

STAFF PAPER

October 2013

Project	IAS 1 <i>Presentation of Financial Statements</i> Current/non-current classification of liabilities		
Paper topic	Summary of proposed amendment		
CONTACT(S)	April Pitman	apitman@ifrs.org	+44 (0)20 7246 6492

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose of this paper

1. At the IASB's September 2013 meeting you asked us to develop a general approach to the classification of liabilities that is based on an assessment of the arrangement(s) in existence at the reporting date.
2. In this paper we will:
 - (a) provide background to this issue, including a summary of outreach conducted;
 - (b) discuss in greater detail the amendments that were suggested at the September 2013 meeting;
 - (c) develop proposals for 'settlement' of liabilities based on the transfer of cash and other assets by the entity; and
 - (d) consider the effect of breaches of conditions and of events after the reporting period on classification.
3. In this paper we will ask whether:
 - (a) you agree with the classification principle identified;
 - (b) you agree with the staff's conclusions about the effect that breaches of conditions and events after the reporting period should have on classification; and

- (c) you agree with the staff's proposed amendments to IAS 1.

Structure of the paper

4. The paper is organised as follows:
- (a) background and outreach conducted;
 - (b) outline of a more general approach to classification;
 - (c) proposed deletion of 'unconditional' and substitution of 'right' for 'discretion';
 - (d) proposal to clarify 'settlement', based on the transfer of resources;
 - (e) proposal to reaffirm the inclusion of 'with the same lender';
 - (f) effect of breaches of conditions and events after the reporting period;
 - (g) staff summary and recommendation;
 - (h) Appendix A—Proposed amendments to the Standard; and
 - (i) Appendix B—Illustrative examples.

Background and outreach conducted

Introduction

5. The IFRS Interpretations Committee (the 'Interpretations Committee') received requests relating to the classification of liabilities as either current or non-current. Paragraph 69 of IAS 1 *Financial Statement Presentation* relates to the classification of *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 right to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 73). 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.

6. Paragraph 73 relates to *non-current* liabilities:

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, 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.

7. The submitters thought that these two paragraphs were asymmetrical and asked for further guidance. In their view, having *an unconditional right to defer settlement* (specified in 69(d)) was different from having *the discretion to refinance or roll over an obligation* (specified in 73).

Outreach conducted

Initial outreach

8. As usual, the Interpretations Committee conducted outreach on this topic by sending out a request for information to the National Standard-setters group. The request for information cited examples of an existing debt that is due to mature six months after the reporting entity's reporting date. Agreement is reached before the reporting date to roll over or refinance the debt with the same lender or a new lender and on similar or different terms.
9. The Interpretations Committee received 11 responses to this outreach request.

- (a) Most respondents thought that an agreement with the same lender on the same or similar terms was non-current debt.
- (b) All respondents thought that a loan negotiated with another (new) lender would be current, whether or not the terms were the same as those of the original loan.
- (c) Responses were divided when the debt is with the same lender but the terms are different.

Proposed Annual Improvement

10. As a result of this consultation, the Interpretations Committee recommended the following proposed amendment to IAS 1 as part of the Annual Improvements project, 2010-2012 Cycle:

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. ...

11. The proposed annual improvement was discussed at the IASB’s September 2011 meeting and approved subject to the Basis for Conclusions being extended to clarify what ‘same or similar terms’ meant. ‘Same or similar terms’ was clarified in the Annual Improvements 2010-2012 Exposure Draft (the ‘Annual Improvements ED’) by including a link in the proposed Basis for Conclusions with guidance on the derecognition of financial instruments in IAS 39 *Financial Instruments: Recognition and Measurement*.

Comment letters received on the proposed annual improvement

12. In January 2013, the Interpretations Committee discussed the comment letters received on the proposed amendment to IAS 1.
13. Many respondents expressed views that agreed with the messages received from the Interpretations Committee’s original outreach conducted in 2010, namely:
- (a) that the liability should be classified as non-current when 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 with the same lender, on the same or similar terms; and

- (b) that the liability should be classified as current when the entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period with a new lender.

14. The link with financial instruments in an attempt to clarify ‘same or similar terms’ gave rise to a range of views in the comment letters received on the Annual Improvements ED. Many respondents thought that the link was inappropriate and would give rise to a number of practical issues and a significant change in practice. Other respondents thought that ‘same or similar terms’ was still unclear.
15. The Interpretations Committee agreed with these comments. At its January 2013 meeting, it decided to recommend that this issue should be addressed through a narrow-scope amendment to IAS 1, rather than finalise the proposed Annual Improvement. At its March 2013 meeting the IASB agreed not to proceed with the proposed amendment as part of the 2010-2012 Annual Improvements.

