IFRS

STAFF PAPER

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Project	**Classification of Debt with Covenants as Current or Non-current (IAS 1)**
Paper topic	Staff analysis of feedback and possible standard-setting

CONTACT(S) Gustavo Olinda golinda@ifrs.org +44 (0) 20 7246 6481

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Introduction and purpose

1. In January 2020, the International Accounting Standards Board (Board) issued *Classification of Liabilities as Current or Non-current*, which amended IAS 1 *Presentation of Financial Statements* (2020 amendments). The amendments clarified how an entity classifies debt and other financial liabilities as current or non-current in particular circumstances. The amendments are effective for annual reporting periods beginning on or after 1 January 2023, with earlier application permitted.

2. In December 2020, the IFRS Interpretations Committee (Committee) published a tentative agenda decision in response to informal feedback and enquiries about how an entity applies the amendments to particular fact patterns.

3. The Committee discussed the comments it received on the tentative agenda decision at its meeting in April 2021. Having considered the feedback, the Committee decided to report to the Board:

   (a) its technical analysis and conclusions on the matter; and

   (b) respondents' comments on the outcomes and potential consequences of applying the amendments, highlighting those that might provide information the Board did not consider when developing the amendments.

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4. Agenda Paper 12B provides further background to the amendments and a summary of the Committee's discussions, including the Committee's technical analysis and conclusions on the matter.

5. The purpose of this paper is to:

   (a) provide the Board with a summary of respondents' comments on the outcomes and potential consequences of applying the amendments, together with our analysis of those comments;

   (b) explore possible standard-setting; and

   (c) ask the Board whether it agrees with our recommendations.

Structure of the paper

6. This paper is structured as follows:

   (a) summary of recommendations (paragraph 8);

   (b) feedback summary and staff analysis (paragraphs 9–41); and

   (c) possible standard-setting (paragraphs 42–80).

7. There are two appendices to this paper:

   (a) Appendix A—Initial outreach with investors and analysts; and

   (b) Appendix B—Comments on due process.

Summary of recommendations

8. We recommend that the Board amend IAS 1 to:

   (a) specify that, if the right to defer settlement for at least twelve months is subject to an entity complying with conditions *after* the reporting period, then those conditions do not affect whether the right to defer settlement exists at the end of the reporting period (the reporting date) for the purposes of classifying a liability as current or non-current.

   (b) for non-current liabilities subject to conditions, require an entity to disclose information about:

(i) the conditions (for example, the nature of the condition and when it must be complied with);

(ii) whether the entity would comply with the conditions based on its circumstances at the reporting date; and

(iii) whether and how the entity expects to comply with the conditions by the date on which they are contractually required to be tested.

(c) require that an entity presents separately, in its statement of financial position, 'non-current liabilities subject to conditions'. This line item would include liabilities classified as non-current for which the right to defer settlement for at least twelve months is subject to the entity complying with conditions after the reporting date.

(d) clarify that an entity does *not* have a right to defer settlement at the reporting date when the related liability could become repayable within twelve months:

(i) at the discretion of the counterparty or a third party (for example, when a loan is callable by the lender at any time without cause); or

(ii) if an uncertain future event occurs (or does not occur) and the event's 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); and

(e) defer the effective date of the 2020 amendments to no earlier than 1 January 2024.

Feedback summary and staff analysis

9. The following paragraphs provide a summary of comments from respondents to the Committee's tentative agenda decision about the outcomes of applying the amendments, requests for standard-setting and other comments related to the amendments, together with our analysis of those comments. These paragraphs do not include comments on the Committee's technical analysis and conclusions, which the

Committee considered at its April 2021 meeting. All comments letters are available on our website.

10. The Committee received comment letters from a range of stakeholders including preparers, national standard-setters, accounting firms and regulators—comments received were broadly consistent across the different stakeholder groups. The Committee however received no comment letters from users of financial statements. To obtain a more complete picture of stakeholder views, we conducted some initial outreach with investors and analysts—Appendix A to this paper summarises the feedback from this outreach.

11. We have grouped comments as follows:

    (a) outcomes and potential consequences of applying the amendments (paragraphs 14–31);

    (b) treatment of conditions based on cumulative financial performance or cash flows and non-financial conditions (paragraphs 32–38); and

    (c) requests for standard-setting (paragraphs 39–41).

12. Some respondents also commented on the Board's due process for developing the requirements in paragraph 72A of IAS 1. Appendix B to this paper includes a summary of these comments together with our analysis.

13. This paper uses the following terms with the meanings specified below:

    (a) *right to defer settlement*—the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period (as required by paragraphs 69(d) of IAS 1).

    (b) *conditions tested after the reporting date (or simply 'future conditions')*—any conditions with which an entity must comply after the reporting date, non-compliance with which would make the liability repayable within twelve months of the reporting date (the conditions addressed by paragraphs 72A of IAS 1). This excludes conditions tested only *after* twelve months of the reporting date—those conditions do not affect an entity's right to defer settlement for the purposes of classifying a liability as current or non-current.

(c) *required / tested at [date]*—the term 'test' is used—with the same meaning as in the amendments—to refer to the date as of which an entity is contractually required to comply with a condition. It does not refer to when compliance with a condition required at a previous date is 'checked' for compliance—for example, in a situation in which an entity is required to comply with a specified condition as of the reporting date (for example, a leverage ratio calculated based on the entity's financial position as of the reporting date) but compliance with that condition is 'checked' later (for example, when audited financial statements are available), the term 'test' is used to refer to the reporting date.

