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21 March 2022

Andreas Barckow
Chair
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom

Dear Dr Barckow

Re: ED 2021/9 Non-current Liabilities with Covenants – Proposed amendments to IAS 1

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's ('the Board') exposure draft *Non-current Liabilities with Covenants – Proposed amendments to IAS 1* (the 'ED').

We support the Board's actions to address the concerns raised about the amendments made to IAS 1 in 2020 (the '2020 Amendments'). Whilst we agree that the proposed amendment to paragraph 72A will resolve the concerns raised, we believe that other amendments proposed in the ED will give rise to new concerns and may not result in relevant information to the users of financial statements.

We agree that an entity should not classify a liability as current merely because it fails to comply at the reporting date with conditions that are, under the contractual arrangements, only tested at a later date. We agree with the result of this proposed deletion that applying paragraph 72A, a liability would be presented as non-current when an entity's right to defer settlement for at least twelve months has substance and exists at the end of the reporting period. However, we believe that it would be important to provide guidance on what it means for the right to defer settlement for at least twelve months to have substance.

We disagree with the proposal in paragraph 76ZA(a) to present a separate line item in the statement of financial position comprised of liabilities that are subject to compliance with specified conditions within twelve months after the reporting period and are classified as non-current. We do not believe that this separate presentation would result in relevant information because most non-current debt arrangements require an entity to comply with various conditions either continually or at interim dates.

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Finally, we are deeply concerned that paragraph 72C(b) would affect the classification of a broad scope of liabilities and would lead to a significant change to current practices. Indeed, it is typical for debt agreements to include a right for the lender to call the debt in case of certain events such as change in control over the borrower, material adverse change in the borrower's financial condition, change in laws and other similar events. Generally, under current practice these rights of the lender do not affect the classification of the instrument by the borrower at all times. We strongly encourage the Board to consider whether this was the intended outcome. In fact, the Board may wish to reconsider whether this paragraph is needed since it does not appear to be added to address the concerns raised about the 2020 Amendments.

We suggest that it may be appropriate for the Board to limit the scope of the amendments made to IAS 1 to the changes proposed in paragraphs 72A, 72B(a) and 76ZA(b), subject to additional comments made in our detailed response. If the Board believes that this would not be an appropriate solution, an alternative solution must be sought and the effective date of the 2020 Amendments should be postponed until this is achieved.

Our detailed responses to the consultation questions are set out in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS and Corporate Reporting Leader

Deloitte.

## Appendix

**Question 1—Classification and disclosure (paragraphs 72B and 76ZA(b))**

The Board proposes to require that, for the purposes of applying paragraph 69(d) of IAS 1, specified conditions with which an entity must comply within twelve 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 twelve months after the reporting period. Such conditions would therefore have no effect on the classification of a liability as current or non-current. Instead, when an entity classifies a liability subject to such conditions as non-current, it would be required to 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:

(a) the conditions (including, for example, their nature and the date on which the entity must comply with them);

(b) whether the entity would have complied with the conditions based on its circumstances at the end of the reporting period; and

(c) whether and how the entity expects to comply with the conditions after the end of the reporting period.

Paragraphs BC15–BC17 and BC23–BC26 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

Classification

We agree with the proposed deletion of the requirement that an entity should present a liability as non-current only if the entity complies, at the reporting date, with conditions for which the testing date is in the future. As indicated in our response to the IFRS Interpretation Committee in February 2021, we believe that the application of this requirement may result in the presentation of an entity's financial position that does not provide relevant information, especially for those entities that have cyclical or seasonal businesses or are emerging growth or start-up businesses.

We agree with the result of this proposed deletion that applying paragraph 72A, a liability would be presented as non-current when an entity's right to defer settlement for at least twelve months has substance and exists at the end of the reporting period. However, we believe that it would be important to provide guidance on what it means for the right to defer settlement for at least twelve months to have substance. We believe that this would be important because it is not clear whether, and if so how, the concept of "substance" is relevant in applying some of the other requirements (existing and proposed) in IAS 1.

In particular, paragraph 72B(b) may be read to imply that when assessing whether it has the right to defer settlement for at least twelve months, an entity can disregard in all cases conditions that are tested after the end of the reporting period. The ambiguity as to the role of substance is further evidenced by the statement in BC15 that "the Board proposes to require that conditions with which an entity must comply only after the reporting date would not affect classification of a liability as current or non-current at the reporting date".

