STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Classification of Debt with Covenants as Current or Non-current (IAS 1)**
Paper topic	Initial Consideration

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Introduction

1. The International Accounting Standards Board (Board) issued *Classification of Liabilities as Current or Non-current*, which amended IAS 1 *Presentation of Financial Statements*, in January 2020 (IAS 1 amendments). In July 2020, in response to the covid-19 pandemic, the Board deferred by one year the effective date of the IAS 1 amendments to provide entities with more time to implement any resulting classification changes.[1] The IAS 1 amendments are now effective for annual reporting periods beginning on or after 1 January 2023.

2. The IAS 1 amendments clarified how to classify debt and other financial liabilities as current or non-current in particular circumstances. Since the amendments were issued, some stakeholders have told us that different interpretations are arising in practice related to the requirements for determining whether an entity has a right to defer settlement of the liability for at least twelve months after the end of the reporting period. Stakeholders

[1] In July 2020 the Board did not make any changes to the IAS 1 amendments other than the deferral of the effective date.

say these different interpretations may result in inconsistent application of the IAS 1 amendments and, without further clarification of the amendments, the deferral of the effective date may not be as useful as the Board intended.

3. The IFRS Interpretations Committee (Committee) has not (yet) received a formal submission. However, based on the informal feedback and enquiries received from stakeholders, we think it is worth considering whether action should be taken before the amendments become effective and divergence in practice develops. Therefore, we are bringing this matter to the Committee now.

4. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our analysis; and

   (c) ask the Committee whether it agrees with our recommendation not to add a standard-setting project to the work plan.

Structure of the paper

5. This paper includes the following:

   (a) background information (paragraphs 7–15);

   (b) staff analysis and conclusion (paragraphs 16–38); and

   (c) staff recommendation (paragraphs 39–40).

6. There are two appendices to this paper:

   (a) Appendix A—proposed wording of the tentative agenda decision; and

(b) Appendix B—excerpts from IAS 1 as amended in January 2020.[2]

Background information

The question

7. Paragraph 69(d) of IAS 1 specifies that, to classify a liability as non-current, an entity must have the right to defer settlement of the liability for at least twelve months after the reporting period. Stakeholders have asked how an entity determines whether it has 'the right to defer settlement' when a long-term liability is subject to a condition (for example, a debt covenant) and the borrower's compliance with the condition is tested at dates after the end of the reporting period.

8. This agenda paper analyses only the question described in paragraph 7. Any other questions related to the IAS 1 amendments are outside the scope of this paper.

Fact patterns

9. The following three cases illustrate the matter described in paragraph 7 of this paper. Stakeholders have asked whether the liabilities in Cases 1–3 would be classified as current or non-current. In all three cases, the entity is preparing its annual financial statements for the year ended 31 December 20X1 and is assessing whether it classifies a liability as current or non-current at that date. For the purposes of these cases, we assume the criteria in paragraph 69(a)–(c)—which would require the entity to classify the liability as current—are not met; that is, in these fact patterns, classification as current or non-current is determined by the criterion in paragraph 69(d).

[2] This agenda paper discusses the relevant requirements in IAS 1 reflecting the amendments issued in January 2020. For Committee members' convenience, Appendix B reproduces those requirements with the IAS 1 amendments shown in marked-up text.

Case 1

10. An entity has a loan with the following contractual terms:

    (a) the loan is repayable in five years (ie at 31 December 20X6).

    (b) however, the loan requires a working capital ratio above 1.0 at each 31 December, 31 March, 30 June and 30 September. The loan becomes repayable on demand if this ratio is not met at any of these testing dates.

    (c) the entity's working capital ratio at 31 December 20X1 is 0.9 but the entity obtains a waiver before the reporting date with respect to the breach at that date. The waiver is for three months after the reporting period. Compliance with the covenant on the other testing dates continues to be required.

    (d) the entity expects the working capital ratio to be above 1.0 at 31 March 20X2 (and the other testing dates in 20X2).

Case 2

11. The fact pattern is the same as Case 1 except:

    (a) instead of the condition described in paragraph 10(b), the loan requires a working capital ratio above 1.0 at each 31 March (ie the ratio is tested only once a year at 31 March). The loan becomes repayable on demand if the ratio is not met at any of these testing dates.

    (b) the entity's working capital ratio at 31 December 20X1 is 0.9. The entity expects the working capital ratio to be above 1.0 at 31 March 20X2.

Case 3

12. The fact pattern is the same as Case 1 except:

    (a) instead of the condition described in paragraph 10(b), the loan requires a working capital ratio above 1.0 at 31 December 20X1 and above 1.1 at 30 June 20X2 (and at each 30 June thereafter). The loan becomes repayable on demand if the ratio is not met at any of these testing dates.