Other topics raised in consultation

16. Respondents to the Annual Improvements ED raised three further areas of concern:
 - (a) syndicated lending;
 - (b) linkage of settlement of the liability with cash outflows; and
 - (c) significance of management’s expectations in the classification of liabilities.

Syndicated lending

17. Some respondents were concerned that inserting ‘with the same lender’ should be clarified within the context of syndicated loans. They were concerned that a rollover with the same consortium might be classified as current if the members of the consortium had changed. In their view, the rollover of a loan with the same consortium should be classified as non-current even when some members of the consortium had changed.

18. These respondents suggested that the use of ‘same lender or consortium of lenders’ would clarify this point.

Linkage of settlement of the liability with cash outflows

19. Some respondents referred to the IASB’s amendments to IAS 1 in 2007 and 2009 with respect to the classification of the liability component of a convertible instrument. They thought that these amendments had linked the classification of a liability with the entity’s liquidity and, in their view, classification should be linked with the outflow of cash or other assets.
20. This topic is considered in greater detail in paragraphs 57-70 of this paper.

Significance of management’s expectations in the classification of liabilities

21. A few respondents noted that the Standard refers to the entity’s expectations when considering classification. They suggested that references to expectations should be replaced by a probability threshold. One respondent, for example, suggested that ‘the entity expects’ should be replaced with ‘it is highly probable’.
22. We do not agree with this recommendation. The application of the Standard is based on management’s assessment of expectations and that requirement is explicit in the Standard.
23. With respect to a classification of the liability as current, paragraph 69 states that:

An entity shall classify a liability as current when:

- (a) it expects to settle the liability in its normal operating cycle; ...

24. Similarly, paragraph 66 of the Standard also includes ‘expects’ when discussing the classification of current assets:

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; ...

25. Paragraph 73 also includes expectation in its guidance about classifying liabilities as non-current:

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, it classifies

the obligation as non-current, even if it would otherwise be due within a shorter period.

26. We think that the IASB's intention to include expectation is clear and is consistently used in its description of the classification of both current and non-current liabilities and the classification of current assets. Consequently, in developing the proposed approach we continue to take into account management's expectations of when the liability will be settled.

Outline of a more general approach to classification

27. At the September 2013 meeting, you asked us to develop a more general approach to the classification of liabilities that is less dependent on specific borrowing fact patterns and renewal terms and that does not require the definition of terms that are common to many types of transactions and are used frequently in IFRSs.
28. In this more general approach, the classification of liabilities will be based on the contractual arrangements in place at the reporting date. Following your discussions at the September 2013 meeting and our review of outreach conducted on this topic, we have established some guidelines as a basis for this approach:
- (a) The more general approach should not use detailed fact patterns to define the precise circumstances in which a liability should be classified as non-current.
 - (b) It should not split our requirements between debt and other liabilities.
 - (c) The notion of management's expectation should be retained in the guidance.
 - (d) The existing wording should be retained when possible. We are concerned that including any guidance about common contractual terms with respect to the classification of liabilities could have unintended consequences if that guidance were applied to other circumstances when the term is used elsewhere in IFRS or if those terms have another meaning in some jurisdictions.

(e) The general approach should also consider whether the timing of the outflow of cash or other assets should play a part in the classification of liabilities.

29. We have used these guidelines to review all paragraphs relating to the classification of liabilities, ie paragraphs 69-76 of IAS 1. This guidance, detailed in Appendix A, is considered below.

Identifying a broad classification principle

30. In this project to date we have tried to reconcile the requirements in 69(d) for classification as ‘current’ with the guidance in 73 for ‘non-current’. Many think that having *an unconditional right to defer settlement* (specified in 69(d)) is inconsistent with having *the discretion to refinance or roll over an obligation* (specified in 73) as the two stated criteria for the classification of a liability as non-current.

31. We have compared the wording of the two relevant paragraphs of IAS 1 in order to identify a single principle that could be employed for the classification of liabilities.

32. What the two requirements for the classification of a liability as non-current have in common at present is the existence of an arrangement that ensures the entity is not required to settle the liability for at least 12 months after the reporting period:

69(d) it does not have an unconditional right *to defer settlement of the liability for at least twelve months* after the reporting period (see paragraph 73).

