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Kris Peach
The Chair
Australian Accounting Standards Board
PO BOX 204
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10 June 2015

Dear Kris

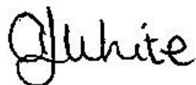
Exposure Draft ED 259 – Classification of Liabilities (Proposed amendments to AASB 101)

Thank you for the opportunity to respond to the Australian Accounting Standard Board's Exposure Draft *Classification of Liabilities (Proposed amendments to AASB 101)* (which incorporates IASB ED/2015/1 of the same name).

I am enclosing a copy of Deloitte Touche Tohmatsu Limited's comment letter to the International Accounting Standards Board's Exposure Draft 2015/1.

This letter reflects the views of the Deloitte Touche Tohmatsu Limited network of the member firms (Deloitte Global) and, therefore, includes our own comments on the Discussion Paper.

Yours sincerely



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Hans Hoogervorst
Chairman
International Accounting Standards Board
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10 June 2015

Dear Mr Hoogervorst

Exposure draft 2015/1 – Classification of Liabilities (Proposed amendments to IAS 1)

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's (the IASB's) Exposure Draft *Classification of Liabilities (Proposed amendments to IAS 1)* ('the exposure draft').

We welcome the IASB's initiative in addressing an area of accounting which often presents issues in practice and recognise that many of the amendments proposed would be beneficial. However, we believe that the Board should consider this conceptual issue more fully as part of its Disclosure Initiative project rather than proceeding with the very limited amendments proposed in the exposure draft.

We are concerned that the amendments do not address many of the practical issues that arise in respect of, for example, loan covenants and refinancing transactions. In addition, we note that the amendments appear to introduce an inconsistency in the treatment of liabilities settled by the transfer of equity instruments to the counterparty.

We recommend that the Board provide guidance on these practical issues and, more broadly, note that many of them result from the mixed model applied by IAS 1 and the lack of a clear principle or disclosure objective underpinning the classification of liabilities as current or non-current. This also makes the resulting information less meaningful for users of financial statements.

Our detailed responses to the questions in the invitation to comment are included in the Appendix to this letter.

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If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Appendix

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?

We do not object to the proposed amendments specified above, in themselves, but are concerned that they are not sufficient to address the issues that arise in practice in classifying liabilities as current or non-current. As such, and taking into account the conceptual issues noted below, we believe that additional work is necessary prior to the completion of any amendments to the Standard.

We believe that *substantive* rights (rather than, as currently stated by paragraph 69(d), only unconditional rights) to defer settlement that exist at the end of the reporting period should affect the classification of a liability. However, as noted below additional guidance is necessary to make this requirement operational.

To address issues that arise in practice, particularly in the context of loan covenants, we recommend that guidance be added to IAS 1 to address circumstances in which a right to defer settlement has not been contractually forfeited at the end of the reporting period but could, nonetheless, be considered to have no substance at that date. Examples of such circumstances include the following:

- a covenant test date immediately after the end of the reporting period (such that financial information will not change materially in the intervening period) when a covenant would be breached based on financial information as at the reporting date; and
- a covenant based on a profit or loss metric largely completed at year-end (for example, cumulative three-year profit for a period ending one month after the end of the reporting period) when financial information as at the reporting date show that the covenant's requirements cannot be met.

Similarly, the guidance in proposed paragraphs 72R and 73R is unclear in respect of the effect of:
- any conditions attached to a right to roll over an obligation (for example, a covenant test date might often coincide with rollover date under a facility agreement);
- covenant tests occurring within twelve months of a waived covenant breach at the reporting date (i.e., whether a 'period of grace' has to be unconditional, including prospective waiver of any covenant test that would have occurred absent any breach); and
- an agreement to refinance entered into with a third party before the end of the reporting period. For example:
  - an issue of commercial paper may be rolled over but with a change in the holders; or
  - an existing loan facility may be replaced with one provided by a third party (with or without gross cash flows between the entity and the new and old lenders).

More broadly, we note that (taking account of the amendments proposed in the exposure draft) paragraph 69 continues to represent a mixed model. Specifically, paragraphs 69(a) and 69(b) suggest a business model test, whilst paragraph 69(c) and 69(d) focus on contractual rights and liquidity. In the absence of a clear and consistent principle underpinning the distinction between current and non-current liabilities, issues will continue to arise in interpreting the disparate elements of paragraph 69. We believe that the Board should consider this conceptual issue more fully as part of its Disclosure Initiative project rather than proceeding with the very limited amendments proposed in the exposure draft.

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?

In general, we agree that, as stated in paragraph BC15 of the Basis for Conclusions on the exposure draft, settlement of a liability for classification purposes may be achieved in different forms. However, we do not believe that the proposed amendments adequately address settlement by transfer of an entity's own equity instruments as we are concerned that the proposed reference to such a transfer paragraph 69 would be inconsistent with the existing statement in paragraph 69(d) 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."

Paragraphs BC38L to BC38P of the Basis for Conclusions on IAS 1 discuss this statement in the context of a conversion option within a compound instrument, but also state that "IAS 1 and the Framework state that information about the liquidity and solvency positions of an entity is useful to users. The terms 'liquidity' and 'solvency' are associated with the availability of cash to an entity. Issuing equity does not result in an outflow of cash or other assets of the entity." This statement is inconsistent with paragraph BC14 of the Basis for Conclusions on the exposure draft which states that "settlement for the purposes of classification of a liability as either current or non-current would also refer to the transfer of equity instruments."

We recommend that the Board consider more fully the principles to be applied in determining when, if ever, a requirement to transfer equity instruments within twelve months of the reporting period should, in isolation, result in classification of a liability as current. This should include consideration of whether a distinction should be drawn between a compound instrument (for which the obligation to deliver equity instruments might be considered to be represented by an equity balance) and an instrument that includes an obligation to deliver equity instruments (for which that obligation forms part or all of the liability balance).

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?

We acknowledge the basis for requiring retrospective application stated in paragraph BC20 of the Basis for Conclusions on the exposure draft are valid. However, if as recommended in our response to Question 1 above the Board provides more guidance on rights to defer settlement and refinancing we believe that prospective application may be more appropriate as the effort of retrospective application

may not be warranted (particularly as it could in some circumstances result in retrospectively reclassifying a liability as non-current that was, in fact, settled within the next reporting period or vice versa).