

**Draft**

**Accounting Interpretation No. 2**

**Draft-AIC 2**

**The Current / Non-current Classification in the Balance Sheet according to IAS 1**  
*Presentation of Financial Statements*

All interested parties are invited to provide their comments by **22 April 2005**. Comments will be published on the GASC website, unless accompanied by a specific request not to publish them.

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## **Introduction**

### *Accounting Interpretations Committee*

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Accounting Interpretations are adopted by the AIC after careful examination of all relevant circumstances, in particular taking account of all valid IFRSs, the Framework of the IASB and the comments received, and after carrying out hearings. The German Accounting Standards Board (GASB) has not applied its right to veto the AIC's draft Interpretation.

### *Note on application*

The Interpretations adopted by the AIC provide guidance for the accounting treatment of the relevant issues in financial statements prepared in accordance with applicable rules of the IASB, unless other specific pronouncements are issued by IFRIC or IASB.

Entities in Germany which state that their financial statements have been prepared in accordance with IFRS should therefore examine carefully whether, given all the circumstances of the individual case, application of the Interpretation is required.

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## **The Current / Non-current Classification in the Balance Sheet according to IAS 1 *Presentation of Financial Statements*<sup>1</sup>**

### **Relevant IFRSs:**

IAS 1 *Presentation of Financial Statements*

IAS 10 *Events after the Balance Sheet Date*

IAS 19 *Employee Benefits*

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

### **Background**

1. As a consequence of EU Regulation 1606/2002, all German capital market-orientated<sup>2</sup> entities are required to prepare their consolidated financial statements in accordance with IFRSs from the financial year 2005 onwards. Endorsed IFRSs represent community law and are thus mandatory for these entities. This applies equally to entities preparing consolidated financial statements in accordance with IFRSs for the first time and to entities that applied IFRSs before 2005.
2. IAS 1.53 (old version)<sup>3</sup> allowed entities to classify the balance sheet either by applying the current / non-current distinction or broadly in the order of their liquidity. This option has been eliminated in conjunction with the *IASB Improvements Project* and, under the new rules, the balance sheet is generally required to be classified using the current/non-current distinction. In addition, a number of specific rules were changed, in particular with regard to the distinction between current and non-current liabilities and, due to the adoption of IFRS 5, specific presentation rules were prescribed for the first time for non-current assets held for sale, disposal groups and related liabilities. The new rules not only result in significant divergences from the previous balance sheet classification permitted by the old version of IAS 1, but also give rise to significant divergences between the balance sheet classification prescribed by § 266 (2) and (3) HGB and that prescribed by IFRS.
3. IAS 1 is required to be applied to all separate and consolidated financial statements which are prepared in accordance with IFRSs. This applies irrespective of the sector and legal form of the reporting entity.
4. IAS 1 does not specify a detailed mandatory balance sheet classification. The format and presentation of the balance sheet are based on the minimum line items required by IAS 1.68 et seq. and in addition, when relevant accounting issues are affected, the specific requirements contained in other Standards. Additional line items must be presented on the face of the balance sheet if this is relevant to an understanding of the entity's or

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<sup>1</sup> This Interpretation deals with selected problem areas relating to the current / non-current distinction in the balance sheet and refers to important passages from IAS 1. It should be noted, however, that when this Interpretation is applied, it should always be read in the context of IAS 1 and other Standards which are relevant for the classification of the balance sheet.

<sup>2</sup> As defined by Article 4 of the EU Regulation 1606/2002.

<sup>3</sup> The term "old version" refers to the version of IAS 1 before changes in conjunction with the *Improvements Project*. When a reference is made in this Interpretation to a paragraph of IAS 1 without indicating "old version", then it refers to the most recent version of IAS 1.

group's financial position. The principles of understandability and consistency of presentation must be complied with.

5. This Interpretation only deals with questions of balance sheet classification; disclosures in the notes to the financial statements are generally not within the scope of this Interpretation. In order to illustrate the minimum requirements of IAS 1, the appendix to this Interpretation contains an example of a balance sheet.

## **Issues**

### *Issue 1*

6. Which criteria are used to distinguish between current and non-current assets when a balance sheet is prepared on the basis of the current / non-current classification?

### *Issue 2*

7. Under which circumstances is it permissible or mandatory not to classify the balance sheet on the basis of the current / non-current distinction?

### *Issue 3*

8. If the balance sheet is classified on the basis of the current / non-current distinction, is it necessary to present the current portion of non-current assets and liabilities separately, and under which circumstances is it required reclassifying items in the balance sheet?

### *Issue 4*

9. Is it permissible, in specific cases, to use the classification format prescribed by § 266 (2) and (3) HGB in separate or consolidated financial statements prepared in accordance with IFRS?