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, it classifies the obligation as non-current,

(emphasis added)

33. Both paragraphs also require that the arrangement already exists at the reporting date. Paragraph 69(d) refers to a right; paragraph 73 refers to an existing loan facility.

34. This shared wording has the effect that classification of a liability as non-current is dependent on whether a contractual arrangement is in place at the reporting date whereby the entity will not be required to settle the liability for more than 12 months. We think that this is the principle on which classification is based in both paragraphs 69(d) and 73.
35. The principle is explicit in 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:

(a) ..

36. Paragraph 66 (d) of the Standard also sets out similar requirements for the classification of current and non-current assets:

An entity shall classify an asset as current when:

(a) ..

(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 to at least twelve months after the reporting date.

37. Basing classification on arrangements in place at the reporting date complies with the existing requirements of IAS 1 and would accord with a general view in IFRS that the presentation of any individual transaction is dependent on the rights and obligations that exist at the reporting date and that arise from that transaction.

Question 1

Do you agree that classification of a liability as non-current depends on whether there is a contractual arrangement in existence at the reporting date whereby the entity will not be required to settle the liability within the next 12 months?

Proposed deletion of ‘unconditional’ and substitution of ‘right’ for ‘discretion’

38. We have identified that not being required to settle a liability for 12 months or longer is the principle on which a liability should be classified as non-current. We need to address why this principle is unclear at present to some when they are applying this Standard
39. We think that the diversity in practice arises, at least in part, because of a perceived asymmetry between paragraphs 69(d) and 73 of the Standard in interpreting the entity’s rights. Paragraph 69(d) states that the liability is current unless the entity has an unconditional right to defer settlement. Paragraph 73, on the other hand, states that an obligation is non-current if the entity expects and has the discretion to roll the obligation over or refinance it. Many readers see an inconsistency between ‘unconditional right’ and ‘discretion’ and consequently have difficulty in reconciling the application of these two paragraphs. In their view, an unconditional right to defer settlement is a much higher hurdle than is having the discretion to defer settlement. In the light of this seeming difference, the question for us is: which level of the entity’s ability to act, unconditional right or discretion, should be used for the purposes of classifying the liability?
40. We think that, in practice, if paragraph 69(d) were applied as worded, it would be rare to classify the liability that relates to any borrowing arrangement as non-current. This is because the majority of—some would say all—borrowing arrangements impose a number of conditions on the borrower. These may include the achievement of gearing or liquidity ratios or capital maintenance measures and/or restrictions on the borrower accessing other sources of borrowings. Specific material adverse condition clauses may also be included. If any of these conditions is breached, the lender generally has the right to immediate settlement of the liability. The requirement in the Standard for an unconditional right is a high hurdle that we think, if read in this way, is unlikely ever to be complied with in practice.

Effect of conditions on the interpretation of ‘unconditional’

41. In the light of the above discussion, it appears that ‘unconditional’ in paragraph 69(d) is not intended to be applied in the usual sense of ‘not subject to conditions’.

We have held consultations about how that term ‘unconditional’ is currently applied in practice. In order to make paragraph 69(d) operational, various interpretations of ‘unconditional’ seem to have been employed when applying these requirements. The rights are sometimes treated as:

- (a) ‘unconditional’—if in compliance with the condition at the reporting date; or
- (b) ‘unconditional’—if the condition is controlled by the entity; and
- (c) ‘unconditional’—if any covenant relating to the condition is waived at the reporting date; and
- (d) ‘conditional’— if the condition is due to be tested.

42. The circumstances in which the right is considered to be ‘unconditional’ for the purposes of interpreting the Standard can vary substantially between entities, jurisdictions and accounting firms, as can the effect of any breach of conditions on that interpretation.

Unconditional if in compliance with the condition

43. Many interpret the Standard to mean that a right is ‘unconditional’ if, at the reporting date, the reporting entity is in compliance with any conditions in the agreement.
44. This interpretation accords with paragraph 74 of the Standard. This paragraph states that the entity does not have an unconditional right if it is in breach of a condition. The implication in paragraph 74 is that until the entity breaches the condition, the right is unconditional.
45. Those who hold this view often think that classification is only dependent on whether the entity is in compliance with the condition at the reporting date. In their view, an expectation that the entity will breach the condition after the reporting date should not affect the classification of the liability.

