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STAFF PAPER

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Project	**IAS 1 *Presentation of Financial Statements*** **Current/non-current classification of liabilities**
Paper topic	Affirming the October decisions and events after the reporting period

CONTACT(S)	April Pitman	apitman@ifrs.org	+44 (0)20 7246 6492

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Purpose of this paper

1. At the IASB's October 2013 meeting you agreed with a number of proposed amendments to IAS 1 *Presentation of Financial Statements* relating to the classification of a liability as current or as non-current. The proposed amendments were based on whether there was a contractual arrangement in place at the end of the reporting period that created a right to defer the settlement of the liability for more than 12 months. You noted, however, in your October discussions that the main classification principle is already contained in paragraph 69 of the Standard which lays out the criteria for *current* classification. In contrast the October Agenda Paper focused on the basis for *non-current* classification. In this Agenda Paper we will reanalyse the proposed amendments in terms of the main classification principle in paragraph 69 of the Standard.

2. At the October meeting you also asked us to further consider the effect on the classification of liabilities of:

   (a) breaches of conditions imposed by lenders; and

   (b) events after the reporting period.

3. In this paper we will:

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(a) provide a summary of the classification principle applied to liabilities in IAS 1;

(b) discuss the classification of liabilities when it is based on the ‘right to defer settlement’ criterion;

(c) summarise the IASB’s tentative decisions to date on this topic and compare them with the requirements of paragraph 69 of the Standard;

(d) discuss what happens when the right to defer settlement is affected by events after the reporting period; and

(e) suggest ways in which the requirements can be clarified by reorganising the guidance.

4. In this paper we will ask you whether:

(a) you affirm the tentative decisions made at the IASB’s October meeting;

(b) you agree with the staff’s further proposals:

(i) to make it explicit that the right to roll over a loan with the same lender affects the classification (as current or non-current) only if the entity has the practical ability to exercise the right and the terms are not so unfavourable to the entity that exercise is unlikely;

(ii) that if management expects to settle a liability within 12 months after the reporting period, notwithstanding the fact that the entity has a right at the end of the reporting period to defer settlement of the liability until after 12 months, the liability should be classified as current; and

(iii) that paragraphs 72–76 of IAS 1 should be simplified and reorganised, as detailed in Appendices A–B.

Structure of the paper

5. The paper is organised as follows:

(a) background;

(b) classification principle for liabilities in IAS 1;

(c) right to defer settlement;

(d) tentative decisions to date;

(e) effect of events after the reporting period on the right to defer settlement;

(f) reorganisation of paragraphs 72–76 of the Standard;

(g) summary of the proposals;

(h) Appendix A—Extract from the amended Standard; and

(i) Appendix B—Proposed amendments to the Standard in mark-up.

Background

Proposed annual improvement

6. The IFRS Interpretations Committee (the ‘Interpretations Committee’) received two requests relating to the classification of liabilities as either current or non-current. Paragraph 69 of IAS 1 relates to the classification of current liabilities and paragraph 73 relates to non-current liabilities. 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 paragraph 69(d)) was different from having the discretion to refinance or roll over an obligation (specified in paragraph 73).

7. These submissions formed the basis for a proposed annual improvement included in the Exposure Draft Annual Improvements to IFRSs 2010–2012 Cycle published in May 2012 (the ‘Annual Improvements ED’). After considering the comments received from the comment letter respondents, however, the Interpretations Committee recommended to the IASB that it should not confirm the amendment to IAS 1.

8. In September we brought you an Agenda Paper that discussed a general approach to the classification of liabilities. The approach was based on whether, at the end of the reporting period, there is in place a contractual arrangement that gives the entity the right to defer settlement of the liability for at least 12 months after the reporting period. We thought that this was the principle on which the

classification of non-current liabilities is based in both paragraphs 69(d) and 73. This proposal was developed further and presented to you in October.

9. At the October meeting, you agreed with a number of the proposed amendments to the Standard based on this approach. You were concerned, however, that this proposed principle was redundant because the main classification principle is already contained in paragraph 69 of the Standard. This paragraph lays out the four criteria for the classification of a liability as 'current'. All other liabilities are 'non-current'. The articulation in the Standard, laying out the criteria for current classification, is in contrast with the approach taken in the October Agenda Paper, which focused on the basis for non-current classification.

10. We think, however, that the articulation presented in October, based on when a liability is *non-current*, would give the same result as applying the classification principle already contained in paragraph 69, ie the criteria for *current* classification. On that basis, we think that the amendments to the Standard proposed and tentatively accepted in October are still valid. Accordingly, in this paper we will re-summarise the proposed amendments to the Standard in terms of the existing classification principle—the four criteria for current classification laid out in paragraph 69 of the Standard.

