STAFF PAPER

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IASB® meeting

Project	**Classification of Liabilities as Current or Non-current (Amendments to IAS 1)**
Paper topic	Project update and next steps

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Purpose of the paper

1. The International Accounting Standards Board (Board) has a project on its agenda to clarify requirements in paragraphs 69-76 of IAS 1 *Presentation of Financial Statements*. Those requirements relate to the classification of liabilities as current or non-current. In April 2016, the Board paused work on this project while it finalised revisions to the definitions of assets and liabilities in its *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).

2. The Board has now finalised those definitions—it issued the revised *Conceptual Framework* in March 2018. So the Board can now resume its discussions on classification of liabilities as current or non-current.

3. This paper reminds Board members of the purpose of the project, and the stage it had reached when work paused in 2016. The paper also sets out the next steps planned by the staff.

4. Board members are asked if they have any comments on the staff plans.

Content of paper

5. This paper:

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(a) explains the background to the project (paragraphs 6-7);

(b) summarises the Exposure Draft proposals (paragraphs 8-12);

(c) summarises other amendments considered in developing the Exposure Draft (paragraphs 13-15);

(d) summarises the feedback on the Exposure Draft proposals and staff recommendations in 2015 for further work in light of that feedback; (paragraphs 16-18);

(e) reports the tentative decisions the Board has subsequently reached on one of these matters (paragraph 19);

(f) summarises the status of FASB proposals on classification of liabilities as current or non-current (paragraphs 20-32);

(g) considers whether there is any interaction between this project and proposals in the Discussion Paper *Financial Instruments with Characteristics of Equity* (paragraph 33); and

(h) describes the next steps planned by staff (paragraphs 34-36).

Background

6. Paragraph 60 of IAS 1 requires an entity to present current liabilities and non-current liabilities as separate classifications in its statement of financial position. Paragraph 69 of IAS 1 specifies criteria for classification as 'current'. Liabilities that do not meet those criteria are classified as 'non-current'.

7. The Board received a request to clarify the classification criteria in paragraph 69 and the way in which those criteria interact with detailed requirements contained in subsequent paragraphs. The main problems raised were lack of clarity about:

   (a) the terms 'unconditional' in paragraph 69(d) and 'discretion' in paragraph 73;

   (b) conditions placed on exercising a right; and

   (c) what constitutes 'settlement'.

Exposure Draft proposals

8. In February 2015, the Board published proposals for clarifying IAS 1 in an [Exposure Draft *Classification of Liabilities*] (the Exposure Draft).

9. The Exposure Draft proposed to clarify that classification of liabilities as either current or non-current should be based on the rights in place at the end of the reporting period.

10. To make this clear, the Board proposed to:

    (a) replace 'discretion' in paragraph 73 of IAS 1 with 'right', to align it with the requirements of paragraph 69(d);

    (b) make it explicit in paragraphs 69(d) and 73 of IAS 1 that only rights in place at the end of the reporting period affect the classification of a liability; and

    (c) delete 'unconditional' from paragraph 69(d) of IAS 1 so that 'an unconditional right' is replaced by 'a right'.

11. The Board also proposed to:

    (a) clarify the link between the settlement of the liability and the outflow of resources from the entity, by adding to paragraph 69 of the IAS 1 that settlement 'refers to the transfer to the counterparty of cash, equity instruments, other assets or services';

    (b) reorganise the guidance in paragraphs 72-76 so that similar examples are grouped together; and

    (c) require retrospective application and permit early application.

12. The proposed changes to IAS 1 were marked in the Exposure Draft and are reproduced in full in the Appendix A to this paper.

Other amendments considered in developing the Exposure Draft

13. In developing the Exposure Draft, the Board considered, but decided against, making further amendments to paragraph 73 of IAS 1 (renumbered as paragraph 72R(a) in the Exposure Draft). That paragraph addresses situations in which an entity has a right to defer settlement of a liability by rolling it over under an existing loan facility. The Exposure Draft proposed that:

> 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.

14. The Board considered whether to specify in paragraph 73 that the existing loan facility must be with the same lender. Furthermore, the Board considered whether the notion of 'the 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'. Due to the complexity introduced by consortia of lenders and the practical difficulties that a reference to 'same lender' would create, the Board decided not to propose adding 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 of IAS 1.

15. 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 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 amending the guidance on the effect of events after the reporting period 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*. Applying that Standard, events are 'adjusting' only if they provide evidence of conditions that existed at the end of the reporting period. The Board decided not to propose amendments to requirements on the effect of events after the reporting period.

Feedback on Exposure Draft proposals

16. The staff summarised feedback on the Exposure Draft proposals 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.

Key messages

17. The key messages reported in that summary were that:

    (a) the majority of respondents agreed with the proposal that classification should be based on the rights in place at the end of the reporting period. Some respondents, however, were concerned by the removal of the term 'unconditional' and requested further guidance about the nature of the rights on which classification is based. A few respondents recommended that the Board undertake a comprehensive review of classification requirements throughout IAS 1, rather than proceeding with narrow-scope amendments for classification of liabilities as current or non-current.

