

EFRAG
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Our ref: RJ-EFRAG 617 D
Direct dial: Tel.: (+31) 20 301 039
Date: Amsterdam, 9 March 2022
Re: EFRAG Draft Comment Letter on IASB's Exposure Draft ED/2021/9 'Non-current Liabilities with Covenants'

Dear Jean-Paul,

The Dutch Accounting Standards Board (DASB) appreciates the opportunity to provide a response to the EFRAG Draft Comment Letter on the Exposure Draft ED/2021/9 'Non-current Liabilities with Covenants' issued by the IASB in November 2021 (the ED). We generally support EFRAG's comments and have in addition (or want to emphasise) some comments (we refer to this letter and the appendix).

The DASB welcomes the IASB's initiative to propose narrow-scope amendments to IAS 1 as a response to concerns about the outcomes and potential consequences of the amendments regarding *Classification of Liabilities as Current or Non-Current* that were issued in January 2020 ('2020 amendments').

In summary, our main observations, considerations and concerns to the proposals in de ED are as follows:

- The IASB proposes a restrictive (rules-based) approach to determine the classification of non-current liabilities with covenants. We are of the opinion that this may increase the risk of structuring. The DASB is of the opinion that the economic substance should be taken into account when determining the classification of a liability. We ask the IASB to reconsider this proposal and to evaluate whether a more principle-based approach would enhance the classification of liabilities as current or non-current giving due consideration to the decision making of users of financial statements.
- As already mentioned by EFRAG, IAS 1 is applicable to all liabilities which means that the proposed changes also apply to other liabilities within the scope of other standards. If this is intended, the DASB suggests, for groups of homogeneous liabilities, a portfolio approach should be allowed or required. Otherwise, some groups of liabilities such as insurance liabilities, pension liabilities and guarantees may need to be classified in their entirety as current, even if the probability that all liabilities within the group will become repayable within 12 months is remote.
- We support EFRAG's view that the relation between paragraphs 72B(b) and 72C(b) is not clear and should be clarified. The DASB however does not support the alternative wording for 72C(b) as proposed by EFRAG in paragraph 15, as it does not provide the clarification that is necessary either.

- The DASB advises the IASB to opt for cross-referencing between IAS 1 and IFRS 7 in order to require disclosure of this information for those liabilities which are relevant in respect of the company's liquidity risk. This would ensure that the disclosure is added for those liabilities of interest for the users instead of adding boilerplate text about specified conditions in general for all liabilities.
- The DASB agrees with EFRAG's disagreement on the proposal to require a separate presentation on the face of the statements of financial position of the 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 specific conditions within 12 months after the reporting period. The DASB prefers classification based on the generic classification of current and non-current liabilities combined with sufficient disclosure requirements instead of a separate presentation.

The DASB's detailed responses to the questions in the ED and to EFRAG's questions to constituents are provided in Appendix 1. Our comments regarding these questions should not be read without the above observations, considerations and concerns to the proposals in the ED.

Please feel free to contact us if you wish to discuss the contents of this letter.

Yours sincerely,

Gerard van Santen
Chairman Dutch Accounting Standards Board

Appendices

Appendix 1 – Responses to the questions of the ED

Appendix 2 – DASB Comment letter on Exposure Draft ED/2021/9 to IASB

Appendix 1 – Responses to the questions of the ED

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.

DASB’s response

Classification

The IASB proposed a restricted (rules-based) approach in paragraph 72B and 72C to determine the classification of non-current liabilities subject to specified conditions. We are of the opinion that this may increase the risk of structuring. For instance, a change in covenant testing date from December 31, 202x to January 2, 202x+1 could result in a classification of a liability as non-current as of December 31, 202x, even if it is clear that the company will not meet the covenants as at January 2, 202x+1. Therefore, the DASB is of the opinion that the economic substance should be taken into account when determining the classification of a liability. We ask the IASB to reconsider this proposal and to evaluate whether a more principle-based approach would enhance the classification of liabilities as current or non-current, giving due consideration to the decision making of users of financial statements.