Classification principle for liabilities in IAS 1

11. Paragraph 69 of IAS 1 sets out the classification principle applied to liabilities by providing the four criteria for the current classification of a liability. This paragraph is in bold in the Standard:

> **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.

12. We think that the first three criteria for classification as current, in paragraph 69(a)–(c), are clear and consistently applied. The Standard also provides further guidance on these criteria for current classification and the guidance is also clear. This guidance is summarised below:

A liability is classified as current when:	
Criteria (a) and (b) (69(a)–(b)):	**the entity expects to settle the liability in its normal operating cycle or** **the entity holds the liability primarily for the purpose of trading.**
Further guidance (70):	liabilities that are part of normal working capital are current even if due to be settled more than 12 months after the reporting period.
Further guidance (71):	examples of current liabilities that are not settled as part of operating cycle includes held-for-trading liabilities in IFRS 9, dividends payable, and income taxes.
Further guidance (71):	financial liabilities that provide financing on a long-term basis and are not due for settlement within 12 months are non-current.
Criterion (c) (69(c)):	**the liability is due to be settled within twelve months after the reporting period.**
Further guidance (72):	current even if the original term was longer than 12 months and an agreement to reschedule is completed *after the reporting period* and before the financial statements are authorised for issue.

Right to defer settlement

13. We think that the Standard becomes more complex when a liability is not classified in accordance with the criteria of paragraph 69(a)–(c) and current

classification is based on the last criterion, the entity's not having the right to defer the settlement of the liability:

> **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). …**

Assessment of right to defer settlement

14. The fourth criterion is whether or not the entity has the right to defer settlement for at least 12 months after the reporting period. Typically, these rights are subject to conditions that may make it unclear at the end of the reporting period whether or not the liability would be required to be settled within 12 months. In particular, some liabilities, such as borrowings, incorporate undertakings by the borrower (covenants) that have the effect that the liability becomes payable on demand if specified conditions related to the borrower's financial position are breached. Additional guidance has been developed over time to deal with different circumstances that can affect those rights in cases of breach and this has added to the complexity in applying this Standard.

15. That additional guidance is noted below:

	A liability is classified as current
Criterion d (69(d))	**if the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.**
Additional guidance	***A liability is classified as* current *even when:***
74	the entity is in breach at the end of the reporting period, rendering the liability payable on demand, but the lender agrees after the reporting period not to demand payment.
76	the following occur between the end of the reporting period and the date the financial statements are authorised for issue: (a) refinancing on a long-term basis; (b) rectification of breach; and

	(c) granting a period of grace.
Additional guidance	***But a liability is classified as* non-current*:***
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.
75	if the entity is in breach, but the lender agrees by the end of the reporting period to provide a period of grace.

16. This guidance has arisen piecemeal over the years giving rise to concerns about its complexity and lack of completeness.

Tentative decisions to date

17. The most specific of the examples of non-current classification appears in paragraph 73 of the Standard with respect to rollovers. It was a perceived discrepancy between this paragraph and the criterion in paragraph 69(d) that originally gave rise to the initial submissions to the Interpretations Committee on this topic.

18. At the October meeting, we discussed reconciling the guidance in paragraph 69(d) with the guidance relating to rollovers in paragraph 73 of the Standard. Those two paragraphs of the Standard are noted below for convenience:

> **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). 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.**

> 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.

19. We discussed the proposed amendments to each paragraph separately in October.

Proposed amendments to paragraph 69(d) of the Standard

20. You tentatively decided in October to make two amendments to paragraph 69(d):

    (a) to remove 'unconditional' from 'unconditional rights'; and

    (b) to clarify that settlement refers to the transfer of resources.

Removal of 'unconditional'

21. You tentatively decided in October to remove 'unconditional' from 'unconditional rights' in paragraph 69(d). You decided this because:

    (a) in practice, if paragraph 69(d) were to be applied as worded, it would be rare to classify any borrowing as non-current because the majority of—some would say all—borrowing arrangements impose a number of conditions on the borrower and many of these conditions will be outside the control of the borrower; and

    (b) between entities, jurisdictions and accounting firms, there is significant diversity in practice in interpreting when the right is considered to be 'unconditional'.

22. We think that this amendment is still valid and will clarify the wording used in the principle that underlies the classification of current liabilities. The proposed wording of paragraph 69(d) of the Standard after this decision is:

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

Clarification that settlement refers to a transfer of resources

23. In October the staff also recommended that settlement in paragraph 69(d) should be clarified as being 'by the transfer of cash or other assets'. You tentatively accepted the recommendation that settlement refers to a transfer of resources because:

    (a) liabilities are defined in the *Conceptual Framework* in terms of an outflow of resources from the entity;

    (b) a transfer of cash or other assets is a readily identifiable and clearly defined event; and

    (c) information about obligations requiring future transfers of cash or other assets is useful information for investors.

