17 March 2022

Mr Andreas Barckow
Chair
International Accounting Standards Board
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Dear Andreas

Exposure Draft ED 2021/9: Non-current Liabilities with Covenants (Proposed Amendments to IAS 1)

As the representatives of over 300,000 professional accountants, CPA Australia and Chartered Accountants Australia and New Zealand (CA ANZ) thank you for the opportunity to comment on the above Exposure Draft (ED).

The classification of liabilities is crucial to enable users of the financial statements of all types and sizes of entities to make informed decisions about the entity's liquidity and solvency.

This means it is essential that the requirements in IAS 1 *Presentation of Financial Statements* provide a clear and consistent framework for reflecting the economic reality behind an entity's financing arrangements.

Therefore, we support the IASB's effort to clarify the current wording of paragraphs 69 to 76 of IAS 1 *Presentation of Financial Statements* in this ED, which seeks to address concerns we have raised in previous submissions to both the IFRIC tentative agenda decision in December 2020 and the earlier IASB Exposure Draft on this topic.

In particular, we support the Board's proposals to ensure that only conditions existing at or before the reporting date are a factor in assessing classification as current or non-current at the reporting date. Where such conditions are imposed after balance date, we agree that they should not impact classification at the reporting date, but that the nature of these conditions and the entity's assessment of their likely impact should be required to be separately disclosed. In this regard, we support the proposed amendments to paragraph 72A.

We also support the Board's proposals:

- To require retrospective application of these clarifications, and the deferral of the 2020 amendments to IAS 1 until such time as the amendments resulting from these proposals are operative.

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- For additional disclosure to be the mechanism for addressing the information needs of users on the impact of future loan conditions.

However, we do not support:

- The Board's specific proposals to require liabilities subject to post balance date conditions to be separately presented on the face of the balance sheet.
- The nature and extent of the proposed disclosures concerning these conditions.

Rather than prescribing these disclosures in detail we believe it would be more beneficial to develop a more general principles-based disclosure requirement that identifies the types of information users find relevant. This would give preparers the guidance they need to provide meaningful disclosure and the flexibility that is necessary to accommodate the variety of entities and loan conditions that will be subject to these requirements. It would also guide auditors assessing the adequacy of these disclosures. Further explanation of our views is set out in the **Attachment** which includes responses to the specific questions posed by the ED.

The need for the 2020 amendments to IAS 1 and these subsequent clarifications has made it very clear that the issue of classification remains a challenging one, dependent on the specific facts and circumstances of the relevant arrangements and the entities that enter into them. At the same time, it is critical that the requirements are applied appropriately and consistently in order to provide users with the information about liquidity and solvency this classification process underpins.

We recommend that the Board undertake a comprehensive education process with both lenders and borrowers ahead of the application date of both these, and the 2020, amendments to IAS 1, given the likely widespread and significant impact of these changes and the importance of ensuring that they are consistently and correctly applied.

We also recommend that these changes be considered for inclusion in the forthcoming Exposure Draft updating IFRS for SMEs, given the important need for consistency in such a fundamental presentation requirement.

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

Your sincerely

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Attachment

Question 1—Classification and disclosure (paragraphs 72B and 76ZA(b))

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.

We agree with the proposal that only conditions impacting the borrowers right to repay the loan that exist at or before the reporting date should be a factor in assessing classification as current or non-current at the reporting date. This will remove the uncertainty that would otherwise be inherent in applying a binary classification model to uncertain or unknown future conditions. Accordingly, we support the proposed amendments to paragraph 72A.

However, we are concerned that the absence of a definition for terms such as "specified conditions" and "covenants" may make the application of these requirements more complicated than intended. We believe the consistent use of the simpler term "conditions" may be all that is necessary.

We also support the proposal that the existence of conditions imposed after balance date should not impact classification at balance date, but that the judgement necessarily exercised by management in making the decision around the right to repay is sufficient to warrant the additional disclosure of this decision and the reasons for it. Accordingly, we support the disclosure of information concerning the conditions as proposed in Paragraph 76ZA(b)(i) of the ED for all loans subject to conditions.

