IFRS

STAFF PAPER

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IASB® meeting

| Project | Classification of Liabilities as Current or Non-current (Amendments to IAS 1) | | |
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| Paper topic | Implications of proposals for particular facts and circumstances | | |



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## Introduction

1. The Exposure Draft *Classification of Liabilities* published in February 2015 (the Exposure Draft) proposed amendments to requirements in paragraphs 69–76 of IAS 1 *Presentation of Financial Statements*. Those requirements relate to classification of liabilities as current or non-current.

2. At its meeting in September 2018, the Board received an update on the status of the project and further work planned by staff.[1] That work comprises further discussion of comments received on:

    (a) the implications of the proposals for liabilities with equity-settlement features—to be discussed at a future meeting; and

[1] IASB meeting, September 2018, Agenda Paper 22 *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)—Project update and next steps*.

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(b) other aspects of the proposed amendments—specifically concerns and questions about the implications of the proposals for particular types of facts and circumstances—to be discussed at this meeting.

3. This paper considers whether the Board should revise any of the Exposure Draft proposals in light of the comments received on the second of those topics, also taking into account potential differences between the Exposure Draft proposals and similar proposals being developed by the US Financial Accounting Standards Board (FASB).

## Staff recommendations

4. The staff recommend that, as proposed in the Exposure Draft, IAS 1 should require an entity to classify a liability as current if the entity does not have a right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period.

5. The staff also recommend:

   (a) adding a reminder that an entity's right to defer settlement must have substance.

   (b) clarifying that an entity's right to defer settlement is not affected by:

      (i) management's expectations about whether the entity will exercise that right; and

      (ii) settlement of a liability between the end of the reporting period and the date the financial statements are authorised for issue.

   (c) adding a reminder that, although factors in paragraph 5(b) do not affect the classification of a liability, an entity may need to disclose information about them to comply with the disclosure requirements of IFRS standards.

## Content of paper

6. This paper contains:

   (a) background information about the Exposure Draft proposals and comments received (paragraphs 7–11);

   (b) discussion of:

      (i) the implications of the proposals for the types of facts and circumstances identified by respondents (paragraphs 12–30); and

      (ii) the situations in which the classification outcomes applying the Exposure Draft proposals would be different from those applying the FASB proposals (paragraphs 31–47).

## Background

### *Exposure Draft proposals*

7. Paragraph 69 of IAS 1 sets out criteria for classifying liabilities as current and requires all other liabilities to be classified as non-current. Paragraphs 70–76 specify how an entity should apply the criteria in particular circumstances.

8. One of the criteria for classifying a liability as current is that the entity does not have a right to defer settlement of the liability for at least twelve months after the reporting period (paragraph 69(d)). The Exposure Draft proposed to clarify this criterion by, among other things:

   (a) stating explicitly that it should be applied to the rights in place at the end of the reporting period; and

   (b) amending the 'application' paragraphs to eliminate possible inconsistencies between those paragraphs and the criterion. The proposed amendments included:

(i) removing from paragraph 73 a suggestion that a right to defer settlement of a liability leads to non-current classification only if the entity expects to exercise the right:

> 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 would otherwise be due within a shorter period.

(ii) emphasising in paragraph 76 that classification is unaffected by changes in rights after the end of the reporting period but before the date the financial statements are authorised for issue.

9. The Exposure Draft proposals are reproduced in full in Appendix B to this paper.

### ***Comments received***

10. Some respondents raised concerns or questions about the implications of the proposed amendments for particular types of facts and circumstances. Examples included circumstances in which:

(a) an entity's right to defer settlement of a liability is subject to a condition that will be tested only after the end of the reporting period.

(b) a lender has a right to repayment on demand but is unlikely to exercise that right. Respondents suggested that many borrowing arrangements contain annual review clauses that give the lender a right to withdraw the loan at any time. However, that right is rarely invoked in practice, unless there has been a significant deterioration in the borrower's financial position.