24. However, during the discussions in October you queried whether including the notion of settlement as a transfer of cash or other assets would adequately address those situations, such as convertible bonds, when the entity may, or will, settle the liability by issuing its own equity. As a result of this query, we also investigated other circumstances when liabilities are settled other than by the transfer of cash or other assets.

25. We note that the new revenue Standard will result in the recognition of customer contract liabilities with respect to performance obligations. These performance obligations will be settled by the transfer of goods or services to the customer. Consequently, we also recommend including the transfer of services in this proposed amendment because of the future significance of performance obligations.

26. The proposed amendment, 'by the transfer of cash, other assets or services', compares with paragraph 4.17 of the Conceptual Framework which refers to a number of ways in which liabilities can be settled:

    (a) the payment of cash;

    (b) transfer of other assets;

(c) provisions of services;

(d) replacement of one obligation by another; or

(e) conversion of the obligation to equity.

27. We recommend the amendment proposed because:

(a) the transfer of cash, other assets or services are events that are readily identifiable;

(b) the transfer of cash, other assets or services reflect the outflow of resources from the entity;

(c) conversion to equity is already covered by the wording of paragraph 69(d); but

(d) the replacement of one obligation by another would not represent settlement for the purposes of classifying liabilities except in the limited circumstances contained in existing paragraph 73, ie roll-over with an existing lender.

Question 1

Do you agree with the following proposals:

(a) to delete 'unconditional' from 'unconditional right' in paragraph 69(d) ; and

(b) to include 'by the transfer of cash, other assets or services ' to clarify the nature of settlement in paragraph 69 for the purposes of the classification of liabilities.

Proposed amendments to paragraph 73 of the Standard

28. In October, you tentatively decided to make three amendments to paragraph 73 of the Standard:

(a) replace 'discretion' with 'right';

(b) re-affirm the inclusion of 'with the same lender' as proposed in the Annual Improvements ED; and

(c) address syndicated lending.

29. You also discussed the significance of whether any agreement to roll over the loan facility is on 'same or similar terms'.

Replace 'discretion' with 'right'

30. You tentatively decided to replace 'discretion' with 'right' because:

    (a) many find 'discretion' a confusing notion and one that does not translate well;

    (b) some think that 'discretion' is better described as a right for which the only condition is the entity's willingness to act; and

    (c) it is confusing to use two terms for the same notion and replacing 'discretion' with 'right' would align with usage in paragraph 69(d).

Affirm the inclusion of 'with the same lender'

31. You tentatively decided to affirm the inclusion of 'with the same lender' as proposed in the Annual Improvements ED because you thought that:

    (a) the old and the new facilities with the lender could both be part of the same loan. Indeed, many loan arrangements state that all accounts with the same lender are treated as a single account for legal purposes.

    (b) it is inappropriate to use a right to borrow from a new lender as a basis for classifying an existing liability from another lender.

Syndicated lending

32. In the light of comment letters received at the time of the Annual Improvements ED, you tentatively decided to add 'or consortium of lenders' to 'same lender' to deal with the circumstance in which the existing lender is a consortium that may change its composition over time. In making this decision you acknowledged that assessing whether the entity is contracting with the same consortium or a different consortium will require judgement. You thought that in making this assessment the entity should consider, among other factors, whether the lead banker in the consortium remains the same.

Significance of 'on the same or similar terms'

33. The Annual Improvements ED proposed the inclusion of 'with the same lender, on the same or similar terms'. The guidance proposed for determining whether terms were 'the same or similar' was linked to the guidance in IFRS 9 *Financial Instruments* for the derecognition of financial liabilities.

34. As a result of views expressed in the comment letters on the Annual Improvements ED, the Interpretations Committee recommended that this proposal should not be included in the final amendment to the Standard. These views related principally to the inclusion of 'same or similar terms'.

35. The respondents who disagreed with the inclusion of 'same or similar terms' gave three reasons:

    (a) they thought that the derecognition requirements for financial liabilities in IFRS 9/IAS 39 *Financial Instruments: Recognition and Measurement* are not consistent with the classification principles for financial liabilities in IAS 1. In particular, they thought that the notion of 'settlement' in paragraph 69(d) of IAS 1 (on which classification is based) is different from the notion of 'extinguishment' in IFRS 9/IAS 39 (on which derecognition of financial liabilities is based). These respondents thought that a liability should be classified on the basis of the timing of the requirement to transfer cash.