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However, we do not support the proposed disclosures in paragraphs 76ZA(b)(ii) and 76ZA(b)(iii) referred to in question 1(b) and 1(c) above. We believe that the wide variety of loan conditions applied in practice may make these requirements difficult to apply and potentially onerous where an entity or a group has multiple loans with varying conditions. In many instances, as noted in the IASB Alternative View, they would require the identification and disclosure of forward-looking information that is difficult to ascertain and may be of limited relevance as it introduces hypothetical scenarios of compliance. Such information is also not practical to audit, especially when it is unclear whether the “end of the reporting period” requires the assessment based on conditions at balance date or those when the financial statements are authorised for issue, since assessments can change within this period. In addition, ascertaining compliance of non-financial conditions at the reporting date in order to fulfil requirements in 76ZA(b)(ii) could impose additional costs on entities who might not otherwise be monitoring those specific details.

Instead, we would prefer that the Board establish a more principles-based requirement that would guide preparers in assessing the nature of the information that users would find helpful in order to assess the reasonableness of the management judgement that has been exercised in classifying a loan subject to conditions as non-current.

We note that the IASB is currently undertaking the project “Disclosure requirements in IFRS Standards – A Pilot Approach”, which proposes an objectives-based approach to disclosures. Given this ED proposes specific disclosure requirements, we suggest the IASB considers the interaction between this ED and the aforementioned project.

Question 2—Presentation (paragraph 76ZA(a))

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.

As noted in our cover letter, we do not support the proposals in paragraph 76Z(A)(a) to require liabilities subject to post balance date conditions to be separately presented on the face of the balance sheet. In our view prescribing such additional presentation serves no purpose when the requirements of paragraph 55 of IAS 1 would already prescribe disaggregation if the impact of these loan conditions was material to a user’s understanding of the financial statements.

We are also of the view that mandating such separate presentation requires the Board to draft clearer guidance and definitions for terms such as “specified conditions” which, given the variety and circumstances of loan conditions, is likely to be difficult to do. Without such additional

guidance the resulting change would not provide users with clear information about loans that are most at risk of early repayment which is what they are seeking. Nor would it provide preparers with confidence that they are applying the standard's requirements consistently.

We believe that disclosure in the notes (as proposed in our response to Question 1) is adequate to provide users with the information they need in order to make their own assessments of the management expectations about repayment that underlie the disclosed classification. It also allows entities the freedom to account for conditions in a manner that is consistent with the underlying relationship that exists between them and their lender, as regards to future behaviour (rather than mandate a presentation that may not be consistent with the underlying economic circumstances).

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.

(a) We support the Board's desire to clarify that the assessment of the "right to defer settlement for at least twelve months" must take into consideration whether the lenders rights to demand repayment can or cannot be constrained in any way by the future actions of the borrower. However, we are concerned that the current wording of paragraph 72C(b), with its reference to "occurrences unaffected by an entity's future actions", does not create the necessary clarity required for this assessment. There are a range of possible loan conditions where the entity does or could play a role (to a greater or lesser degree) in influencing them e.g., "change of control clauses". Therefore, we believe the requirement should be redrafted and that the commentary in Paragraph BC 20, which is helpful in this regard, should be transferred into the Standard.

(b) We also support the Board's proposals to require retrospective application of the proposals in this ED as we are of the view that information about the existence and impact of loan

conditions is a valuable piece of solvency/liquidity information that is important to users. It is also usually regularly monitored by the entity and so should be readily available.

(c) We also support the deferral of the 2020 amendments to IAS 1 impacting this issue until the operative date of the amendments resulting from these proposals. Given the widespread nature and significance of these reforms we believe it is important that stakeholders are given adequate time to prepare to implement the changes and that they should be implemented as a single package.

In supporting this deferral, we recommend that the Board undertake a comprehensive education process with both lenders and borrowers ahead of the application date of these, and the 2020, amendments. This will ensure that their impact is well understood, and lenders and borrowers have sufficient time to understand the impact of both standard and specific loan clauses and modify the wording, if necessary, to ensure that the economic substance of the transaction is being fairly reflected in the financial statements.

In particular, this education process should address annual review and other similarly broadly worded clauses designed to protect the lenders interests. It remains unclear whether such clauses would constitute “specified conditions” or be “rights that have substance” for the purposes of this ED as these terms are undefined. Guidance on the analysis process to be applied would be helpful to promote consistency.