October 28, 2019

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


Dear Mr. Kuhaneck:

We appreciate the opportunity to comment on the revised proposed ASU, Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent). We support the Board’s objective to identify, evaluate and improve areas of GAAP in which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to financial statement users.

We generally believe that the proposals would reduce complexity, consistent with the Board’s objectives in undertaking this project.

This cover letter summarizes our key observations. Appendix I provides our detailed responses to the Board’s Questions for Respondents. Appendix II provides our other observations and recommendations.

Classification principle

In current GAAP, the underlying principle for classifying debt is based on the definition of current liabilities in the Master Glossary, which states “Current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of current liabilities.” [Emphasis added.] The manner in which an entity applies that definition informs the entity’s users about the entity’s expectations and liquidity position as of the balance sheet date.

The proposals would introduce a new principle under which classification of debt would be based on the contractual terms of the debt arrangement as of the balance sheet date rather than the expected timing of cash flows, which is inconsistent with the definition of current liabilities in the Master Glossary. If the Board finalizes the proposals as issued, we recommend that the Board revise the definition of current liabilities in the Master Glossary to align with the proposed principle so that the principle applies to the classification of all liabilities. Alternatively, we recommend that the Board clarify in the definition of current liabilities that additional guidance
about how to apply the definition to debt arrangements in the scope of Subtopic 470-10 is found in that subtopic.

**Interaction with current assets classification**

The classification of assets would continue to be based on the definition of current assets in the Master Glossary, which states “Current assets is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.”

We believe the definitions of current assets and current liabilities are interrelated and, in some situations, the proposed debt classification principle will create a disconnect between them, which may affect certain metrics, such as working capital and current ratio, that are important for users of financial statements.

For example, assume an entity enters into a five-year debt arrangement that stipulates that if the borrower sells certain assets during the life of the debt arrangement, a percentage of the proceeds from the sale of the assets must be used to pay down the outstanding debt. At the end of year two of the debt agreement, the borrower designates certain assets as held-for-sale with the intention to sell the assets in the next twelve months. Based on the definition of current assets, the entity classifies the assets held-for-sale as current on the balance sheet. Under current GAAP, the amount of debt expected to be paid down within the next twelve months using the proceeds received from the sale may, in certain circumstances, be classified as current. However, under the proposed classification principle, at the end of year two, the debt arrangement would satisfy the criteria in proposed paragraph 470-10-45-22(a) to be classified as non-current. Therefore, although a portion of the proceeds from the sale of the assets will be used to pay down the outstanding debt within the next twelve months, the proposals would require the entire amount of outstanding debt to be classified as non-current. We recommend that the Board consider the interaction with current assets classification before finalizing the proposals. Our response to Question 6 in Appendix I provides additional discussion on this point.

If you have questions about our comments or wish to discuss the matters addressed in this comment letter, please contact Kimber Bascom at (212) 909-5664 or kbascom@kpmg.com, Mahesh Narayanasami at (212) 954-7355 or maheshnarayanasami@kpmg.com, or Patrick Garguilo at (212) 954-2852 or pgarguilo@kpmg.com

Sincerely,

KPMG LLP
Appendix I – Responses to Selected Questions for Respondents

Question 1:

Proposed paragraph 470-10-45-23 would preclude any 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?

The proposed requirement would simplify the guidance. However, we believe it would significantly affect the balance sheets of entities that issue variable rate demand obligations with a remarketing agreement secured by an unused long-term financing arrangement. Entities in the healthcare and not-for-profit industries frequently use these instruments and would be most affected by the change in guidance. In general, the proposed requirement would cause issuers to classify variable rate demand obligations as current liabilities. We believe this change in practice would substantially affect the usefulness of certain financial metrics (e.g. current ratio) unless financial statement users make adjustments based on the disclosures in the notes to the financial statements. We believe this change in practice also may prompt these entities to enter into more expensive debt arrangements, without a corresponding economic benefit, to avoid noncurrent classification.

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?

We understand that variations of both approaches are currently applied in practice based on the definition of current liabilities in the Master Glossary. We believe that preparers and users are in the best position to comment on the expected costs and benefits, and operability of applying those approaches.

The proposals to simplify the debt classification guidance introduce a principle for classifying debt that is inconsistent with how the definition of current liabilities in the Master Glossary has been interpreted and applied in practice. If the Board finalizes the proposals as issued, we recommend that the Board revise the definition of current liabilities in the Master Glossary to align with the proposed principle so that the principle applies to the classification of all current liabilities. Alternatively, we recommend that the Board clarify in the definition of current liabilities.
liabilities that additional guidance about how to apply the definition to debt arrangements in the scope of Subtopic 470-10 is found in that subtopic.

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?

