IFRS

STAFF PAPER

June 2022

IASB Meeting

Project	**Non-current Liabilities with Covenants (IAS 1)**
Paper topic	Cover paper

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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. The purpose of this meeting is to:

   (a) provide the IASB with:

      (i) a summary of feedback on the Exposure Draft; and

      (ii) our analysis and recommendations on how to proceed with the project.

   (b) ask the IASB whether it agrees with our recommendations.

Structure of agenda papers for this meeting

3. This cover paper includes:

   (a) background (paragraphs 6–17);

   (b) feedback overview (paragraphs 18–22); and

   (c) a summary of staff recommendations (paragraphs 23–25).

4. In addition to this paper, there are three agenda papers that summarise the feedback on the Exposure Draft and provide our analysis of that feedback and recommendations:

   (a) Agenda Paper 12B *Classification as current or non-current*—this paper considers feedback on the proposals about the classification of liabilities with conditions (hereafter, covenants)[1] as current or non-current (including the proposed clarification in paragraph 72C of the Exposure Draft);

   (b) Agenda Paper 12C *Separate presentation and disclosure*—this paper considers feedback on the proposals to require an entity to present separately, and disclose information about, non-current liabilities with covenants; and

   (c) Agenda Paper 12D *Transition and effective date deferral*—this paper considers feedback on the transition proposals and the proposal to defer the effective date of the amendments in *Classification of Liabilities as Current or Non-current*, issued in January 2020.

5. The papers for this meeting use the following terms to describe the extent to which feedback was provided by respondents:

Term	**Extent of response among respondents**
Almost all	all except a very small minority
Most	a large majority, with more than a few exceptions
Many	a small majority or large minority
Some	a small minority, but more than a few
A few	a very small minority

Background

The requirements in the 2020 amendments

6. IAS 1 includes requirements an entity applies in determining how to classify liabilities as current or non-current. In particular, paragraph 69(d) of IAS 1 requires that, to

[1] Throughout the agenda papers, we refer to conditions as ‘covenants’.

classify a liability as non-current, an entity must have the right at the reporting date to defer settlement of the liability for at least 12 months after that date (right to defer settlement).

7. In January 2020, the IASB issued *Classification of Liabilities as Current or Non-current* (2020 amendments). The 2020 amendments clarified aspects of how an entity classifies liabilities as current or non-current; in particular, how an entity assesses whether it has the right to defer settlement of a liability when that right is subject to compliance with covenants within 12 months after the reporting date.

The Committee's discussion

8. In December 2020, responding to questions from stakeholders, the IFRS Interpretations Committee (Committee) published a tentative agenda decision explaining how to apply the 2020 amendments to particular fact patterns. The tentative agenda decision explained that, applying the 2020 amendments, an entity does not have the right to defer settlement of a liability—and thus classifies the liability as current—when the entity would not have complied with covenants based on its circumstances at the reporting date, even if compliance with such covenants were required only within 12 months after that date.

9. Responding to the Committee's tentative agenda decision, stakeholders said the outcomes of applying the 2020 amendments might, in some circumstances, fail to faithfully represent an entity's financial position at the reporting date. They said the requirements:

   (a) could result in an entity classifying a liability as current even if, at the reporting date, the entity has no contractual obligation to settle the liability at that date or within 12 months.

   (b) take no account of the design of covenants negotiated to reflect an entity's specific circumstances. For example, a contract may specify different covenants at different dates to incorporate the expected effects of seasonality or the entity's future performance.

New information the IASB had not considered

Challenges of reflecting conditionality in a binary classification model

10. The principle in paragraph 69(d) of IAS 1 is consistent with the objective of classifying, as current, liabilities that are repayable within the current operating cycle (or within 12 months after the reporting date). If an entity does not have such a right to defer settlement, it may be unable to avoid having to repay a liability within 12 months even if, at the reporting date, the entity has no contractual obligation to settle the liability within that period.

