IFRS™

Agenda Paper 12B

STAFF PAPER

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Project	**IAS 1 *Presentation of Financial Statements*** **Current/non-current classification of liabilities**
Paper topic	Comment letter analysis

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Purpose

1. This paper summarises the feedback received in response to the IASB's Exposure Draft *Classification of Liabilities* ('the ED'). In the ED, the IASB proposes clarifications to the guidance in IAS 1 *Presentation of Financial Statements* relating to the classification of liabilities as either current or non-current.

2. The ED was published for public comment in February 2015; the comment period ended on 10 June 2015. The summary contained in this paper is based on the staff's preliminary analysis of comment letters as well as on feedback received from outreach activities undertaken by IASB members and staff members.

3. In this paper the staff recommends that the IASB should finalise its proposals and asks whether you agree with the staff's recommendations about the next steps that should be taken in finalising the proposals.

Structure of this paper

4. This topic is organised, by reference to questions asked in the ED, as follows:
   (a) background;
   (b) overview of the comment letter respondents;
   (c) key messages;
   (d) Question 1–Classification based on rights at the reporting date;

(e) Question 2–Linking settlement with the outflow of resources;

(f) Question 3–Transition arrangements;

(g) the US project on the classification of debt;

(h) expected effect on current practice; and

(i) staff summary and recommendation.

5. For convenience, each question asked in the ED precedes the discussion in this paper. The proposed amendments to IAS 1 and IAS 34, as laid out in the ED, are included in Appendix A for convenience.

Background

6. Classification of liabilities is the subject of paragraphs 69-76 of IAS 1. The proposals in the ED clarify that classification of liabilities as either current or non-current is based on the rights that are in place at the end of the reporting period.

7. In order to make this clear, the IASB proposed in the ED that:

(a) 'discretion' in paragraph 73 of the Standard is replaced with 'right' to align it with the requirements of paragraph 69(d) of the Standard;

(b) it should be made explicit in paragraphs 69(d) and 73 of the Standard that only rights in place at the reporting date affect the classification of a liability; and

(c) 'unconditional' is deleted from paragraph 69(d) of the Standard so that 'an unconditional right' is replaced by 'a right'.

8. The ED also proposed making clear the link between the settlement of the liability and the outflow of resources from the entity, by adding the words that settlement 'refers to the transfer to the counterparty of cash, equity instruments, other assets or services' to paragraph 69 of the Standard. The IASB further proposed that guidance in the Standard should be reorganised so that similar examples are grouped together.

9. Finally, the IASB proposed that retrospective application should be required and that early application should be permitted.

Overview of the comment letter respondents

10. The comment letter period on the ED ended on 10 June 2015. We received 88 comment letters, which are summarised below by type of respondent and geographical region.

Type of comment letter respondent

Respondent type	Number of respondents	Percentage of respondents
Auditors and accounting firms	29	33
Standard-setters	26	30
Preparers and industry organisations	15	17
Individuals	8	9
Regulators and government agencies	5	6
Users	2	2
Consultants	2	2
Academics	1	1
Total	**88**	**100**

Geographical distribution of comment letter respondents

Geographical region	Number of respondents	Percentage of respondents
Asia and Oceania	39	44
Europe	26	30
International	8	9
South America	6	7
Africa	6	7
North America	3	3
Total	**88**	**100**

11. Views tend to be common to all types of participants and all geographical regions, but the analysis below identifies the circumstances in which different populations of respondents hold different view.

