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2 June 2020

Dear Sir

Exposure Draft ED/2020/3: Classification of Liabilities as Current or Non-current - Deferral of Effective Date, Proposed amendments to IAS 1

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the ED.

We support the IASB's deferral of the effective date. However, since the issue of the original amendments, we have also identified differing views about certain aspects of the amendments themselves, which we believe are likely to give rise to diversity in the application of the requirements. We encourage the IASB to revisit this point, and to make further clarifying amendments.

Our responses to the questions in the ED are set out in the attached Appendix A.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Andrew Buchanan

Global Head of IFRS

[1] Service provision within the international BDO network of independent member firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BV, a limited liability company incorporated in Belgium. Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BV, BDO IFR Advisory Limited and the member firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BV, BDO IFR Advisory Limited and/or the member firms of the BDO network.
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Appendix A

Question – The Board proposes to defer the effective date of amendments to IAS 1, Classification of Liabilities as Current or Non-current, to annual reporting periods beginning on or after 1 January 2023. Do you agree with the proposal? Why or why not?

We agree with the Board's proposal to defer the effective date of the amendments. As noted in the basis for conclusions to the ED, the amendments may cause entities to renegotiate loan covenants, which is likely to have become become more complex and difficult due to the effects of COVID-19.

Diversity in views about the requirements of the amendments

We have identified that there is significant diversity in how paragraph 72A of the amendments is being interpreted in practice.

IAS 1.72A states (emphasis added):

> *An entity's right to defer settlement of a liability for at least twelve months after the reporting period must have substance and, as illustrated in paragraphs 73–75, must exist at the end of the reporting period. If the right to defer settlement is subject to the entity complying with specified conditions, the right exists at the end of the reporting period only if the entity complies with those conditions at the end of the reporting period. The entity must comply with the conditions at the end of the reporting period even if the lender does not test compliance until a later date.*

In our view, we believe that IAS 1.72A should be interpreted to mean that compliance with conditions that are only contractually tested based on particular financial results and at particular dates (e.g. the year-end statement of financial position) must nonetheless be calculated at each reporting period end (e.g. interim reporting dates), and the results of that compliance are used in determining the presentation requirements of financial liabilities (e.g. a bank loan that is payable on demand based on a gearing ratio). An illustration of this requirement is included in Example 4 of our IFR Bulletin 2020/01, which we have attached to this letter for your reference.

We believe this is the intention of paragraph 72A for the following reasons.

1. BC48D states (emphasis added):

   The Board considered whether an entity's right to defer settlement needs to be unconditional. The Board noted that rights to defer settlement of a loan are rarely unconditional—they are often conditional on compliance with covenants. The Board decided that if an entity's right to defer settlement of a liability is subject to the entity complying with specified conditions, the entity has a right to defer settlement of the liability at the end of the reporting period if it complies with those conditions at that date. Accordingly, the Board:
   (a) deleted the word 'unconditional' from the classification principle in paragraph 69(d); and
   (b) added paragraph 72A to clarify that if an entity's right to defer settlement is subject to compliance with specified conditions:

   (i) *the right exists at the end of the reporting period <u>only if the entity complies with those conditions at the end of the reporting period</u>; and*
   (ii) *<u>the entity must comply with the conditions at the end of the reporting period even if the lender does not test compliance until a later date</u>.*
2. Agenda paper 12B from the IASB's February 2016 board meeting summarises the IASB staff's analysis of this issue. We believe the staff paper and the subsequent February 2016 IASB update make it clear that, as stated in the IASB update, 'compliance with any condition in a lending agreement should be assessed as at the reporting date'.

Despite this, we acknowledge that it is possible to interpret the requirements of IAS 1.72A in such a way that another conclusion could be reached. This is because some of those who believe that compliance need not be assessed as at periods where compliance is not tested contractually is supported by 72A stating:

> *The entity must comply with the conditions at the end of the reporting period even if the lender does not test compliance until a later date.*

Some may interpret this to mean that if a condition is not contractually assessed as at a specific point in time, then an entity does not have any contractual conditions to 'comply with', as noted in paragraph 72A.

If we have interpreted the Board's intention correctly, we suggest that the Board clarify paragraph 72A to reduce the risk of diversity in practice occurring before the amendment becomes mandatorily effective. The paragraph could be amended as follows (<u>additional text underlined)</u>:

> *An entity's right to defer settlement of a liability for at least twelve months after the reporting period must have substance and, as illustrated in paragraphs 73–75, must exist at the end of the reporting period. If the right to defer settlement is subject to the entity complying with specified conditions, the right exists at the end of the reporting period only if the entity complies with those conditions at the end of the reporting period. The entity must <u>assess</u> ~~comply~~ <u>compliance</u> with the conditions at the end of the reporting period even if the lender does not require or test compliance until a later date. <u>An entity evaluates paragraph 69(d) based on the results of this assessment.</u>*

The following might be included in the basis for conclusions:

> *<u>The board noted that, if an entity's compliance with a debt to equity covenant in a loan agreement is only contractually tested for compliance as at an entity's year-end, in preparing an interim financial statement in accordance with IAS 34, Interim financial reporting, an entity assesses compliance with that covenant as at the interim reporting period and classifies the loan as current or non-current based on the results of assessing covenant compliance as at the interim reporting period.</u>*