(c) at the end of the reporting period, management has a right to defer settlement of a liability for at least twelve months but:

(i) the right includes potentially uneconomic terms that would cause management to avoid exercising those rights;

(ii) management also has a right to repay the debt within twelve months of the end of the reporting period and intends to do so;

(iii) the entity repays the debt after the end of the reporting period but before the financial statements are finalised; or

(iv) management expects that there will be a breach of a covenant after the reporting period, with the effect that the liability will become repayable within twelve months of the reporting period.

(d) third parties underwrite existing loan arrangements.

(e) an entity provides warranties on goods that it sells, the warranty obligations extend for several years and there is uncertainty about the amount and timing of cash flows required to settle the obligations.[2]

### *Subsequent decisions*

11. In February 2016, the Board discussed the first of these matters—the effect of conditions that will be tested only after the end of the reporting period.[3] The Board tentatively decided that:

(a) compliance with any conditions in the lending agreement should be assessed as at the reporting date;

(b) any requirement in the lending agreement to test compliance with those conditions at a date after the end of the reporting period should not change the requirement for classification to be based on an assessment of compliance as at the end of the reporting period;

(c) the proposed amendments should require that compliance with a condition as at the end of the reporting period should determine whether a right that is subject to that condition should affect classification (as described in paragraph BC4 of the Exposure Draft);

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2 A more detailed summary of the responses to the Exposure Draft is in Agenda Paper 12B *IAS 1 Presentation of Financial Statements Current/non-current classification of liabilities—Comment letter analysis* for the December 2015 Board meeting

3 IASB meeting February 2016, Agenda Paper 12B *Conditions that are tested after the end of the reporting period.*

(d) when an agreement includes a periodic review clause, in which the lender has the right to demand repayment, the entity has a right to defer settlement only up to the date of the periodic review; and

(e) the Board's proposals, that classification of a liability is based on rights in existence at the end of the reporting period and compliance with any conditions is assessed as at the end of the reporting period, should not be amended in respect of a periodic review clause.

## Implications of proposals for facts and circumstances identified by respondents

### *Staff analysis of implications*

12. The staff have analysed in Appendix A the implications of the proposed requirements for each set of facts and circumstances identified by respondents.

13. The main points of the staff analysis can be summarised as:

(a) a lender's right to require repayment on demand would result in classification of a liability as current even if the lender is unlikely to exercise that right.

(b) an entity's right to defer settlement of a liability for at least twelve months after the reporting period would affect the classification outcome (resulting in classification of the liability as non-current if the other criteria in paragraph 69 are satisfied) even if:

(i) the right to defer settlement arises from a right to roll over the liability on terms that are potentially uneconomic—unless the terms are such that the apparent right to roll over the liability lacks substance;

(ii) management does not intend, or does not expect, to exercise its right to defer settlement beyond twelve months;

(iii) the entity exercises an option to repay the liability early, after the end of the reporting period but before the financial statements are finalised; or

(iv) management expects that the entity will breach a covenant after the reporting period, with the liability becoming repayable on demand if and when the breach occurs.

(c) classification of an existing loan with one lender is not affected by a refinancing agreement with another lender.

(d) depending on the facts and circumstances, obligations to provide warranty cover for periods of more than twelve months may need to be split between current and non-current components.

14. The staff note that, although some of the circumstances described in paragraph 13 would not affect classification of a liability, an entity may need to disclose information about those circumstances to meet the disclosure requirements of IFRS Standards, including the requirement in paragraph 112(c) of IAS 1 to provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them. The staff think that it could be helpful to add a reminder to this effect to the IAS 1 requirements for classification of liabilities.

