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17 March 2022

International Accounting Standards Board
7 West ferry Circus
Canary Wharf
London E14 4HD
United Kingdom
Email: commentletters@ifrs.org

Dear Sir/Madam

SAICA SUBMISSION ON ED/ 2021/9 – *NON-CURRENT LIABILITIES WITH COVENANTS*: PROPOSED AMENDMENTS TO IAS 1

In response to your request for comments on the ED/2021/9 – *Non-Current Liabilities with Covenants: Proposed Amendments to IAS 1*, attached is the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of SAICA's Accounting Practices Committee (APC). The APC comprises members from reporting organisations, regulators, auditors, IFRS specialists, investment analysts and academics.

We thank you for the opportunity to provide comments on this Exposure Draft.

Please do not hesitate to contact us should you wish to discuss any of our comments

Prof Ahmed Mohammadali-Haji
Chairperson: APC

Bongeka Nodada
Project Director: Financial Reporting

GENERAL COMMENTS

The respondents welcomed the Exposure Draft (ED) and appreciated the International Accounting Standards Board's (IASB or Board) objective to provide further clarity related to the amendments issued in January 2020 (2020 amendments) surrounding the classification of liabilities as current or non-current.

However, respondents noted that to implement the principles in the ED, entities will be required to make certain judgements and prepare extensive disclosures to meet the requirements of paragraph 76ZA (of which we expand on further below), the application of which will reduce comparability between entities, introduce onerous disclosure subjectivity for preparers and raise auditability concerns in order to achieve compliance.

We recommend that the Board remove the presentation and disclosure requirements introduced in paragraph 76ZA. Our analysis and proposals are included in the detailed comments below.

SPECIFIC COMMENTS

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.

Overall, we agree with the proposal by the Board, however, we recommend certain clarifications to be provided. We recommend that the Board consider the following items prior to finalising these amendments:

- The interdependence between paragraphs 72B and 75, specifically where it relates to the assessment of the classification of a loan where a lender agrees to provide a period of grace to an entity. We believe this may provide unintended consequences and diversity in practice on application.

  Paragraph 72B notes that "*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') … a condition based on the entity's financial position six months after the end of the reporting period"*. However, the assessment of whether a right exists at the end of the reporting period should be based on whether an entity **is required to comply with the condition on or before the end of the reporting period** (emphasis added). This is the case even if compliance with the condition is assessed only after the reporting period.

  Paragraph 72B(a) specifically refers to paragraph 75 which notes that "*an entity classifies the liability as* ***non-current*** *if the lender agreed* ***by the end of the reporting period*** *to provide a* ***period of grace ending at least twelve months after the reporting period****, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment*." (emphasis added)

  For example, an entity has a loan contract for which covenants are assessed at the end of the reporting period. The entity, based on information at the end of the reporting period, is in breach of its loan covenants. However, per the loan contract, the entity has a contractual 60-day remediation period in which it can rectify any breaches which would result in reassessment of any breach.

  Based on our interpretation of the requirements of paragraph 72B, the entity should classify the loan as current as the right that exists at the end of the reporting period, based on the covenant conditions per the loan contract, is in breach. Based on the requirements of paragraph 72B(a) the period of grace may be interpreted as additional compliance after the end of the reporting which should not affect the current right that exists at the end of the reporting period. The contractual grace period prohibits the lender from calling on the loan during the 60-day remediation period. This is the same as having a loan with a covenant that is only assessed for compliance after year end. Therefore, the loan would be classified as non-current when applying paragraph 72B(a). This directly contradicts paragraph 75 which would require the loan to be presented as current.

We recommend that the Board provide an illustrative example to IAS 1 – *Presentation of Financial Statements* to clarify instances of when compliance with conditions at the end of the reporting period will result in a right that exists at the end of a reporting period.

