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February 15, 2021

Ms. Sue Lloyd
Chair of the IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

RE: Tentative Agenda Decision - Classification of Debt with Covenants as Current or Non-current

Dear Ms. Lloyd,

The International Organization of Securities Commissions (IOSCO) Committee on Issuer Accounting, Auditing and Disclosure (Committee 1) thanks you for the opportunity to provide our comments on the IFRS Interpretations Committee (IFRS IC) tentative agenda decision, *Classification of Debt with Covenants as Current or Non-current* (TAD).

IOSCO is committed to promoting the integrity of the international markets through promotion of high-quality accounting standards, including rigorous application and enforcement. Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect the general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

Consistency with IAS 1 *Presentation of Financial Statements* (IAS 1)

Overall, we believe the TAD is a technically correct application of the amendments to IAS 1[1] and the examples within the TAD are helpful in supporting consistent application.

However, the TAD has made many members aware of new concerns, not previously appreciated during the Exposure Draft (ED/2015/1) process, that were not expressed in our Comment Letter dated June 15, 2015. Although a few members continue to agree with the amendments to IAS 1, many members question

[1] In January 2020 the International Accounting Standards Board (Board) issued *Classification of Liabilities as Current or Non-current*, which amended IAS 1 *Presentation of Financial Statements* and clarified how to classify debt and other financial liabilities as current or non-current.

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the usefulness of information that results from application of the amendments, particularly in certain situations as illustrated in the TAD. These members have identified certain aspects of the TAD that have raised concerns that may require a standard-setting response, including potential additional disclosures.

Differences in Approach within IAS 1 for Financial Position Covenants vs Other Covenants

Many members observe a significant difference between IAS 1.72A, which restricts the ability to consider management's expectations, with IAS 1.BC48E[2], which suggests that some form of adjustment to include expectations about cumulative financial performance / future transactions. Specifically, to these members, it appears the amendments (and the TAD appears to confirm) draw a distinction between how financial position covenants are evaluated (which do not permit consideration of management judgement, intentions, or expectations) versus financial performance and cashflow covenants (which appear to permit consideration of expectations). These members observe that the amendments to IAS 1 do not sufficiently explain the basis for such distinction (i.e., difference in approach) and believe the TAD could be expanded to explain the reasoning for this difference.

Although a few members acknowledge that limiting management expectations can mitigate against the risk of overly optimistic management expectations and assumptions and support consistent auditability and enforcement, many other members are not persuaded that these benefits are sufficient to outweigh the need to address the identified difference in approach. Specifically, many members believe that this difference should be addressed through standard-setting to permit consideration of expectations and support consistency across financial performance and cash flow covenants with financial position covenants (and any other potential covenants).

Use of Judgement in other IFRS Standards

Many members observe that the IAS 1.72A prohibition on incorporating management expectations differs from other IFRS Standards, that permit or require such incorporation, for example:

- IFRS 5 (held-for-sale analysis)
- IAS 1 (going concern analysis)
- IAS 19 (short-term employee benefits definition)
- IAS 36 (impairment testing)
- IAS 37 (measurement of provisions)

[2] It is acknowledged that Basis for Conclusion is not part of the Standard and does not contain official requirements. Nevertheless, we understand that many stakeholders do look to the Basis for Conclusions for additional guidance and insight.

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These members believe that consistency in approach among standards is important. The use of estimates and judgements is acknowledged to be a fundamental part of financial reporting. However, some members observe that classifying debt as current versus non-current is often more an objective process compared to most of the other examples above.

Expansion of the IFRS IC Process

Members noted that this issue did not appear to come to the IFRS IC through the usual inquiry submission process by a stakeholder. Nevertheless, similar to how the IASB has used Transition Resource Groups (TRGs), we believe it can be helpful when issues are identified prior to a standard or amendment's effective date and brought to an open forum, such as the IFRS IC, for a discussion and clarification on the application of the standard or amendment as this can support consistent application of the standard or amendment once it is effective.

We understand that for issues brought to TRGs there is extensive outreach with stakeholders in advance of any discussion. Since we are unable to clearly track the origin of the inputs to the TAD, we are unclear whether such outreach has occurred for this issue, in particular with lenders and borrowers. Considering the potential significance of this issue to a wide array of constituents, we believe additional formal outreach would be a useful step in the process to determine whether there are other related issues before finalizing the TAD.

Useful of Information

Many members observe that the usefulness of information produced by the amendments to IAS 1 could be diminished in certain circumstances because, for example, of:

- *Volatility of classification* – the potential for liability classification to flip between current and non-current for interim reporting periods (because of passing and failing the covenant from period-to-period due to seasonality, for example), when actual testing is only performed on specific dates (e.g., once or twice a year);
- *Hypothetical covenant testing* – hypothetical testing for financial reporting purposes at a date different than testing for actual loan agreement compliance purposes[3];

[3] For example, in Case 2 of the TAD, where the covenant is only tested at March 31, the accounting standards are establishing the need to test at December 31, even though the lender itself did not design the test to be done at that time. Thus, the accounting requirement is seen by some as negating the will of the parties to the loan agreement and what they agreed to with respect to the timing of the test.

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Although a few members continue to support the amendments to IAS 1, most members believe that some form of standard-setting is needed in the short-term. We intend to reiterate this view when responding to the broader Agenda Consultation.

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We appreciate your thoughtful consideration of the views provided in this letter.

If you have any questions or need additional information, please do not hesitate to contact Cameron McInnis, Chair of the Accounting Subcommittee of Committee 1 at +1 416-593-3675 or myself. In case of any written communication, please mark a copy to me.

Yours sincerely,

Makoto Sonoda

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