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Comments on the Exposure Draft (ED/2021/9)
Non-current Liabilities with Covenants **（Proposed amendment to IAS 1）**

1. The Accounting Standards Board of Japan (the "ASBJ" or "we") welcome the opportunity to provide our comments on the International Accounting Standards Board ("IASB")'s Exposure Draft *Non-current Liabilities with Covenants* (Proposed amendments to IAS 1) (the "ED"), issued in November 2021.

2. We agree with the ED's proposal that the specified conditions that an entity must comply with within twelve months after the reporting period do not affect the current or non-current classification of liabilities to address concerns about the outcome of *Current and Non-Current Classification of Liabilities* (the "2020 Amendments") under particular fact patterns.

3. However, we do not support the proposal to specifically require that liabilities with covenants be presented separately in the statement of financial position when they are classified as non-current. Neither do we support the proposed disclosure requirements in paragraphs 76ZA(b)(ii) and (iii) of the ED.

4. In addition, we are concerned that the proposed paragraph 76ZA(b)(i) of the ED which requires disclosure of covenants might lead to a large volume of detailed

information in the financial statements. Therefore, we suggest that additional guidance be provided.

5. Further, our understanding is that paragraph 72C of the ED is proposed so that the new requirements would not affect other types of liabilities with conditional settlements other than long-term loans with covenants. However, we are concerned that this paragraph may lead to different interpretations and thus we believe that paragraph 72C should be modified or deleted.

6. For our comments on the specific questions, please refer to the Appendix.

7. We hope our comments are helpful for the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

Y. Kawanishi

Yasunobu Kawanishi
Vice Chair
Accounting Standards Board of Japan

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.

1. As described in the cover letter, we support the ED's proposal that the specified conditions that an entity must comply with within twelve months after the reporting period do not affect the classification of a liability as current or non-current.

Disclosures about conditions

2. We agree that it is necessary to disclose the covenants with which an entity is required to comply in order to provide financial statement users with useful information to help them assess the uncertainty of the timing of payments due to future events occurring after the reporting period.

3. However, in the case of loans, covenants may differ depending on the lending financial institution, and there are concerns that a large volume of detailed

information may be provided when there are multiple financial and non-financial conditions with strict definitions. In addition, we question the usefulness of information regarding conditions where an entity has assessed that the possibility of a breach occurring within twelve months after the reporting period is remote.

4. We note that the ED would require disclosure when liabilities with covenants are classified as non-current (proposed paragraph 76ZA of the ED). We believe, from the perspective of costs and benefits, it is necessary to consider the consistency of the level of disclosure in cases where the proposed amendments in the ED are applied (when current and non-current liabilities are classified in the statement of financial position) and where they are not applied, regarding when disclosure of covenants is not required and to what extent disclosure should be made (with reference to IFRS7 *Financial Instruments: Disclosures,* paragraphs 31 and B3, and IFRS Practice Statement 2, *Making Materiality Judgements,* paragraphs 81 to 83*)*.

5. Therefore, we suggest that the main part of IAS 1 should explicitly prescribe that information about covenants is not required when an entity assesses that the likelihood of a breach is remote, regardless of the significance of the consequences of the breach.

6. In addition, regarding to what extent specified conditions should be disclosed, we propose that additional requirement be added to the main part of IAS 1 to assess the materiality of information about specified conditions in light of the entity's circumstances, by considering both the consequences (magnitude of impact) of a breach of a covenant and the likelihood of such breach occurring, and to require the entity to determine the level of disclosure.

7. We also propose to require disclosure of a breakdown of the carrying amount of liabilities with different covenants.

Whether the entity would have complied with the conditions based on its circumstances at the end of the reporting period

8. We disagree with the proposal in the ED regarding the disclosure of "whether the entity would have complied with the conditions based on its circumstances at the end of the reporting period" for the following reasons:

    (1) Regarding the risk that non-current liabilities with covenants may become due for repayment within 12 months, we do not think it is necessary to provide the

disclosure proposed in paragraph 76ZA(b)(ii), because the disclosure of "conditions with which the entity is required to comply" provides information about the possibility of early repayment if the entity is unable to comply with such conditions. We do not see any need to additionally require disclosure of such information.

(2) If the conditions required to be complied with within twelve months after the reporting date incorporate the seasonality of the entity's business, disclosing whether the entity has complied with those conditions based on conditions as of the end of the reporting period would not reflect the seasonality of the business and could mislead financial statement users.

Whether and how the entity expects to comply with the conditions after the end of the reporting period

9. We have the following concerns regarding the disclosure of "whether and how the entity expects to comply with the conditions after the end of the reporting period".

(1) In light of paragraph 3.6 of the IASB's *Conceptual Framework*, forward-looking information about compliance with covenants would not normally be considered information that should be included in financial statements. However, if the entity expects to breach specified conditions and the impact of the breach is expected to be significant, forward-looking information about expected compliance with the covenants would be useful information for financial statement users. In such a case, significant doubt upon the entity's ability to continue as a going concern may arise, and thus the disclosure requirements of the current IFRS standard on going concern and on judgments in applying accounting policies (IAS 1 paragraphs 25 and 122) would be applied.

(2) If the entity expects to comply with the specified conditions, the requirement might lead to boilerplate disclosures.

10. Therefore, we object to the new requirement to disclose whether and how the entity expects to comply with the conditions after the end of the reporting period.

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.

11. We do not support the proposed separate presentation in the ED. We do not believe it is necessary to specifically require separate presentation, because paragraph 55 of IAS 1 already requires separate presentation after exercising an entity's judgment according to the relevance of the information. We also propose requiring disclosure of the line item and the carrying amount of liabilities with covenants when an entity does not present such information separately in the statement of financial position.

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.

12. Our understanding is that paragraph 72C of the ED is proposed so that the new requirements would not affect other types of liabilities with conditional settlements other than long-term loans with covenants. However, we are concerned that this paragraph may lead to interpretations that are different from that is intended by the IASB. Therefore, based on the intent indicated in paragraph BC19 of the ED, we recommend the following modifications to clarify the relationship between those situations in paragraph 72C(a) or (b) and the conditions that an entity must comply with in paragraph 72B:

    (1) In the first sentence of paragraph 72C, to specify that both situations in paragraph 72C(a) or (b) are not subject to such conditions with which the entity must comply as described in paragraph 72B.

    (2) To delete "An entity does not have the right to defer settlement of a liability for at least twelve months (as described in paragraph 69(d))" from the first sentence of paragraph 72C because it could be interpreted to affect the classification of other types of liabilities with conditional settlement other than long-term loans with covenants.

    (3) To clarify the wording of paragraph 72C(b) so that non-financial conditions do not meet the requirements of paragraph 72C(b) because they may be unaffected by the entity's future actions.

13. On the other hand, it is usually understandable without specific guidance that the situation in section 72C(a) or (b) is not met for covenants for loans that require an entity to commit to certain actions or to confirm financial indicators on a recurring basis. Consequently, we do not think it necessary to specify that the situations in paragraph 72C(a) or (b) are not subject to the conditions that an entity must comply with to defer the settlement of a liability within twelve months after the reporting period. Rather, we think that the guidance in paragraph 72C may lead to different interpretations regarding the scope of the proposed amendment, which may result in unintended consequences for other types of liabilities with conditional settlements other than long-term loans with covenants.

14. Therefore, we propose that paragraph 72C be modified as described in paragraph 12 of this letter or deleted.