



Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

Mr. Shayne Kuhaneck
Acting Technical Director
File Reference No. 2019-780
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

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Proposed Accounting Standards Update (Revised): Debt (Topic 470) – Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent)

Dear Mr. Kuhaneck:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB's simplification initiative and applaud the Board's efforts to reduce the cost and complexity of determining whether debt should be classified as current or noncurrent on a classified balance sheet. We believe the proposal would improve the transparency and comparability of information on an entity's debt arrangements that is provided to users of financial statements.

Our responses to the questions in the proposal are in Appendix A to this letter, and additional suggestions to further clarify the proposal are in Appendix B.

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We would be pleased to discuss our comments with the Board or its staff at its convenience.

Very truly yours,

Appendix A: Responses to Questions for Respondents included in the FASB's proposal**Presentation matters**

Question 1: Proposed paragraph 470-10-45-23 would preclude an entity from considering an unused long-term financing arrangement (for example, a letter of credit) in determining the classification of a debt arrangement. Would that proposed requirement simplify the guidance without diminishing the usefulness of the financial statements? Why or why not?

We believe the proposed principles-based approach that would preclude the consideration of unused long-term financing arrangements would simplify debt classification and achieve the Board's objective of reducing the cost and complexity of determining the classification of debt. Requiring entities to consider only the contractual rights of the debt arrangement itself also would provide consistent and transparent information to financial statement users.

We believe that if the Board had proposed the contractual linkage approach that it described in the Background Information and Basis for Conclusions, it would have introduced unnecessary complexity into practice. We also believe that the contractual linkage approach would be confusing to financial statement users because the classification of some debt instruments would be based solely on their terms, while the classification of other debt instruments would be based on their terms and those of other instruments with other counterparties.

We do not believe that the usefulness of the financial statement information would be diminished by requiring entities to disregard unused long-term financing arrangements when they determine the classification of debt. The proposal would promote comparability of financial statements by establishing a clear principal that focuses on the contractual rights of the instrument being evaluated rather than on other instruments or management's intent and ability to refinance. To supplement the information provided to financial statement users, entities could provide disclosures about their intent and ability to refinance short-term debt on a long-term basis in the notes to the financial statements.

However, we suggest that the Board pay particular attention to feedback from not-for-profit, business-oriented health care entities that issue variable rate demand bonds with remarketing agreements that are secured by unused letters of credit. Those debt arrangements generally are classified as noncurrent under today's guidance but would generally be classified as current under the proposal.

Question 2: The Board considered and rejected both of the following approaches in determining the classification of debt when an entity has unused long-term financing arrangements that require an entity to:

- a. Combine the debt with all unused long-term financing arrangements
- b. Evaluate the contractual linkage between debt and other financing arrangements.

In both approaches, the debt classification might change from a current liability to a noncurrent liability. (See paragraphs BC29-BC35 in this proposed Update for further information.) Is there any additional information about the expected costs and benefits, simplification of classification guidance, or operability of applying those approaches that the Board should be aware of?

While we support the Board's decision to reject the approaches discussed in paragraphs BC29 through BC35, we believe that the Board should clarify that a revolving credit arrangement that has a maturity date within the next 12 months and gives the borrower the right to convert any outstanding balances into a term loan that would have a maturity date beyond the next 12 months would not be considered current under any final guidance.

In this type of arrangement, the option to convert any outstanding borrowings into a term loan (e.g., a five-year loan) with the same lender is part of the original debt arrangement, and the conversion into a term loan would not be accounted for as an extinguishment of the revolver and the issuance of a term loan. Rather, it would be considered the same unit of account. That is, the borrower is effectively exercising an option to extend the debt's maturity date. In contrast, a debt instrument that is contractually linked to another debt instrument that has been issued by another lender would require extinguishment accounting for the revolver because the new instrument is with a different lender.

We are not aware of further information the Board should be aware of.

Question 3: Proposed paragraph 470-10-45-24 would provide classification guidance in scenarios in which an entity violates a provision of a long-term debt arrangement and the debt arrangement provides a grace period. Is that proposed guidance clear and understandable? Why or why not?