## **Consensus**

*Issue 1: Which criteria are used to distinguish between current and non-current assets when a balance sheet is prepared on the basis of current / non-current classification?*

10. Various criteria are given in IAS 1.57 and IAS 1.60 which lead to assets and liabilities being presented as current balance sheet items. It is sufficient for any one of the criteria to be satisfied.
11. The dividing line between current and non-current balance sheet items is generally 12 months. An asset is required to be classified as current if it is expected to be realised within 12 months after the balance sheet date (IAS 1.57 (c)). Similarly, a liability is required to be classified as current if it is due to be settled within 12 months after the balance sheet date (IAS 1.60 (c)).
12. Assets and liabilities which are held primarily for the purpose of being traded (see IAS 1.57 (b) and IAS 1.60 (b)), as well as cash and cash equivalents unless they are restricted from being exchanged or used to settle a liability for at least 12 months after the balance sheet date (see IAS 1.57 (d)) must always be classified as current.

13. An asset which is part of an operating cycle of an entity or group must be classified as current if it is expected to be realised within the normal course of this operating cycle (IAS 1.57 (a)). Similarly, a liability must be classified as current if it is expected to be settled within this period (IAS 1.60 (a)). This applies also if the operating cycle is longer than 12 months (IAS 1.59).
14. The operating cycle commences with the acquisition of necessary resources for processing and ends with the receipt of cash and cash equivalents as consideration for the sale of the goods or services resulting from this process (IAS 1.59).
15. IAS 1.57 (a) states that for an asset to be classified as current it has to be expected to be realised in, or is intended for sale or consumption in, the entity's normal operating cycle. Despite the use of the singular form, the criterion set out in IAS 1.57 (a) is also satisfied if several operating cycles can be identified for an entity or a group.<sup>4</sup> This means that all assets that are part of one of the identified operating cycles are required to be classified as current if they are expected to be realised within, or are intended for sale or consumption within, the duration of the relevant operating cycle. The same applies to liabilities (IAS 1.60 (a)).
16. As a general rule, the application of IAS 1.57 (a) and IAS 1.60 (a) therefore results in inventories, trade receivables and trade payables being classified as current (IAS 1.59). The same also applies to other assets and liabilities if they are part of an operating cycle of the entity or group and are expected to be realised or settled within the normal duration of that cycle.
17. If operating cycles of an entity or group differ significantly, disclosure of relevant information on these operating cycles in the notes of the financial statements is encouraged.
18. For each balance sheet line item that includes assets and liabilities, which are expected to be recovered or settled more than 12 months after the balance sheet date, it is necessary to disclose, in the notes to the financial statements, the total amount expected to be recovered or settled after more than 12 months (IAS 1.52).
19. If individual assets or disposal groups are classified as being held for sale pursuant to IFRS 5, then they are required to be presented as the last line item of current assets and designated as "non-current assets classified as held for sale", whereby this item is required to be separated from the remainder of current assets by the use of a sub-total.<sup>5</sup> Alternatively, the item "non-current assets classified as held for sale" can be presented separately below current assets.
20. Paragraph 19 applies in a similar way for liabilities included in disposal groups.
21. Although the use of the terms "current assets", "non-current assets", "current liabilities" and "non-current liabilities" in the balance sheet is not compulsory (IAS 1.58), their use

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<sup>4</sup> IAS 1.57 (a) would otherwise only be applicable if an entity or group had a single operating cycle. The consequence would be that, in the case of entities or groups with several operating cycles, the dividing line between current and non-current items would also be 12 months for inventories, so that inventories would have to be classified as non-current if longer operating cycles were identified. This, however, would contradict the explicit wording of IAS 1.59.

<sup>5</sup> See the illustration in IFRS 5, *Implementation Guidance*, Example 12 and in the appendix to this Interpretation.

is encouraged. The concept of classification into current and non-current balance sheet items differs from HGB. For this reason the terms “Anlagevermögen” for non-current assets and “Umlaufvermögen” for current assets are not appropriate.

**Issue 2:** *Under which circumstances is it permissible or mandatory not to classify the balance sheet on the basis of current / non-current distinction?*

22. IAS 1.51 requires that the balance sheet is classified applying the current / non current distinction except when a presentation based on liquidity provides information that is reliable and is more relevant.
23. A classification of the balance sheet by order of liquidity can generally only be applied by insurance entities, investment companies, equity investment companies and financial institutions (IAS 1.54), provided that the balance sheet of such entities comprises almost entirely financial instruments.
24. In exceptional cases, an entity does not have to adhere strictly to the current / non-current distinction, but is permitted in accordance with IAS 1.55 to present some of its assets and liabilities using the current / non-current classification and others in order of liquidity. However, this Interpretation explicitly encourages entities not to use this mixed basis of presentation. This also applies to highly diversified entities (for example those with significant financial operations). In contrast, it may be appropriate to sub-classify current and non-current assets and liabilities respectively by order of liquidity.
25. Entities, for which IAS 1.55 is relevant, but which apply a uniform current / non-current balance sheet classification in accordance with paragraph 24 of this Interpretation, are encouraged to disclose a classification of the relevant items by order of liquidity in the notes to the financial statements.

