IFRS

STAFF PAPER

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IASB Meeting

Project	Non-current Liabilities with Covenants (IAS 1)
Paper topic	Separate presentation and disclosure

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Introduction and purpose

1. In November 2021, the International Accounting Standards Board (IASB) published the Exposure Draft *Non-current Liabilities with Covenants*, which proposed amendments to IAS 1 *Presentation of Financial Statements*. The comment period ended on 21 March 2022.

2. Agenda Paper 12A sets out the structure of the agenda papers for this meeting, the background of the proposed amendments and an overview of the feedback on the Exposure Draft.

3. The purpose of this paper is to:

   (a) summarise feedback on the proposals to require an entity to present separately, and disclose information about, non-current liabilities with covenants; and

   (b) provide our analysis of that feedback and recommendations for the IASB.

Structure of the paper

4. This paper includes:

   (a) summary of staff recommendations (paragraph 6).

   (b) summary of feedback, staff analysis and recommendations on:

      (i) separate presentation (paragraphs 7–21): and

(ii) disclosure of information about covenants (paragraphs 22–88).

(c) question for the IASB.

5. There are three appendices to this paper:

(a) Appendix A—other comments

(b) Appendix B—feedback from outreach activities

(c) Appendix C—extracts from IFRS Practice Statement 2

Summary of staff recommendations

6. Based on our analysis in this paper, we recommend that the IASB:

(a) not finalise the proposal to require an entity to present separately non-current liabilities with covenants. Instead, we recommend requiring an entity to disclose the carrying amount of such liabilities in the notes.

(b) finalise the proposal to require an entity to disclose information about non-current liabilities with covenants, with some modifications—specifically, we recommend requiring that, when an entity classifies liabilities arising from loan arrangements as non-current and those liabilities are subject to covenants, the entity disclose information that enables investors to assess the risk that the liabilities could become repayable within 12 months, including:

(i) the covenants with which the entity is required to comply (including, for example, their nature and the date on which the entity must comply with them); and

(ii) facts and circumstances that indicate the entity may have difficulty complying with covenants when it is required to do so—for example, the fact that it has taken actions during or after the reporting period to avoid or mitigate a potential breach. Facts and circumstances could also include the fact that the entity would not have complied with the covenants based on its circumstances at the reporting date.

Separate presentation

Proposals in the Exposure Draft

7. Paragraph 72B(b) of the Exposure Draft would specify that conditions with which an entity must comply only within 12 months after the reporting date do not affect whether an entity's right to defer settlement exists at the reporting date.[1]

8. The IASB proposed to add paragraph 76ZA(a) to IAS 1, which would state:

> 76ZA When an entity classifies liabilities subject to the conditions described in paragraph 72B(b) as non-current, the entity shall:
>
> (a) present such liabilities separately in its statement of financial position. The entity shall use a description that indicates that the non-current classification is subject to compliance with conditions within twelve months after the reporting period. …

9. Paragraph BC21 of the Exposure Draft explains the reasons for the proposals:

> …The Board concluded that separate presentation would:
>
> (a) avoid users of financial statements being misled by a non-current classification without any indication that the liability could become repayable within twelve months;
>
> (b) alert users of financial statements to seek additional information about such conditions in the notes; and
>
> (c) be relevant for all entities that present current and non-current liabilities—such presentation reflects that the non-current classification of some liabilities is not absolute (such a liability could become repayable within twelve months).

[1] In this paper, we refer to non-current liabilities subject to such conditions as 'non-current liabilities with covenants'.

10. Paragraph BC22 of the Exposure Draft explains that the IASB considered alternatives to its proposals:

> Although the majority of [IASB] members preferred the proposal described in paragraph BC21, some [IASB] members favoured one of the following alternatives:
>
> (a) not specifically requiring separate presentation of those liabilities in the statement of financial position. Some [IASB] members favoured this alternative because they view specific presentation requirements as contrary to the principle-based nature of IFRS Standards, which already include a requirement to present line items separately when such presentation is relevant to an understanding of an entity's financial position…
>
> (b) specifically requiring separate presentation only for liabilities with conditions with which an entity would not have complied based on its circumstances at the reporting date. Some [IASB] members favoured this alternative because separate presentation of a more limited set of liabilities may highlight liabilities at a greater risk of becoming repayable within twelve months. In contrast, the [IASB]'s proposal would apply to a broader set of liabilities, thus reducing signalling benefits. However, this alternative might require the [IASB] to specify how an entity assesses compliance with non-financial conditions or financial performance conditions for the purposes of that separate presentation, which would introduce complexity.

11. The Exposure Draft includes the alternative views of IASB members who disagreed with the proposal to require separate presentation and instead favoured the alternative described in paragraph BC22(a) above.

Summary of feedback

12. Most respondents disagreed with the proposal to require separate presentation of non-current liabilities with covenants. They disagreed for one or more of the following reasons:

    (a) respondents said most loan arrangements are subject to covenants that, if breached, would result in the related liability becoming repayable. Therefore, the proposal could result in an entity presenting all its non-current liabilities arising from loan arrangements in a separate line item. In their view, this would not provide useful information because it would fail to distinguish between liabilities for which there is a low or insignificant risk of a breach and those for which there is a higher risk of a breach. For example, BDO said:

    > The majority of these types of liabilities are bank loans or other similar financial liabilities, of which substantially all are subject to some type of condition. In our experience, it is unusual in the current global lending environment for a lender to grant a loan to a borrower where there are no conditions that if violated, may result in accelerated repayment. Because of this, we believe a majority (perhaps a substantial majority) of such bank loans would be presented separately in accordance with this proposed requirement, which in our view, defeats the purpose of the requirement.

    (b) respondents agreed with arguments included in the Alternative View. In particular, they said:

        (i) the proposal would contradict the principle-based nature of IFRS Accounting Standards—the fact that non-current liabilities could become repayable within 12 months if an entity fails to comply with covenants does not represent a sufficiently compelling case to require separate presentation.

        (ii) paragraph 55 of IAS 1 already requires further disaggregation in the statement of financial position when it is relevant to an understanding of an entity's financial position—therefore, an entity should apply judgement and determine whether to present liabilities separately based on its specific facts and circumstances.[2]

(iii) requiring disclosure of such liabilities in the notes to the financial statements would be sufficient to satisfy investor information needs.

13. Some respondents said presenting separately non-current liabilities with covenants may be confusing or misleading to investors. Investors might interpret these liabilities as being at a heightened risk of becoming repayable within 12 months. For example, BusinessEurope said:

> …presenting such liabilities separately could also lead to a perception that the solvency of such entities may be uncertain because of the existence of covenant conditions, even though these may actually be highly unlikely to become effective.