Key messages

12. The majority of respondents agree with the proposal that classification should be based on the rights in place at the year-end. Some respondents, however, were concerned by the removal of ‘unconditional’ and requested further guidance about the nature of the rights on which classification is based.
13. Some respondents recommend that the IASB test its proposals against specific types of facts and circumstances, such as when:
    (a) the right to defer settlement includes uneconomic terms that would cause management to avoid exercising those rights;
    (b) the lender has a right to repayment on demand;
    (c) covenants are only required to be tested after the end of the reporting period;
    (d) management has the right to repay the debt early and intends to repay the debt within twelve months of the end of the reporting period despite also having the right to defer payment beyond twelve months; and
    (e) management repays the debt after the end of the reporting period but before the financial statements are finalised.
14. Most respondents thought that linking settlement of a liability with the transfer of cash or assets was useful. Some respondents were concerned, however, about how the inclusion of ‘equity’ in the settlement guidance interacted with other guidance in IFRS.
15. A few respondents questioned how the boundary of an arrangement to defer settlement would be affected by factoring those liabilities to a third party or by a third party, such as a bank, underwriting a commercial paper programme.
16. Some respondents were concerned by what they saw as the existing mixed classification model in IAS 1. A few of these respondents would prefer a comprehensive review of classification throughout IAS 1, whether as a separate project or as part of the Disclosure Initiative, rather than proceeding with the narrow-scope proposals.
17. Several respondents who agreed with the IASB’s proposal to require retrospective application disagreed with justifying that proposal in terms of IAS 8

Accounting Policies, Changes in Accounting Estimates and Errors. They think that the reference to IAS 8 is unnecessary and confusing.

18. These messages and the staff's recommended responses to each are discussed in greater detail in this paper.

Question 1: Classification based on rights at the reporting date

The IASB proposes clarifying that the classification of liabilities as either current or non-current should be based on the entity's rights at the end of the reporting period. To make that clear, the IASB proposes: (a) replacing 'discretion' in paragraph 73 of the Standard with 'right' to align it with the requirements of paragraph 69(d) of the Standard; (b) making it explicit in paragraphs 69(d) and 73 of the Standard that only rights in place at the reporting date should affect this classification of a liability; and (c) deleting 'unconditional' from paragraph 69(d) of the Standard so that 'an unconditional right' is replaced by 'a right'. Do you agree with the proposed amendments? Why or why not?

Q1 (a) Replacing discretion with right in paragraph 73

19. The majority of respondents agreed with the IASB's proposal to replace 'discretion' with 'right' in paragraph 73 of IAS 1. They agreed with the IASB that aligning the wording would prevent confusion. For example, one respondent wrote:

> … The term 'discretion' could lead to unnecessary diversity in practice, as different entities and their management may interpret (and exercise) discretion differently. Using the term 'right' should significantly narrow the choices. (*Austrian Financial Reporting and Auditing Committee)*

20. Some respondents, however, thought that replacing 'discretion' with 'right' moved from an approach to classification based on expectations to one based on contract terms. These respondents were concerned about the mixed nature of the classification model currently used in IAS 1. These concerns are discussed further in paragraphs 42-50 of this paper.

Q1 (b) Rights in place at the end of the reporting period

21. Most respondents agree, for the reasons given by the IASB, that it is only rights that are in place at the end of the reporting period that should affect classification.
22. Some were concerned, however, that ‘right’ had not been defined in IAS 1. These respondents suggested that rights used as the basis of classification should be restricted only to substantive rights. These respondents described substantive rights in terms that distinguish substantive rights from those rights that could not realistically be enforced or rights that would not be exercised by the entity in practice.
23. Much of the detailed discussion on the effect of rights on the classification of liabilities focussed on the effect of conditionality on those rights.

Q 1 (c) removal of ‘unconditional’

24. We received mixed views about the proposal to remove ‘unconditional’ from paragraph 69(d).
25. Many supported this proposal and agreed with the IASB’s view in paragraph BC2 that rights to defer settlement are rarely unconditional. These respondents also agree with the conclusion in paragraph BC4 that it is whether the entity complies with the condition as at the end of the reporting period that determines whether the right should affect classification. Some respondents think that the rationale in paragraphs BC2 and BC4 should be included in the Standard. The staff agree with that suggestion and recommend including this topic in the IASB’s redeliberations.
26. Others were concerned about removing ‘unconditional’ from paragraph 69(d). They think that the use of ‘unconditional’ provides rigour to the classification assessment by ensuring that entities fully take into account the conditions in the agreement when making that assessment. They thought that the removal of ‘unconditional’ would make the classification assessment more subjective.
27. Respondents raised questions, often with reference to specific examples, on three aspects of the guidance that they thought might be affected by the proposed removal of ‘unconditional’:

    (a) the nature of the rights at the end of the reporting period;

(b) the effect of expectation on assessing events after the reporting date; and

(c) the classification objective and underlying principle of IAS 1.

