Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Non-current Liabilities with Covenants**	**Meeting**	June 2023 (M196)
Topic:	**Summary of Stakeholder Feedback ED 323 *Disclosure of Non-current Liabilities with Covenants – Proposed Amendments to Tier 2***	**Agenda Item:**	12.1
		Date:	6 June 2023
Contact(s):	Ao Li ali@aasb.gov.au Kimberley Carney kcarney@aasb.gov.au	**Project Priority:**	Medium
		Decision-Making:	High
		Project Status:	Consider pre-ballot draft

Objective of this paper

1 The objective of this agenda item is:

(a) to **inform** the Board of stakeholder feedback received on AASB ED 323 *Disclosure of Non-current Liabilities with Covenants – Proposed Amendments to Tier 2*;

(b) to **provide** staff analysis on the issues raised by stakeholders; and

(c) to **consider** and, if appropriate, **vote** on a pre-ballot draft version of amending Standard AASB 2023-X *Amendments to Australian Accounting Standards – Disclosure of Non-current Liabilities with Covenants: Tier 2*.

Attachments

Agenda Paper 12.2	Pre-ballot draft AASB 2023-X *Amendments to Australian Accounting Standards – Disclosure of Non-current Liabilities with Covenants: Tier 2*
Agenda Paper 12.3	AASB ED 323 *Disclosure of Non-current Liabilities with Covenants – Proposed Amendments to Tier 2* [supporting documents folder]
Agenda Paper 12.4	ED 323 comment letters [supporting documents folder]

Structure

2 This paper is structured as follows:

(a) Background (paragraphs 3 - 7);

(b) Summary of staff recommendations (paragraph 8);

(c) Summary of stakeholders' feedback (paragraphs 9 - 13)

(d) Staff analysis and recommendations (paragraphs 14 - 44); and

(e) Next steps (paragraphs 45 - 46)

Background

3 In March 2023, the Board issued AASB ED 323, which proposed amendments to AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* to clarify the criteria for classifying a liability as current or non-current. In particular, ED 323 proposed amendments to AASB 1060 to:

(a) clarify that a liability is classified as non-current if an entity has the right at the reporting date to defer settlement of the liability for at least twelve months after the reporting date;

(b) clarify the reference to settlement of a liability by the issue of equity instruments in classifying liabilities; and

(c) require the disclosure of information that enables users of the financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months (i.e. proposed paragraph 47A).

4 ED 323 also proposed that the amendments would apply to annual periods beginning on or after 1 January 2024, with earlier application permitted.

5 The proposed amendments in paragraphs 3-4 above are consistent with amendments already made to AASB 101 *Presentation of Financial Statements* by AASB 2020-1 *Amendments to Australian Accounting Standards – Classification of Liabilities as Current or Non-Current* and AASB 2022-6 *Amendments to Australian Accounting Standards – Non-current Liabilities with Covenants*.[1]

6 The Board considered that the proposed amendments were necessary to ensure there is consistency in the terminology and presentation requirements in Australian Accounting Standards, and to minimise the risk of interpretation and application differences.[2]

7 Staff are aware of some stakeholders preparing Tier 2 general purpose financial statements (Tier 2 GPFS) that would like to early adopt the amendments made to AASB 101 by AASB 2020-1 and AASB 2022-6 if the amendments are also made to AASB 1060.

Summary of staff recommendations

8 Staff recommend the Board finalise the proposals and issue an amending Standard that:

(a) revises the proposed amendments to AASB 1060 paragraph 40(d) by:

(i) removing the statement about counterparty conversion options from paragraph 40(d); and

(ii) including the statement in a new paragraph, paragraph 41A, instead; and

(b) proceeds with all other proposals in ED 323 with no further changes.

