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Accounting Standards Committee of Germany
IFRS-Fachausschuss®

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Mr Hans Hoogervorst
Chairman of the
International Accounting Standards Board
30 Cannon Street
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Berlin, 9 June 2015

Dear Hans,

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

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB's Exposure Draft ED/2015/1 (herein referred to as the 'ED'). We welcome the opportunity to comment on the ED and provide our answers to the specific questions raised in the ED in the appendix to this letter.

We appreciate the IASB's clarification efforts regarding the current/non-current classification of liabilities recognised in the balance sheet. We acknowledge and agree that the lack of clarity for the classification arises in part through the use of the word 'unconditional' in the current guidance of IAS 1 regarding rights to defer the settlement of a liability and that the IASB has therefore suggested to remove this term. Nonetheless, we render the view that the proposed clarifications do not answer the main questions so as to make the current/non-current classification decisions clearer and more consistent in the future.

We think it would be necessary to clarify whether and to what extent the economic substance of a right to defer settlement shall be considered and not solely the legal form of any deferral right itself. Furthermore, we cannot clearly conclude from the amended wording proposed in IAS 1 how the IASB would consider the classification of a liability in circumstances where the entity has a right to defer settlement but also has a right to early redeem the liability.

In addition, we think the IASB needs to consider the interaction of the proposals with other existing disclosure guidance. Particularly, we foresee potential cross-cutting issues regarding the disclosure of a maturity analysis in accordance with paragraph 39 (a) of IFRS 7. Users of financial statements might get confused if they are unable to reconcile the information provided by maturity analysis in the notes and a different classification of remaining maturities in the balance sheet.

Overall, we think the proposals in the ED are capable of removing some existing lack of clarity in IAS 1. However, without further clarifications, especially as regards spelling out the objective for making the current/non-current distinction and the interactions with other IFRSs, we think the IASB will receive further clarification requests on this issue, and divergence in practice is likely to continue.

If you would like to discuss any aspect of our comments further, please do not hesitate to contact Holger Obst or me.

Yours sincerely,

Andreas Barckow
President

Appendix – Additional responses to the questions of the Exposure Draft

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?

In general, we think some fundamental questions regarding the current/non-current distinction in IAS 1 *Presentation of Financial Statements* remain unanswered under the proposed amendments. Therefore, the ED proposals are, in our view, not capable of addressing the lack of clarity that exists in current guidance. We think the issues described in the subsequent paragraphs need to be addressed by the IASB in light of the current/non-current classification of liabilities.

Purpose of the distinction

We believe it is necessary to better articulate the objective of making the distinction in the balance sheet. Such an objective should help preparers in making the necessary judgement. It would also prevent from lengthy guidance for particular loan contract scenarios and arrangements.

Characteristics of an entity's right to defer settlement

We understand the IASB's conclusion for deleting the term 'unconditional' from paragraph 69(d). However, we believe the IASB needs to provide more clarity around whether the concept of substance over form still applies. In other words, it would be helpful if the IASB stated clearly whether a right to defer the settlement of a liability must be substantial and whether a strict reliance on the legal terms for settlement would not be appropriate for the current/non-current distinction, ie not provide relevant information about amount, timing and uncertainty of future cash flows.

We think that application of substance over form is necessary as, otherwise, there might be an incentive for an entity to seek including an option in a loan arrangement to defer settlement on economically unfavourable terms to achieve the favourable classification of the loan as non-current liability. Since the exercise of such an option would not be a realistic alternative at the end of the reporting period, we think classification as non-current would be inappropriate and would impair the quality of information for users. In other words, it would not appropriately depict the expected timing of cash outflows.

Management expectations

We note that the proposals in the ED focus on the right to defer settlement rather than the expectation of the timing of settlement. On the other side, paragraphs 61 and 69(a) of IAS 1 refer to an entity's 'expectation' for settling the liability. We wonder whether this conflicts with the revised criterion in paragraph 69(d). Especially, it appears to be unclear whether the criteria in paragraphs 69(a)–(d) should apply to different kinds of liabilities, ie liabilities from operating activities vs. liabilities from financing activities. We encourage the IASB to clarify the interaction of paragraphs 69(a)–(d) and paragraph 61 by stating whether the expectation of management only plays a role for the classification if the timing of settlement of the liability is not contractually determined.

From the wording of the proposed amendments, it is our understanding that it is the IASB's intention to limit the role of management expectations about the timing of cash flows and rather focus on the legally possible delays of settlement in regard of the current/non-current classification of liabilities in the statement of financial position. Within this context, we also have received feedback from our constituents that the proposed changes would impact the current reporting practice, as more liabilities would be classified as non-current obligations. Current practice focuses on the expected settlement of liabilities and not on the latest contractually possible date of settlement. Loan arrangements may not only include options to defer settlement but could also include options of early redemption. In those cases current practice would apply judgement about the likelihood of exercising any of the options. For example, liabilities are classified as current if the exercise of an early redemption option within the next twelve months is economically favourable and expected by management, even if the regular settlement date of the loan arrangement would be more than twelve months after the reporting period. This also appears to be in line with the objective of financial statements to provide information helping to prospect amount, timing and uncertainty of future cash flows. Thus, we think the IASB needs to clarify the impact of early redemption options vs. deferral options for the current/non-current classification of liabilities.

Cross-cutting issues

In addition, we think the IASB should provide further guidance about the interaction between the proposed clarifications of current/non-current classification in the balance sheet and other disclosure requirements in IFRS regarding the maturities of entity's liabilities. We are concerned that the proposed classification approach in the balance sheet might be different from the classification approach about the disclosure of maturities of entity's liabilities in the notes (eg the maturity analysis per paragraph 39 (a) of IFRS 7 *Financial Instruments: Disclosures*) without a clear justification based on different objectives. This might confuse users of financial statements and could impair the understandability of financial information.

Furthermore, we think it would be helpful to provide clarity about the interaction between the ED proposals and the existing guidance in IAS 32 *Financial Instruments: Presentation* regarding the distinction between liabilities and equity. We think guidance in IAS 32 with reference to the entity's 'unconditional right' to refuse redemption tends to focus on the legal form rather than economic substance. Therefore, we think a clarification would be necessary to better understand to what extent substance over form should play a role for the current/non-current distinction of liabilities in the balance sheet.

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 that proposed clarification.

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 transition arrangements for the amendments.