(b) some respondents identified specific types of facts and circumstances against which they recommended the Board test its proposals. Examples included situations in which:

   (i) the right to defer settlement includes uneconomic terms that would cause management to avoid exercising those rights.

   (ii) the lender has a right to repayment on demand.

   (iii) the right to defer settlement is subject to a condition that will be tested only after the end of the reporting period.

   (iv) management has the right to repay the debt early and intends to repay the debt within twelve months of the end of the reporting period despite also having the right to defer payment beyond twelve months.

   (v) management repays the debt after the end of the reporting period but before the financial statements are finalised.

   (vi) third parties underwrite existing loan arrangements. Respondents gave an example of an entity that has a rolling one-year commercial paper programme and a linked facility with a bank that can be drawn down if the commercial paper cannot be reissued as it falls due. These respondents asked whether the bank facility was part of the commercial paper arrangement that rolled over annually or constituted a separate arrangement that would not affect the classification of commercial paper that was not reissued.

(c) most respondents thought that the proposed new guidance linking settlement of a liability with the transfer of cash or assets was useful. Some respondents were concerned, however, about including the transfer of equity instruments in the list of ways of settling a liability. Some thought this reference to equity instruments contradicted the reference in paragraph 69(d). Respondents raised several specific examples of a liability that is extinguished by the transfer of equity for further consideration by the Board.

Staff recommendations in 2015 for further work

18. The Feedback Summary discussed by the Board in December 2015 also included staff recommendations. The staff recommended that the Board should finalise the proposals in the Exposure Draft, but in doing so should:

    (a) discuss and reach decisions on rights to defer settlement that are subject to a condition that will be tested only after the end of the reporting period (see paragraph 17(b)(iii));

    (b) test the Exposure Draft proposals by reference to some of the other specific types of facts and circumstances identified by respondents (see paragraph 17(b)); and

    (c) discuss further the proposed new guidance in paragraph 69 on settlement by the transfer of equity to the counterparty (see paragraph 17(c)).

Subsequent decisions

19. 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.[1] 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

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

a right that is subject to that condition should affect classification (as described in paragraph BC4 of the Exposure Draft);

(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.

FASB project on Simplifying the Classification of Debt

20. The US Financial Accounting Standards Board (FASB) is also updating its requirements for classification of liabilities as current or non-current. It is close to finalising a proposed Accounting Standards Update, *Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent)*. The amendments in the proposed Update, if finalised, will replace the current, fact-specific guidance with an overarching, cohesive principle. For public business entities, the amendments will be effective for fiscal years beginning after 15 December 2020. For all other entities, they will be effective for fiscal financial years beginning after 15 December 2021. The amendments have been developed as part of the FASB's Simplification Initiative and are expected to be issued before the end of 2018.

21. The differences in wording between the FASB's proposals and IAS 1 are highlighted in Appendix B.

Proposed classification principle

22. The classification principle proposed by the FASB is similar to the classification principle in IAS 1, so would bring greater convergence between US GAAP and IFRS Standards in this area. The principle proposed by the FASB is that debt and other instruments within the scope of the final Update should be classified as non-

current liabilities 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.

23. That classification principle would apply to short-term debt that is refinanced on a long-term basis after the balance sheet date: an entity would classify that debt as a current liability.

Exception to classification principle

24. The FASB proposes to provide an exception to its classification principle for waivers of debt covenant violations received after the balance sheet date but before the financial statements are issued. That exception would continue to require an entity to classify a debt arrangement as a non-current liability when there has been a debt covenant violation, if the entity receives a waiver of that violation that meets specified conditions[2] before the financial statements are issued (or are available to be issued). The proposed amendments would require an entity to separately present in the balance sheet liabilities that are classified as non-current because of waivers received after the balance sheet date.

25. There is no such exception in IAS 1. Paragraph 74 of IAS 1 specifies that, if an entity's breach of a condition at the end of the reporting period caused a liability to become payable on demand, the liability is classified 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'.

26. This difference between the FASB proposals and IAS 1 does not create a new divergence between US GAAP and IFRS Standards—it perpetuates an existing

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[2] It is necessary that the waiver does not result in a debt extinguishment or a troubled debt restructuring and that it is not probable that any other covenants will be violated from 12 months from the balance sheet date.

difference. The difference was considered by the Board when it was developing its Exposure Draft.

27. An example illustrates the difference. Suppose Entity A has an outstanding loan that matures in 10 years with Bank B. The arrangement requires Entity A to maintain a minimum current ratio[3] of 0.7 on a quarterly basis. If Entity A does not comply with this covenant, Bank B can demand repayment of the loan. On 31 December 20X1, Entity A's current ratio is 0.6, resulting in a covenant violation that gives Bank B the right to demand repayment of the loan. Entity A issues its 31 December 20X1 financial statement in March 20X2. In January 20X2, Bank B provides a waiver of the right to demand repayment of the loan for two years from the reporting date due to the current ratio covenant violation. There is no change to the interest rate, duration of the loan, or other terms of the loan agreement.

