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Amendments to IAS 1 Non-current Liabilities with Covenants Cover note

Objective

- 1 The objective of session is to discuss and agree EFRAG's Draft Letter to the European Commission regarding endorsement of Amendments to IAS 1: *Non-current Liabilities with Covenants*, endorsement of Amendments to IAS 1: *Classification of Liabilities as Current or Non-current*; and endorsement of Amendment to IAS 1: *Classification of Liabilities as Current or Non-current - Deferral of Effective Date* (collectively "the Amendments")

Background

- 2 IAS 1 paragraph 69(d) require an entity to classify a liability as current when it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. In interaction with paragraphs 74 and 75 divergences in practice has been observed related to loans with provisions or covenants.
- 3 In January 2020 the IASB issued *Classification of Liabilities as Current or Non-current* (2020 amendments). The 2020 amendments clarified aspects of how entities classify liabilities as current or non-current; especially how an entity assesses whether it has the right to defer settlement of a liability when that right is subject to compliance with specified conditions within twelve months after the reporting period.
- 4 In July 2020 the IASB issued *Classification of Liabilities as Current or Non-Current - Deferral of Effective Date* which deferred the application date to annual reporting periods starting on or after 1 January 2023.
- 5 In a submission to the IFRS Interpretations Committee questions were raised about the application of the proposals in particular fact patterns. Respondents to the tentative agenda decision raised concerns about the outcomes and potential consequences of the 2020 amendments in some situations (e.g., when covenants are negotiated that will have to be complied with after the reporting period end due to seasonality reasons). The Committee reported this feedback to the IASB, highlighting new information (seasonality) that the IASB had not considered when developing the amendments.
- 6 In October 2022, the IASB issued *Non-current Liabilities with Covenants* which by amending IAS 1 and *Classification of Liabilities as Current or Non-current* aims to improve the information an entity provides when its right to defer settlement of a liability arising from a loan arrangement for at least twelve months is subject to compliance with

covenants, in addition to addressing concerns about the classification of such a liability as current or non-current.

- 7 Applying the Amendments, an entity shall:
- (a) classify a liability as current, when one or more of the criteria in paragraph 69(a) to (c) of IAS 1 is met or, when it does not have the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 69(d) of IAS 1);
 - (b) classify a liability as current or non-current unaffected by management's intent or expectations about whether the entity will exercise its right to defer settlement (guidance in new paragraphs 75A of IAS 1);
 - (c) apply enhanced guidance on the notion of settlement (guidance in new paragraphs 76A and 76B of IAS 1);
 - (d) apply new guidance in paragraphs 72A and 72B of IAS 1, partly amended guidance in paragraphs 73 and 74 of IAS 1 and the guidance in paragraph 75 of IAS 1 when considering whether it 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. A short description of the content of the new and amended requirements is that an entity considers the covenant in a loan arrangement if the entity is required to comply with the covenant on or before the end of the reporting period, and does not consider the covenant in a loan arrangement if the entity is only required to comply with the covenant based on facts and circumstances after the reporting period;
 - (e) provide certain disclosures when it has classified a liability arising from a loan arrangement as non-current and the right is subject to the entity complying with covenants within twelve months after the reporting period (requirements in new paragraph 76ZA of IAS 1);
 - (f) apply enhanced guidance (in amended paragraph 76 of IAS 1) on disclosures in case of non-adjusting events in accordance with IAS 10 *Events after the reporting period*.
- 8 The European Commission issued a letter requesting advice on the endorsement of the Amendments from EFRAG on 15th November 2022. The letter contains a standard request for advice on the endorsement that does not identify specific issues or areas to investigate. EFRAG is asked to carry out an assessment of the Amendments against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and is also assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

Summary of previous discussions and EFRAG's comment letter

- 9 In March 2022, EFRAG issued its final comment letter in response to the exposure-draft *Non-current Liabilities with Covenants* in which:
- (a) EFRAG supported the IASB's efforts to address the concerns of constituents that have emerged in the context of the IFRS Interpretations Committee's agenda decision of December 2020 and supports that liabilities should be classified as either current or non-current based on the situation as at the end of the reporting period.
 - (b) EFRAG was concerned that the targeted scope of the disclosure requirements may in practice be too broad and recommended to the IASB in paragraph 76ZA(b) to require the disclosure only in case of significant uncertainties on whether the

specified conditions will be met within twelve months after the end of the reporting period, specifying a probability threshold to support consistent application.

- (c) EFRAG recommended the IASB to consider a broader review of the current/non-current classification in the primary financial statements, including on a conceptual view.
 - (d) Noted a minor number of other issues.
- 10 At its June, July and September 2022 meeting, the IASB adjusted its position on the minor number of issues mentioned in the EFRAG comment letter and confirmed that the proposed amendments did not require re-exposure.
 - 11 At the July 2022 meeting, EFRAG FR TEG received an update on the IASB's tentative decisions on this project. Members expressed support for the way forward chosen by the IASB and noted that the tentative decisions were mainly in line with the messages in the EFRAG comment letter.
 - 12 At the 30 November 2022 meeting, EFRAG FR TEG unanimous agreed to recommend the Draft Endorsement Advice, subject to some drafting changes, (as contained in agenda paper 08-02) and Invitation to Comment (contained in agenda paper 08-03) for approval by the EFRAG FRB.

Draft endorsement advice

- 13 Having taken into consideration the input of EFRAG FR TEG, the EFRAG Secretariat has prepared a Draft Endorsement Advice and invitation to comment which are contained in agenda papers 08-02 and 08-03, respectively.
- 14 Under the agreement with the IASB to use their copyrighted material, the Amendments are published to EFRAG's website during the time necessary for EFRAG to complete its endorsement advice work. The Amendments will be removed from EFRAG's website when the EC will publish the regulation adopting the Amendments in the EU Official Journal.
- 15 The letter from the EC requesting endorsement advice on IAS 1 amendments can be found [here](#).

Questions for EFRAG FRB

- 16 Does the EFRAG FRB agree to issue the Draft Endorsement Advice (contained in agenda paper 08-02) and Invitation to Comment (contained in agenda paper 08-03)?

Agenda Papers

- 17 In addition to this cover note, the following agenda papers are provided for this session:
 - (a) Agenda paper 08-02 – EFRAG's Draft Letter to the European Commission (DEA)
 - (b) Agenda paper 08-03 – Invitation to comment on EFRAG's assessments; and
 - (c) Agenda paper 08-04 – EFRAG Secretariate unofficial consolidated version of the Amendments (for background information only).