AASB Exposure Draft

ED 259
February 2015

Classification of Liabilities

Proposed amendments to AASB 101

Comments to the AASB by 9 May 2015

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 9 May 2015. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 10 June 2015. Comments should be addressed to:

The Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@aasb.gov.au

Respondents to the IASB are asked to send their comments electronically to the IFRS Foundation website (www.ifrs.org), using the 'Comment on a proposal' page.

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

While comments may be lodged by email or by post, email lodgement is preferred. To enable the submissions to be accessible to all users of the website, including those with disabilities, please submit comments via email in an accessible Word format. An additional accessible and unsecured PDF version may also be submitted.

Enquiries

Phone: (03) 9617 7600
E-mail: standard@aasb.gov.au

ISSN 1030-5882

AASB REQUEST FOR COMMENTS

The International Accounting Standards Board (IASB) has proposed amendments to IAS 1 *Presentation of Financial Statements* (to be incorporated into AASB 101 of the same name) to clarify the criteria for the classification of a liability as either current or non-current. This topic is the subject of paragraphs 69–76 of IAS 1.

The proposals clarify that classification of liabilities as either current or non-current is based on the rights that are in existence at the end of the reporting period. In order to make this 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’.

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

The IASB further proposes that guidance in the Standard should be reorganised so that similar examples are grouped together.

Finally, the IASB proposes that retrospective application should be required and that early application should be permitted.

In light of the Australian Accounting Standards Board’s (AASB’s) policy of incorporating International Financial Reporting Standards (IFRSs) into Australian Accounting Standards, the AASB is inviting comments on:

(d) any of the proposals in the attached IASB Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and

(e) the ‘AASB Specific Matters for Comment’ listed below.

Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue.

Due Date for Comments to the AASB

Comments should be submitted to the AASB by 9 May 2015. This will enable the AASB to consider those comments in the process of formulating its own comments to the IASB. Constituents are also strongly encouraged to send their response to the IASB.

Reduced Disclosure Requirements

AASB 1053 *Application of Tiers of Australian Accounting Standards* establishes a differential reporting framework consisting of two tiers of reporting requirements for preparing general purpose financial statements:

(a) Tier 1: Australian Accounting Standards; and

(b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition and measurement requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

The proposals in this Exposure Draft would not make amendments to any disclosure requirements. Accordingly, this Exposure Draft does not give rise to any particular implications for Tier 2 disclosures.

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

    (a) not-for-profit entities; and

    (b) public sector entities, including GAAP/GFS implications;

2. whether, overall, the proposals would result in financial statements that would be useful to users;

3. whether the proposals are in the best interests of the Australian economy; and

4. unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

February 2015

Exposure Draft ED/2015/1

Classification of Liabilities

Proposed amendments to IAS® 1

Comments to be received by 10 June 2015

IASB®

IFRS®

Classification of Liabilities

(Proposed amendments to IAS 1)

Comments to be received by 10 June 2015

Exposure Draft ED/2015/1 *Classification of Liabilities* (Proposed amendments to IAS 1) is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments need to be received by **10 June 2015** and should be submitted in writing to the address below, by email to commentletters@ifrs.org or electronically using our 'Comment on a proposal' page.

All comments will be on the public record and posted on our website unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

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IFRS Foundation Publications Department
30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749
Email: publications@ifrs.org Web: www.ifrs.org

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Introduction

The International Accounting Standards Board (IASB) has published this Exposure Draft of proposed amendments to IAS 1 *Presentation of Financial Statements* to clarify the criteria for the classification of a liability as either current or non-current. This topic is the subject of paragraphs 69–76 of IAS 1.

What are the main proposals?

The proposals clarify that classification of liabilities as either current or non-current is based on the rights that are in existence at the end of the reporting period. In order to make this 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'.

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

The IASB further proposes that guidance in the Standard should be reorganised so that similar examples are grouped together.

Finally, the IASB proposes that retrospective application should be required and that early application should be permitted.

Invitation to comment

The IASB invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the questions as stated;

(b) indicate the specific paragraph or group of paragraphs to which they relate;

(c) contain a clear rationale; and

(d) include any alternative that the IASB should consider, if applicable.

The IASB is not requesting comments on matters in IAS 1 that are not addressed in this Exposure Draft.