We believe the guidance in proposed paragraph 470-10-45-24 is clear and understandable. Proposed paragraph 470-10-45-26 would require entities to present separately in a classified balance sheet debt that is classified as a noncurrent liability for which the entity obtained a waiver or forbearance agreement after the balance sheet date. We recommend that the Board similarly require separate presentation in a classified balance sheet of debt arrangements classified as noncurrent for which the entity violated a covenant when the grace period extends beyond the balance sheet date.

See also our suggested amendments to paragraph 470-10-55-3G in Appendix II.

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?

Based on the language in paragraph BC21, we infer that the Board did not intend that the form of settlement of the debt (i.e. settlement in cash, other assets, or the entity’s own shares) would affect how an entity classifies the debt in its balance sheet. Thus, the proposed classification principle can be applied to a debt arrangement with contractual terms that require settlement entirely through the issuance of equity.

As a result of some of the language in paragraph BC21, it is unclear how an entity would apply the classification principle to debt that is convertible to equity at the balance sheet date. Paragraph BC21 states in part, “In applying the debt classification principle to convertible debt, an entity would classify that debt on the basis of when the liability is contractually due to be settled (that is, when there is a required use of current assets) rather than on the timing of the conversion of debt to equity.”

This proposed language suggests that classification of convertible debt is based on when it is contractually due to be settled (i.e. maturity date) rather than the timing of potential conversion. In addition, the use of the phrase “when there is a required use of current assets” appears to contradict the language in paragraph BC21 that the form of settlement does not affect balance sheet classification. Further, the proposed edits to paragraph 470-20-45-3 do not sufficiently clarify how to classify convertible debt.
We recommend that the Board clarify proposed paragraph BC21, move the guidance into the body of the final ASU and provide additional examples to illustrate how an entity would apply the proposed classification principle to common convertible debt arrangements, including those arrangements for which, on conversion, the issuer:

a. must settle the principal amount in cash and can settle the conversion premium in any combination of cash or shares,

b. can settle the entire conversion value in cash, shares, or any combination of cash and shares.

**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 understand that the disclosures in proposed paragraph 470-10-50-9 would be required only if (1) a grace period expires after the balance sheet date, (2) the covenant violation has not been cured before the financial statements are issued (or are available to be issued) and (3) the failure to cure the violation would give the lender the right to demand payment of the long-term debt arrangement when the grace period expires. The disclosure requirements do not appear to apply if the grace period expires after the balance sheet date and the entity cured its covenant violation before the financial statements were issued (or were available to be issued). We believe that disclosures about the terms of the grace period and the fact that the entity actually cured the covenant violation may be relevant and decision-useful and recommend that the Board consider addressing those scenarios in the final disclosure requirements.

In addition, we recommend that the Board retain proposed paragraph 470-10-50-6(d) from the 2017 proposals, which would require an entity in default to describe the course of action that it took, or that it proposes to take, to remedy the deficiency. We believe this disclosure provides decision-useful information to the users of the financial statements.

**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?*
There are aspects of the proposals that would reduce the cost and complexity for preparers and auditors. However, we believe some elements of the proposals could be seen as counterintuitive and/or potentially confusing to financial statement users in some situations. In addition to the example discussed in our cover letter, the following situations could give rise to counterintuitive financial reporting results.

**Use of judgment in current GAAP**

Because the proposed ASU focuses exclusively on circumstances that exist at the balance sheet date (with the exception of covenant waivers), the resulting debt classification could be seen as counterintuitive and/or potentially confusing to financial statement users in some situations. We believe the amendments that would preclude the consideration of (a) unused long-term financing arrangements, (b) subsequent refinancing after the balance sheet date, and (c) a probability assessment in analyzing subjective covenant provisions of a debt arrangement when an entity has not violated a covenant as of the balance sheet date, would have the most impact. For example, an entity in strong financial health may have more debt arrangements classified as current despite having secured other long-term financing arrangements or refinancing short-term debt on a long-term basis after the balance sheet date. Conversely, an entity in poor financial health may have more debt arrangements classified as noncurrent despite the probability that a subjective covenant provision would be triggered in the 12 months (or operating cycle, if longer) from the balance sheet date.