In addition, we are of the opinion that the relation between paragraph 72B(b) and 72C(b) is not clear. Paragraph 72B(b) arranges that a loan should classify as non-current if the company is required to comply with specified conditions within 12 months after the balance sheet date. Paragraph 72C(b) however states that if there is an uncertain future event within 12 months after the balance sheet date which could not be affected by the company’s actions, a liability should be classified as current. The unclarity arises when an event is not affected by the company’s actions, but does affect compliance with specified loan conditions. The DASB asks to IASB to further clarify this relation or change the proposed amendments on this matter (the DASB however does not support the alternative wording for 72C (b) as proposed by EFRAG in paragraph 15, as it does not provide the clarification that is necessary either).

The DASB further wants to highlight that IAS 1 is applicable to all liabilities which means that the proposed changes also apply to other liabilities within the scope of other standards. If this is intended

the DASB suggests that, for groups of homogeneous liabilities, a portfolio approach should be allowed or required. Otherwise, some groups of liabilities such as insurance liabilities, pension liabilities and financial guarantees may need to be classified in their entirety as current, even if the probability that all liabilities within the group will become repayable within 12 months is remote.

Disclosure

The DASB is of the opinion that disclosure is a key element to inform the users of the financial statements about the specified conditions to be met within twelve months after the balance sheet date in order to defer settlement of the liability for at least twelve months after the balance sheet date.

The DASB therefore supports the requirement to disclose the required information as mentioned in question 1 part b.) and c.). However, the DASB advises the IASB to opt for cross-referencing between IAS 1 and IFRS 7 in order to require disclosure of this information for those liabilities which are relevant in respect of the company's liquidity risk. This would ensure that the disclosure is added for those liabilities of interest for the users instead of adding boilerplate text about specified conditions in general for all liabilities. In our opinion, this would result in relevant disclosures about the risk of not meeting the specified conditions within twelve months after balance sheet date including the potential impact on the going concern assessment of the company.

Question to Constituents

20 Do Constituents agree with issues identified by EFRAG?

21 Do Constituents agree with the EFRAG proposed alternative wording for 72C(b) proposed in paragraph 15 above, as a way to address the risk of possible different interpretations for the term 'unaffected by the entity's future actions'?

22 Do Constituents agree that covenants to be complied with based on conditions (even shortly) after the end of the reporting period should not cause presentation as current? Does this reflect the economic substance of covenants?

23 IAS 1 paragraph 69(d) focuses on right to defer settlement as opposed to assumptions about timing of cashflows as used in the measurement of the liabilities. Some stakeholders observe that this may lead to misalignments between presentation and measurement. They note that this ED is a narrow scope amendment to IAS 1, it gives some clarification on presentation but does not solve the driver for the misalignment. At the same time, other stakeholders note that solving the concerns of constituents that have emerged in the context of the IFRS Interpretations Committee's December 2020 tentative agenda decision should be the priority of this IASB project, therefore they accept the proposals in this ED as a solution. Do Constituents agree with EFRAG position to support the decision to clarify but not amend the principle in paragraph 69(d) of IAS 1?

DASB's response

20) The DASB agrees with the issues identified by EFRAG especially with respect to the issue that the amendments apply to all liabilities under the scope of IAS 1 and other standards and the issue with respect to the unclear relationship between paragraph 72B(b) and 72C(b).

21) The DASB however does not support the alternative wording for 72C(b) as proposed by EFRAG in paragraph 15, as it does not provide the clarification that is necessary either. The DASB is of the opinion that the wording 'discrete event' will lead to new interpretation issues about whether an event is a 'discrete event' or not. In addition, the DASB questions whether sub b.) regarding financial guarantees to be classified as current in all circumstances reflects the economic substance of the guarantee as there is a variety of terms and conditions of guarantees including financial guarantees with non-current characteristics.

22) As mentioned above in our reaction to the IASB the DASB is in favor of a more principle-based approach in order to reflect the economic substance in the classification of a loan combined with disclosure requirements about the nature of the specific conditions of the liabilities.

23) The DASB agrees with the position of EFRAG in question 23 of the comment letter.

Question to Constituents

30 What are the Constituent's views on additional disclosure requirements in IAS 1 with regard to specified conditions? Do you think that IFRS 7 already requires the preparer to make such disclosures? If yes, do you think that there is a problem to enforce possible disclosures under IFRS 7? If not, do you consider that those disclosures would be better off as part of IFRS 7?

