Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Non-current Liabilities with Covenants**	**Meeting**	AASB February 2022 (M185)
Topic:	**Analysis of stakeholder feedback on ED 316**	**Agenda Item:**	7.1
		Date:	7 February 2022
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OBJECTIVE OF THIS PAPER

1 The objective of this agenda item is:

(a) to **inform** the Board of stakeholder feedback received on AASB ED 316 (ED 316) *Non-current Liabilities with covenants* (IASB ED/2021/9);

(b) to **provide** staff analysis on issues raised by stakeholders; and

(c) for the Board to **decide** its response to the specific questions posed in the ED.

ATTACHMENTS

Agenda Paper 7.2	AASB ED 316 (ED 316) *Non-current Liabilities with covenants* (IASB ED/2021/9) [supporting documents folder]
Agenda Paper 7.3	Summary of Stakeholder Feedback [Board only, supporting documents folder]

STRUCTURE

2 This paper is structured as follows:

(a) Background (paragraphs 3-11)

(b) Summary of stakeholders' feedback, Staff analysis and recommendations (paragraphs 12-44)

(c) Next Steps (paragraphs 45-46)

BACKGROUND

Objectives and overview of ED 316

3 AASB 101 *Presentation of Financial Statements* (IAS 1) requires a company to classify a liability as non-current only if an entity has a right to defer settlement of the liability for at least twelve 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 twelve months of its reporting date.

4 In January 2020, the IASB issued IAS 1 amendments *Classification of Liabilities as Current or Non-current* (AASB 2020-1). The 2020 amendments clarified how a company assesses whether it has the right to defer settlement of liability when that right is subject to compliance with specified conditions (often referred to as 'covenants') within twelve months after the reporting date. The IFRS Interpretations Committee (IFRS IC) further concluded that, applying the 2020 amendments, an entity could not classify a liability as non-current when it did not comply with covenants based on its circumstances at the reporting date, even though compliance was required only within twelve months after the reporting period. The 2020 amendments are effective for annual reporting periods beginning on or after 1 January 2023.

5 Stakeholders raised concerns about the tentative agenda decision and noted that the requirements do not consider specific conditions negotiated to reflect an entity's circumstances, such as the seasonality of the business or the entity's future performance.

6 To address stakeholders' concerns, ED 316 proposes to amend AASB 101 to specify that conditions a company must comply with within twelve months after the reporting date do not affect the classification of a liability as current or non-current at the reporting date. Instead, a company is required to:

(a) present non-current liabilities which are subject to compliance with specific conditions separately in its balance sheet;

(b) disclose information in the notes about the conditions it must comply with (e.g. nature and date);

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

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

7 ED 316 also 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 twelve months:

(a) at the discretion of the counterparty or a third party – for example, when the lender can call a loan at any time without cause; or

(b) if an uncertain future event or outcome occurs and its occurrence is unaffected by the company's future actions – for example, when the liability is a financial guarantee or insurance contract.

8 ED 316 also 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.

<u>Respondents to ED 316</u>

9 The comment period for ED 316 to AASB closed on 3 February 2022. The comment period to IASB closes on 21 March 2022. To date, the AASB has not received any comment letter.

<u>Outreach activities on ED 316</u>

10 Staff undertook various outreach activities on the matters raised on ED 316, including:

- 16 December 2021 – AASB's Disclosure Initiative Project Advisory Panel (DI PAP). Six DI PAP members provided feedback to AASB staff;
- 13 January 2022 – meeting with a representative from the Australian Institute of Company Directors (AICD);

- 25 January 2022 – meeting with representatives from two professional bodies;
- 3 February 2022 – AASB staff attended a joint meeting organised by CAANZ and CPA Australia to obtain their members' views. Six members, including four auditors and two preparers, provided feedback on ED 316; and
- other targeted consultations. One individual stakeholder [preparer] provided feedback to AASB staff.

Summary of stakeholders' feedback is provided in Agenda Paper 7.3 (Supplementary folder).

11 Staff have considered all feedback received in the staff analysis below.

Staff analysis and recommendations

12 ED 316 contains three questions:

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.

Related proposals in ED 316

In relation to Question 1, ED316 proposed the following amendments to AASB 101:

<u>72B 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>

(a) <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>

Related proposals in ED 316

(b) 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).

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

(a) 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.

(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.

Summary of stakeholder feedback

13 All of the stakeholders participating in the outreach supported the proposal that compliance with debt covenants within twelve months after the reporting date should not affect the classification of a liability as current or non-current at the reporting date.

