asian-oceanian standard-setters group

21 March 2022

Dr. Andreas Barckow
Chair
International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London, E14 4HD
United Kingdom

Dear Dr. Barckow,

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the International Accounting Standards Board's ('the IASB's') Exposure Draft (ED) *Non-current Liabilities with Covenants (Proposed amendments to IAS 1)*. In formulating these comments, the views of the constituents within each jurisdiction were sought and considered.

The AOSSG currently has 27 member standard-setters from the Asian-Oceanian region: Australia, Bangladesh, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Syria, Thailand, Uzbekistan and Vietnam. To the extent feasible, this submission to the IASB reflects in broad terms the collective views of AOSSG members. The intention of the AOSSG is to enhance the input to the IASB from the Asia-Oceania region and not to prevent the IASB from receiving the variety of views that individual member standard-setters may hold. This submission has been circulated to all AOSSG members for their comment. In responding to the ED, AOSSG members have provided their responses to the questions in the ED as described in Appendix of this submission.

Almost all AOSSG members agree with the proposed clarification in the ED 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. However, many members are concerned with the proposed disclosure requirements (paragraph 72ZA(b)). They believe that the addition to the disclosure requirements in IAS 1 should be made in the interaction with other IFRSs and in harmony with the ongoing IASB's Disclosure Initiative. Also, they mention the implementation issue of applying the proposal and the quality of disclosure, as liabilities may contain numerous clauses. One member insists that principle of the ED for the classification of liabilities (paragraph 72B) is not clear, especially the meaning of "conditions".

Most AOSSG members do not agree with the proposal of separate presentation in the ED. They believe that the proposal of separate presentation is against the principal-based approach in IFRS.

As for the clarification for circumstances in which the entity does not have a right to defer settlement (paragraph 72C), all AOSSG members are concerned in that it causes a necessity of other interpretation and application issues in practice.

AOSSG highly appreciates the IASB's significant efforts in addressing disclosure problems. If you have any questions regarding this submission, please contact either one of us.

Yours sincerely,

Nishan Fernando

Chair of the AOSSG

Eui-Hyung Kim

Leader of the AOSSG Presentation and Disclosure Working Group

Appendix – Comments from AOSSG members

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.

[Australia][1]

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

AASB supports the proposed clarification in the ED 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.

This clarification would address many stakeholders' concerns about the *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)* and the IFRS IC's tentative agenda decision, and it would provide more faithful representation when the lender has no

1 AASB staff undertook various outreach activities on the proposals in ED/2021/9. These include discussions with the AASB's Disclosure Initiative Project Advisory Panel, and targeted consultation with preparers, auditors and professional bodies. The feedback has been summarised below.

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)

The AASB generally supports the intention to enhance disclosures about covenants and the proposals in paragraph 76ZA(b). However, due to concerns about the feasibility of the proposed disclosure requirements in 76ZA(b)(i) and 76ZA(b)(iii), the AASB suggests that the IASB:

(a) considers the interaction between the proposals in the ED and those in the Primary Financial Statements project, IFRS 7 *Financial* Instruments*: Disclosures* and Management Commentary to ensure consistent principles are applied in standard-setting and to avoid repetitive requirements;[2]

(b) develops 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).

The AASB is concerned that the proposed disclosure requirements in paragraph 76ZA(b)(i) could be challenging to implement as a liability may be subject to compliance with numerous conditions. It is unclear in the ED how the disclosures could be aggregated to avoid voluminous disclosures. Therefore, further guidance is needed;

(c) requires the proposed disclosure in paragraph 76ZA(b)(iii), only if the entity did not comply with the specified conditions based on its circumstances at the end of the reporting period.

The AASB considers that the proposed disclosure in paragraph 76ZA(b)(iii) is a logical extension of 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. However, paragraph 76ZA(b)(iii) may result in boilerplate disclosures with limited added value if the entity complies 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) and forward-looking information (e.g. information in management commentary or other market guidance, which covers forward-looking information about risks and financial position). Therefore, the AASB suggests that the IASB considers amending paragraph 76ZA(iii) as below:

76ZA…

(iii) whether and how the entity expects to comply with the conditions after the end of the reporting period <u>if the entity would not have complied with</u>

2 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.

<u>the conditions based on its circumstances at the end of the reporting period</u>;

(d) considers whether the proposed disclosure requirement in paragraph 76ZA(b)(iii) should be subject to an "undue cost" proviso to improve the feasibility of the proposed disclosure. The AASB is concerned that information required by paragraph 76ZA(b)(iii) may not be readily available and may represent an undue burden for some entities.