Outcomes and potential consequences of applying the amendments

Summary of comments

14. Almost all respondents raised concerns about the outcomes of applying the 2020 amendments in at least one of the cases described in the tentative agenda decision.

15. Most respondents said the outcomes of applying the amendments do not faithfully represent the entity's financial position at the reporting date, particularly in Cases 2 and 3 (see Agenda Paper 12B for information about the three cases). They said the amendments therefore do not provide users of financial statements with useful information, with some saying the outcomes could be misleading or counterintuitive. In their view, the outcomes:

    (a) *do not reflect the contractual rights and obligations of the parties*—classification is based on a compliance test that is not contractually required at the reporting date and that may result in a current classification even if, at the reporting date:

        (i) the lender has no contractual right to demand repayment; and

        (ii) the borrower has no contractual obligation to settle the liability at that date or within twelve months.

        In Cases 2 and 3, the entity is contractually obliged to comply with a covenant only at a date after the reporting date and, therefore, has no contractual obligation to repay until the covenant is breached.

(b) *do not reflect the intention behind the contract and its design*—the requirements ignore the design of conditions negotiated to cater for an entity's specific circumstances. For example, the contract may specify different conditions at different dates because the parties to the contract anticipate changes in the entity's financial position due to the seasonality of the business or growth of the entity's operations (for example, for start-up entities or entities undergoing restructuring). The requirements may therefore result in classification that reflects the expectations of neither the borrower nor the lender, and could result in frequent reclassifications between current and non-current.

16. Some respondents said the amendments could cause other challenges. For example:

(a) to avoid a current classification, an entity might wish to obtain a waiver at the reporting date for a breach that has yet to occur legally. Some said lenders are unlikely to agree to such a waiver.

(b) classifying a liability as current could have practical and commercial consequences, such as negatively affecting (i) an entity's relationship with suppliers and lenders; and (ii) its ability to access financing and the cost of that financing. It could also create costs if an entity is required to renegotiate lending terms or seeks to obtain a waiver to achieve a non-current classification.

(c) classifying a liability as current before a legal breach occurs would affect an entity's financial position, which in turn could trigger current classification of other liabilities (for example, if classifying a liability as current affects compliance with conditions related to other liabilities). It could also cause a legal breach of other liabilities subject to conditions based on the entity's financial position at the reporting date, and that could trigger 'cross-default' provisions. Some also said it would affect an entity's going concern assessment.

(d) the amendments ignore mitigating actions that an entity might undertake between the reporting date and the date compliance with the condition is tested. Respondents said this might result in actions being taken for reporting purposes and not business purposes.

17. Some respondents said entities might need to disclose additional information to explain a classification they view as counterintuitive.

Staff analysis

Contractual rights and obligations

18. Respondents said the 2020 amendments do not reflect the entity's contractual rights and obligations because the amendments may result in current classification even if, at the reporting date:
    (a) the lender has no contractual right to demand repayment; and
    (b) the borrower has no contractual obligation to settle the liability at that date or within twelve months.

19. We agree with respondents that the amendments may require an entity to classify a liability as current even if, at the reporting date, the entity has no contractual obligation to settle the liability within twelve months and the lender has no contractual right to demand repayment. However, that is not the principle in paragraph 69(d) of IAS 1.

20. Applying paragraph 69(d), a liability is classified as non-current only if the entity has the 'right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period'. It is insufficient that, at the reporting date, the entity has no contractual obligation to settle the liability within twelve months (or that the lender has no contractual right to demand repayment)—the entity must have the right to defer settlement. In other words, it is possible for an entity that has no contractual obligation to settle the liability within twelve months to *also* lack a right to defer settlement for at least twelve months if that right is conditional on compliance with specified conditions with which the entity is yet to comply.

21. We acknowledge that complying at the reporting date with conditions that are not contractually required to be tested until a later date (as required by paragraph 72A of IAS 1) does not provide an entity with the *legal* right to defer settlement for twelve months—the entity is still required to comply with the conditions at that later date. However, the requirements in paragraph 72A reflect the Board's view that such future conditions cannot be disregarded. Paragraphs 43–49 of this paper further analyse the

challenges of reflecting *conditional* rights and obligations in a binary current/non-current classification model.

The intention behind the contract and its design

22. When developing the 2020 amendments, the Board specifically decided that an entity's circumstances at the reporting date—rather than management's intentions or expectations—would determine whether the entity classifies a liability as current or non-current.[1]

23. When redeliberating the draft amendments and considering how an entity assesses conditions tested after the reporting date, the Board considered the staff view at that time that, in general:

    (a) the objective of conditions tested after the reporting date is to protect the lender's interests and that, for the condition to be effective in doing so, the protection must be in place continuously; and

    (b) the right to defer settlement is implicitly conditional on continuous compliance with the conditions specified by the lender, even if those conditions are tested only on a specified date or dates.[2]

24. Feedback on the tentative agenda decision however provided information about conditions that are not meant to provide protection to the lender by being 'in place continuously', and for which the entity's right to defer settlement would not be 'implicitly conditional on continuous compliance'. In particular, this is the case for conditions specifically designed to incorporate the expected effects of:

    (a) the seasonality of an entity's business (conditions reflecting seasonality); and

    (b) the entity's future performance (conditions reflecting future performance).