Comments should be submitted in writing so as to be received no later than **10 June 2015**.

Questions for respondents

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?

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?

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?

How to comment

Comments should be submitted using one of the following methods.

Electronically (our preferred method)	Visit the 'Comment on a proposal' page, which can be found at: go.ifrs.org/comment
Email	Email comments can be sent to: commentletters@ifrs.org
Postal	IFRS Foundation 30 Cannon Street London EC4M 6XH United Kingdom

All comments will be on the public record and posted on our website unless confidentiality is requested. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

[Draft] Amendments to IAS 1 *Presentation of Financial Statements*

Paragraphs 69 and 71 are amended. Paragraphs 72–76 have been amended and reorganised so that similar examples are grouped together. Consequently, paragraphs 74–76 are deleted and paragraphs 72 and 73 have been renumbered as 73R(b) and 72R(a) respectively. Paragraph 139Q is added. Deleted text is struck through and new text is underlined. Paragraph 70 is not amended, but has been included for ease of reference. The paragraphs that have been reorganised so that similar examples are grouped together are shown in the following table:

Source paragraph reference	Destination reference
72	73R(b)
73	72R(a)
74	73R(a)
75	72R(b)
76	73R(c)

Current liabilities

69 **An entity shall classify a liability as current when:**

(a) it expects to settle the liability in its normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after the reporting period; or

(d) it does not have ~~an unconditional~~ <u>a</u> right <u>at the end of the reporting period</u> to defer settlement of the liability for at least twelve months after the reporting period (see paragraph ~~73~~ <u>72R</u>). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

<u>For the purposes of classification as current or non-current, settlement of a liability refers to the transfer to the counterparty of cash, equity instruments, other assets or services that results in the extinguishment of the liability.</u>

70 Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period. The same normal operating cycle applies to the classification

of an entity's assets and liabilities. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months.

71 Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading. Examples are some financial liabilities that meet the definition of held for trading in IFRS 9, bank overdrafts, and the current portion of non-current financial liabilities, dividends payable, income taxes and other non-trade payables. Financial liabilities that provide financing on a long-term basis (ie are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting period are non-current liabilities, subject to paragraphs ~~75~~ 72R(b) and ~~74~~ 73R(a).

72R The following are examples of circumstances that create a right to defer settlement that exists at the end of the reporting period and, thus, affect the classification of the liability in accordance with paragraph 69(d).

(a) If an entity ~~expects, and~~ has the ~~discretion,~~ right to ~~refinance or~~ roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. ~~However, when refinancing or rolling~~ When the entity does not have the right to roll over the obligation ~~is not at the discretion of the entity,~~ ~~(~~because, for example, there is no arrangement ~~for refinancing~~ in place at the end of the reporting period for rolling over the obligation~~)~~, the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

(b) ~~However,~~ When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable within twelve months after the reporting period, the entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

73R The following are examples of circumstances that do not create a right to defer settlement that exists at the end of the reporting period.

(a) When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have ~~an unconditional~~ a right to defer its settlement for at least twelve months after that date.

(b) An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if:

(i) the original term was for a period longer than twelve months, and

(ii) an agreement to refinance, or to reschedule the payments of an existing loan, on a long-term basis is completed after the reporting period and before the financial statements are authorised for issue.

(c) In respect of loans classified as current liabilities, if the following events occur between the end of the reporting period and the date the financial statements are authorised for issue, those events are ~~disclosed as~~ non-adjusting events in accordance with IAS 10 *Events after the Reporting Period* and do not affect classification at the end of the reporting period:

(i) refinancing on a long-term basis;

(ii) rectification of a breach of a long-term loan arrangement; and

(iii) the granting by the lender of a period of grace to rectify a breach of a long-term loan arrangement ending at least twelve months after the reporting period.

An entity discloses non-adjusting events in accordance with IAS 10.

74–76 [Deleted]

...

Transition and effective date

...

139Q [Draft] *Classification of Liabilities* (Amendments to IAS 1), issued in [date to be inserted after exposure] amended paragraphs 69 and 71 and amended and reorganised paragraphs 72–76. Paragraphs 74–76 are deleted and paragraphs 72 and 73 have been renumbered as 73R(b) and 72R(a) respectively. Some paragraphs have been reorganised so that similar examples are grouped together. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure] retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

Approval by the Board of *Classification of Liabilities* (Proposed amendments to IAS 1) published in February 2015

The Exposure Draft *Classification of Liabilities* was approved for publication by the fourteen members of the International Accounting Standards Board.

