Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

The Chairman of the IASB

IASB
30 Cannon Street
London EC4M 6XH
UK

5 April 2016

Dear Mr. Hoogervorst,

Re: Board Decision on Paper 12B of the February 2016 Board Meeting

We would like to inform you that we do not share the latest conclusions reached by the Board regarding the current/non-current classification of liabilities in the statement of financial position.

Although we agree with the core principle that only rights and obligations existing at the reporting date should be considered in order to classify liabilities, we disagree with the interpretation of this principle as developed in your last meeting concerning the effect of events occurring after the reporting period on a right to defer settlement (or an obligation to make early settlement).

When an agreement for automatic renewal is conditional upon compliance with a covenant, as long as the covenant as specified in the contract is not effectively breached, one cannot consider that the entity has failed in its engagement based on figures in force at another date. We share the view expressed in paragraph 17b) of the agenda paper 12B, that the right (or obligation) is not subject to a condition as at the reporting date because the condition is not due to be tested at the end of the reporting period. In accordance with this view, the right to defer settlement could never be breached (or the obligation to reimburse triggered) as at the end of the reporting period–it could only be breached at a future date because the condition only applies at a future date.

We believe that the Board is making an assumption which may go far beyond the legal reality of contracts when it asserts in paragraph 24 that "the lender is relying effectively on continual compliance with the condition to protect its interest". This assertion may be true for some contracts but not for others. We believe that covenants are negotiated with full consideration of the specific operating environment of the entity and the specific purpose of the contract, and it is not appropriate for the Board to extrapolate a specific circumstance to form a general rule about all contracts. For example, entities that operate in a seasonal or cyclical activity or which have predictable periodical high cash inflows, will take care to ensure that the dates at which the compliance with covenants has to be confirmed take into account this cyclical environment.

Take the following example: an entity with a year-end date of 31 December borrows for 5 years; each year the bank examines the entity's debt-to-equity ratio and may demand early repayment if the ratio is greater than x%. Given the seasonal activity of the entity, the lender and the borrower have agreed that the ratio is to be considered and reported as of 1 March, since, because of this seasonal activity, the covenant would always be breached if it were computed with figures as of 31 December (the reporting date). We believe that it is neither relevant, nor faithful, to present the liability as a current debt because the covenant is not effectively breached at the reporting date. If significant, information should be disclosed in notes.

To go further in the analysis, if we apply the logic developed by the Board, the debt is classified as current at 31 December because the figures on that date indicate a ratio greater than x%. The covenant report transmitted to the Bank as of 1 March (before the issue of financial statements) indicates a ratio of less than x% and therefore does not allow the lender to demand early repayment. We consider the information provided by this report to be an adjusting event since it confirms that the entity was not actually in breach during the last reporting period. It would be misleading to report the debt as current in the published financial report

In our view, when a right is subject to a condition, the assessment of whether the condition has been complied with or not at the reporting date should include an assessment of whether the condition is actually relevant at that date and is in fact intended to be met at that date. This should be based on the facts and circumstances of the actual contract and not a generic assumption about the intentions of the parties to the contract. In the case of the example given above, the condition is not relevant at that date and should not be given weight in the classification of the debt, unless there is sufficient evidence that the condition will not be met at the relevant testing date.

Finally, because a covenant may have important consequences for the entity's liquidity, information about compliance with its conditions and the consequences of non-compliance should be disclosed in the notes to inform users. Such information is often already provided in accordance with IFRS 7 since our national supervisory body (the AMF) encourages issuers to perform risk assessments of non-compliance with covenants related to long-term financing agreements which might lead to a change in the classification of such debt to current liabilities. The situation and the risk should therefore be clearly communicated to users.

We remain at your disposal should you need further clarification or background information.

Yours sincerely,

ACTEO

Patrice MARTEAU
Chairman