[China]

We agree with the Board's proposal of the classification and disclosure requirements.

[Hong Kong]

Classification (paragraphs 72B and 72C)

The HKICPA supports the IASB's effort in addressing the concerns raised by stakeholders about the outcomes and potential consequences of the 2020 amendments and the related agenda decision published by the IFRS Interpretations Committee in December 2020.

Having said that, we consider that the ED does not provide a clear principle for the classification of liabilities that are subject to specified conditions within twelve months after the end of the reporting period, and has inadvertently created the following issues with the introduction of paragraphs 72B and 72C of the ED.

<u>The notion of "unaffected by the entity's future actions"</u>

We have significant concerns over the notion of "unaffected by the entity's future actions" in paragraph 72C(b) of the ED. This is a new concept in the context of IFRS Standards, yet the ED only provides limited guidance in paragraphs BC19 and 20 on how to apply this new concept. We consider that the ED is unclear as to how an entity assesses the nature and extent of an entity's "ability to affect", and this may lead to a risk of wide interpretation.

In addition, some respondents questioned the meaning of "conditions" in paragraph 72B when determining the scope of paragraph 72B. Specifically, questions were raised as to whether the following common covenants are considered to be "conditions" or events "unaffected by the entity's future actions", and whether paragraphs 72B or 72C of the ED should be applied in these cases.

(a) Loan repayment subject to "completion of IPO" or "a change of control";
(b) Liability that is repayable when, for example,
    i. the entity fails to meet certain project milestones;
    ii. the entity's credit rating deteriorates to a certain level; or
    iii. the entity fails to identify the existence of mineral reserves;
(c) Financial covenants based on the fair value of collateral;
(d) A very ambitious target, for example, increasing revenue by ten times over the last year;

and

(e) Liability with multiple conditions, for example, having both a financial covenant and a “material adverse change in borrower’s operation" clause.

We and our respondents noted that paragraphs 72B and 72C of the ED are not necessarily mutually exclusive. This is problematic as they would lead to different classification outcomes.

For example, a loan is contractually repayable in five years, but it is repayable on demand if there is a change in control of the entity at any time.

(a) It is arguable that paragraph 72C(b) of the ED is not applicable to such a loan because the entity’s future actions may to a greater or lesser extent “affect” whether the controlling shareholder disposes all or some of its equity interest in the entity resulting in a loss of control.
(b) If one takes the view that retaining the same controlling shareholder is at the discretion of the controlling shareholder, then such a loan would be classified as current applying paragraph 72C(a) of the ED.
(c) If, in contrast, one takes the view that retaining the same controlling shareholder is a “condition” that must be complied with to allow the entity to defer the settlement of the loan for at least twelve months after the reporting period, then as long as there is no change of control at the reporting date, such loan would be classified as non-current applying paragraph 72B(b) of the ED.

As seen from the above example, applying paragraph 72C(a) or 72C(b) (if a change of control is considered to be an event “unaffected by the entity’s future actions”) of the ED, a long-term loan that is repayable on demand upon a change of control would be classified as current even when there is no actual breach at the reporting date. This outcome seems to contradict the ED’s objective that only an actual breach of covenants at the reporting date would lead to a current classification.

In addition, some respondents shared that under the existing requirements in IAS 1 Presentation of Financial Statements, entities usually apply paragraph 74 of IAS 1 to a long-term loan that is repayable on demand upon change of control and classify such loan as non-current when there is no change of control (i.e. no actual breach). If the IASB were to proceed with the proposals, there would be a significant change to the current practice.

Another common scenario is that a long-term loan is repayable on demand if the current ratio is below a certain threshold or if there is a material adverse change in the entity’s operation (i.e. with multiple conditions).

(a) Applying paragraph 72B(b) of the ED, such loan would be classified as non-current if the entity complies with both conditions at the reporting date.
(b) If one takes the view that a material adverse change in the entity’s operation is unaffected by the entity’s future actions, such loan would be classified as current applying paragraph 72C(b) of the ED.

As noted from this example, applying paragraph 72B and 72C separately to loans with multiple conditions could lead to opposite answers – which classification outcome prevails in this case?

