# ED 2021/9 Non-current liabilities with Covenants

## Presentation to IFASS

**7 March 2022**

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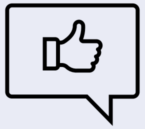
# ED/2021/9 Non-current liabilities with Covenants

| Proposal | Preliminary comments |
|---|---|
| Proposed amendments to IAS1.72A<br>-removal of the last two sentences |  |
| Proposed IAS 1.72B |  |
| Proposed IAS 1.72C |  |
| Proposed IAS 1.76ZA |  |

# Proposed amendment to IAS 1.72A

- Support the proposed amendments to IAS 1.72A, i.e., removal of the last two sentences.

*Right to defer settlement for at least twelve months (paragraph 69(d))*

72A An entity's right to defer settlement of a liability for at least twelve months after the reporting period must have substance and, as illustrated in paragraphs <u>72B–75</u>~~73–75~~, must exist at the end of the reporting period.~~ If the right to defer settlement is subject to the entity complying with specified conditions, the right exists at the end of the reporting period only if the entity complies with those conditions at the end of the reporting period. The entity must comply with the conditions at the end of the reporting period even if the lender does not test compliance until a later date.~~

# Proposed IAS 1.72B

- Agree that specified conditions with which an entity must comply within 12 months after the reporting period have no effect on whether an entity has, at the end of the reporting period, a right to defer settlement of a liability for at least 12 months after the reporting period.
- Support the addition of paragraph 72B.

<u>72B</u> <u>An entity's right to defer settlement of a liability for at least twelve months after the reporting period may be subject to the entity complying with specified conditions (often referred to as 'covenants'). For the purposes of applying paragraph 69(d), such conditions:</u>

<u>(a)</u> <u>affect whether that right exists at the end of the reporting period—as illustrated in paragraphs 74–75—if an entity is required to comply with the condition on or before the end of the reporting period. This is the case even if compliance with the condition is assessed only after the reporting period (for example, a condition based on the entity's financial position as of the end of the reporting period but assessed for compliance only after the reporting period).</u>

<u>(b)</u> <u>do not affect whether that right exists at the end of the reporting period if an entity is required to comply with the condition only within twelve months after the reporting period (for example, a condition based on the entity's financial position six months after the end of the reporting period).</u>

# Significant concerns on proposed IAS 1.72C

**NOT** to proceed with the proposed paragraph 72C

- Any changes to IAS 1 should focus on addressing the issue arising from the earlier actions of the IFRS Interpretations Committee in relation to the TAD published in Dec 2020.

72C An entity does not have the right to defer settlement of a liability for at least twelve months (as described in paragraph 69(d)) if the liability could become repayable within twelve months after the reporting period:

(a) 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

(b) if an uncertain future event or outcome occurs (or does not occur) and its occurrence (or non-occurrence) is unaffected by the entity's future actions—for example, when the liability is a financial guarantee or insurance contract liability. In such situations, the right to defer settlement is not subject to a condition with which the entity must comply as described in paragraph 72B.

# Significant concerns on proposed IAS 1.72C

**<u>NOT</u>** to proceed with the proposed paragraph 72C

- **<u>IAS 1.72C(a):</u>** Proposal appears to presume there is a 'bright line' between cases when a loan is callable by the lender or third party and when it is not.

- Extent to which this is the case can <u>depend on a range of factors</u> that might affect the **<u>commercial substance</u>** of a lender's or third party's rights to call-in a loan.

  - Various legal cases which have upheld that, in the absence of a default being committed by the borrower, the bank is not entitled to exercise its right pursuant to the overriding clause to demand for repayment of the term loan from the borrower at any time due to the repayment tenure.

✓ *Bank Bumiputra Malaysia Berhad v Mae Perkayuan Sdn. Bhd*

✓ *Bumiputra-Commerce Bank Berhad v Chendering Development Sdn. Bhd.*

✓ *Sabah Bank Berhad v Master Perkasa (M) Sdn. Bhd.*

https://www.masb.org.my/pdf.php?pdf=MAIG%202%20Classification%20by%20the%20borrower%20of%20a%20term%20loan_FINAL.pdf&file_path=pdf_file

# Significant concerns on proposed IAS 1.72C

**NOT** to proceed with the proposed paragraph 72C

- **IAS 1.72C(a):**

  - It is imperative that only terms of a liability contract that have commercial substance are considered and that any terms are **assessed in the context of the relevant regulatory and business environment.**

- The practices and processes for establishing contracts with counterparties vary across jurisdictions -there may be, for example, cases in which the terms of a contract have no commercial substance due to the impacts of the legal or commercial environment in which the entity operates.

