The Japanese Institute of
Certified Public Accountants
4-4-1, Kudan-Minami, Chiyoda-ku, Tokyo 102-8264 JAPAN
Phone: +81-3-3515-1128 Fax: +81-3-5226-3355
e-mail: kigyokaikei@jicpa.or.jp
http://www.hp.jicpa.or.jp/english/

17 March 2022

International Accounting Standards Board
Columbus Building, 7 Westferry Circus
Canary Wharf, London, E14 4HD
United Kingdom

Comments on the Exposure Draft *Non-current Liabilities with Covenants (Proposed amendments to IAS 1)*

To the IASB Board Members:

The Japanese Institute of Certified Public Accountants ("we", "our" and "JICPA") appreciates the continued efforts of the International Accounting Standards Board on this project. We welcome the opportunity to comment on the Exposure Draft *Non-current Liabilities with Covenants (Proposed amendments to IAS 1)* ("ED").

JICPA supports the ED's proposal in paragraph 72B(b) because we believe that it would resolve issues raised during the IFRS Interpretations Committee's discussion related to the 2020 amendments (i.e. *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)* issued by the IASB in January 2020). We appreciate the IASB's continuous effort in developing the proposal.

However, we disagree with the proposal in paragraph 76ZA(a) to separately present liabilities subject to the conditions described in paragraph 72B(b) because the usefulness of such information is doubtful, and inconsistency may arise among other IASB projects. Instead of presenting specified liabilities separately in the statement of financial position, we think it is sufficient to provide information by disclosing such liabilities amount in the notes just like other information proposed in paragraph 76ZA(b), including the conditions with which the entity is required to comply.

We disagree with the proposal in paragraph 72C(b) because the difficult judgement would be required under the proposal to classify liabilities as current or non-current, causing diversity in classification and deterioration in the comparability of information.

In paragraph 8 of our comment letter, we have provided examples illustrating cases where it is not always clear how to determine whether or not an entity has the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period.

We suggest the IASB develop additional application guidance and illustrative examples for clarification purposes so that the examples we illustrated would be classified appropriately.

Although we are not against the proposal in paragraph 76ZA(b)(iii), we are concerned about the auditability of the required information because the information is not used in the measurement of assets and liabilities recognised in the financial statements, and it is more like a forward-looking type of information that largely depends on management's judgement.

Please see our comments on individual proposals of the ED in the following pages.

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.

Comment:

(Paragraph 72B(b))

1. We support the ED's proposal in paragraph 72B(b) as it would solve issues raised during the IFRS Interpretations Committee's discussion process related to the 2020 amendments.

(Paragraph 76ZA(b))

2. Although we are not against the proposal in paragraph 76ZA(b)(iii), we are concerned about the auditability of the required information because the information is not used in the measurement of assets and liabilities recognised in the financial statements, and it is more like a forward-looking type of information that largely depends on management's judgement. As we commented to the Discussion Paper *Disclosure Initiative—Principles of Disclosure* published by the IASB in March 2017, we believe a general rule should be developed, basically restricting entities from including non-financial information not used to measure assets and liabilities in

financial statements for disclosure purposes.

3. Despite our concern mentioned above, we still support the proposed disclosure conditions in paragraph 76ZA(b) because they do not specify assessment methods or other detailed information in relation to compliance with covenants. This would allow entities to have a certain flexibility in preparing disclosure information, thereby making a judgement based on the substance of the transaction and avoiding undue burden in practice.

4. We comment on the disclosure objective described in paragraph 76ZA(b), though, which is 'to enable users of financial statements to assess the risk that the liability could become repayable within twelve months.' We are concerned that the description is too simple without explicitly providing 'specific disclosure objectives and 'what the information is intended to help users of financial statements do.' The objective described in paragraph 76ZA(b) does not appear to align with the basic approach pursued by the IASB's Disclosure Initiative, which is to provide disclosure information based on disclosure objectives. That said, we recommend including the sentence per paragraph BC25 of the Basis for Conclusions, which says 'this would allow an entity to provide context by explaining how it made the assessment and, when applicable, why it would not have complied with such conditions based on its circumstances at the reporting date,' into paragraph 76ZA(b) of the ED in response to providing information on 'specific disclosure objectives' and 'what the information is intended to help users of financial statements do.'

5. We also recommend the IASB clarify how the proposal in paragraph 76ZA(b) is correlated to other similar disclosure requirements under current IFRS Standards, such as disclosures on liquidity risk in IFRS 7 *Financial Instruments: Disclosures*.

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.