25. In developing the amendments, the Board did not specifically consider such conditions. This feedback may therefore provide new information about loan agreements that the Board had not specifically considered.

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[1] Paragraph BC48C states (emphasis added) 'the Board added paragraph 75A, which explicitly clarifies that *classification is unaffected by management intentions or expectations…*'

[2] See paragraphs 18–25 of Agenda Paper 12B for the Board February 2016 meeting

Conditions reflecting seasonality

26. An entity with a seasonal business may negotiate with lenders conditions that reflect a required financial position or performance at a specific point in its operating cycle (for example, immediately after its high season). The parties may do so in the knowledge that, because of seasonality, the entity's financial position and performance varies significantly over its operating cycle. Depending on the effects of seasonality, assessing compliance with such conditions at a date other than the one specified might not be meaningful. Further, whether an entity complies with these conditions might frequently change between reporting dates.

27. For example, assume an entity that reports on 30 June and 31 December. The entity generates a large proportion of its revenue in the last quarter of the year and, as a consequence, its working capital varies significantly throughout the year. If the entity is required to comply with a specified working capital ratio as of 31 December each year (immediately after its high season) and that ratio is determined taking its seasonal revenue into account, applying the 2020 amendments the entity might classify liabilities as non-current when reporting on 31 December and as current on 30 June solely because of the seasonality of its business.

28. We therefore agree with respondents who said classification outcomes based on such an assessment might not provide useful information in these circumstances.

Conditions reflecting future performance

29. An entity may also negotiate with lenders conditions that (a) reflect a required financial position or performance *after* the occurrence of expected future events; or (b) are set as a 'goal' that an entity is expected to achieve only in a future period. Examples include conditions:

    (a) that reflect the expected growth of a start-up entity;

    (b) that become increasingly stricter over the term of a loan (eg tightening leverage ratios); and

    (c) that reflect an entity's expected financial position after it completes a restructuring.

30. In the cases above, the lender does not require the entity to comply with such conditions at the reporting date but has set conditions that reflect performance the

entity must achieve *only in future periods*. Therefore, assessing compliance with such conditions before the specified date might not be meaningful.

Potential consequences and challenges

31. We acknowledge respondents' concerns about the potential consequences and challenges of applying the amendments. In our view, many of those concerns could be mitigated by (a) explaining the reasons an entity classifies a liability as current and its expectation that the conditions will be satisfied in the future; and (b) a broader understanding of the requirements that would develop once the amendments are applied. We have nonetheless considered those potential consequences and challenges in exploring possible standard-setting (see paragraphs 42–77).

Conditions based on financial performance and non-financial conditions

Summary of comments

32. Some respondents noted that the Committee considered only cases in which an entity is required to comply with conditions based on its financial position. These respondents said it is unclear how an entity applies the 2020 amendments to fact patterns in which an entity's right to defer settlement is subject to:
    (a) *conditions based on cumulative financial performance or cash flows for a period extending beyond the reporting period*—for example, a condition that requires a minimum amount of revenue for a 12-month period ending on 31 March for an entity reporting on 31 December; and
    (b) *non-financial conditions (ie covenants that are not based on financial position, financial performance or cash flows)*—for example, a condition that requires the delivery of audited financial statements after the reporting date or that the entity's controlling shareholder does not change (change of control clauses).

33. In particular, these respondents said it is unclear how an entity assesses performance-based conditions because paragraph BC48E of IAS 1 implies that an entity is allowed to adjust—either its performance up to the reporting date or the required

performance—in assessing whether it has a right to defer settlement. Paragraph BC48E states:

> The Board considered whether to specify how management assesses an entity's compliance with a condition relating to the entity's cumulative financial performance (for example, profit) for a period extending beyond the reporting period. The Board concluded that comparing the entity's actual performance up to the end of the reporting period with the performance required over a longer period would not provide useful information—one of these measures would have to be adjusted to make the two comparable. However, the Board decided not to specify a method of adjustment because any single method could be inappropriate in some situations.

34. Some respondents said the requirements for cumulative financial performance conditions appear to be inconsistent with the requirements for financial position conditions. Some of these respondents said the distinction between financial performance and financial position is arbitrary because an entity's financial position can also be viewed as the accumulation of financial performance over time.

Staff analysis

Cumulative financial performance conditions

35. The wording of paragraph BC48E has created uncertainty about how an entity applies the requirements in paragraphs 69(d) and 72A of IAS 1 in assessing whether an entity complies with cumulative performance conditions at the reporting date. Paragraph BC48E suggests that an entity adjusts either the entity's actual performance or the required performance in assessing whether the entity satisfies the condition at the reporting date, but the amendments do not prescribe a particular method or provide requirements on how an entity would make such an adjustment.

36. In our view, if the Board decides to explore possible standard-setting in response to new information received, it would also be necessary to consider developing requirements on how an entity assesses compliance with cumulative financial performance conditions.