Nature of the rights at the end of the reporting period

28. Some were concerned that removing ‘unconditional’ might give the impression that *any* right to defer settlement would result in classification as non-current.

(a) Some thought that the right to defer settlement should be substantive. They were concerned that a right to defer settlement would not be exercised if it were uneconomical under the terms of the agreement–if, for example, the right was subject to excessive refinancing fees or disadvantageous interest rates.

(b) Several respondents referred to concerns about what they saw as an increased emphasis on legal rights over economic substance. These respondents queried whether classification based on legal rights would give more relevant information to investors. One respondent expressed concerns about the perceived emphasis on legal form in comparison with the *Conceptual Framework,* which states that faithful representation provides information about the substance of an economic phenomenon instead of merely providing information about its legal form.

(c) Others suggested that rights should be enforceable, although this term was not defined. One respondent thought that an unconditional right was, in effect, a unilateral right.

(d) A few suggested that when assessing any conditions that attached to the right, the important factor in that assessment should be whether the condition was controlled by the entity or not.

29. Several respondents asked about rights that are subject to a condition that will be tested only after the reporting period. Some asked the IASB to be explicit about whether that right could be included in an assessment of classification as at the end of the reporting period, because the condition could not be satisfied until the future assessment date. They thought that such a right was ineffective at the end

of the reporting period. Others took a contrary view. They think that the right at the reporting date is an unconditional right to defer settlement, because the condition cannot be breached as at the end of the reporting period. It can only be breached at a future date. The staff recommends that this type of circumstance should be considered by the IASB as part of its redeliberations.

30. A few respondents suggested that the IASB should also include guidance to remind borrowers that *lenders'* rights should also be considered, because these might affect the borrower's own right to defer settlement.

31. These respondents referred to a number of examples of rights to repayment that are held by lenders:

(a) Many borrowing arrangements contain annual review clauses, which gives the lender the right to review the loan and to withdraw it, without reason, at any time.

(b) Many borrowing arrangements, in particular overdrafts, have 'repayable on demand' clauses.

32. Many of these respondents thought that these lenders' rights could be ignored for classification purposes because:

(a) they say that it is rare in practice for a loan to be withdrawn by a lender;

(b) they think that these rights are rarely invoked by lenders; and

(c) they think that minor breaches of covenants are generally forgiven.

33. These respondents think that loans subject to these types of conditions should be classified as non-current and are concerned that the proposed amendment would result in classification as current.

34. Others think that the existence of these rights on the part of the lender means that the entity does not have a right to defer settlement, because any right to defer settlement are overridden by the lender's right to immediate repayment. We think that is the appropriate interpretation of the requirements in IAS 1.

35. A few such respondents referred, for example, to existing local guidance in Hong Kong that advises that arrangements that contain a repayment-on-demand clause should be classified as current. We note that one respondent in Hong Kong is concerned that the local interpretation would be weakened by the proposed amendment because that interpretation frequently refers to an 'unconditional

right'. We do not think that respondents should be concerned, because we think that the proposed amendment, which places reliance on rights at the end of the reporting period and not on expectations about those rights, further clarifies and strengthens the interpretation made locally in Hong Kong.

The effect of expectations on assessing events after the reporting period

36. Some respondents were concerned about what they perceive as a reduction in the importance of both management's and the lender's expectations on the classification decision.

