THE 100 GROUP

Financial Reporting Committee

IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD

10 February 2021

Dear Ms. Lloyd,

Thank you for the opportunity to respond to the IFRS Interpretations Committee's Tentative Agenda Decision on the Classification of Debt with Covenants as Current or Non-current (IAS 1).

This response has been prepared by the 100 Group Financial Reporting Committee and is intended to speak on behalf of the Group as a whole. The 100 Group membership represents around 87% of the FTSE100 market capitalisation as well as a number of equally significant sized unlisted businesses. We note that whilst this letter expresses the views of the 100 Group as a whole, these views are not necessarily those of individual members nor their respective employers. We thank you for the opportunity to comment on your proposal and are happy to have any follow up discussion if helpful.

While we do not disagree with how the amendments to IAS 1 have been interpreted, we have significant concerns about the resulting conclusions which, in our view, are counter intuitive and likely to have a detrimental impact on the market. Any changes to the International Accounting Standards should provide users of the financial statements with better and/or more transparent information regarding the performance of a company which, based on the Tentative Agenda Decision, we do not consider the amendments to IAS1 do.

Classifying debt based on a hypothetical test at the reporting date does not take into account the intended design of covenants and disconnects reporting of debt from its contractual terms and conditions. Doing so is likely to result in the classification of debt as current, suggesting that the company is not in compliance with the terms of the loan, when neither the company nor the lender expect a breach of covenants at the actual test date.

For example, seasonal businesses may not be expected to pass hypothetical covenant tests throughout the year. However, based on the tentative agenda decision they would be required to repeatedly re-classify debt between current and non-current at different reporting dates, irrelevant of whether an actual breach has occurred or is expected. We believe this would reduce the understandability and comparability of the resulting financial statements, particularly when biannual and quarterly financial statements are prepared.

A hypothetical test would also not take into account the mitigating actions, proactive covenant management or business planning exercises that a business can take. A company may plan to make divestments or to maintain working capital ratios, the example used by the Committee, a company can use factoring, offer early payment incentives to customers and defer payments to suppliers. Conversely, a company that expects to pass a covenant at the test date but that, if measured, would fail the test at the reporting date may enter into mitigating actions to avoid this hypothetical situation, increasing the level of accounting disclosure and incurring additional costs. It is important that changes to standards do not mean companies need to adapt their commercial operations solely for the purpose of year-end reporting.

Additionally, the Committee's Tentative Agenda Decision does not provide examples of non-financial covenants. Requiring companies to comply with all conditions that will be tested within 12 months of the reporting date, in order to classify its debt as non-current, is likely to cause further complications when these covenants are considered. For example, a common requirement is that companies file accounts with an unmodified audit opinion within a set time period of their year-end. It is also not uncommon for a company to have covenants with cross-default clauses with respect to other covenants. In these instances, a hypothetical covenant breach at the reporting date could give rise to an actual breach of other covenants, and the associated ramifications.

We also consider that the Tentative Agenda Decision would create inconsistency with almost all other accounting standards where projected financial information is applied in the determination of the measurement and presentation of assets and liabilities. Such inconsistency would further contribute to making the financial statements less understandable and comparable for users.

Users of the financial statements could, in our opinion, obtain a better understanding as to the 'health' of the company through additional disclosure (as opposed to reclassification of balances between non-current and current). Such disclosure would vary on the degree of estimation uncertainty as to whether a company is expected to pass the financial covenant at the test date. Where appropriate, this could lead to disclosure of significant estimation uncertainty if the covenant is not expected to pass at the test date or is dependent on a number of factors not fully within the control of the company or that the company has limited historical experience of achieving.

In our view, the fact that the amendments lead to the conclusions set out in the Tentative Agenda Decision raises questions about the appropriateness of the proposed amendments themselves.

We recommend that the IFRS Foundation conduct additional outreach with stakeholders, particularly preparers and lenders, to consider any other unintended consequences and that the Interpretations Committee add a standard setting project to the IASB's work plan to revisit the appropriateness of the amendments to IAS 1.

We hope you find that our observations helpful and insightful as you move forward. Please do contact our secretariat Hannah Maughan at secretariat@the100group.co.uk should you wish to discuss any of our comments in further detail and she will be very happy to put you in touch with us.

Yours sincerely,

**Iain J Mackay,**
*Chair of the 100 Group Financial Reporting Committee*