IFRS

STAFF PAPER

September 2019

IASB® meeting

Project	**Classification of Liabilities as Current or Non-current**
Paper topic	Completion of due process and permission to begin balloting process

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Project overview

1. The purpose of this project is to clarify requirements in paragraphs 69–76 of IAS 1 *Presentation of Financial Statements*. These requirements relate to the classification of liabilities as current or non-current.

Purpose of session

2. The purpose of this session is to complete the due process for the project and decide whether the staff can begin the process of balloting amendments to IAS 1.

Content of paper

3. The due process steps covered in this paper include:
   (a) summarising the steps the Board has taken in developing the amendments (paragraphs 4–18);
   (b) completing the analysis of the effects of the amendments (paragraphs 19–24);

(c) considering whether the revised proposals require re-exposure (paragraphs 25–26);

(d) selecting an effective date for the amendments (see paragraphs 27–29); and

(e) reviewing the due process steps undertaken, deciding whether to give the staff permission to begin the balloting process and identifying any Board members who intend to dissent (see paragraphs 30–31).

Steps taken in developing amendments

Initiation of project and development of Exposure Draft

4. Paragraph 69 of IAS 1 requires an entity to classify a liability as *current* if the entity ‘does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period’. Paragraph 73 requires an entity to classify a liability as *non-current* if the entity ‘expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility’.

5. The IFRS Interpretations Committee received two requests for guidance on the relationship between these two requirements. The Committee proposed new guidance as part of the *Annual Improvements to IFRSs 2010–2012 Cycle* but, after considering feedback from respondents, decided not to recommend finalising the guidance. At its March 2013 meeting the IASB accepted that recommendation and decided to reconsider the issue.

6. At its meeting in September 2013, the Board tentatively decided to develop clarifications applying a principle that the classification of a liability as current or non-current should reflect the rights existing at the end of the reporting period. In February 2015, the Board published its proposals in the Exposure Draft *Classification of Liabilities*.

Exposure Draft proposals

7. To clarify that classification should reflect the rights existing at the end of the reporting period, the Board proposed to:

   (a) replace 'discretion' in paragraph 73 of IAS 1 with 'right';

   (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'.

8. The Board also proposed to:

   (a) clarify the meaning of the term 'settlement', by adding to paragraph 69 of the IAS 1 a statement 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.

9. The proposed changes to IAS 1 are shown in Appendix A to this paper.

Feedback on Exposure Draft proposals

10. The Board discussed feedback on the Exposure Draft proposals at its meeting in December 2015.[1]

11. The key messages reported in the feedback summary were that:

[1] IASB meeting December 2015 Agenda Paper 12B: IAS 1 Presentation of Financial Statements *Current/non-current classification of liabilities—Comment letter analysis*

(a) most respondents agreed with the proposal that classification should reflect the rights existing at the end of the reporting period.

(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.

(c) most respondents supported the proposal to clarify the meaning of the term ‘settlement’. However, some asked on the Board to clarify how the proposed new reference to equity instruments would interact with a statement in paragraph 69(d) of IAS 1 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’.

Staff recommendations for further work

12. The feedback summary discussed by the Board in December 2015 included staff recommendations. The staff recommended that the Board 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 (see paragraph 11(b)(iii));

(b) test the Exposure Draft proposals by reference to the other specific types of facts and circumstances identified by respondents (listed in paragraph 11(b)); and

(c) discuss further the classification of liabilities with equity-settlement features (see paragraph 11(c)).

Subsequent tentative decisions

13. The Board subsequently discussed all the matters listed in paragraph 12. It discussed them at its meetings in February 2016, November 2018, March 2019 and July 2019 (pausing the project between 2016 and 2018 while it finalised revisions to the definition of a liability in the *Conceptual Framework for Financial Reporting*).

14. As a result of these discussions, the Board made no fundamental changes to the proposed amendments but tentatively decided to clarify some aspects of them. The tentative decisions are set out in Appendix B.