Hans Hoogervorst	Chairman
Ian Mackintosh	Vice-Chairman
Stephen Cooper	
Philippe Danjou	
Amaro Luiz De Oliveira Gomes	
Martin Edelmann	
Patrick Finnegan	
Gary Kabureck	
Suzanne Lloyd	
Takatsugu Ochi	
Darrel Scott	
Chungwoo Suh	
Mary Tokar	
Wei-Guo Zhang	

Basis for Conclusions on *Classification of Liabilities* (Proposed amendments to IAS 1)

This Basis for Conclusions accompanies, but is not part of, the proposed amendments. All references are to existing paragraph numbers, before the proposed reorganisation, unless otherwise stated.

Current liabilities (paragraphs 69–76)

Background

BC1 The principle relating to the classification of liabilities is contained in paragraph 69 of IAS 1 *Presentation of Financial Statements*, which defines the criteria for current classification. Liabilities that do not meet these criteria are classified as non-current in accordance with that paragraph. The Board received a request to clarify how that classification principle interacts with the detailed guidance contained in two paragraphs in the Standard. The Board was asked how having *an unconditional right to defer settlement* (specified in paragraph 69(d)) related to having *the discretion to refinance or roll over an obligation* (specified in paragraph 73) as two bases for the classification of a liability as non-current.

Nature of the rights that affect classification

BC2 The Board concluded that the lack of clarity arises in part through the use of 'unconditional' in paragraph 69(d). The Board observed that rights to defer settlement are rarely unconditional, because such rights are often conditional on compliance in future periods with covenants made by the borrower. In order to address this inconsistency, the Board proposes deleting 'unconditional' from paragraph 69(d) of the Standard so that 'an unconditional right' is replaced by 'a right'.

BC3 The Board concluded that the word 'discretion' in paragraph 73 could be confusing and compared this with the use of 'right' in paragraph 69(d). Accordingly, the Board proposes replacing 'discretion' in paragraph 73 of the Standard with 'right' to align the requirements of paragraphs 69(d) and 73 of the Standard.

Rights at the end of the reporting period as the basis of classification

BC4 The Board considered a number of examples of conditions that could be placed on exercising a right. The Board concluded that when a right is subject to a condition, it is whether the entity complies with that condition as at the end of the reporting period that determines whether the right should affect classification.

BC5 The Board also confirmed that the criteria for classification of a liability as non-current in accordance with paragraphs 69(d) and 73 should be based on the rights in existence at the end of the reporting period. Rights granted after the end of the reporting period should not affect the classification of a liability as at the end of the reporting period.

BC6 In order to make these requirements clear, the Board proposes making it explicit in paragraphs 69(d) and 73 of the Standard that only rights in place at the reporting date should affect the classification of a liability, by adding a reference to rights 'at the end of the reporting period' to each paragraph.

Right to roll over an obligation

BC7 The Board considered the particular case, described in paragraph 73 of the Standard, in which an entity has a right to defer settlement of the liability by rolling over the borrowing under an existing loan facility. In accordance with this paragraph, the entity classifies the obligation as a non-current liability.

BC8 The Board noted that this represents an exception to the classification principle in paragraph 69 and was intended to apply only in limited circumstances, ie when there is the right at the end of the reporting period to roll over an existing loan under an existing loan facility. The Board did not want to extend this exception.

BC9 The *Annual Improvements 2010–2012* Exposure Draft proposed clarifying this exception by including a reference to 'same lender' in paragraph 73. Feedback received by the Board was that the wording was not practical, especially within the context of lender consortia. Consequently, the Board considered whether 'same lender' should be extended to include the same consortium of lenders and, if so, when changes to the membership of that consortium would prevent qualification of the consortium as 'the same lender'.

BC10 Some Board members thought that if the lead lender remained the same, the risk profile of the consortium would not change, because the lead lender has the primary responsibility for determining the terms of the lending. Other Board members thought that maintaining the same lead lender would not be a sufficiently relevant basis for drawing a distinction between the same lender and a different lender. The Board members also noted that lender consortia can be structured in different ways. The Board acknowledged the complexity introduced by consortia of lenders and the practical difficulties that a reference to 'same lender' would create.