Unconditional if the condition is controlled by the entity

46. Others think that in interpreting ‘unconditional’ in paragraph 69(d), its usage should be limited to those conditions that are within the control of the entity.
47. This interpretation can be difficult to apply because, in practice, it can be difficult to identify conditions that are controlled solely by the entity. Some think the

entity may be able to control a condition that restricts it from borrowing from other lenders. On the other hand, some would argue that whether or not the entity's gearing ratio exceeds certain limits may be largely outside its control.

Unconditional if any condition has already been waived

48. Paragraph 75 of the Standard makes it clear that if, before the reporting date, the entity obtains a period of grace of at least 12 months in which it can rectify the breach, the right is 'unconditional'.

Conditional if the condition is due to be tested

49. Some think that if the condition is due to be tested before 12 months after the reporting date, then the right to defer settlement is conditional on the condition being met and, consequently, the liability cannot be classified as non-current.

Proposed amendment—deletion of 'unconditional'

50. We think that it is confusing that the Standard refers to an 'unconditional right' in paragraph 69(d) yet subsequently refers, in paragraphs 74 and 75, to conditions that apply to that right and how breach or waiver of those conditions should be treated. Interpreting the exemptions in paragraphs 74 and 75, and extrapolating that guidance onto other conditions, has led to considerable diversity in practice. We think it would be clearer if paragraph 69(d) referred simply to 'rights'.
51. Consequently, we would propose deleting 'unconditional' so that paragraph 69(d) reads:

69 An entity shall classify a liability as current when:

(a) ...

(d) it does not have ~~an unconditional~~ right to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 73).

52. If 'unconditional' is deleted, paragraphs 74 and 75 of the Standard would become *examples* of the application of the proposed classification principle ('settle in more than 12 months') rather than *rules for, or exemptions to*, the designation 'unconditional'. We think that it is beneficial to revise the Standard in this way

because including rules within the Standard can lead to structuring possibilities as well as to diversity in practice.

53. In addition, we think that the revised wording of paragraph 69(d) would no longer cause a contradiction with the additional guidance on the identification of non-current liabilities in paragraph 73:

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, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period.

Proposed amendment—substitution of ‘right’ for ‘discretion’

54. We think that management’s ‘discretion’, in the sense of ‘freedom to act’, is compatible with having a right to defer settlement, but that management discretion is not compatible with an unconditional right. Removing ‘unconditional’ would improve the symmetry of the articulation of current and non-current classification in the Standard.
55. In addition, many find ‘discretion’ a confusing notion and one that does not translate well. Some think that ‘discretion’ is better described as a right for which the only condition is the entity’s will to act. These commenters think that ‘discretion’ in paragraph 73 of the Standard should be replaced by ‘right’. We agree that it is confusing to use two terms for the same notion and propose substituting ‘right’ for ‘discretion’ in this paragraph.
56. We do not think that removing ‘unconditional’ or replacing ‘discretion’ with ‘right’ changes the principle involved in classifying liabilities as non-current. Classification would still be based on the rights of the entity in existence at the reporting date including any contractual arrangements whereby it will not be required to settle the liability within 12 months of the reporting date.

Proposal to clarify ‘settlement’, based on the transfer of resources

57. We have identified the date of settlement of a liability as the basis of the classification of liabilities. Some think that this classification should be based more specifically on the date at which that liability should be *cash*-settled.

Current requirements of IAS 1

58. We note the two different current wordings with respect to the classification of a liability as non-current:

69(d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 73).

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, it classifies the obligation as non-current,

59. The effect of referring to ‘defer settlement’ in paragraph 69(d), we think, is that the cash outflow is deferred. The effect of using ‘refinance’ and ‘roll over’ in paragraph 73 is that one liability replaces another. The outcome that is shared by these paragraphs is that in neither case does the entity have a cash outflow for at least 12 months after the reporting date. Consequently, we think that ‘no cash outflow for 12 months’ is the characteristic that identifies a non-current liability in IFRS.
60. This view is supported both by other existing guidance in IFRS and by the views of investors and some respondents to the Annual Improvements ED.

Other guidance in IFRS

61. Liabilities are defined in the *Conceptual Framework* in terms of an outflow of resources from the entity:

a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

62. Respondents to the Annual Improvements ED also referred to work done on related amendments to IAS 1 in 2007 and 2009. Those amendments dealt with how to classify the liability component of a financial instrument (eg a convertible bond). According to the Basis for Conclusions added to the Standard at this time:

BC 8H The Board concluded that classifying the liability on the basis of the requirement to transfer cash or other assets rather than on settlement better reflects the liquidity and solvency position of an entity, and therefore it decided to amend IAS 1 accordingly.