37. These respondents thought it was counterintuitive to ignore management's expectations if management expects to breach a debt covenant after the balance sheet date. They think that this debt should be classified as current, and not classified as non-current solely on the basis of compliance at the end of the reporting period.

38. A few respondents also queried the focus on the entity's right to *defer* settlement. Management might expect to repay debt early, but that debt would be classified as non-current on the basis of a right to defer settlement that is in place at the reporting date. One respondent queried how an entity's right to redeem the liability earlier than scheduled, common in many borrowing arrangements, should interact with the entity's right to defer settlement for the purposes of classification.

39. Some respondents were concerned that in assessing events that take place after the reporting date, expectations about the lender's behaviour should also be considered. These respondents think that lenders rarely enforce their rights, especially those relating to annual review clauses or minor breaches. (See also paragraph 32.)

40. As discussed in paragraph 29, other respondents were concerned that the circumstances at the reporting date are applied to an assessment of compliance with covenants even when the lender has only required that an assessment of compliance with a condition must be made at a date after the reporting period, for example on the anniversary of granting the loan.

Staff summary

41. The staff think that the comment letter responses support the IASB's proposals with respect to basing classification on the rights in place at the end of the reporting period, on compliance with any conditions as at that date and on not changing the resulting classification for management's expectations about events after the end of the reporting period. Nevertheless, to clarify the impact of its proposals, we recommend that the IASB should test these decision against specific fact patterns identified in the comment letters. These fact patterns include examples in which:

    (a) the right to defer settlement includes uneconomic terms that would cause management to avoid exercising those rights;

    (b) the lender has a right to repayment on demand;

    (c) covenants are only required to be tested after the end of the reporting period;

    (d) management has the right to repay the debt early and intends to repay the debt within twelve months of the end of the reporting period despite also having the right to defer payment beyond twelve months; and

    (e) management repays the debt after the end of the reporting period but before the financial statements are finalised.

The classification objective and underlying principle of IAS 1

42. Some respondents queried the objective and underlying classification principle of IAS 1 and how that principle should be affected by conditionality.

43. A few respondents think that any current diversity in practice arises because the existing guidance is based on a mixed classification model. These respondents think that paragraphs 69(a) and 69(b) of IAS 1 are arguably business model approaches, because they refer to the 'normal operating cycle' and 'trading', while paragraphs 69(c) and 69(d) use a contractual model that focusses on contractual rights and solvency. A few other respondents categorise paragraphs 69(a) and 69(b) as a model based on management's expectations. One respondent thinks that working capital classification in paragraph 69(a) and 69(b) is based on

expectation to repay, while debt, in paragraphs 69(c) and 69(d) is based on a right to defer.

44. Many of these respondents suggest that a single classification model should be used throughout IAS 1 but are unclear on whether that model would be one based on expectations, the business cycle, contractual rights or liquidity.

45. A few of these respondents think that the IASB should perform a complete review of classification in IAS 1, rather than continuing with the narrow-scope amendment:

> We think attempting to address only a few issues on a narrow scope basis on a standard that has no clear principle… raises a host of issues. We think a more comprehensive project that identifies a principle and deals with the meaning of paragraph 69(a) as well as the inherent inconsistency between paragraphs 69(c) and 69(d) is necessary. *(Accounting Standards Board of Canada)*

Staff summary

46. The staff do not think that the IASB should undertake a complete review of classification in IAS 1.

47. The staff note that the classification model with respect to liabilities mirrors that of the classification of assets as current in paragraph 68–69 of the Standard. Both are mixed models–guidance with respect to working capital is classified according to operating cycles and expectations of settlement, while financing arrangements are classified according to explicit contract terms.

48. This mixed model means that paragraphs 69(a)-(b) relate more naturally to working capital-type liabilities and paragraphs 69(c)-(d) to liabilities that arise from financing arrangements. Several respondents noted that they consider paragraph 69(d) to be an exception to paragraph 69(c). This is at odds with the current wording of IAS 1, which lists all four criteria for current classification separated by the word 'or', which indicates that the criteria are of equal status.