14 Stakeholders generally supported the intention to enhance disclosures about covenants. However, five stakeholders[1] raised concerns about the feasibility of the proposed disclosure requirements and requested further implementation guidance. Two stakeholders suggested that further guidance is required to clarify the aggregation (and disaggregation) principles for disclosing the compliance conditions. Nine stakeholders[2] also raised concerns about the limited usefulness of the information (e.g. entities might have already disclosed sufficient information for users to assess the liquidation risk in other documents), possible confidentiality, high level of judgement required, and undue effort for entities to disclose the required information in paragraph 76ZA(b)(iii).

Staff analysis and recommendations

Clarification for the right to defer settlement (paragraphs 72A-72B)

15 Consistent with the stakeholder feedback (paragraph 13), staff support the proposed clarification in ED 316 that covenants with which a company must comply within twelve months after the reporting date do not affect the classification of a liability as current or non-current at that date.

16 Staff consider that this clarification would address many stakeholders' concerns about the 2020 amendments and the IFRS IC's tentative agenda decision (see paragraph 5 above). In

1 Two preparers, regulator, auditor and two professional bodies.

2 Two preparers, five auditors and two professional bodies.

addition, staff consider that the amendment would provide more faithful representation when the lender has no contractual right to demand repayment and the borrower has no contractual obligation to settle the liability within twelve months after the reporting date.

Proposed disclosure requirements (paragraph 76ZA)

17 The proposals in paragraph 76ZA(a) require entities to present separately in the statement of financial position a non-current debt that is subject to compliance with specified conditions within twelve months after the reporting period (i.e. debts with covenants that would be classified as non-current under the ED 316 proposal). Staff agree with the IASB's view (paragraphs BC9-BC11) that the binary model that classifies liabilities as 'current' or 'non-current' alone is insufficient to meet users' information needs. Under this model, the uncertainty created by the conditionality is not apparent to users of financial statements. Therefore, staff support IASB's initiative to enhance disclosure about debts with covenants.

18 However, consistent with stakeholders' view, staff are concerned that the proposed disclosure requirements in paragraph 76ZA(b)(i) could be challenging to implement. Paragraph 76ZA(b)(i) requires entities to disclose in the notes to financial statements the conditions with which the entity is required to comply. A liability may be subject to compliance with numerous conditions. Staff acknowledge stakeholders' concerns that it is unclear how the disclosures could be aggregated to avoid voluminous disclosures and support stakeholders' view that further guidance is needed. Staff, therefore, suggest the Board recommends that the IASB considers developing additional guidance clarifying the aggregation criteria (e.g. identifying similar economic characteristics of the debt conditions) to support entities when preparing the required disclosure in paragraph 76ZA(b)(i).

19 Staff support the proposed disclosure in paragraph 76ZA(b)(ii), which requires entities to disclose their compliance with the conditions at the reporting date. Staff agree with IASB's view that this information would help users of financial statements assess the risk that a liability classified as non-current could become repayable within twelve months.[3]

20 Staff consider that the proposed disclosure in paragraph 76ZA(b)(iii), whether and how the entities expect to meet the conditions after the reporting period, is a logical extension for paragraph 76ZA(ii). Such information would be particularly useful for assessing the risk that a non-current liability that does not comply with the specified conditions at the end of the reporting period would become repayable. Entities would have the opportunity to explain how they made the classification assessment and how they expect to manage the risk in the next twelve months.

21 However, paragraph 76ZA(b)(iii) may result in boilerplate disclosures with limited added value if the non-current debts comply with the specified conditions at the end of the reporting period. Users should already have access to sufficient financial and non-financial information, enabling them to assess the entities' overall liquidity risk (e.g. disclosures about liquidity risks required by IFRS 7 *Financial Instruments: Disclosure*) and forward-looking information (e.g. in management commentary or other market guidance, which covers forward-looking information about risks and financial position). Therefore, staff suggest the Board recommends that the IASB considers amending paragraph 76ZA(iii) as below:

3 Paragraph BC23, ED 316. The Board proposes to require an entity to disclose information about conditions with which it must comply within twelve months after the reporting period and to which its right to defer settlement of a liability is subject. The Board concluded that this information would help users of financial statements understand the nature of the conditions and assess the risk that a liability classified as non-current could become repayable within twelve months.

76ZA…

(iii) whether and how the entity expects to comply with the conditions after the end of the reporting period, if the entity would have not complied with the conditions based on its circumstances at the end of the reporting period.

