Australian Government

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Dr Andreas Barckow
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UNITED KINGDOM

11 March 2022

Dear Dr Barckow,

IASB Exposure Draft ED/2021/9 *Non-current Liabilities with Covenants*

The Australian Accounting Standards Board (AASB) is pleased to have the opportunity to provide comments on the *IASB ED/2021/9 Non-current Liabilities with Covenants* (the ED), issued in November 2021.

In formulating these comments, the views of Australian stakeholders were sought and considered. This included:

(a) consultation with the AASB User Advisory Committee, comprising a range of primary users of financial statements;

(b) consultation with the AASB's Disclosure Initiative Project Advisory Panel, which comprises subject matter experts across a range of stakeholder groups; and

(c) other targeted consultations with financial statement preparers, auditors, professional bodies, and regulators.

The AASB acknowledges the efforts of the IASB to address stakeholders' concerns about the *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)* and the IFRS Interpretations Committee tentative agenda decision.

Overall, our stakeholders have indicated that the proposed changes will provide useful information to users. Our detailed recommendations and responses to the three questions in the exposure draft are in the Appendix to this letter. However, recognising the potential implementation challenges, the AASB recommends that the IASB:

(a) considers the interaction between the proposals in the ED and the IASB's Primary Financial Statements project, the Management Commentary project and IFRS 7 *Financial Instruments: Disclosures,* to ensure consistent principles are applied and to avoid duplicative requirements;

(b) develops additional guidance concerning aggregation criteria to help entities with the identification of similar economic characteristics for specified conditions when disclosing the conditions required by paragraph 76ZA(b)(i);

(c) requires entities to disclose whether and how an entity expects to comply with the conditions after the end of the reporting period (i.e. paragraph 76ZA(b)(iii)), only if the entity would not have complied with the specified conditions based on its circumstances at the end of the reporting period;

(d) considers whether the proposed disclosure requirement regarding whether and how an entity expects to comply with the conditions after the end of the reporting period should be subject to an "undue cost" proviso;

(e) clarifies the requirement regarding uncertain future events (paragraph 72C(b)) and developing application guidance; and

(f) considers the potential unintended legal consequence in some jurisdictions of issuing the amendment to the Standard without specifying a particular date.

The AASB, however, disagrees with the proposals in the ED to require an entity to:

(a) present separately, in its statement of financial position, non-current liabilities that are subject to compliance with specified conditions within twelve months after the reporting period. The AASB suggests that note disclosure would be sufficient; and

(b) apply the amendments retrospectively. Instead, the AASB suggests that prospective application would be more appropriate.

If you have any questions regarding this letter, please do not hesitate to contact me or Deputy Technical Director, Helena Simkova (hsimkova@aasb.gov.au).

Yours sincerely,

Dr Keith Kendall
Chair – AASB

Appendix

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.

Responses to Question 1

Clarification of the right to defer settlement **(paragraphs 72A–72B)**

The AASB supports the proposed clarification in the ED that compliance with specified conditions with which a company must comply within twelve months after the reporting date do not affect the classification of a liability as current or non-current at that date.

This clarification would address many stakeholders' concerns about the 2020 amendments and the IFRS IC's tentative agenda decision. Further, the AASB agrees that this information provides more faithful representation when the lender has no contractual right to demand repayment, and the borrower has no contractual obligation to settle the liability within twelve months after the reporting date.

Proposed disclosure requirements **(paragraph 76ZA)**

The AASB generally supports the intention to enhance disclosures about covenants and the proposals in paragraph 76ZA(b). However, due to concerns about the feasibility of the proposed disclosure requirements in 76ZA(b)(i) and 76ZA(b)(iii), the AASB suggests that the IASB:

(a) considers the interaction between the proposals in the ED and those in the Primary Financial Statements project, IFRS 7 *Financial* Instruments*: Disclosures* and

Management Commentary to ensure consistent principles are applied in standard-setting and to avoid repetitive requirements;[1]

(b) develops additional guidance clarifying the aggregation criteria (e.g. identifying similar economic characteristics of the debt conditions) to support entities when preparing the required disclosure in paragraph 76ZA(b)(i).

The AASB is concerned that the proposed disclosure requirements in paragraph 76ZA(b)(i) could be challenging to implement as a liability may be subject to compliance with numerous conditions. It is unclear in the ED how the disclosures could be aggregated to avoid voluminous disclosures. Therefore, further guidance is needed;

(c) requires the proposed disclosure in paragraph 76ZA(b)(iii), only if the entity did not comply with the specified conditions based on its circumstances at the end of the reporting period.