63. This was reflected in the revised Standard by the inclusion of the following sentence in paragraph 69(d) to distinguish the effect on classification of cash settlement of convertible instruments compared with equity settlement:

Terms of the liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

Liabilities settled other than as cash or equity

64. In the majority of transactions, liabilities will be settled by the outflow of cash and so far our discussions have focused on cash-settled liabilities. We note, however, that liabilities are defined in terms of the outflow of resources embodying economic benefits. In some cases liabilities may be settled by an outflow of resources other than cash. In order to adequately cover these transactions we propose including the wording ‘settled by the transfer of cash or other assets’ in the proposed amendment.

Practical advantages of settlement by the transfer of cash or other assets

65. Linking the classification of liabilities to the transfer of cash or other assets has a number of practical advantages:
- (a) A transfer of cash or other assets is a readily identifiable and clearly defined event.
 - (b) Information about obligations requiring future transfers of cash or other assets is useful information for investors.

- (c) Specifying settlement by the transfer of cash or other assets makes it less important to determine whether any replacement liability is with the same lender or on similar terms.

66. Consequently, we propose amending paragraph 69(d) so that it reads:

it does not have an ~~unconditional~~ right to defer settlement of the liability by the transfer of cash or other assets for at least twelve months after the reporting period (see paragraph 73).

Net settlement

67. In basing the classification of liabilities on the timing of the transfer of cash or other assets from the entity, we need to consider the effect of net settlement.
68. Some entities enter into a number of different transactions with the same counterparty. For practical reasons, the counterparties will often offset a transfer of cash or assets from one counterparty against a transfer of cash or assets to that counterparty. The two (or more) transactions with the same counterparties are said to be net settled. As a result of this offset no cash or other assets, or a reduced amount, will transfer between the entity and the counterparty.
69. The effect of net settlement is to both settle the liability and realise the asset, with respect to two separate transactions that are only related by having the same two counterparties. For the purpose of analysing these two transactions, it is important that the two transfers should be grossed up and that the settlement of the liability by the transfer out of cash or other assets is recognised separately from the realisation of the asset by the transfer in of cash or other assets. (We do not propose changing existing guidance on presentation; we have only considered the effect of net settlement on classification.)

Views of investors

70. Many investors think that the classification of elements in the entity's statement of financial position should reflect the liquidity of those elements. Consequently, we think that classifying liabilities in a way that is based on the timing of outflows from the entity provides useful information to investors.

Proposal to reaffirm the inclusion of ‘with the same lender’ reaffirm the inclusion of ‘with the same lender’

71. The original outreach focused on the distinction between ‘roll over’ and ‘refinance’. The conclusion from that outreach and from the IASB’s deliberation of the Annual Improvement process is that:
- (a) ‘Roll over’ is used exclusively for liabilities with the same lender; ‘refinance’ can be used for either liabilities with the same lender or finance obtained from another lender.
 - (b) If the entity has the right before the reporting date to roll over a liability with the same lender for longer than 12 months after the reporting date, it is generally classified as non-current at the reporting date. (Some supporters of this view think that there may be a case for arguing that the old and new facilities with the lender are both part of the same loan, because loan arrangements often state that all accounts with the same lender should be treated as a single account for legal and set-off purposes.)
 - (c) If a borrower has a right at the reporting date to refinance a liability with another lender after the reporting date, the liability is always classified as current at the reporting date. Supporters of this view think it is inappropriate to use a right to borrow from a new lender as a basis for classifying an existing liability from another lender at the reporting date.

Proposed amendment—clarifying new and existing arrangements

72. We think therefore that the original proposal in the Annual Improvement ED to treat liabilities rolled over with the same lender under an existing loan facility as non-current should be retained. In order to clarify that any agreement to refinance with a new lender should not be anticipated when classifying the existing liability at the reporting date, we propose amending the second part of paragraph 73 to make the rollover or refinancing of the liability with the same lender an explicit requirement for non-current classification.