    (b) most of the respondents asked for greater clarification of the notion of 'same or similar terms'. They noted that the derecognition requirements in IAS39/IFRS 9 refer to 'substantially different terms' whereas the proposed amendment refers to 'same or similar terms'. They questioned whether the notion of 'same or similar terms' is similar to the notion of 'substantially different terms' in IAS 39/IFRS 9.

    (c) the assessment of whether terms are 'substantially different' in IAS39/IFRS 9 is by qualitative and quantitative analysis. The quantitative analysis includes the so-called '10 per cent test'. Respondents thought that the 10 per cent test was not appropriate for classification purposes and would be burdensome to apply. In particular, the likelihood of classification of a liability as current would

increase if the loan is refinanced for a longer period. This did not seem an appropriate outcome.

36. When discussing whether to include ‘with the same lender’, however, many of you said that it was important for the new facility with the same lender to be on the same or similar terms. You referred to a practice that was common in the period following the financial crisis. During this period a number of lenders agreed to renew loan facilities with existing customers, but the lenders offered these facilities on such disadvantageous terms that their customers could not afford to accept the facility. The lenders did this because they wanted to restrict lending to these customers, many of whom subsequently suffered financial distress as a result of the lack of available finance, and to restrict lending in general.

37. You expressed concern that unless ‘on same or similar terms’ was included in the proposed amendment, facilities would satisfy the criterion for classification as non-current even though the entity would not be able, from a practical point of view, to use the rolled over facility in the future. Some were also concerned that the change in terms after the reporting period would not be sufficiently visible to users.

38. We’ll look at these two concerns separately:

    (a) ability to use the facility; and

    (b) visibility of changes in terms after the reporting period.

Ability to use the facility

39. Bearing in mind the comments received in response to the Annual Improvements ED, we were concerned at reinstating ‘on same or similar terms’. However, we do not think that your proposed solution in October is reliant specifically on the inclusion of ‘same or similar terms’. The central point of your discussions was that in order for a right to roll over the loan with the same lender to affect classification, the right must:

    (a) be offered on terms that are not so unfavourable to the entity that there is no expectation of acceptance; and

    (b) the entity must have the practical ability to exercise that right.

Visibility of a change in terms after the reporting period

40. In the October discussions some board members were concerned that the change in terms after the reporting period would not be sufficiently visible to users.

41. IFRS 7 *Financial Instruments: Disclosure*, paragraph 31 records the objective of disclosures that relate to borrowings:

> An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.

42. In our research we have noted, that in the guidance issued by the major accounting networks, this objective is generally achieved by disclosing:

    (a) the average future coupon rate; and

    (b) the amounts of borrowings subject to future interest rate changes by date.

43. We think that this existing disclosure requirement would provide sufficient visibility of any changes in interest rate or other terms after the reporting period.

Staff recommendation

44. Rather than including 'on same or similar terms' in the proposed amendment, and risk the problems highlighted by the comment letters received in response to the Annual improvements ED, we recommend including a specific requirement that the right to roll over the borrowing can only affect classification if the entity has the practical ability to exercise the right and the terms are not so unfavourable to the entity that exercise is unlikely.

Proposed wording

45. The proposed wording of paragraph 73 of the Standard, after affirming the October decisions and accepting the staff recommendation to include a reference to unfavourable terms and the practical ability to exercise the right, would then be:

> 73 If an entity expects, and has the right 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.

(a)The membership of a consortium is subject to change over time. In making its assessment about whether the consortium should be considered the same after changes to its membership, management should consider the extent of those changes and, in particular, whether the lead banker is unchanged.

(b)The right to roll over the loan with the same lender can only affect classification if the entity has the practical ability to exercise that right and the terms are not so unfavourable to the entity that acceptance is unlikely.

(c)When the entity has no right to refinance or roll over the obligation, because there is no arrangement in place at the end of the reporting period, the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

Question 2

Do you affirm the decisions made in October:

(a) to replace 'discretion' with 'right'?

(b) to require that the borrowing is with the same lender? and

(c) to include a specific reference to consortium?

Question 3

Do you agree with the staff proposal that the right to roll over the obligation can only affect classification of the liability if the entity has the practical ability to exercise the right and the terms are not so unfavourable to the entity that acceptance is unlikely?

Do you have any suggestions on how this wording could be refined?

Effect of events after the reporting period on the right to defer settlement

46. In October you also asked us to further consider the effect of events after the reporting period on the classification of liabilities in accordance with paragraph 69(d) of the Standard. Events after the reporting period can be of two types:

    (a) events that affect the right to defer settlement; and

    (b) events that affect how those rights are applied.