In light of the above, the HKICPA strongly recommends that the IASB:

(a) Test the proposals with real-life examples (with reference to the examples in paragraph 4 above) and assess whether the resulting outcomes from the proposals are line with what the IASB intends to achieve and the ED's objectives;
(b) Clarify the notion of "unaffected by the entity's future actions" in paragraph 72C(b) and the term "conditions" in paragraph 72B;
(c) Clarify the interaction between paragraphs 72B and 72C of the ED; and
(d) Clarify how the proposals in the ED should be applied to the examples in paragraphs 4, 6 and 9 above.

<u>Examples in paragraph 72C(b)</u>

Paragraph 72C(b) of the ED specifies that financial guarantees and insurance contract liabilities are examples that would fall within the scope of this paragraph. This may imply that all financial guarantee contracts and insurance contract liabilities would be entirely classified as current liabilities applying the proposals, which may lead to unintended consequences.

We disagree with classifying the entire insurance contract liabilities as current liabilities for the following reasons:

(a) An insurance contract usually has a long policy period, especially a life insurance contract, and its liability is determined as the present value of expected future cash flows (among others). Classifying the insurance liability as current would presume that all uncertain future events (e.g. claims) would happen within twelve months after the reporting period. This does not reflect the business substance of the insurance contracts and does not provide relevant information to users of financial statements.
(b) A long-term insurance contract often has a surrender clause stipulating that a cash surrender value will be paid to the policyholder upon voluntary termination or occurrence of an insured event. Given the nature of long-term insurance and the existence of a surrender penalty, policyholders would normally suffer losses if they surrender an existing life insurance policy, particularly during the early years of the policy. In other words, only a small portion of the surrender value inherent in the insurance contract liability is expected to be settled within twelve months after the reporting period. Under these circumstances, classifying the whole insurance contract liability (the measurement of which might assume the repayment of a much higher surrender value beyond twelve months) as current might result in a net current liability position for the insurer (if it chooses to present the current/non-current distinction on the statement of financial position), which would not be a true and fair presentation of the financial position of the insurance companies.
(c) According to paragraph 32 of IFRS 17 *Insurance Contracts*, an insurance company measures a group of insurance contracts at the total of two components: a) the present value of fulfilment cash flows (FCF), and b) the contractual service margin (CSM). It is unclear whether paragraph 72C(b) of the ED should be applied to the insurance contract liability as a whole, or to the different components separately, given FCF is associated with cash flows whereas CSM has a similar nature to deferred profit. Hence, classifying

the entire CSM component as a current liability for an insurance contract with a coverage period of more than one year would be misleading.

(d) Insurance companies normally invest in non-current assets so as to match with the liquidity profile of their liabilities. Classifying the whole insurance contract liability as current could be misleading.

(e) Paragraph 72C(b) of the ED implies that entities classify the entire insurance contract liabilities as current liabilities based on the worst case scenario. This is, however, inconsistent with the liquidity disclosure for insurance contract liabilities under paragraph 132(b) of IFRS 17 which is based on the estimated timing of future cash flows.

We also do not agree that financial guarantee contracts should be classified as current liabilities in all circumstances. For example, the reporting entity is a guarantor and a related party or business partner of the borrower. It is possible that such special relationships may allow the guarantor to affect whether the borrower could settle its loans on time, e.g. through the reporting entity's advancing money to the borrower, other forms of prepayments or business activities.

Given the above, the HKICPA recommends that the IASB consider seeking feedback from the insurance industry regarding the classification of insurance contract liabilities and the interaction between the proposal and IFRS 17, and re-consider whether classifying all financial guarantee contracts and insurance contract liabilities as current liabilities, as implied by paragraph 72C(b) of the ED, is appropriate. One respondent suggested that IASB may consider introducing an exception by classifying insurance contract liabilities on the same basis as the liquidity disclosure requirements under paragraph 132(b) of IFRS 17.

<u>Interaction between paragraph 72B(a) of the ED and paragraphs 74 and 75 of IAS 1</u>

Some respondents raised concerns over the interaction between paragraph 72B(a) of the ED and paragraphs 74 and 75 of IAS 1. For example, an entity enters into a five-year loan with a specific condition to be complied with quarterly. The entity breaches the condition on 31 March 20X1 and obtains a waiver for twelve months till 31 March 20X2. The entity complies with the condition at its reporting date (31 December 20X1).

Applying paragraph 72B(a) of the ED, the entity would classify the loan as non-current given the condition is met at the reporting date. However, applying paragraphs 74 and 75 of IAS 1, the grace period provided by the lender is not more than twelve months after the reporting period, and hence the entity would classify such loan as current.