31 Two IASB Board members voted against the publication of the ED. Paragraph AV5 of the ED illustrates that they (in addition to being contrary to the separate presentation proposal) disagree with the requirement proposed in paragraph 76ZA(b)(iii) to disclose whether and how an entity expects to comply with conditions after the reporting date. They disagree because, in their view, entities should not be required to provide forward-looking information with respect to future compliance with covenants.

- a) Do Constituents have particular concerns related to the provision on such forward-looking information? Please explain.
- b) Do Constituents agree to change 76ZA(b)(iii) as proposed by EFRAG in paragraph 27 above?
- c) Some EFRAG members questioned the usefulness of the disclosure required by 76ZA (b). Do constituents agree with the usefulness of such disclosure?
- d) Do Constituents consider that the proposed disclosures are needed in cases where the company expects to comply with the covenant after the reporting year end?

DASB's response:

30) The DASB advises the IASB to opt for cross-referencing between IAS 1 and IFRS 7 in order to require disclosure of this information for those liabilities which are relevant in respect of the company's liquidity risk. This would ensure that the disclosure is added for those liabilities of interest for the users instead of adding boilerplate text about specified conditions in general for all liabilities. This would result in relevant disclosures about the risk of not meeting the specified conditions within twelve months after balance sheet date for those liabilities relevant for the going concern of the company.

31)

- a) The DASB does not have concerns related to the the requirement to provide forward-looking information. The DASB is of the opinion that forward-looking information is already used (and if relevant, disclosed) for other purposes such as impairment testing and the evaluation of the going concern assumption for which cash flow projections are relevant.
- b.) Given this opinion on forward-looking information the DASB is of the opinion that it is not necessary to change paragraph 76ZA(b)(iii) as proposed by EFRAG.
- c) and d) As mentioned above in our answer to question 30, the DASB shares the concern whether these disclosure requirements have to be applied for all liabilities with specified conditions. In the opinion of the DASB, this would lead to boilerplate texts in financial statements and we therefore ask the IASB to reconsider these requirements.

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.

DASB's response

The DASB agrees with EFRAG's disagreement on the proposal of the IASB 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 reporting period is subject to compliance with specified conditions within twelve months after the reporting date. The DASB considers that this will not result in more useful information as we expect that many liabilities will be captured in this category as most liabilities contain specified conditions. In our opinion, a separate presentation of a small group of non-current liabilities that would not be subject to specific conditions will not be useful for investors and it creates a risk of obscuring relevant information. The DASB prefers classification based on the generic classification of current and non-current liabilities combined with sufficient disclosure requirements instead of a separate presentation.

The DASB could sympathize with a proposal to present some liabilities separately. However, given the aforementioned concerns, the requirement should be further elaborated. For example, perhaps for liabilities with financial and/or non-financial conditions of which there is a reasonable uncertainty that the entity is not able to meet the conditions. Then this separate line item in the balance sheet would provide information to users and function as a highlight to encourage users of the financial statements to read the disclosures, including the disclosure requirements of paragraph 76ZA. In the opinion of the DASB adequate disclosure requirements are key to provide relevant information about the terms and conditions of liabilities to the users of the financial statements.

Question to Constituents

38 Do Constituents agree with the position of not recommending a separate presentation, irrespective of the scope of the separate presentation?

The DASB agrees with the position of EFRAG not to recommend a separate presentation as also mentioned in our response to the questions of the IASB.

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.

DASB’s response

- a) The DASB agrees with the intention of the IASB to clarify 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. However, the DASB disagrees with the proposal in the ED. As we identify the relation between paragraphs 72B(b) and 72C(b) as not clear we are not satisfied that the proposed wording in paragraph 72C is sufficient to clarify the circumstances as intended by the IASB.
- b) The DASB agrees with the proposal to apply the amendments in accordance with IAS 8 with earlier application permitted.
- c) The DASB agrees with the proposal to defer the effective date to 1 January 2024.

Question to Constituents

46 Do Constituents agree with the EFRAG’s comments on the other topics?

47 Do Constituents would like to raise additional questions or issues that should be highlighted by EFRAG?

DASB’s response

We agree with EFRAG’s comments on the other topics. There are no additional questions or issues to be highlighted by EFRAG other than those already mentioned above in our answers to the questions to constituents.