While we believe the proposed guidance is clear and understandable, we do not believe the application of this guidance results in a classification that is consistent with debt arrangements that are substantively similar. For example, a debt arrangement where the lender has the right to call the debt at some point within 12 months after the balance sheet date would require current classification under paragraph 470-10-45-22. That is clear in paragraph 852-10-45-8. While that guidance is included in the Accounting Standards Codification (ASC) topic on reorganizations, it is clear from that paragraph that a debt arrangement that will be due on demand within 12 months after the balance sheet is a current liability. That paragraph states, in part (after the proposed amendments):

852-10-45-8: Paragraph 470-10-45-22 requires current liabilities classification in a classified balance sheet for long-term liabilities that, by their terms, are due on demand or will be due on demand within one year, or the operating cycle, if longer. Current liabilities classification is required because those liabilities do not meet the criteria in paragraph 470-10-45-22

In contrast, consider a fact pattern that involves a debt arrangement in which a covenant is violated at the balance sheet date, but a contractual grace period is provided to give the borrower time to cure the violation. The grace period expires in less than 12 months after the balance sheet date, at which time the lender may demand repayment unless the borrower has cured the violation. Under the proposed guidance, that debt would be classified as noncurrent because the debt is not callable by the lender at the balance sheet date (see paragraphs 470-10-45-24, 470-10-55-3G and BC37). This

would be the case, even though the debt arrangement would become callable by the lender merely upon the passage of time, unless there is a change in circumstances. That is, the proposed guidance considers the lender's right to call the debt contingent upon the borrower not curing the covenant violation, which is inconsistent with how similar call rights are considered in other areas of US GAAP.

We do not view these debt arrangements to be substantively different. In the first debt arrangement, the lender will have the right in the next 12 months to demand repayment. For that reason, that debt arrangement would be classified as current. In the second debt arrangement, the lender will also have the right to demand repayment in the next 12 months merely by the passage of time without a change in circumstances. Yet the proposed guidance on grace periods would require that debt arrangement to be classified as noncurrent. That's because that proposed guidance considers the lender's right to demand repayment, that will become effective merely by the passage of time without a change in circumstances, as contingent.

Lenders' rights to demand repayment of debt or convert it to equity that are exercisable upon the passage of time without a change in circumstances (e.g., if an initial public offering does not occur) are generally not considered to be contingent features under the guidance on the bifurcation of puts and calls in debt instruments in ASC 815-15-25-42 and the guidance on beneficial conversion features in ASC 470-20. We do not believe such features should be considered noncontingent in these areas of US GAAP and contingent for the purposes of debt classification.

Notwithstanding the above, we understand that the Board's conclusion on the classification of debt with these redemption features was an attempt to simplify the guidance. If that is the case, to avoid confusion in other areas of US GAAP, we recommend that the Board characterize the proposed grace period guidance as an exception to the principle in paragraph 470-10-45-22 and require a separate presentation on the balance sheet of debt classified as noncurrent because of a contractual grace period, similar to the presentation requirements for debt with a waiver.

If the Board does not take our recommendation, we believe that any final guidance should explain why the Board's conclusion on debt that will become callable within one year unless a debt covenant violation is cured is different from its conclusion on debt that is callable within one year unless a remarketing is successful (e.g., variable-rate demand bonds).

Question 4: Proposed paragraph 470-10-45-22 includes a principle for classifying debt as a noncurrent liability in a classified balance sheet. Would the guidance in that proposed paragraph be operable for an entity that has a debt arrangement with contractual terms that require settlement entirely through the issuance of equity?

We do not believe the proposal would be operable in its current form. While paragraph BC21 of the Basis for Conclusions provides the Board's views on convertible debt and debt arrangements that include contractual terms that require settlement entirely in shares, how those views would be applied in practice is not clear. We believe this guidance should be clarified for the following issues and included in the body of the standard.

We believe that, in all cases, debt classification should focus on an entity's required use of current assets or creation of other current liabilities rather than on when an entity may redeem or convert debt through the issuance of equity. Therefore, we believe debt that the issuer may settle entirely in shares under all settlement alternatives should be classified as noncurrent throughout its life. This view would be consistent with current practice and the definition of current liabilities.

We observe that the last sentence in paragraph BC21 of the Basis for Conclusions would require current classification for "a debt instrument with contractual terms that require settlement entirely through the issuance of equity" when that debt instrument is contractually due to be settled within one year after the balance sheet date.

The Board acknowledged that some debt arrangements could include contractual terms that require settlement entirely in shares. In those scenarios the Board would expect that in applying the classification principle, an entity would determine the classification of that debt on the basis of when the liability is contractually due regardless of the form of settlement.

We do not believe this view would be consistent with the definition of current liabilities, which states that current liabilities are obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets or the creation of other current liabilities.

In addition, some debt instruments have contractual terms that require the issuer to settle those instruments either (1) at maturity, by issuing a variable number of shares with a fair value equal to the par amount, or (2) before maturity, by issuing a fixed number of shares (i.e., a conversion option). Such instruments, frequently referred to as convertible share-settled debt, are not uncommon in bridge loan financings.