22 Staff also suggest that the IASB considers the interaction between the proposals in ED 316 and those in PFS project, IFRS 7 and Management Commentary to ensure consistent principles are applied in standard-setting and to avoid repetitive requirements.[4]

23 Staff acknowledge stakeholders' concerns for the potentially high level of judgement required to prepare disclosures required by paragraph 76ZA(b)(iii). However, staff do not consider that IASB should develop further guidance or requirements to specify how an entity assesses whether it would comply with the covenants at a future date, as it would add complexity to the Standard and move further away from the principle-based nature of IFRS Standards. Thus, staff do not recommend suggesting any amendments to ED 316 for this issue.

24 Staff also acknowledge stakeholders' comments that disclosure required by paragraph 76ZA(b)(iii) would involve forward-looking information. Entities could be hesitant to disclose details as they could be commercially sensitive or the information could be challenging for auditors to express an assurance.[5] While commercial sensitivity could affect the disclosure, staff expect entities should be able to provide users with the information they need without disclosing information that may be commercially sensitive.[6] Therefore, staff do not recommend suggesting any amendments to the proposals in ED 316.

25 Some stakeholders also raised concerns that the information required by paragraph 76ZA(b)(iii) may not be readily available and, therefore, would represent an undue burden for some entities.

26 Some staff have highlighted the following for Board consideration. To address the concerns about undue costs, the IASB could develop cost relief for paragraph 76ZA(b)(iii). Staff noted that as part of the Primary Financial Statements (PFS) project, the IASB is evaluating whether to provide cost relief for general disclosure requirements.[7] Staff also noted that, in IFRS 9 *Financial Instruments*, entities are required to consider reasonable and supportable information that is available without undue cost or effort in determining expected credit losses and significant changes in credit risk. Therefore, the IASB could consider developing cost relief similar to PFS and IFRS 9, to improve the feasibility of the proposed disclosure. However, staff have mixed views in respect of this recommendation. Some staff do not expect the cost of implementation of paragraph 76ZA(b)(iii) to be onerous, as entities should have access to

4 For example, paragraph 76ZA(b)(ii) and (iii) in ED 316 may overlap with some already existing requirements. Paragraph 39 of IFRS 7 requires entities to disclose information that enables users to evaluate the nature and extent of liquidity risks arising from financial instruments to which the entity is exposed at the end of the reporting period and how the entities manage the risks.

5 For example, some covenants may include a change in key management personnel (KMP) clause. In this case, the entities would be required to estimate the probability of KMP's retention in assessing its compliance with covenants. Such information could be confidential and difficult to audit due to its subjectivity.

6 Concerns over disclosing commercially sensitive information was also identified in other IASB projects, including the Goodwill and Impairment project. The AASB Board supported the IASB's view in its *Discussion Paper Business Combinations–Disclosures, Goodwill and Impairment* that entities may be able to provide useful information in a way that limits the disclosure of commercially sensitive information and concerns over commercial sensitivity are not a sufficient reason to prevent disclosure of information that investors need (paragraphs 2.27-2.28). See AASB staff analysis in Agenda paper 4.1, M177 (page 10).

7 The IASB has not made any decision for this topic and will discuss it again at a future meeting. See IASB agenda paper 21D (September 2021) – Principles of aggregation and disaggregation and their application in the primary financial statements and notes.

sufficient information from their existing risk management practice because covenants compliance management should be part of the embedded in the planning process.

27 **Recommendation**: staff recommend that the comment letter to IASB should:

(a) **agree** with the proposed clarification that covenants, with which an entity must comply within twelve months after the reporting date, 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;

(b) **agree** with the proposal to disclose in the notes the conditions (paragraph 76ZA(b)(i)) and **suggest** that the IASB develops a guide, for example, aggregation criteria to identify similar economic characteristics for specified conditions, to support entities when preparing the disclosure required in paragraph 76ZA(b)(i);

(c) **agree** with the requirements proposed in paragraph 76ZA(b)(ii) which requires entities to disclose whether the entity would have complied with the conditions based on its circumstances at the end of the reporting period;

(d) **agree with** the requirements proposed in paragraph 76ZA(b)(iii), which requires entities to disclose whether the entity expects and how it expects to comply with the conditions after the end of the reporting period, but

(i) **suggest** that this disclosure is required only if the entity would have not complied with the specified conditions based on its circumstances at the end of the reporting period;

(ii) **suggest** that the IASB considers the interaction between the proposals in ED 316 with the PFS project, IFRS 7 and Management Commentary to ensure consistent principles are applied in standard-setting and avoid duplicative requirements; and

(iii) **suggest** that, if the IASB progress with the proposal, the IASB should consider whether developing cost relief for the proposed disclosure requirements in paragraph 76ZA(b)(iii) is necessary.[8]

Question 1 for Board members:
Do Board members agree with the staff analysis and staff recommendation in paragraphs 27(a)-(d)? If not, how do Board members wish to respond to Question 1 of the ED?

