Snapshot: *Non-current Liabilities with Covenants*

This snapshot provides an overview of the Exposure Draft *Non-current Liabilities with Covenants* published by the International Accounting Standards Board (Board).

The Board's objective:	To improve the information a company provides about liabilities with covenants, in addition to addressing stakeholders' concerns about how a company classifies those liabilities as current or non-current.
Proposals:	The Board proposes to amend IAS 1 *Presentation of Financial Statements* to specify that covenants with which a company must comply after the reporting date do not affect the classification of a liability as current or non-current at that date. Instead, a company would be required to: (a) present non-current liabilities with covenants separately in its balance sheet; and (b) disclose information in the notes about the covenants with which it must comply within 12 months after the reporting date.
Next steps:	The Board will consider the comments it receives on the Exposure Draft and will decide whether to proceed with the proposed amendments. The Board plans to complete any resulting amendments in the second half of 2022.
Comment deadline:	21 March 2022.

Background

The classification requirements in IAS 1

IAS 1 *Presentation of Financial Statements* sets out general requirements about how a company presents its financial statements. The Standard includes requirements on the classification of liabilities as **current** or **non-current**.

The classification of a liability as current or non-current provides useful information to investors because it highlights those liabilities that are due for settlement within a company's current operating cycle (or within 12 months of the reporting date).

IAS 1 requires a company to classify a liability as **non-current** only if the company has a **right to defer settlement** of the liability for **at least 12 months** after the reporting date (right to defer settlement). Without this right, the company might be unable to avoid having to repay the liability within 12 months of its reporting date.

The 2020 amendments

In January 2020 the Board issued *Classification of Liabilities as Current or Non-current* (2020 amendments). The 2020 amendments clarified some aspects of the classification of liabilities as current or non-current.

In particular, the 2020 amendments clarified how a company assesses whether it has the right to defer settlement of a liability when that right is subject to compliance with specified conditions (often referred to as 'covenants') within 12 months *after* the reporting date.

The 2020 amendments are effective for annual reporting periods beginning on or after 1 January 2023.

To classify a liability as non-current, a company must have a **right to defer settlement** of that liability for at least 12 months after the reporting date.

What problem is the Board trying to solve?

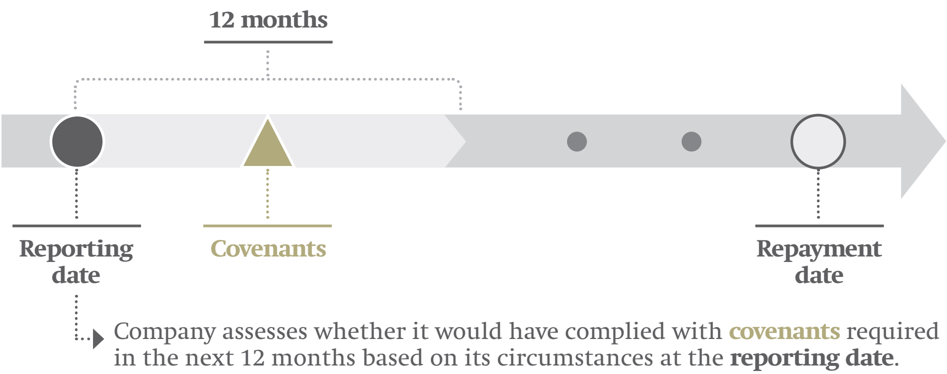
The Committee's discussion—applying the 2020 amendments

In response to questions from stakeholders, the IFRS Interpretations Committee (Committee) discussed how companies would apply the 2020 amendments to particular fact patterns. The Committee discussed situations in which:

(a) the company's right to defer settlement is subject to compliance with covenants within 12 months after the reporting date; and

(b) the company would not have complied with such covenants based on its circumstances at the reporting date.

According to the 2020 amendments, for the purposes of classifying a liability as current or non-current, a company has a right to defer settlement only if it would have complied with covenants *based on its circumstances at the reporting date*, even though compliance is required only after that date.



Accordingly, the Committee concluded that, applying the 2020 amendments, a company would not have a right to defer settlement of the liability in the fact patterns discussed. The company would therefore present the related liability as a **current liability** in its balance sheet.

Example—covenants required after the reporting date

A company has a loan repayable in five years. The loan includes a covenant requiring a working capital ratio above 1.0 on 30 June 2022. The loan becomes repayable on demand if the ratio is not met at that specified date.

The company reports on 31 December 2021. At that date, the company's working capital ratio is 0.9. Management expects to meet the minimum working capital ratio by the date on which it is required (30 June 2022).

At the reporting date, the company would not have complied with the covenant required within 12 months of that date—it has a working capital ratio of 0.9; the covenant requires a ratio above 1.0 on 30 June 2022. Applying the 2020 amendments, the company does not have a right to defer settlement at the reporting date—and thus classifies the liability as current.

What problem is the Board trying to solve? continued ...