49. One respondent suggested that the guidance should reflect this by linking paragraphs 69(c) and 69(d) with 'and', instead of 'or'. The paragraph would then read, in essence, that a liability is current if the entity:

69(a)–expects to settle in its normal operating cycle; OR

69(b)–holds it for trading; OR

69(c)–it is due to be settled in 12 months AND

69(d)–there is no right to defer.

50. The staff recommend that the IASB should consider this drafting suggestion as part of its redeliberations.

Interaction with Disclosure Initiative

51. A few respondents suggest that this amendment should be included with work undertaken as part of the Disclosure Initiative. The staff notes that this amendment was originally to be bundled with *Disclosure Initiative* (Amendment to IAS 1), published in December 2014. That narrow-scope amendment, which responded to an excessively-prescriptive interpretation of the wording in IAS 1, was separated from the proposed amendment with respect to the classification of liabilities in order that *Disclosure Initiative* could be finalised in 2014. The staff also notes that re-describing this amendment as part of the Disclosure Initiative would not affect the IASB's method of deliberation or due process.

Question 2—Linking settlement with the outflow of resources

The IASB proposes making clear the link between the settlement of the liability and the outflow of resources from the entity by adding 'by the transfer to the counterparty of cash, equity instruments, other assets or services' to paragraph 69 of the Standard. Do you agree with that proposal? Why or why not?

52. There was wide support for linking the settlement of the liability with the transfer of resources to the holder. Many thought that this was helpful and also noted that the notion of transfer reflects the definition of liability proposed by the current *Conceptual Framework* project:

> 4.24 A liability is a present obligation of the entity to transfer an economic resource as a result of a past event.

53. Respondents to Question 2 in the ED also commented on four related topics:

(a) when timing of settlement is uncertain;

(b) rollover and refinancing;

(c) nature of the counterparty; and

(d) the inclusion of 'equity' in the proposed wording.

When timing of settlement is uncertain

54. Two respondents noted that the emphasis on the contractual nature of the right was unhelpful when the timing of the settlement was uncertain, for example in the case of repairs or the replacement of faulty product in accordance with a warranty. They asked for additional guidance to be provided in this area.

55. We think that this was not a concern to most respondents, because most entities apply the guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* when accounting for warranties. IAS 37 includes specific guidance in relation to the time value of money and requires disclosure of the expected timing of the outflows of economic benefits. We think that this Standard provides adequate guidance about provisions; which are defined in that Standard as a liability of uncertain timing or amount. Consequently, the staff do not think that any revision to the IASB's proposals is necessary with respect to this concern.

Rollover and refinancing

56. Many agree that a rollover of debt does not constitute settlement for the purposes of classification. They think that the new sentence, by referring to 'transfer', helps to clarify the difference between refinancing (when an existing liability is extinguished and replaced by a new liability) and rolling over (when an existing liability is extended and no settlement takes place because there is no outflow of resources.)

57. Some suggested that the guidance should be more explicit. A few respondents suggested that definitions of rollover and/or refinancing should be included. Others suggested that the discussion in paragraph BC11 should be included in the Standard:

> BC11 … emphasis should be placed on there being a right at the end of the reporting period to roll over the obligation

under the existing loan facility that directly relates to the loan being classified.

58. One respondent asks whether the guidance about settlement should be extended to deal with further situations that result in the extinguishment of a liability, such as offsetting or waiver of a liability.

59. A few respondents queried the boundary of the existing loan arrangement. They asked how a commercial paper programme that is underwritten by a bank would be classified. They gave an example of an entity that has a rolling one-year commercial paper programme and a linked facility with a bank that can be drawn down if the commercial paper cannot be reissued as it falls due. These respondents asked whether the bank facility was part of the commercial paper arrangement that rolled over annually or constituted a separate arrangement that would not affect the classification of commercial paper that was not reissued. The staff thinks that this example should be considered by the IASB as part of its redeliberations.