Additional targeted consultation on liabilities with equity-settlement features

15. One of the Board’s tentative decisions in March 2019 was to clarify the IAS 1 requirements for classifying liabilities with equity-settlement features, specifically by clarifying the circumstances in which an obligation to transfer the entity’s own equity instruments affects the classification of a liability.

16. The Board also asked the staff to perform targeted consultation to obtain a better understanding of the practical consequences of the clarification. The staff consulted members of the IFRS Interpretations Committee asking committee members with relevant experience for their views on how the clarification could affect practice.

17. Committee members:

    (a) confirmed there is diversity in practice, which the proposed clarification should help to eliminate (see paragraph 21(b) below)

    (b) noted the clarification could result in some entities re-classifying some liabilities from non-current to current and stressed the need for time to re-negotiate loan covenants (see paragraph 22 below); and

    (c) asked the Board to clarify whether the reference to counterparty options in paragraph 69(d) of IAS 1 applies to a counterparty conversion option recognised separately from the host liability, but as an embedded derivative not an equity instrument.

18. The Board considered the request in paragraph 17(c) at its meeting in July 2019 and tentatively decided to clarify that the reference:

    (a) applies to a counterparty option recognised separately from the host liability as the equity component of a compound financial instrument;

    (b) does not apply to a counterparty option or other obligation classified as a liability or part of a liability.[2]

Effects analysis

Magnitude of effects

19. The staff do not think the proposed amendments have major implications for financial reporting. The amendments would clarify IAS 1 requirements but not fundamentally change them. Furthermore, the amendments would affect only the presentation of liabilities in the statement of financial position—not the amount or timing of recognition of any asset, liability income or expenses, or the information that entities disclose about those items.

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2 IASB July 2019 Agenda Paper 29A *Classification of Liabilities as Current or Non-current—Liabilities with equity-settlement features*.

Benefits

20. At several stages of this project, stakeholder feedback has confirmed diversity in practice for classifying liabilities as current or non-current. The proposed amendments should reduce that diversity making the information provided to users more comparable.

21. The amendments should reduce diversity by, for example:

    (a) clarifying that classification of a liability as current or non-current is based purely on the rights existing at the end of the reporting period. Amendments to paragraph 73 will remove the contradictory suggestion that classification is also sometimes affected by management's expectations about whether and when the entity or counterparty would exercise its rights.

    (b) clarifying the statement in paragraph 69(d) of IAS 1 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'. Practices differ at present because views differ on whether this statement applies only to counterparty options that are separately recognised as an equity component of a compound financial instrument or also to counterparty options (and possibly even other types of obligations) classified as liabilities.[3]

Costs and difficulties

22. Some respondents to both the Exposure Draft and subsequent targeted consultation noted that, because the clarifications would result in some entities reclassifying debt from non-current to current, applying the clarifications could jeopardise those entities' compliance with loan covenants.[4] Those respondents stressed the need for enough time between any amendments being issued and becoming effective for affected

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[3] See IASB July 2019 Agenda Paper 29A *Classification of Liabilities as Current or Non-current—Liabilities with equity-settlement features*, paragraph 13(a).

[4] See IASB July 2019 Agenda Paper 29A *Classification of Liabilities as Current or Non-current—Liabilities with equity-settlement features*, paragraph 14 and Agenda Paper 29B *Classification of Liabilities as Current or Non-current—Transition and early application*, paragraph 8(d).

entities to re-negotiate covenants. The staff have considered this point in developing recommendations on the effective date for the amendments (see paragraphs 27–29).

23. The feedback from stakeholders did not highlight any other significant cost or reporting burden that might result from the proposed amendments. The amendments should not make classification more difficult—indeed, they should make classification easier by clarifying the requirements and removing any suggestion that classification would require judgements about future events.

Staff conclusions

24. For the reasons in paragraphs 20–23, the staff conclude that the benefits of the amendments would outweigh the costs.

Re-exposure

25. The final amendments include changes from the Exposure Draft proposals. The staff have considered whether these changes, which are listed in Appendix B, create a need to re-expose the amendments. In doing so, the staff have considered the criteria for re-exposure in 6.25–6.29 of the IFRS Foundation *Due Process Handbook*.

