October 28, 2019

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

File Reference No. 2019-780

The Accounting Principles Committee of the Illinois CPA Society (“Committee”) appreciates the opportunity to provide its perspective on the Financial Accounting Standards Board’s (“FASB” or the “Board”) Proposed Accounting Standards Update (“ASU”) (Revised), Simplifying the Classification of Debt in a Classified Balance Sheet (Current Versus Noncurrent) (Topic 470) (“Update”). The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

We support the FASB’s simplification in the accounting for the classification of debt and agree the current guidance is disparate and difficult to navigate. We support the Update’s principle that an entity should classify debt based on the terms and conditions of the debt arrangement because that will provide more useful information to financial statement users in assessing an entity’s liquidity and financial condition. However, we have specific concerns with the Update. In particular, we do not believe debt arrangements which are settled solely through the issuance of equity should be included in the scope of the classification principle and included in current liabilities. We also do not believe there is a meaningful difference between debt arrangements in default at the balance sheet date (and subject to a grace period cure), where in one scenario, a waiver is received before the financial statements are issued/available to be issued, and another scenario a waiver is not received, yet in both cases the borrower does not expect to be able to cure the default. The Update would result in different classification outcomes in these situations, which we believe would not faithfully depict the borrower’s financial condition or liquidity. We also do not believe a waiver which gives rise to either an extinguishment or a troubled debt restructuring should preclude noncurrent liability classification, or that debt should be separately classified in noncurrent liabilities solely because a waiver has been received.

Our response to the questions and our discussion of our concerns with the Update is included below.

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We appreciate the opportunity to provide our comments and observations on the Update and would be pleased to discuss them with the Board members or the FASB staff at your convenience.
Sincerely,

**Brian Kot, CPA**  
Chair, Accounting Principles Committee

**William Keirse, CPA**  
Vice Chair, Accounting Principles Committee
**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?

**Response:** Yes. We believe the proposed requirement would simplify the guidance without diminishing the usefulness of the financial statements.

**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?

**Response:** No, we are not aware of any additional information that the Board should be aware of related to this issue. We also do not believe either alternatives would not reduce cost or complexity as intended by the Board.

**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?

**Response:** No. We believe that proposed guidance in paragraph ASC 470-10-45-24 is not clear and understandable as drafted. Some committee members do not believe it results in a classification that will provide relevant information to users of the financial statements. Those members do not believe that there should be different classification outcomes for (1) a debt arrangement in default at the balance sheet date and subject to a grace period where the borrower does not expect to be able to cure the event of default or other covenants 12 months from the balance sheet date and (2) a debt arrangement in default at the balance sheet date for which the borrower has obtained a waiver and does not expect to be in compliance with the covenant or other covenants when it is required to assess 12 months from the balance sheet date.

If the Update is adopted as drafted, some committee members believe the criteria in paragraph ASC 470-10-45-22 may be interpreted differently resulting in different conclusions when a debt covenant is violated at the balance sheet date and the arrangement provides a grace period for the borrower before the lender can demand repayment of the debt. Those committee members believe some may conclude neither criteria in paragraph ASC 470-10-44-22 are met because the ability to defer settlement is contingent upon curing the default within the grace period, resulting in current classification. Others believe the
illustration in ASC 470-10-55-3G and the Basis for Conclusions provides clarification to these fact patterns leading some to conclude the liability should be classified as noncurrent. If noncurrent classification is what the Board had intended for these situations, we recommend to the Board to clarify paragraph ASC 470-10-45-24 similar to that provided in transactions governed by paragraph ASC 470-10-45-25. For example, the Board could amend proposed sentence in paragraph ASC 470-10-45-24 to read as follows (inserted text underlined; deleted text line through):

\textit{470-10-45-24 Some long-term loans require compliance with certain covenants that must be met on a periodic or ongoing basis. When a debt covenant is violated at the balance sheet date, the debt arrangement may provide a grace period for the borrower to become compliant, in which case the lender cannot demand repayment of the debt at the balance sheet date. That debt shall be classified as a noncurrent liability if one of the criteria in paragraph 470-10-45-22 would have been met absent the covenant violation. See paragraph 470-10-55-3G for an illustration.}

We also recommend the Board to provide an additional illustration for situations where a loan covenant violation at the balance sheet date may not be cured within the grace period and where the grace period expires prior to the date the financial statements are issued or available to be issued. That illustration would be similar to the one described in ASC 470-10-55-3G except modified where the borrower’s financial statements are issued after the balance sheet date, at which time the violation of the covenant has not been cured and after the grace period, at which time the violation of the covenant has not been cured. Based on the Update, we believe in those situations the debt is classified as noncurrent at the balance sheet date and the non-cured covenant violation is a non-recognized subsequent event not impacting the debt’s classification at the balance sheet date. If that was the Board’s intention, we recommend the Board clarify in an illustration.

