

February 15, 2021

[commentletters@ifrs.org](mailto:commentletters@ifrs.org)

**IFRS Foundation**

Columbus Building  
7 Westferry Circus  
Canary Wharf  
London

**Reference: Tentative agenda decision Classification of Debt with Covenants as Current or Non-current (IAS 1 Presentation of Financial Statements)**

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)<sup>1</sup>welcomes the opportunity to respond to the Tentative agenda decision Classification of Debt with Covenants as Current or Non-current (IAS 1 Presentation of Financial Statements).

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

If you have any questions about our comments, please do not hesitate to contact us at [operacoes@cpc.org.br](mailto:operacoes@cpc.org.br).

Yours sincerely,



Rogerio Lopes Mota  
Chair of International Affairs  
Comitê de Pronunciamentos Contábeis (CPC)

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<sup>1</sup>The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).



We appreciate the Committee's efforts to clarify the International Accounting Standards Board's (the Board) amendments to IAS 1, as by accompanying the Tentative Agenda Decision from the Committee, we realized that the application of IAS 1.72A, as written, will achieve a different accounting outcome than we would expect.

We agree that the conclusions set out in all three illustrative cases reflect a literal reading of the new IAS 1 requirements; however, **we have significant concerns with the potential outcome of these amendments in Brazil. We do not agree** with: (i) the potential mismatch between the accounting classification and the loan's contractual terms and conditions; and, (ii) with the narrow focus of financial position covenants (i.e., without a clarification on how to apply the concept added in IAS 1.71A on performance and qualitative covenants). (iii) We also would like to, even though it is not the object of outreach, highlight our long-standing disagreement with IAS 1.74. Please, see below the summary of our comments on the Tentative Agenda Decision issued by the Committee.

**(i) Potential mismatch between the accounting classification and the loan's contractual terms and conditions.**

The amendments introduce a new simple test, which could be considered easy to apply as no estimation is required. But, the outcome of applying this amendment, as illustrated in all scenarios analysed by the Committee, does not represent a relevant information to users of financial statements. We believe that the liability would be classified as current at the reporting date, yet the lender does not have the contractual right to demand repayment and the borrower does not have the contractual obligation to settle the liability at that date.

The test introduced by the amendments ignore both contractual terms and conditions in our jurisdiction and how covenants are designed to attend certain specificity of the entities (e.g., start-ups). In practice, the use of a hypothetical test would also mean that a loan's classification may change from one reporting date to another, including from one interim reporting date to another, without any actual breach of its contractual conditions having occurred. We do not agree with this outcome – as we do not believe the approach introduced by the Board results in an outcome that provides relevant information to users of the financial statements.

**(ii) Focus of the TAD is too narrow**

While the TAD refers broadly to classification of debt with covenants, it illustrates loans with covenants that test conditions only based on the borrower's financial position (e.g. a required working capital ratio) and is limited to the three fact patterns described. The TAD does not clarify if/how classification of a loan with a financial performance condition (e.g. annual revenue / earnings target to be tested after the



reporting date) or qualitative covenants (e.g. submission of audited financial statements of the borrower by a certain date) would be affected by the amendments.

Since the amendments apply to all financial liabilities, not only to loans with financial position covenants, we believe the clarification in the TAD is insufficient to resolve the ambiguity in the amendments. Additional application issues will arise in the absence of a clear articulation of the underlying principle across a much wider set of examples of liabilities with covenants. A clear explanation is needed as to what the 'right to defer settlement' actually means and how a borrower is to assess appropriately and consistently whether such right has substance. While the 'substance' criterion was introduced by the amendments, there is limited guidance in the amended IAS 1 on how to determine whether a right has substance. This could lead to different interpretations arising in practice.

**(iii) Applicability of IAS 1.74**

Despite the rationale described above, we take the opportunity to address a different issue already expressed by CPC in the response to the Exposure Draft 2015/1 – Classification of liabilities. We believe that if a debt arrangement is renegotiated after year-end (e.g. a waiver was obtained for a covenant default), but before the release date of the financial statements, should be classified as non-current liability at year end in order to provide meaningful information to the users of the financial statements. In many cases, entities realize that they are in default after the preparation of the financial statements, thus after year-end, and immediately request a waiver to the counterparty, obtaining such waiver before the release date of the statements. In paragraph 73 (R) the Board express its view that said waiver is not a company "right" at the end of the report date, and as such, the company should classify the debt breach as a current liability. We kindly request that the Board reassess such issue in this revised standard. We believe that classifying the debt as a current liability, and disclosing the waiver in a subsequent event note may not be fully meaningful for the user of the information in this specific scenario, and in fact, will provide incorrect and misleading information to such user.

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As a response of our comment letter, we believe that the Committee should send this matter to the Board; then, we believe that the Board members should review its evaluation to add IAS 1.71A hypothetical test (or improve it) and to review paragraph IAS 1.74, as explained above.