**Subjective acceleration clauses**

Under the proposals, the classification of debt with subjective acceleration clauses is based on the timing of when the lender notifies the borrower rather than on the events or circumstances that existed at the balance sheet date. Proposed paragraph 470-10-55-41 provides a fact pattern in which a borrower has an outstanding loan agreement that contains a subjective acceleration clause. As of the end of the reporting period, the borrower has not received any notification from the lender that it is not in compliance with the subjective acceleration clause. As of the end of the reporting period, the borrower has not received any notification from the lender that it is not in compliance with the subjective acceleration clause. The borrower also determines that both of the criteria in proposed paragraph 470-10-45-22 are met. Therefore, the borrower classifies the debt as a noncurrent liability as of the balance sheet date. In practice, the borrower may only provide the information the lender needs to determine whether or not a subjective acceleration clause has been triggered after the balance sheet date (for example, the most recent financial statements, or communication about the loss of a major customer that occurred before the balance sheet date).
Appendix II – Other Observations and recommendations

Debt arrangements that are due on demand, or puttable

Based on the language in paragraph BC20, we infer that debt arrangements that are due on demand, or puttable by the holder would not meet the criteria for noncurrent classification under the proposals because the lender has the contractual right to require settlement of the liability in less than one year. The Board has proposed similar guidance in the proposed revisions to paragraph 852-10-45-8, which states:

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.

The guidance in proposed paragraph 852-10-45-8 for classifying debt that is due on demand, or puttable by the holder is clear. To enhance the guidance in Subtopic 470-10, we recommend that the Board clarify the classification principle in paragraph 470-10-45-22 to address debt arrangements that are due on demand or puttable by the holder. In addition, we recommend that the Board retain Example 2 in existing paragraphs 470-10-55-7 – 55-9 (which the proposals would delete), which will help illustrate scenarios where remarketing agreements exist for puttable debt instruments.

Contingent demand features

Many debt arrangements include features that allow the holder to demand payment from the issuer contingent on the occurrence of an event. We believe these features can take many forms, including contingent put options, subjective acceleration clauses, debt covenants, and other default provisions. We believe the Board should provide an illustrative example to clarify how these features affect the classification of the debt arrangement when they are required to be bifurcated from the debt host and separately accounted for as an embedded derivative under Subtopic 815-15.

Example 1 - Case E of the Implementation Guidance

We believe the language in proposed paragraph 470-10-55-3G suggests that the date the financial statements are issued (or are available to be issued) affects the classification of a debt arrangement that includes a grace period. We recommend that the Board revise the language as indicated to clarify the guidance (additions are underlined and deletions are struck through):
Assume the same facts as in Case A (the borrower violates a covenant as of December 31, 20X1), except that the lender does not issue a waiver. Instead, the debt arrangement provides a 90-day grace period for the borrower to become compliant, in which case the lender cannot demand repayment of the debt at December 31, 20X1. The borrower’s financial statements are issued after the balance sheet date, at which time the violation of the covenant has not been cured. On the basis of the guidance in paragraph 470-10-45-24, the borrower assesses the criteria in paragraph 470-10-45-22 to determine whether the debt should be classified as a noncurrent liability on its classified balance sheet. Because the lender cannot demand payment at the balance sheet date and the liability is contractually due to be settled more than one year after the balance sheet date, the borrower determines that at least one of the criteria in paragraph 470-10-45-22 is met. Therefore, the debt is classified as a noncurrent liability on the borrower’s classified balance sheet at December 31, 20X1. The borrower’s financial statements are issued after the balance sheet date, at which time the violation of the covenant has not been cured. Accordingly, the borrower also complies with the disclosure requirements in paragraph 470-10-50-9.

Example 9 of the Implementation Guidance

Proposed paragraph 470-10-55-45 states:

Assume that at December 31, 20X1, the amount of outstanding debt does not exceed the borrowing base. In that case, the borrower would meet the criteria in paragraph 470-10-45-22 because the debt is due in three years. The borrower would classify the debt as a noncurrent liability in its classified balance sheet. However, if the outstanding debt as of the balance sheet date exceeds the borrowing base at the balance sheet date, the borrower would classify the amount in excess of the borrowing base that would be due in less than one year as a current liability. The remainder of the debt would be classified as a noncurrent liability in the borrower’s classified balance sheet because it would meet the criteria in paragraph 470-10-45-22.

Example 9 assumes that the date at which the borrowing base calculation is performed and the balance sheet date are December 31, 20X1. In many debt arrangements, the date for which the borrowing base calculation is contractually stipulated to be performed and the balance sheet date are different. For example, assume a debt arrangement stipulates that the borrowing base calculation is performed annually on September 30 and the balance sheet date of the borrower is December 31. In this scenario, it is unclear whether the entity would determine its balance sheet classification at December 31 based on the September 30 borrowing base calculation or alternatively, based on a separate borrowing base calculation for December 31. We recommend that the final ASU include an example to clarify how an entity would apply the proposed debt classification principle to situations in which the date of the borrowing base calculation and the balance sheet date are different.
Paragraph 210-10-45-9

We recommend that the Board make conforming revisions to paragraph 210-10-45-9 (additions are underlined and deletions are struck through):

Other liabilities whose regular and ordinary liquidation is *contractually due* expected to occur within a relatively short period of time, usually 12 months, are also generally included, such as the following:

a. Short-term debts arising from the acquisition of capital assets