Stakeholders' feedback

Respondents to ED 323

9 The comment period for ED 323 closed on 22 May 2023. As of that date, the AASB had received four comment letters:[3]

Category	Respondent
3 Professional Services firms	Deloitte
	PricewaterhouseCoopers (PwC)
	KPMG
2 Professional Bodies	CPA Australia and Chartered Accountants Australia & New Zealand (joint submission)

1 The amendments made by AASB 2020-1 and AASB 2022-6 apply to entities preparing Tier 1 general purpose financial statements (Tier 1 GPFS) and apply to annual periods beginning on or after 1 January 2024, with earlier application permitted."

2 See Agenda paper 4.1, March 2023 (M194) and Minutes of the March AASB meeting.

3 See Agenda Paper 12.4, June 2023 (M196) for the full comment letters.

10 In addition to the feedback received in the comment letters, staff received feedback on ED 323 from various outreach activities, including:

- 6 March 2023 – AASB User Advisory Committee (UAC). Six UAC members provided feedback to AASB staff;[4]
- 25 May 2023 – AASB's Disclosure Initiative Project Advisory Panel (DI PAP). Six DI PAP members provided feedback to AASB staff;
- 29 May 2023 – AASB met with representatives from one professional body (IPA).

<u>High-level summary of feedback from respondents</u>

11 In summary, **all** respondents to ED 323 were supportive of the amendments proposed in the Exposure Draft.

12 Of note, ED 323 proposed adding disclosure requirement to AASB 1060 to require entities to disclose information about the risk an entity's liabilities could become repayable within twelve months after the reporting date. The Board considered that the proposed disclosures would provide useful information to the users of Tier 2 financial statements because it would allow them to understand the nature of the entity’s covenants and the risk that a liability classified as non-current could nonetheless be repayable within twelve months.[5] **All** stakeholders agreed that the proposed disclosure would help to close the existing disclosure gap and provide useful information to users of the financial statements, especially information about the entities’ intended actions (or plans) in managing covenants.

13 The following specific comments were raised:

(a) **One** respondent [KPMG] provided feedback suggesting the Board reconsider including certain guidance paragraphs added to AASB 101 (i.e. paragraphs 72B and 75A of AASB 101) in AASB 1060. This feedback is considered below as **Issue 1**.

(b) **One** respondent [Deloitte] provided feedback suggesting the Board reconsider the drafting of proposed paragraph 40(d). This feedback is considered below as **Issue 2**.

(c) **One** respondent [Deloitte] provided an editorial suggestion. This feedback is considered below as **Issue 3**.

(d) **One** stakeholder [DI PAP member] raised concerns over the practicability of the proposed disclosure requirement in paragraph 47A(b). This feedback is considered below as **Issue 4.**

(e) **One** respondent [PwC] suggested the Board consider whether further amendments to AASB 1060 would be required once the IASB finalises its proposed revisions to the *IFRS for SMEs* Accounting Standard. This feedback is considered below as **Issue 5**.

Staff analysis and recommendations

Issue 1 – Include additional guidance in AASB 1060

Background

14 Historically, when developing AASB 1060, the Board decided to replace any Standards that dealt exclusively with presentation and disclosure requirements in their entirety with the corresponding requirements in AASB 1060.[6]

15 In developing AASB 1060, the Board noted that replacing certain Standards with sections in AASB 1060 also removed some of the guidance included in those standards, where such guidance was also not included in the *IFRS for SMEs Accounting Standard*. However, to maintain the simplicity of the disclosure requirements, the Board contemplated this to be preferable to consider on a

4 This feedback was discussed with the Board at the March meeting prior to the issue of ED 323 being published.

5 ED 323 paragraph BC6.

6 Paragraph BC54 of AASB 1060.

case-by-case basis which guidance should be included, and which could be omitted. The Board also included AASB 1060 paragraph 2, which specifically permits entities to refer to other Standards (including AASB 101) for guidance on requirements in AASB 1060.[7]

16 When developing ED 323, the Board considered the guidance paragraphs added to AASB 101 and decided not to propose including similar paragraphs in AASB 1060.