- We further recommend that the Board clarify the wording in paragraph 72C. Paragraph 72C states that *"An entity* ***does not*** *have the right to defer settlement of a liability for at least twelve months … 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."* (emphasis added)

  Our interpretation of paragraph 72C requires that entities should classify loans as current in two instances irrespective of any conditions that may be subject to compliance by the entity and when this compliance is assessed (based on paragraph 72B):

  - When a liability could become payable at the discretion of the counterparty or a third party; and
  - When a liability could become payable based on an uncertain future event or outcome unaffected by the entity's future actions.

  For example, liability contracts may include conditions which may be outside the control of the entity such as material breach clauses, repayment in the event of death for life insurance policies, change of accounting or tax rules etc. These clauses represent an uncertain future event and does not consider any future action by the entity.

  Thus, our interpretation of paragraph 72C(b), is that it requires that these liabilities should be classified as current, irrespective of the inherent conditionality. We believe that the wording in paragraph 72C will create unintended consequences to preparers which may result in any loan contract being classified as current due to loan contracts including multiple conditions both that are within and outside the control of the entity and is not only limited to financial conditions. Paragraph 72C(b) requires that paragraph 72B be ignored in this assessment.

  We suggest the Board amend paragraph 72C as follows:

  *"****Notwithstanding the specified conditions mentioned in 72B****, where an entity does not have the right to defer settlement of a liability for at least twelve months and 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~~."

We further recommend that the Board include illustrative examples to convey the principle arising from paragraph 72C.

- We recommend that the Board remove paragraph 76ZA(b). The current requirements as written may prove to be onerous and introduce an added area of complexity of judgement in determining the amount of disclosure to be provided in order to achieve compliance with the requirements. We believe that there is sufficient guidance in IAS 1 and IFRS 7 – *Financial Instruments: Disclosures* that will enable users to determine the amount of disclosure to be provided.

  For example, entities with significant loan commitments may have contracts that include numerous conditions, not limited to financial covenants, which require compliance at the end of the reporting period. These conditions may include and are not limited to regulatory approvals required, free cash flow forecasts, non-GAAP and non-financial covenants, restrictions on material acquisitions and disposals etc. in order to avoid a breach event. Determining which conditions are required, whether and how these conditions are expected to be complied with, in order to meet the minimum requirements of paragraph 76ZA(b), will create a disclosure burden on preparers of 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.

We disagree with this proposal. We do not believe that separate disclosure in the statement of financial position is warranted.

In addition the proposal suggested by the Board does not clarify whether this would also be required for entities that present their statement of financial position in order of liquidity. As

noted by the dissenting members, Mr Mackenzie and Mr Scott, in paragraph AV3, this contradicts the principle-based nature of IFRS Standards and may be adequately dealt with in IFRS 7.

We, however, agree with the alternative proposal in paragraph BC22(a). We believe that this disclosure can be included as part of the disclosure requirements of another Standard, for example IFRS 7.B10A (which requires entities to explain how the liquidity risk data that is disclosed in accordance with IFRS 7.34(c) are determined if the outflows of cash included in that data could occur significantly earlier or be significantly different).

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.

(a) We disagree with the current wording of paragraph 72C, which refers to the fact that a liability could become payable if there is an uncertain future event which is unaffected by an entity's future actions. We believe the wording "uncertain future event" is too broad and is open to interpretation. Liability contracts may include various conditions which may be outside the control of the entity such as material breach clauses, repayment in the event of death for life insurance policies, changes of accounting or tax rules etc. We recommend that the Board reword paragraph 72C as proposed in our response to Question 1.

(b) We disagree that the amendments should be applied retrospectively. A retrospective application would require an entity to assess the conditions attached to its liabilities in existence for earlier financial periods. Disclosing this information would be of no benefit to the users of the financial statements as any liability that would have been

classified as current in the prior period would have either been repaid or renegotiated (if there was a period of grace). We therefore propose a prospective application of these amendments.

(c) We agree with the deferral of the effective date.