ASC
ACCOUNTING STANDARDS COUNCIL
SINGAPORE

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(By online submission)

Dear Andreas

RESPONSE TO EXPOSURE DRAFT ON NON-CURRENT LIABILITIES WITH COVENANTS (PROPOSED AMENDMENTS TO IAS 1)

The Singapore Accounting Standards Council welcomes the opportunity to comment on the Exposure Draft on *Non-Current Liabilities with Covenants* (Proposed Amendments to IAS 1) (the ED) issued by the International Accounting Standards Board (the IASB or the Board) in November 2021.

We appreciate the IASB's efforts in addressing stakeholders' concerns about the classification outcomes that would result from application of *Classification of Liabilities as Current or Non-current* issued by the IASB in January 2020 (the 2020 amendments). The ED has the potential to improve the information an entity provides when its right to defer settlement of a liability is subject to compliance with conditions.

Our comments on the ED are as follows:

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.

We agree with the proposal that conditions with which an entity must comply within twelve months after the reporting period do not affect the classification of a liability as current or non-current. We consider that the proposal would result in a more faithful representation of an entity's financial position at the reporting date vis-à-vis the 2020 amendments.

We also agree that the information provided by a binary classification model (whether under the 2020 amendments or the ED), alone, is insufficient to meet the information needs of users of financial statements (users) when an entity's right to defer settlement of a liability is subject to compliance with the aforesaid conditions. Accordingly, we are generally supportive of the proposed disclosure requirements for such liabilities on the basis that the resulting information would enable users to assess the risk that those liabilities could become repayable within twelve months after the reporting period.

Nonetheless, we think that the IASB should consider whether it would be more useful to require those disclosures to be provided only in situations where there are significant uncertainties over an entity's compliance with the specified conditions, rather than for all liabilities that are subject to compliance with conditions within twelve months after the reporting period. This is because the latter would not only have the potential to result in excessive and/or boilerplate disclosures of limited information value, particularly when the risk of non-compliance is low, but also increase burden on preparers.

Furthermore, we note that the proposed disclosure in paragraph 76ZA(b)(ii) may not result in meaningful information in certain situations, for example, when the specified conditions incorporate the effects of the seasonality of an entity's business (i.e. such conditions are designed to be assessed only at a specified point in time). In such situations, we understand that it may not be clear as to whether the entity: (i) could omit the proposed disclosure by virtue of the overarching concept of materiality in paragraph 31 of IAS 1; or (ii) is nonetheless still required to provide the proposed disclosure. We suggest that the IASB considers whether there are merits in refining or clarifying the proposed disclosure requirements.

Additionally, we have the following comments:

Interaction with paragraph 75 of IAS 1 *Presentation of Financial Statements*

We think that it is not clear how proposed paragraph 72B(b) would interact with paragraph 75 of IAS 1.

For example, an entity negotiated with its lender before the end of the reporting period for a six-month grace period to rectify the breach of a condition of a long-term loan arrangement and the grace period ends within twelve months after the end of the reporting period. It is not clear whether the loan should be classified as: (i) non-current applying proposed paragraph 72B(b), because the entity's compliance with that condition is required only within twelve months after the reporting period by virtue of the grace period granted by the lender; or (ii) current applying paragraph 75, because the grace period ends within twelve months after the end of the reporting period. It is also not clear whether the answer would be different if the grace period was obtained in anticipation of a breach.

We suggest that the IASB provides more clarity on the above.

Interaction with the liquidity presentation method in IAS 1

IAS 1: (i) permits an entity to adopt a liquidity (instead of a current and non-current) presentation method in its statement of financial position; and (ii) requires the entity to disclose the amount expected to be settled after more than twelve months for each liability line item that combines amounts expected to be settled no more than and more than twelve months after the reporting period.

In situations where the aforesaid disclosure includes liabilities subject to the conditions described in proposed paragraph 72B(b), we note that information that would help users assess the risk that those liabilities could become repayable within twelve months after the reporting period would likewise be relevant to users. Accordingly, we suggest that the IASB considers whether proposed paragraph 76ZA(b) should be extended to an entity that adopts the liquidity presentation method in its statement of financial position.