17 KPMG suggested that paragraphs 72B and 75A of AASB 101 are "the guidance paragraphs in AASB 101 that most clearly set out the impact of covenants that are 'tested' before, at and after reporting (balance) date. They are a clear/simple English explanation of the guidance set out in the proposed amended AASB 101.40(d). Arguably they would provide the most assistance to financial statement preparers". Staff note that:

(a) paragraph 72B was added to AASB 101 to assist an entity with determining when it has a right to defer settlement for at least 12 months, including illustrating which covenants should be considered (i.e. only those covenants that an entity is required to comply with on or before the end of the reporting period);

(b) paragraph 75A explicitly clarifies that classification is not affected by the management intentions or expectations, or by settlement of the liability within twelve months after the reporting period.

18 KPMG commented that Tier 2 preparers might not be aware of the useful guidance in AASB 101 or have to refer to AASB 101 for guidance if the paragraphs suggested in paragraph 17 are not included in AASB 1060.

Staff analysis:

19 Staff acknowledge that paragraphs 72B and 75A may assist entities with determining if a liability is current or non-current. However, adding paragraphs 72B and 75A (and other related guidance paragraphs) to AASB 1060 would be inconsistent with previous Board decisions on whether to include guidance paragraphs from the full IFRS Accounting Standards in AASB 1060.[8] Staff consider in this case that including only some of the guidance paragraphs added to AASB 101 and not others in AASB 1060 might be unhelpful for stakeholders. Instead, staff consider that it is preferable not adding paragraphs equivalent to 72B and 75A (of AASB 101) in AASB 1060.

Staff recommendation:

20 Based on the analysis above in paragraph 19, staff recommend not adding paragraphs 72B and 75A of AASB 101 to AASB 1060.

Questions to the Board:

Q1: Do Board members agree with the staff recommendation in paragraph 20 not to add paragraphs 72B and 75A of AASB 101 to AASB 1060? If not, do Board members have other suggestions?

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7 AASB 1060 paragraph 2 states "Except to the extent specifically addressed in this Standard, the definitions and presentation requirements of other Australian Accounting Standards continue to apply. Entities are permitted to refer to other Standards for guidance on the requirements in this Standard, including AASB 7 *Financial Instruments: Disclosures*, AASB 12 *Disclosure of Interests in Other Entities*, AASB 101 *Presentation of Financial Statements*, AASB 107 *Statement of Cash Flows* and AASB 124 *Related Party Disclosures*."

8 When making AASB 2021-6 *Amendments to Australian Accounting Standards – Disclosure of Accounting Policies: Tier 2 and Other Australian Accounting Standards*, the Board considered whether to add to AASB 1060 the guidance paragraphs that were added to AASB 101. Exposure Draft ED 312 *Disclosure of Accounting Policies – Proposed Amendments to Tier 2 and Other Australian Accounting Standards* proposed adding guidance paragraphs 95A–95E to AASB 1060 (corresponding with paragraphs 117A-117E of AASB 101). However, after considering feedback from stakeholders, the Board decided that although the guidance might be helpful to users, AASB 1060 permits entities to refer to AASB 101 (and other Standards) for guidance. Therefore, the Board did not include the proposed guidance paragraphs in AASB 1060.

Issue 2 – proposed amendments to paragraph 40(d) inconsistent with AASB 2020-1

Background

21 Before it was amended, paragraph 69(d) of IAS 1 and AASB 101 contained a statement about counterparty conversion options. The paragraph was intended to apply only in certain circumstances. However, the IASB was concerned the statement may be applied to other circumstances, which was not the intended result. Therefore, in 2020 the IASB amended IAS 1 and this statement was relocated to paragraph 76B and expanded. A consistent amendment was also made to AASB 101.

22 When developing AASB 1060, the Board decided to include this additional guidance in AASB 1060 paragraph 40(d) (using paragraph 4.7 of the *IFRS for SMEs* Standard as the base) confirming that the terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification (from paragraph 69(d) of AASB 101). The Board considered this would further ensure no presentation differences to full AAS.