26. The staff conclude that the final amendments do not require re-exposure because:

   (a) the changes have been made in response to requests from respondents to the Exposure Draft and clarify the Exposure Draft proposals without fundamentally changing them;

   (b) the clarifications affect only presentation requirements—not the amount or timing of recognition of any asset, liability, income or expenses; and

   (c) the most significant of the clarifications applies only to liabilities with equity-settlement features. As explained in paragraph 16, the Board consulted members of the IFRS Interpretations Committee on the practical consequences of this clarification. Committee members from large accounting firms were able to consult colleagues with practical experience of classifying liabilities with equity-settlement features. Given the quality of information fed back to the Board from that targeted consultation, the staff do not think the Board is likely to learn much more by re-exposing the proposals for general public comment.

Effective date

27. Paragraph 6.35 of the IFRS Foundation *Due Process Handbook* requires the Board to set a mandatory effective date for new requirements that gives jurisdictions sufficient time to incorporate the requirements into their legal systems, and those applying IFRS Standards sufficient time to prepare for the requirements.

28. As reported in paragraph 22, applying the amendments proposed in this project could affect some entities' compliance with loan covenants. Respondents to both the Exposure Draft and the subsequent targeted consultation stressed the need for enough time between any amendments being issued and becoming effective for affected entities to re-negotiate covenants.

29. The staff expect the Board to issue the amendments early in the first quarter of 2020. Considering the need for time to re-negotiate covenants, the staff recommend making the amendments effective for annual reporting periods beginning on or after 1 January 2022.

Review of due process and permission to begin the balloting process

30. Appendix C lists the due process steps undertaken in developing the proposed amendments. All steps required for finalising amendments to a Standard have been completed and the staff request permission to begin the balloting process.

31. No Board member dissented from the Exposure Draft. Any Board members who intend to dissent from the final amendments are asked to make their intention known at this meeting.

Questions for the Board

Due process and permission to begin balloting process
1. Re-exposure—do you agree that the proposed amendments can be finalised without re-exposure (see paragraphs 25–26)? 2. Effective date—do you agree that the amendments should apply for annual reporting periods beginning on or after 1 January 2022 (see paragraphs 27–29)? 3. Dissent—do you intend to dissent from issuing the amendments? 4. Permission to ballot—are you satisfied that the due process requirements have been met and that the Board has undertaken sufficient consultation and analysis to begin the balloting process for the amendments?

Appendix A—Exposure Draft proposals

[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.][5] 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:

[5] 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.

(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]

...

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.

Appendix B—Subsequent changes to Exposure Draft proposals

<table>
<tr><th></th><th>Tentative decisions</th></tr>
<tr><td>IASB Update
December 2015</td><td>Comment letter analysis (Agenda Paper 12B)
• No decisions were made.</td></tr>
<tr><td>IASB Update
February 2016</td><td>Conditions tested after the end of the reporting period (Agenda Paper 12B)
• 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 ED);
(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.</td></tr>
<tr><td>IASB Update
November 2018</td><td>Implications of proposals for particular facts and circumstance (Agenda Paper 29)
• The Board tentatively decided 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 12 months after the reporting period.</td></tr>
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- The Board tentatively decided to add to IAS 1 a reminder that an entity's right to defer settlement must have substance.
- The Board tentatively decided to clarify in IAS 1 that:
  - (a) 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; and
  - (b) 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.
- The Board discussed differences between the requirements of IAS 1 and proposed requirements on the classification of debt being developed by the US Financial Accounting Standards Board and tentatively decided not to consider further amendments to IAS 1.

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<tr><td>IASB *Update*
March 2019</td><td>

Liabilities with equity-settlement features (Agenda Paper 29A)

- The Board tentatively decided to clarify the IAS 1 requirements for classifying liabilities with equity-settlement features by:
  - (a) clarifying the circumstances in which an obligation to transfer the entity's own equity instruments affects the classification of a liability:
  - (b) clarifying that the existing and proposed references to equity instruments are to the entity's own equity instruments.
  - (c) aligning the terminology—referring to the 'transfer to the counterparty' (not 'issue') of the entity's own equity instruments. The term transfer would apply to any means of delivering the entity's equity instruments to the counterparty, including issuing new instruments.