Comment:

6. We disagree with the proposal in paragraph 76ZA(a) for the following reasons. Instead of presenting specified liabilities separately in the statement of financial position, we think it is sufficient to provide information by disclosing such liabilities amount in the notes just like other information proposed in paragraph 76ZA(b), including the conditions with which the entity is required to comply.

   (a) Under the ED's proposal, it may end up directing all the liabilities that are subject to compliance with specified conditions, such as covenants, and required to comply with such conditions only within twelve months after the reporting period would be subject to separate presentation when classified as non-current. In such cases, entities will be required to present the number of borrowings with financial covenants separately, even when the possibility of the borrowings becoming immediately due and payable is remote under the financial covenant. We are doubtful whether such separately presented liability information can provide valuable information to users of financial statements.

   (b) If entities were to follow the proposed requirement for separate presentations, we are afraid consistency would not be maintained among other line items presented in the financial statements. According to the Exposure Draft, *General Presentation and Disclosures* developed as part of the IASB's Primary Financial Statements project, the role of the primary financial statements is to 'provide a useful, structured and comparable summary of a reporting entity's recognised assets, liabilities, equity, income, expenses and cash flows.' Also, the Primary Financial Statements project aims to improve the aggregation and disaggregation principles. We recommend that the ED's proposed requirement for separate presentations should align with the disaggregation principle proposed under the Primary Financial Statements project.

7. Paragraph BC22(a) discusses an alternative view provided in paragraph AV4 of the ED, which supports the principle-based accounting treatment stipulated in paragraph 55 of IAS 1 *Presentation of Financial Statements*, requiring to present line items separately when such presentation is relevant to an understanding of an entity's financial position. We support this alternative view.

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.

Comment:

(Paragraph 72C)

8. We disagree with paragraph 72C(b) due to the following reasons:

   (a) No clear guidance is provided about what kind of specific circumstances are expected when an entity does not have the right to defer settlement of the liability for at least twelve months as described in paragraph 72C, and also how the compliance with paragraph 69(d) is determined in those cases. As a result, the classification of liabilities could be diverse among entities, thereby deteriorating the comparability of information.

   (b) In particular, difficult judgement is required for the classification of liabilities as current or non-current 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 as described in paragraph 72C(b).

   (c) Further, we are concerned that paragraph 72C(b) could affect the practice of entities, separately presenting its financial guarantee or insurance contract liability as current or non-current.

9. The following examples illustrate cases where it is not always clear how to determine whether or not an entity has the right at the end of the reporting period to defer

settlement of the liability for at least twelve months after the reporting period.

Example 1: Change-in-control provision

When an entity issues preferred stocks with a mandatory redemption provision in five years, which are subject to conditions under which holders of the preferred stocks are entitled to demand early redemption whenever there are changes in control of the entity, and when its occurrence is unaffected by the entity's future actions.

Example 2: Initial public offering (IPO) within twelve months

When an entity issues preferred stocks with a mandatory redemption provision in five years, which are subject to conditions under which holders of the preferred stocks are entitled to demand early redemption whenever the entity cannot execute IPO within twelve months, and when its occurrence is unaffected by the entity's future actions.

Example 3: A contract requiring an entity to obtain an unqualified opinion from auditors within three months from a reporting period

When an entity, as the borrower, has a loan with maturity in five years, which is subject to conditions under which the lender is entitled to demand early redemption if the entity cannot obtain an unqualified opinion from auditors within three months from a reporting period.

Example 4: Defined benefit obligations

When an entity is aware that voluntary resignations that occur after the reporting period can be reduced by improving benefit packages, for example, the entity has no intention to make such improvements.

Example 5: Provision for loss on litigation

When an entity is dealing with litigation whose appeal period arrives after the reporting period, but when the entity has no intention to appeal even though the entity acknowledges, it may be able to avoid incurring litigation losses due to the appeal.

Example 6: Financial guarantee

An entity can avoid extending a financial guarantee to a counterparty by entering into transactions that are part of the entity's normal operating cycle after the reporting period to support the counterparty.

10. If the IASB were to finalise the proposal in paragraph 72C, we suggest the IASB clarify the proposal by adding further guidance or illustrative examples so that the examples described above would be classified appropriately.

(Paragraph 139U)

11. The January 2020 amendments are not withdrawn in paragraph 139U. According to the proposal in paragraph 139U, the effective date of the 2020 amendments could be no earlier than 1 January 2024, with earlier application permitted. However, the proposal does not stipulate the transition for early adopters of the 2020 amendments. Given that the ED is proposing to revise part of the 2020 amendments, a transition requirement should also be set forth for entities early adopting the 2020 amendments.

Yours faithfully,

Takako Fujimoto
Executive Board Member－Business Accounting Standards and Practice/Corporate Disclosure
The Japanese Institute of Certified Public Accountants