### *Matters for further consideration by the Board*

15. The staff think that, although some of the outcomes described in paragraph 13 seemed counterintuitive to some respondents, they are consistent with the overall purpose of the statement of financial position. The purpose is to provide information about the entity's rights and obligations at the end of the reporting period—not necessarily a forecast of the entity's future cash flows (which could be affected by management intentions or expectations). Consistently with this purpose, the entity should classify its liabilities as current or non-current by reference to the rights it has or does not have at the end of the reporting period to defer settlement of the liability existing at that date, not by reference to management intentions or expectations about the future behaviour of the entity or the counterparty, nor by reference to possible changes in the rights or obligations after the reporting period.

16. However, the staff think that its analysis raises two questions for further consideration by the Board:

    (a) whether IAS 1 should explicitly address rights that lack substance (see paragraphs 17–20); and

    (b) whether any other aspects of the classification requirements should be clarified (see paragraphs 21–25).

*Rights that lack substance*

17. As stated in paragraph 13(b)(i), the staff have concluded that a right to roll over a liability for at least 12 months after the reporting period affects classification of the liability, even if the terms of the roll-over are potentially uneconomic. However, our conclusion is subject to a caveat that the right to roll over the liability must have substance.

18. The need for a right to have substance is not explicitly stated in paragraph 69 of IAS 1. However, it can be deduced from IAS 1 requirements for fair presentation:

    (a) paragraph 15 of IAS 1 requires financial statements to 'present fairly' the financial position, financial performance and cash flows of an entity. It adds that 'fair presentation requires the faithful representation of the effects of transaction, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*; and

    (b) the *Conceptual Framework* states that:

    > 4.59 The terms of a contract create rights and obligations for an entity that is party to that contract. To represent those rights and obligations faithfully, financial statements report their substance, …
    >
    > …
    >
    > 4.61 Terms that have no substance are disregarded. …

19. The staff have considered whether the need for a right to have substance should be stated explicitly in paragraph 69 of IAS 1:

    (a) on one hand, it could be argued that the general requirements in paragraph 15 of IAS 1 are sufficient. They mean that the requirement to consider the substance of rights and obligations pervades all aspects of financial statement presentation. Specifically highlighting the requirement in one context could suggest otherwise.

    (b) on the other hand, a reminder of the need for a right to have substance could help entities apply paragraph 69 of IAS 1 to contracts whose substance might differ from their legal form—and clarify the boundary of the requirement to classify liabilities by reference to the entity's rights rather than management's expectations. Several other Standards that focus on an entity's contractual rights and obligations contain explicit requirements to account for the substance of those rights and obligations. For example:

        (i) IAS 32 *Financial Instruments—Presentation* states that the substance of a financial instrument, rather than its legal form governs its classification as either a liability or an equity instrument.[4]

        (ii) IFRS 2 *Share-based Payment* states that an entity has a present obligation to settle in cash if the choice of settlement in equity instruments has no commercial substance.[5]

        (iii) IFRS 10 *Consolidated Financial Statements* states that an investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns.[6]

        (iv) IFRS 15 *Revenue from Contracts with Customers* states that entity shall account for a contract with a customer that is within the scope of this

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[4] Paragraph 18 of IAS 32.

[5] Paragraph 41 of IFRS 2.

[6] Paragraph B56 of IFRS 3.

Standard only when, among other conditions, the contract has commercial substance.[7]

(v) IFRS 16 *Leases* states that whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract.[8]

(vi) IFRS 17 *Insurance Contracts* requires an entity applying that Standard to consider its substantive rights and obligations, and disregard terms of a contract that have no commercial substance.[9]

20. Because the requirement for a right to defer settlement to have substance is implicit in the IAS 1 requirement for fair presentation, the staff think that adding an explicit reminder of that requirement would not significantly change the Exposure Draft proposals.

*Other aspects of the classification requirements*

21. The staff think that, for the types of facts and circumstances identified by respondents, the implications of the requirements proposed in the Exposure Draft—as clarified by the tentative decisions made by the Board in February 2016 (see paragraph 11)—are generally sufficiently clear. Hence the benefits of further clarification of any particular implication would in general be outweighed by the risk that further detail could raise new questions or have unintended consequences.