14. A few respondents suggested that, if the proposed requirement for separate presentation is retained, the IASB:

(a) refine the criteria for separate presentation to ensure that the resulting information is relevant; and

(b) clarify whether:

(i) an entity should split each type of liability between those subject to compliance with covenants and those that are not, or present in one line item all liabilities subject to compliance with covenants, regardless of their nature.

(ii) the requirement would apply only to financial liabilities within the scope of IFRS 9 *Financial Instruments*, or whether it would also apply to liabilities within the scope of other Standards (such as IFRS 2 *Share-based Payment* or IFRS 16 *Leases*).

(iii) the requirement would also apply when an entity presents assets and liabilities in order of liquidity applying paragraph 60 of IAS 1.

15. A few respondents supported the alternative of requiring separate presentation only for liabilities with covenants with which an entity would not have complied based on its circumstances at the reporting date (see paragraph BC22(b) of the Exposure Draft,

[2] A few respondents also suggested that the IASB consider whether the proposal would align with the principles of aggregation and disaggregation being developed as part of the Primary Financial Statements project.

reproduced in paragraph 10 of this paper). However, a few other respondents disagreed with this alternative.

Staff analysis

The purpose of the proposal

16. As explained in paragraph 9 of this paper, the IASB proposed to require an entity to present separately non-current liabilities with covenants to:

    (a) avoid investors being misled by a non-current classification without any indication that the liability could become repayable within 12 months; and

    (b) alert investors to seek additional information about such covenants in the notes.

17. The IASB therefore concluded that separate presentation of non-current liabilities with covenants would be relevant to all entities that present liabilities as current or non-current—such presentation would reflect that the non-current classification is not absolute.

18. We therefore disagree with the views that the proposal would contradict the principle-based nature of IFRS Accounting Standards. In our view, simply applying paragraph 55 of IAS 1 in determining whether to present liabilities separately would not to meet the objectives the IASB had in mind when it developed the proposal. The IASB proposed to require an entity to present liabilities separately not as a matter of aggregating or disaggregating information in the statement of financial position—rather, the IASB considered it necessary to qualify the categorisation of such liabilities as 'non-current' so that the categorisation would not be misleading. This proposal was made in the light of the classification proposals, which would result in non-current classification even when a liability might become repayable within 12 months if the entity failed to comply with covenants in that period.

Respondents' feedback

19. Nonetheless, feedback from respondents—as well as outreach with investors during the comment period (see feedback from members of the Capital Markets Advisory Committee (CMAC) and other investor groups in Appendix A to this paper)—indicates that separate presentation is not needed to avoid the non-current

classification of liabilities being misleading to investors. In other words, feedback revealed no significant risk that investors would be misled if the conditionality of non-current liabilities is not highlighted in the statement of financial position, but explained only in the notes. Many respondents who disagreed with the proposal to require separate presentation said it would be sufficient to disclose such information in the notes.

20. We also acknowledge some of the concerns raised about applying the proposals. In particular, the risk that the proposals could capture most non-current liabilities and therefore might fail to distinguish between liabilities with covenants in a manner that would always provide useful information.

Staff recommendation

21. Based on our analysis in paragraphs 16–20, we recommend that the IASB not finalise the proposal to require an entity to present separately non-current liabilities with covenants. Instead, we recommend requiring an entity to disclose the carrying amount of such liabilities in the notes.

Disclosure of information about covenants

Proposals in the Exposure Draft

22. The IASB proposed to add paragraph 76ZA(b) to IAS 1, which would state:

> 76ZA When an entity classifies liabilities subject to the conditions described in paragraph 72B(b) as non-current, the entity shall:
>
> …
>
> (b) 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:
>
> (i) the conditions with which the entity is required to comply (including, for example, their nature and the date on which the entity must comply with them);

(ii) whether the entity would have complied with the conditions based on its circumstances at the end of the reporting period; and

(iii) whether and how the entity expects to comply with the conditions after the end of the reporting period.

23. Paragraph BC17 of the Exposure Draft explains the relationship between the proposed disclosure requirements and the proposals on the classification of liabilities as current or non-current:

> The [IASB]'s classification proposals are linked to its proposals on presentation and disclosure. The [IASB] is of the view that the classification of a liability as current or non-current, alone, would not meet the information needs of users of financial statements when an entity's right to defer settlement of that liability is subject to compliance with conditions within twelve months after the reporting period… Rather, the classification proposals in this Exposure Draft would provide useful information when considered together with the proposals that would require an entity to present separately, in the statement of financial position, such liabilities classified as non-current … and disclose information about such conditions in the notes…

24. Paragraph BC23 of the Exposure Draft states:

> The [IASB] concluded that [its disclosure proposals] would help users of financial statements understand the nature of the conditions and assess the risk that a liability classified as non-current could become repayable within twelve months.

25. The Exposure Draft includes the alternative views of IASB members who disagreed with the proposal to require an entity to disclose whether and how it expects to comply with covenants after the reporting date (paragraph 76ZA(b)(iii) of the Exposure Draft).

Summary of feedback

The objective of the disclosure proposals

26. Most respondents supported enhancing the disclosure requirements about covenants. They agreed that the information provided by the binary classification as current or non-current is insufficient to meet investor information needs. For example, EY said:

> We believe the proposal fills an existing gap for such disclosure, since current standards … only explicitly require disclosures related to covenants in specific circumstances (e.g., a breach or remedied breach at the reporting date). The proposed disclosure requirements could drive more consistency in disclosure of covenants.

27. However, respondents commented on, or disagreed with, some of the disclosure requirements proposed in paragraphs 76ZA(b)(i)–(iii). They also commented on the interaction of those proposals with the disclosure requirements on liquidity risk in IFRS 7 *Financial Instruments: Disclosures* and going concern in IAS 1. We describe the comments received in more detail in the following paragraphs.

Information about covenants (paragraph 76ZA(b)(i))

28. Most respondents agreed with the proposal to require an entity to disclose information about covenants with which it is required to comply after the reporting date (paragraph 76ZA(b)(i)). However, many suggested that the IASB either:

(a) provide application guidance on how an entity applies materiality in determining what information about covenants to provide; or

(b) narrow the scope of the proposed disclosures.

Applying materiality

29. Some respondents said it would be challenging for entities to apply materiality in determining what information about covenants to provide. For example, the Japan Foreign Trade Council said:

> Paragraph 31 of IAS 1 stipulates that an entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. In practice, however, it is highly difficult for entities to appropriately assess

> the qualitative materiality of detailed and specific disclosures required by IFRS Standards like this Exposure Draft…

30. These respondents suggested providing further guidance on how to apply materiality to avoid entities providing boilerplate information. For example, the Accounting Standards Board of Japan (ASBJ) suggested specifying that an entity assesses whether information about covenants is material by considering both the consequences of a breach and the likelihood of the breach occurring.