28. Applying the exception proposed by the FASB (and assuming all the specified conditions are met), Entity A would classify the loan as non-current. In contrast, applying the IASB proposals, Entity A would classify the loan as current because at the end of the reporting period, Bank B had a right to demand immediate settlement of the loan within 12 months at the end of the reporting period.

Clarification of classification principle

29. The FASB has tentatively decided to clarify two aspects of its classification principle.

30. First, in September 2017, it tentatively decided to clarify that the issuance of equity instruments does not constitute settlement when determining whether debt should be classified as current or non-current. The staff think that this clarification is consistent with paragraph 69 of IAS 1, which states that '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'. The staff think that

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3 Current ratio is a liquidity ratio that measures an equity's ability to pay short-term and long-term obligations. The formula for calculating current ratio is: Current Ratio (Times) = Current Assets / Current Liabilities

applying both IAS 1 and the FASB clarification, the classification of debt that is convertible into an equity instrument at the option of the holder would be determined on the basis of when the liability is contractually due to be settled rather than on the possible timing of conversion of debt to equity.

31. Secondly, 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 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 no longer callable at the balance sheet date, the borrower should classify the debt as a non-current liability. The borrower would be required to disclose information about the violation if it had not been cured before the financial statements were issued (or available to be issued) and would make the long-term obligation callable.

32. The staff have not yet had time to reach a view on whether this second FASB clarification is consistent with the IASB proposals—we plan to address this question in a future Board paper. Our tentative view is that there are differences—applying the FASB proposals, a grace period of any length would be sufficient whereas, applying paragraph 75 of IAS 1 (renumbered as paragraph 72R(b) in the Exposure Draft), the grace period would have to end at least twelve months after the reporting period.

Interaction with proposals in the Discussion Paper *Financial Instruments with Characteristics of Equity*

33. The Board has recently published a Discussion Paper *Financial Instruments with Characteristics of Equity*. That Discussion Paper develops principles that the Board could apply for classifying financial instruments as financial liabilities or equity instruments. The staff considered whether that Discussion Paper has any implications for this project on classification of liabilities as current or non-current, or vice versa. The staff did not identify any implications—the two projects are addressing different aspects of classification.

Next steps

34. The staff are resuming work on this project with a view to the Board finalising the amendments proposed in the Exposure Draft.

35. The staff plan to follow previous staff recommendations for further work by:

    (a) testing the Exposure Draft proposals by reference to some of the specific types of facts and circumstances identified by respondents (see paragraph 18(b)); and

    (b) considering further the guidance proposed in paragraph 69 of IAS 1 on settlement by the transfer of equity to the counterparty (see paragraph 18(c)).

36. In considering these two matters, the staff plan to consider:

    (a) whether and how proposed FASB guidance on grace periods differs from the Board's proposals (see paragraph 31); and

    (b) whether the revisions to the Board's *Conceptual Framework* have any implications for this project.

Question for the Board

Question for the Board
Do you have any questions about the project or comments on the staff plans for further work?

Appendix A

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~~ <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) [Existing paragraph 73.][4] 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 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

[4] 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.

(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

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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.

Appendix B

Comparison of wording between IFRS and US GAAP

IFRS defines current liabilities as liabilities that meet any one of four criteria. All other liabilities are defined as non-current liabilities. In contrast, US GAAP defines non-current liabilities as liabilities that meet either of two criteria and defines all other liabilities as current liabilities.

<table>
<tr><th></th><th>IFRS
(2015 Exposure Draft)</th><th>US GAAP
(2017 Exposure Draft)</th></tr>
<tr><td>Operating cycle</td><td>[para 69 (a)]
Settle … in its normal operating cycle</td><td>[470-10-45-22 a.]
Settled … (or operating cycle, if longer)</td></tr>
<tr><td>Holds for trading</td><td>[para 69 (b)]
Holds … for the purpose of trading</td><td>Not mentioned</td></tr>
<tr><td>How to call
- Reference period
- Reference date</td><td rowspan="2">[para 69 (c)]
Current liability;
Is ____(blank)____ due to be settled within twelve months after the reporting period</td><td rowspan="2">[470-10-45-22 a.]
Non-current liability;
Is contractually due to be settled more than one year after the balance sheet date</td></tr>
<tr><td rowspan="2">Contractual right or not</td></tr>
<tr><td rowspan="2">[para 69 (d)]
A ____(blank)____ right at the end of reporting period to defer settlement of the liabilities</td><td rowspan="2">[470-10-45-22 b.]
A contractual right
(blank)
______________ to defer settlement of the liabilities</td></tr>
<tr><td>At the time of having a right</td></tr>
</table>