(b) the entity's working capital ratio at 31 December 20X1 is 1.05. The entity expects the working capital ratio to be above 1.1 at 30 June 20X2.

Summary of the cases

13. The table below summarises the facts in these three cases.

	Case 1	Case 2	Case 3	
Required working capital ratio	above 1.0	above 1.0	above 1.0	above 1.1
Testing date	each 31 December, 31 March, 30 June, and 30 September	each 31 March	31 December 20X1	30 June 20X2 and each 30 June thereafter
Conditions at 31 December 20X1 (the reporting date)	Working capital ratio is 0.9	Working capital ratio is 0.9	Working capital ratio is 1.05	
	The entity obtains a waiver for the breach before 31 December 20X1. The waiver is for three months. The entity expects the working capital ratio to be above 1.0 at 31 March 20X2 (and the other testing dates in 20X2).	The entity expects the working capital ratio to be above 1.0 at 31 March 20X2.	The entity expects the working capital ratio to be above 1.1 at 30 June 20X2.	

Outreach

14. The purpose of any outreach we perform is to understand:

(a) the prevalence of the transaction or fact pattern submitted; and

(b) the accounting applied to that transaction or fact pattern.

15. We decided not to perform outreach on this matter because:

(a) we are aware through informal discussions with stakeholders that the fact patterns described in this paper (or similar variations thereof) are common. Accordingly, we concluded that the matter could be prevalent.

(b) the matter described in this paper relates to the application of the IAS 1 amendments and, in the light of the effective date (annual reporting periods beginning on or after 1 January 2023), there is likely to be limited observable practice at this time.

Staff analysis

16. The IAS 1 amendments amended paragraph 69(d) of IAS 1 and added paragraph 72A. As described in paragraphs BC48B and BC48D of the Basis for Conclusions on IAS 1, which are reproduced in Appendix B, these amendments clarify that an entity's right to defer settlement of a liability for at least twelve months *must exist at the end of the reporting period*. In order to make that determination, the entity must consider whether it complies with any conditions *at that date*, even if compliance is tested at a later date.

17. Paragraph 69(d) specifies that an entity classifies a liability as current when it does not have the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period.[3]

18. Paragraph 72A provides related application requirements:

> 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

[3] As noted in paragraph 9 of this paper, our analysis focuses only on the criterion in paragraph 69(d) of IAS 1. We assume that the criteria in paragraph 69(a)–(c)—which would require the entity to classify the liability as current—are not met.

> 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.

19. Paragraphs 74 and 75 of IAS 1 discuss circumstances in which an entity breaches a condition of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability would become payable on demand. Paragraph 74 requires an entity to classify such a liability as current because, at the end of the reporting period, it does not have the right to defer settlement of the liability for at least twelve months after that date. However, paragraph 75 addresses circumstances in which the lender agrees by the end of the reporting period to provide a period of grace (emphasis added):

> … an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide *a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.*

Case 1

20. In Case 1, the entity's right to defer settlement of the loan for at least twelve months after the reporting period is subject to the entity complying with a specified condition—a working capital ratio above 1.0 at each 31 March, 30 June, 30 September and 31 December. The loan becomes repayable on demand if the ratio is not met on any of these testing dates.

21. Based on the fact pattern, at the end of the reporting period, the entity does not comply with the condition because its working capital ratio is 0.9. The entity obtains a waiver from the lender; however, the period of grace is for only three months (not twelve, as required by paragraph 75 of IAS 1). The entity is still required to comply with the condition at the next testing date—31 March 20X2. Consequently, the entity does not

have the right to defer settlement of the liability *for at least twelve months after the reporting period*, but only for three months.

22. When classifying the loan as current or non-current, paragraph 69(a) requires the entity to assess whether it 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. It is not relevant that the entity expects to meet the condition at 31 March 20X2, or may expect to receive another period of grace from the lender. Similarly paragraph 72A of IAS 1 states that the entity's right to defer settlement of the liability for at least twelve months after the reporting period *must exist at the end of the reporting period*.

23. Accordingly, in Case 1, applying paragraphs 69(d), 72A and 75 of IAS 1, the entity does not have the right at the end of the reporting period to defer settlement of the loan for at least twelve months after the reporting period.

Case 2

24. Similar to Case 1, in Case 2 the entity's right to defer settlement of the loan for at least twelve months after the reporting period is subject to the entity complying with a specified condition—a working capital ratio above 1.0 at each 31 March. The loan becomes repayable on demand if the ratio is not met on the testing date. In Case 2, the lender measures the working capital ratio only once a year on 31 March.