23 ED 323 proposed amending paragraph 40(d) of AASB 1060 to clarify the scope of the statement relating to conversion options and incorporate the amendments made in paragraph 76B (of AASB 101) by amending existing paragraph 40(d) of AASB 1060 and not relocating the statement to a new paragraph.[9]

24 Deloitte suggested that the amendments proposed to paragraph 40(d) of AASB 1060 are inconsistent with the amendments made to AASB 101 and may lead to differences between Tier 2 reporting requirements and the full AAS. In their view, AASB 2020-1 indicates that paragraph 76B relates to paragraphs 69(a), 69(c) and 69(d) (i.e. paragraphs 40(a), 40(c) and 40(d) in AASB 1060, respectively). The proposed amendment to paragraph AASB 1060.40(d) in ED 323, however, implies that the added clarification is relevant only to paragraph 40(d) and not to paragraphs 40(a) and 40(c).

Staff analysis:

25 Staff note that when the IASB developed the 2020 amendments (AASB 2020-1), the IASB further considered the term "settlement" and how it relates to an entity's liabilities that can be settled by issuing its own equity instruments (i.e. converting the liability to equity).[10] The IASB considered that in cases where an obligation to transfer equity instruments is classified as a liability or part of a liability according to IAS 32 *Financial Instruments: Presentation*, the transfer of equity instruments would be considered a settlement of the liability for the purpose of determining its current or non-current classification. To reflect these conclusions, the IASB Board moved the

9 ED323 proposed to amend paragraph 40(d) in AASB 1060 as below:

"40 An entity shall classify a liability as current when:

(a) it expects to settle the liability in the entity's normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after reporting date: or

(d) the entity does not have <u>the</u> ~~an unconditional~~ right <u>at the reporting date</u> to defer settlement of the liability for at least twelve months after <u>the</u> reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by ~~the issue of equity instruments do not affect its classification~~ <u>the transfer of the entity's own equity instruments do not affect its classification as current or non-current if, applying AASB 132 *Financial Instruments: Presentation*, the entity classifies the option as an equity instrument, recognising it separately from the liability as an equity component of a compound financial instrument</u>."

10 The current statement in AASB 1060.40(d) – "Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification" – was originally added to IAS 1 in 2009 (and later being adopted by *IFRS for SMEs Accounting Standard* and AASB 1060) to clarify a bond that the holder may convert to equity before maturity is classified as current or non-current according to the terms of the bond, without considering the possibility of earlier settlement by conversion to equity. The statement was added with the intention to only apply to liabilities that include a counterparty conversion option meeting the definition of an equity instrument (paragraph BC48G of IASB Basis for Conclusions – *Classification of Liabilities as Current or Non-current*).

statement about counterparty conversion options from paragraph 69(d) to a new paragraph, 76B, and clarified its scope.

26 When developing ED 323, the Board decided to incorporate paragraph 76B of AASB 101 in AASB 1060 via extending the existing guidance in paragraph AASB 1060.40(d) rather than relocating the statement to a new paragraph. At the time, the Board took the view that this approach was the most efficient way to clarify the statement without introducing additional paragraphs into AASB 1060. The Board also considered this approach would ensure no presentation differences to full AAS.[11]

27 Acknowledging stakeholders’ comment that the extended clarification could be relevant to paragraphs 40(a) and 40(c) of AASB 1060 as well and that this was not clear from the proposed amendments, staff consider that removing the statement about counterparty conversion options from paragraph 40(d), and adding a new paragraph 41A as below is appropriate.

> 40 An entity shall classify a liability as current when:
>
> (a) it expects to settle the liability in the entity’s normal operating cycle;
>
> (b) it holds the liability primarily for the purpose of trading;
>
> (c) the liability is due to be settled within twelve months after reporting date: or
>
> (d) the entity does not have the ~~an unconditional~~ right at the reporting date to defer settlement of the liability for at least twelve months after the reporting date. ~~Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.~~
>
> [Based on *IFRS for SMEs* Standard paragraph 4.7]
>
> 41 An entity shall classify all other liabilities as non-current. [*IFRS for SMEs* Standard paragraph 4.8]
>
> 41A Terms of a liability that could, at the option of the counterparty, result in its settlement by the transfer of the entity's own equity instruments do not affect its classification as current or non-current if, applying AASB 132 *Financial Instruments: Presentation*, the entity classifies the option as an equity instrument, recognising it separately from the liability as an equity component of a compound financial instrument.