22. However, we think it might be worth clarifying that classification of a liability is not affected by:

(a) management's expectations about whether the entity will exercise a right to defer settlement; and

(b) settlement of a liability between the end of the reporting period and the date the financial statements are authorised for issue.

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7 Paragraph 9(d) of IFRS 15.

8 Paragraph 63 of IFRS 16.

9 Paragraph 2 of IFRS 17.

23. A reason for clarifying these matters would be that at present, paragraph 73 of IAS 1 suggests that classification *is* affected by management's expectations about the timing of settlement (evidence of which could be provided by settlement after the reporting period). The removal of the reference to management expectations is evident in the Exposure Draft because it is marked in paragraph 72R(a), but would not be evident in the amended Standard.

24. Furthermore, paragraph 76 already refers to examples of events after the reporting period that an entity would disclose as non-adjusting events to comply with IAS 10 *Events after the Reporting Period*. Settlement before the financial statements are authorised for issue of a liability that is classified as non-current could be a significant non-adjusting event and so worthy of including in the list of examples.

25. The staff think that, although these matters were questioned by some respondents, they were understood by most respondents. So clarifying them in IAS 1 would not be viewed as a significant change to the Exposure Draft proposals.

### *Staff recommendations and questions for the Board*

26. Amending IAS 1 to achieve outcomes different from those described in paragraph 13 would involve changing—as opposed to clarifying—the requirements of IAS1. The changes would be more significant than those proposed in the Exposure Draft (or contemplated when the Board started this project) and would require further research and consultation.

27. For the reasons in paragraph 15, the staff think that the analysis in this paper does not indicate a need to make significant changes to the Exposure Draft proposals. Accordingly, the staff recommend that, as proposed in the Exposure Draft, IAS 1 should require an entity to classify a liability as current if the entity does not have a right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period.

| **Question 1—affirming Exposure Draft proposals** |
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| Do you agree that, as proposed in the Exposure Draft, IAS 1 should require an entity to classify a liability as current if the entity does not have a right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period? |

28. For the reasons in paragraph 19(b), the staff recommend adding a reminder that an entity's right to defer settlement must have substance.

| **Question 2—requirement for right to have substance** |
| --- |
| Do you agree that the Board should add to IAS 1 a reminder that an entity's right to defer settlement must have substance? |

29. For the reasons in paragraphs 14, 23 and 24, the staff also recommend :
    (a) clarifying that an entity's right to defer settlement of a liability is not affected by:
        (i) management's expectations about whether the entity will exercise that right; and
        (ii) settlement of a liability between the end of the reporting period and the date the financial statements are authorised for issue;
    (b) adding a reminder that, although these factors do not affect the classification of a liability, an entity may need to disclose information about them to comply with the disclosure requirements of IFRS Standards.

30. For the reasons in paragraph 21, the staff do not recommend clarifying any other matters discussed in this paper.

| **Question 3—clarifications** | |
|---|---|
| (a) | Do you agree that IAS 1 should clarify the matters set out in paragraph 29? |
| (b) | Do you agree that IAS 1 should not clarify any other matters discussed in this paper? |

## Differences between Exposure Draft and FASB proposals

### *FASB proposals*

31. The FASB is also updating its requirements for classification of debt as current or non-current. Its objective is to replace fact-specific guidance in US GAAP with an overarching, cohesive principle. In January 2017, the FASB published for comment a proposed Accounting Standards Update, *Debt (Topic 470):* Simplifying *the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent)*. It is now redeliberating its proposals and expects to issue the final Update in the first quarter of 2019.

32. The principle proposed by the FASB is that debt and other instruments within the scope of the Update should be classified as non-current liabilities in a classified balance sheet if either of the following criteria is met as of the balance sheet date:

    (a) the liability is contractually due to be settled more than one year (or operating cycle, if longer) after the balance sheet date.

    (b) the entity has a contractual right to defer settlement of the liability for at least one year (or operating cycle, if longer) after the balance sheet date.