Given the above, the HKICPA suggests that the IASB clarify the relationship between paragraph 72B of the ED and paragraphs 74 and 75 of IAS 1, and which paragraph should be applied to the scenario provided in paragraph 16 above.

<u>Meaning of "substance" in paragraph 72A</u>

Paragraph 72A of IAS 1 introduces a notion that the right to defer settlement of a liability "must have substance". A few respondents considered that there is no guidance on the meaning of "substance" in IAS 1 which may lead to a risk of different interpretation. We note that the concept of "substance" is not new in the context of IFRS Standards and several standards (e.g. IAS 32 Financial Instruments: Presentation and HKFRS 16 Leases) contain explicit requirements to take account of the substance of an entity's rights and obligations. However, to enhance consistent application of the proposals, we suggest that the IASB:

(a) explain what is meant by a right that has or does not have substance in the context of current/non-current classification of a liability, e.g. whether it should be viewed from a legal perspective; and
(b) clarify whether the condition of "a change of control" would be considered to have substance.

"Affect" in IAS 1 vs "control" in IAS 32

A few respondents questioned the differences between the requirements for the current/non-current classification of a liability in IAS 1 and the equity/liability classification in paragraph 25 of IAS 32 as both requirements relate to potential cash outflows. In IAS 32, a change in control triggers a financial liability classification when the entity cannot avoid the occurrence of such event (i.e. the worst case scenario), but then this liability would be classified as non-current if the entity can avoid that event occurring in the coming twelve months applying the proposal (i.e. not the worst case scenario). These respondents noted that paragraph BC20 of the ED states that the meaning of "affect" in paragraph 72C(b) of the ED is not the same as "control" in paragraph 25 of IAS 32, but does not explain why they should be different.

In light of the above, we suggest the IASB explain clearly the reasons for the differences between the requirements in the proposal and IAS 32, as well as how they are different in the Basis for Conclusions. We also suggest that the IASB clarify whether the liquidity disclosure for financial liabilities under IFRS 7 Financial Instruments: Disclosures should follow the "not within the entity's control" principle or the "affect" principle in the proposal.

Disclosures (paragraph 76ZA(b))

Many respondents raised the following concerns with respect to the proposed disclosure on future compliance with covenants in paragraph 76ZA(b)(iii) of the ED:

(a) The proposed disclosure may not be useful to users of financial statements because a definitive "yes/no" description of whether the covenants would be met after the reporting period could be misleading.
(b) The proposed disclosure involves forward-looking information which would likely increase the costs for preparers to prepare, and the practical difficulties for auditors to audit, such information.
(c) A respondent is also concerned about the legal implication arising from the proposed disclosure. For example, whether it would trigger any legal obligation of an entity if the final outcome is different from that disclosed in the financial statements (e.g. the entity discloses in the financial statements that management expects to comply with the covenants after the reporting period but it fails to fulfil the condition subsequent to the reporting period).

(d) An investor appreciated the intention of the proposed disclosure but considered that the assessment of whether an entity expects to comply with the conditions after the end of the reporting period is highly subjective and hence, the disclosure may not be useful to users. This respondent also considered that whether an entity expects to comply with covenants in the future might affect the entity's going-concern and in the case of a listed entity, its share price. Therefore, the relevant disclosure should be set and enforced by regulators, instead of the IASB.

On the other hand, a minority of the respondents supported the proposed disclosure. They disagreed with the arguments in paragraph AV5 of the ED for the reason that recent IFRS Standards also require the incorporation of forward-looking information to measurement, e.g. expected credit loss in IFRS 9 Financial Instruments. A respondent further considered that the argument in paragraph AV5 that users of financial statements should be capable of assessing the risk that a condition may be breached based on the proposed disclosures supported by an analysis of financial reports along with additional economic information would not work for certain non-financial covenants, e.g. reaching milestones for developing a generic drug.

The HKICPA acknowledges the concerns raised by our respondents in paragraph 22 above, in particular, the costs and benefits considerations and the potential legal implication of pursuing the proposal. In light of this, we recommend the IASB replace the proposed disclosure in paragraph 76ZA(b)(iii) of the ED with the disclosures of key factors which may affect the ability of an entity in complying with the conditions after the reporting date. We consider these suggested disclosures would be objective and provide more useful information for users of financial statements to make their own decisions.