28 Paragraph 69 of AASB 101, which corresponds with paragraph 40 of AASB 1060, includes a statement that “An entity shall classify all other liabilities as non-current.” after sub-paragraph 69(d). AASB 1060 separates this statement from paragraph 40 as a separate paragraph 41, based on the *IFRS for SMEs* Accounting Standard. Since the statement about conversion options has been moved from paragraph 69(d) to paragraph 76B of AASB 101 to provide extended guidance assisting the application of paragraph 69, staff suggest adding the new paragraph to AASB 1060 as paragraph 41A to keep paragraphs 40 and 41 together, consistent with the drafting in AASB 101.

Staff Recommendation:

29 On balance, staff recommend:

(a) removing the statement about counterparty conversion options from paragraph AASB1060.40(d), and

(b) including the statement in a new paragraph, paragraph 41A, in AASB 1060 with the added clarification.

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11 Paragraph BC61 of AASB 1060.

30 Staff consider this approach would address the stakeholder's concern about the possible inconsistency between Tier 2 reporting requirements (i.e. paragraph AASB 1060.40) and the full AAS (AASB 101.69).

> **Question to the Board:**
>
> **Q2**: Do Board members agree with the staff recommendation in paragraph 29 to remove the statement about counterparty conversion options from paragraph AASB1060.40(d) and include a new paragraph, paragraph 41A, in AASB 1060 with the added clarification? If not, do Board members have other suggestions?

Issue 3 – Reference to Reporting Date

31 Deloitte also suggested to use the phrase 'at the end of the reporting period' to maintain consistency with the terminology used in AASB 2020-1 and AASB 2020-6, rather than referring to 'reporting date' for the proposed amendments to AASB 1060.

Staff analysis:

32 Staff acknowledge the difference in terminology between AASB 101, AASB 2020-1, and AASB 2022-6, which use the phrase "at the end of the reporting period," and ED 323, which uses the phrase "at the reporting date". AASB 1060 was developed using the *IFRS for SMEs Accounting Standard* as a base, which uses the terminology "at the reporting date". Therefore AASB 1060 adopted the *IFRS for SMEs* Accounting Standard terminology when referring to reporting date.

33 Staff consider that the objective should be to maintain consistent terminology throughout AASB 1060, rather than consistency with AASB 101. Furthermore, the staff do not consider that the use of 'at the reporting date' would lead to different interpretations or applications of the proposed amendments compared to 'at the end of the reporting date.'

Staff recommendation:

34 Based on the analysis above, staff do not recommend any changes to the 'reporting date' terminology proposed in ED 323.

> **Question to the Board:**
>
> **Q3**: Do Board members agree with the staff recommendation in paragraph 34 that no changes are required to AASB 1060? If not, do Board members have other suggestions?

Issue 4 – Practical challenges applying the disclosure requirement in proposed paragraph 47A(b)

35 Paragraph 47A(b) proposed introducing a new disclosure requirement into AASB 1060 that would require entities to disclose facts and circumstances, if any, that indicate the entity may have difficulty complying with the covenants, for example, the entity having acted during or after the reporting date to avoid or mitigate a potential breach.

36 One DI PAP member was concerned that the disclosure proposed in paragraph 47A(b) is a forward-looking statement and that management may not have sufficient information at the reporting date to identify any/all possible breaches in the future, or to act on any future breaches until it occurs. The stakeholder considered this was also a challenge when applying the equivalent disclosure requirement in AASB 101.

37 However, all other stakeholders who commented on ED 323 did not consider the proposed disclosure would pose any significant challenges. They expect entities would already have the

information to prepare the proposed disclosures and the benefits of the proposed disclosure would outweigh the additional preparation costs.[12]

Staff analysis:

38 Consistent with the majority of the stakeholders, staff do not consider that paragraph 47A(b) would create significant challenges for Tier 2 entities as it only requires entities to disclose information they are aware of at the reporting date.