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 are not supportive of the proposal to require non-current liabilities that are subject to conditions with which an entity must comply within twelve months after the reporting period to be presented separately in the statement of financial position for reasons similar to those described in paragraphs AV3–AV4 of the Alternative View on the ED.

Moreover, we understand that in practice, most non-current financial liabilities would be subject to compliance with conditions within twelve months after the reporting period. The proposal would therefore result in most, if not all, non-current liabilities to be presented separately in the statement of financial position, which considerably weakens the intended benefits of separate presentation as described in paragraph BC21 of the Basis for Conclusions on the ED (the BC).

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.

Proposed paragraph 72C

We appreciate the IASB's effort in 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. However, we have the following concerns about proposed paragraph 72C(b):

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

We are concerned that significant diversity in practice could result from the application of proposed paragraph 72C(b), which would impair the comparability of financial statements. This is because the notion 'unaffected by the entity's future actions' is likely to be susceptible to different interpretations by different stakeholders, notwithstanding that paragraph BC20 of the BC usefully explains that an entity can affect the occurrence (or non-occurrence) of future events or outcomes, even if their occurrence is beyond the entity's control. Specifically, we think that an entity's compliance with conditions may generally be affected to some extent by its actions, however insignificant or minor. Therefore, stakeholders could reach different conclusions on whether or not an entity can affect the occurrence (or non-occurrence) of future events or outcomes.

Moreover, as drafted, the term 'future actions' could be interpreted as precluding actions on or before the end of the reporting period, even if those actions could affect the occurrence (or non-occurrence) of the uncertain future event or outcome. The IASB's rationale for the dividing line is not clear, if this is indeed its intention.

Therefore, we suggest that the IASB:

- Provides further guidance on how an entity determines whether an uncertain future event or outcome is 'unaffected by the entity's future actions'.
- Clarifies whether the term 'future actions' precludes actions on or before the end of the reporting period, and explains its rationale accordingly.

Examples of liabilities within the scope of proposed paragraph 72C(b)

The ED cites financial guarantee and insurance contract liabilities as examples of liabilities that would fall within the scope of proposed paragraph 72C(b).

However, we note that there may be situations where the issuer of a financial guarantee contract could be deemed to have some ability to affect the repayment of a debt instrument by the specified debtor, for example, when the issuer is the parent or an investor that has joint control of the specified debtor. Confusion could therefore arise as to whether and why such financial guarantee liabilities fall within the scope of proposed paragraph 72C(b), instead of proposed paragraph 72B(b).

Moreover, the ED appears to imply that all insurance contract liabilities should be either classified as current or possibly disclosed as due within twelve months after the reporting period, which may not reflect the underlying business of insurers nor result in useful information. It is also not clear how this outcome would interact with the requirements in IFRS 17 *Insurance Contracts*.

We suggest that the IASB provides more clarity on the intended scope of proposed paragraphs 72B(b) and 72C(b) as well as its intentions with respect to insurance contract liabilities.

Potential consequences of the proposed requirements

We note that some conditions that are commonly included in loan arrangements that relate to future events or outcomes, such as 'change of control' or 'material adverse changes' clauses, could be construed as unaffected by an entity's future actions, triggering current classification for many loan arrangements under the ED. We understand that such clauses generally do not result in current classification under the existing requirements in IAS 1.

Classifying a liability as current before the occurrence of a breach of contractual terms, which would affect an entity's financial position, could in turn cause a breach of the contractual terms of other liabilities, triggering current classification of those liabilities, and affect an entity's going concern assessment.

Therefore, depending on the feedback received on the ED, we suggest that the IASB carefully considers the potential consequences of changing the existing classification of many loan arrangements from non-current to current before finalising proposed paragraph 72C(b).

Other proposals

We are generally supportive of the proposed transition requirements and deferral of the effective date of the 2020 amendments on the basis of the IASB's rationale. Moreover, the proposed transition requirements are consistent with the transition requirements for the 2020 amendments, which we were supportive.

We hope that our comments will contribute to the IASB's deliberation on the ED. Should you require any further clarification, please contact our project managers Junwei Quek at Quek_Junwei@asc.gov.sg and Yat Hwa Guan at Guan_Yat_Hwa@asc.gov.sg.

Yours faithfully

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