In addition, we recommend the IASB consider improving liquidity disclosures under paragraph B11C-11F of IFRS 7 and defaults and breaches of loan covenants under paragraphs 18-19 of IFRS 7 by requiring additional disclosures of covenants in the absence of a breach and the associated risks. This would improve the interaction between IFRS 7 and IAS 1, and address the concerns stated in paragraph BC21 of the ED.

[Malaysia]

The MASB supports clarifying the manner in which specified conditions are considered at the end of the reporting period. Accordingly, the MASB supports the addition of paragraph 72B.

The MASB considers that, it is necessary to make clear that specified conditions with which an entity must comply within twelve months after the reporting period have no effect on assessing 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.

However, the MASB is not supportive of the disclosure requirements proposed in paragraph 76ZA(b) for the following reasons.

(a) The MASB supports a broad-ranging and principle-based approach to the topic of presentation and disclosure in the financial statements and does not support introducing specific new requirements (outside the IASB's project on Primary Financial Statements and the IASB's Disclosure Initiative) in the absence of an urgent need.

(b) The MASB considers that the existing classification issue at stake can be addressed without the proposed additional disclosures. A broader approach to the disclosures relating to non-current liabilities would, in the MASB's view, involves considering a range of factors beyond the scope of ED/2021/9 and includes the following:

   i. if the existence of "specified conditions" is regarded as a suitable basis for subclassification, a thorough examination should be undertaken to determine what constitutes relevant "specified conditions", which the MASB notes are not explained in the proposals.

   Although the term 'specified conditions' was already included in IAS 1.72A (by virtue of the January 2020 amendments to IAS 1), the proposals would magnify the significance of this term to the application of IAS 1 and the term would warrant greater explanation if the proposals were to proceed.

   ii. whether subclassifications of current or non-current liabilities are needed and the basis for those subclassifications;

   iii. whether additional subclassifications might be needed when entities apply a liquidity presentation basis to the statement of financial position; and

   iv. how any new subclassification requirements might interact with the disclosure requirements for financial instruments that fall within the scope of IFRS 7.

(c) Many liabilities have conditions attached and the MASB is concerned about entities having to determine which conditions are worthy of disclosure and the extent those of disclosures should be. In particular, the MASB is concerned about the potential for information 'clutter' as a result of applying the proposed paragraph 76ZA(b)(i).

(d) Asking entities to disclose whether and how they expect to comply with specified conditions after the end of the reporting period as specified in the proposed paragraph 76AZb(iii) seems to require provision of forward-looking information on future compliance with covenants. Also, this may also be likely to impinge on areas already addressed in Management Commentary. For example, a specified condition might be that borrowing expenses do not exceed a certain percentage of profit, which could involve the entity in explaining its profit projections and how it plans to achieve them.

The MASB considers that more thought needs to be given to the circumstances in which it might be relevant for the IASB to introduce disclosures about meeting conditions attaching to liabilities either as at a current reporting date or a future reporting date.

[Pakistan]

We agree with the Board's views that only those specified conditions with which an entity must comply on or before the reporting date affect the classification of a liability as current or non-current. While conditions with which an entity has to comply after the reporting date do not affect the classification of liability at the reporting date.

However, we have concerns regarding the extent of disclosures required in paragraph 76ZA(b). The proposed disclosures of paragraphs 76ZA(b)(i) and 76ZA(b)(i), requiring information about the conditions with which the entity is required to comply and whether the entity has complied at the year-end with those conditions, are too extensive. In many cases, these extensive disclosures may not provide any useful information to the users of financial statements. Further, such detailed disclosure would involve practical challenges for entities as this information may not be readily available and the cost of preparing proposed disclosure might outweigh the benefits.

We also disagree with the proposed disclosure of 76ZA(b)(iii) requiring entities to provide information that whether and how the entity expects to comply with the conditions after the end of the reporting period. Such disclosure would involve forward-looking information, which besides management judgments and preparation costs can also pose auditing challenges. On this proposed disclosure we agree with the alternative views expressed by the Board members (Mr. Mackenzie and Mr. Scott) in paragraph AV5 of ED.

We suggest that a principle-based approach is followed, outlining the requirement to disclose those covenants only which are at high risk of breach and could materially impact the financial statements.