Events that affect the right to defer settlement

47. The effect of the current guidance is summarised below, analysed between those circumstances that create a right as at the end of the reporting period and those that do not.

Does not create a right to defer settlement in accordance with 69(d); classify the liability as current	***Creates a right to defer settlement in accordance with 69(d); classify the liability as non-current***
A right is not created as at the end of the reporting period by agreements entered into after the reporting period. Circumstances include:	**A right is created as at the end of the reporting period by agreements entered into before the end of the reporting period. Circumstances include:**
an agreement to refinance or reschedule repayments is completed after the reporting period (72); refinancing on a long-term basis is agreed after the reporting period; (76) the breach is rectified after the reporting period (76); the lender agrees after the reporting period not to demand payment (74); or a period of grace is granted after the reporting period (76).	an agreement to roll over a liability is in place at the end of the reporting period, ie 'under an existing loan facility' (73).
	the borrower is in breach, but the lender agrees by the end of the reporting period to provide a period of grace (75).

49. We think that it is clear from the guidance (above) that:

    (a) classification is based on the rights that exist at the end of the reporting period;

    (b) changes made to those rights after the reporting period do not affect the classification of liabilities at the end of the reporting period; and

(c) agreements reached after the reporting period will not alter the right at the end of the reporting period.

50. The amendment proposed at the October meeting makes it explicit that only rights in place at the end of the reporting period affect the classification assessment in accordance with paragraph 69(d) of the Standard:

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

51. We also think that this should be made explicit in paragraph 73 of the Standard:

> 73 … .However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing in place at the end of the reporting period), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

Question 4
Do you agree that it should be made explicit in the Standard that only rights in place at the reporting date affect the classification of liabilities?

Events after the reporting period that affect how the right is applied

52. The Standard currently provides guidance about events after the reporting period that affect the right to defer settlement as at the reporting date, but it does not provide guidance about events after the reporting period that affect the subsequent application of those rights. In your October discussions, you suggested that the expected outcome of applying the right after the reporting period should be considered when making the classification decision.

53. You discussed in October two types of circumstance that could affect the outcome of applying a right (that already exists at the reporting date) to defer settlement of the liability after the reporting period:

(a) the entity expects not to apply the right to defer settlement; or

(b) a breach of covenant after the reporting period could affect the application of that right, ie the breach might mean that the entity no longer has a right to defer settlement after the reporting period.

54. You noted in your discussions in October that anticipating the effect of early settlement on the classification of liabilities might already be captured by the requirements of either paragraph 69(a) or 69(c):

> **An entity shall classify a liability as current when:**
>
> **(a) it expects to settle the liability in its normal operating cycle;**
>
> **(b) …**
>
> **(c) the liability is due to be settled within twelve months after the reporting period;**

55. We do not agree that paragraph 69(a) and paragraph 69(c) apply to these types of circumstances.

(a) The current classification discussed in paragraph 69(a) is based on the liability being settled within 12 months as part of its *normal operating cycle*. We think that both examples discussed in October, detailed in paragraph 53 of this paper, are outside the normal operating cycle.

(b) Similarly, the liability is not due to be settled within 12 months in accordance with paragraph 69(c) if the entity has a right as at the reporting date to defer settlement in accordance with paragraph 69(d).

Significance of management's expectations in the classification of liabilities

56. We do think, however, that paragraph 69 (a) is relevant to this discussion because it makes it clear that management's expectations affect classification:

> An entity shall classify a liability as current when:
>
> (a) it *expects* to settle the liability in its normal operating cycle; …(*emphasis added)*

57. Similarly, paragraph 73 of the Standard 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. (*emphasis added)*

58. The requirement in IAS 1to include management's expectation in the classification decision is clear. Consequently, we think that we need to take into account the effect of management's expectations about the subsequent application of the right in making the classification decision.
59. In October you discussed two types of events after the reporting period, detailed in paragraph 53 of this paper, that are affected by the notion of management's expectations. These are each discussed separately below.

The entity expects not to apply the right to defer settlement

60. The entity will often have the ability not to apply its right to defer settlement.
61. In your discussions in October, you suggested that if an entity had a right at the end of the reporting period to defer settlement for more than 12 months from the end of the reporting period, but management expect not to apply that right and, instead, expects to settle the liability within 12 months of the end of the reporting period, the entity should classify the liability as current. In accordance with this view, View A, management's expectation of early settlement would result in classification of the liability as current at the end of the reporting period.