11. When an entity's right to defer settlement is subject to compliance with covenants, the related liability could be repayable either within or after 12 months, depending on whether the entity complies with those covenants after the reporting date. It is therefore impossible to know at the reporting date when the liability will ultimately be repayable. Despite this uncertainty, IAS 1 still requires an entity to classify the liability as either current or non-current at the reporting date.

12. In this context, the 2020 amendments specified one way of reflecting that conditionality within the constraints of a model that classifies liabilities as either current or non-current. However, having considered stakeholders' feedback, the IASB concluded that the information provided by such a binary classification model, alone, is insufficient to meet the information needs of users of financial statements (investors) when an entity's right to defer settlement is subject to compliance with covenants after the reporting date.

Covenants incorporating the effects of seasonality or future performance

13. Stakeholders' feedback provided new information about covenants designed to incorporate the expected effects of the seasonality of an entity's business and the entity's future performance. In particular, stakeholders said the classification outcomes of applying the 2020 amendments might not provide useful information for liabilities subject to such covenants because they were designed to be assessed only at a specified point in time. The IASB shared those concerns, particularly in relation to entities whose business is highly seasonal.

Summary of the proposals in the Exposure Draft

14. Having considered the new information, the IASB decided to propose narrow-scope amendments to IAS 1. The proposed amendments aim to improve the information an entity provides when its right to defer settlement of a liability is subject to compliance with covenants within 12 months after the reporting date, in addition to addressing stakeholders' concerns about the outcomes of applying the 2020 amendments.

15. The proposals cover three main areas:

    (a) *classification of liabilities as current or non-current*—the IASB proposed to specify that covenants with which an entity must comply only after the reporting date would not affect classification of a liability as current or non-current. In addition, the IASB proposed to clarify situations in which an entity would not have a right to defer settlement.

    (b) *disclosure of information about covenants*—the IASB proposed to require an entity to disclose information that enables investors to assess the risk that the liability could become repayable within 12 months, including:

        (i) the covenants (their nature and date on which the entity must comply with them);

        (ii) whether the entity would have complied with the covenants at the reporting date; and

        (iii) whether and how the entity expects to comply with the covenants in the future.

    (c) *separate presentation*—the IASB proposed to require an entity to present separately, in its statement of financial position, non-current liabilities subject to compliance with covenants within 12 months after the reporting date.

16. The proposed amendments would also defer the effective date of the 2020 amendments so that entities would not be required to change their assessment of the classification of liabilities before the proposed amendments are in effect.

17. The other agenda papers for this meeting provide further information about the proposals.

Feedback overview

Overview of respondents

18. The IASB received 84 comment letters. Responses were received from national standard-setters, accountancy bodies, preparers, accounting firms, regulators, individuals and, to a lesser extent, investors and academics. The chart below groups the responses by type of respondent and geographical region:

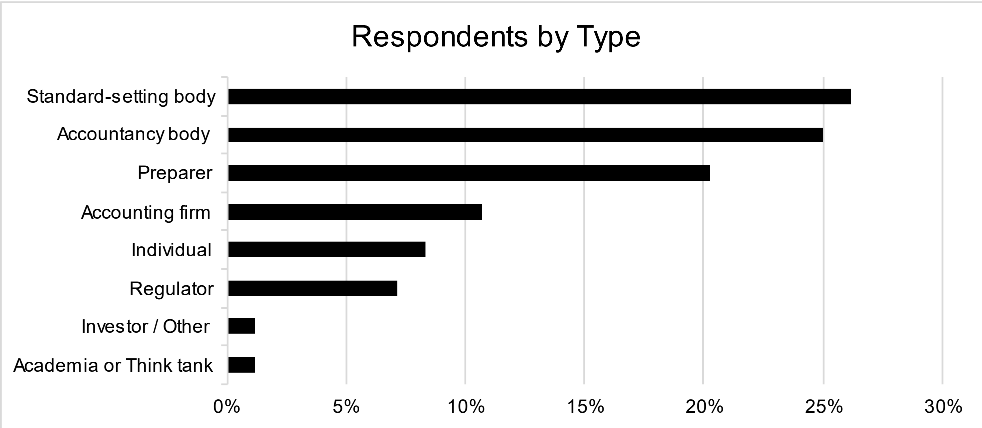

Chart 1— Respondents by type of respondent

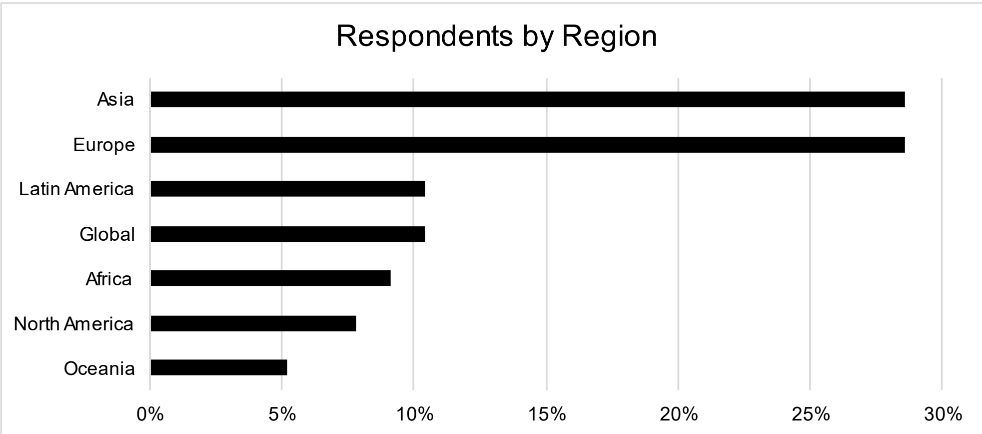

Chart 2— Respondents by geographical region

Summary of feedback on the proposals

19. The following is a high-level summary of feedback on the main aspects of the proposals:

    (a) almost all respondents generally agreed with the proposals on the classification of liabilities as current or non-current. However, most respondents disagreed with, or commented on, the proposed clarification in paragraph 72C of situations in which an entity would not have a right to defer settlement. Some respondents asked for further clarification about how to apply existing requirements in IAS 1.

(b) most respondents generally supported enhancing disclosure about covenants. However, respondents suggested narrowing the scope of the covenants for which disclosure would be required or commented on particular aspects of these proposals.

(c) most respondents disagreed with the proposal to require separate presentation of non-current liabilities subject to compliance with covenants.

20. Agenda Papers 12B and 12C provide further information about the feedback received on the main aspects of the proposals, together with our analysis and recommendations.

Feedback from outreach activities

21. 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, the Capital Markets Advisory Committee and the Accounting Standards Advisory Forum.

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

22. Agenda Papers 12B and 12C include a summary of feedback from these meetings.

Summary of staff recommendations

Classification as current or non-current

23. We recommend that the IASB:

(a) finalise the proposed amendments to paragraph 72A of IAS 1 and the addition of paragraph 72B—that is, confirm that only covenants with which an entity must comply on or before the reporting date would affect a liability’s classification as current or non-current.

(b) not provide further clarification or application guidance on:

 (i) determining whether a right to defer settlement has substance; or

 (ii) applying paragraphs 74–75 of IAS 1.

(c) not finalise the proposed clarification in paragraph 72C about situations in which an entity would have no right to defer settlement; instead, specify that the proposed requirements in paragraph 72B apply only to liabilities arising from loan arrangements.

Separate presentation and disclosure of information about covenants

24. 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.

Transition and effective date

25. We recommend that the IASB:

    (a) require an entity to apply the proposed amendments retrospectively in accordance with IAS 8.

    (b) allow an entity to early adopt the proposed amendments or the 2020 amendments only if the entity early adopts both amendments at the same time.

    (c) defer the effective date of the 2020 amendments to align it with the effective date of the proposed amendments (to be decided at a future meeting, but no earlier than annual reporting periods beginning on or after 1 January 2024).