73. In the light of comment letters received we propose adding ‘or consortium of lenders’ to this paragraph to deal with the circumstance in which the existing lender is a consortium that may change its composition over time.
74. Because the composition of the consortium may change over time, assessing whether the entity is contracting with the same consortium or a different consortium will require judgement. We think that in making this assessment the entity should consider, amongst other factors, whether the lead banker in the consortium remains the same.
75. The proposed wording of paragraph 73 of the Standard would then be:

If an entity expects , and has the right 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 or consortium of lenders, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when the entity has no right to refinancing or rolling over the obligation ~~is not at the discretion of the entity~~ (for example, there is no arrangement in place at the reporting date for refinancing or rolling over the loan with the same lender or consortium of lenders), the entity does not consider the potential to refinance the obligation with any other lender and classifies the obligation as current.

Refinancing from a new lender

76. Under these proposals, refinancing an existing loan through obtaining a replacement loan from a new lender would always constitute settlement of the liability by the transfer of cash or other assets. The existing lender can require the transfer of cash or another asset to settle the existing loan regardless of whether the new lender pays. The transfers from and to the entity are from two different counterparties and cannot be offset. Consequently, a right to refinance an existing loan by obtaining a loan from a new lender can never result in that original loan being classified as non-current.

77. This outcome contrasts with the right to roll over an existing loan into a new loan with the same lender. In this case, the liability continues without settlement but its terms change. There is no transfer of cash or other assets.

Rollover to same lender, on different terms

78. Some have expressed concern that in accordance with these proposals borrowings that are rolled over for more than 12 months with the same lender, but on different terms, will be classified as non-current at the reporting date. We do not think that this should be a cause for concern. Settlement of the principal will take place in more than 12 months in those circumstances and that is the principle underlying classification.
79. We think that in any event loans with the same lender are rarely rolled over on the same terms. In our view, it is normal practice that when the loan is rolled over, the terms are altered to reflect differences in current market rates and changes to the borrower's circumstances that have occurred since the initial loan was agreed.
80. Similarly, the terms themselves may vary over time *within an existing loan arrangement*. The interest rate charged is often based on a publicly-quoted rate, uplifted by a few percentage points based on the borrower's credit risk and the term of the loan. Consequently, the terms of the loan change frequently over the period of the agreement as the publicly-quoted rate, or other variable in the agreement, changes.
81. In classifying liabilities, we do not think that it is the terms of the loan that is relevant; only the date of settlement of the liability, specified by the arrangement, is important.

Effect of breaches of conditions and events after the reporting period

82. As discussed in paragraphs 41-49, much of the diversity in practice has arisen because of the different ways in which conditionality can be applied to classification. Consider the following example:

An entity's loan facility will expire 6 months after the end of the reporting period. At the reporting date, the entity has obtained an extension of the loan facility for a further two years. The loan is subject to a number of conditions. If any condition is breached, the lender can demand immediate repayment of the loan.

How would the proposed amendments to IAS 1 be applied to each of the following fact patterns?

- (a) The entity is in compliance with the conditions at the reporting date.
- (b) The entity is in compliance with the conditions at the reporting date, but it thinks that it will breach the conditions six months after the reporting date.
- (c) The entity is in compliance with the conditions at the reporting date, but it thinks that it will breach the conditions six months after the reporting date. The lender conducts a review of the conditions at six-monthly intervals.
- (d) The entity is in compliance with the conditions at the reporting date, but the terms are such that it is inevitable that it will breach the conditions six months after the reporting date.
- (e) The entity is in breach of several of the conditions as at the reporting date.

Effect of events after the reporting period

83. We think that in circumstance (a) in the example, all would agree that the entity would classify this loan as non-current at the reporting date because, at the reporting date, the entity is in compliance with all conditions of the loan facility.
84. However, some think that the Standard is unclear about how the classification of the liability would be affected by a change in the conditions that takes place after the reporting date. The key aspect of IAS 1 that needs to be clarified before we can assess the other fact patterns consistently seems to be—what effect do events after the reporting date have on the classification decision?

Previous IASB deliberations

85. The IASB discussed this in 2002. The results of those deliberations indicate that it is the position at the reporting date, and whether the entity is in compliance with any conditions at that date, that is the basis for the decision on classification. We include below an extract from the Basis for Conclusions to IAS 1:

BC 42 Therefore, the exposure draft of 2002 proposed:

- (a) ...
- (b) to amend paragraph 65 [outdated reference] to specify that a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach. However, if the lender has agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during which the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:
- (i) the entity rectifies the breach within the period of grace; or
- (ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified.