Whilst we agree that an entity should not classify a liability as current merely because it fails to comply at the reporting date with conditions that are only tested at a later date, we believe that facts and

circumstances may indicate that these conditions affect whether the right to defer settlement has substance.

Accordingly, we recommend that guidance be added to IAS 1 to address the circumstances in which a right to defer settlement has not been contractually forfeited at the end of the reporting period but could, nonetheless, be considered to have no substance at that date. Examples of such circumstances include the following:

- a covenant test date immediately after the end of the reporting period (such that financial information will not change materially in the intervening period) when a covenant would be breached based on financial information as at the reporting date; and
- a covenant based on a profit or loss metric largely completed at year-end (for example, cumulative three-year profit for a period ending one month after the end of the reporting period) when financial information as at the reporting date shows that the covenant's requirements cannot be met.

We note that no changes are proposed to paragraph 75 which requires that, despite having breached the conditions attached to a long-term loan, an entity presents the liability as non-current when the lender has agreed, by the end of the reporting period, to provide a period of grace ending at least twelve months after the reporting date. In practice, when the entity is required to comply with conditions at various dates throughout the year (e.g. annually and semi-annually), the lender may grant a waiver in respect of the breach of covenants at the reporting date (say, 31 December 20X1) whilst retaining its rights to call the loan if the covenants are not met at the next testing date (say, 30 June 20X2). In effect, because of the waiver, the entity is in the same position as an entity that is only required to comply with specified conditions after the reporting date (and would present the liability as non-current, under proposed paragraph 72B(b)). Yet it appears that the entity (that breached the conditions of the loan agreement) would present its liability as current since, strictly speaking, the waiver obtained does not provide a grace period of at least twelve months. We believe that it is important that the Board explains that paragraphs 72B and 75 are consistent and integrate, albeit differently, the concept of substance.

We are of the view that if an entity has obtained a waiver in respect of a breach of long-term loan condition at or before the reporting date but is required to meet conditions in the twelve months after the reporting date, the entity would present the loan as non-current only if there are realistic actions available to the entity, and within its control, to rectify the breach before the next testing date. We believe that the fact that the entity has breached a condition at or before the reporting date is a significant factor to consider in assessing the classification of a loan agreement. In effect, a waiver that in substance provides relief for less than 12 months (because the lender has retained the right to test conditions within the next twelve months) does not provide a substantive right to defer settlement for at least 12 months. Therefore, in such cases, the onus is on the entity to demonstrate that it has realistic actions available to it, and within its control, to rectify the breach and 'reinstate' the substance of the loan as long-term. This justifies why in applying paragraph 75 an entity considers the impact of conditions that must be met in the next twelve months differently than in proposed paragraph 72B. We believe that such an explanation should be provided because the application of paragraph 75 is currently a source of diversity in practice, which may be increased by the apparent contradiction with paragraph 72B.

Disclosure

We agree that the proposed disclosure would generally provide relevant information, but we would recommend highlighting the necessary links that should exist between the proposed disclosure and the existing disclosures requirements in IAS 1 regarding going concern and IFRS 7 regarding liquidity risk.

In particular, we note that the proposed disclosure aims to achieve, in part, the same objective as the information that an entity is already required to disclose in respect of liquidity risk (in particular the information required by IFRS 7:B10A when outflows of cash could occur significantly earlier than indicated in the maturity analysis or is already considered when providing the maturity analysis as required by IFRS 7:B11F(f)). The information will likely be more impactful if included in a single place in the notes to the financial statements. Therefore, we suggest that the Board should consider how to integrate the new proposed disclosure with the existing requirements of IFRS 7 thereby also avoiding unnecessary repetition.

We also note that paragraph 76ZA(b) proposes that an entity should disclose "whether and how the entity expects to comply with conditions after the end of the reporting period". We question whether it would be relevant for an entity to disclose this information in all circumstances. Consistent with our understanding of the requirement in paragraph 72A that that the right to defer settlement must have substance, we suggest that it may be appropriate to require this information to be disclosed when the assessment that the right to defer settlement has substance represents a significant judgement as defined in IAS 1:122.