Expected breach of covenant after the reporting period

62. In October you also discussed whether an expected breach of a covenant after the reporting period should affect the classification of liabilities. In those discussions two views were expressed:
    (a) some IASB members thought that if management expects to breach a covenant after the reporting period, rendering the liability payable on demand, that liability should be classified as current as at the end of the reporting period. These IASB members thought that classifying the liability as non-current when management expects to be required to

settle the liability within 12 months after the reporting period does not provide useful information for users of the financial statements. This is similar to View A in paragraph 61.

(b) other IASB members were concerned about anticipating how these rights will be applied after the reporting period and how application might be changed by events after the reporting period. In this paper, we have described these concerns as View B.

The effect of views A and B on the application of paragraph 69(d) of the Standard

63. We think that it is the right at the reporting date that forms the basis of applying paragraph 69(d). We also think that the classification decision made, ie whether the liability is current or non-current, should reflect management's expectations about the outcome of applying those rights after the reporting period. We discuss this proposal in paragraphs 64–77.

Arguments in support of View A

64. If it is expected that events after the reporting period will affect the outcome of applying the right, we think it is misleading not to include this knowledge in the classification decision. We think that management should not just base their classification decision on circumstances as at the reporting date, but should also consider how events after the reporting period will affect the outcome of applying those rights.

65. We think that reflecting this knowledge provides more relevant information to users. Current and non-current liabilities are both important figures to users and if changes in classification were not made, but were only disclosed, users would be required to make a number of individual revisions to the presented classification of liabilities before they could begin their analysis.

Concerns expressed in View B

66. In our view, those IASB members who expressed concern about taking information about the application of rights after the reporting period into account in classifying liabilities were principally concerned that management might reclassify a current liability as a non-current liability. Many constituents think

that the classification decision is not neutral; they think that there should be a higher hurdle for non-current classification than for current classification with respect to liabilities. One IASB member described this view as 'In case of doubt, it should be current.'

67. From the analysis in paragraphs 47-50, we know that events after the reporting period cannot create a right to defer settlement. Consequently, such events could not result in the current classification of a liability becoming a non-current classification because of events after the reporting period The only effect that an event after the reporting period can have on the right is on its application.

68. It follows that, if events after the reporting period cannot create such a right, the only effect that events after the reporting period can have on the application of a right to defer settlement is to *prevent* the application after the reporting period of that right. As discussed above, the events after the reporting period that prevent application of the right include either management's choosing not to exercise the right or a breach after the reporting period that makes the right void.

Staff recommendation

69. In considering how the right at the end of the reporting period to defer settlement affects classification of the liability, we think that management should consider the effect of any events after the reporting period that would prevent the application of that right.

70. If management expects that an event after the reporting period will prevent application of the right, and consequently it expects to settle the liability within 12 months, we think that management should classify the liability as current in accordance with paragraph 69 (d). Such events would include a decision not to apply the right or management's expectation that circumstances will arise, such as breaching a condition of that right after the reporting period, that would prevent its application.

Question 5
Do you agree that management's expectation about events after the end of the reporting period that prevent the application of rights to defer settlement should affect the classification of liabilities?

Time scale for gathering information about events after the reporting period

71. In October you also discussed what time scale should be used for gathering information about events after the reporting period. You asked whether management's assessment of the outcome of applying the rights in paragraph 69(d) should be based solely on circumstances at the reporting date or should also take into account events up to the authorisation date of the financial statements.

72. We accept that it is difficult to assess circumstances in a way that demonstrates whether the conditions that result in early settlement of the liability could have been identified at the end of the reporting period or arose subsequently. Many of you thought that early settlement due to breach after the reporting period was often an indication that a future breach had been unavoidable *as at the end of the reporting period*. In accordance with that view, events between the reporting date and the authorisation date of the financial statement may provide more information about conditions at the reporting date or the likely effect of applying those rights after the reporting period.

73. It may also be difficult to avoid applying hindsight in assessing whether events after the reporting period reflect circumstances as at the end of the reporting period. Accordingly, it may be difficult to assess whether early settlement of the liability is due to a practical inability to exercise the right that existed at the reporting date or to circumstances that arose after the reporting date, ie a non-adjusting event in accordance with IAS 10 *Events after the Reporting Period*.

74. For simplicity and understandability we think that if, at the date the financial statements are authorised for issue, management expect that events after the reporting period will prevent the application of the right to defer settlement, these events should be treated as adjusting events. In our view, if management expect at that time that a liability will be settled within 12 months of the reporting date, management should classify the liability as current. We recommend this time-scale for management's assessment because:

    (a) it will result in more relevant information for users; and

    (b) we think it would be counter-intuitive to present a liability as non-current in those circumstances when the liability has been settled after

the reporting period but before the financial statements are authorised for issue.