Although paragraph BC21 of the Basis for Conclusions indicates that, when determining the classification of convertible debt, an entity should not consider the timing of when convertible debt can be converted to equity (by the holder's exercise of the conversion option), it is unclear how the last sentence of paragraph BC21 would be applied to convertible share-settled debt.

More specifically, it is not clear whether the conversion option, which generally is exercisable by the holder at any time, would require the convertible share-settled debt to be classified as current, since it could be viewed as being contractually due immediately, regardless of its maturity. Such a conclusion would be consistent with that of due-on-demand debt, which requires current classification because the debt provides the holder with the right to redeem at any time.

Disclosure

Question 5: Proposed paragraph 470-10-50-9 would require that an entity disclose additional information in the period in which the entity violates a provision of a long-term debt arrangement about the violation and the terms of the grace period. Would the proposed requirements provide decision-useful information? Why or why not?

Yes, we believe that the proposed disclosures in paragraph 470-10-50-9 would provide decision-useful information. They would alert investors about the uncured violation and the amount of the obligation that potentially could be called by the lender.

Expected costs and benefits

Question 6: The objective of this project is to reduce the cost and complexity for preparers and auditors when determining whether debt should be classified as current or noncurrent in the balance sheet while providing financial statement users with more consistent and transparent information. Given the additional changes in this revised proposed Update, will that objective be achieved? For example, would the expected benefits of the proposed amendments justify the expected costs? Why or why not?

We believe that the Board's objective would be achieved. We believe the principle in the proposal would significantly reduce complexity for most preparers, enhance financial statement users' understanding and improve comparability. We do not expect most entities to incur significant costs to implement the proposed guidance.

Appendix B: Other comments

We recommend the following clarifications to the proposal:

Debt arrangements with subjective acceleration clauses: The Board should further clarify how entities would consider ASC 855, *Subsequent Events*, when classifying a debt arrangement that includes a subjective acceleration clause (SAC) in circumstances where the entity receives notice of noncompliance of the SAC after the balance sheet date related to events that occurred before the balance sheet date.

Paragraph BC42 of the Basis for Conclusion in the proposal notes that there could be a variety of scenarios that might result in a lender notifying the borrower after the balance sheet date of its intent to exercise its right to accelerate payment of the debt, and those scenarios could include events that take place before the balance sheet date. The paragraph states, "The Board clarified that an entity would consider those events in determining the classification of debt by applying the guidance in Topic 855 only upon the trigger (that is, when the borrower is notified by the lender of noncompliance) of the subjective acceleration clause."

This would seem to require an evaluation under ASC 855 whenever a SAC is triggered after the balance sheet date but before the financial statements are issued (or are available to be issued). Such an evaluation may result in a conclusion that the debt is current when the event or condition occurred before the balance sheet date. That's because ASC 855 requires entities to recognize in the financial statements the effects of subsequent events that provide additional evidence about conditions that existed at the balance sheet date.

Paragraph 470-10-55-41 would provide an example of a debt instrument with a SAC and conclude that because the borrower has not received any notification from the lender as of the end of the reporting period, the debt is noncurrent. However, the paragraph would not consider whether a notification is received after the balance sheet date but before the financial statements are issued (or are available to be issued). Paragraph BC42 would seem to require such a consideration because a notification received after the balance sheet date but before the financial statements are issued (or are available to be issued) would require an analysis under ASC 855 to determine classification. We suggest that the Board revise the example to include such a consideration or add a separate example to illustrate the view in paragraph BC42.

In addition, the summary section of the proposal on the top of page 4 states that "the subjective acceleration clause *would* [emphasis added] affect the classification of debt when it is triggered." This could be read as current classification of long-term debt always being required when the SAC is triggered after the balance sheet date but before the financial statements are issued (or are available to be issued). We suggest following revisions to that sentence:

The amendments in this proposed Update would remove that probability assessment, and, instead, the subjective acceleration clause ~~would~~could affect the classification of debt only when it is triggered.

Clarifications on the scope: Paragraph 470-10-15-4 would include in the scope of the proposal liability-classified mandatorily redeemable financial instruments that are in the scope of ASC 480-10. The proposal would also apply to debt instruments settled entirely in shares. It is unclear whether a financial instrument that embodies an unconditional obligation to issue a variable number of shares under ASC 480-10-25-14 would be in the scope of the proposal. That's because paragraph 470-10-15-4 of the proposal could be interpreted to exclude from its scope all instruments classified as liabilities under ASC 480-10, except for mandatorily redeemable financial instruments. The Board should clarify the scope of this proposal in paragraph 470-10-15-4.