BC11 The Board does not propose including an explicit requirement that rolled-over lending must be with the same lender. Instead it decided that emphasis should be placed on there being a right at the end of the reporting period to roll over the obligation under the existing loan facility that directly relates to the loan being classified. The Board noted that the requirement that it must be an existing loan facility is already explicit in paragraph 73.

Meaning of the term 'settlement' for the purposes of the classification of liabilities

BC12 The Board considered the meaning of the 'right to defer settlement' of a liability within the context of classification of a liability as either current or non-current. In the circumstances described in paragraph 73, the Board agreed that the rollover of the borrowing does not constitute 'settlement' and would not result in the liability being classified as current. The Board thought that the rollover of the borrowing was the extension of an existing liability. The Board concluded that it was important to link the settlement of the liability with the outflow of resources of the entity.

BC13 The Board considered the nature of the outflow of resources from the entity. Many liabilities would be settled by the transfer of cash from the entity. However, the Board also noted that some liabilities would arise from those obligations, such as performance obligations, as discussed in IFRS 15 *Revenue from Contracts with Customers*, that are settled by the transfer of resources other than cash, such as goods or services.

BC14 The Board also considered the case of an equity-settled instrument, or a component of a financial instrument, that is classified as a liability in accordance with IFRS. The Board concluded that settlement for the purposes of classification of a liability as either current or non-current would also refer to the transfer of equity instruments to the counterparty of such a financial instrument.

BC15 Accordingly, the Board proposes explaining that 'settlement' of a liability for classification purposes may be achieved in different forms, ie cash, other assets, services, and in some cases, equity.

Effect of events after the reporting period

BC16 The Board considered whether events after the reporting period, such as breach of covenant or early repayment by the entity, should affect the classification of the liability. In particular, the Board considered the effect on classification of management's expectations about events after the reporting period that prevent the application of rights to defer settlement (such as management's intention to repay borrowings within twelve months or management's expectation about a future breach of covenants that would render the borrowings repayable on demand). Some Board members expressed concern that such a proposal would place too much emphasis on management intentions and expectations. Others thought the proposal would represent an exception to IAS 10 *Events after the Reporting Period*. In accordance with that Standard, adjusting events are only those events that provide evidence of conditions that existed at the end of the reporting period.

BC17 As a result of these concerns, the Board does not propose amending guidance on the effect of events after the reporting period.

BC18 Discussions about the effect of events after the reporting period on the classification decision confirmed the Board's view that classification should be based on the entity's rights at the end of the reporting period. In order to make a clear distinction between circumstances that do affect the rights that are in existence at the end of the reporting period and those that do not, the Board proposes that guidance in the Standard should be reorganised so that similar examples are grouped together.

Transition and first-time adoption

BC19 The Board noted that requirements for transition arrangements are set out in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. That Standard requires that changes in accounting policies are generally applied retrospectively in accordance with paragraph 19(b) and changes in accounting estimates are applied prospectively in accordance with paragraph 36. The Board concluded that the proposals would not result in a *change* of accounting policy; instead the proposed amendment would clarify existing requirements about the classification of liabilities. Consequently, any resulting change in classification would be more in the nature of a change in accounting estimate which, in accordance with IAS 8, would warrant prospective application.

BC20 The Board concluded, however, that these proposals should nonetheless be applied retrospectively because:

(a) paragraph 41 of IAS 1 requires that, if an entity changes the presentation or classification of items in its financial statements, it shall reclassify comparative amounts unless reclassification is impracticable;

(b) the Board considered that the retrospective application of the proposed narrow-scope amendments would not be onerous, because they deal solely with classification, rather than recognition or measurement;

(c) the proposed narrow-scope amendments would clarify existing requirements rather than imposing additional requirements; and

(d) information about the classification of liabilities would be most useful if current and prior period information is presented on the same basis.

BC21 The Board proposes that early application should be permitted.

BC22 The Board also considered the effects of the amendments when an entity adopts IFRS for the first time and concluded that no exemption to the requirements of IFRS 1 *First-time Adoption of International Financial Reporting Standards* would be required.