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IASB (International Accounting Standards Board)

2022-03-21

OBSERVATIONS regarding the IFRS Standards ***Exposure Draft ED/2021/19*** **Non-current Liabilities with Covenants** (Later – ED) proposed amendments to IAS 1.

It is very gratifying that IASB has decided to approach such an important standard that is relevant to almost each and every company. I hope that thoughts expressed may be valuable to the Standard setters in approving the changes.

The remarks below are only the opinion of Daiva Žumbakienė, auditor of Raimda auditas UAB, and are not the opinion of other[1] public organizations to which the company or auditor belongs.

Before answering 3 (three) questions, we want to summarize some aspects:

1. Having read the information provided to me, I do not consider that the document is complete. There is a lot of ambiguity left in it.
2. The document lacks integrity and a broader approach to the whole. This may be due to the fact that the document is based on theory rather than practice (preparation and examination of financial statements).
3. There is a lack of specific and comprehensible explanations regarding IAS 1 Presentation of Financial Statements, and in particular paragraph 69 (and other related paragraphs). There is a lot of room for interpretation here, which is not possible especially in the absence of officially approved IFRS methodological guidelines.

If you have any question, please do not hesitate to revert.

Sincerely yours,
UAB Raimda auditas Director – Auditor
Daiva Žumbakienė

[1] UAB Raimda auditas/auditor Daiva Žumbakienė is a member of ACCA; a member of the Lithuanian Chamber of Auditors; a member of the board of the Lithuanian Chamber of Auditors; a member of the Lithuanian Association of accountants and auditors; a member of the British Chamber of Commerce in Lithuania, and a member of other committees of the professional organization (LCA).

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.

Answer Q 1.

1. We agree regarding "Disclosure". Without any doubt, we agree that an additional requirement to disclosure guarantees more information for the users of Financial Statements.

2. We partially do not agree regarding "classification" *concept*. Internal contradictions in the document:
   - In the Q1 it is stated that "…specified conditions with which an entity must comply within twelve months after the reporting period <u>**have no effect on**</u> 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…"
   - In the introduction of Exposure Draft it is stated that the Board "…decided to narrow scope amendments to IAS 1. The proposed amendments would specify that conditions with which an entity **must comply** within twelve months after the reporting period <u>**do not affect classification of liability as current or not-current**</u> instead entities would **present separately**, and disclose information about non-current liabilities subject to such conditions".
   - Concept "have no effect on classification" and "present separately" are considered partially contradictory by us.

3. Some other remarks:
   - According to the amendment to IAS 1 paragraph 69, assessment for the company's management regarding liability classification as either (i) current or (ii) non-current basically remains the same. So proposed amendment to ED by the Board basically remains the same regarding to *classification*.
   - There seems to be a lack of specificity of legal concepts such as "right to defer settlement". It is not clear what criteria should be applied in order for an entity to claim for the meaning of these words: "…the entity must have the right at the end of the reporting period to defer settlement of

the liability for at least twelve months after reporting period…”. • usually, *Covenant* is included in all Loan Contracts between Banks and Companies. It is hard to guess that company’s management could have *supremacy* over a bank Authority.

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.

Answer Q 2.
1. We partially agree with this proposal. However, we have a few additional points: • In the second question concerns “non-current liabilities”. Is the legal meaning of words “liability”, “obligation”, “constructive obligation” is equal? • As I mentioned previously practically all companies should provide this type of presentation on the statement of financial position. • For the users of financial statements, it could be partially confusing when on the statement of financial position there will appear two separate lines: (i) non-current liabilities (ii) non-current liabilities with “covenants”.

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.

Answer Q 3.
1. Regarding part (a) of question – there is not enough information provided on the proposal of the amendments. There should be more explanations. 2. Regarding (b) and (c) – yes, we agree. 3. Otherwise, some additional points: • A more detailed explanation would be needed regarding the meaning of "reporting period". The standards only mention "twelve months after reporting period". • IAS 34 *Interim Financial Reporting* there is no requirement on how to provide appropriate *disclosure*, except for material amounts. • Usually "Disclosure" is related with the Annual Reporting period. • The question remains open: whether all *Disclosures* that are mandatory regarding IAS 1 and other standards, i.e. disclosure to "Covenants" of non-current liabilities, must be provided **only in the Annual Financial Statements** (during annual Reporting Period)? Because of the absent of more explanation regarding this from the Board it is possible to imply that "Disclosure" and "Reporting Period" are coherently related with the Annual Financial Statements only.