# Significant concerns on proposed IAS 1.72C

**<u>NOT</u>** to proceed with the proposed paragraph 72C

- **<u>IAS 1.72C(b):</u>** The meaning of "*unaffected by the entity's future actions*" is not clear in the context of liabilities generally.
  - The notion that the accounting (including presentation) for an asset or liability would be based on whether it is "*unaffected by the entity's future actions*" seems to be a potentially broadly applicable benchmark.
  - Before introducing another presentation notion/concept to IFRS Standards, the IASB should give this matter greater thought in a wider context.

# Significant concerns on proposed IAS 1.72C

<u>**NOT**</u> to proceed with the proposed paragraph 72C

- **<u>IAS 1.72C(b):</u>** The meaning of "*unaffected by the entity's future actions*" is not clear in the context of liabilities generally.

- E.g., in IAS 1.72C(b) [financial guarantees and insurance contracts] presumably relate to a counterparty's creditworthiness and a policyholder having a valid insurance claim – both of which are beyond the entity's control.

- However, in the context of a borrowing, it is unclear what types of factors would be identified as being beyond the entity's control.

  - For e.g., there might be cases when an entity's profitability, revenues, or interest expense are among the factors affecting conditions attaching to the continuation of a loan.

  - It seems equally plausible, depending on the circumstances, to consider that these factors would be unaffected by the entity's future actions; or, alternatively, that they could be affected by the entity's future actions.

# If proposed IAS 1.72C is retained …

- ❑ For the proposed IAS 1.72C(a) in relation to identifying cases when a loan is callable by the lender or third party and when it is not, a paragraph similar to IFRS 17.2 should be considered.

- ❑ For the proposed IAS 1.72C(b) in relation to "*unaffected by the entity's future actions*", additional explanation / clarification is required.

    - ▪ This would help provide certainty about what IAS 1.72C(b) is meant until IASB has the opportunity to (possibly) consider the application of this notion of "*unaffected by the entity's future actions"* in a wider context, such as the Primary Financial Statements project or the IASB's Disclosure Initiative.

# Not supportive of proposed IAS 1.76ZA

Support a holistic approach to topic of presentation and disclosure.

A holistic approach to disclosures relating to non-current liabilities would, in our view, involve considering a range of factors beyond the scope of ED/2021/9, including:

- if the existence of ‘specified conditions’ is regarded as a suitable basis for subclassification, a thorough examination should be undertaken to determine **what constitutes relevant specified conditions,** which we note are not explained in the proposals.
- how any new subclassification requirements might interact with the disclosure requirements for financial instruments that fall within the scope of IFRS 7.

# Not supportive of proposed IAS 1.76ZA(a)

- In the absence of an urgent need, we do not support introducing specific new requirements (outside IASB's project on Primary Financial Statements and the Disclosure Initiative)

We consider the existing classification issue at stake can be addressed without the proposed additional presentation requirement.

<u>76ZA</u> <u>When an entity classifies liabilities subject to the conditions described in paragraph 72B(b) as non-current, the entity shall:</u>

<u>(a)</u> <u>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.</u>

# Not supportive of proposed IAS 1.76ZA(b)

- In the absence of an urgent need, we do not support introducing specific new requirements (outside IASB's project on Primary Financial Statements and the Disclosure Initiative)

(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.

Proposed IAS1.76ZA(b)(i)

- Will result in potential for information 'clutter'
- Many liabilities have conditions attached and we are concerned about entities having to determine which conditions are worthy of disclosure and the extent of disclosures.

# Not supportive of proposed IAS 1.76ZA(b)

Proposed IAS1.76ZA(b)(ii)

- Asking entities to disclose projections about how they expect to comply with specified conditions after the end of the reporting period seems likely to impinge on areas already addressed in Management Commentary.
    - For e.g., a specified condition might be that borrowing expenses do not exceed a certain % of profit, which could involve the entity in explaining its profit projections and how it plans to achieve them.

Proposed IAS1.76ZA(b)(iii)

- Asking entities to disclose how they expect to comply the condition after the end of the reporting period seems like requiring forward-looking information on future compliance with covenants as this may involved projecting future profit, cash flows and borrowing beyond the reporting date

# THANK YOU