ICAEW REPRESENTATION 84/15

ED/2015/1 Classification of liabilities: proposed amendments to IAS 1

ICAEW welcomes the opportunity to comment on the *ED/2015/1 Classification of Liabilities*: *proposed amendments to IAS 1* published by the IASB in February 2015, a copy of which is available from this link.

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MAJOR POINTS

More clarify required

1. ICAEW supports the IASB decision to clarify the criteria for the classification of a liability as either current or non-current, as outlined in paragraphs 69 to 76 of IAS 1 *Presentation of Financial Statements*. However, in our view, the proposed amendments are not drafted clearly enough and are unlikely to reduce uncertainty in this area. Our concerns are discussed in more detail below.

RESPONSES TO SPECIFIC QUESTIONS

Question 1: Classification based on the entity's rights at the end of the reporting period.

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?

2. No. While we agree with the proposal to clarify how the principles for classifying a liability as either current or non-current interact with the detailed guidance provided in IAS 1, in our view, the proposed amendments have not been drafted in a clear or easily comprehensible manner. We are therefore concerned that uncertainty in this area will continue or, indeed, that further confusion will arise.

3. For example, it is proposed that paragraph 69(d) is amended to state that a liability is current if the entity does not have 'a right at the end of the reporting period to defer settlement … for at least 12 months after the reporting period.' However, it is not entirely clear what is meant by a 'right'. One interpretation might be that it is still a 'right' if it is conditional on there being no material adverse change in the entity's position before it comes to seek to defer settlement. Or if a covenant test must be met at the time the entity seeks to roll over the obligation. However, this reading would seem to be a significant change from the previous 'unconditional right', unless that conditionality was to be assessed solely on the position as at the reporting date.

4. In general, we would expect to achieve a similar classification for a 1 year drawdown under a 5 year facility compared to a 5 year loan in its first year of drawdown. For the latter, we would not anticipate that potential breaches of covenant within the next year from the reporting date would result in that loan being classified as current at the reporting date: therefore, we do not believe it correct to classify the former loan as current, if a covenant test has to be met at rollover. However, it is not clear, from the proposed amendments, what the IASB's position is on this matter. It is important for the IASB to redraft the amendments to ensure that they are clear and to enable a consistent approach to be taken.

5. Although not specifically posed as a question in this consultation, we also note that the IASB is proposing to reorganise the examples in IAS 1 in order to group together those that are similar. We support this proposal but believe it would be useful to include an additional example of a situation in which management expects to breach a covenant between the reporting date and the date at which they could, but for the breach, roll over the obligation. This is discussed in BC16 and we agree with the conclusion reached - that this expectation of breach does not mean that, as at the reporting date, the existing liability is current. However, as this particular scenario appears to have been one of the main areas of uncertainty causing the IASB to reconsider the wording of the standard, an example would be helpful.

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?

6. No. In our view, the proposed amendment results in a discrepancy with regards to equity settlement of a liability. This is because paragraph 69 currently states that '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'. However, it is proposed that there would be additional text in this paragraph which would state 'For the purposes of classification … settlement of a liability refers to the transfer to the counterparty of … equity instruments …that result in the extinguishment of the liability.' We do not believe it is clear from the proposed wording whether or not the ability to settle in equity instruments should be ignored when determining whether a liability should be classified as current or non-current. We recommend that the IASB considers rewording the proposed amendment in order to clarify this matter.

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?

7. Yes, subject to the matters identified above being satisfactorily addressed, we would broadly support retrospective application of the amendments. However, we are concerned that proposed paragraphs BC19 and BC20 are, as drafted, very unclear and likely to cause confusion. They appear to suggest that if an entity reached a conclusion different to that which would be reached under the proposed revisions it will be considered to have misinterpreted the existing guidance. We believe it would be preferable to steer clear of any reference to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

8. If the only reason for proposing retrospective application is because of the IAS 1 consistency requirement, IASB should simply state that the amendments should be applied retrospectively 'in accordance with IAS 1', with no mention of IAS 8. Or, as the IASB is in fact proposing to change IAS 1, it should make very clear that the relevant sections of IAS 8 are those relating to a change of accounting policy or a new accounting standard rather than those relating to errors.