86. The IASB subsequently removed the criteria noted in (i) and (ii) above:

BC 47 After considering respondents' comments, the Board decided that *the occurrence or probability of a rectification of a breach after the reporting period is irrelevant to the conditions existing at the end of the reporting period*. The revised IAS 1 requires that, for the loan to be classified as non-current, the period of grace must end at least twelve months after the reporting period (see paragraph 75). Therefore, the conditions ... are redundant. (*emphasis added*)

87. The Basis for Conclusions gives further guidance about the effect of events after the reporting date.

BC 44 However, the Board decided that the following arguments for changing paragraphs 63 and 65 [outdated references] were more persuasive:

(a) refinancing a liability after the balance sheet date does not affect the entity's liquidity and solvency *at the balance sheet date*, the reporting of which should reflect contractual arrangements in force on that date. Therefore, it is a non-adjusting event in accordance with IAS 10 *Events after the Balance Sheet Date* and should not affect the presentation of the entity's balance sheet.

(b) ...

(c) ... The granting of a waiver or a period of grace changes the terms of the loan agreement. Therefore, an entity's receipt from the lender, after the balance sheet date, of a waiver or a period of grace of at least twelve months does not change the nature of the liability to non-current until it occurs.

88. Many of the examples discussed in the basis deal with the waiver of conditions or the rectification of breaches. We think these views should apply equally to the occurrence of breaches. From the Basis for Conclusion dated 2002, we think the following conclusions apply when a liability due for settlement in more than 12 months is subject to conditions:

(a) BC 42 B If a breach is rectified or waived before the reporting date the liability is classified as non-current. The corollary to this is that an unrectified breach at the reporting date would result in the liability being classified as current.

(b) BC 47 If a breach is rectified after the reporting period, the rectification does not change the conditions existing at the end of the reporting period.

(c) BC 44 Refinancing a liability after the balance sheet date does not affect the entity's liquidity and solvency *at the balance sheet date*, the reporting of which should reflect contractual arrangements in force on that date. Consequently, it is a non-adjusting event in accordance with

IAS 10 *Events after the Balance Sheet Date* and should not affect the presentation of the entity's balance sheet. A rollover after the reporting date with the same lender under a facility that *already exists at the reporting date* does affect classification. That liability would be classified as non-current in accordance with the arrangement at the reporting date.

Guidance in IAS 10

89. IAS 10 provides general guidance about how changes after the reporting date should affect elements recognised in the financial statements:
- (a) the financial statements are adjusted for the type of event that provides evidence of conditions that existed at the end of the reporting period; and
 - (b) those events that are indicative of conditions that arose after the reporting period are not adjusted but are disclosed.
90. We think that if a condition that affects the classification of a liability changes after the reporting period, that change should be treated in accordance with the guidance in IAS 10. This would mean that:
- (a) an event after the reporting date that *provides more information* about the conditions that existed at the reporting date would affect classification;
 - (b) an event after the reporting date that does not provide more information about the condition *as at the reporting date* would not affect classification. For example, if an entity complied with the conditions at the reporting date but breached those conditions before the financial statements were authorised for issue, that would be a non-adjusting event. The liability would be classified as non-current at the reporting date, although the subsequent breach would be disclosed (and its effect on classification explained) if the breach of the condition means that the liability would be repayable on demand.
 - (c) Any change in a condition that is expected to occur after the financial statements are authorised for issue does not affect classification or

disclosure at the reporting date. Consequently, if management expects to be in breach of the conditions at a time after the financial statements are issued, this is a non-adjusting event and would not affect classification at the reporting date. In addition, because no event (ie breach of conditions) has occurred by the date that the financial statements are authorised for issue there is no ‘event after the reporting date’ to be disclosed. Possible future changes in the conditions should not affect the classification of liabilities as at the reporting date.

Application of the proposals to the examples

91. We think that the effect on classification of these events in the examples in paragraph 80 would be as follows, if the proposed amendments to IAS 1 were applied:

Fact pattern	Classification
(a) Compliance at reporting date	Non-current
(b) Compliance at reporting date, but expect to breach in 6 months	Non-current <i>(if in breach before issue of financial statements is authorised, disclose effect of breach on classification)</i>
(c) Compliance at reporting date, but expect to breach in 6 months and lender will review	Non-current <i>(if in breach before issue of financial statements is authorised, disclose effect of breach on classification)</i>
(e) In breach at reporting date	Current

92. We have included some further illustrative examples based on the proposed amendments as Appendix B to this paper.

Summary and proposed amendment

93. We think that management should focus on the fact pattern as at the reporting date. The classification of the liability should be based on the entity’s rights as at

the reporting date and any conditions that affect those rights should be assessed based on compliance with those conditions as at the reporting date.