The AASB considers that the proposed disclosure in paragraph 76ZA(b)(iii) is a logical extension of paragraph 76ZA(ii). Such information would be particularly useful for assessing the risk that a non-current liability that does not comply with the specified conditions at the end of the reporting period would become repayable. However, paragraph 76ZA(b)(iii) may result in boilerplate disclosures with limited added value if the entity complies with the specified conditions at the end of the reporting period. Users should already have access to sufficient financial and non-financial information, enabling them to assess the entity's overall liquidity risk (e.g. disclosures about liquidity risks required by IFRS 7) and forward-looking information (e.g. information in management commentary or other market guidance, which covers forward-looking information about risks and financial position). Therefore, the AASB suggests that the IASB considers amending paragraph 76ZA(iii) as below:

76ZA…

(iii) whether and how the entity expects to comply with the conditions after the end of the reporting period <u>if the entity would not have complied with the conditions based on its circumstances at the end of the reporting period</u>;

(d) considers whether the proposed disclosure requirement in paragraph 76ZA(b)(iii) should be subject to an "undue cost" proviso to improve the feasibility of the proposed disclosure. The AASB is concerned that information required by paragraph 76ZA(b)(iii) may not be readily available and may represent an undue burden for some entities.

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1 For example, paragraph 76ZA(b)(ii) and (iii) in the ED may overlap with some already existing requirements. Paragraph 39 of IFRS 7 requires entities to disclose information that enables users to evaluate the nature and extent of liquidity risks arising from financial instruments to which the entity is exposed at the end of the reporting period and how the entities manage the risks.

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.

Responses to Question 2

The AASB does not support the proposal in paragraph 76ZA(a) for the reasons outlined in paragraphs AV3– AV4 of the ED. The AASB suggests that the IASB considers requiring entities to disclose such information in the notes to financial statements.

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.

Responses to Question 3

***Clarification of circumstances in which the entity does not have a right to defer settlement* (paragraph 72C)**

The AASB appreciates the IASB's effort to 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, as reflected in paragraph 69(d) of IAS 1. However, the AASB is concerned that the proposals in paragraph 72C may not effectively achieve their intention because the proposed wording may introduce interpretation and application diversity in practice.[2] The AASB suggests that the IASB considers:

(a) adopting wording consistent with *Exposure Draft ED/2015/1 Classification of Liabilities* and used throughout IAS 1 for improved clarity (e.g. using 'right' instead of 'discretion' in paragraph 72C(a));

(b) clarifying the requirement in paragraph 72C(b) and developing application guidance that assists entities in applying the paragraph; and

(c) including paragraph BC20 in the body of the Standard and amending paragraph 72C(b) as below:

> 72C(b) if an uncertain future event or outcome occurs (or does not occur) and its occurrence (or non-occurrence) is unaffected by the entity's future actions—for example when the liability is a financial guarantee or insurance contract liability. In such situations, the right to defer settlement is not subject to a condition with which the entity must comply, as described in paragraph 72B. <u>This excludes situations in which an entity can affect the occurrence (or non-occurrence) of future events or outcomes, even if their occurrence is beyond the entity's control. For example, an entity that must comply with a condition based on its future revenues can affect, but not control, whether the required outcome is achieved.</u>

***Transitional requirements* (paragraph 139V)**

The AASB disagrees with the proposals in paragraph 139V to require the retrospective application of the amendments. The AASB continues to support the view expressed in the AASB's comment letter (paragraphs 13–15) to the IASB on the ED/2015/1 and suggests that the IASB amends the proposed transition requirement to require prospective application and revises the explanation in the Basis for Conclusions addressing the transitional requirements.

***Deferral of the 2020 amendments effective date* (paragraph 139U)**

The AASB supports the proposals in paragraph 139U to defer the effective date of the 2020 amendments to IAS 1 to annual reporting periods beginning on or after a date to be decided after exposure, but no earlier than 1 January 2024.

However, the AASB would like to highlight that, in jurisdictions such as Australia, where Accounting Standards are legislative instruments, they are required to have a specific effective date. Issuing an amendment to Accounting Standards without specifying an effective date may lead to unintended legal consequences (for example, it may result in the requirements becoming effective immediately). Accordingly, the AASB urges the IASB to consider how its proposals may impact constituents from a legislative perspective.

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2 For example, some borrowing agreements may include market capitalisation clauses. Compliance with such conditions requires the entity's market capitalisation to be above a certain level. Market capitalisation may be beyond the entity's control but can be affected by the entity's future actions. It can be challenging to determine the extent to which market capitalisation is affected by the entity's future actions and further determine whether paragraph 72C(b) applies.