The committee (including those members who disagree with noncurrent classification) believes debt that is in default at the balance sheet date and subject to a grace period which has not been cured prior to the date the financial statements are issued or available to be issued should be subject to the presentation requirements proposed in paragraph ASC 470-10-45-26 for the reasons noted by the Board in paragraph BC49. However, we do not believe that proposed presentation requirement in paragraph ASC 470-10-45-26 should apply to debt arrangements classified as noncurrent because of a waiver or forbearance agreement obtained after the balance sheet date but before the date the financial statements are issued or available to be issued because they are still considered noncurrent liabilities similar to any other noncurrent liability under the Conceptual Framework for Financial Reporting. We believe the proposed disclosure requirements noted in our response to question 5 below would provide users better decision-useful information versus the proposed classification in paragraph ASC 470-10-45-26 for those debt arrangements classified as noncurrent because of a waiver or forbearance agreement obtained after the balance sheet date.
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?

Response: No. We do not believe paragraph ASC 470-10-45-22 should apply to those debt arrangements which are solely convertible/settled through the issuance of equity because the terms “settled” and “settlement of a liability” are not sufficiently defined. We note the Board indicated in paragraph BC21 it would expect those debt arrangements to be classified based on “when the liability is contractually due regardless of the form of settlement” which would imply these debt arrangements could be classified as current liabilities even if they don’t use an entity’s current assets or do not affect the entity’s liquidity. If that is the Board’s intention it should further clarify paragraph ASC 470-10-45-22 relative to those debt arrangements. However, we do not support current liability classification of these debt arrangements for the reasons noted by the Board in paragraph BC21. Because there is no required use of current assets, such as cash, or creation of other current liabilities to settle these debt arrangements, we believe current liability classification would not provide decision useful information to financial statement users.

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?

Response: Yes. We believe paragraph 470-10-50-9 would provide decision-useful information. We also recommend the Board consider disclosure requirements similar to those required under ASC 235-10-S99-1 (SEC Rule 4-08(c) of Regulation S-X) which would require disclosing when the “cure” is not probable within the grace period as well as cross-default provisions with other debt arrangements. We believe this will provide useful information to financial statement users.

We also believe the Board should require disclosure of the significant terms of debt instruments, particularly those with subjective acceleration clauses. That disclosure would include the types of provisions that a lender could cite to accelerate the maturity of the debt. Further, we believe the Board should require the reporting entity to provide its assessment of whether the lender has the right to exercise the subjective acceleration clause at the date of the financial statements.

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?
Response: We generally believe the revised Update will achieve the Board’s objective; however, we believe the requirement in paragraph ASC 470-10-45-25(c) will continue to add cost and complexity to accounting for debt arrangement classification. We do not believe an entity should be required to determine whether any modification accompanying the waiver qualifies as an extinguishment or a troubled debt restructuring. We believe such a requirement will increase the cost of applying the exception unnecessarily and require additional time in issuing financial statements. The entity will effectively have to determine the accounting for the transaction even though the accounting outcome will not affect the measurement of the liability at the reporting date, and the auditor will have to audit the reporting entity’s proposed accounting in order to be able to issue its report. We note waivers are typically received near completion of an audit and the date the financial statements are due (e.g., SEC filing or bank debt reporting deadline) which may affect the entity’s financial reporting timing and have unintended consequences (e.g., entities could be motivated to defer the timing of waivers until after the financial statements are issued or available to be issued) to avoid current liability classification. Even if a modification accompanying the waiver results in an extinguishment or a troubled debt restructuring, the modification did not require the use of any of the reporting entity’s assets or the creation of current liabilities. We do not believe the Board has provided a basis for why a modification that results in an extinguishment or a troubled debt restructuring should be present as a current liability at the date of the financial statements.
The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee’s comments reflect solely the views of the Committee and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to fully study and discuss exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

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**Staff Representative:** Rafael Wiesenberg, CPA

- Illinois CPA Society