International Financial Reporting Standard

Non-current Liabilities with Covenants

October 2022

BASIS FOR CONCLUSIONS – AMENDMENTS

[IAS 1 & IFRS PS 2]

[Related to AASB 2022-6]

Amendments to the Basis for Conclusions on IAS 1 *Presentation of Financial Statements*

This Basis for Conclusions accompanies, but is not part of, IAS 1.

The heading above paragraph BC48A is amended; new text is underlined. Paragraphs BC48EA–BC48EF and related headings are added after paragraph BC48E. Paragraphs BC105FD–BC105FF and related headings are added after paragraph BC105FC. For ease of reading, paragraphs BC48EA–BC48EF and BC105FD–BC105FF and related headings have not been underlined.

Statement of financial position

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Current liabilities (paragraphs 69–76B)

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Right to defer settlement for at least twelve months (paragraphs 69(d) and 72A–76)<u>—2020 amendments</u>

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Right to defer settlement for at least twelve months (paragraphs 69(d) and 72A–76ZA)—2022 amendments

BC48EA In October 2022, the IASB issued *Non-current Liabilities with Covenants*. The IASB made the amendments to:

(a) improve the information an entity provides about liabilities arising from loan arrangements for which an entity's right to defer settlement of those liabilities for at least twelve months after the reporting period is subject to the entity complying with conditions specified in the loan arrangement (liabilities with covenants); and

(b) respond to stakeholders' concerns about the outcomes of applying the amendments in *Classification of Liabilities as Current or Non-current* issued in 2020. In particular, stakeholders said the 2020 amendments:

(i) could result in an entity classifying a liability as current even if, at the end of the reporting period (reporting date), the entity has no contractual obligation to settle the liability at that date or within twelve months;

(ii) took no account of the design of covenants negotiated to reflect an entity's required financial position or performance at specified dates, such as when a loan arrangement specifies different covenants at different dates to reflect the expected effects of seasonality or the entity's future performance; and

(iii) were unclear about how an entity would assess, at the reporting date, whether it would have complied with covenants that are not based on an entity's financial position or performance (non-financial covenants) and covenants based on cumulative financial performance or cash flows for a period extending beyond the reporting period (financial performance covenants).

Classification and disclosure of non-current liabilities with covenants

BC48EB The IASB considered stakeholders' concerns, which included new information it had not considered when developing the 2020 amendments. In particular, the IASB considered the usefulness of the information that would result from applying the 2020 amendments in some circumstances. The IASB observed that an entity may be unable to avoid having to repay a liability within twelve months if the entity's right to defer settlement of the liability is subject to compliance with covenants during that period. The entity may be unable to avoid such repayment even if, at the reporting date, the entity has no contractual obligation to settle the liability within that period. Therefore, in such situations, the related liability could be repayable either within or after twelve months, depending on whether the entity complies with those covenants after the reporting date. The 2020 amendments specified one way of reflecting this conditionality within the constraints of a model that classifies liabilities as either current or non-current. However, the IASB concluded that the information provided by such a binary classification model, alone, cannot meet user information needs in such situations. For example, the classification of a liability as current or non-current does not in itself provide information about the potential effects of such conditionality on when the liability is repayable.

BC48EC Having considered the new information, the IASB decided to amend the requirements in IAS 1 on:

(a) *the classification of liabilities with covenants as current or non-current*—the IASB decided that only covenants with which an entity is required to comply on or before the reporting date should affect the classification of a liability as current or non-current. The IASB concluded that amending the requirements in this way would:

(i) avoid classification outcomes that might not provide useful information to users of financial statements (for example, for some entities whose business is highly seasonal);

(ii) make it unnecessary for the IASB to specify how the 2020 amendments apply to non-financial and financial performance covenants, thereby avoiding adding complexity to the requirements; and

(iii) resolve many of the other concerns stakeholders raised.

(b) *the disclosure of information about non-current liabilities with covenants*—the IASB decided to require an entity to disclose information in the notes that enables users of financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months. The IASB concluded that this information would be useful to users of financial statements because it would allow them to understand the nature of the covenants and the risk that a liability classified as non-current could nonetheless be repayable within twelve months.