Finally, we recommend that the Board clarifies what information, if any, is required in interim financial reports prepared applying IAS 34. Specifically, the requirements of paragraph 76ZA(a) might reasonably be applied in interim financial statements given it relates to the line items in the statement of financial position, whereas the requirements of paragraph 76ZA(b) might not apply given it is a specific disclosure in the notes to the financial statements.

| Question 2—Presentation (paragraph 76ZA(a)) |
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| The Board proposes to require an entity to present separately, in its statement of financial position, liabilities classified as non-current for which the entity's right to defer settlement for at least twelve months after the reporting period is subject to compliance with specified conditions within twelve months after the reporting period.<br>Paragraphs BC21–BC22 of the Basis for Conclusions explain the Board's rationale for this proposal.<br>Do you agree with this proposal? Why or why not? If you disagree with the proposal, do you agree with either alternative considered by the Board (see paragraph BC22)? Please explain what you suggest instead and why |

Consistently with some of the arguments raised in the alternative view presented in the ED, we do not agree with the proposal to present a separate line item, in an entity's statement of financial position, comprised of liabilities classified as non-current, subject to compliance with specified conditions within twelve months after the reporting period. We do not believe that this separate presentation would result in relevant information because most non-current debt arrangements require an entity to comply with various conditions either continually or at interim dates.

Paragraph BC26 acknowledges that it is likely that the right to defer settlement of many non-current liabilities will be subject to the entity complying with conditions within twelve months from the reporting date and that an entity would not be required to provide the information proposed in paragraph 76ZA when it is not material. We agree that this is a relevant conclusion in respect of the disclosures required by paragraph 76ZA(b). However, the materiality of the conditions does not appear to be a consideration when it comes to presentation on the statement of financial position. The need to present a separate line on the statement of financial position (when this line item is required to be presented separately under IAS 1) would generally be assessed based on its quantum rather than based on a qualitative appreciation. This view that the materiality of the condition does not appear relevant to the presentation on the

statement of financial position is further reinforced by the fact that paragraph BC26 addresses the qualitative assessment of the materiality in the context of the disclosure. Accordingly, the informational value of the separate line item proposed in paragraph 76ZA(a) will likely be reduced by the fact that this line item may end up grouping non-current liabilities for which the condition that may trigger repayment is considered material and those for which the condition is not considered material.

IAS 1:55 already requires an entity to present additional line items in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position. This requirement along with the additional disclosure proposed in paragraph 76ZA(b) of the ED should result in an entity providing relevant information to users of the financial statements about the risk that certain liabilities presented as non-current could become repayable within twelve months. Integrating the disclosures proposed in paragraph 76ZA(b) as part of the disclosure on liquidity risk could be useful in that respect.

If the Board determines that the proposals in paragraph 76ZA(a) should be finalised, we believe that it would be relevant to indicate whether this requirement applies to entities that present assets and liabilities by order of liquidity as permitted by IAS 1:64.

Question 3—Other aspects of the proposals

The Board proposes to:

(a) clarify circumstances in which an entity does not have a right to defer settlement of a liability for at least twelve months after the reporting period for the purposes of applying paragraph 69(d) of IAS 1 (paragraph 72C);

(b) require an entity to apply the amendments retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, with earlier application permitted (paragraph 139V); and

(c) defer the effective date of the amendments to IAS 1, Classification of Liabilities as Current or Non-current, to annual reporting periods beginning on or after a date to be decided after exposure, but no earlier than 1 January 2024 (paragraph 139U).

Paragraphs BC18–BC20 and BC30–BC32 of the Basis for Conclusions explain the Board's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Requirement in paragraph 72C

We agree with the requirement in paragraph 72C(a) that a liability should be classified as current if the liability could become repayable within twelve months after the reporting date at the discretion of a counterparty or a third party.

However, we are concerned that paragraph 72C(b) would affect the classification of a broad scope of liabilities and would lead to a significant change to current practices. Further, there is a risk that diversity in practice could arise because of the potential ambiguity of what it means for a future event or outcome to be "unaffected" by an entity's future action.