Scope of disclosures

31. Because non-current liabilities are often subject to covenants, many respondents said the proposals could result in entities providing a large volume of detailed information. This could result in excessive disclosure, which might obscure material information about covenants. For example, the Accounting Standards Committee of Germany (ASCG) said:

> We are concerned that the proposals would lead to extensive disclosures about conditions in the notes, as the proposed scope of the disclosure requirements under paragraph 76ZA(b) refers to all liabilities subject to conditions that are classified as non-current. Therefore, particularly with respect to the disclosures about conditions in proposed paragraph 76ZA(b)(i), entities might be prompted to disclose a long list of conditions that they must comply with within the next twelve months, regardless of whether or not there is a risk that a liability could become repayable

32. Many respondents suggested that the IASB narrow the scope of the disclosure proposals. Most said the IASB could require disclosure based on an assessment of the likelihood of the entity not complying with covenants after the reporting period, thereby focusing the disclosure on information that is most relevant to investors.

33. Respondents suggested different ways in which the IASB could narrow the scope of the proposals. For example, they suggested requiring disclosure only if:

    (a) there is a high risk that the entity will not comply with covenants;

(b) there are significant uncertainties about whether the entity will comply with covenants;[3]

(c) there is no reasonable assurance that liabilities will not become repayable within 12 months; and

(d) the likelihood of a breach is more than remote.

34. A few respondents suggested limiting the scope of the proposals to only financial liabilities in the scope of IFRS 9.

Compliance at the reporting date (paragraph 76ZA(b)(ii))

35. Some respondents disagreed with, or commented on, the proposal to require an entity to disclose whether it would have complied with a covenant based on its circumstances at the reporting date. They said this requirement:

(a) is unnecessary if an entity is already disclosing information about covenants as proposed in paragraph 76ZA(b)(i).

(b) would not provide useful information when covenants are designed to reflect the seasonality of an entity's business or its future performance. These respondents said disclosing the result of a 'hypothetical test' could instead confuse or mislead investors.

(c) could be difficult and costly to apply—for example, determining whether an entity would have complied with non-financial covenants or covenants based on cumulative financial performance or cash flows for a period extending beyond the reporting period (financial performance covenants). A few respondents suggested that the IASB specify how an entity assesses compliance with these covenants.

Expected compliance after the reporting date (paragraph 76ZA(iii))

36. Most respondents either disagreed with, or commented on, the proposal to require an entity to disclose whether and how it expects to comply with covenants after the reporting date. Some of these respondents acknowledged that the proposal would

[3] These respondents also suggested that the IASB develop a probability threshold for what an entity should consider to be a 'significant uncertainty'.

result in useful information. However, many disagreed for reasons similar to those in the Alternative View, namely that:

(a) the proposal would require an entity to provide forward-looking information—some respondents said this is inconsistent with paragraph 3.6 of the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*);[4]

(b) investors should be capable of assessing the risk that an entity will not comply with covenants based on the other proposed disclosures; and

(c) it would prompt an entity to provide a high volume of information or produce boilerplate disclosures.

37. Further, these respondents said:

(a) the cost of preparing the information is likely to outweigh the benefits of providing it—in particular, some respondents said the information would be challenging to audit. For example, BDO said:

> …we believe that this type of disclosure would be difficult to audit, as it would require an examination of every assumption an entity makes about its expected performance over the next 12 months…

(b) whether an entity expects to comply with covenants in the future is a highly subjective statement, and therefore of limited use to investors. A simple 'yes' or 'no' answer would also not provide useful information. For example, the Autorité des Normes Comptables said:

> …we expect an entity to make any such statement, having considered a number of assumptions and scenarios and, ultimately, having applied its judgement. A statement along the lines of the proposed disclosure is unlikely to reflect the complexity of the thought process an entity has developed…

38. A few respondents supported the proposal. These respondents said:

[4] We reproduce paragraph 3.6 of the *Conceptual Framework* in paragraph 62 of this paper as part of our analysis of respondents' comments.

(a) the *Conceptual Framework* does not prohibit the inclusion of forward-looking information in the notes—for example:

(i) an entity includes forward-looking information as part of its disclosures on going concern; and

(ii) IFRS Accounting Standards often require the inclusion of forward-looking information in the measurement of assets and liabilities (for example, when measuring expected credit losses applying IFRS 9);

(b) it would provide useful information—for example, the credit rating agency, Moody's, agreed with the disclosure proposal and suggested also requiring an entity to disclose any available headroom in complying with covenants.

(c) the proposals could encourage management to act sooner, for example in negotiating a waiver of compliance with covenants.

39. A few respondents that disagreed with the proposal suggested alternatives, including:

(a) requiring disclosure only if an entity assess that it will be unable to comply with covenants;

(b) requiring disclosure of the key factors that might affect an entity's ability to comply with covenants after the reporting date; and

(c) clarifying that an entity should provide the disclosure based on the knowledge obtained up to the date the financial statements are authorised for issue.

40. A few respondents also commented specifically on the proposal to disclose 'how' an entity expects to comply with covenants. A few suggested not finalising the proposal because in their view it would:

(a) result in entities providing boilerplate information; and

(b) include a behavioural component that is not usually required by IFRS Accounting Standards.

Interaction with other disclosure requirements

Liquidity risk disclosure requirements in IFRS 7

41. Some respondents said the disclosure proposals would require an entity to provide information that is also relevant in the context of the liquidity risk disclosure requirements in IFRS 7:

   (a) paragraphs 18–19 of IFRS 7 require an entity to disclose information about breaches of loan agreement terms that occurred during the period;

   (b) paragraph B10A of IFRS 7 requires an entity to disclose if cash outflows could occur significantly earlier than indicated in the entity's summary quantitative data about its exposure to liquidity risk (required by paragraph 34(a) of IFRS 7); and

   (c) paragraph B11F of IFRS 7 specifies other factors an entity might consider in providing the disclosure required by paragraph 39(c) of IFRS 7, including whether the entity has 'instruments that include accelerated repayment terms (eg on the downgrade of the entity's credit risk)'.[5]

Going concern disclosures in IAS 1

42. Some respondents said, in applying paragraph 25 of IAS 1, an entity considers its ability to comply with covenants as part of assessing its ability to continue as a going concern. If there are 'material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern', the entity would already disclose those uncertainties applying paragraph 25. For example, the ACSG said that:

> …if an entity discloses that it does not expect to comply with the conditions, such a statement will not be limited to a single liability due to cross-default clauses that are common in practice, with the effect of casting significant doubts on its ability to continue as a going concern…

[5] Paragraph 39(c) requires an entity to disclose a description of how it manages liquidity risk inherent in the maturity analysis of financial liabilities required by paragraph 39(a) and (b).

