Australian Government
Australian Accounting Standards Board

Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600

10 June 2015

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Hans

IASB Exposure Draft ED/2015/1 *Classification of Liabilities*

The Australian Accounting Standards Board is pleased to submit its comments on Exposure Draft ED/2015/1 *Classification of Liabilities* (Proposed amendments to IAS 1). In formulating its views, the AASB sought and considered the views of its Australian constituents. The comment letters received directly by the AASB are published on the AASB's website. The AASB's responses to the specific matters for comment in ED/2015/1 are included in Appendix A to this letter.

The AASB supports clarifying the requirements of IAS 1 *Presentation of Financial Statements* regarding classification of liabilities as either current or non-current. However, the AASB is concerned that (a) the proposals in the Exposure Draft do not currently achieve the intended clarity; and (b) the proposed amendments would continue to require some degree of interpretation.

In particular, as noted in paragraphs 1-2 of Appendix A, the AASB is not clear as to the IASB's overall objective in replacing the term 'discretion' with 'right'. The AASB is concerned the proposed amendment could be interpreted such that the classification decision should not consider management expectations or intentions. The AASB considers there are situations in which management's intentions should impact the classification of a liability. The AASB recommends that the IASB include in IAS 1 a decision tree (see Appendix B) and/or equivalent text that clarifies the hierarchy of rights and intentions of management as the basis for classification.

Furthermore, as noted in paragraphs 3-5 of Appendix A, although the AASB agrees with the proposed deletion of the word 'unconditional' from paragraph 69(d) of IAS 1, the AASB considers the impact of conditional rights at reporting date as noted in paragraph BC4 should be in the body of the Standard.

In addition, as noted in paragraphs 6-12 of Appendix A, the AASB is concerned that the proposed changes to paragraph 72R(a) would still result in ambiguity in relation to the classification of loans under an existing loan facility when the loans are held with a consortium or there is a second counterparty included in the loan facility. Furthermore, the AASB considers it is not clear how these changes would interact with the derecognition criteria in IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments*.

The AASB does not agree with the proposed transitional requirements. As noted in paragraphs 13-15 of Appendix A, the AASB considers the proposed amendments should be applied prospectively on the basis that in determining the classification of a liability an entity needs to have an understanding of the terms and conditions at that point in time. The AASB considers that retrospective application would require an entity to use hindsight.

If you have queries regarding any matters in this submission, please contact Lisa Panetta (lpanetta@aasb.gov.au).

Yours sincerely

K. E. Peach

Kris Peach
Chair

Appendix A: Specific Comments on IASB ED/2015/1 *Classification of Liabilities*

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

The IASB proposes clarifying that the classification of liabilities as either current or non-current should be based on the entity's rights at the end of the reporting period. To make that clear, the IASB proposes:

(a) replacing 'discretion' in paragraph 73 of the Standard with 'right' to align it with the requirements of paragraph 69(d) of the Standard;

(b) making it explicit in paragraphs 69(d) and 73 of the Standard that only rights in place at the reporting date should affect this classification of a liability; and

(c) deleting 'unconditional' from paragraph 69(d) of the Standard so that 'an unconditional right' is replaced by 'a right'

Do you agree with the proposed amendments? Why or why not?

<u>Replacing 'discretion' with 'right'</u>

1 The AASB agrees with the IASB's decision to have consistent wording throughout the Standard and appreciate it is in response to constituent feedback. However, the AASB is not clear as to the IASB's overall objective in replacing the term 'discretion' with 'right'.

2 The AASB considers the replacement of 'discretion' with 'right' could be interpreted such that the classification decision should not consider management expectations or intentions. The AASB considers management intent, so long as it is backed by a right, should be considered in potentially reclassifying a non-current liability as a current liability. The risk is that liabilities may be classified as non-current when, on the basis of management intent, they should be classified as current. For example, if an entity would otherwise have the ability to defer repayment beyond 12 months after the reporting date, but has the intention to repay the liability in the next 6 months, the AASB considers current classification is necessary. The AASB recommends the IASB clarify the impact of management intent in the Standard. Appendix B sets out a decision tree that may be useful. We note management intent is considered in determining classification of assets as current or non-current.

<u>Rights at reporting date</u>

3 The AASB agrees with the IASB's decision to make it explicit in the Standard that only rights in place at the reporting date should affect the classification of a liability. However, the AASB considers the IASB's conclusions regarding conditional rights at the end of the reporting period, as outlined in paragraph BC4 of the ED, are not clearly conveyed in the proposed Standard.

