October 28, 2019

Technical Director
File Reference No. 2019-780
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116
Via email: director@fasb.org

Dear Technical Director:

Munson Healthcare (MHC) appreciates this opportunity to comment on the Financial Accounting Standards Board's (FASB’s) exposure draft of the revised proposed Accounting Standards Update, Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent) (Update).

Munson Healthcare is northern Michigan’s largest and leading health care system. Based in Traverse City, Mich., our team of medical experts, nine award-winning community hospitals, and related organizations serve people in 30 counties. The MHC System employs over 8,400 people, and has operating revenues exceeding $1 billion.

General Comments

In the exposure draft, the FASB states it is issuing this proposed update as part of its initiative to reduce complexity in accounting standards (Simplification Initiative). The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to financial statement users.

The FASB considered but rejected a “contractual linkage” approach in situations where a financing arrangement (such a letter of credit (LOC)) can only be used to provide liquidity support to a specified debt arrangement. This is described in par. 31-35 of the proposal’s Basis for Conclusions. MHC believes that the contractual linkage approach should be included in the final standard because variable rate debt and the underlying LOC are inexorably linked. Further, MHC believes variable rate debt linked with a long-term LOC should be classified as non-current on the balance sheet.

Specific Issue

An example of a change in the classification would be short-term debt that has a contractually linked long-term financing arrangement. Under current GAAP, short-term debt is classified as a noncurrent liability if an entity enters into a financing arrangement and meets certain conditions, including the fact that the debt is not expected to be paid within the next period of reporting. The amendments in this proposed Update would preclude an entity from considering contractually...
linked long-term financing arrangements (such as letters or lines of credit) in determining the classification of the debt.

**Munson Healthcare Response**

Variable Rate Debt Obligations (VRDOs) were developed as a viable alternative for long-term financing arrangements. The option to finance via VRDOs backed by a letter of credit (LOC) or standby bond purchase agreement (SBPA) has been seen as interchangeable with other long-term financing options such as direct purchase, floating rate notes, or fixed rate bonds. It is clearly intended to be a long-term debt vehicle in practice.

As proposed, the accounting standards update would require short-term classification for VRDOs which would have a significant impact on financial metrics and debt covenants of healthcare organizations. This change would unduly impact and skew metrics of healthcare organizations, including Munson Healthcare, who happen to be using VRDOs backed by a LOC as their long-term financing vehicle, causing incongruent comparisons of debt metrics among healthcare organizations. Consequently, such debt would only be considered noncurrent after a failed remarketing, which seems counter intuitive.

MHC has entered into two VRDO issues. One remarkets daily and one remarkets weekly. Both issues of debt were entered into simultaneously with the issuance of an LOC. The issuance of variable rate debt such as VRDOs is an integral part of the debt structure for the MHC System. Variable rate debt allows MHC to effectively manage interest rate risk as well as match the variable nature of interest rates on the asset side of the balance sheet. The entire debt portfolio is key to the long-range plans of MHC. The variable debt provides flexibility as well as a strategic ability to manage our investments and capitalization over the long-term.

The issuance of variable rate bonds follows the same process as the issue process for fixed rate bonds. Both arrangements are described in a prospectus issued to our potential investors. The LOC is entered into simultaneously with the issuance of the VRDOs. The LOC has a term, typically 3 years, which must be re-negotiated in advance of its expiration. If MHC cannot renew the LOC, the bonds must be restructured. They cannot be outstanding without a liquidity facility in place. Also, the liquidity facility cannot be utilized for any other purpose. It exists to ensure the bond holders of payment. MHC cannot initiate draws on the facility. If the bonds are refinanced, the liquidity facility terminates.

As of June 30, 2018, our most recent fiscal year end, MHC had $47 million in variable rate bonds, all due in excess of one year and therefore classified as long-term debt. Reclassifying these bonds to current liabilities would have the following impacts:
1. Possibly trigger a default on all outstanding bonds due to the impact on the maximum annual debt service ratio. This would depend on whether the market could accommodate a change in accounting treatment but look to the underlying true economic term of the variable debt as defined in the current bond documents.

2. Significantly alter ratios for the MHC System. The Current Ratio for MHC at June 30, 2018 was 3.2 and would drop to 2.5 under the proposed update. The LT Debt to Capitalization was 19.1% at June 30, 2019 and would drop to 15.8% under the proposed updated. The inequitable use of variable rate debt by healthcare systems will render balance sheet comparisons exceptionally challenging and possibly misleading.

3. Confuse bond holders and necessitate a re-education of investors. The market is sensitive to the duration and risk exposure for variable rate debt. While the disclosure on the financial statements would not change the underlying substance of the debt, the removal of the variable rate issues from long-term debt would fundamentally alter the market’s perception. We will have to provide significant additional disclosures to address why the information reported on the financial statements is not reflective of the economic substance of our debt structure. The change would not simplify the guidance; it would make it harder for us to tell our story.

4. Mislead users of our financial statements by displaying this debt as if we would actually have to repay the entire amount of the bonds within the next year. Users of our financial statements focus on our ability to generate cash flows that are sufficient to cover our operations plus our debt service during the period. It is misleading to report as if the entire long-term bond obligation will require use of our current resources.

5. Display our VRDOs and related LOC as two separate financing agreements - one of which is recognized, the other of which is only disclosed. This is misleading, because the financial statements will not reflect the economics of the financing arrangement. This would be a “form over substance” presentation.

6. Require MHC to explain to analysts and investors that there isn’t a substantive liquidity difference between us and our GASB competitor that has VRDOs. We would be required to show all our VRDOs as current obligations, while our GASB competitor is able to report current and long-term portions that reflect economic reality.

The cost to accommodate this proposed change would be excessively burdensome. If the amendments are finalized as proposed, MHC would be compelled to re-negotiate restrictive bond covenants. Specifically the maximum annual debt service coverage ratio would exceed the current covenant level if VRDO issues were to be considered due in one year. Other debt with cross-default provisions would also be impacted. The re-negotiation of bond covenants would alter the Master Trust Indenture which underlays MHC’s entire debt portfolio. The costs to change this covenant would involve significant fees to engage attorneys and other consultants to negotiate new covenants with at least 3 banks.
We respectfully request review and reconsideration of the exposure draft as it will not result in a more simplified approach to debt classification and subsequently lead to additional administrative burden and expense for healthcare organizations. We support a provision to the proposed update allowing VRDOs that are contractually linked to a long-term LOC or SBPA to still be classified as non-current. The concept of the contractual linkage would appear to be a practical solution that would more appropriately reflect the intent and economics of the entire financing transaction. At a minimum, we suggest that existing VRDO financing arrangements in place be grandfathered from the proposed classification to avoid unnecessary additional costs and administrative burden.

Thank you for the opportunity to comment. We are always ready to provide additional comments, or meet with you or members of your board to discuss this matter further. If we can provide additional material or perspective on this issue, please contact Nicole Sulak, System Director of Accounting at nsulak@mhc.net or 231-935-7730.

Sincerely,

Mary E. Clulo
Corporate Director of Treasury & Tax
Munson Healthcare