Suggestions

43. These respondents suggested considering:

(a) the interaction between the proposed requirements and those in IFRS 7 (about liquidity risk) and IAS 1 (about going concern); and

(b) whether it is possible to leverage or integrate the proposed disclosures with those in IFRS 7 on liquidity risk.

44. Some respondents suggested adding requirements to IFRS 7, instead of IAS 1, and then cross-referring to these requirements in IAS 1. For example, PwC said:

> …the IFRS 7 requirements could be expanded to provide factors to consider when identifying helpful disclosure in the context of covenants. Examples of such factors include, but are not limited to:
>
> - any covenants that management views to be at risk based on their internal monitoring process during the reporting period;
> - any covenants for which management has taken steps during and after the end of the reporting period to mitigate a potential breach;
> - any individually material non-current liabilities that are subject to financial covenants and whether these financial covenants would have been breached at the end of the reporting period;
> - any material actions taken or judgements made by the entity's risk committee (or similar function) in respect of its review of covenants.

Staff analysis

The objective of the disclosure proposals

45. Most respondents supported enhancing the disclosure requirements about covenants but had comments on the disclosure requirements proposed in paragraphs 76ZA(b)(i)–(iii). In the following paragraphs, we analyse respondents' comments and recommend

ways the IASB could address those comments while still achieving the objective of enhancing disclosure about covenants. Our analysis also considers feedback obtained from outreach activities, including feedback from investors (see feedback from members of CMAC and other investor groups in Appendix A to this paper).

Information about covenants (paragraph 76ZA(b)(i))

46. Most respondents agreed with the proposal to require an entity to disclose information about covenants with which it is required to comply after the reporting date. However, these respondents suggested either:

(a) providing application guidance on how an entity applies materiality; or

(b) narrowing the scope of the proposed disclosure requirements.

Applying materiality

47. Paragraph BC26 of the Exposure Draft states:

> An entity's right to defer settlement of many non-current liabilities is likely to be subject to the entity complying with conditions within twelve months after the reporting period. In accordance with paragraph 31 of IAS 1, an entity would apply judgement in determining what information about such conditions is material, based on the entity's specific facts and circumstances. In other words, an entity would not need to provide the information required by paragraph 76ZA for a liability or condition if such information is immaterial.

48. In developing its proposals, the IASB therefore considered the fact that many non-current liabilities are likely to be subject to covenants. IAS 1 includes requirements that an entity would apply in determining what information about covenants is material. In particular:

(a) paragraph 31 of IAS 1 states:

> Some IFRSs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. This is the case even if the IFRS contains a list of specific requirements or describes them as minimum requirements.

(b) paragraph 30A of IAS 1 states:

> When applying this and other IFRSs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which include the notes. An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.

49. Further, paragraphs 81–83 of the IFRS Practice Statement 2 *Making Materiality Judgements* provide non-mandatory guidance on assessing the materiality of information about covenants. Appendix C to this paper reproduces these paragraphs. In summary, that guidance explains that, in assessing whether information about a covenant is material, a combination of the following considerations applies:

   (a) *the consequences of a breach occurring*—the impact a breach would have on the entity's financial position, financial performance and cash flows. If those consequences would affect the entity's financial position, financial performance or cash flows in a way that could reasonably be expected to influence investors' decisions, then the information about the existence of the covenant and its terms is likely to be material.

   (b) *the likelihood of a covenant breach occurring*—the more likely it is that a covenant breach would occur, the more likely it is that information about the existence and terms of the covenant would be material.

50. In addition to the above, paragraph 83 of Practice Statement 2 states that, irrespective of the consequences of a breach, information about covenants for which there is only a remote likelihood of the breach occurring is not material.

51. Applying the definition of material—and the requirements in paragraphs 30A and 31 of IAS 1—an entity would consider what information about covenants is material, as well as determine how to aggregate such information. The entity would not disclose immaterial information about covenants that would reduce the understandability of its financial statements by obscuring material information. In addition to those requirements, entities in need of further guidance when making materiality

judgements could refer to the guidance on assessing the materiality of information about covenants in Practice Statement 2.

Scope of disclosures

52. Respondents suggested different ways the IASB could narrow the scope of the proposed disclosure requirements based on the probability of a breach occurring after the reporting date. Those suggestions ranged from requiring disclosure only when there is a 'high' or 'significant' risk of a breach occurring, to requiring disclosure only when the probability of a breach is more than remote.

53. In our view, information about covenants could be useful to investors even if the risk of a breach is not 'high' or 'significant'. In such situations, it is still possible that an entity could breach a covenant and such a breach could significantly affect the entity's financial position, financial performance and cash flows. For example, the risk of a breach occurring might not be 'high', but its consequences might be severe for an entity.

54. Furthermore, in our view it would be extremely difficult to either define terms like 'high' or 'significant' or provide application guidance to ensure such thresholds are applied consistently. As well as adding complexity to the narrow-scope amendments, doing so would risk unintended consequences to requirements in IFRS Accounting Standards that use similar terms.

55. We considered whether the IASB could specify that disclosure is required only when the possibility of a breach is more than remote. Such clarification could help address respondents' concerns and would be consistent with:

    (a) paragraph 83 of Practice Statement 2 (see paragraph 50 of this paper); and

    (b) the requirement in paragraph 86 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* on disclosure of contingent liabilities when the possibility of any outflow in settlement is remote.[6]

56. However, making such a clarification within the requirements could create a precedent for setting thresholds every time the IASB sets new disclosure requirements. Instead, in our view an entity should apply judgement in assessing what

[6] Paragraph 86 of IAS 37 requires an entity to disclose particular information about each class of contingent liability 'unless the possibility of any outflow in settlement is remote'.

information about covenants is material, as it does when applying other disclosure requirements in IFRS Accounting Standards.

57. Finally, in Agenda Paper 12B, we recommend clarifying that the proposed requirements in paragraph 72B would apply only to liabilities arising from loan arrangements. If the IASB agrees with that recommendation, the proposed disclosure requirements in paragraph 76ZA would consequently also apply only to such liabilities. This would address comments from some respondents that the scope of the proposed disclosure requirements should be limited to financial liabilities in the scope of IFRS 9.

Staff recommendation

58. Based on our analysis in paragraphs 46–57, we recommend that the IASB:

(a) finalise its proposal to require an entity to disclose the covenants with which it is required to comply (including, for example, their nature and the date on which the entity must comply with them) (paragraph 76ZA(b)(i)); and

(b) neither narrow the scope of covenants for which an entity would provide information nor provide further guidance on how an entity applies materiality in determining what information to disclose.

