Project **Work in progress**

Topic **IAS 1 *Presentation of Financial Statements* – current/non-current classification of debt (rollover agreements) – outreach results**

Introduction and purpose of this paper

1. A request was received in October 2010 by the IFRS Interpretations Committee, to clarify the meaning of 'unconditional right to defer settlement' in paragraph 69(d) of IAS 1 *Presentation of Financial Statements*. This issue was discussed at the Committee's November 2010 meeting[1]. The Committee asked the staff to perform outreach on the topic in order to understand the level of diversity in practice.

2. The purpose of this paper is

   (a) to discuss the outreach responses received from the National Standard Setters' group, and

   (b) to consider the staff's recommended course of action in respect of this issue.

[1] http://www.ifrs.org/NR/rdonlyres/3A756C3A-D1B0-41F1-AA68-9D78ABA08756/0/1011obs1111AIAS1.pdf

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

Background and outreach request

3. The original submission received requested clarification of one of the criteria for classification of liabilities in paragraph 69 of IAS 1, as read with paragraph 73. Specifically, the submission asked for guidance on what an 'unconditional right to defer settlement' means.

4. In agenda paper 11 discussed at the Committee's November 2010 meeting, the Committee considered scenarios where an agreement was reached before the reporting date to refinance an existing borrowing with the same lender and with a different lender, with the same and with different terms. The debate concerned the classification of the existing debt at reporting date, under the different circumstances.

5. There were mixed views among the Committee members as to whether the existing borrowing should be classified as current or non-current.

6. The staff sent out a request for information to the National Standard Setters group. 11 responses were received. The tabulated details of those responses can be found in Appendix A.

7. The fact pattern of the request, and the questions asked, were as follows:

> Consider an existing borrowing that was originally taken out for 5 years, and that is due to mature 6 months after the entity's reporting date. How would you classify this existing borrowing at reporting date, under the following circumstances:
>
> 1. An agreement is reached before reporting date to refinance the existing borrowing with the **same lender, at the same or similar terms**?
>
> 2. An agreement is reached before reporting date to refinance the existing borrowing with the **same lender, at different terms**?
>
> 3. An agreement is reached before reporting date to refinance the existing borrowing with a **different lender, at similar or different terms**?

Discussion of the responses received

Existing loan renegotiated with the same lender, at same/similar terms (question 1)

8. The majority of the respondents supported classifying the existing loan as non-current. The new loan is seen as an extension, or a roll-over, of the existing loan.

Existing loan renegotiated with the same lender, at different terms (question 2)

9. Here, the views were divided:

   (a) some said that the existing loan would be classified as non-current, and it was a roll-over of an existing arrangement between two parties (some said this would depend on the terms being 'substantially' the same), and

   (b) some said that the existing loan would be current, regardless of the fact that the lender remained the same. The different terms would mean a new loan arrangement.

Existing loan renegotiated with a different lender at the same, or different, terms (question 3)

10. All of the respondents said that the existing loan would be classified as current – a new lender meant a new loan arrangement. Whether or not the terms were the same or different seemed not to affect the classification choice.

Staff analysis

11. From the above, there was consensus of views on the classification of the existing loan, where it is renegotiated (some say 'rolled over') with the same lender at the same/similar terms. There was also consensus of views where the existing loan is replaced (some say 'refinanced') by a loan with a different lender, regardless of the terms.

12. However, in the case where the existing loan is renegotiated with the same lender but at different terms (question 2), the views were divided as to how to classify the existing loan. It appears that the decision for some respondents rests

on whether the new terms introduced would mean a substantial modification to the existing loan. In response to this question, some respondents cited the principles in paragraphs 39 and 40 of IAS 39 *Financial Instruments: Recognition and Measurement* would be persuasive to their answer. Paragraph 40 of IAS 39 states that:

> An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

13. The staff note however that the extinguishment of the existing loan would only take place when it was paid off 6 months(per the outreach example) *after* the reporting date, but the staff presumes that this would be persuasive to the decision regarding the classification of the existing liability at reporting date.

14. Therefore, from the outreach responses received, the staff draw some conclusions, as follows:

    (a) When IAS 1 paragraph 69(d) is read with paragraph 73, it seems that this is interpreted to mean that an existing liability that is due within 12 months after the reporting date may be classified as non-current, if it is renegotiated for at least another 12 months, *with the same lender at the same, or similar, terms*.

    (b) Where an existing liability that is due within 12 months after the reporting date is negotiated with a *new lender (regardless of the terms)*, it seems that paragraph 73 is interpreted not to apply, and the existing liability will be classified as current.