BC48ED The amendments to the requirements on the classification of liabilities with covenants as current or non-current are linked to the requirements on disclosure about such liabilities. The IASB concluded that the classification requirements would provide useful information when considered together with the requirements to disclose information about non-current liabilities with covenants in the notes. For this reason, the disclosure requirements in paragraph 76ZA apply only to an entity that presents current and non-current liabilities as separate classifications in its statement of financial position. However, the IASB observed that an entity that presents liabilities in order of liquidity might nonetheless disclose similar information about liabilities with covenants when applying the requirements in IFRS 7 on its exposure to liquidity risk.

BC48EE Some respondents to the draft amendments noted that, because non-current liabilities are often subject to covenants, the disclosure requirements could result in entities providing a large volume of detailed information. In these respondents' view, the amendments could result in excessive disclosure, which might obscure material information about covenants. In response to these comments, the IASB observed that:

(a) in applying the requirements in paragraphs 30A and 31 of IAS 1, an entity would assess what information about covenants is material and determine how to aggregate such information. Accordingly, the entity would not disclose immaterial information about covenants that would reduce the understandability of its financial statements by obscuring material information.

(b) an entity in need of further guidance when making materiality judgements could refer to the guidance on assessing the materiality of information about covenants in paragraphs 81–83 of IFRS Practice Statement 2 *Making Materiality Judgements*. That guidance explains that:

    (i) an entity considers both the consequences and the likelihood of a breach occurring when assessing whether information about a covenant is material; and

    (ii) information about a covenant for which there is only a remote likelihood of a breach occurring is immaterial irrespective of the consequences of that breach.

Other considerations

BC48EF When developing the amendments, the IASB also considered:

(a) *the presentation of non-current liabilities with covenants*—when it exposed draft amendments for comment, the IASB proposed to require an entity to present non-current liabilities with covenants separately in the statement of financial position. The main reason for this proposal was to avoid users of financial statements being misled by a non-current classification without any indication that the liability could become repayable within twelve months. However, feedback on the draft amendments suggested that users of financial statements would not be misled if the conditionality of non-current liabilities were explained in the notes instead of through separate presentation of these liabilities in the statement of financial position. Therefore, the IASB decided not to finalise the proposal. Instead, in providing information about non-current liabilities with covenants in the notes, an entity is required to disclose the carrying amount of related liabilities.

(b) *disclosure about expected compliance with covenants*—when it exposed draft amendments for comment, the IASB proposed to require an entity to disclose whether and, if so, how it expected to comply with covenants after the reporting date. Feedback on the draft amendments suggested that the costs of providing this information might outweigh the benefits of providing it. Consequently, the IASB decided instead to require an entity to disclose any facts and circumstances that indicate the entity may have difficulty complying with covenants. The IASB concluded that this information 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.

(c) *other conditional settlement terms*—when it exposed draft amendments for comment, the IASB proposed to clarify some situations in which an entity would not have a right to defer settlement of a liability. The IASB intended the clarification to avoid the classification requirements in paragraph 72B being applied to liabilities outside the scope of the amendments. However, feedback on the draft amendments suggested that the proposed clarification would fail to achieve that objective. Therefore, the IASB decided instead to specify that the requirements in paragraph 72B apply only to liabilities arising from loan arrangements.

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Transition and effective date

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Non-current Liabilities with Covenants (Amendments to IAS 1)

BC105FD The IASB decided to require entities to apply *Non-current Liabilities with Covenants* (2022 amendments) retrospectively in accordance with IAS 8 because:

(a) classifying a liability as current or non-current on the same basis in current and prior periods would result in more comparable, and thus more useful, information than the information that would result from not reclassifying comparative amounts; and

(b) applying the amendments retrospectively is not expected to be onerous for entities.

BC105FE The 2022 amendments changed some of the requirements introduced by the 2020 amendments before those requirements were in effect. Therefore, the IASB deferred the effective date of the 2020 amendments to align it with the effective date of the 2022 amendments. The IASB did so to avoid an entity potentially having to change its assessment of the classification of liabilities twice within a relatively short period.

BC105FF The IASB observed that it would be impractical to apply the 2022 amendments early without also applying the 2020 amendments. Therefore, the IASB decided to allow an entity to apply the 2022 amendments early, but only if the entity also applies the 2020 amendments from the same date.