We also note that IFRS 7 has set out disclosure of liquidity risk. Entities are required to disclose a maturity analysis for financial liabilities (showing the remaining contractual maturities). IFRS 7 disclosure can be enhanced to cover the disclosure of information about the risks of earlier cash outflows owing to a possible breach of debt covenants after the reporting date. This information would enable users of financial statements to evaluate the nature and extent of liquidity risk arising from the probable breach of debt covenants.

[Sri Lanka]

We agree with the proposed amendment since Detail disclosure will enable the end user to be more vigilant about the financial position of the organization. And also it provides more futuristic information by stating its future companies at the year-end in the notes of the Financial Statements.

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.

[Australia]

AASB staff do not support the proposals in paragraph 76ZA(a) for the reasons outlined in paragraphs AV3-AV4 of ED/2021/9. AASB staff suggest that the IASB requires entities to disclose the amount of liabilities subject to covenants, if material, in the notes to financial statements.

[China]

We disagree with the separate presentation proposal. Main reasons are as follow:

Firstly, we agree with the suggestion in BC22 (a). The IFRS standards are principal-based, which already include a requirement to present line items separately when such presentation is relevant to an understanding of an entity's financial position. Therefore, there is no need to highlight the presentation requirements of this kind of non-current liabilities with covenants.

Secondly, non-current liabilities with covenants might be existed in many non-current liabilities items in the statement of financial position. If it is required to present the non-current liabilities with covenants separately, the statement of financial position will be complicated.

Thirdly, the Board has already make requirements on disclosure, we think the disclosure in the notes could satisfy the information needs of investors. Therefore there is no need to present such non-current liabilities separately in the statement of financial position.

[Hong Kong]

We disagree with the proposed separate presentation requirement in paragraph 76ZA(a) of the ED. Instead, we agree with the Alternative Views in paragraphs AV3 and AV4 of the ED that the disaggregation requirements in paragraph 55 of IAS 1 already set out the principles for presenting additional line items in the statement of financial position when it is relevant to an understanding of an entity's financial position. The proposed separate presentation seems to contradict the principle-based nature of IFRS Standards.

We support identifying non-current liabilities for which the entity's right to defer settlement for at least twelve months after the reporting period subject to compliance with specified conditions within twelve months after the reporting period through disclosures in the notes to the financial statements. We also consider that providing the proposed disclosures in paragraph 76ZA(b)(i) and (ii) of the ED, together with our recommendations in paragraphs 24 and 25 above, would be sufficient for users to identify and assess the risk of those liabilities. Hence, we suggest that the IASB remove the separate presentation requirements in paragraph 76ZA(a) of the ED.

[Malaysia]

The MASB is not supportive of the presentation requirement proposed in paragraph 76ZA(a). Nor is the MASB supportive of the alternative identified in paragraph BC22 of specifically requiring separate presentation only for liabilities with conditions with which an entity would not have complied based on its circumstances at the reporting date.

As noted in our response to Question 1, the MASB supports a broad-ranging and principle-based approach to the topic of presentation and disclosure in the financial statements and does not support introducing specific new requirements in the absence of an urgent need.

The MASB considers that the existing classification issue at stake can be addressed without the proposed additional presentation requirement

[Pakistan]

Paragraph 76ZA(a) of ED proposes the separate presentation of (in entity's 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.

We do not support the requirement of paragraph 76ZA(a), and we agree with the Board's alternative view of not requiring separate presentation of those liabilities in the statement of financial position, as mentioned in paragraph BC22(a) of ED (In this context, we support the views of Board members discussed in paragraphs AV3 and AV4 of ED).

Users of financial statements might construe the separate presentation as a matter of concern when in fact they might not be. It would be difficult for preparers of financial statements to comply with the proposed approach of mandating such presentation.

The principle-based approach of providing relevant and useful disclosures and information in consideration of specific needs of entity's financial statements users is the preferred approach.

[Sri Lanka]

We agree with the proposed amendment since separate presentation will highlight the information that needs to be raise special attention towards the end users of Financial Statements. In addition to that, it could create the alertness by presenting it in the face of the financial statements.

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.

[Australia]

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

AASB staff appreciate the IASB's effort but 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. However, AASB staff are concerned that the proposals in paragraph 72C may not effectively achieve its intention, because the proposed wording may introduce interpretation and application diversity in practice.[3] AASB staff have the following suggestions:

(a) For paragraph 72C(a), AASB staff suggest that the IASB adopts consistent wording (i.e. use 'right' instead of 'discretion' in paragraph 72C(a)) with the *Exposure Draft ED/2015/1 Classification of Liabilities* and throughout the IAS 1 for improved clarity.