94. We propose making this explicit by adding ‘ at the reporting date’ to paragraph 69 (d):

it does not have an ~~unconditional~~ right at the reporting date to defer settlement of the liability by the transfer of cash or other assets for at least twelve months after the reporting period (see paragraph 73).

Question 2

Do you agree that the classification of liabilities should be based on compliance with any conditions *as at the reporting date*?

Staff summary and recommendation

95. The proposed amendments include:
- (a) basing classification on the arrangements in existence at the reporting date and on the entity’s compliance with any conditions in those arrangements as at the reporting date;
 - (b) focusing on the requirement to transfer cash or other assets within 12 months to settle the liability;
 - (c) removing the need to interpret ‘unconditional’ and ‘discretion’; and
 - (d) clarifying that the potential for refinancing from new lending from new lenders should not be anticipated in classification.
96. As discussed in this paper, we recommend making the following amendments to IAS 1 with respect to the classification of liabilities:
- (a) delete ‘unconditional’ from paragraph 69(d) and paragraph 74;
 - (b) replace ‘discretion’ with ‘right’ in paragraph 73;
 - (c) insert ‘settled by the transfer of cash or other assets’ into paragraph 69(d);
 - (d) insert ‘at the reporting date’ into paragraph 69(d); and

- (e) clarify the distinction between existing loans and loans from a new lender in paragraph 73.

Question 3

Do you agree with the staff recommendation to:

- (a) delete 'unconditional' from paragraphs 69(d) and 74;
- (b) replace 'discretion' with 'right' in paragraph 73;
- (c) revise 'settle' to read 'settled by the transfer of cash or other assets' in paragraph 69 (d);
- (d) insert 'at the reporting date' into paragraph 69 (d); and
- (e) clarify the distinction between existing loans and loans from a new lender in paragraph 73?

Appendix A Proposed amendments to the Standard

- A1. The existing wording of IAS 1 is noted below. The staff's recommended amendments to that wording are noted by underlining added text and striking through deleted text.

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~~ right at the reporting date to defer settlement of the liability by the transfer of cash or other assets for at least twelve months after the reporting period (see paragraph 73). 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.

- 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 74 and 75.
- 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:
- (a) the original term was for a period longer than twelve months, and
 - (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are authorised for issue.
- 73 If an entity expects, and has the ~~right 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 or consortium of lenders, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when the entity has no right to ~~refinancing or rolling~~ over the obligation ~~is not at the discretion of the entity~~ (for example, there is no arrangement in place at the reporting date for refinancing or rolling over the loan with the same lender or consortium of lenders), the entity does not consider the potential to refinance the obligation with any other lender and classifies the obligation as current.
- 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~~ the right to defer its settlement for at least twelve months after that date.
- 75 However, an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

- 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*:
- (a) refinancing on a long-term basis;
 - (b) rectification of a breach of a long-term loan arrangement; and
 - (c) 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.

Appendix B Illustrative examples

An entity is due to settle a liability previously classified as non-current six months after the year end. In accordance with these proposals, how would that liability be classified at the reporting date in the following circumstances?

Circumstances	Classification
The rollover with the same lender has not been agreed at the reporting date.	Current
At the reporting date the entity has an agreement with the same lender to roll over the liability for more than 12 months from the reporting date.	Non-current
The liability will be refinanced using the proceeds of a new loan that is agreed with a new lender at the reporting date.	Current
The entity is in compliance with all terms of the arrangement and has an arrangement at the reporting date to roll over the loan with the same lender.	Non-current
The entity has an arrangement at the reporting date to roll over the loan with the same lender but is in breach of the conditions of the loan arrangement.	Current
The entity has an arrangement at the reporting date to roll over the loan with the same lender but is in breach of the conditions of the loan arrangement. A 12 month waiver of the breach of conditions is obtained before the reporting date.	Non-current
The entity has an arrangement at the reporting date to roll over the loan with the same lender but is in breach of the conditions of the loan arrangement. A waiver of the breach of conditions is obtained after the reporting date.	Current. Disclose waiver in accordance with IAS 10
The entity has an arrangement at the reporting date to roll over the loan with the same lender. The entity complies with all conditions of the arrangement at the reporting date, but is in breach of the conditions before the financial statements are authorised for issue.	Non-current Disclose breach in accordance with IAS 10.