**Issue 3:** *If the balance sheet is classified on the basis of the current / non-current distinction, is it necessary to present the current portion of non-current assets and liabilities separately, and under which circumstances is it required reclassifying items in the balance sheet?*<sup>6</sup>

26. Intangible assets and property, plant and equipment are not separated into a current and a non-current portion. Accordingly, these items are not reclassified as current as they approach the end of their useful lives. However, in the case of intangible assets and property, plant and equipment classified as held for sale in accordance with IFRS 5, those items are required to be reclassified (see paragraph 22).
27. In the case of non-current financial assets, the portion that will be realised within 12 months after the balance sheet date is required to be presented as a current asset. Correspondingly, the portion of non-current liabilities (including provisions<sup>7</sup>) that is expected to be settled within 12 months after the balance sheet date is required to be classified as current.
28. Deferred tax assets and deferred tax liabilities shall always be presented as non-current (IAS 1.70).

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<sup>6</sup> This Interpretation does not deal with any measurement issues arising from the reclassifications described in this section.

<sup>7</sup> Since provisions in HGB financial statements often include items which are required to be classified as liabilities in accordance with IAS 37, it is important to note the distinctions between *provisions*, *accruals* and *trade payables* made in IAS 37.11.

29. The classification of liabilities as either current or non-current shall only be based on circumstances that have occurred up to the balance sheet date (IAS 1.63-66). For example, a loan which is due in the short-term shall be classified as current even if, prior to the date of authorisation of the financial statements for issue, an agreement is reached with the lender that the loan does not have to be repaid in the short-term. Therefore, events occurring between the balance sheet date and the date of authorisation of the financial statements for issue do not represent adjusting events, but rather require disclosure in accordance with IAS 10 (IAS 1.67).
30. Only in the case, when the reporting entity expects, and has the discretion, to refinance or roll over an obligation, the classification of a liability as current (see paragraph 29) is prohibited (IAS 1.64).
31. If a liability represents a provision, then both the current and non-current portion are required to be presented as a provision. As an example, the current portion of a warranty provision is required to be presented within provisions, and not within other liabilities.
32. In the case of unfunded pension plans, there is no requirement to distinguish current and non-current portions of provisions arising from post-employment benefits (IAS 19.118); however, this is explicitly encouraged.
33. In the case of funded pension plans, it is not possible to distinguish between the current and non-current portions due to the requirements in IAS 19. In this case, the asset or liability surplus recognised shall be classified as non-current unless it can be clearly demonstrated that it is current.
34. In the case of finance leases a lessee's liabilities have to be divided into a current and a non-current portion in accordance with IAS 17.23. Similarly, the lessor has to divide finance lease receivables into a current and a non-current portion.

**Issue 4:** *Is it permissible, in specific cases, to use the classification format prescribed by § 266 (2) and (3) HGB in separate or consolidated financial statements prepared in accordance with IFRS?*

35. The balance sheet format prescribed by § 266 (2) and 3 HGB does not conform to the balance sheet classification requirements set out in IAS 1. This is the case for all balance sheet classifications prescribed or permitted by IAS 1, i.e. the current / non-current classification, the classification by order of liquidity or the mixed basis of presentation. It is therefore not permitted to use the HGB balance sheet format for the purposes of reporting separate or consolidated financial statements in accordance with IFRS.

### **Transitional provisions**

36. The change in the classification of the balance sheet shall be made in accordance with IAS 1.27 (b). If the classification of the balance sheet is changed, the comparative figures shall be reclassified in accordance with IAS 1.38 and IAS 1.39.

## **Appendix: Illustrative balance sheet format**

### **Assets**

#### **Non-current assets**

Intangible assets

Biological assets

Property, plant and equipment

Investment property

Investment measured at-equity

Financial assets

Trade receivables

Other receivables

Deferred tax assets

*Total non-current assets*

#### **Current assets**

Inventories

Trade receivables

Financial assets

Other receivables

Current tax assets

Cash and cash equivalents

*Sub-total current assets*

Non-current assets classified as held for sale

*Total current assets*

**TOTAL ASSETS**

## **EQUITY AND LIABILITIES**

### **Equity**

#### **Equity attributable to equity holders of the parent**

Share capital

Reserves

Cumulative income or expense recognised directly in equity relating to a non-current asset (or disposal group) classified as held for sale

#### **Treasury shares**

#### **Minority interest**

*Total equity*

### **Liabilities**

#### **Non-current liabilities**

Provisions

Deferred tax liabilities

Financial liabilities

Trade payables

Other liabilities

Deferred government grants

*Total non-current liabilities*

#### **Current liabilities**

Provisions

Current income tax liabilities

Financial liabilities

Trade payables

Other liabilities

*Sub-total current liabilities*

Liabilities directly associated with non-current assets classified as held for sale

*Total current liabilities*

*TOTAL liabilities*

## **TOTAL EQUITY AND LIABILITIES**