33. This principle is similar to that in IAS 1, so would bring greater convergence between US GAAP and IFRS Standards in this area. However, aspects of the FASB proposals potentially differ from the IASB Exposure Draft proposals. These aspects relate to:

(a) waivers of debt covenant violations received after the balance sheet date but before the financial statements are issued (see paragraph 34–37);

(b) grace periods granted for debt covenant violations (see paragraph 38–42); and

(c) unused long-term financing arrangements (see paragraphs 43–46).

## ***Differences between IASB's proposals and FASB's proposals***

### *Waivers of debt covenant violations*

34. The FASB proposes an exception to its classification principle for some waivers of debt covenant violations. Applying that exception, a debt covenant violation would not cause an entity to reclassify its debt from non-current to current if the entity receives a waiver of that violation that meets specified[10] conditions before the financial statements are issued (or are available to be issued).

35. Paragraph 74 of IAS 1—carried forward as paragraph 73R(b) in the IASB Exposure Draft—specifies the opposite. It states that:

> 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.

36. The staff think that the proposed FASB exception is inconsistent with both the existing requirements of IAS 1 and the requirements of IAS 10 *Events after the Reporting Period*. In the view of the staff, a waiver received after the reporting period

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[10] The following conditions are necessary:
(i) one of the criteria in the classification would have been met absent the covenant violation;
(ii) the waiver is for a period greater than one year from the balance sheet date;
(iii) the waiver does not result in a debt extinguishment or a troubled debt restructuring; and
(iv) it is not probable that any other covenants will be violated from twelve months from the balance sheet date.

is indicative of conditions that arose after the reporting period, not evidence of conditions that existed at the end of the reporting period. Hence, applying IAS 10, the waiver is a non-adjusting event that may need to be disclosed but should not lead to a change in classification of a liability.

37. The FASB describes its proposals on waivers as an exception to—not an application or clarification of—its own classification principle. By including this exception, the FASB will avoid overturning an existing US GAAP requirement. In contrast, if the IASB were to include the same exception in IAS 1, it would be changing and adding complexity to IFRS requirements.

*Grace periods*

38. In August 2018, the FASB tentatively decided to clarify how to apply its classification principle when a debt covenant violation exists and the creditor provides a grace period. The FASB tentatively decided that, when a borrower violates a provision of a long-term debt agreement and the creditor provides a specified grace period for the borrower to cure the violation, which makes the debt not callable at the balance sheet date, the borrower should classify the debt as a non-current liability if one of the criteria in the debt classification principle is met.

39. IAS 1 also addresses grace periods for situations in which an entity has breached a provision of a long-term loan arrangement before the end of the reporting period with the effect that the liability becomes payable on demand. Paragraph 75 of IAS 1—carried forward as paragraph 72R(b) in the IASB Exposure Draft—states that:

> 75 …an 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.

40. The IASB Exposure Draft proposals and FASB tentative decision would lead to a different outcome if a lender provides a grace period ending after the reporting period, but less than twelve months after the reporting period—an entity would classify the liability as current applying the IASB Exposure Draft proposals, but as non-current applying the FASB tentative decision.

41. The IASB Exposure Draft proposals on grace periods do not change the existing requirements of IAS 1. Furthermore, they are consistent with both the IASB's tentative decisions on conditions that are tested only after the end of the reporting period and with the general classification requirements in paragraph 69 of IAS 1:

    (a) as noted in paragraph 11, the IASB has tentatively decided that compliance with any conditions in a lending agreement should be tested as at the reporting date, even if that condition will not be tested until a later date.

    (b) if, at the end of the reporting period, an entity is in breach of the provisions of a loan agreement such that the loan becomes payable on demand, the entity does not have the right at the end of the reporting period to defer settlement by at least twelve months unless by that date it has been granted a grace period of at least twelve months.

42. Hence, the staff think that, if the IASB were to align its Exposure Draft proposals on grace periods with the FASB proposals it would be adding an exception that changed and added complexity to IAS 1 requirements.