25. Paragraph 72A addresses circumstances in which the lender tests compliance with a specified condition at a date after the end of the reporting period (emphasis added):

> …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*.

26. Therefore, in Case 2, the entity must determine if it complies with the condition—that it, whether its working capital ratio is above 1.0—at the end of the reporting period. The entity has a working capital ratio of 0.9 at 31 December 20X1 and, thus, does not comply with the condition at the end of the reporting period (31 December 20X1).

27. In addition, as described in paragraph 22 of this paper, when classifying the loan as current or non-current, it is not relevant that the entity expects the working capital ratio to be above 1.0 at 31 March 20X2. That is because, applying paragraphs 69(d) and 72A, the entity's right to defer settlement of a liability for at least twelve months after the reporting period *must exist at the end of the reporting period*.

28. Accordingly, in Case 2, the entity does not have the right at the end of the reporting period to defer settlement of the loan for at least twelve months after the reporting period.

Case 3

29. Similar to Case 1 and Case 2, in Case 3 the entity's right to defer settlement of the loan for at least twelve months after the reporting period is subject to the entity complying with specified conditions—a working capital ratio above 1.0 at 31 December 20X1 and a working capital ratio above 1.1 at 30 June 20X2. The loan becomes repayable on demand if the relevant ratio is not met on the testing date.

30. Paragraph 72A specifies that if the right to defer settlement for at least twelve months 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*. In this case, the entity's right to defer settlement of the loan for at least twelve months after the reporting period is subject to complying with *both* specified working capital ratios required during that twelve-month period—a working capital ratio above 1.0 at 31 December 20X1 and a working capital ratio above 1.1 at 30 June 20X2. That is, applying paragraph 72A, the entity has the right at the end of the reporting period to defer settlement of the loan for at least twelve months after the reporting period only if it complies with *both* conditions at 31 December 20X1.

31. The entity has a working capital ratio of 1.05 at 31 December 20X1. Therefore, at the end of the reporting period, the entity complies with the condition tested at that date (a working capital ratio above 1.0).

32. However, the entity does not comply with the condition that will be tested at 30 June 20X2 (a working capital ratio above 1.1). As described in our analysis set out in paragraphs 24–26 of this paper, paragraph 72A of IAS 1 addresses circumstances in which the lender does not test compliance with a specified condition until a later date. That paragraph states that an entity must comply with the condition at the end of the reporting period *even if the lender does not test compliance until a later date*. Applying these requirements, at the end of the reporting period, the entity does not comply with the condition that will be tested at 30 June 20X2.

33. Consistent with our analysis in paragraphs 22 and 27 of this paper, when classifying the loan as current or non-current, it is not relevant that the entity expects the working capital ratio to be above 1.1 at 30 June 20X2. Applying paragraph 72A the entity's right to defer settlement of a liability for at least twelve months after the reporting period *must exist at the end of the reporting period*.

34. Accordingly, in Case 3, the entity does not have the right at the end of the reporting period to defer settlement of the loan for at least twelve months after the reporting period.

Relevance of paragraph BC48E on Cases 1-3

35. Some may argue that paragraph BC48E in the Basis for Conclusions on IAS 1 (reproduced in Appendix B) is relevant when an entity assesses whether it complies with a specified condition at the end of the reporting period but the lender does not test compliance until a later date. Specifically, in the context of the fact patterns described in this paper, some suggest that the entity should adjust its working capital ratio at the end of the reporting period (31 December 20X1) to reflect the effect of expected transactions between that date and a later testing date (for example, 31 March 20X2 in Case 2)—ie the

entity would estimate what it *expects* its working capital ratio *will be* at a subsequent testing date.

36. We think paragraph BC48E is not relevant to the fact patterns described in this paper. First, the Basis for Conclusion is not part of the Standard and does not contain requirements—it accompanies the Standard, explaining the reasons for the Board's decisions in developing the requirements in the Standard. As set out in our analysis in paragraphs 16–34 of this paper, we think the *requirements* in IAS 1 are clear with respect to the fact patterns described. In addition, we think paragraph BC48E discusses the Board's observations on the application of paragraph 72A of IAS 1 to particular conditions relating to an entity's cumulative financial *performance*—not conditions relating to an entity's financial *position*.[4] That is, we think paragraph BC48E is referring to circumstances in which an entity's actual performance up to the end of the reporting period reflects a shorter period of performance than specified in the condition (eg actual revenue for nine months and a covenant requiring a particular level of revenue over a twelve-month period)—and the Board observed that one of those measures would have to be adjusted in order to provide useful information.

