October 17, 2019

Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2019-780
Re: Proposed Accounting Standards Update (Revised), Simplifying the Classification of Debt in a Classified Balance Sheet (Current Versus Noncurrent)

Dear Mr. Kuhaneck:

Deloitte & Touche LLP is pleased to comment on the FASB’s revised proposed Accounting Standards Update (ASU), Simplifying the Classification of Debt in a Classified Balance Sheet (Current Versus Noncurrent).

We support the Board’s efforts to reduce unnecessary cost and complexity in the application of generally accepted accounting principles (GAAP). We believe that the revised proposed ASU would further these efforts by establishing a unified debt classification principle that is centered on a debt arrangement’s terms and conditions as of the balance sheet date. We expect that such a principle will be easier to apply than the existing patchwork of requirements for classifying debt arrangements as current or noncurrent and result in more consistent and meaningful information for financial statement users. Accordingly, we support finalization of the revised proposed ASU. As discussed in the appendixes to this letter, however, we recommend that the Board clarify and revise certain aspects of the proposal.

Appendix A contains our responses to the revised proposed ASU’s questions for respondents, and Appendix B contains other comments.

We appreciate the opportunity to comment on the revised proposed ASU. If you have any questions concerning our comments, please contact Ashley Carpenter at (203) 761-3197 or Jon Howard at (203) 761-3235.

Yours truly,

Deloitte & Touche LLP

cc: Ashley Carpenter
    Jonathan Howard
    Robert Uhl
**Appendix A**

**Deloitte & Touche LLP**

**Responses to Revised Proposed ASU’s Questions for Respondents**

**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?

Yes. We believe that this proposed requirement would simplify the guidance, and with appropriate disclosures by an entity, the usefulness of the resulting information would not be diminished. If the Board were to require or permit an entity to consider unused long-term financing arrangements in determining the classification of a debt arrangement, the entity would need to consider its intent and expectations about whether and how it might refinance the debt arrangement. However, such an approach would be inconsistent with the proposed debt classification principle.

Our understanding is that the debt arrangements described in Example 2 of ASC 470-10-55-7 and 55-8 would be classified as a current liability under the revised proposed ASU because proposed ASC 470-10-45-23 prohibits an entity from considering an unused long-term financing arrangement. However, the deletion of this guidance may create confusion in practice as to how the proposed debt classification principle applies. Therefore, we suggest that the FASB retain this example and amend the language to illustrate the application of the proposed debt classification principle.

Further, our understanding is that the debt arrangements described in Example 2 of ASC 470-10-55-7 and 55-8 generally do not become due within 12 months from the balance sheet date because the remarketing rarely fails. As a result, we suggest that the FASB consider the following:

- Requiring disclosures that are useful to investors when debt arrangements are classified as current liabilities but are not anticipated to require repayment within 12 months.
- Ascertaining whether certain entities may need additional time to restructure such agreements to avoid negative ramifications arising from the reclassification of such liabilities from long term to current (e.g., covenant violations that may result from the change in accounting).

**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?

No. There is no additional information about the expected costs and benefits, simplification of classification guidance, or operability of applying those approaches that we are aware of. We expect that these alternative approaches would increase the cost and complexity of the application of the guidance.
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?

Yes. The proposed guidance is consistent with the Board’s proposed debt classification principle.

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?

No. The proposed wording of ASC 470-10-45-22 is inconsistent with the Board’s explanation in paragraph BC21 of the revised proposed ASU regarding how the guidance should be applied. While the proposed wording of ASC 470-10-45-22(a) requires a liability to be classified as noncurrent if it is “contractually due to be settled more than one year . . . after the balance sheet date,” it does not specify the form of settlement (e.g., current or noncurrent assets or equity shares). However, paragraph BC21 implies that an entity would classify the debt on the basis of “when there is a required use of current assets” unless the contractual terms require settlement entirely in shares. Further, ASC 210-10-20 defines current liabilities as “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.” If a debt agreement contractually stipulates that settlement must occur entirely in shares (or allows the obligor to elect to settle in shares), it would not require the use of current assets or the creation of other current liabilities. Accordingly, we believe that the arrangement should not be classified as a current liability even if it is contractually required to be converted into the debtor’s equity shares within one year of the balance sheet date. We recommend that the Board clarify the proposed guidance in a manner consistent with the definition of current liabilities in ASC 210-10-20.

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?

We believe that users of financial statements are best positioned to provide views on this question to the Board.

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?