4 The AASB notes that paragraph BC4 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 classification. The AASB recommends this key point be included in the classification criteria in paragraph 69(d) or paragraph 72R.

<u>Deletion of 'unconditional'</u>

5 The AASB agrees with the IASB's decision to remove the word 'unconditional' from paragraph 69(d) on the basis noted in paragraph BC2 in the Basis for Conclusions that rights to defer settlement are rarely unconditional. The AASB's suggestion in paragraph 4 above would help clarify in the body of the Standard that rights generally involve conditions.

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?

6 The AASB supports the IASB making a clear link between the settlement of a liability and the outflow of resources; however the AASB does have concerns regarding the proposed amendments in paragraph 72R(a) and paragraph 69.

7 The proposed text in paragraph 72R(a) focuses on 'an existing loan facility' and the word 'refinance' would be omitted from the paragraph. However, the AASB envisages some scenarios for which further clarification would be required to determine the appropriate treatment under the proposed amendments, including whether a right to refinance 'directly relates to the loan being classified'.

8 A common scenario is where there is a backup long-term facility. In this scenario, an entity might have an existing note liability with Investor A (an investor), which is to be settled within 12 months of the end of the reporting period, and therefore would be classified as current. However, in some situations there might be a second counterparty, Bank Z, which provides a long-term credit facility that enables the entity to refinance the note liability due to Investor A. In this situation, Bank Z may then on-sell the note liability to Investor B or retain. The outcome is that the liability to Investor A is repayable as a long-term liability. The AASB considers the omission of the word 'refinance' from paragraph 72R(a) would create ambiguity as to whether the note liability in the above scenario could be classified as non-current.

9 Another common scenario that relates to paragraph 72R(a)'s focus on 'an existing loan facility' is the situation in which an entity has an existing loan facility with a consortium of lenders. In light of the amendments to paragraph 72R(a) and the explanation of the IASB's conclusions provided in paragraphs BC9 to BC11, the AASB is concerned about the continuing ambiguity regarding the nature and degree of changes to the membership of a consortium that would render an existing loan facility no longer able to be labelled as such. The AASB strongly recommends the IASB clarify this issue.

10 In addition, the AASB recommends the IASB clarify in the Basis for Conclusions the interaction between the proposed amendments and IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* in relation to the derecognition of financial liabilities and the extinguishment of liabilities as a result of a modification of a loan agreement.

11 In regard to the proposed amendments to paragraph 69, the AASB considers further guidance is required to explain the intended interaction between the reference to equity instruments in paragraph 69(d) and in the proposed additional text at the end of paragraph 69. Currently paragraph 69(d) states settlement by the issue of equity instruments does not affect its classification if it is at the option of the counterparty, whilst the proposed additional text states 'for the purpose of classification … settlement of a liability refers to the transfer to the counterparty of cash, equity instruments …' The AASB notes that, paragraphs BC83L to BC83P of the Basis for Conclusions to IAS 1 focus on the liquidity and solvency position of the entity, noting that issuing equity does not result in an outflow of cash from an entity. Paragraph BC83O states that classification of liabilities on the basis of the requirement to transfer cash or other assets rather than on the basis of settlement by the issue of equity instruments better reflects the liquidity and solvency position of an entity. However, the additional text in paragraph 69 might be interpreted as being inconsistent with this approach. The AASB recommends the IASB clarify whether, and if so how, the ability of a counterparty to require equity settlement within 12 months of the reporting date affects liability classification.

12 Paragraph 69(a) requires current classification when an entity expects the liability to be settled within the normal operating cycle. This appears to be inconsistent with the general premise of the ED that management expectations about events after the reporting period are not relevant to the classification of liability at the reporting date. There is also an apparent conflict between paragraphs 69(a) and (b) which are arguably business model approaches and paragraphs 69(c) and (d) which focus on contractual rights and solvency. The AASB recommends these apparent inconsistencies be clarified.

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?

13 The AASB does not agree with the proposed transitional requirements. The Board considers the proposed amendments should be applied prospectively on the basis that, in determining the classification of a liability, an entity needs to have an understanding of the terms and conditions at that point in time. The AASB considers that retrospective application would require an entity to use hindsight. Furthermore, the AASB considers that, if a change in classification is required, prospective application of the amendments would highlight the implications of the change.

14 In addition, the AASB views the proposals in the nature of a change in classification and accordingly considers the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* should not be specifically referred to.

15 Therefore, the AASB recommends the IASB amend the proposed transition requirements to require prospective application and revise the explanation in the Basis for Conclusions addressing the transitional requirements.

Appendix B: Decision Tree – Rights and Intentions and the Classification of Liabilities