75. In some circumstances, this would be an exception to IAS 10, but it would be restricted solely to expectations about the application of the right after the reporting period and would affect only classification and not recognition or measurement of the liability.

Question 6
Do you agree that in arriving at their expectations about how the right described in paragraph 69 (d) of the Standard will be applied, management should take into account all information up to the date that the financial statements are authorised for issue?

Staff Recommendation

76. We recommend adding the following guidance to the Standard:

> The following are examples of circumstances after the reporting period that may prevent an entity from exercising its right to defer settlement of a liability for 12 months:
>
> a. if management expects at the date the financial statements are authorised for issue that a breach of a condition of a loan will occur within 12 months of the reporting date and will make the loan repayable within 12 months of the reporting date; or
>
> b. if management expects at the date the financial statements are authorised for issue that it will not exercise the right to defer settlement and, notwithstanding the right to defer settlement, it will repay the loan within 12 months of the reporting date.

Staff summary

77. We think that in applying the requirements of paragraph 69(d) of the Standard to the classification of liabilities, the effect of the proposed amendments will be that:

(a) only rights that exist at the reporting date are considered in making the classification decision and that is now explicitly stated in revised paragraphs 69(d) and 73.

(b) events after the reporting period cannot create such a right and that is already explicit in paragraphs 72–76 of the Standard.

(c) in assessing the outcome of applying the right after the reporting period, management will be required to take into account their expectations at the date that the financial statements are authorised for issue about events after the reporting period that may prevent the entity from exercising its right to defer settlement These circumstances may include an expected breach of a condition of the loan that renders the loan repayable immediately or management's expectation not to exercise the right after the reporting period and to repay the loan with 12 months of the reporting date. That is now explicitly stated in the proposed guidance.

Question 7

Do you agree with the proposed amendment to IAS 1 as drafted in paragraph 77 of this Agenda Paper?

Reorganisation of paragraphs 72–76 of the Standard

78. We think that part of the complexity that arises in applying paragraphs 72–76 of the Standard is due to the piecemeal way in which guidance has evolved. We think that the Standard would be clearer and more consistently applied if the guidance were split between:

(a) examples of circumstances that create a right at the end of the reporting period and, consequently, can result in a non-current classification; and

(b) examples of circumstances that do not create a right at the end of the reporting period and, consequently, cannot result in a non-current classification.

79. Accordingly we propose re-ordering paragraphs 72–76 into two sections (as detailed in Appendices A–B of this Agenda Paper):

Effect of events after the reporting period

The following are examples of circumstances that create a right at the end of the reporting period and, thus, affect the classification of the liability in accordance with paragraph 69(d).

[Insert paragraphs 73 and 75]

The following are examples of circumstances that do not create a right at the end of the reporting period and, thus, do not affect the classification of the liability at the end of the reporting period.

[Insert paragraphs 72, 74 and 76]

80. The tracking of this reorganisation is shown in the table below:

Source paragraph reference	Destination reference
73	72R (a)
75	72R (b)
74	73R (a)
72	73R (b)
76	73R (c)

81. When reordering these paragraphs some incidental editing will also be required to avoid duplication. See Appendix B for editorial mark-up.

Question 8

Do you agree with the staff proposal to reorder the detailed guidance in the Standard to make its application clearer?

Summary of the proposals

82. A liability is classified as current if:

(a) it is expected to be settled as part of the normal operating cycle even if it is due to be settled more than 12 months after the reporting period.

(b) it is held primarily for the purpose of trading.

(c) the liability is due to be settled within 12 months of the end of the reporting period.

(d) at the end of the reporting period the entity does not have a right that gives it the practical ability to defer settlement for more than 12 months after the reporting period.

83. The further guidance in the proposals make it clear that:

(a) the right to defer settlement can only affect classification if the entity has the practical ability to exercise that right and the terms are not so unfavourable to the entity that exercise is unlikely;

(b) the creation of a right after the reporting period is a non-adjusting event because it does not create a right as at the end of the reporting period; and

(c) in making the classification decision, management should consider the effect that events after the reporting period could have on preventing the application (after the reporting period) of the right as at the reporting date.

Question 9
Do you agree with the proposed amendments in Appendices A and B?

Appendix A
Extract from the amended Standard

A1. The final form of the proposed amendments is shown below, not in mark up, for ease of reading

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 a right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 72R). 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.

For the purposes of classification, settlement of a liability refers to the transfer to the holder of cash, other assets or services. The replacement of one obligation by another would not represent settlement for the purposes of classifying liabilities except in the limited circumstances contained in paragraph 72R (a), ie roll-over with an existing lender.