Staff recommendation:

39 Based on the stakeholders' feedback, staff recommend the Board proceed with the additional disclosure requirement proposed in paragraph 47A(b) with no changes.

Question to the Board:
Q4: Do Board members agree with staff recommendation in paragraph 39 to not make any changes to the proposed paragraph 47A(b)? If not, do Board members have other suggestions?

Issue 5 – Interaction with the IASB's project proposing amendments to the IFRS for SMEs Accounting Standard

40 One stakeholder (PwC) recommended that the disclosures and guidance in AASB 1060 be reviewed against any future changes made by the IASB to the *IFRS for SMEs Accounting Standards* in due course to consider if any changes are warranted.

41 Another stakeholder (KPMG) suggested that consideration should be given to AASB 1060 when amendments to corresponding full IFRS disclosures are made and that they should not be delayed until the *IFRS for SMEs* Accounting Standard is updated.

Staff analysis:

42 At its November 2022 meeting, the Board gave initial consideration to IASB Exposure Draft ED/2022/1 *Third edition of the IFRS for SMEs Accounting Standard*. Although the IFRS for SMEs Accounting Standard is not applicable in Australia, when finalising AASB 1060 the Board noted that amendments by the IASB to the *IFRS for SMEs* Accounting Standard would necessitate a review of the related disclosure requirements of AASB 1060. The Board acknowledged that should the IASB finalise the amendments to the *IFRS for SMEs* Accounting Standard, the AASB would need to consider the effect of any changes on AASB 1060 in due course.

43 Staff note that a post-implementation review of AASB 1060 is due to commence shortly. Staff consider that the PIR of AASB 1060 should be closely linked with the AASB's assessment of the IASB's draft *Third edition of IFRS for SMEs Accounting Standard* and the IASB ED/2021/7 *Subsidiaries without public accountability: Disclosure*. At its March 2023 meeting, the Board had initial consideration of possible options for adopting the IFRS Standard and directed staff to obtain evidence and undertake targeted outreach to better understand current Tier 2 financial reporting in Australia.

Staff recommendation:

44 Staff recommend that no action is required. Staff suggest the Board continues with the review of the disclosures and guidance in AASB 1060 as planned in conjunction with the third edition of the *IFRS for SMEs* Accounting Standards, the IASB's ED/2021/7 proposals and the AASB 1060 PIR assessment.

12 The IASB also concluded that information in paragraph 47A(b) (i.e. paragraph 76ZA(b) in AASB 101) would not be costly to prepare and would be useful to users of financial statements by helping them to understand the risk that non-current liabilities with covenants could become repayable within twelve months (paragraph BC48EF(b) of AASB 2022-6).

Question to the Board:

Q5: Do Board members agree with staff recommendation in paragraph 44 that no action is required and that the Board continues with the review of the disclosures and guidance in AASB 1060 as planned in conjunction with the third edition of the *IFRS for SMEs* Accounting Standards, the IASB's ED/2021/7 proposals and the AASB 1060 PIR? If not, do Board members have other suggestions?

Next steps

45 Subject to Board decisions on previous questions, staff recommend that Board members vote to make AASB 2023-X *Amendments to Australian Accounting Standards – Disclosure of Non-current Liabilities with Covenants: Tier 2* based on the Pre-Ballot Draft set out in Agenda Paper 12.2 (including any revisions agreed by the members at this meeting).

46 If Board members vote to make the proposed amending Standard, the content of the Standard will be finalised by replacing "AASB 2023-X" with the next Standard number in the sequence and the various dates formally inserted into the Standard as indicated. The Standard would then be registered on the Federal Register of Legislation and published on the AASB website.

Questions to the Board:

Q6: Do Board members have any questions or comments?

Q7: Do Board members vote in favour of making AASB 2023-X *Amendments to Australian Accounting Standards – Disclosure of Non-current Liabilities with Covenants: Tier 2*?