AASB Staff Issues Paper

ED 259 *Classification of Liabilities* (Proposed amendments to AASB 101)

1 Outlined below is a list of the constituents that have submitted comment letters to the AASB and the constituents that AASB staff spoke to through targeted outreach followed by a summary of the comments received by those constituents.

Summary of Submission & Outreach Comments

Submissions Received:

Organisation

Westworth Kemp Consultants
Saward Dawson
Representatives of the Australian Accounting Profession: CPA Australia and Chartered Accountants Australia New Zealand
HoTARAC

Targeted Outreach Participants:

BHP Billiton
KPMG
Ernst & Young
Chartered Accounts ANZ
Taryn Rulton

Summary of Comments Received

Question 1 – Classification based on the entity's rights at the end of the reporting period

2 The following comments were received regarding replacing 'discretion' in paragraph 73 with 'right'

(a) After agreeing with the proposed amendment, a constituent noted that they are not clear what objective the IASB is trying to achieve with this amendment. The constituent questioned if the replacement of the term 'discretion' and the removal of the term from the second sentence in paragraph 72R(a) is to make clear that that the classification decision should not consider management expectations. The constituent agreed with the IASB's decision to not consider management's expectation about what may occur after the reporting period however, noted that the explanation in the Basis for Conclusions is not very clear.

(b) A constituent noted support for using the same word in paragraphs 73 and 69(d), noting that it would likely increase consistency when classifying liabilities under IAS 1. In addition, the constituent noted is there is a currently exercisable right (without impediment) for the reporting entity to defer settlement, the classification is clearly non-current.

Only rights at reporting date affect classification of the liability

3 The following comments were received regarding consideration of only rights at the reporting date in determining classification of a liability:

(a) General support for the IASB's decision to consider only rights at the reporting date in determining of a liability should be current or non-current.

(b) Classification of a liability based entirely on the legal right to defer settlement that exists at balance date in certain circumstances distorts the financial statements and results in them being less useful for users. It is further noted that where a lender does agree to extend grace for a breach, or rollover a facility post year end but prior to signing of the financial report, extensive disclosures are often included to explain why the classification as current is misleading and that the settlement is now not required to occur within 12 months.

(c) This topic is already addressed in IAS 10 *Events after the Reporting Period*, however perhaps the IASB is adding it to IAS 1 for ease of use and clarification.

(d) It is questionable whether it is appropriate for an entity to take into account rights to defer settlement that exist at the end of the reporting period, before the entity has actually met the associated conditions.

Furthermore, the constituent notes that paragraph BC4 of the amending standard makes it clear that when a right is subject to a condition, it is whether the entity complies with that condition at the end of the reporting period that determines whether the right should affect the classification. However, the constituent is of the view that this intent is not clear in the proposed amendments to the existing standard and to avoid confusion and misinterpretation, recommends that the IASB clarify this in the final classification criteria and include further application guidance to reinforce this point.

'Unconditional right' replaced by 'right'

4 The following comments were received regarding 'unconditional right' being replaced with 'right':

(a) The proposed deletion of the word 'unconditional' has the potential to create diversity in practice with the risk that reasonable people may reach different conclusions.

(b) The amendment could be said to creating less clarity rather than more clarity.

(c) The deletion of the word 'unconditional' does not make it clear what a 'right' is and that in Australia, a common scenario is to see a right as conditional and therefore the removal of the word won't change the current practice in Australia.

(d) The removal of the term does not appear to address the fact that most loan agreements contain various rights and obligations on each party to the contract and not an explicit right. Particularly evident in Australia where a majority of loan contracts with Australian banks contain an 'Annual Review' clause.

(e) Preference is for the IASB not to remove the word 'unconditional' from paragraph 69(d)

(f) If the IASB proceeded with the proposed amendment, the IASB should include a specific example to provide clear guidance to preparers and auditors on the appropriate classification.

(g) The IASB needs to provide further clarification of what they are trying to achieve in proposing the amendment.

(h) 'Unconditional right' has a stronger inference that the entity is able to control the decision compared to 'right' alone. The constituent noted, given our issues in Australia with Centro, there is a risk if changes increases the potential for subjectivity.

(i) The term 'right' is used differently in other IFRSs/IASs and refers to the use of 'enforceable rights' and 'unconditional rights' in IAS 18 *Revenue*. The constituent has noted they would prefer consistency between these amendments and the usage of the word 'right' in other standards. The constituent has further noted that perhaps the term 'enforceable right' better conveys the intent of these amendments, consistent with paragraph BC4.

Question 2 – Linking settlement with the outflow of resources

The IASB proposes making clear the link between the settlement of the liability and the outflow of resources from the entity by adding 'by the transfer to the counterparty of cash, equity instruments, other assets or services' to paragraph 69 of the Standard.

Do you agree with that proposal? Why or why not?

5 The following comments were received regarding the addition of the words 'by the transfer to the counterparty of cash, equity instruments, other assets or services' to paragraph 69 of the Standard:

(a) The proposed amendments to paragraph 69 could pose some issues in the context of NFP entities. The constituent highlights in the context of AASB 15, for the NFP entity, delivery of services may be to a third party and not the counterparty to the agreement as such. Therefore, it is unclear how a NFP entity would apply this requirement in determining the classification of a liability if the transfer of service was to a party other than the direct counterparty.

(b) The requirements in paragraph 69 and the guidance in paragraphs 72R – 73R and BC7 – BC11 is not consistent and may cause some confusion on the application of the revised classification criteria.