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 72 R and 73R.

Effect of events after the reporting period

72R The following are examples of circumstances that create a right that exists at the end of the reporting period and, thus, affect the classification of the liability, in accordance with paragraph 69(d).

a) If an entity expects, and has the right, 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. When applying this requirement, the entity shall consider the following:

   i. The membership of a consortium is subject to change over time. In making its assessment about whether the consortium should be considered the same after changes to its membership, management should consider the extent to which the consortium has changed and, in particular, whether the lead banker is unchanged.

   ii. The right to roll over the loan with the same lender can only affect classification if the entity has the practical ability to exercise that right and the terms are not so unfavourable to the entity that exercise is unlikely.

   iii. When the entity has no right to refinance or roll over the obligation, because there is no arrangement in place at the end of the reporting period, the entity does not consider the potential to refinance the obligation with any other lender and classifies the obligation as current.

b) 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, 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.

73R The following are examples of circumstances that may prevent an entity from exercising its right to defer settlement of a liability for 12 months and, thus, affect the classification of the liability, in accordance with paragraph 69 (d):

a. if management expects at the date that the financial statements are authorised for issue that a breach of a condition of a loan will occur within 12 months of the reporting date and will make the loan repayable immediately; or

b. if management expects at the date that the financial statements are authorised for issue that, notwithstanding the right to defer settlement, it repay the loan within 12 months of the reporting date.

74R The following are examples of circumstances that do not create a right that exists at the end of the reporting period and thus do not affect the classification of a liability.

a) 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.

b) When an entity's financial liabilities are due to be settled within twelve months after the reporting period, the entity classifies them as current even if the original term was longer than twelve months, and 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.

c) When the following events occur between the end of the reporting period and the date the financial statements are authorised for issue, those events are non-adjusting events after the reporting period (see IAS 10 *Events after 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.

An entity discloses non-adjusting events when so required by IAS 10.

[Paragraphs 74 - 76 deleted]

Appendix B
Proposed amendments to the Standard

B.1 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 though 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 a~~n unconditional~~ right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period (see paragraph ~~73~~ 72R). 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.

For the purposes of classification, settlement of a liability refers to the transfer to the holder of cash, other assets or services. The replacement of one obligation by another would not represent settlement for the purposes of classifying liabilities except in the limited circumstances contained in paragraph 72R (a), ie roll-over with an existing lender.

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 72R ~~74~~ and 73R ~~75~~.

Effect of events after the reporting period

72R The following are examples of circumstances that create a right that exists at the end of the reporting period and, thus, affect the classification of the liability in accordance with paragraph 69(d).

a) 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. When applying this requirement, the entity shall consider the following:

i. The membership of a consortium is subject to change over time. In making its assessment about whether the consortium should be considered the same after changes to its membership, management should consider the extent to which the consortium has changed and, in particular, whether the lead banker is unchanged.

ii. The right to roll over the loan with the same lender can only affect classification if the entity has the practical ability to exercise that right and the terms are not so unfavourable to the entity that exercise is unlikely.

iii. ~~However, w~~ When the entity has no right to refinanc~~ing~~e or roll~~ing~~ over the obligation ~~is not at the discretion of the entity,~~ because there is no arrangement in place at the end of the reporting period, the entity does not consider the potential to refinance the obligation with any other lender and classifies the obligation as current.

b) ~~However, a~~ 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, 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.

73R The following are examples of circumstances that may prevent an entity from exercising its right to defer settlement of a liability for 12 months and, thus, affect the classification of the liability in accordance with 69 (d):

a) if management expects at the date that the financial statements are authorised for issue that a breach of a condition of a loan will occur within 12 months of the reporting date and will make the loan repayable immediately; or

b) if management expects at the date that the financial statements are authorised for issue that, not withstanding the right to defer settlement, it will not exercise the right to defer settlement and will repay the loan within 12 months of the reporting date.

74R The following are examples of circumstances that do not create a right that exists at the end of the reporting period and, thus, do not affect the classification of the liability.

a) 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 right to defer its settlement for at least twelve months after that date.~~

b) When an entity's financial liabilities are due to be settled within 12 months after the reporting period, ~~An~~ the entity classifies ~~its financial liabilities~~ them as current ~~when they are due to be settled within twelve months after the reporting period~~, even if the original term was ~~for a period~~ longer than twelve months, and 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.

c) ~~In respect of loans classified as current liabilities, if~~ When 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 after the reporting period (see ~~in accordance with~~ IAS 10 *Events after 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.

[Paragraphs 74 - 76 are deleted]