Non-financial conditions

37. The requirements in paragraphs 69(d) and 72A of IAS 1 do not distinguish between *financial* and *non-financial* conditions. Therefore, applying these paragraphs, an entity assesses whether it complies with such conditions at the reporting date in the same way that it assesses financial conditions. If the entity does not comply with non-financial conditions at the reporting date, it would conclude that it does not have the right to defer settlement at that date.

38. Nonetheless, we think non-financial conditions that are only administrative in nature should not affect an entity's assessment of its right to defer settlement. In our view, if the Board decides to explore possible standard-setting in response to new information received, it would also be necessary to consider clarifying the treatment of non-financial conditions.

Requests for standard-setting

Summary of comments

39. Most respondents suggested that the matters identified be referred to the Board. Some suggested that the Board reconsider the amendments before they become effective. A few suggested changing the requirements so that an entity would classify liabilities as current or non-current either:

    (a) based on management's expectations about the entity's compliance with conditions to be tested after the reporting date—these respondents said incorporating management expectations is consistent with other IFRS Standards (for example, the impairment test in IAS 36 *Impairment of Assets* or the measurement of provisions in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*); or

    (b) based only on compliance with conditions that are tested as of or before the reporting date—these respondents suggested that the Board address uncertainty about an entity's future compliance with conditions by requiring additional disclosures.

Staff analysis

40. The Board issued the amendments in January 2020 after undertaking research and public consultation over several years. As discussed in Appendix B to Agenda Paper 12B, when developing the amendments the Board already considered comments and views similar to some of those provided by respondents to the Committee's tentative agenda decision (for example, the Board already considered whether to develop a model based on management's expectations about the future).

41. Nonetheless, the analysis in paragraphs 9–38 of this paper indicates that respondents' comments also provide information about situations the Board did not specifically consider when developing the amendments. Therefore, in our view the Board should explore whether to undertake standard-setting in the light of this new information.

Possible standard-setting

Challenges of reflecting conditionality in a binary classification model

42. Paragraph 62 of IAS 1 explains why classifying assets and liabilities as current or non-current provides useful information:

> When an entity supplies goods or services within a clearly identifiable operating cycle, separate classification of current and non-current assets and liabilities in the statement of financial position provides useful information by distinguishing the net assets that are continuously circulating as working capital from those used in the entity's long-term operations. It also highlights assets that are expected to be realised within the current operating cycle, and liabilities that are due for settlement within the same period.

43. The requirement in paragraph 69(d) of IAS 1—that an entity classifies a liability as current if it does not have a right to defer settlement (for at least twelve months)—is consistent with the objective of identifying liabilities that are due for settlement within the current operating cycle (or within twelve months after the reporting period). If the entity does not have a right to defer settlement, it does not have the ability to avoid a

potential settlement of the liability within twelve months even if the liability is not due for settlement within that period.

44. However, when an entity's right to defer settlement is conditional (for example, on the entity's compliance with future conditions), it is difficult to classify the related liability as either due for settlement within twelve months or due for settlement after twelve months. If the settlement date of a liability could be either within or after twelve months (depending on whether the entity complies with future conditions), at the reporting date that liability is neither contractually repayable within twelve months nor contractually repayable after twelve months—it will be one or the other but that will be known only in the future.

45. For example, consider a loan that is repayable in three years but that becomes repayable on demand if the entity fails to comply with conditions required to be tested six months after the reporting date. At the reporting date, the loan could either be repayable (a) three years after the reporting date, or (b) six months after the reporting date—it is unknown as of the reporting date which it will be.

46. In such situations, even though it is unknown at the reporting date when the liability will be due for settlement, an entity is nonetheless required to classify the liability as either current or non-current. Such classification—to the extent it is intended to represent liabilities that are due within or after twelve months—cannot *directly* reflect the entity's contractual rights and obligations. In other words, it cannot reflect that the liability contractually could be repayable either within or after twelve months depending on future events.

47. The objective of the requirements in paragraph 72A of IAS 1 is therefore to specify how conditionality affects classification as current or non-current within the constraints of such a binary classification model. In specifying requirements on conditionality, there are a number of approaches the Board could have chosen, including approaches in which an entity is considered to have the right to defer settlement (for at least twelve months) if:

    (a) *the entity's right is unconditional*—the entity has a right to defer settlement only when it has already complied with any conditions attached to that right (ie any conditionality negates the existence of the right to defer settlement).

(b) *the entity has not breached a condition*—the entity has the right to defer settlement until it breaches a contractual condition and, therefore, only conditions contractually required to be tested as of or before the reporting date affect classification.

(c) *the entity expects to comply with future conditions*—the entity has the right to defer settlement only if it expects to comply with future conditions.

(d) *the entity complies with future conditions based on its circumstances at the reporting date*—an entity has the right to defer settlement only if it complies with future conditions based on its circumstances at the reporting date (ie without looking forward).

48. Before the 2020 amendments, paragraph 69(d) of IAS 1 required an entity to have an *unconditional* right to defer settlement (the approach in paragraph 47(a) above). When developing the amendments, the Board noted that 'rights to defer settlement of a loan are rarely unconditional—they are often conditional on compliance with covenants.'[3] Maintaining that requirement could therefore have resulted in most long-term loans being classified as current. Instead, the Board decided to delete the word 'unconditional' from paragraph 69(d) and specify in paragraph 72A that an entity has the right to defer settlement only if the entity complies with future conditions based on its circumstances at the reporting date (the approach in paragraph 47(d)).