*Unused long-term financing arrangements*

43. Applying existing US GAAP, an entity classifies a short-term debt as a non-current liability if it has an unused long-term financing arrangement in place and that arrangement satisfies particular conditions.

44. In August 2018, the FASB tentatively decided that, consistent with its proposed classification principles, an unused long-term financing arrangement should be disregarded in determining the classification of existing debt. However, in October 2018, the FASB reconsidered this tentative decision. It did not make any further decisions but directed its staff to conduct additional research, focusing on a potential alternative that considers the contractual linkage between certain debt arrangements and unused long-term financing arrangements in place at the balance sheet date. That research also would consider the need to include other conditions within or surrounding that financing arrangement, such as the financial capability of the lender,

the existence of a subjective acceleration clause, the required use of the proceeds, and the timing and terms of the arrangements.

45. The IASB staff think that, if the FASB reverses its August 2018 tentative decision, its proposals regarding unused long-term financing arrangements could be different from the IASB Exposure Draft proposals. Paragraph 72R of the Exposure Draft clarifies that in classifying a liability as current or non-current 'the entity does not consider the potential to refinance the obligation'.

46. The IASB staff think that the IASB Exposure Draft proposals are consistent with the general classification requirements in paragraph 69 of IAS 1. If the IASB were to align the Exposure Draft proposals on unused long-term financing arrangements with the FASB proposals it would be adding an exception that changed and added complexity to IAS 1 requirements

### *Staff recommendations*

47. For the reasons in paragraphs 36, 37, 41, 42 and 46, the staff recommend that the Board should not consider further amendments to IAS 1 in light of differences between the requirements of IAS 1 and proposed requirements on classification of debt being developed for US GAAP by the FASB.

| Question 4—implications of FASB proposals |
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| Do you agree that the Board should not consider further amendments to IAS 1 in light of differences between the requirements of IAS 1 and proposed requirements on classification of debt being developed for US GAAP by the FASB? |

## Appendix A—Implications of proposed requirements for particular facts and circumstances identified by respondents

| | Facts and circumstances | Staff analysis<br>Implications of IASB proposals |
|---|---|---|
| (a) | The right to defer settlement includes uneconomic terms that would cause management to avoid exercising those rights. | |
| i | ➢ An entity has debt and has the right to roll it over with the same lender for at least twelve months after the reporting period. However, the terms and conditions of the roll-over:<br>- are no longer at market rates (at an interest rate out of any realistic range); or<br>- have become uneconomic compared to other means of financing (for example, equity or other debt offering). | ➢ The staff think that the entity's right to roll over the debt would affect the classification unless the right lacked substance. The fact that the terms make roll-over unlikely would not affect the classification unless the terms were such that, in substance, the right did not exist. |
| (b) | The lender has a right to repayment on demand | |
| i | ➢ An entity has a loan agreement which is due to be settled more than twelve months after the reporting date. However, the agreement includes an overriding repayment on demand clause, which gives the lender the right to demand repayment at any time at its sole discretion, irrespective of whether a default event has occurred. | ➢ The staff think that, if the lender has a right to demand repayment at any time at its sole discretion, the entity does not have a right to defer settlement for more than twelve months and so would classify the loan as current, irrespective of the likelihood of the lender exercising its right. |

| (c) | The impact of management expectations. | |
|---|---|---|
| i | ➢ An entity has a right to defer settlement of a debt for more than twelve months after the reporting period. However, it expects to settle the debt within twelve months to execute an anticipated transaction that is highly likely to occur and that it publicly disclosed before the end of the reporting period. | ➢ The staff think that expectations about the future transaction would not affect the classification, however likely the transaction was to occur.<br>➢ Unless the public disclosure of the transaction before the end of the reporting period (or any other action of the entity before the end of the reporting period) removed the entity's right to defer settlement of the debt for more than twelve months, that right would still exist at the end of the reporting period and would affect the classification of the debt. |
| ii | ➢ An entity has a debt that is due to be settled more than twelve months after the reporting period. However, the debt agreement gives the entity an option of early redemption within the next twelve months. There is evidence that management intends to exercise the early redemption option (for example, early redemption would be economically favourable, or is built into latest budgets/forecasts etc.). | ➢ The entity should classify the debt on the basis of the entity's rights at the end of the reporting period, regardless of management expectations/intentions. |
| iii | ➢ Management expects there will be a breach of a covenant after the reporting date. | ➢ The staff think that the classification of the liability would not be affected by management's expectation that the entity will breach a covenant after the reporting period. |