Nature of the counterparty

60. One respondent thought that the wording ‘transfer to the counterparty’ should be extended to include ‘the counterparty or any entity authorised by the counterparty’ to include circumstances when a debt is factored and the liability is extinguished by transfer to the factor.

61. The staff think that the IASB should consider this drafting suggestion as part of its redeliberations.

The inclusion of ‘equity’ as a means of settlement

62. The proposed wording includes a reference to settlement as the transfer to the counterparty of, among other things, equity. The staff note that ‘equity’ had been included to deal with the circumstances in which a liability would be settled by the entity’s own shares, those shares being neither cash nor an asset.

63. Several respondents thought that including the reference to equity was confusing and asked the IASB to consider the following:

(a) An apparent contradiction between what is stated in the existing paragraph 69(d)–namely, that settlement at the option of the counterparty does not affect classification–with the proposed amendment, which includes the transfer of equity instruments as a means of settling liabilities for the purposes of classification.

(b) A contention that IAS 1 (as articulated in paragraphs BC38L-38P) focusses on liquidity as the basis of classification. In accordance with that basis of classification, the respondent thinks that issuing equity instruments should not affect classification because issuing equity does not affect liquidity.

(c) A concern that the Standard does not make it clear whether the equity instruments referred to are those of the entity or those of another party held as an investment by the entity. There was some general concern about how that interacts with paragraph BC38N.

(d) A broader concern that the use of 'extinguishment' in the proposals differs from the way in which 'extinguishment' is used in IFRS 9.

64. A number of specific examples were raised for further consideration by the IASB before finalising these proposals, such as:

(a) the situation in which a holder of a convertible note can demand cash repayment if, for example, the entity's share price falls below a certain price;

(b) the situation in which convertible debt is due to be settled in more than 12 months, but is convertible on demand in exchange for a variable amount of shares, ie the convertible amount is a liability; and

(c) the situation in which an entity may be forced to settle within 12 months at the option of the counterparty.

65. The comment letters contain a number of further examples of a liability that is extinguished by the transfer of equity. The staff intend to prepare a further analysis of these transactions for discussion by the IASB at a future meeting.

Question 3—Transition arrangements

The IASB proposes that the proposed amendments should be applied retrospectively. Do you agree with that proposal? Why or why not?

66. The IASB proposed retrospective application and discussed this in paragraphs 19-20 of the Basis for Conclusions by reference to IAS 8. That discussion concludes that the proposals would not result in a change in accounting policy, but are in the nature of a change in accounting estimate which, in accordance with IAS 8, would warrant prospective application. Nevertheless, the IASB concluded that the proposals should be retrospective because:

> (a) paragraph 41 of IAS 1 requires that, if an entity changes the presentation or classification of items in its financial statements , it shall reclassify comparative amounts unless reclassification is impracticable;
>
> (b) the Board considered that the retrospective application of the proposed narrow-scope amendments would not be onerous, because they deal solely with classification, rather than recognition or measurement;
>
> (c) the proposed narrow-scope amendments would clarify existing requirements rather than imposing additional requirements; and
>
> (d) information about the classification of liabilities would be most useful if current and prior period information is presented on the same basis.

67. Most respondents agree with the IASB's proposal that the amendments should be applied retrospectively for the reasons given in the Basis for Conclusions. The majority emphasised the importance of comparability of reported information. Many also agreed that the proposed amendments were clarifications and not new requirements and consequently they would not be burdensome to preparers.

68. A few respondents, although they supported retrospective application, had concerns about the reference in the Basis for Conclusions to IAS 8. There were varied views as to whether clarification resulted in a change in accounting policy or in an accounting estimate. In particular:

    (a) One or two respondents were concerned that the reference to IAS 8 might imply that an error had been made previously with respect to the classification decision and suggested that this point should be clarified.