Question 2—Presentation (paragraph 76ZA(a))
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. Paragraphs BC21–BC22 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, do you agree with either alternative considered by the Board (see paragraph BC22)? Please explain what you suggest instead and why.

8 Staff have mixed views on the suggestion for IASB to develop cost relief for the proposed disclosure requirements in paragraph 76ZA(b)(iii). See discussion in paragraph 26.

Related proposals in ED 316

In relation to Question 2, ED316 proposed the following amendments to AASB 101:

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

(a) 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.

…

Summary of stakeholder feedback

28 Stakeholders had mixed views on the proposal in relation to the proposal in paragraph 76ZA(a). Stakeholders who agreed with the proposals considered the cost of implementation would not be significant. One stakeholder [preparer] indicated they have the required information readily available.[9]

29 Four stakeholders [auditor, preparer and professional bodies] considered the proposed separate presentation unnecessary. IAS 1 already requires disaggregation in the statement of financial position when it is relevant to an understanding of an entity's financial position.[10] Three stakeholders [auditors and professional bodies] commented that paragraph 76ZA(a) appears to be too prescriptive, which does not necessarily align with the principle-based accounting standards that IASB has pursued in other recent projects (e.g. PFS). Four stakeholders [auditors and a preparer] prefers to disclose information on liabilities with covenants in the notes to financial statements rather than on the face of the financial statements.

30 Another stakeholder [auditor] who disagreed with the proposals commented that accounting standards should not create a rule where one type of contingency is highlighted in the statement of financial position while ignoring others. Contingency is a feature of all balance sheet items, for example, the amount and timing of a receivable might be contingent on the debtor refinancing its arrangements, classification of an item of PPE might be contingent on mechanic's findings during the next overhaul, or the carrying amount and classification of exploration and evaluation (E&E) assets are contingent on the explorer finding economically viable deposits.

Staff analysis and recommendations

31 Paragraphs AV3-AV4 of the ED outline the IASB members' alternative view that does not support the proposals in paragraph 76ZA(a) due to concerns that this proposal contradicts the principle-based nature of IFRS Standards. Moreover, as also identified by some Australian stakeholders, the current principles for disaggregation in IAS 1 and the expected improved principles for disaggregation proposed in the PFS project should be an overarching principle applied across IFRS Standards, and govern disaggregation in all financial statements.

32 Consistent with the IASB members alternative view and Australian stakeholders' concerns outlined in paragraph 29 above, staff do not support the proposals in paragraph 76ZA(a). Staff suggest that the Board recommends the IASB requires entities to disclose the amount of liabilities subject to covenants, if material, in the notes to financial statements.

9 One public sector stakeholder commented they have no debts subject to covenants.

10 Paragraph 55 of IAS 1 requires that an entity shall present additional line items (including disaggregating financial liabilities), headings and subtotals in the statement of financial position when such presentation is relevant to understanding the entity's financial position.

33 **Recommendation**: staff recommend the IASB comment letter should:

(a) **disagree** with the proposals to require an entity to present separately, in its statement of financial position, non-current liabilities that are subject to compliance with specified conditions within twelve months after the reporting period; and

(b) **suggest** that the IASB requires entities to disclose that information, if material, in the notes to financial statements.

Question 2 for Board members:
Do Board members agree with the staff analysis and proposed response in paragraphs 33 (a) – (b)? If not, how do Board members wish to respond to the question?

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.

Related proposals in ED 316

In relation to Question 3, ED316 proposed the following amendments to AASB 101:

<u>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:</u>

<u>(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</u>

<u>(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.</u>

Transition and effective date ...

