

Association of Accounting Technicians response to Exposure Draft ED/2015/1 Classification of Liabilities – Proposed amendments to IAS 1

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the exposure draft ED/2015/1 "Classification of Liabilities – Proposed amendments to IAS 1", (the ED) released on 10 February 2015.
- 1.2. AAT is submitting this response on behalf of our membership and from the wider public benefit.
- 1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.
- 1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities in implementing the measures outlined.
- 1.5. Furthermore, the comments reflect the potential impact that the proposed changes would have on businesses, many of which employ AAT members or are likely to be represented by our operationally skilled members in practice.

2. Executive summary

- 2.1. This ED clarifies how entities classify debt, particularly at the time of renewal. The proposed amendments are designed to improve presentation in financial statements by clarifying the criteria for the classification of a liability either as current or non-current.
- 2.2. The proposed amendments do this by:
 - clarifying that the classification of a liability as either current or non-current is based on the entity's rights at the end of the reporting period; and
 - making clear the link between the settlement of the liability and the outflow of resources from the entity.
- 2.3. IAS 1 *Presentation of Financial Statements* requires a reporting entity to classify liabilities as either current or non-current so as to enable users of the financial statements to make an assessment of the entity's liquidity and solvency. Paragraph 69 of IAS 1 requires a liability to be classified as current when any of the following criteria are met:
 - it expects to settle the liability in its normal operating cycle;
 - it holds the liability primarily for the purposes of trading;
 - the liability is due to be settled within 12 months after the reporting period; or
 - it does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting period.
- 2.4. An issue has arisen with regard to an entity having an 'unconditional right to defer settlement of the liability' contained in paragraph 69(d) of IAS 1 and how this relates with that entity having the discretion to refinance or roll over an obligation (per paragraph 73 of IAS 1). The IASB has been asked to clarify how an unconditional right to defer settlement in paragraph 69(d) of IAS 1 is reconciled with an entity having the discretion to refinance or roll over an obligation in paragraph 73 of IAS 1.

- 2.5. The IASB is also proposing to require retrospective application of the amendments to IAS 1.
- 2.6. AAT is supportive of the proposed amendments to IAS 1 and also the classification of a liability as either being current or non-current based on the reporting entity's rights at the end of the reporting period (4.1, below).
- 2.7. In addition, AAT supports the retrospective application proposal for the reasons given in 4.3, below).

3. AAT response to the exposure draft ED/2015/1 on "Classification of Liabilities – Proposed amendments to IAS 1"

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

The IASB proposes clarifying that the classifications 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?

- 3.1. AAT supports the proposals (para (a), page 4, ED) to replace 'discretion' in para 73 of the Standard with 'right'.
- 3.2. AAT believes that the proposed action in 3.1 (above) will bring the wording in paragraph 73 in line with the requirements in para 69(d) of the Standard (question 1(a)). It is AAT's belief that this will remove inconsistencies with the current terminology employed in the Standard and avoid divergent practices emerging.
- 3.3. AAT also supports the proposal (para (b), page 4, ED) to emphasise in both paragraph 69(d) and 73 of IAS 1 that only rights in place at the reporting date should affect the classification of a liability (question 1(b)), although AAT views this as more of a clarification rather than an amendment. Notwithstanding that view, AAT believes that clarifying that only rights in place at the reporting period should affect the classification of a liability will enable consistent application of the paragraphs which, in turn, will result in comparable financial statements for users.
- 3.4. AAT agrees with the proposal (para (c), page 3, ED) to remove the word 'unconditional' from paragraph 69(d) of the Standard (question 1(c)) as this will enable consistency with the remainder of the Standard.

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?

- 3.5. AAT agrees with the proposal (para 3, page 4, ED) to clarify the link between an entity settling a liability and the associated outflow of resources in paragraph 69 of the Standard. AAT considers this to be a helpful amendment that makes it clear that in order to settle a

liability there has to be an associated outflow of economic resources, whether that be cash, an equity instrument or other assets or services. Entities that seek to refinance their borrowings would not effectively settle their previous borrowings and would be unable to reclassify them as current. Thereby, emphasising that there has to be an actual transfer of economic benefits adds clarity to the Standard.

- 3.6. AAT recommends that the IASB should include additional application guidance to assist entities that have convertible debt (debt whereby the capital element can be converted into equity instruments at the option of the holder). If the terms of the liability make provision for settlement in cash after a period of more than 12 months, or settlement in equity instruments within 12 months, then the entity could still classify the liability as non-current if they choose to disregard the option to settle in equity instruments for the purposes of classifying the liability. However, paragraph 69(d) states that when an entity does not have an unconditional right to defer settlement of a liability for at least 12 months after the reporting period, the liability should be classified as current. AAT believes that further application guidance is needed in this area to clarify this situation.
- 3.7. AAT makes its recommendations 3.5 & 3.6 (above) to address inconsistencies in the proposed wording of paragraph 69 and the existing wording in paragraph 69(d) which states that the liability may be classified as non-current where the option to settle the liability in shares is disregarded for classification purposes.
- 3.8. Conversely, the liability might be regarded as current where the entity does not have a right to defer settlement for more than 12 months if the holder exercises the option.

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?

- 3.9. AAT agrees that the proposed amendments should be applied retrospectively so as to be consistent with the provisions in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 3.10. Changes in presentation of items in the financial statements are considered to be a change in accounting policy and hence should be applied retrospectively to ensure that the financial statements are comparable and consistent and AAT would view this as a clarification as opposed to an amendment. In addition, IAS 1 also requires entities to reclassify comparative financial information when making changes in presentation (again, to achieve comparability and consistency).

4. Conclusion

- 4.1. AAT is supportive of the proposed amendments to IAS 1 and also the classification of a liability as either current or non-current based on the reporting entity's rights at the end of the reporting period (page 7, the ED) (2.6, above).
- 4.2. The proposed clear linkage between the settlement of the liability and the outflow of resources from an entity will aid clarity in the standard and distinguish 'settlement' of a transaction from a 'roll over' of a liability; however AAT would suggest further clarification as to the treatment of a liability which is convertible to equity instruments at the option of the holder (3.5, above).
- 4.3. Retrospective application of the amendments to IAS 1 will enable comparability and consistency to be achieved as well as complying with the requirements of paragraph 46 of IAS 1 which requires a change in presentation to be applied retrospectively as well as complying with the requirements of IAS 8 which requires a change in accounting policy

(which a presentational change would be considered to be) to also be applied retrospectively (3.9, above).

5. About AAT

- 5.1. AAT is a professional accountancy body with over 49,800 full and fellow members¹ and 78,400 student and affiliate members worldwide. Of the full and fellow members, there are over 4,100 Members in Practice who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.
- 5.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

6. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact AAT at:

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¹ Figures correct as at 31 March 2015