

MINUTES



To: Board Members
From: Nesta (ext. 330)
Subject: Minutes of the June 4, 2003 Board Meeting **Date:** June 6, 2003
cc: Bielstein, Leisenring, Petrone, Smith, Swift, Polley, J. Johnson, Coburn, Tovey, Nesta, Cassel, Kazazean, Thompson, Allen (GASB), Bean (GASB), FASB Intranet (e-mail), Vernuccio, Sutay, Gabriele

Topic: Liability Classification

Basis for Discussion: Memorandum dated May 16, 2003

Length of Discussion: 9:00 a.m. to 9:45 a.m.

Attendance:

Board members present: Crooch, Foster, Herz, Schieneman, Schipper, Trott, Wulff

Board members absent: None

Staff in charge of topic: J. Johnson

Other staff at Board table: Bielstein, Leisenring, Cassel, Coburn, Kazazean, Nesta

Outside participants: Marie-Christine Batt (IASB, via phone)

Summary for ACTION ALERT:

The Board discussed the balance sheet classification of short-term obligations expected to be refinanced and the balance sheet classification of obligations due on demand because of breach of a borrowing agreement. The Board decided the following:

- To converge with the IASB position that a long-term financial liability due to be settled within 12 months of the balance sheet date should be classified as a current liability, unless an agreement to refinance the liability on a long-term basis is completed on or before the balance sheet date. The current practice of classifying such liabilities as current if a financing agreement is completed after the balance sheet date but before the financial statements are authorized for issue would no longer be permitted.
- To retain the application guidance currently included in U.S. GAAP that establishes conditions which must be met for a financing agreement in place at the balance sheet date to be considered evidence of an ability to consummate a refinancing
- That a long-term financial liability payable on demand at the balance sheet date because the entity breached a condition of its loan agreement should be classified as current, unless
 1. the lender has agreed on or before the balance sheet date to not demand payment as a consequence of the breach (convergent with the IASB position) or
 2. the lender has agreed on or before the balance sheet date to provide a period of grace within which an entity can rectify the breach, the obligation is not callable during that time, and either (1) the entity rectifies the breach within the period of grace, or (2) at the time that the financial statements are issued, it is probable that the breach will be rectified within the period of grace (consistent with existing U.S. GAAP).
- To ask the staff to explore the implications of adopting the IASB's definition of current assets and current liabilities.

Matters Discussed and Decisions Reached:

Mr. Johnson stated that the Board was being asked to answer the four questions in the attached handout. He stated that the first question concerned the classification of a liability due within one year from the balance sheet date that is expected to be refinanced. He stated that the staff recommended convergence

with the IASB position that a long-term financial liability due to be settled within 12 months of the balance sheet date should be classified as a current liability, even if an agreement to refinance on a long-term basis is completed after the balance sheet date and before the financial statements are authorized for issuance.

The Board agreed with the staff recommendation. Board members noted that the balance sheet should reflect conditions that exist at the balance sheet date, and an entity's refinancing of debt after the balance sheet date is a post-balance sheet event that should not be recognized in the balance sheet of the period prior to the refinancing event. Board members also noted that entities that did not have an agreement in place at the balance sheet date but entered into a refinancing agreement after the balance sheet date would be able to disclose that fact.

Mr. Johnson stated that, in light of the Board's first decision, the Board would need to decide whether to retain the guidance in current U.S. GAAP that establishes conditions which must be met for a financing agreement in place at the balance sheet date to be considered evidence of an ability to consummate a refinancing.

The Board decided to retain that application guidance. Board members noted that the application guidance provides explicit information for entities to consider when evaluating their refinancing agreements, which eliminates potential ambiguity that would arise in determining whether an entity has the intent and ability to refinance an obligation. The Board directed the staff to work with the IASB staff to ask the IASB to consider incorporating that guidance into their standard.

Mr. Johnson stated that the third question for the Board to answer concerned the classification of liabilities due within one year of the balance sheet date because of a violation of a debt covenant. He asked the Board to decide whether to

converge with the IASB position that a long-term financial liability that is payable on demand at the balance sheet date because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date even if the lender agreed after the balance sheet date, and before the financial statements are authorized for issuance, not to demand payment as a consequence of the breach. The Board decided to converge with the IASB position.

The Board decided that if a lender has agreed by the balance sheet date to provide a period of grace within which an entity can rectify a breach of a condition of its loan agreement and during that time the obligation is not callable, the obligation is classified as noncurrent if it is due for settlement, absent the breach, at least 12 months after the balance sheet date, and either (1) the entity rectifies the breach within the period of grace, or (2) at the time that the financial statements are issued, it is probable that the breach will be rectified within the period of grace. Mr. Herz and Mr. Crooch disagreed with the Board's decision, noting that they would prefer to require current classification if the breach is not rectified at the time that the financial statements are issued, regardless of the probability that the breach could be subsequently rectified.

Some Board members noted that the decisions are consistent with the general principle that conditions existing at the balance sheet date should determine liability classification. Ms. Batt noted that the Board's decision is consistent the IASB's Exposure Draft in its improvements project but is not consistent with the IASB's decision made subsequent to the exposure period. She added that the term "probable" implies a lower threshold of likelihood internationally than in the United States and that the IASB was uncomfortable with the classification of debt as noncurrent when there was a substantial degree of likelihood that the violation would not be cured.

Mr. Johnson then asked the Board whether it wanted to converge with the IASB on the definitions of current assets and current liabilities. He stated that the staff

believes that the practical effects of the differing definitions are limited to the issues the Board had already discussed during the meeting. He added, though, that the short-term convergence project provides the Boards an opportunity to revisit their respective definitions with the objective of converging them.

The Board directed the staff to explore the implications of adopting the IASB's definition of current assets and current liabilities.

Follow-up Items:

The Board directed the staff to explore the implications of adopting the IASB's definition of current assets and current liabilities.

The FASB staff will ask the IASB to consider whether to add the application guidance currently included in U.S. GAAP that establishes conditions which must be met for a financing agreement in place at the balance sheet date to be considered evidence of an ability to consummate a refinancing.

General Announcements:

None