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The Chair
Australian Accounting Standards Board
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Dear Ms Peach

ED 259 Classification of Liabilities

Our comments and recommendations regarding ED 259 are provided in this submission. Responses to specific questions as requested by the AASB and IASB are provided in the attachment on pages 3-5.

Saward Dawson operates in Melbourne, Australia. Our clients come from a range of industries and include large private businesses, small to medium enterprises, and a significant number of not-for-profit entities. We are focused on enhancing the relevance, reliability and understand ability of financial reporting for users.

In summary we hold the following views in relation to the attachment:

1. The removal of the term 'unconditional right' and replacement with 'a right' or 'the right' is likely to result in additional confusion and divergence of liability classification as the proposal appears to not to address the fact that most loan agreements (or any other contract) contain various rights and obligations on each party to the contract and not an explicit right.

This is particularly evident in Australia where the majority of loan contracts with Australian banks contain an 'Annual Review' clause. Under such agreements a borrower may have a facility that does not require repayment for a number of years however this right to defer payment is subject to annual review by the financier. Currently such facilities are classified as current as the right to defer settlement is not unconditional even though the likelihood of repayment being required by the financier based on the annual review clause is often remote.

We strongly hold the view that the IASB should include a specific example with these facts to provide clear guidance to preparers and auditors of financial reports on the appropriate classification of such liabilities. Should the IASB fail to provide such guidance the AASB should address the issue.

2. We believe that the classification of a liability being 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.

In particular where the lender agrees to extend grace for a breach, or rollover a facility post year end but prior to the signing of the financial report, extensive disclosures are often included to explain why the classification of the liability as current is misleading and that settlement is now not required to occur within the next 12 months.

Similarly where a breach of agreement occurs post balance date a liability is classified as non-current but extensive disclosures occur in relation the post balance date event and potentially going concern implications as required.

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Accordingly we believe that the IASB should reconsider its view the liabilities are classified based on an as at balance date legal right. Where events occur post balance date we believe such events should impact classification as this would represent the commercial reality of the future requirement to settle a liability and would provide more useful information to users of financial statements.

Please do not hesitate to contact us should you wish to discuss further any matters arising from this submission.

Yours Sincerely

P Shield	J Tulk
Partner	Senior Manager - Technical

AASB Specific Matters for Comment

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;

As most current banking agreements in Australia contain an 'Annual Review' clause that result in them currently being classified as current liabilities by borrowers as the rights under a facility do not provide the borrower with an unconditional right to defer. The proposed removal of 'unconditional' is likely to result in further diversity of practice as a borrower will have a right to defer while a lender has a right to review and alter the agreement. This specific fact pattern should be addressed by the IASB or AASB to avoid uncertainty and diversity of practice should the proposed changes occur.

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

We consider the proposal to remove 'unconditional' will be useful if the clarification detailed in 1 above is provided.

A Statement of Financial position that accurately reflects a commercial reality of current and non-current liabilities taking into account rights that are established or removed post balance date will be more useful to users as this would reflect the commercial likelihood of the timing of the settlement of a liability rather than solely the legal right at balance date.

We believe that any legal right to review where the likelihood of altering the arrangement is in isolation remote could be more appropriately acknowledged through additional disclosure.

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

We support revisions that improve the relevance, reliability and user understanding of financial reports.

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.

In our experience significant time and cost is involved is justifying current classification requirements that are based on legal rights however remote the likelihood of them being exercised. Without specific clarification of the treatment of common facility agreements in Australia this cost is likely to continue to occur.

IASB Specific Matters for Comment

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?

Part (a) – we agree with the proposed amendments and the reasons stated in BC3

Part (b) – although we agree that the proposal achieves the aim of making an explicit requirement to classify liabilities based on the legal rights at the reporting date, we do not believe that this provides useful information for users and should be reconsidered by the IASB.

In particular, where a breach occurs post reporting date but prior to report signing, a liability may be classified as non-current where payment is in fact now due on demand. Similarly where a lender agrees to extend grace for a breach or rollover a facility after reporting date but prior to report signing, a liability is classified as current even though a settlement is no longer required within the next 12 months.

Part (c) – although we agree with the proposal to delete 'unconditional' we believe more explicit guidance is required where a borrower has rights in relation to a long term facility but where a lender also has rights to alter the agreement or an increase in uncertainty of classification and diversity of practice will result.

In Australia such rights are often contained in an 'annual review' clause within borrowing agreements. Although altering the agreement under an annual review clause is not common and the likelihood is often remote, certain lenders have utilised these clauses to demand settlement earlier than the term of the agreement.

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?

No comment.

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?

We agree with the proposal as any change in classification should be applied to the comparative period to ensure consistency and comparability.