139U Classification *of Liabilities as Current or Non-current*, issued in January 2020 amended paragraphs 69, 73, 74 and 76 and added paragraphs 72A, 75A, 76A and 76B. An entity shall apply those amendments for annual reporting periods beginning

Related proposals in ED 316

on or after [date to be decided after exposure, but no earlier than 1 January 2024] ~~1 January 2023~~ retrospectively in accordance with IAS 8. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

139V Non-*current Liabilities with Covenants*, issued in [Month, Year], amended paragraphs 71 and 72A and added paragraphs 72B–72C and 76ZA. An entity shall apply those amendments for annual reporting periods beginning on or after [date to be decided after exposure, but no earlier than 1 January 2024] retrospectively in accordance with IAS 8. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

Summary of stakeholder feedback

34 Stakeholders generally supported the proposal in paragraph 72C to clarify circumstances relating to deferring liability settlement. Seven stakeholders [auditors and professional bodies] commented that the proposed wording is too ambiguous and requested further clarification. In particular, five stakeholders [auditors] commented that the proposed requirements in paragraph 72C(b) is unclear and could be difficult to apply in practice.[11] Further clarification would be helpful.

35 Stakeholders expressed mixed views about the proposal's retrospective application of the amendments. Two stakeholders [auditor and regulator] were concerned that the cost of retrospective application would likely outweigh its benefit. Two stakeholders [preparers] commented that the key challenge for retrospective application is that decisions made at a later date for the classification of liabilities for the comparative periods may not faithfully reflect how the liability would have been classified at the end of comparative periods, as decision-makers may apply judgements differently due to hindsight.

36 All stakeholders who participated in the outreach agreed with the proposals in paragraph 139U about deferring the effective date of the amendments to IAS 1 (AASB 101).

Staff analysis and recommendations

Clarification for circumstances in which the entity does not have a right to defer settlement (paragraph 72C).

37 Staff appreciate the IASB's effort to clarify circumstances in which an entity does not have a right to defer settlement of a liability at least twelve months after the reporting period as reflected in paragraph 69(d) of IAS 1 (i.e. an entity can only classify liabilities as current if it has the right at the reporting date to defer the settlement more than twelve months after the reporting period). However, staff do not consider the proposals in paragraph 72C effectively achieve its intention.

38 Paragraph 72C(a) proposes that an entity does not have the right to defer settlement of the liability for at least twelve months when the liability could become repayable within twelve months at the **discretion** of the counterparty or a third party [emphasis added]. Staff noted that the previous IASB Exposure Draft ED/2015/1 *Classification of Liabilities* (ED/2015/1)

11 For example, some borrowing agreements may include market capitalisation clauses. Compliance with such conditions requires the entities' market capitalisation to be above a certain level. Market capitalisation may be beyond the entity's control but can be affected by entities future actions. It can be challenging to determine the extent to which market capitalisation is affected by entity's future actions and further determine whether paragraph 72C(b) applies.

proposed to replace 'discretion' with 'right' in paragraph 72R[12] to avoid potential confusion caused by 'discretion', and to align the wording with paragraph 69(d) related to having the right to defer settlement.[13] Staff suggest that the IASB adopts consistent wording (i.e. use 'right' instead of 'discretion' in paragraph 72C(a)) throughout the Standard for improved clarity.

39 In regard to the proposals in paragraph 72C(b), staff acknowledge that the proposed wording could be further improved for better clarity. In paragraph BC20[14], the IASB has provided further clarification explaining that paragraph 72C(b) excludes situations in which an entity can affect the occurrence (or non-occurrence) of future events or outcomes, even if their occurrence is beyond the entity's control. Staff consider that this clarification would be useful to assist entities with their classification decisions. Considering that BCs may be overlooked by entities, staff, therefore, suggest that the IASB includes paragraph BC20 in the body of the Standard and considers amending paragraph 72C(b) as below:

> 72C(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. <u>This excludes situations in which an entity can affect the occurrence (or non-occurrence) of future events or outcomes, even if their occurrence is beyond the entity's control. For example, an entity that must comply with a condition based on its future revenues can affect, but not control, whether the required outcome is achieved.</u>

Staff also suggest the IASB consider developing additional application guidance that assists entities in applying paragraph 72C(b).

Transitional requirements (paragraph 139V)

40 Staff do not agree with the proposals in paragraph 139V to require the retrospective application of the amendments. In its comment letter (paragraphs 13-15) to the IASB on the Exposure Draft ED/2015/1 *Classification of Liabilities*, AASB disagreed with the proposed transitional requirement for retrospective application of the amendments.

