Dr Andreas Barckow
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21 March 2022

Dear Dr Barckow

Invitation to Comment: Exposure Draft – *Non-current Liabilities with Covenants* (proposed amendments to IAS 1)

The UK Endorsement Board (UKEB) is responsible for endorsement and adoption of IFRS for use in the UK and therefore is the UK's National Standard Setter for IFRS Accounting Standards. The UKEB also leads the UK's engagement with the IFRS Foundation (Foundation) on the development of new standards, amendments and interpretations. This letter is intended to contribute to the Foundation's due process. The views expressed by the UKEB in this letter are separate from, and will not necessarily affect the conclusions in, any endorsement and adoption assessment on new or amended International Accounting Standards undertaken by the UKEB.

There are currently approximately 1,500 entities with equity listed on the London Stock Exchange that prepare their financial statements in accordance with IFRS Accounting Standards[1]. In addition, UK law allows unlisted companies the option to use IFRS Accounting Standards and approximately 14,000 such companies currently take up this option[2].

We welcome the opportunity to provide comment on the IASB's Exposure Draft (ED) – *Non-current Liabilities with Covenants* (proposed amendments to IAS 1). Our response is based on in-house research and stakeholder feedback. Our main comments with regard to the ED are outlined below. For detailed responses to the questions in the ED please see Appendix 1.

1 UKEB calculation based on LSEG and Eikon data. This calculation includes companies listed on the Main market as well as the Alternative Investment Market (AIM).
2 UKEB estimation based on FAME, Companies Watch and other proprietary data

We support a number of the proposals in the ED as we believe they will lead to clearer classification and disclosure of non-current liabilities with covenants that will assist users' decision making.

1. We agree with the proposed amendments to paragraph 72A removing the requirement to classify debt as a current liability where the entity is in technical breach of covenants for which compliance is to be tested at a future date. The tentative IFRIC Agenda Decision that was the catalyst for this Exposure Draft had the potential to create significant unintended consequences, and confusion for users of financial statements, as was clearly outlined by many respondents to that decision.

2. We agree with the principle in paragraph 72B that the classification of a liability as current or non-current should be based on conditions that exist at the end of the reporting period, even if that compliance is only tested later. However, we believe that this paragraph could be worded more clearly as discussed at paragraphs A1 – A5 in Appendix 1.

3. We agree with paragraph 72C(a), though we believe this principle is already implicit in the existing paragraphs.

4. We support the objective of enhancing disclosure about non-current liabilities in the notes to the financial statements to provide useful information that enables users of financial statements to assess the risk that a liability classified as non-current could become repayable within twelve months, as proposed in paragraphs 76ZA(b) and 76ZA(b)(i). However, we suggest paragraphs 76ZA(b)(ii) – (iii) are deleted as we do not consider that they are directly relevant to the disclosure objective. See our detailed response at paragraphs A6 – A7 in Appendix 1.

However, we are concerned about some of the proposals in the ED as follows:

1. We do not support the specific requirement for separate presentation in the Statement of Financial Position (paragraph 76ZA(a)). We believe that the current general requirements in IAS 1 *Presentation of Financial Statements* are sufficient. See our detailed response at paragraphs A8 – A12 in Appendix 1.

2. We are concerned about the potential for unintended consequences of some elements of the ED's proposals. These include (but are not limited to):

    a) The meaning of "specified conditions" (paragraph 72B). If the term is meant to have a particular meaning it needs to be defined, otherwise we suggest "conditions" should be used. See our detailed response at paragraphs A2 – A5 in Appendix 1.

    b) The application of paragraph 72C(b) when determining if a liability is current. We have encountered significant diversity in interpreting the intent of this paragraph and suggest paragraph 72C is deleted in its entirety. See our detailed response at paragraphs A14 – A17 in Appendix 1.

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Given that the ED is aimed at addressing specific concerns arising from the as yet unimplemented 2020 Amendments to IAS 1, to enable timely completion of the project we suggest that the IASB only proceed with amending paragraphs 72A, 72B (with clarifications as discussed) and enhancing disclosure on conditions that could be breached leading to earlier repayment of non-current liabilities. Further standard setting should happen only if there is evidence of significant diversity in practice. Our discussions with the FRC, in their role as the UK regulator responsible for corporate reporting review, confirmed that classification of liabilities is not a frequently raised issue in their financial statement reviews.

If you have any questions about this response, please contact the project team at UKEndorsementBoard@endorsement-board.uk

Yours sincerely

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Chair
UK Endorsement Board

UKEB UK Endorsement Board

Appendix 1: Questions on Exposure Draft ED/2021/9 – Non-current Liabilities with Covenants

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

The IASB 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 IASB'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.

Paragraph 72B

A1 We agree with the principle in paragraph 72B that the classification of a liability as current or non-current should be based on conditions that exist at the end of the reporting period, even if that compliance is only tested later. However, we believe that this paragraph could be worded more clearly as discussed below.

A2 The amendments in paragraph 72B refer to "specified conditions", and notes that these may also be referred to as "covenants". We understand that neither 'specified conditions' nor 'covenants' are defined in the IFRS. Under English common law, as applied to contracts, the term 'covenant' means any condition in a contract, but we accept this may not be the case in other jurisdictions. We are concerned that this could lead to different interpretations of the conditions intended to be captured by these amendments.