(b) For paragraph 72C(b), AASB staff consider that the clarification in paragraph BC20 would be useful to assist entities with their classification decisions. Considering that BCs may be overlooked by entities, AASB staff 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. 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.

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

***Transitional requirements* (paragraph 139V)**

AASB staff do not agree with the proposals in paragraph 139V to require the retrospective application of the amendments. AASB staff supports the AASB's view in its comment letter (paragraphs 13-15) to the IASB on the ED/2015/1 and suggest the IASB to amend the proposed transition requirement to require prospective application and revise the explanation in the Basis for Conclusions addressing the transitional requirements.

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

AASB 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 the ED would amend some of the requirements introduced by the 2020 amendments. Deferring the effective date would

3 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.

avoid an entity potentially needing to change its assessment of the classification of liabilities twice within a relatively short period.

[China]

We agree with (b) and (c) in this question.

We have concerns on (a). In paragraph 72C (b), it states that '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.' Firstly, it might be difficult to estimate whether the entity's future action could have an effect on the liability in practice. Secondly, the examples listed here, i.e. financial guarantee or insurance contract liability, would cause confusion, because financial and insurance companies will not classify liabilities as current or non-current. Besides, if 72C (b) sets out these two examples, insurance companies might classify most of the liabilities as current, which is not in line with the business substance. Based on the reasons above, we suggest the Board revise the wording or description in this sentence and remove the examples of 'financial guarantee and insurance contract liability'.

[Hong Kong]

Transition and effective date

The HKICPA has no major comments on the retrospective application and the deferral of the effective date of the amendments to IAS 1.

[Malaysia]

The MASB would prefer that the IASB not proceed with the proposed paragraph 72C for the following reasons.

(a) The proposal appears to presume there is a 'bright line' between cases when a loan is callable by the lender or third party and when it is not. However, in practice, the extent to which this is the case depends on a range of factors that might affect the commercial substance of a lender's or third party's rights to call-in a loan.

(b) The meaning of "unaffected by the entity's future actions" is not clear in the context of liabilities generally. The examples provided in proposed paragraph 72C(b) [financial guarantees and insurance contracts] presumably relate to a counterparty's creditworthiness and a policyholder having a valid insurance claim – both of which are beyond the entity's control.

However, in the context of a borrowing, it is unclear what types of factors would be identified as being beyond the entity's control. For example, there might be cases when an entity's profitability, revenues, or interest expense are among the factors affecting conditions attaching to the continuation of a loan. It seems equally plausible, depending on the circumstances, to consider that these factors would be unaffected by the entity's future actions; or, alternatively, that they could be affected by the entity's future actions.

(c) The MASB considers that proposed paragraph 72C is not needed to address the current issue. The notion that the accounting (including presentation) for an asset or liability would be based on whether it is "unaffected by the entity's future actions" seems to be a potentially broadly applicable benchmark.

Before introducing new presentation notion/concept to the IFRS Standards, the MASB encourages the IASB to give this matter greater thought in a wider context.

However, in the event that the IASB decides to retain a paragraph along the lines of proposed paragraph 72C, the MASB strongly believes further improvements are required.

(a) In relation to identifying cases when a loan is callable by the lender or third party and when it is not [proposed paragraph 72C(a)], a paragraph similar to IFRS 17.2 should be considered. This is because in our jurisdiction, there have been various legal cases which have upheld that, in the absence of a default being committed by the borrower, the lender is not entitled to exercise its right pursuant to the overriding clause to demand for repayment of the term loan from the borrower at any time due to the repayment tenure.

It is imperative that only terms of a liability contract that have commercial substance are considered and that any terms are assessed in the context of the relevant regulatory and business environment. For example, a paragraph along the following lines might be relevant:

> An entity shall consider the discretions available to the counterparty or a third party to a liability based on the substantive rights and obligations, whether they arise from the contract, a law or regulation. Contractual terms include all terms in a contract, explicit or implied, but an entity shall disregard terms that have no commercial substance (ie no discernible effect on whether the liability would be callable). Implied terms in a contract include those imposed by law or regulation. The practices and processes for establishing contracts with counterparties vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of counterparty or the nature of the liability). There may be, for example, cases in which the terms of a contract have no commercial substance due to the impacts of the legal or commercial environment in which the entity operates.