(b) Another respondent suggested that IAS 8 should be extended to list a fourth driver of change–a change in presentation in addition to a change in accounting policy, a change in an accounting estimate or an error.

(c) Several respondents considered any reference to IAS 8 to be unnecessary. In their view, paragraphs 41 and 46 of IAS 1 specifically require a restatement of comparatives on a change in presentation. In accordance with that view, the proposed requirements could be rephrased as a requirement to restate comparatives in accordance with IAS 1.

69. A few respondents do not agree with the transition proposals. These respondents are concerned that the entity might be required to use hindsight.

70. A few respondents also thought that retrospective application might be onerous and one noted that an amendment to presentation in the comparative amounts might cause misunderstandings for investors. Another thought that retrospective application was unnecessary, because investors were not very concerned about the classification of liabilities in prior periods, but only about the classification at the reporting date, because they saw it as an indication of future cash flows.

Staff summary

71. The staff agree with the view that the discussion about accounting estimates and accounting policies is unnecessary and will include a discussion of that drafting suggestion in the IASB's redeliberations.

The US project on the classification of borrowings

72. The US Financial Accounting Standards Board (FASB) is expected to issue proposals to amend its guidance on the classification of debt in the next few months as part of its Board Simplification Initiative. The existing US guidance has been developed over many years through several standards that were issued to address individual, narrow-scope issues such as an obligation called by the creditor, revolving credit schemes and expectations of refinancing.

73. The simplified US proposals will show increased convergence with IAS 1, because all the US guidance proposed on the classification of borrowings is based

on the criteria in paragraphs 69(c) and 69(d). The US proposals differ from IFRS requirements, however, with respect to waivers of debt covenant violation. The FASB has tentatively decided that, as an exception to the classification principle, the waiver of a breach granted between the reporting date and authorisation of the financial statements will affect classification.

Expected effect on current practice

74. The comment letters contain differing views about the effect of the proposals on the classification of liabilities. Many think that the proposals are clarifying in nature and are unlikely to change existing presentation significantly, although these respondents do think that the proposals will increase consistent application. Others think, however, that basing classification on whether the entity complies with conditions at the end of the reporting period will affect current practice. Those respondents think that management expectations about events after the reporting period are currently used as the basis for some classification decisions.

75. Similarly, respondents express differing views about whether or not more liabilities will be classified as non-current than currently. Some think that fewer liabilities will be classified as non-current, because covenants that were not due to be tested until a future date will now be tested for compliance as at the end of the reporting period. Others take the contrary view that more liabilities will be classified as non-current because events, such as breach or voluntary settlement after the reporting date, or management's expectations about these events, will not affect classification. Respondents who hold this latter view are particularly concerned because they think that it is imprudent to classify these liabilities as non-current.

76. Because we have received a variety of views about what effect, if any, these proposals will have on practice, the staff recommend that the IASB should confirm its decisions by testing them against a number of the transactions referred to in the comment letters. (See paragraph 82.) This will enable the IASB to clarify the expected effect of its proposals in advance of publication.

Staff summary and recommendation

77. The staff think that most respondents agree with the proposals contained in the ED to base the classification of liabilities on rights in place at the end of the reporting period and that settlement of liabilities, for the purposes of classification, should be linked to the notion of transfer. There was general support for these proposals for the reasons given by the IASB.

78. The proposals also make it clear that an assessment of compliance with any conditions attached to the right is based on the entity's ability to comply with the condition as at the year-end and the staff think that this guidance will significantly reduce diversity in how the requirements of IAS 1 are currently applied. The staff think that the differing views held by respondents about the effect of the IASB's proposals arise, in part, because there is significant diversity in how compliance with conditions is currently assessed.

79. The staff do not think that the mixed classification model, which is based on a combination of operating norms, expectation and rights, that is used throughout IAS 1 should be comprehensively revised at this stage.

