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International Accounting Standards Board

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*These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

**INFORMATION FOR OBSERVERS**

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| **Board Meeting:** | **11 March 2008, London** |
| **Project:** | **ED Annual improvements process–Comment analysis** |
| **Subject:** | **IAS 1 Current/non-current classification of derivatives (Q6) (Agenda paper 8E)** |

## Introduction

1. The purpose of this agenda paper is to summarise the staff's analysis of the comments received on the proposed amendment in Question 6 of the annual improvements ED.

## Staff recommendation

2. The staff recommends that the Board revise the amendment to paragraphs 68 and 71 of IAS 1, and add the Board's rationale in the Basis of Conclusion to clarify the difference between 'held primarily for the purpose of trading' under IAS 1 and 'held for trading' under IAS 39 as requested by respondents (proposed wording is included in Appendix 1 to this agenda paper).

## Background

3. The issue stems from an IFRIC recommendation from its March 2007 meeting that the Board make a minor amendment to paragraph 71 of IAS 1 (revised 2007) because some might read this guidance as implying that financial liabilities classified as held for trading in accordance with IAS 39 for measurement purposes are required to be presented as current (see Appendix 2 for extracts of relevant paragraphs from IAS 1).

4. Paragraph 9a of IAS 39 defines financial instruments held for trading in three parts (see Appendix 2 for extracts of relevant paragraphs from IAS 39). Parts (i) and (ii) of that definition include a reference to short-term buying and selling of the instruments. However, part (iii) includes all derivatives that are not designated and effective hedging instruments.

5. Consequently, a derivative that is not a designated and effective hedging instrument but which has a maturity of more than 12 months and is expected to be held for at least 12 months will be classified as 'trading' to be measured at fair value through profit or loss under IAS 39. Obligations or derivatives to deliver financial assets borrowed by a short seller are examples.

6. Applying the guidance set out in paragraphs 69 and 71 of IAS 1 to such a 'held for trading' derivative under IAS 39 that is not a designated and effective hedging instrument but which has a maturity of more than 12 months and is expected to be held for at least 12 months leads to a non-current classification.

7. The Board expects the criteria set out in paragraph 69 of IAS 1 to be used to assess whether a financial liability should be classified as current or non-current. Therefore the Board decided to remove the identified inconsistency by amending the examples of current liabilities in paragraph 71 of IAS 1. The Board also decided to make a similar amendment to paragraph 68 in respect of current assets.[1]

8. The ED amendment will result in the classification of a derivative financial liability as current or non-current on the basis of the criteria set out in paragraph 69 of IAS 1 rather than based on the classification as 'trading' in accordance with IAS 39.

## Comment Analysis

9. Of the 75 comment letters received by the Board, 56 commented on this issue. Respondents generally agreed that 'held for trading' financial assets and liabilities under IAS 39 should not be automatically classified as current under IAS 1.

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[1] *IASB Update* (June 2007)

10. A majority of the concerns or objections expressed to the proposed amendments arose from the presumption that either ‘held primarily for the purpose of trading’ under IAS 1 would be equivalent to the ‘held-for-trading’ category in IAS 39, or vice versa.[2] Therefore, many believed that deleting references to IAS 39 in paragraphs 68 and 71 of IAS 1 is not sufficient to resolve the identified inconsistency in classification of such derivatives.

11. Respondents also felt that the ‘held-for-trading’ label in IAS 39 is misleading. Many therefore suggested that the Board should review the classification of derivatives that are not designated and effective hedging instruments that are currently included in paragraph 9a, part (iii), of the IAS 39 definition of ‘financial asset or financial liability at fair value through profit or loss’.[3] Suggestions include separating these derivatives as a standalone subcategory of ‘financial asset or financial liability at fair value through profit or loss’ rather than as a part of the current ‘held for trading’ subcategory of paragraph 9a of IAS 39.

12. One respondent also commented that it would be helpful to clarify how to treat derivatives with staggered settlement dates. [4] The staff notes that the IFRIC decided in its March 2007 meeting not to address how to split the carrying amount of a derivative into current and non-current components because it requires the development of Application Guidance. The staff believes that this is beyond the scope of the annual improvements project.

13. Regarding the similar terminologies in IAS 1 and IAS 39 that respondents find confusing, the staff notes that the ‘held for trading’ category under paragraph 9a of IAS 39 provides guidance on recognition and measurement, whereas paragraphs 69 and 71 of IAS 1 deal with the classification of assets and liabilities as current and non-current. The two are separate and distinct sets of guidance.

14. The staff also notes that both the IFRIC (March 2007) and the Board (June 2007) have discussed the difference between instruments ‘held primarily for

[2] CL 10, 40, 42, 58, 59, 65, 75
[3] CL 11, 12, 13, 16, 23, 28, 45, 48, 54, 56, 71, 72
[4] CL 75

the purpose of trading’ under IAS 1 and those in the ‘held-for-trading’ category under IAS 39.

15. The comments received and analysis above indicate that the proposed amendment received broad support although some respondents find that the amended text as currently proposed does not adequately explain the difference between the similar terminologies, and therefore may not remove the identified inconsistency as the Board intended.

16. Therefore, the staff recommends that the Board revise the amendment to paragraphs 68 and 71 of IAS 1 to show how these terms relate to each other, and add the Board’s rationale in the Basis of Conclusion to clarify the difference between ‘held primarily for the purpose of trading’ under IAS 1 and ‘held for trading’ under IAS 39 as requested by respondents.

17. **Does the Board agree with the staff’s recommendation?**

18. **Does the Board have any drafting comments on Appendix 1?**

## Appendix 1 – DRAFTING

[Omitted from observer notes]

## Appendix 2 – EXTRACTS (IAS 1 and IAS 39)

# IAS 1

### Current assets

**66 An entity shall classify an asset as current when:**

**(a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;**

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

**(c) it expects to realise the asset within twelve months after the reporting period; or**

**(d) the asset is cash or a cash equivalent (as defined in IAS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.**

**An entity shall classify all other assets as non-current.**

68 The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading (financial assets within this category are classified as held for trading in accordance with IAS 39) and the current portion of non-current financial assets.

### 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) the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.**

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

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 financial liabilities classified as held for trading in accordance with IAS 39, 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 74 and 75.

# IAS 39

**9 The following terms are used in this Standard with the meanings specified:**

## Definitions of four categories of financial instruments

**A *financial asset or financial liability at fair value through profit or loss* is a financial asset or financial liability that meets either of the following conditions.**

**(a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if it is:**

- **(i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term;**
- **(ii) part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or**
- **(iii) a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).**