It is typical for debt agreements to include a right for the lender to require settlement of the debt in case of certain events such as a change in control over the borrower (i.e. an event that is within the control of the entity's shareholders), material adverse change in the borrower's financial condition (a change that may be largely outside the control of the entity), change in laws and other similar events. These rights

held by the lender are generally designed to protect the lender's exposure to credit risk of the borrower and become exercisable only upon an event that is outside the control of the lender. Generally, under current practice, these rights of the lender do not affect the classification of the instrument by the borrower at all times. We understand from paragraph BC18 and BC19 that paragraph 72C is being added to limit the scope of liabilities affected by the amendments made to IAS 1. However, inadvertently, it appears that paragraph 72C(b) will have a significant effect and result in the classification as current of most debt arrangements. We strongly encourage the Board to consider whether this was the intended outcome. In fact, the Board may wish to reconsider whether this paragraph is needed since it does not appear to be added to address the concerns raised about the 2020 Amendments.

Based on the examples provided in paragraph 72C(b) (i.e. financial guarantee and insurance contract liability), the Board may have intended to capture a narrower set of liabilities for which the event that affects the settlement date appears intrinsic to the nature of the liability. In these examples, the payment arising from the contingent event is not designed to protect the counterparty's exposure to credit risk arising from the party to the contract that owes them as is the case for a lender that has made an advance to a borrower. Instead, the contingent event necessitates a payment to the counterparty that is designed to reimburse the counterparty for loss suffered as a result of the contingent event. The Board may wish to consider whether this characteristic forms the basis of a principle that justifies the presentation of this limited scope of liabilities as current liabilities without affecting the classification of debt arrangements that include typical lender protective rights such as those mentioned in the previous paragraph.

In establishing such a principle, we suggest that the concept of an uncertain event or outcome that is "unaffected by an entity's future actions" should either be avoided or better explained. For example, it is not clear whether this would capture events such as:

- Loan becomes repayable upon a credit downgrade. Whilst an entity can affect to a certain extent its own credit quality (which feeds into the credit rating), the downgrading is determined by the credit rating agency.
- Loan becoming repayable if a license is not renewed by a regulator when the renewal is subject to the entity meeting certain performance thresholds.
- Loan becoming repayable if the entity (the borrower) does not complete an IPO within a certain timeframe.

We are therefore concerned that as presented in the ED (including the discussion in BC20) the assessment of whether a future event or outcome is considered to be "unaffected" by an entity's future action would be subject to diversity in interpretation.

If the Board believes that it is important to retain paragraph 72C(b) but a principle that captures the appropriate scope of liability cannot be established, we believe that it would be necessary to establish a list of exceptions to identify terms of a debt arrangements that should not be considered in applying paragraph 72C(b). We believe that these exceptions would include clauses that entitle the lender to demand repayment in case of change of control, change of management, change of law (including tax laws and accounting standards), material adverse effects, and similar. If the Board intends to pursue this solution, it would be important to perform appropriate outreach activities to identify an appropriate list of exceptions.

We acknowledge that insurance companies generally present assets and liabilities in order of liquidity and will therefore generally not be affected by paragraph 72C(b). However, when an insurance company is held as part of a larger consolidated group that classifies assets and liabilities as current/non-current, this paragraph would apply and insurance contract liabilities would be presented as current. We note that this differs from the requirements in IFRS 17:132 which requires that the maturity analysis for portfolios of

insurance and reinsurance contracts liabilities should reflect the expected timing of the related cash flows. We suggest that the Board considers whether more relevant and clearer information would be provided to users of the financial statements if the insurance contract liability is classified on the statement of financial position consistently with the basis of presentation of the related cash flows in the liquidity risk disclosure.

Transition method and effective date

We agree that the amendments should be applied retrospectively and that the effective date of the amendments should not be earlier than 1 January 2024.

We suggest that it may be appropriate for the Board to limit the scope of the amendments made to IAS 1 to the changes proposed in paragraphs 72A, 72B(a) and 76ZA(b), subject to additional comments made in this response. If the Board believes that this would not be an appropriate solution, an alternative solution must be sought to address the concerns that this ED attempts to address. Until this is achieved, the effective date of the 2020 Amendments should be indefinitely postponed. Nevertheless, we believe that it would be appropriate that the addition of paragraphs 76A and 76B and the changes to paragraph 69(d) made as part of the 2020 Amendments could be effective without further delay (i.e. for annual reporting periods beginning on or after 1 January 2023).