Lending conditions tested after the reporting period (Agenda Paper 29B)

- The Board tentatively decided not to add further guidance on how to test compliance with conditions linked to the entity's financial performance.

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	Tentative decisions
IASB *Update* July 2019	**Liabilities with equity-settlement features** • Paragraph 69(d) of IAS 1 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 as current or non-current. The Board tentatively decided to amend IAS 1 to clarify that this statement applies only to a counterparty conversion option recognised separately from the liability as an equity component of a compound financial instrument. Any other term of a liability that could result in its settlement by the transfer of the entity's own equity instruments does affect the classification of the liability as current or non-current. **Transition and early application** • The Board tentatively decided to: (a) require an entity to apply the amendments retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; (b) provide no exemption for an entity adopting IFRS Standards for the first time; and **(c)** permit an entity to apply the amendments before their effective date (early application), but to require an entity that applies the amendments early to disclose that fact.

Appendix C—Due process steps

Step	Required or optional?	Actions
Consideration of information gathered during consultation		
All comment letters received on the Exposure Draft posted on the project pages.	Required	All comment letters received were posted and remain on the project webpage. https://www.ifrs.org/projects/work-plan/classification-of-liabilities/comment-letters-projects/ed-classification-of-liabilities/#consultation
Round-table meetings between external participants and members of the Board.	Optional	Not considered necessary for these narrow-scope clarifications.
Board and Interpretation Committee meetings are held in public, with papers being available for observers. All decisions are made in public sessions.	Required	Discussed at IFRS Interpretations Committee public meeting in January 2013. Discussed at IASB public meetings in January 2013, March 2013, September 2013, October 2013, March 2014, September 2014, December 2015, February 2016, April 2016, September 2018, November 2018, March 2019 and July 2019. A project page on the IFRS Foundation website has been in place over the course of the Board project. https://www.ifrs.org/projects/work-plan/classification-of-liabilities/#project-history The project page contains a full description of the project with meeting papers and decision summaries.
Analysis of likely effects of the forthcoming Standard or major amendment, for example, costs or ongoing associated costs.	Required	See analysis in paragraphs 19–24 of this paper.
Email alerts are issued to registered recipients.	Optional	Subscribers to news about the Classification of Liabilities project have been notified when key documents, eg the Exposure Draft and IASB Update newsletters, are issued.
Outreach meetings to promote debate and hear views on proposals that are published for public comment.	Optional	Not considered necessary for these narrow-scope clarifications.
Regional discussion forums are organised with national standard-setters and the Board.	Optional	Not considered necessary for these narrow-scope clarifications.

Step	Required or optional?	Actions
Finalisation		
Due process steps are reviewed by the Board.	Required	To be done at this meeting.
Board considers need for re-exposure.	Required	To be done at this meeting. See paragraphs 25–26 of this paper.
The Board sets an effective date for the Standard, considering the need for effective implementation, generally providing at least one year.	Required	To be done at this meeting. See paragraphs 27–29 of this paper.
Drafting		
The implications for the IFRS Taxonomy are considered during the development and drafting of new or amended Standards.	Required	The taxonomy team will review the pre-ballot draft. The amendments do not introduce any new classifications or disclosure requirements so we do not think there are major implications.
Drafting quality assurance steps are adequate.	Optional	The editorial and translations teams will review drafts during the balloting process. External parties will be invited to perform an editorial review of the pre-ballot draft.
Publication		
Press release to announce the final Standard.	Required	A press release will be published with the final amendments.
Project Summary and Feedback Statement.	Required only for new Standards and major amendments	Not considered necessary for these narrow-scope clarifications.
Podcast, webcast. Q&A pack, presentation pack.	Optional	Will be considered closer to publication.