Stakeholders' concerns

Stakeholders raised concerns about the classification requirements introduced by the 2020 amendments:

What stakeholders said	Board's considerations
The 2020 amendments require a company to classify a liability as current even when, at the reporting date, it has no contractual obligation to repay the liability within 12 months.	Although a company may have no contractual obligation to repay the liability within 12 months of the reporting date, the company's right to defer settlement is not absolute—the liability could become repayable within 12 months depending on whether the company complies with covenants after the reporting date. In such situations, it is impossible to know at the reporting date when the liability will ultimately be repayable. The Board therefore concluded that the information provided by classification as either current or non-current, alone, is insufficient to meet investor information needs—such a classification does not provide information about the potential effects of covenants on when the liability is repayable.
The requirements take no account of the design of conditions negotiated to reflect a company's specific circumstances.	The Board shared concerns of stakeholders that the 2020 amendments could result in classification outcomes that would not provide useful information in some situations. This might be the case when covenants are designed to incorporate the expected effects of: (a) the seasonality of a company's business—for example, covenants that reflect the company's expected financial position immediately after its high season; and (b) the company's future performance—for example, covenants that become increasingly strict over the term of a liability.

What are the Board’s proposals?

The Board’s proposals can be summarised in the following diagram:

Classification as current or non-current

A company would classify liabilities as **current** or **non-current** based on its compliance with covenants required only on or before the reporting date

Presentation and disclosure

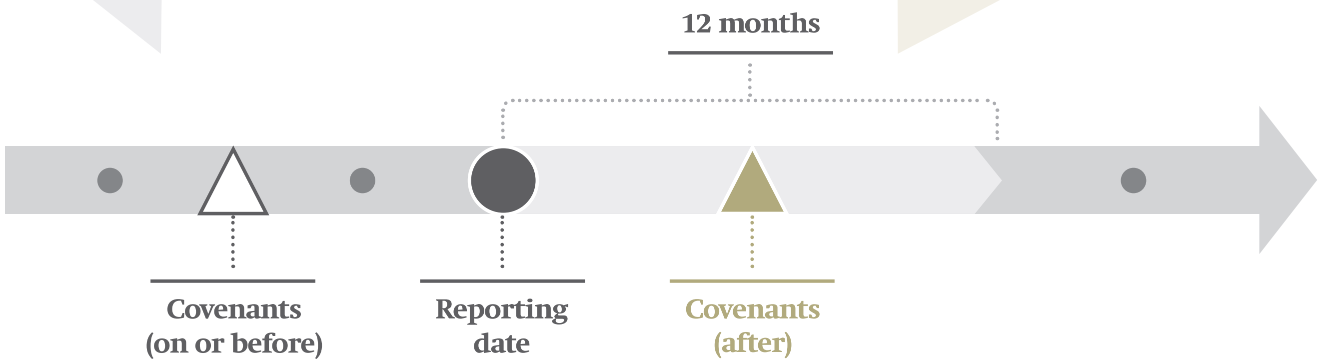
A company would:

- **present separately** non-current liabilities subject to convenants required within 12 months after the reporting date
- **disclose information** that enables investors to assess the risk that the liabilities could become repayable within 12 months

Information companies would disclose include:

the **covenants** and whether the company:

- would have complied with them at the reporting date
- expects to comply with them in the future (including how it would do so)



The Board expects that its proposals would improve the information a company provides about liabilities with covenants and address stakeholders’ concerns.

Other aspects of the proposals

In addition to its proposals regarding classification, presentation and disclosure of liabilities with covenants, the proposed amendments would also cover:

1. Other conditional settlement terms	2. Deferral of the effective date of the 2020 amendments
The Board proposes to clarify that a company does not have a right to defer settlement—and thus would classify a liability as current—when the liability could become repayable within 12 months: (a) at the discretion of the counterparty or a third party—for example, when a loan can be called by the lender at any time without cause. (b) depending on an uncertain future event or outcome that is unaffected by the company's future actions—for example, when the liability is a financial guarantee or insurance contract.	The Board proposes to defer the effective date of the 2020 amendments to no earlier than 1 January 2024. Companies would therefore not be required to change their assessment of the classification of liabilities before the proposed amendments are in effect.

Information for respondents

The deadline for comments on the Exposure Draft is 21 March 2022

You can submit comments on our 'Open for comment documents' page at: www.ifrs.org/projects/open-for-comment/.

Stay informed

To stay up to date with the latest developments on this project and to sign up for email alerts, please visit:

https://www.ifrs.org/projects/work-plan/classification-of-debt-with-covenants-as-current-or-non-current-ias-1/.

Exposure Draft package

The Exposure Draft includes:

- questions for respondents; and
- the Board's detailed proposals, in the form of proposed amendments to IAS 1.

The Basis for Conclusions on the Exposure Draft includes:

- a summary of the Board's considerations in developing its proposals; and
- an analysis of the expected effects of the proposals.

The Exposure Draft also includes the Alternative View of two Board members.

This document

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