Staff conclusion

37. In the three cases described in this paper, in our view, the entity is required to classify the loan as current because it does not have the right at the end of the reporting period (31 December 20X1) to defer settlement of the loan for at least twelve months after the reporting period.

[4] This is explained in AP29B for the Board's March 2019 meeting. In that agenda paper the staff observed that, although it should be clear how to assess whether an entity complies at the reporting date with a condition relating to its *financial position* (for example, a gearing ratio), it might be less clear how to assess whether an entity complies at the reporting date with a condition relating to its *financial performance* (for example, operating profit or a ratio of EBITDA to net interest-bearing debt) for a period that extends beyond the reporting date. Paragraph BC48E was added to the Basis for Conclusions on the IAS 1 amendments to address the latter.

Question 1 for the Committee
1. Does the Committee agree with our analysis of the application of the requirements in IFRS Standards to the fact patterns described in this paper?

Should the Committee add a standard-setting project to the work plan?

Is it necessary to add or change requirements in IFRS Standards to improve financial reporting?[5]

38. Based on our analysis, we conclude that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine whether the liabilities in the fact patterns described in this paper are classified as current or non-current.

Staff recommendation

39. Based on our assessment of the work plan criteria in paragraph 5.16 of the *Due Process Handbook* (discussed in paragraph 38 of this paper), we recommend that the Committee does not add a standard-setting project to the work plan. Instead, we recommend publishing a tentative agenda decision that outlines how an entity accounts for the fact patterns described in this paper applying IFRS Standards.

40. Appendix A to this paper sets out the proposed wording of the tentative agenda decision. In our view, the proposed tentative agenda decision (including the explanatory material contained within it) would not add or change requirements in IFRS Standards.[6]

[5] Paragraph 5.16(b) of the *Due Process Handbook*.

[6] Paragraph 8.4 of the *Due Process Handbook* states: 'Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.'.

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add a standard-setting project to the work plan?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision in Appendix A to this paper?

Appendix A—proposed wording of the tentative agenda decision

Classification of Debt with Covenants as Current or Non-current (IAS 1 *Presentation of Financial Statements*)

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 in particular circumstances (IAS 1 amendments). The amendments are effective for annual reporting periods beginning on or after 1 January 2023.

The Committee discussed how an entity applies the IAS 1 amendments to particular fact patterns. Specifically, the Committee discussed how an entity determines whether it has the right to defer settlement of a liability for at least twelve months after the reporting period applying paragraph 69(d) of IAS 1 when the right to defer settlement is subject to the entity complying with specified conditions and compliance with the specified conditions is tested at a date after the end of the reporting period. In the fact patterns discussed, it is assumed that the criteria in paragraph 69(a)–(c) of IAS 1 are not met.

Fact patterns

The Committee discussed three fact patterns. In all fact patterns, the entity is assessing whether it classifies a loan as current or non-current at the end of the reporting period (31 December 20X1)

Case 1

An entity has a loan with the following contractual terms:

a. the loan is repayable in five years (ie at 31 December 20X6).

b. however, the loan requires a working capital ratio above 1.0 at each 31 December, 31 March, 30 June and 30 September. The loan becomes repayable on demand if this ratio is not met at any of these testing dates.

c. the entity's working capital ratio at 31 December 20X1 is 0.9 but the entity obtains a waiver before the reporting date with respect to the breach at that date. The waiver is for three months. Compliance with the covenant on the other testing dates continues to be required.

d. the entity expects the working capital ratio to be above 1.0 at 31 March 20X2 (and the other testing dates in 20X2).

Case 2

The fact pattern is the same as Case 1 except:

a. instead of the condition described in Case 1, the loan requires a working capital ratio above 1.0 at each 31 March (ie the ratio is tested only once a year at 31 March). The loan becomes repayable on demand if the ratio is not met at any testing date.

b. the entity's working capital ratio at 31 December 20X1 is 0.9. The entity expects the working capital ratio to be above 1.0 at 31 March 20X2.

Case 3

The fact pattern is the same as Case 1 except:

a. instead of the condition described in Case 1, the loan requires a working capital ratio above 1.0 at 31 December 20X1 and above 1.1 at 30 June 20X2 (and at each 30 June thereafter). The loan becomes repayable on demand if the ratio is not met at any of these testing dates.

b. the entity's working capital ratio at 31 December 20X1 is 1.05. The entity expects the working capital ratio to be above 1.1 at 30 June 20X2.

