstances, while still protecting the lender's interests.

Arriving at the classification of a loan as current, without adequately considering the conditions and intent behind the financial arrangement entered into, would appear to negate the substance of the underlying economic phenomenon and result in the imposition of restrictions to the entity's borrowing rights that are more onerous than the lender has chosen to allow.

We accept that management expectation that the entity will meet the specified condition at 30 June 20X2 is not enough to defer settlement for at least 12 months at the reporting period end. However, the rights of the borrower are, more importantly, subject to what the lender expects to occur between, and at, the two points in time. Feedback received from our members suggests that as long as the entity continues to perform consistently in line with future lender expectations, the rights of the entity in respect of the liability and its intended repayment remain unchanged from the lender's perspective.

Therefore, we do not believe that it is appropriate for an accounting standard (or an interpretation thereof) to place a more onerous condition on an entity's right to defer settlement of a liability, with its associated reporting consequences, than that placed on the entity by the lender itself.

We also consider that the interpretation of the wording of the revised paragraph 72A in IAS 1 to support the case 3 conclusion is inappropriate. This paragraph states that "*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*". In our view, this particular requirement was introduced to address the common scenario where the financial information required to test the specified condition is not available until after the reporting period end (e.g. audited financial statements are often only available three to four months after the reporting period end). In such circumstances, the test of compliance will be carried out at a later date but using conditions existing at the end of the reporting period. Again, we do not agree that it is appropriate to use this clause as justification to include, at the reporting date, the effect of future events that the lender clearly expects both to exist, and then be tested for, at a later date.

Finally, we note that as part of the discussions by the International Accounting Standards Board (IASB) in arriving at the amendments to IAS 1' and the subsequent discussions by IFRIC that gave rise to the TAD, consideration was given to why lenders may place different conditions at different points in time, including seasonal fluctuations in business and major debt restructuring. However, we consider that a lack of reference to these considerations in the TAD is an important oversight in reasonably interpreting the new requirements of IAS 1.

Due process concerns

In addition to the above, we also have concerns about the due process followed by IFRIC on this issue. We note that a formal submission in respect of this matter has not been received but that the decision to discuss and issue a TAD has been based on informal feedback and enquiries received from stakeholders on how to apply the amendments to IAS 1. Given the deferral of the intended application date and the significance of the amendments to IAS 1 to many entities, this approach pre-empts the widespread practical application of the changes to IAS 1. It provides only minimal opportunity at this time for preparers and other stakeholders to consider the practical ramifications of the amendments to IAS 1. Accordingly, we request that IFRIC considers all the relevant facts and circumstances associated with a specific fact pattern presented to it of practical challenges faced by entities when they apply the amended requirements of IAS 1 in due course. Since IFRIC Agenda Decisions now have the same authority as the applicable IFRS due to modifications made to the IFRS Due Process Handbook, we suggest IFRIC needs to give more careful consideration to any potential unintended consequences that may arise from this TAD before it is finalised.

Referral to the IASB

It is possible that the IFRIC conclusions arrived at in the TAD represent a fair technical interpretation of the IASB's final amendments made to IAS 1 and issued in January 2020. However, if this is the case, we believe this potentially identifies an underlying problem with the implementation of these amendments. Although our stakeholders have been made aware of the revisions, many have only recently commenced considering the ramifications of the necessary changes to financial statements. The recent publication of IFRIC's preliminary conclusions in the TAD has raised concern amongst our stakeholders about how the revised IAS 1 should be interpreted and applied, not only to the examples discussed in the TAD, but to many other loan agreements with conditions attached.

We believe that there is a need for clearer direction on the issue of making current/non-current classification decisions when loans are subject to conditions and such direction needs to deal with both the variety of conditions that are imposed and the reasons why they are imposed and change over time. This direction should then be supported by a substantive education process undertaken with lenders and borrowers about the new requirements in IAS 1. As it stands, these new requirements appear to lead to a classification of many loans with conditions attached as current, a situation that we do not believe necessarily reflects the economic substance of the conditions being imposed by lenders, the rights granted to the borrower under such loan agreements, or indeed lender expectations in respect of such loans. We also note that paragraph 72A was not included in the public consultations predating the IAS 1 amendments and as a result we are concerned that insufficient opportunity has been provided to stakeholders to ensure the words used now provide the clarity stakeholders are seeking. Therefore, we recommend that our concerns be referred to the IASB for further consideration.

If you have any questions about our submission, please contact either Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au or Amir Ghandar (CA ANZ) amir.ghandar@charteredaccountantsanz.com.

Your sincerely

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