49. This paper explores whether the Board should reconsider the way in which conditionality affects classification—or whether exceptions are justified—in the light of new information provided by respondents to the Committee's tentative agenda decision. Nonetheless, irrespective of the approach, in our view the information provided by a binary model that classifies liabilities as 'current' or 'non-current', *alone*, is insufficient to provide all information investors would find useful about long-term liabilities subject to conditionality—such classification cannot provide information about the potential effects of conditionality on the timing of settlement. This paper therefore also explores whether the Board should consider developing presentation or disclosure requirements to supplement information provided by classification.

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[3] Paragraphs BC48D of the Basis for Conclusions on IAS 1.

Exploring standard-setting options

50. Based on our analysis in this paper, we have identified the following two possible standard-setting approaches the Board could consider:

    (a) *Approach A—Retain the requirements in the 2020 amendments*: applying this approach, the Board would retain—unchanged—the general classification requirements in the amendments, but:

        (i) provide an exception for seasonal businesses; and

        (ii) clarify how an entity assesses compliance with particular conditions.[4]

    (b) *Approach B—Disclose information about conditionality*: applying this approach, only conditions the entity is contractually required to comply with as of or before the reporting date would affect classification. However, an entity would be required to disclose whether it complies with conditions tested within twelve months of the reporting date based on its circumstances at that date and present related liabilities separately in the statement of financial position.

51. Both approaches retain the Board's view that information about whether an entity would comply with future conditions based on its financial position and performance at the reporting date is useful to users of financial statements—such information draws attention to the risk that long-term liabilities could become repayable within twelve months if an entity (not in compliance with conditions at the reporting date) is unable to improve its financial position and performance after the reporting date. However, Approach B would require an entity to provide that information in the notes to the financial statements rather than having it affect classification as current or non-current (as would be the case applying Approach A). We explore the two alternatives in more detail in the following paragraphs.

[4] Approach A could also add presentation and disclosure requirements similar to those proposed by Approach B.

Approach A—Retain the requirements in the 2020 amendments

52. Approach A would retain the requirement in paragraphs 72A that, when an entity's right to defer settlement is subject to the entity complying with specified conditions, the entity must comply with those conditions at the reporting date even if the lender does not test compliance until a later date. In other words, an entity assesses compliance with future conditions based on its circumstances as of the reporting date.

53. This approach builds on the underlying principle of the amendments that classification is based on whether the entity complies with conditions based on its financial position, financial performance and circumstances as of the reporting date—ie it should not consider performance (or expectations about performance) the entity is yet to achieve because, in such cases, the entity has not yet 'done enough' by the reporting date to be considered to have a right to defer settlement at that date.

Conditions reflecting seasonality

54. As discussed in paragraph 26, an entity with a seasonal business might have negotiated conditions that specifically reflect its required financial position and performance at a specific point in its operating cycle (taking into account the expected effects of seasonality at that point); therefore assessing whether the entity complies with such conditions at a date other than the one specified might not be meaningful. In our view, the outcomes of applying the requirements in paragraph 72A in these circumstances might not provide useful information.

55. If the Board concludes that a change is required for seasonal businesses, it could amend IAS 1 to prescribe requirements specifically for entities with such a business. The Board could, for example, require such entities to assess compliance with the required conditions with reference to the entity's financial position at the same point in the entity's current operating cycle. For example, an entity reporting on 30 June 2021 would assess compliance with a condition required on 31 December 2021 (its high season) based on its financial position as of 31 December 2020.

56. Such a proposal would be consistent with the principles underlying the requirements in paragraph 72A because it would (a) require an entity to assess compliance with future conditions based on a simple and objective test; and (b) not be based on an entity looking forward (ie not assess compliance based on management's expectations). Nonetheless, we acknowledge that requiring an entity to assess

compliance with reference to its financial position as of a date before the reporting date would shift the focus of the requirements away from the entity's position as at that reporting date and therefore would not reflect changes in an entity's financial position or performance since that date.

Conditions reflecting future performance

57. The 2020 amendments require an entity to assess compliance with future conditions based on the entity's circumstances at the reporting date. Those requirements, by design, do not take into account an entity's future performance or whether management expects to achieve that future performance. In our view, an exception for conditions reflecting future performance would require the Board to change its view regarding management's expectations. Any such change would go beyond narrow-scope standard-setting—it would represent a more significant change to the classification principles in IAS 1 (both before or after the 2020 amendments).

Further clarifications

58. In our view, Approach A would require the Board to provide further clarification or develop specific requirements for conditions that were not dealt with explicitly in the amendments—namely cumulative financial performance conditions and non-financial conditions.

59. The Board could specify that an entity assesses whether it complies with cumulative financial performance conditions by considering its financial performance for a period of equal length ending on the reporting date. For example, an entity reporting on 30 June 2021 would assess its compliance with a condition based on revenue for the 12-month period ending on 30 September 2021 by assessing its actual revenue for the 12-month period ending on 30 June 2021 (its reporting date).

60. The Board concluded in paragraph BC48E that, when a condition relates to an entity's cumulative performance for a period extending beyond the reporting period, the entity would need to adjust either the actual performance up to the reporting date or the required performance because, otherwise, the entity would be comparing performance over periods of different lengths. Requiring entities to consider performance of a period of equal length ending on the reporting date would resolve this issue and would be consistent with the principles underlying the amendments (for example, an entity

would not consider management expectations about future performance in adjusting its actual performance to be comparable in length with the required performance).