Expected compliance after the reporting date (paragraph 76ZA(iii))[7]

59. Feedback from investors indicates that information about whether and how an entity expects to comply with covenants after the reporting date would be helpful to them in assessing the risk that a non-current liability could become repayable within 12 months after the reporting date. Furthermore, some of the respondents that disagreed with the proposal nonetheless acknowledged that it would result in information that is useful.

60. Respondents that disagreed with these proposals did so mainly because, in their view:

(a) the proposals would require an entity to disclose forward-looking information; and

[7] For the purposes of our analysis, we first consider comments on the proposals in paragraph 76ZA(iii) of the Exposure Draft, and then comments on the proposals in paragraph 76ZA(ii).

(b) the benefits of providing the information would not outweigh the costs.

Requiring disclosure of forward-looking information

61. Some of the respondents who disagreed with the proposal in paragraph 76ZA(b)(iii) said it would be inconsistent with paragraph 3.6 of the *Conceptual Framework*.

62. We disagree with these views. Paragraph 3.6 of the *Conceptual Framework* states:

> 3.6 Information about possible future transactions and other possible future events (forward-looking information) is included in financial statements if it:
>
> (a) relates to the entity's assets or liabilities—including unrecognised assets or liabilities—or equity that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period; and
>
> (b) is useful to users of financial statements.
>
> For example, if an asset or liability is measured by estimating future cash flows, information about those estimated future cash flows may help users of financial statements to understand the reported measures. Financial statements do not typically provide other types of forward-looking information, for example, explanatory material about management's expectations and strategies for the reporting entity.

63. In our view, the proposed disclosure requirement is consistent with paragraph 3.6 of the *Conceptual Framework* because it would result in an entity providing information that is useful to investors and relates to an entity's liabilities.

64. In arguing that the proposal would be inconsistent with paragraph 3.6, a few respondents specifically referred to the final sentence of that paragraph. We note that the sentence refers to *other* types of forward-looking information. In other words, that sentence is saying financial statements do not typically provide forward-looking information that is *unrelated* to the entity's assets and liabilities. Forward-looking information about an entity's assets or liabilities often reflects management's expectations. We also note that paragraph 129 of IAS 1 includes the 'expected

resolution of an uncertainty' as a disclosure an entity could provide to meet the requirements in paragraph 125 of IAS 1.[8]

The benefits of providing the information would not outweigh the costs

65. As part of its risk management activities, an entity's management would be expected to closely monitor the entity's compliance (and expected compliance) with covenants. Consequently, we would expect most entities to have information available to them on whether and how the entity expects to comply with covenants after the reporting date.

66. Nonetheless, we acknowledge respondents' concerns about the costs of preparing and auditing such information if it were to be disclosed in the notes. Management's monitoring activities might involve developing different assumptions and estimates in various scenarios (involving considerable judgement) for each of its loan arrangements with covenants. We understand that it could therefore be difficult and costly to disclose such information in a way that is meaningful to investors, and to have that information examined and tested by auditors.

67. We also agree with respondents that, when an entity expects *not* to comply with covenants, there might already be material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern—in particular when loan arrangements include cross-default clauses and, therefore, a breach in one liability could trigger breaches in other liabilities. In those cases, an entity is already required to disclose such uncertainties applying paragraph 25 of IAS 1.

68. In our view, these factors might indicate that the benefits of providing the information that would be required by paragraph 76ZA(b)(iii) might not outweigh the costs. We therefore considered whether the IASB could modify its proposals to address respondents' concerns, while still requiring the disclosure of information that would be useful to investors.

[8] Paragraph 125 of IAS 1 requires an entity to disclose 'information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year…'

Alternative disclosure considered

69. Instead of requiring an entity to disclose the information proposed in paragraph 76ZA(b)(iii), the IASB could instead require an entity to disclose facts and circumstances that indicate it may have difficulty complying with covenants when it is required to do so—for example, the entity would disclose if it has taken actions during or after the reporting period to avoid or mitigate a potential breach. An example of such an action would be the entity seeking to agree with the lender to defer the date on which compliance with covenants is required.

70. In our view, the information above would:

(a) be useful to investors and relevant in meeting the proposed disclosure objective—to enable investors to assess the risk that a non-current liability could become repayable within 12 months; and

(b) be based on known facts and circumstances, instead of requiring an entity to disclose its expectations about the future (therefore addressing respondents' concerns about the proposal in paragraph 76ZA(b)(iii)).

71. We also heard from respondents that situations in which an entity has taken actions during or after the reporting period to avoid or mitigate a potential breach—such as agreeing with the lender to defer the date on which compliance with covenants is required—are common.[9] Disclosing that fact is not specifically required by IFRS Accounting Standards but, in our view, would provide useful insight into the risk that an entity may not comply with covenants after the reporting date.

72. We also considered whether, alternatively, the IASB should require an entity to disclose any significant uncertainties about its ability to comply with covenants after the reporting date. Similar to the approach described above, such an approach could address respondents' main concerns about the proposal in paragraph 76ZA(b)(iii). However, we have rejected this approach because, similar to the discussion in paragraph 54 of this paper, it would be difficult to define 'significant' uncertainties.

Staff recommendation

73. Based on our analysis in paragraphs 59–72, we recommend that the IASB:

[9] See paragraph 18 of Agenda Paper 12B for further information.

(a) not finalise the proposal to require an entity to disclose whether and how it expects to comply with covenants after the reporting date (paragraph 76ZA(b)(iii)); and instead

(b) require an entity to disclose facts and circumstances that indicate it may have difficulty complying with covenants after the reporting date—for example, the fact that it has taken actions during or after the reporting period to avoid or mitigate a potential breach.

Compliance at the reporting date (paragraph 76ZA(b)(ii))

74. Feedback from investors indicates that information about whether an entity would have complied with covenants based on its circumstances at the reporting date would be helpful to them in assessing the risk that a non-current liability could become repayable within 12 months after the reporting date.

75. Respondents that disagreed with the proposal in paragraph 76ZA(b)(ii) did so mainly because, in their view, the proposal:

(a) might be unnecessary or would not provide useful information for covenants designed to reflect the seasonality of an entity's business or its future performance; and

(b) would be difficult and costly to apply.

The basis for the proposal in the Exposure Draft

76. Before analysing respondents' comments, we think it is helpful to note the basis for the proposal in paragraph 76ZA(b)(ii). Paragraphs BC24–BC25 of the Exposure Draft state:

> The Board did not change its view—which underpinned the 2020 amendments—about the usefulness of information about an entity's compliance with conditions based on its circumstances at the reporting date. This information highlights the risk that a non-current liability could become repayable within twelve months if an entity's circumstances are unchanged after the reporting date. However, the Board proposes to require an entity to disclose this information in the notes, rather than having these conditions affect the classification of liabilities as is the case in the 2020 amendments.

