IFRS Today

Our series on the most topical issues in IFRS® Standards and financial reporting

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"In its April meeting, the Committee decided to take a very unusual step. It decided not to finalise an agenda decision it believed to be technically correct."

VIDEO TRANSCRIPT

IFRIC agenda decisions – Classification of debt as current vs non-current

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Hello – I'm Brian O'Donovan – I'm a partner at KPMG and I'm a member of the IFRS Interpretations Committee – the IFRIC.

In its April meeting, the Committee decided to take a very unusual step. It decided not to finalise an agenda decision it believed to be technically correct. I want to explain why the Committee took such an unusual step – and what will happen next.

Classification of debt as current vs non-current

In December, the Committee published a tentative agenda decision – about how to apply new guidance on classifying debt with covenants as current or non-current. Now, this new guidance isn't effective yet – but that didn't stop the tentative agenda decision receiving a very large postbag indeed.

To explain why that happened, let me give you an example.

Suppose you have a December year end – you have a long-term loan that features a covenant test that depends on your financial position – for example, it tests your working capital ratio. Now, under the loan agreement, this test is performed in June each year – not December. The loan agreement is written like that for a reason – you and your bank understand your business is very seasonal. Year after year, your working capital looks much better in June than it ever does in December.

The tentative agenda decision explains that under the new requirements – although the loan agreement requires the covenant to be tested in June – when you prepare your December financial statements, you have to perform an additional covenant test yourself, as at December using your December numbers. If you fail that covenant test based on your December numbers, then you classify the debt as current in your December balance sheet. The fact that the loan agreement was drawn up on the understanding that your business is seasonal doesn't matter. The fact that you and your bank never expected to pass this covenant test using your December numbers doesn't matter.

As I said, this generated a very big postbag.

Next steps

In April, the Committee confirmed its original technical analysis and conclusion. The Committee – and many people who wrote in comment letters – believes that's just how these new requirements work.

But – before finalising the agenda decision – the Committee has asked the Board to look again at this whole area. Now, the Board issued these new requirements for a reason – it believes this version of the classification test can be performed objectively and consistently.

It will be interesting to see what the Board makes of these outcomes – the potential consequences identified through the Committee process.

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