| (d) | Management repays the debt after the end of the reporting period but before the financial statement are finalised. | |
|---|---|---|
| i | ➢ An entity with a December X1 year-end had a bond that was due to mature in January X3 but was repaid early in January X2. This was before the approval of the financial statements. | ➢ The staff think that the classification of the liability would not be affected by management's settlement of the bond after the reporting date. The classification would take into account only the entity's rights and obligations at the end of the reporting period. |
| ii | ➢ An entity with a December X1 year-end had a bond that matured in January X3. In November X1the entity announced that it would settle the bond early. Per this announcement, the settlement took place in January X2. This was before the approval of the annual financial statements. | ➢ The staff think the entity would classify the bond as a current liability if the effect of the announcement (or any other action of the entity before the end of the reporting period) was to remove its right to defer settlement until the maturity date. Otherwise, the decision to settle the bond early would not affect its classification. |
| (e) | Third parties underwrite existing loan arrangements. | |
| i | ➢ An entity has a commercial paper facility managed by a bank in which the entity issues short-term commercial paper on a rollover basis. The lenders are third party investors attracted by the bank. The entity also has a committed credit facility with the same bank in case there is insufficient investor demand for the entity to roll over enough commercial paper. | ➢ The staff think the entity would classify the commercial paper as a current liability. Each issue is short-term—the entity does not have the right at the end of the reporting period to defer settlement of the paper in issue at that date. Although the bank has committed to provide credit if it fails to roll over enough commercial papers, the credit provided would be a new loan. Future issues of commercial paper result in a new liability, not in a continuation of the existing commercial paper. |
| ii | ➢ An entity has a long-term loan arrangement that is due to be settled within ten months after the reporting period. However, before the end of the reporting period, the entity enters into an arrangement with another bank to refinance the loan on the same terms. Under the new arrangement, the second bank will transfer funds directly to the first bank to settle the loan. | ➢ The staff think the entity would classify the loan as a current liability. When the entity refinances with another lender, it settles the existing liability and incurs a new liability. |

| (f) | Others | |
|---|---|---|
| i | ➢ An entity provides 3-year warranties against defects in goods that it sells. The timing of claims is uncertain, but management does not expect that claims will be made within one year after the reporting date. | ➢ Unless the warranty obligation is within the scope of another Standard, the entity is likely to recognise and measure the obligation applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The staff think that, depending on the terms of the warranties and the length of the entity's normal operating cycle, the obligation may need to be split into current and non-current components.<br>➢ Although the entity has no control over when the warranty claims are made, it could view each period of cover as a separate obligation. The obligations to provide cover in years 2 and 3 may be non-current liabilities because the entity could not be required to settle those obligations before defects became apparent in years 2 or 3. The obligation to provide cover in year 1 would be a non-current liability. |

# Appendix B—Proposals in Exposure Draft *Classification of Liabilities*

## [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~~ a right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period (see paragraph ~~73~~ 72R). 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.**

**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.**

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) [Existing paragraph 73.][11] 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) [Existing paragraph 75.] ~~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) [Existing paragraph 74.] 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

[11] These references to the existing paragraphs of IAS 1 were not in the Exposure Draft. They are added to this appendix for ease of reference.

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) [Existing paragraph 72.] 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) [Existing paragraph 76.] 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]

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## Transition and effective date

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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.