61. We note that the Board considered a similar staff recommendation in March 2019.[5] At that time, the Board decided to not add requirements on how to test compliance with conditions based on an entity's cumulative financial performance. However, feedback indicates that, without such requirements, stakeholders are unclear about how to test conditions based on cumulative performance. Specifying requirements could therefore improve consistent application and would avoid methods of adjustment that might be inconsistent with the principles underlying the amendments.

62. As explained in paragraphs 37–38, in our view the Board could also clarify that the requirements in paragraph 69(d) and 72A apply to non-financial conditions, but that an entity should disregard any such conditions that are only administrative in nature.

Challenges with Approach A

63. Approach A would retain the principles underlying the amendments but provide an exception for entities with a seasonal business. It would also aim to address questions about how an entity applies the amendments to cumulative financial performance conditions and non-financial conditions. Nonetheless, in our view Approach A would continue to be challenging because:

    (a) determining whether a business is 'seasonal' would require judgement—most businesses are affected by seasonality to some degree. The Board might be unable to provide further requirements without either (i) significantly adding to the complexity of the classification requirements in IAS 1; or (ii) setting an arbitrary 'bright line'.

    (b) the alternative test for conditions reflecting seasonality described in paragraphs 55–56 of this paper would be based on an entity's financial position at a date before the reporting date, and would therefore be different from the assessment of compliance with other conditions.

    (c) the approach could result in outcomes perceived as not providing useful information for conditions reflecting future performance. For example,

[5] See Agenda Paper 29B for the March 2019 Board meeting.

some said the outcome of applying the amendments to case 3 discussed by the Committee (ie a situation in which an entity complies with conditions required at the reporting date but does not comply with conditions to be met only in the future) would not provide useful information.

(d) some may consider the requirements for assessing compliance with cumulative financial performance conditions and non-financial conditions to be inappropriate for reasons similar to those stated for conditions reflecting future performance—ie information at the reporting date might not be a good reflection of an entity's expected financial position and performance at the testing date, and conditions might not have been designed to implicitly require continuous compliance. Furthermore, adding specific requirements for such conditions would (i) increase the complexity of applying the amendments; and (ii) likely result in further application questions.

64. In our view, it would be difficult to develop exceptions for conditions reflecting seasonality and future performance while retaining the principles underlying the amendments (ie without basing the assessment on management's expectations about the future). At the same time, a model based on management's expectations would be a significant departure from the classification principle in paragraph 69(d) of IAS 1—both before and after the 2020 amendments. Such an approach was also opposed as the basis for classification by the investors and analysts consulted in our initial outreach (see Appendix A to this paper).

Approach B—Disclose information about conditionality

Exploring an alternative approach

65. Considering the challenges involved with Approach A, the Board could explore an alternative approach that avoids those challenges while still providing useful information about whether an entity, as of the reporting date, complies with conditions to be tested within twelve months, thereby retaining the Board's view that those conditions should not be ignored.

Disclosure

66. As explained in paragraph 51 of this paper, Approach B would retain the assessment of future conditions required by paragraph 72A of IAS 1 but, rather than the outcome of the assessment determining classification, an entity would instead provide that information in the notes to the financial statements together with other information relevant for an understanding of the conditions. For example, an entity could be required to disclose information about:

    (a) the conditions (for example, the nature of the condition and when it must be complied with);

    (b) whether the entity would comply with the conditions based on its circumstances as of the reporting date; and

    (c) whether and how the entity expects to comply with the conditions by the date on which they are contractually required to be tested.

Classification

67. Classification as current or non-current would be based on assessing whether an entity complies with conditions contractually required to be tested as of or before the reporting date. This includes conditions required as of the reporting date, but checked for compliance only at a later date (see paragraph 13(c) of this paper). Conditions with which an entity must comply only after the reporting date would not affect classification.

68. We note that Approach B could result in non-current classification in situations in which:

    (a) the entity expects to fail to comply with future conditions; or

    (b) it has failed to comply with conditions after the reporting date (but before financial statements are authorised for issue).

69. In our view, however, such an outcome is consistent with the Board's view that (a) management's expectations should not affect classification; and (b) a breach that occurs after the reporting date is a non-adjusting event. Neither management's expectations nor a post period-end breach of conditions affects an entity's rights and obligations at the reporting date. We also note that this outcome is not unique to Approach B—it could arise applying the 2020 amendments or Approach A.

Presentation

70. Applying Approach B, an entity would not take into account whether, at the reporting date, it complies with future conditions—or expects to comply with future conditions—for the purposes of classifying a liability as current or non-current. To make investors aware that some liabilities classified as non-current could become repayable within twelve months if a future condition is not met, Approach B would require entities to provide information about non-current liabilities that are subject to compliance with future conditions. In our view, this could be done in one of two ways:

    (a) require separate presentation of 'non-current liabilities subject to conditions' (or another appropriate term like 'long-term borrowings with covenants') in the statement of financial position; or

    (b) require entities to provide information about liabilities with conditions in the notes to the financial statements—the Board could later consider whether to require separate presentation of these liabilities as part of its discussions on the *Primary Financial Statements* project.