A3 We would suggest the IASB consider either using the term "condition" or it defines what is meant by "specified conditions".

A4 We agree with paragraph 72B(a) that if an entity fails to comply with a condition at the end of the reporting period, which is only assessed after the reporting period (say once audited financial statements are produced), it should still be treated as a breach at the end of that reporting period. However, we suggest that this is most relevant to paragraph 74 and should be incorporated there.

A5 We believe then paragraph 72B could be made much simpler and clearer, perhaps along the lines of:

> 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 conditions related to circumstances in that 12-month period. For the purposes of applying paragraph 69(d), these future conditions do not affect whether that right exists at the end of the reporting period.

Paragraph 76ZA(b)

A6 We support the objective of the proposals and specifically the requirements in paragraph 76ZA(b) and 76ZA(b)(i) to disclose information that enable users of financial statements to assess the risk that the liability could become repayable within twelve months and the material conditions with which an entity must comply.

A7 However, we agree with some stakeholders who are concerned that the specific requirements in subparagraphs 76ZA(b)(ii) - (iii) may be too prescriptive and require entities to disclose information that may be potentially irrelevant and may obscure or omit more useful information about potential breaches of debt conditions. UK stakeholders are also concerned that the requirements may encourage boilerplate disclosure that does not support the original objective of the amendments. We therefore recommend that these requirements are deleted. We suggest the IASB consider if there are alternative disclosures that would better support the overall disclosure objective. The UKEB would be interested to work with the IASB to undertake outreach with stakeholders on possible alternative disclosure requirements.

Question 2—Presentation (paragraph 76ZA(a))

The IASB 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.

Paragraphs BC21–BC22 of the Basis for Conclusions explain the IASB's rationale for this proposal.

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 IASB (see paragraph BC22)? Please explain what you suggest instead and why.

A8 We do not support the proposals in paragraph 76ZA(a) for separate presentation of non-current liabilities subject to conditions as described in paragraph 72B(b).

A9 Most non-current financial liabilities would be subject to conditions that must be complied with in the twelve months following the reporting date (for example, a requirement to make regular payments of principal and interest, meeting certain accounting ratios, or a material adverse change or change of control clause not being triggered). Furthermore, financial liabilities almost universally contain a cross-default provision, meaning if payment of any one financial liability is accelerated then all other financial liabilities with that provision are accelerated. Therefore, unless 'specified condition' is defined, most liabilities would require this separate presentation.

A10 If the IASB's intention is for most non-current liabilities to be presented in this way, then we are concerned that the requirement will be effectively meaningless and could result in boilerplate disclosures being given.

A11 Even if "specified condition" were to be defined, our views are also aligned with the Alternative View, in that a blanket requirement for separate disclosure on the face of the financial statements is not consistent with a principle-based approach to financial accounting:

> "The proposed presentation requirement does not represent a compelling case to forgo a principle-based approach. Under a principle-based approach, to provide the most relevant information to users of financial statements, an entity would apply principles to prioritise the information presented in the statement of financial position relative to disclosure in the notes" (paragraph AV3 of the Exposure Draft).

A12 We note that paragraph 55 of IAS 1 already requires disaggregation in the statement of financial position when it is relevant to an understanding of an entity's financial position. The current principles for disaggregation in IAS 1, and the expected improved principles for disaggregation proposed in the Primary Financial Statements project, in our view are sufficient to support appropriate presentation when required. When coupled with the proposal in this ED for disclosure in the notes to the financial statements we believe this would provide sufficient information to users to allow them to understand that some liabilities classified as non-current could be required to be paid earlier.

Question 3—Other aspects of the proposals

The IASB 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 IASB'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.

Paragraph 72C

A13 We agree with paragraph 72C(a), though we believe this principle is already implicit in the existing paragraphs. We believe that it should already be clear under paragraph 69(d) that if a counterparty has discretion to call a loan at any time without cause, then the entity does not have the right to defer settlement.

A14 We believe that paragraph 72C(b) would likely lead to diversity in practice. Stakeholders in the UK hold divergent views on what would or would not be captured by these requirements.

A15 Some stakeholders have highlighted that some general conditions found in many loan agreements may be "unaffected" by the entity's future actions and therefore could lead to them being classified as current in accordance with paragraph 72C(b). Two specific examples are loans subject to material adverse change clauses or change of control clauses, which are generally not considered to require current classification today.

A16 Other stakeholders have noted that there are many outcomes that can be affected by an entity's future actions which could lead to liabilities that are classified as current at this point in time being classified as non-current depending on the interpretation of the term "unaffected".

A17 We believe that significant redrafting or additional explanation would be required to address the concerns with paragraph 72C(b).

A18 We are not aware that paragraph 72C addresses issues raised with IFRIC. We suggest the IASB delete this paragraph in its entirety and rely on existing principles and practice.

Other Aspects of the Proposal

A19 We believe that retrospective application of any amendments made on the basis of the Exposure Draft would be appropriate.

A20 We agree that the effective date of IAS 1, *Classification of Liabilities as Current or Non-current* should be deferred to no earlier than 1 January 2024, and subject to finalisation of these proposals.

A21 We recommend the IASB make early adoption of the 2020 Amendments to IAS 1 conditional on adoption of these amendments at the same time.