> The Board decided not to specify how an entity assesses whether it would have complied with non-financial conditions and financial performance conditions based on its circumstances at the reporting date. In the Board's view, adding further requirements would add unnecessary complexity. The Board proposes to require an entity to disclose in the notes whether it would have complied with conditions based on its circumstances at the reporting date, together with information about those conditions and whether the entity expects to meet them after the reporting period. This would allow an entity to provide context by explaining how it made the assessment and, when applicable, why it would not have complied with such conditions based on its circumstances at the reporting date. It would not be possible to provide this context in the statement of financial position as part of the classification of a liability as current or non-current.

Useful information

77. In proposing the disclosure requirement, the IASB was aware that an entity would be required to disclose whether it would have complied with covenants based on its circumstances at the reporting date, even when covenants are designed to reflect the seasonality of an entity's business or its future performance. Although the IASB concluded that classifying liabilities on that basis would not always provide useful information, it nonetheless concluded that disclosing this information in the notes would provide useful information—an entity would provide the information together with other information required about covenants so the information would be provided in context.

78. However, we acknowledge that, if the IASB agrees with our recommendation in paragraph 73 of this paper, disclosure of whether an entity would have complied with covenants at the reporting date might be less useful because an entity would not be required to accompany it with information about whether the entity expects to comply with covenants in the future.

Costs and application complexity

79. As explained in paragraph BC25 of the Exposure Draft, the IASB considered and decided not to propose requirements about how an entity would assess whether it would have complied with non-financial covenants and financial performance covenants at the reporting date. In our view, respondents have not provided new information in this regard.

80. However, we acknowledge that entities could incur what might be viewed as unnecessary costs in assessing whether they would have complied with covenants at each reporting date (in addition to the date on which they are required to comply) if the entity is not already monitoring compliance on each of those dates. This might be the case when non-compliance at each reporting date provides little information about the risk of non-compliance on the required date—for example, when an entity's business is highly seasonal.

Alternative disclosure considered

81. If the IASB agrees with our recommendation in paragraph 73 of this paper, instead of finalising the proposal in paragraph 76ZA(b)(ii), the IASB could instead include—as an example of a fact or circumstance that *could* indicate the entity may have difficulty complying with covenants after the reporting date—the fact that an entity would not have complied with a covenant based on its circumstances at the reporting date.

82. In our view, this would address respondents' comments by requiring an entity to disclose information about whether it would have complied with covenants at the reporting date only when this is deemed to indicate that the entity may have difficulty complying with covenants when it is required to do so in the future.

Staff recommendation

83. Based on our analysis in paragraphs 74–82, we recommend that the IASB not finalise the proposal in paragraph 76ZA(b)(ii). However, we recommend including, as an example of a fact or circumstance that could indicate the entity may have difficulty complying with covenants after the reporting date, the fact that an entity would not have complied with the covenant based on its circumstances at the reporting date.

Interaction with the other disclosure requirements

Liquidity risk disclosures in IFRS 7

84. As explained in paragraph BC17 of the Exposure Draft (reproduced in paragraph 22 of this paper), the IASB developed its disclosure proposals in the context of its proposals on the classification of liabilities as current or non-current. In other words, given that covenants with which an entity must comply after the reporting date would no longer affect the classification of liabilities, the IASB considered what information an entity should provide to enable investors to assess the risk that such liabilities could become repayable within 12 months (despite their classification as non-current). The IASB therefore proposed to include the disclosure requirements in IAS 1, rather than IFRS 7.

85. The information an entity would disclose applying the disclosure proposals could also meet some of the disclosure requirements in IFRS 7 on liquidity risk. However, the scope of the disclosure requirements in IFRS 7 is broader than that of the proposed amendments. Consequently, the scope of any new disclosure requirements would be broadened if, instead of adding them to IAS 1, those requirements were added to IFRS 7, for example as part of the information an entity provides to meet the requirement in paragraph B10A of IFRS 7 (see paragraph 41(b) of this paper). This is because disclosure requirements in IFRS 7 apply:

    (a) to entities that present their liabilities in order of liquidity as well as those that present liabilities as current or non-current; and

    (b) when cash outflows for liabilities could occur significantly earlier than their contractual maturity at any time in the future (the proposals in the Exposure Draft apply only when a liability could become repayable within 12 months after the reporting date, and not beyond).

86. Adding requirements to IFRS 7 would therefore expand the scope of the disclosure requirements beyond both the proposals and the main matter the IASB is addressing in this project (the classification of liabilities as current or non-current).

Going concern disclosures in IAS 1

87. We agree with respondents that, applying paragraph 25 of IAS 1, an entity would consider its ability to comply with covenants as part of assessing its ability to continue

as a going concern. However, the disclosure requirements in that paragraph address a specific situation—when there are material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern—and would not necessarily result in the entity providing the information required by the proposed disclosures. The proposed disclosures are intended to enable investors to assess the risk of the liability becoming repayable within 12 months, even in the absence of the material uncertainties referred to in paragraph 25 of IAS 1.

Staff recommendation

88. Based on our analysis in paragraphs 84–87, we recommend that the IASB confirm its proposal to add the proposed disclosure requirements to IAS 1.

Question for the IASB

Question for the IASB

1. Does the IASB agree with the staff recommendations to:

   (a) not finalise the proposal to require an entity to present separately non-current liabilities with covenants. Instead, we recommend requiring an entity to disclose the carrying amount of such liabilities in the notes?

   (b) finalise the proposal to require an entity to disclose information about non-current liabilities with covenants, with some modifications—specifically, we recommend requiring that, when an entity classifies liabilities arising from loan arrangements as non-current and those liabilities are subject to covenants, the entity disclose information that enables investors to assess the risk that the liabilities could become repayable within 12 months, including:

      (i) the covenants with which the entity is required to comply (including, for example, their nature and the date on which the entity must comply with them); and

      (ii) facts and circumstances that indicate the entity may have difficulty complying with covenants when it is required to do so—for example, the fact that it has taken actions during or after the reporting period to avoid or mitigate a potential breach. Facts and circumstances could also include the fact that the entity would not have complied with the covenants based on its circumstances at the reporting date?

Appendix A—other comments

A1. The following table summarises other matters raised by respondents together with our analysis and recommendation on these matters.