71. There are arguments for and against each of these options:

    (a) separate presentation of 'non-current liabilities subject to conditions' in the statement of financial position might be necessary to avoid misleading investors by presenting these liabilities as 'non-current' without any indication that they could be repayable within twelve months. Such separate presentation, if considered necessary, would be relevant for all entities because it clarifies that the non-current classification of these liabilities is not absolute. Further, requiring separate presentation would have the advantage of signalling to investors to look for additional information in the notes—in other words, that line item would provide a 'hook' for investors to look for further relevant information in the notes to the financial statements.

    (b) some however may consider it unnecessary to require separate presentation of non-current liabilities subject to conditions—the presentation of line items in the statement of financial position is dealt with in another part of IAS 1 and the Board is currently developing requirements for the

aggregation and disaggregation of items within its *Primary Financial Statements* project. Therefore, the Board could specifically consider whether to require separate presentation of these liabilities as part of that project, instead of doing so at this stage. The Board would nonetheless require entities to provide information about such liabilities in the notes to the financial statements, together with the other information discussed in paragraph 66 of this paper.

72. Having considered the arguments above, on balance, we recommend that the Board require separate presentation of 'non-current liabilities subject to conditions' in the statement of financial position. In our view, requiring such presentation could mitigate concerns about not taking future conditions into account for the purposes of classifying loans as current or non-current. It would make visible the fact that such classification is not absolute and that investors may consider looking for further information about conditions in the notes to the financial statements. Such separate presentation would be required only for entities that present current and non-current liabilities as separate classifications in their statement of financial position applying paragraph 60 of IAS 1 (ie it would not be required for entities that present liabilities based on liquidity).

Advantages of Approach B

73. In our view, Approach B would:

(a) enhance the information an entity provides about the conditionality associated with its right to defer settlement while avoiding retaining classification requirements that could be complex and might not work as the Board expected for particular conditions.

(b) retain the principles in IAS 1—both before and after the amendments—that classification reflects the circumstances at the reporting date, and not management's expectations of the future.

(c) be simple and easy to understand, while still providing information about future conditions and related risks through presentation and disclosure. It would also resolve concerns from stakeholders about the practical challenges and consequences of applying the amendments.

Scope of conditions to which Approach B would apply

74. Throughout the development of the 2020 amendments, the Board focused mainly on how an entity classifies loans with covenants. This is reflected in the requirements in paragraph 72A of IAS 1, which refer to situations in which the right to defer settlement is 'subject to the entity *complying* with specified conditions' (emphasis added). The Board has therefore not considered other types of conditional settlement terms within loan agreements.

75. In our view, any standard-setting the Board decides to undertake should retain its focus on conditions with which an entity must comply (ie covenants). We note that respondents' comments also focused only on loans with covenants. Therefore, in order to avoid any new requirements being inappropriately applied to liabilities with other conditional settlement terms, the Board could clarify that an entity does *not* have a right to defer settlement at the reporting date when the related liability could become repayable within twelve months:

    (a) at the discretion of the counterparty or a third party (for example, a loan callable by the lender at any time without cause); or

    (b) if an uncertain future event occurs (or does not occur) and the event's 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).

76. In both situations described above, there are no conditions with which the entity must or could *comply*. In our view, it would be helpful to clarify that such conditional settlement terms are outside the scope of any new requirements the Board might develop.

Staff recommendation

77. Based on our analysis in paragraphs 42–76 of this paper, we recommend that the Board amend IAS 1 to:

    (a) specify that, if the right to defer settlement for at least twelve months is subject to an entity complying with conditions *after* the reporting period, then those conditions do not affect whether the right to defer settlement

exists at the end of the reporting period (the reporting date) for the purposes of classifying a liability as current or non-current.

(b) for non-current liabilities subject to conditions, require an entity to disclose information about:

   (i) the conditions (for example, the nature of the condition and when it must be complied with);

   (ii) whether the entity would comply with the conditions based on its circumstances at the reporting date; and

   (iii) whether and how the entity expects to comply with the conditions by the date on which they are contractually required to be tested.

(c) require that an entity presents separately, in its statement of financial position, 'non-current liabilities subject to conditions'. This line item would include liabilities classified as non-current for which the right to defer settlement for at least twelve months is subject to the entity complying with conditions after the reporting date.

(d) clarify that an entity does *not* have a right to defer settlement at the reporting date when the related liability could become repayable within twelve months:

   (i) at the discretion of the counterparty or a third party (for example, when a loan is callable by the lender at any time without cause); or

   (ii) if an uncertain future event occurs (or does not occur) and the event's 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).

Question 1 to the Board

1. Does the Board agree with our recommendations to amend the requirements in IAS 1 with respect to:
   a. the classification of liabilities subject to conditions and disclosure of information about such conditions—as set out in paragraphs 77(a)–(b)?
   b. the separate presentation of these liabilities—as set out in paragraph 77(c)?
   c. whether an entity has a right to defer settlement when that right is not subject to conditions with which an entity must comply—as set out in paragraphs 77(d)?