80. Consequently, the staff recommend that the IASB should finalise its proposals in the ED.

81. In finalising those proposals the staff propose:

    (a) including wording currently in paragraphs BC2, BC4 and BC11 within the Standard to further clarify the guidance;

    (b) considering the drafting advice received about 'counterparty' with respect to the effect of factoring;

    (c) considering the drafting advice about linking paragraphs 69(c) and 69(d) of IAS 1 as discussed in paragraph 49 of this Agenda Paper; and

    (d) removing the reference in the Basis for Conclusions to IAS 8 with respect to retrospective application, because the requirement in paragraph 41 of IAS 1 is sufficient to require retrospective application of these proposed amendments.

82. The staff intend presenting papers to the IASB as part of its redeliberations of this topic that:

(a) discuss what effect a condition that is not required to be assessed by the lender until a date after the reporting period should have on classification (see paragraph 29);

(b) confirm the IASB's proposals by reference to some specific types of transactions raised in the comment letters (see paragraphs 41 and 59); and

(c) examine the guidance with respect to the transfer of equity as a means of settlement by using specific examples to develop that guidance (see paragraphs 62-65).

83. The staff intend bringing further analysis of the topics referred to in paragraphs 81 and 82 to a future meeting of the IASB.

Question
(a) Do you have any questions or comments on the comment letter analysis? (b) Do you agree with the staff recommendation to provide further analysis of the topics raised in paragraphs 81 and 82 before finalising the proposals? (c) Are there any other matters that you think require further analysis before finalising the proposals?

Appendix A
Proposed amendments to the Standard

A.1 The proposed amendments contained in the ED are noted below:

Paragraphs 69 and 71 are amended. Paragraphs 72–76 have been amended and reorganised so that similar examples are grouped together. Consequently, paragraphs 74–76 are deleted and paragraphs 72 and 73 have been renumbered as 73R(b) and 72R(a) respectively. Paragraph 139Q is added. Deleted text is struck through and new text is underlined. Paragraph 70 is not amended, but has been included for ease of reference. Some paragraphs have been reorganised so that similar examples are grouped together:

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

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~~ 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~~ 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.

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

For the purposes of classification as current or non-current, settlement of a liability refers to the transfer to the counterparty of cash, equity instruments, other assets or services that results in the extinguishment of the liability.

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(b) ~~75~~ and 73R(a) ~~74~~.

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

a) If an entity ~~expects, and~~ has the ~~discretion,~~ right to ~~refinance or~~ roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. ~~However, when~~ When the entity does not have the right to ~~refinancing or rolling~~ roll over the obligation ~~is not at the discretion of the entity,~~ (because, for example, there is no arrangement ~~for refinancing~~ in place at the end of the reporting period for rolling over the obligation~~)~~, the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

b) ~~However,~~ When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable within twelve months after the reporting period, the entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

73R The following are examples of circumstances that do not create a right to defer settlement that exists at the end of the reporting period.

a) When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have ~~an unconditional~~ a right to defer its settlement for at least twelve months after that date.

b) 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 the payments of an existing loan, on a long-term basis is completed after the reporting period and before the financial statements are authorised for issue.

c) In respect of loans classified as current liabilities, if the following events occur between the end of the reporting period and the date the financial statements are authorised for issue, those events are ~~disclosed as~~ non-adjusting events in accordance with IAS 10 *Events after the Reporting Period* and do not affect classification at the end of the reporting period:

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.

An entity discloses non-adjusting events in accordance with IAS 10.

74-76 [Deleted]

Transition and effective date

...

139Q *Classification of Liabilities* (Amendments to IAS 1), issued in [date to be inserted after exposure] amended paragraphs 69 and 71 and amended and reorganised paragraphs 72–76. Paragraphs 74–76 are deleted and paragraphs 72 and 73 have been renumbered as 73R(b) and 72R(a). Some paragraphs have been reorganised so that similar examples are grouped together. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure] retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

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