Application of IAS 1 to the fact patterns

Paragraph 69(d) of IAS 1 specifies that an entity classifies a liability as current when 'it does not have the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period'. Paragraphs 72A and 75 of IAS 1 provide related application requirements.

Case 1

The entity's right to defer settlement of the loan for at least twelve months after the reporting period is subject to the entity complying with a specified condition—a working capital ratio above 1.0 on 31 March, 30 June, 30 September and 31 December 20X2. The entity does not comply with the condition at the end of the reporting period because its working capital ratio is 0.9.

The entity obtains a waiver from the lender but the waiver is for only three months after the reporting period. Paragraph 75 of IAS 1 states that 'an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period…'.

Accordingly, the Committee concluded that the entity does not have the right at the end of the reporting period to defer settlement of the loan for at least twelve months after the reporting period.

Case 2

The entity's right to defer settlement of the loan for at least twelve months after the reporting period is subject to the entity complying with a specified condition—a working capital ratio above 1.0 at 31 March 20X2.

Paragraph 72A of IAS 1 addresses circumstances in which compliance with a specified condition is tested at a date after the end of the reporting period. That paragraph states that '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'. The entity does not comply with the condition at the end of the reporting period because its working capital ratio is 0.9.

Accordingly, the Committee concluded that the entity does not have the right at the end of the reporting period to defer settlement of the loan for at least twelve months after the reporting period.

Case 3

The entity's right to defer settlement of the loan for at least twelve months after the reporting period is subject to the entity complying with two specified conditions—a working capital ratio above 1.0 at 31 December 20X1 and a working capital ratio above 1.1 at 30 June 20X2.

Paragraph 72A of IAS 1 states that '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'. The entity has a working capital ratio of 1.05 at 31 December 20X1. Therefore the entity complies with the condition tested at that date (a working capital ratio above 1.0) but does not comply with the condition that will be tested at 30 June 20X2 (a working capital ratio above 1.1).

Accordingly, the Committee concluded that the entity does not have the right at the end of the reporting period to defer settlement of the loan for at least twelve months after the reporting period.

Consequently, in the three fact patterns described in this agenda decision, the Committee concluded that the entity is required to classify the loan as current because the entity does not have the right at the end of the reporting period (31 December 20X1) to defer settlement of the loan for at least twelve months after the reporting period.

In reaching its conclusion, the Committee noted that the entity's expectation that it will meet the condition tested after the reporting period does not affect its assessment of the criterion in paragraph 69(d) of IAS 1. Applying paragraphs 69(d) and 72A of IAS 1, the entity's right to defer settlement of a liability for at least twelve months after the reporting period must exist at the end of the reporting period.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for the entity to determine its accounting for the three fact patterns described in the agenda decision. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix B—excerpts from IAS 1 as amended in January 2020

B1. We have reproduced excerpts from IAS 1 below. For Committee members' convenience, the amendments issued in January 2020 are shown in marked-up text (new text is underlined and deleted text is struck through).

69 An entity shall classify a liability as current when:

(a) it expects to settle the liability in its normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after the reporting period; or

(d) it does not have ~~an unconditional~~ the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period ~~(see paragraph 73). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification~~.

An entity shall classify all other liabilities as non-current.

…

72A 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.

73 If an entity ~~expects, and~~ has the ~~discretion,~~ right, at the end of the reporting period, to ~~refinance or~~ roll over an obligation for at least

twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. ~~However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing)~~ <u>If the entity has no such right</u>, the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

74 When an entity breaches a ~~provision~~ <u>condition</u> of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have ~~an unconditional~~ <u>the</u> right to defer its settlement for at least twelve months after that date.

75 However, an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

B2. We have reproduced paragraphs BC48B, BC48D and BC48E of the Basis for Conclusions on IAS 1 below.

BC48B The Board added to the classification principle in paragraph 69(d) and the example in paragraph 73 clarification that an entity's right to defer settlement must exist 'at the end of the reporting period'. The need for the right to exist at the end of the reporting period was already illustrated in the examples in paragraphs 74 and 75 but was not stated explicitly in the classification principle.

BC48D 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 only if the entity complies with those conditions at the end of the reporting period; and

  (ii) 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.

BC48E The Board considered whether to specify how management assesses an entity's compliance with a condition relating to the entity's cumulative financial performance (for example, profit) for a period extending beyond the reporting period. The Board concluded that comparing the entity's actual performance up to the end of the reporting period with the performance required over a longer period would not provide useful information—one of these measures would have to be adjusted to make the two comparable. However, the Board decided not to specify a method of adjustment because any single method could be inappropriate in some situations.