(b) In relation to explaining the meaning of "unaffected by the entity's future actions" [proposed paragraph 72C(a)], the MASB suggests the IASB might consider specifying cases of when an uncertain future event or outcome occurs (or does not occur) and its occurrence (or non-occurrence), rather than simply providing examples. That might involve only specifying financial guarantees and insurance contract liabilities, and possibly provisions recognised under IAS 37. This would help provide certainty about what is meant until the IASB has the opportunity to (possibly) consider the application of this notion of ‘unaffected by the entity’s future actions’ in a wider context, such as the Primary Financial Statements project or the IASB’s Disclosure Initiative.

Retrospective application

The MASB supports requiring an entity to apply the amendments retrospectively in accordance with IAS 8, with earlier application permitted in the interests of inter-period comparability of financial information.

The MASB considers that it would be worthwhile making it clearer in the Basis for Conclusions that entities do not apply hindsight when preparing the comparative information.

Application in 2024

The MASB supports an application date in 2024.

[Pakistan]

Comments on classification of circumstances in which an entity does not have a right to defer settlement

We support the Board’s initiative of clarifying the 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.

However, we have concerns about the proposed approach and wording of paragraph 72C. In our view, the application of the proposed paragraph would be subject to interpretation and possibly differing views. It might also result in liabilities being classified as current merely due to the existence of certain covenants.

(a) The proposed wording of paragraph 72C(a) would require the current classification of a liability when at the discretion of the counterparty or a third party, liability is payable within twelve months of the reporting date.

(b) In Pakistan, debt arrangements include protective financial covenants (for example, the borrower is required to maintain specified financial ratios). Debt arrangements also state that any non-compliance with any covenant would be an event of default. Under the contractual terms, the lender has to serve a notice to the borrower, prior to exercising its rights in the event of default. In practice, in case of borrower’s non-compliance with financial covenants (such as borrower’s inability to maintain a specified ratio), the lender using discretionary power does not serve, and resultantly event of default is not triggered. We believe that the application of proposed paragraph

72C(a) in the above scenario would lead to interpretational issues and risk of divergent views, about;

i. entity's (i.e. borrower's) right to defer the settlement of liability; and

ii. and 'discretion' of the counterparty.

(c) Paragraph 72C(a) uses the phrase 'discretion of the counterparty'. The contractual arrangements are based on the 'rights' and obligations. Paragraph 69(d) and related proposed paragraphs of IAS 1 use and discuss the 'right' of the borrower. We understand that the counterparty's discretion to demand payment would arise only if it has the contractual right to demand such payment. The contractual arrangements are based on the 'rights' and obligations. Paragraph 69(d) and related proposed paragraphs of IAS 1 also use and discuss the term 'right', in the context of the borrower.

In accordance with paragraph 69(d) an entity shall classify liability as current when it does not have a right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting date. In other words, a liability should be classified as a current liability when the counterparty, has the unconditional right at the end of the reporting date, to demand payment of the liability within twelve months after the reporting date. We suggest that the Board considers the principle-based approach that is based on the unconditional right of the counterparty, in place of proposed paragraph 72C.

If Board decides to retain paragraph 72C, then in certain cases proposed paragraph 72C(b) could interact with paragraph 75 of IAS 1. Paragraph 75 states that a debt is classified as non-current if the lender agrees by the reporting date to provide a grace period ending at least 12 months after the reporting date. The interaction between proposed paragraph 72C(b) and paragraph 75 of IAS 1 will arise in the scenario where an entity has received a waiver from the lender at end of the reporting period. However, this grace period is ending within twelve months. A discussion and clarification on the possible interaction of these two paragraphs would be helpful.

Comments on transition

We agree with the transition requirement of applying the proposed amendments retrospectively, in accordance with IAS 8.

Comments on deferral of the effective date of the amendments to IAS 1, Classification of Liabilities as Current or Non-current

The amendments to IAS 1, Classification of Liabilities as Current or Non-current, issued by the Board in 2020, are effective January 1, 2023. We note that the proposed requirements of the ED would amend some of the requirements introduced by the Board in 2020. In view of this, we agree with the proposed paragraph 139U of the ED, deferring the effective date of the 2020 amendments to IAS 1.

[Sri Lanka]

We agree with the proposed amendment except for 3 (a) due to below facts.

Concern over Para 72 C
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:

(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

(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

Most of the loan agreements in Sri Lanka consist on demand clause (e.g if the bank reserve the right to demand any time) and all of them need to be classified ad current and that is not practicable.