Yes. We expect that the proposed debt classification principle will be easier to apply and result in more consistent and meaningful information than the existing debt classification requirements in GAAP, which lack a unified principle for determining whether debt should be classified as current or noncurrent.
Appendix B
Deloitte & Touche LLP
Other Comments

ASC 470-10-45-25

As discussed below, we recommend that the Board simplify the guidance on waivers of covenant violations in proposed ASC 470-10-45-25 by eliminating conditions (b) and (d). These conditions are inconsistent with the proposed debt classification principle in proposed ASC 470-10-45-22, so their elimination would result in a simpler and more consistent approach to debt classification. Further, because proposed ASC 470-10-45-26 and ASC 470-10-50-8(c) require separate presentation and disclosure of debt subject to covenant waivers, financial statement users would receive information about the related amount and terms.

- **Proposed ASC 470-10-45-25(b).** We question the need for a waiver to be for a period greater than one year (or operating cycle, if longer) from the balance sheet date as opposed to a simple statement that a debtor has received a waiver for the specific covenant violation. If a waiver has been received for a specific covenant violation, the lender has waived its right to demand payment arising from that covenant violation and the debt arrangement’s terms and conditions as of the balance sheet date would dictate a noncurrent classification on the basis of the legal rights and obligations that exist as of the balance sheet date (provided that one of the criteria in proposed ASC 470-10-45-22 would have been met in the absence of the covenant violation). Accordingly, we recommend that the Board eliminate the requirement that the waiver extend for a period greater than one year from the balance sheet date.

If this requirement is retained, we question the necessity of referring to subsequent interim measurement dates within one year (or operating cycle, if longer) after the balance sheet date in proposed ASC 470-10-45-25(d) and ASC 470-10-55-3A.

- **Proposed ASC 470-10-45-25(d).** This proposed condition requires the borrower to determine “that it is not probable that any other covenants in the debt arrangement will be violated for 12 months (or operating cycle, if longer) from the balance sheet date (that is, through the date of the next annual balance sheet).” This is inconsistent with the proposed debt classification principle, which would require long-term debt obligations to be classified as noncurrent even if the borrower is expected to violate a debt covenant after the balance sheet date when either (1) no covenant violation had occurred as of the balance sheet date or (2) a covenant violation had occurred as of the balance sheet date but the borrower received a waiver before the balance sheet date. That is, because a debtor is not required to assess the probability of whether any other covenants in the same debt arrangement will be violated for 12 months (or operating cycle, if longer) from the balance sheet date when no covenant violation exists as of the balance sheet date, it is unclear why a debtor should be required to assess such expected violations if it has received a waiver. Further, this condition is inconsistent with the guidance on grace periods, which does not require any assessment of the likelihood that they will be met in a subsequent period. Accordingly, we recommend that the Board eliminate this condition.

ASC 470-10-55-3E

Proposed ASC 470-10-55-3E illustrates a situation whereby a borrower obtains a waiver from a covenant violation but continues to classify the debt arrangement as a current liability because the criterion in proposed ASC 470-10-45-25(c) has not been met because the modification is being accounted for as an extinguishment under ASC 470-50. ASC 470-50-40-12(c) states, “[i]f either the new debt instrument or the
original debt instrument is callable or puttable, then separate cash flow analyses shall be performed assuming exercise and nonexercise of the call or put. The cash flow assumptions that generate the smaller change would be the basis for determining whether the 10 percent threshold is met.” In accordance with this guidance, in performing the 10 percent cash flow test in ASC 470-50-40-10, the borrower may consider the new (or modified) debt instrument to not be prepayable since early repayment would occur only from a future covenant violation, which is not considered a likely outcome given the modification. However, the borrower may evaluate the old (or premodified) debt instrument to be one that, in absence of the modification and waiver, is currently prepayable because of the covenant violation. To prevent the example in proposed ASC 470-10-55-3E from creating an unintended consequence regarding the application of ASC 470-50-40-12(c), we suggest that the Board amend proposed ASC 470-10-55-3E as follows (added text is underlined and deleted text is struck out):

**470-10-55-3E** Assume the same facts as in Case A (the borrower violates a covenant as of December 31, 20X1), except that in granting the waiver the lender modifies the debt arrangement to significantly increase the borrower’s interest rate. The borrower concludes that the modification does not result in a troubled debt restructuring under Subtopic 470-60. However, the borrower concludes that the criterion in paragraph 470-10-45-25(c) has not been met because the modification will be accounted for as an extinguishment under Subtopic 470-50 in 20X2 because the original instrument and the new instrument are not prepayable and the increase in the interest rate changed the present value of cash flows under the terms of the original instrument by at least 10 percent. (Note that in performing the evaluation prescribed by paragraph 470-50-40-10, the borrower considered the guidance in ASC 470-50-40-12.) Thus, the borrower classifies the debt as a current liability as of December 31, 20X1, in its classified balance sheet. The borrower also complies with the disclosure requirements in paragraph 470-10-50-8.