41 In its 2015 comment letter, the Board considered the proposed amendments should be applied prospectively because, in determining the classification of a liability, an entity needs to understand the terms and conditions at that point in time. However, the retrospective

12 ED/2015/1 proposes to amend paragraph 72 to:
"72R <u>The following are examples of circumstances that create a right to defer settlement that exists at the end of the reporting period and, thus, affect the classification of the liability in accordance with paragraph 69(d).</u>
(a) If an entity ~~expects, and~~ has the ~~**discretion,**~~ <u>**right**</u> to ~~refinance or~~ roll over an obligation for at least twelve months after the reporting period under and existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due with a shorter period. ~~However, when refinancing or rolling~~ <u>When the entity does not have the **right** to roll</u> over the obligation ~~is not at the **discretion** of the entity, (~~<u>because,</u> for example, there is no arrangement ~~for refinancing~~ <u>in place at the end of the reporting period for rolling over the obligation</u>~~)~~, the entity does not consider the potential to refinance to obligation and classifies the obligation as current…." [**emphasise added**]

13 Paragraph BC3 of IASB ED/2015/1. The Board concluded that the word 'discretion' in paragraph 73 could be confusing and compared this with the use of 'right' in paragraph 69(d). Accordingly, the IASB proposed replacing in 'discretion' in paragraph 73 of IAS 1 with 'right' to align the requirements of paragraphs 69(9) and 73 of the Standard. [see proposed amendments to paragraph 72R in footnote 12 above]

14 Paragraph BC20 of ED316 states that the IASB Board "intends the clarification set out in paragraph BC18(b) to exclude situations in which an entity can affect the occurrence (or non-occurrence) of future events or outcomes, even if their occurrence is beyond the entity's control. For example, an entity that must comply with a condition based on its future revenues can affect, but not control, whether the required outcome is achieved."

application would require an entity to use hindsight, which is a concern also expressed by a stakeholder during the outreach (paragraph 35 above). Also, in the previous comment letter, the Board expressed a view that if a change in classification is required, prospective application of the amendments would highlight the implications of the changes.

42 Staff support the AASB's view in its 2015 comment letter. Staff recommend the Board to retain this view and encourage the IASB to amend the proposed transition requirement to require prospective application.

Deferral of the 2020 amendments effective date (paragraph 139U)

43 Consistent with stakeholders' feedback summarised in paragraph 36 above, staff support the proposals in paragraph 139U to defer the effective date of the 2020 amendments to IAS 1 to annual reporting periods beginning on or after a date to be decided after exposure, but no earlier than 1 January 2024. Proposals in ED 316 would amend some of the requirements introduced by the 2020 amendments. Deferring the effective date would avoid an entity potentially needing to change its assessment of the classification of liabilities twice within a relatively short period.

44 **Recommendation**: staff recommend the Board submission should:

(a) **suggest** that the IASB replaces 'discretion' paragraph 72C(a) with 'right' (and reword the proposed paragraph accordingly) to maintain consistency with paragraphs 69(d) and to improve clarity;

(b) **suggest** the IASB considers including paragraph BC20 of ED 316 in paragraph 72C(b) to improve clarity, and **suggest** the IASB considers developing additional application guidance on how to apply paragraph 72C(b); and

(c) **disagree** with the proposal to require an entity to apply the amendments retrospectively in accordance with IAS 8, with earlier application permitted; and **suggest** that the IASB amends the proposed transition requirements to require prospective application, and revises the explanation in the Basis for Conclusions addressing the transitional requirements; and

(d) **agree** with the proposal to 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.

Question 3 for Board members:

Do Board members agree with the staff analysis and proposed response to Question 3 in paragraph 44(a) - (d)? If not, how do Board members wish to respond to the question?

NEXT STEPS

45 The comment period to IASB ED/2021/9 closes on 21 March 2022. As there is no further AASB meeting before the comment period close date, staff suggest that the comment letter, which will reflect the Board's discussion at this meeting, is finalised out-of-session via the subcommittee of the Board.

46 If the Board agrees with the staff's recommendations above, staff suggest the following timeline:

Task	Timing
Staff to draft submission letter to the IASB and distribute to the subcommittee	By 2 March 2022
The subcommittee reviews the comment letter and provides comments	By 9 March 2022
Staff to address the comments and circulate the amended draft submission back to the subcommittee	By 11 March 2022
The subcommittee approves the final submission letter	By 16 March 2022
AASB staff submit a final submission to the IASB	By 21 March 2022

Questions to Board members:

Question 4: Do Board members wish to finalise the comment letter to the IASB out-of-session via the subcommittee?

(a) If yes, which Board member(s) would like to be on the subcommittee?

(b) If not, do Board members wish to finalise the comment letter out--of--session via the Chair?

Question 5: Do Board members agree with the suggested next steps and timeline? If not, what do Board members suggest?