Respondents' comments	**Staff analysis and conclusions**
1. Litigation risk and commercial sensitivity A few respondents said disclosing information about whether and how the entity expects to comply with covenants after the reporting date (paragraph 76ZA(b)(iii)) could expose an entity to litigation risk in some jurisdictions or be commercially sensitive.	*Addressed by the staff recommendation* If the IASB agrees with our recommendation in paragraph 73 of the paper, these comments would no longer be applicable.
2. Disclosure objective in paragraph 76ZA(b) Paragraph 76ZA(b) would require an entity to disclose information in the notes that enables investors to assess the risk that liabilities with covenants could become repayable within 12 months. A few respondents referred to the approach in the Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach* for developing disclosure requirements and said this disclosure objective is too simple and does not specify why that information is useful to investors.	*We recommend no change.* Having considered feedback from investors, in our view the proposals set out a disclosure objective that adequately explains why the information would be useful. That objective relates to the proposals on the classification of liabilities—an entity would disclose information that enables investors to understand the risks that a liability classified as non-current could nonetheless become repayable within 12 months.
3. Location of disclosures EY suggested requiring an entity to disclose the information required by the proposals in the same note as the information on liquidity risk to avoid related information being provided in different parts of the financial statements.	*We recommend no change.* We think it unnecessary to specify where an entity would provide the information required by the proposals.
4. Actions taken to mitigate a potential breach The Saudi Organization for Chartered and Professional Accountants suggests that, when an	*Addressed by the staff recommendation* We agree with respondents that information about actions taken to avoid or mitigate a

Respondents' comments	Staff analysis and conclusions
entity expects not to comply with covenants after the reporting date, it should be required to disclose any actions taken by the entity to address the possible inability to comply with the covenants in the future (for example, actions taken to renegotiate the covenants). The ACSG suggests requiring entities to disclose significant modifications to covenant arrangements that occurred during the reporting period (for example, information about a waiver obtained during the reporting period or renegotiations of covenants).	potential breach would be useful in assessing the risk that the related liability could become repayable within 12 months. An entity would disclose this information applying the alternative disclosure recommended in paragraph 73 of this paper.
5. Interaction with IAS 34 Deloitte suggested clarifying what information an entity would disclose applying IAS 34 *Interim Financial Reporting*. It said the proposal on separate presentation might be applied in interim financial statements, but the disclosure proposal might not.	*We recommend no change.* In our view, it is unnecessary to provide further clarification about what information an entity would disclose in interim financial statements—the entity would apply the requirements in IAS 34 in the same way it does in other situations.
6. Consistency of disclosures The ASBJ suggested that the IASB consider consistency between the amount of disclosure required by entities that present liabilities as current or non-current (to which the proposals apply) and those that present liabilities in order of liquidity (to which the proposals do not apply). A few respondents suggested the proposed disclosure requirements should apply to all entities.	*Addressed by the staff recommendation* In our view, if the IASB agrees with our recommendation in paragraph 73 of this paper, the information required by entities presenting liabilities as current and non-current would be more consistent with the information we expect entities presenting liabilities in order of liquidity to provide applying IFRS 7. We recommend no expansion of the scope of the proposed requirements beyond liabilities classified as non-current for the reasons explained in paragraphs 85–86 of this paper.

Respondents' comments	Staff analysis and conclusions
7. Scope—roll-over facilities KPMG said the proposed disclosure requirements appear to apply only to 'term loans' but not for 'roll-over facilities' discussed in paragraph 73 of IAS 1.[10] It suggested that the proposed disclosure requirements also apply to roll-over facilities because these facilities are economically similar to term loans.	*We recommend no change.* The proposed disclosure requirements apply when an entity classifies, as non-current, liabilities subject to compliance with covenants within 12 months after the reporting date. If an entity classifies a liability as non-current because it has a right to roll over that liability for at least 12 months after the reporting date and that right is subject to the entity complying with covenants, then the proposed disclosure requirements are applicable.
8. Further clarification of paragraph 76ZA(b)(iii) With respect to the proposed requirement for an entity to disclose whether and how an entity expects to comply with covenants after the reporting date, KPMG suggested clarifying: (a) whether this assessment be made at the reporting date or the date the financial statements are authorised for issue; and (b) what type and extent of information is expected—for example, judgements and estimates applied when making the assessment.	*We recommend no change.* If the IASB agrees with our recommendation not to finalise the proposed disclosure requirements in paragraph 76ZA(b)(iii), the comment would no longer be applicable.

[10] Paragraph 73 of IAS 1 states 'If an entity has the right, at the end of the reporting period, to roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. If the entity has no such right, the entity does not consider the potential to refinance the obligation and classifies the obligation as current.'

Appendix B—feedback from outreach activities

B1. In addition to feedback received in comment letters, we also obtained feedback on the proposals in the Exposure Draft from:

(a) members of the Global Preparers Forum (GPF), the Accounting Standards Advisory Forum (ASAF) and the Capital Markets Advisory Committee (CMAC).

(b) members of the User Advisory Committee of the Canadian Accounting Standards Board, the Corporate Reporting Users' Forum and the EFRAG User Panel (collectively, investor groups).

B2. The following paragraphs include a summary of the feedback received on the topics discussed in this paper.

Feedback from GPF members

Separate presentation

B3. GPF members generally said it was unnecessary to require separate presentation of non-current liabilities with covenants in the statement of financial position. One GPF member said it may be costly to obtain the information required for separate presentation; disclosing that information in the notes would be enough. Another GPF member said entities should apply judgement in determining whether separate presentation is necessary based on their particular circumstances.

Disclosure of information about covenants

B4. One GPF member said disclosing information about covenants was a legitimate request from investors. However, that member asked whether the proposals would require an entity to provide information even when the risk of a breach is remote, saying the disclosures would be too extensive if that was the case. Another GPF member said disclosure is unnecessary unless there is a risk of a breach—entities should provide information only when it is useful for investors.

B5. One GPF member said entities consider compliance with covenants when assessing their ability to continue as a going concern, and that information about covenants might be relevant in that context.

B6. A few GPF members expressed concerns about the requirement to disclose whether the entity expects to comply with the covenants in the future. One GPF member said such disclosure could create litigation risk.

B7. One GPF member said it was unclear how an entity should assess whether it would comply with non-financial and financial performance covenants at the reporting date.

Feedback from ASAF members

Separate presentation

B8. ASAF members generally disagreed with the proposal to require separate presentation of non-current liabilities with covenants in the statement of financial position for the reasons set out in the alternative view to the Exposure Draft.

Disclosure of information about covenants

B9. ASAF members generally agreed that entities should be required to disclose information about covenants. However, some ASAF members said:

(a) the IASB should require disclosure only of a subset of liabilities with covenants—for example, a subset based on the probability of not complying with covenants—to prevent entities from providing boilerplate information.

(b) it was difficult to apply materiality judgements in this area, which involves assessing both the likelihood of a breach of covenants and the magnitude of its consequences.

B10. One ASAF member suggested adding more guidance on how to apply materiality judgements so that an entity discloses only information that is relevant to investors.

B11. Some ASAF members commented on the proposal to require disclosure of whether and how the entity expects to comply with covenants in the future. One ASAF member said it would be difficult for entities to explain how they expect to comply with covenants. Another ASAF member said the proposal would require entities to disclose their expected behaviour and that similar disclosures are not required in other areas of financial reporting (such as goodwill impairment).