Deferring the effective date of the 2020 amendments

78. The 2020 amendments are effective for annual reporting periods beginning on or after 1 January 2023, with earlier application permitted. If the Board decides to amend IAS 1 to change requirements added or amended by the 2020 amendments, then we also recommend deferring the effective date of the 2020 amendments. This would avoid entities having to change the classification of liabilities applying the 2020 amendments and then shortly thereafter potentially change the classification of liabilities again to reflect any new amendments. Said differently, we recommend that, if the Board amends IAS 1, it does so in a way that avoids an entity having to apply any aspect of the 2020 amendments that is then subsequently amended.

79. Deferring the effective date of the 2020 amendments would:
    (a) as noted above, avoid entities having to change their assessment of the classification of liabilities potentially twice within a relatively short period;
    (b) provide clarity for entities that the Board intends to propose to amend particular requirements within the 2020 amendments before they become effective; and
    (c) allow additional time for entities to prepare for the new amendments and for jurisdictions to incorporate them into their legal systems.

80. Considering the complex nature of this topic and that it affects the vast majority of entities' financial statements, we expect that the Board would finalise any new

amendments no earlier than the second half of 2022. We therefore recommend deferring the effective date of the 2020 amendments by at least one year so that they apply to annual reporting periods beginning no earlier than on or after 1 January 2024. The Board would confirm the exact effective date when finalising any new amendments.

Question 2 to the Board
2. Does the Board agree with our recommendation to defer the effective date of the 2020 amendments by at least one year to annual reporting periods beginning no earlier than on or after 1 January 2024?

Appendix A—Initial outreach with investors and analysts

A1. As explained in paragraph 10 of this paper, we conducted some initial outreach with users of financial statements to obtain a more complete picture of stakeholder views on the application of the 2020 amendments as described in the tentative agenda decision. We met mainly with representatives from credit-rating agencies and asked for their views on the outcomes of applying the amendments in the fact patterns described in the tentative agenda decision.

A2. Investors and analysts consulted expressed the following views about the outcomes of applying the amendments:

(a) representatives of two credit-rating agencies and an equity analyst generally did not support the outcomes of applying the amendments:

(i) representatives of one rating agency and the equity analyst said an entity should classify a loan as current only if it has legally breached covenants on or before the reporting date. Classifying a loan as current before a legal breach occurs could be confusing and create a liquidity event even though the entity might still comply with the covenants on the testing date.

(ii) representatives of another rating agency expressed a preference for a classification model that either (a) takes into account events occurring after the reporting date; or (b) classifies liabilities based only on their maturity dates.

(b) representatives of another rating agency generally agreed with the outcomes, saying it would prompt entities to provide further information and explain in the notes the reasons for the classification. They said entities should classify loans as current when there is execution risk (for example, when compliance with covenants depends on the successful completion of a business restructuring) but view seasonal businesses differently. They do not support the outcomes if those outcomes arise because of the effects of seasonality.

A3. Despite expressing differing views as noted above, the investors and analysts consulted generally agreed on the following:

(a) they were concerned about the potential for frequent changes in classification that might arise in some cases, particularly for seasonal businesses;

(b) the information provided by current/non-current classification alone is insufficient and should be supplemented with information about conditions required to be tested after the reporting date; and

(c) management's expectations alone should not determine classification.

Appendix B—Comments on due process

B1. This appendix includes a summary of respondents' comments on due process regarding the requirements in paragraph 72A of IAS 1, together with our analysis of these comments.

Respondents' comments

B2. Some respondents commented on the development of the requirements in paragraph 72A. They noted that paragraph 72A was not included in the Exposure Draft—exposed for comment—but added as part of the Board's redeliberations of the draft amendments. The Board did not re-expose the amendments.

B3. Some respondents also said the Basis for Conclusions on the amendments do not explain the Board's reasons for adding paragraph 72A.

Staff analysis

B4. Before the amendments, paragraph 69(d) of IAS 1 required an entity to classify a liability as current if the entity did not have an *unconditional* right to defer settlement of the liability for at least twelve months after the reporting period. The Exposure Draft proposed to clarify that condition by:

(a) replacing 'an unconditional right' with 'the right'; and

(b) making it explicit that only rights in place at the end of the reporting period affect the classification of a liability.

B5. The Board decided to add paragraph 72A in response to comments from stakeholders that asked whether conditions to be tested only after the reporting period should affect whether an entity has the right to defer settlement. The Board concluded that an entity should assess compliance with specified conditions as of the reporting date, even if the condition is tested after that date. The Board's conclusion aligns with views it had explained in paragraph BC4 of the Exposure Draft, which stated:

> The Board considered a number of examples of conditions that could be placed on exercising a right. The Board concluded that when a right is subject to a condition, it is whether the entity

complies with that condition as at the end of the reporting period that determines whether the right should affect classification.

B6. Therefore, the requirements in paragraph 72A:

(a) were added in response to comments on the Exposure Draft; and

(b) align with the clarification to paragraph 69(d) and with explanations included in the Basis for Conclusions on the Exposure Draft.

B7. At its September 2019 meeting, the Board discussed the due process steps undertaken in developing the amendments and, having considered the re-exposure criteria in paragraphs 6.25–6.29 of the *Due Process Handbook*, concluded that the amendments did not require re-exposure. The Board made changes to the draft amendments—including the addition of paragraph 72A—in response to requests from respondents to the Exposure Draft. Those changes clarified the proposals without fundamentally changing them.