Tel: +44 20 7893 3300
Fax: +44 20 7487 3686
@: abuchanan@bdoifra.com
www.bdointernational.com

BDO IFR Advisory Limited
55 Baker Street
London W1U 7EU
United Kingdom

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XG

21 June 2015

Dear Sir

Exposure Draft ED/2015/1: Classification of Liabilities - Proposed amendments to IAS 1

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the ED.

We agree with the IASB's objective to clarify the requirements of IAS 1 *Presentation of Financial Statements* in respect of the current and non-current classification of liabilities. However, although the proposed amendments are helpful we believe that they could be clarified further, in particular for arrangements that are subject to covenant and other similar tests in less than 12 months after the reporting date. We also believe that the proposed guidance in paragraph 69(d) needs to be amended in order to clarify the approach to classification for those liabilities that can be settled, at the option of the counterparty, in the entity's own equity instruments.

Our responses to the questions in the ED are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Andrew Buchanan

Global Head of IFRS

[1] Service provision within the international BDO network of independent member firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium with its statutory seat in Brussels. Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and the member firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and/or the member firms of the BDO network.
BDO is the brand name for the BDO network and for each of the BDO member firms.
BDO IFR Advisory Limited, registered in England No 7295966
Registered office: c/o Hackwood Secretaries Limited, One Silk Street, London, EC2Y 8HQ

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 generally agree with the proposed amendments as they further clarify the classification of liabilities as either non-current or current.

However, we have the following concern in relation to the proposed use of the term 'a right' in paragraph 69(d). It is noted in paragraph BC2 that the Board observed that rights are rarely unconditional and that the reference to 'conditional' should therefore be replaced with 'a right' in paragraph 69(d).

This would imply that 'a right' also includes rights that are conditional. The future fulfilment of a conditional right is not always within the control of the entity and might depend on internal and/or external factors. In these situations the question appears to be both whether 'a [*conditional*] right' exists as at the end of the reporting period and whether the fulfilment of that [conditional] right is within the control of the entity.

For example, an entity might have a loan which is subject to covenants, the compliance with which is tested quarterly. If, at the end of a reporting period, an entity is in compliance with the covenants and has the practical ability to take actions to remain in compliance, this would give rise to a non-current liability. In contrast, if a covenant includes a requirement that a certain asset or subsidiary is not sold and, as at the reporting date, although the asset or subsidiary is still held the entity has entered into a contractually binding commitment to sell the asset or subsidiary during the next calendar quarter, compliance with the next quarterly covenant test would appear to be no longer within the control of the entity.

It is also common for a loan that is due to be settled within 12 months of the reporting date to be subject to a roll over facility, subject to meeting certain condition(s), such as specified financial ratios, at the rollover date. At the reporting date, although no test is required, if the financial ratios were tested the entity would fail. There are differing views about whether a right to defer settlement for more than 12 months exists. Should the focus be on the position at the reporting date, or should this instead be on whether the entity has the practical ability to do something about the breach such that it will comply by the time the term of the current loan comes to an end? It would appear that the intention of the amendments is that, if the entity has the practical ability to address the position such that it could realistically meet the covenants at the future date, the obligation would be classified as non-current (in the same way as the example above, with quarterly covenants tests). However, it would be helpful for the amendments to clarify this point.

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?

We agree with most of the proposed amendments. However, we note that the wording in paragraph 69 does not provide a clear distinction by what is meant in relation to the settlement in equity instruments.

A. Text added to the end of paragraph 69 clarifies the term 'settlement':

   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.* [emphasis added]

B. The last part of the original text of paragraph 69(d) remains unchanged and states:

   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* [emphasis added]

It is not entirely clear how to make a distinction between the content of paragraph 69(d) which states that situations where a liability is settled by the issue of equity instruments does not affect classification, and the definition of the term 'settlement' which appears below, according to which settlement includes the transfer of equity instruments.

Paragraph BC38N appears to indicate that there is a distinction between the settlement in another entity's equity instruments (A above) and the issuance of (own) equity instruments (B above) with regard to the outflow of resources. We suggest that the wording of paragraph 69 is revisited in order to clarify the meaning of the amendment.

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 agree with the proposed retrospective application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, we note that the classification might have an impact on the measurement of a liability through the application of the effective interest method.