B12. Some ASAF members suggested considering whether the disclosure requirements should be included in IFRS 7 instead of IAS 1.

B13. One ASAF member suggested requiring entities to disclose whether they have obtained waivers or renegotiated covenants during the reporting period, saying such information would be a good indicator of the risk of a future breach.

Feedback from CMAC members

Separate presentation

B14. A few CMAC members said separate presentation of non-current liabilities subject to covenants could be helpful, while others said that the proposal might capture too many liabilities (because many liabilities are subject to covenants).

Disclosure of information about covenants

B15. CMAC members supported the proposal to require disclosure of information about covenants. A few CMAC members said investors need all three specific pieces of information that the proposals would require an entity to disclose.

B16. A few CMAC members said the proposed requirement to disclose information about whether and how an entity expects to comply with the covenants in the future would be very helpful. One CMAC member said entities are expected to provide granular information about how they expect to comply with covenants. Another CMAC member would also want information about an entity’s available headroom in complying with covenants. One CMAC member, however, said it might be difficult for an entity to say exactly how it expects to comply with its covenants.

B17. One CMAC member suggested that providing information about covenants could be commercially sensitive in some cases. Another CMAC member said it might be necessary to explain that a breach of a covenant would not necessarily result in early repayment but in a renegotiation of the liability’s terms.

B18. In responding to the question of whether the proposed requirements should be focused on covenants with a higher risk of a breach, one CMAC member said it would be difficult to specify a risk threshold. However, the member said information about covenants would not be needed if breaches would have no significant impact on an entity.

Feedback from members of investor groups

Separate presentation

B19. Some members supported the proposal to require separate presentation, saying it is important to differentiate between liabilities with or without covenants. For example, one member said entities with higher credit ratings typically would not agree to covenants being added to their loans arrangements; only entities with lower credit ratings do so.

B20. Most members that commented on the proposal said, however, they would not oppose requiring entities to provide information about liabilities with covenants in the notes instead of in the statement of financial position. These members said, for them, the disclosure proposals are most important.

Disclosure of information about covenants

B21. All members supported the proposed disclosures in the Exposure Draft. These members said:

(a) information about covenants is useful for their analysis. One member (a credit analyst) said they would like entities to disclose as much information as possible about covenants. Another member said information that helps investors assess how close an entity is to breaching covenants is useful.

(b) many entities provide little or no information about covenants. One member (an equity investor) said equity investors often receive little (if any) information about covenants but that this information would be useful for their analysis.

B22. One member said forward-looking information about expected compliance is useful. That member said some entities already disclose that information but outside the financial statements. However, stating whether (or not) an entity expects to comply with covenants, alone, would not be meaningful—entities should disclose information about the covenants, and disclose when they are close to breaching the covenant or have obtained waivers.

B23. One member said entities agree to the inclusion of covenants in loan arrangements for a good reason—to lower their financing costs—and that they should not be discouraged from doing so. However, that member said entities should agree to covenants only when they expect to be able to comply with them. They also said information about covenants should be readily available to those entities because management would be expected to closely monitor compliance with covenants.

Appendix C—Extracts from IFRS Practice Statement 2

C1. We reproduce below paragraphs 81–83 of IFRS Practice Statement 2:

Information about covenants

81 An entity assesses the materiality of information about the existence and terms of a loan agreement clause (covenant), or of a covenant breach, to decide whether to provide information related to the covenant in the financial statements. This assessment is made in the same way as for other information, that is, by considering whether that information could reasonably be expected to influence decisions that its primary users make on the basis of the entity's financial statements (see 'A four-step materiality process', from paragraph 33).

82 In particular, when a covenant exists, an entity considers both:

(a) the consequences of a breach occurring, that is, the impact a covenant breach would have on the entity's financial position, financial performance and cash flows. If those consequences would affect the entity's financial position, financial performance or cash flows in a way that could reasonably be expected to influence primary users' decisions, then the information about the existence of the covenant and its terms is likely to be material. Conversely, if the consequences of a covenant breach would not affect the entity's financial position, financial performance or cash flows in such a way, then disclosures about the covenant might not be needed.

(b) the likelihood of a covenant breach occurring. The more likely it is that a covenant breach would occur, the more likely it is that information about the existence and terms of the covenant would be material.

83 In assessing whether information about a covenant is material, a combination of the considerations in paragraph 82(a)–82(b) applies. Information about a covenant for which the consequences of a breach would affect an entity's financial position, financial performance or cash flows in a way that could reasonably be expected to influence primary users' decisions, but for which there is only a remote likelihood of the breach occurring, is not material.

Example P—assessing whether information about covenants is material

Background

An entity has rapidly grown over the past five years and recently suffered some liquidity problems. A long-term loan was granted to the entity in the current reporting period. The loan agreement includes a clause that requires the entity to maintain a ratio of debt to equity below a specified threshold, to be measured at each reporting date (the covenant). According to the loan agreement, the debt-to-equity ratio has to be calculated on the basis of debt and equity figures as presented in the entity's IFRS financial statements. If the entity breaches the covenant, the entire loan becomes payable on demand. The disclosure of covenant terms in an entity's financial statements is not required by any local laws or regulations.

Application

Paragraph 31 of IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risk arising from financial instruments to which the entity is exposed at the end of the reporting period.

In the preparation of its financial statements, the entity assesses whether information about the existence of the covenant and its terms is material information, considering both the consequences and the likelihood of a breach occurring.

In these circumstances, the entity concluded that, considering its recent liquidity problem, any acceleration of the long-term loan repayment plan (the consequence of the covenant breach occurring) would affect the entity's financial position and cash flows in a way that could reasonably be expected to influence primary users' decisions.

The entity also considered the likelihood of a breach occurring.

Scenario 1—the lender defined the covenant threshold on the basis of the three-year business plan prepared by the entity, adding a 10 per cent tolerance to the forecast figures

In this scenario, even though the entity has historically met its past business plans, it assessed the likelihood of a breach occurring as higher than remote. Therefore, information about the existence of the covenant and its terms was assessed as material and disclosed in the entity's financial statements.

Scenario 2—the lender defined the covenant threshold on the basis of the three-year business plan prepared by the entity, adding a 200 per cent tolerance to the forecast figures

In this scenario, the entity assessed the likelihood of a breach occurring as remote, on the basis of its historical track record of meeting its past business plans and the magnitude of the tolerance included in the covenant threshold. Therefore, although the consequences of the covenant breach would affect the entity's financial position and cash flows in a way that could reasonably be expected to influence primary users' decisions, the entity concluded that information about the existence of the covenant and its terms was not material.