The constituent has noted the proposed amendment in paragraph 69, in particular the additional sentence that has been added to the end of paragraph 69, suggests the classification criteria is applied to a liability that exists with a *particular counterparty*, with the proposed additional text noting 'transfer to the counterparty of cash … that results in the extinguishment of the liability'.

Therefore, the wording suggests the right to defer settlement only refers to rights to defer the settlement of a specified liability with a particular counterparty/lender. As a result, a right with a different lender that may enable the entity to defer a net outflow of resources in connection with a specified liability would not be considered in applying the revised classification criteria.

However, the constituent further highlights the text in the proposed paragraph 72R(a) that focuses on 'an existing loan facility', and the IASB's deliberations in Basis for Conclusion paragraphs BC9-BC11 that outlines the IASB's decision not to propose including an explicit requirement that rolled-over lending must be with the same lender, but rather opting for the emphasis to be placed on their being a right at the end of the reporting period to roll over the obligation under the existing loan facility, suggests that a reference 'to an existing loan facility' can still be interpreted as being a facility with a different lender.

The constituent further notes a similar interpretation can be taken to the reference to 'an agreement to refinance' in paragraph 73R(b).

It would be useful to understand the overriding objective of the proposed amendments. The constituent has questioned if the objective is to:

(i) inform users of financial statements when a specified liability with a particular counterparty is expected to be settled and result in an outflow of resources to settle that specified liability; or

(ii) inform users of financial statements when there is expected to be a (net) outflow of resources from the entity.

(c) Suggests the IASB clarify the scope of the proposed new paragraph for 'settlement of a liability' in paragraph 69, as to whether it encompasses circumstances where certain liabilities can be extinguished without the transfer of cash, equity instruments, other assets or services to the counterparty within twelve months after balance date.

The constituent has noted that in the public sector, certain arrangements allow for loans or part thereof to be forgiven. For example, a government department lends money to another public sector entity. Under the loan agreement, 100 per cent of the loan is repayable by a certain timeframe, but 30 per cent of the total amount may be waived by the government department if the borrowing entity meets certain terms and conditions. There is no assurance that the borrowing entity would meet those specific terms and conditions. Conceptually, the full amount of the loan should be initially recognised by the borrowing entity as a liability (i.e. at the inception of the agreement, the borrowing entity has a present obligation to repay the full amount of the loan). The 30 per cent of the loan would only be extinguished in subsequent periods upon the fulfilment of those terms and conditions.

Such an extinguishment (of the 30 per cent) does not involve the transfer of cash, equity instruments, other assets or services from the borrowing entity to the government department, and the borrowing entity is likely to be in control of whether and when it will fulfil those waiver terms and conditions. In such circumstances, it is unclear whether that constitutes a 'right to defer settlement'. The constituent therefore seeks clarification whether liabilities extinguished through mechanisms other than those specified in paragraph 69 would also represent a 'right to defer settlement'.

6 In addition, in relation to the proposed amendments to paragraph 69(d), AASB staff asked outreach constituents what they thought the relationship was between paragraph 69(d) and the proposed additional paragraph in paragraph 69. Extracts of the paragraph is outlined below:

> 'at the option of the counterparty, results in its settlement by the issue of equity instruments do not affect its classification'
>
> and
>
> 'For the purpose of classification as current or non-current, settlement of a liability refers to the transfer to the counterparty of cash, equity instruments…'

(a) One constituent noted it could be read as 'ignore settlements in equity if it is the counterparty decision; however she also noted that it would be interesting to know what is meant by the option in the second paragraph. In addition, it was noted that the interpretation could affect the interpretation of the main body of paragraph 69(d) in regard to not basing classification on equity instruments. Therefore, AASB staff request an explanation by the IASB of what is the intended interaction between the two statements.

(b) Another constituent questioned what the IASB's intention was for the relationship between paragraphs 69(a) and 69(d)? Paragraph 69(a) appears to imply that if management expects the settle a liability within its normal operating cycle (which it is presumed is intended to mean within 12 months) then the liability should be classified as current. However, paragraph 69(d) notes that only if an entity does not have right at the end of the reporting period to defer settlement should the classification be current. In addition, the basis for conclusion suggests that emphasis should not be placed on management expectations. Therefore, in determining classification of a liability, in accordance with paragraph 69(a) should management take into consideration their expectations or should it look at the rights held by the entity and if the entity has a right at the end of the reporting period to defer settlement should management classify the liability as non-current?

Although there are no proposed amendments for paragraph 69(a), IASB need to provide clarification of what the intended relationship is between these two paragraphs, and/or clarify that paragraph 69(a) was only to be considered for liabilities such as trade payables.

Question 3 – Transition Arrangements

The IASB proposes that the proposed amendments should be applied retrospectively.

Do you agree with that proposal? Why or why not?

7 The following comments were received regarding the transition arrangements:

(a) The wording merely clarifies the requirements in the standard and does not change the requirements and therefore we support the retrospective application.

(b) Agree with the proposal.

(c) Does not follow the logic in the Basis for Conclusion concerning the transition provisions regarding if the proposed amendments are a change in accounting policy or change in accounting estimate. The constituent agrees that the change should be retrospective however the logic in paragraphs BC19-BC20 does not make sense.

(d) Accepts the IASB's justification that, in principle, retrospective application is more appropriate, however recommends prior to finalising the amendments, the IASB undertake outreach work to assess the extent of nature of practical issues with identifying 'rights' in existence at a point of time in the past.