    (c) As for the situation where an existing liability due within 12 months after the reporting date is renegotiated for at least another 12 months, *with the same lender at different terms,* some think that paragraph 73

applies - that is, the existing liability would be classified as non-current under these circumstances. Some think it does not.

15. The staff think that paragraph 73 needs to be clarified, to address the confusion that seems to be arising in practice with circumstances such as in (c), above.

16. The staff think that, due to the inclusion of the words 'under an existing loan facility' in paragraph 73, that paragraph 73 intended to apply to situations where a existing loan is renegotiated with the same lender. However, the staff thinks that the paragraph is not clear as to whether renegotiated loans with the same lender should be classified as non-current when different loan terms apply or only when the same/similar terms apply.

17. The staff think that, if paragraph 73 applied to a renegotiated loan with different terms, that this would be inconsistent with the derecognition guidance for financial liabilities, as discussed in paragraph 12, above. It does not make sense that a loan would be classified as non-current at reporting date by applying paragraph 73, only to be derecognised or 'extinguished' less than 12 months after reporting date, and replaced by a new loan facility at that time, in accordance with paragraph 40 of IAS 39.

Staff recommendation

18. Therefore, the staff recommend that the wording of paragraph 73 of IAS 1 is amended to clarify that it deals with situations where an existing loan is renegotiated with the same lender, at the same or similar terms:

> If an 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 with the same lender, on the same or similar terms, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

Question 1 for the Committee
1(a) Does the Committee agree with the staff's analysis in paragraphs 16 and 17? 1(b) Does the Committee agree with the staff's recommended amendment in paragraph 18?

Annual Improvements criteria assessment

19. The staff suggest that this amendment be made through the next *Annual Improvements* cycle (2010 – 2012).

Assessment against the proposed new criteria

20. The IFRS Foundation has exposed for public comments proposed enhanced criteria for issues to be included in *Annual Improvements* as part of an amendment to the Due Process Handbook. The comment period ended on 30 November 2010.

21. The staff proposes an assessment of the inclusion of the issue against the proposed enhanced criteria reproduced in full below. Note that all criteria (a)-(d) must be met to qualify for inclusion in annual improvements:

Proposed new criteria	Staff assessment of the proposed amendment
(a) The proposed amendment has one or both of the following characteristics: (i) clarifying—the proposed amendment would improve IFRSs by: • clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles	(a) The proposed amendment provides clarification in determining whether a liability renegotiated before the end of the reporting period, should be classified as current or non-current.

within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle. (ii) correcting—the proposed amendment would improve IFRSs by: • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.	
(b) The proposed amendment has a narrow and well-defined purpose, ie the consequences of the proposed change have been considered sufficiently and identified.	(b) The staff think the proposed amendment has a narrow and well-defined purpose – it is limited to instances where a liability is renegotiated before the end of the reporting period No consequential amendments are considered necessary.
(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach agreement on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	(c) The staff think that if the Interpretations Committee reach a conclusion on a timely basis, it is likely that the Board will do the same.
(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a pressing need to make the amendment sooner than the project would.	(d) IAS 1 is the subject of the Financial Statement Presentation project. According to that project team, the general distinction between current and non-current has been considered, but has not been brought in front of the Board yet. The timing of when the FSP standard will be issued is not finalised at this time. The staff think, because of the delay to the FSP project, this issue should be addressed through *Annual Improvements*.

22. Following the analysis in the table above, in the staff's opinion, the proposed amendment satisfies the *Annual Improvements* criteria.

Question 2 for the Committee

2(a) Does the Committee agree with the staff's recommendation that the proposed amendment be made through the *Annual Improvements* process? 2(b) Does the Committee agree with the amendment to IAS 1 as set out in Appendix B to this paper?

A related issue – assessment of the financial stability of the lender

23. Paper 11A[2] of the Committee meeting in November 2010 discussed whether the assessment of a right as unconditional (as contemplated in paragraph 69 of IAS 1) requires consideration of all possible future circumstances, or only those that exist at reporting date. Specifically, whether there is any reason to believe that the lender providing the long-term finance would not be able to honour the facility if called upon. In that paper, the staff presented the following view:

> The staff think that the financial health of the entity providing the re-financing is an important factor when considering whether a liability is current or non-current. Presenting a loan as non-current when there is evidence that the provider of the new loan is not financially stable at reporting date, may be misleading. This is especially relevant in circumstances where the liability is in the form of a long-term line of credit to be drawn upon as and when the borrowing entity requires funding.
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> IAS 10 *Events after the Reporting Period* states that an entity shall consider adjusting for particular events occurring between the end of the reporting period and the date when the financial statements are authorised for issue[3]. IAS 1 paragraph 26 explains that the assessment of the going concern of an entity requires looking forward at least 12 months from the end of the reporting period. The staff thinks that paragraph 69(d) does not require an entity to assess the financial health of the finance provider beyond this requirement.

[2] http://www.ifrs.org/NR/rdonlyres/3A756C3A-D1B0-41F1-AA68-9D78ABA08756/0/1011obs1111AIAS1.pdf

[3] IAS 10 paragraph 3

The staff do not recommend that the Committee take any action in respect of this issue.

24. The Committee suggested that the staff include this issue in the outreach performed, to assess if there was diversity in practice.

25. Of the outreach responses received, almost all of the respondents stated that only circumstances at balance sheet date (and up to the approval of the financial statements) should be considered, and that assessing the going concern of the lender is not required for purposes of classifying the liability.

26. The staff agree with this conclusion, and recommend that the Committee take no action in respect of this issue.

Question 3 for the Committee
Does the Committee agree with the staff's recommendation in paragraph 26?

Appendix A – Detailed summary of responses received from the National Standard Setter group

A1 The table below summarises the responses we received.

Respondent	Question 1	Question 2	Question 3	Question 4
1. South Africa	Non-current - the lender has not changed and thus evidence of unconditional deferral.	Non-current, as the lender has not changed. Disclose the changed terms.	Current – this is a different party to the original lender - the entity is still required to repay the original lender.	Circumstances existing at the balance sheet date and up to approval of the financial statements. Any further period is subject to events and circumstances that may not be foreseeable and may be subjectively determined.
2. Mexico	Similar to a roll-over; non-current	Similar to a roll-over; non-current	Depends on the terms of the new agreement; likely to be current	Assess at the time the financing is provided
3. Germany (representatives of the Big 4 National offices provided input to the Standard setter)	Generally non-current	Generally non-current, but depends on whether the different terms represent a 'substantial modification' or not.	Current – cash will flow to settle the debt with the existing lender; the liability will be derecognised.	Circumstances at balance sheet date – anything further into the future goes to a going concern assessment of the lender
4. Singapore	If refinancing allows the entity to roll over the outstanding balance into the new borrowing with same/similar terms, the classification should be based on the tenure of the new borrowing.	Current - if there are substantial changes in the terms that results in an extinguishment of the existing borrowing within 12 months after the entity's reporting date.	Current	We believe it should be based on circumstances existing at balance sheet date.

Respondent	Question 1	Question 2	Question 3	Question 4
5. Israel	Non-current	Current - substantially different terms = extinguishment of the original financial liability and the recognition of a new financial liability.	Current – refinancing with a different lender.	
6. Japan (opinion as SS; not sufficient entities on IFRS to report on diversity in practice)	Non-current	Non-current if the terms are substantially the same	Current – terms are not substantially the same	Agree with staff view in AP 11A
7. Australia (no diversity known of)	Non-current	Current, if new terms are more than 10% different from the existing terms	Current – different party; derecognition of existing debt	
8. Taiwan	Non-current	Current - new facility has been negotiated	Current - new facility has been negotiated	Only circumstances at BS date
9. UK Standards Board	Generally treated as non-current	Divided views from respondents on whether this was non-current or current; also require disclosure of the revised terms.	Generally treat as current; disclose new facility and new lender.	Going concern issue of the lender
10. Holland – general response: depends on terms of the contract			Generally speaking, current	
11. Hong Kong (response from a member of the financial reporting standards committee)	Depends on how roll-over and refinance are defined and understood.		If there is settlement of the existing liability, then current	

Appendix B – Draft amendment to IAS 1 *Presentation of Financial Statements*

B1 This appendix includes drafting of the proposed amendment. It is based on the text included in the most recently issued standards (including the *Improvements to IFRSs* issued in May 2010). New text is underlined and deleted text is struck through.

Proposed amendment to IAS 1 *Presentation of Financial Statements*

Paragraph 73 is amended (new text is underlined).

73 If an 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 with the same lender, at the same or similar terms, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

Transitional provisions and effective date

140G Paragraph 73 was amended by *Improvements to IFRSs* issued in [date]. An entity shall apply this amendment for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Basis for Conclusions on proposed amendment to IAS 1 *Presentation of Financial Statements*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Changes as a result of *Improvements to IFRSs* (2012)

BC1 The Board noted that Paragraph 73 of IAS 1 was not clear when read with the words ‘an unconditional right to defer settlement’ in paragraph 69(d). The Board noted that there was inconsistency in application of the principles when an existing loan was refinanced with the same lender. Therefore, as part of *Improvements to IFRSs* issued in [month] 2012, the Board decided to amend the wording of paragraph 73, to clarify that, for the paragraph to apply, an existing loan must be refinanced with the same lender, at the same or similar terms.