October 28, 2019

Via email: director@fasb.org

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 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 Technical Director:

BKD, LLP 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).

BKD is a national CPA and advisory firm with 40 offices in 18 states. BKD and its subsidiaries offer accounting, auditing, other assurance, tax, risk management, technology and forensic valuation services. Many of our clients present a classified balance sheet. Our reply is targeted primarily toward those in the health care industry.

General Comments

We support the Board’s efforts to reduce the cost and complexity of applying the accounting standards while maintaining or improving the usefulness of the information provided to financial statement users. We are overall supportive of the Board’s proposal to simplify the classification of debt in a classified balance sheet; however, we believe the effort of simplification should not come at the cost of misleading the financial statement users about the true liquidity and classification of certain debt instruments. We would like to provide feedback about the decision to preclude certain financing arrangements (such as letters or lines of credit) that are contractually linked to a debt agreement in determining the classification of the debt.

Thank you for the opportunity to comment. Our response is limited to Questions 1 and 2 in the exposure draft and are included in Appendix A. If we can provide additional material or perspective on this issue, please contact Doug Bennett at dbennett@bkd.com or 417.831.7283.

Sincerely,

BKD, LLP
Appendix A

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?

No. We believe that although the proposed language in 470-10-45-23 would simplify the classification of debt, it would significantly diminish the usefulness of the financial statements to the financial statement user.

Variable Rate Debt Obligations (VRDOs) were developed by the financial markets as a viable alternative for long-term financing arrangements. VRDOs require a form of liquidity in the event of a failed remarketing. The liquidity facility used could be a letter of credit (LOC) or standby bond purchase agreement (SBPA). A LOC or SBPA provides an unconditional commitment by a credit facility to pay investors the principal and interest on the VRDOs in the event of default. The liquidity facility is executed simultaneously with the issuance of the VRDOs and is an integral part of the financing arrangement. Draws on the liquidity facility can only be initiated by the bond trustee upon notification of a failed remarketing. To report the bonds solely on the demand repayment terms of the bonds provides the users of the financial statements a distorted picture of the financing arrangement on the face of the financial statements and it is not representative of the economics of the debt instrument.

Many organizations that enter into these arrangements are not-for-profit health care entities which have widely distributed financial statements. The users of the financial statements have a wide understanding of financial statements from sophisticated users to unsophisticated users who represent contributors and the general public. As proposed, the accounting standards update would require short-term debt classification which would have a significant negative impact on financial metrics and debt covenants of health care entities and would ignore legally enforceable agreements which are contractually linked to the original debt issuance. The impact may simplify the reporting of the debt, but it will significantly complicate the interpretation of the financial statements to the end users because the face of the financial statements will not reflect the underlying economics and contractual arrangement of the debt instrument. A user would be required to interpret footnote disclosures to determine the economic substance of the arrangements.
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. 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?

In response to the original proposal, some commenters expressed concerns about permitting linkage of debt agreements with other financing arrangements that were entered into separately, rather than in concert with each other—for example, classifying a due-on-demand bank loan based on the terms of a line of credit that is available for general purposes. This is described in BC 26 of the exposure draft. FASB is proposing to eliminate the ability to classify debt based on an associated financing arrangement under any circumstances, even in situations where the financing arrangement is embedded within the debt agreement (as is the case with VRDOs with SBPAs).

As mentioned above, SBPAs are contractually linked to the VRDO, and any financial statement user should consider these two legal agreements together since they cannot be separated. The SBPA is triggered in the event there is a failed remarketing specifically to keep the debt from being immediately callable and considered as a long-term obligation therefore providing the entity time to react to this economic event and obtain alternative financing. The proposed change would have a significant impact on entities that both utilize VRDO financing and present a classified balance sheet, whether voluntarily or through a GAAP requirement. It is expected this proposal would impact many health care entities, many of which are required to present a classified balance sheet.

This proposal may cause health care entities to make business decisions to discontinue the use of a well-proven and cost-effective method of long-term financing provided by this integrated financing arrangement to avoid these incongruent comparisons. Modifying financing arrangements creates incremental administrative burden and expense for these entities and therefore would significantly increase the costs to these entities.

The change to preclude consideration of the impact of lines of credit which are contractually linked to debt agreement would also distort the true economics of the financing arrangement on the face of the financial statements. As evidenced by the proposed requirement for separate-line-item presentation in a classified balance sheet for debt that is classified as a noncurrent liability because of a waiver of a debt covenant violation received after the reporting date but before the financial statements are issued, presentation on the face of the statements is important.

We believe the contractual linkage approach is consistent with the guidance in paragraph 470-10-45-22 that an entity shall classify debt arrangements and other instruments as noncurrent liabilities in a classified balance sheet if the liability is contractually due to be settled more
than one year after the balance sheet date or the entity has a contractual right to defer settlement of the liability for a period greater than one year after the balance sheet date. The evidence of an embedded LOC or SPBA is a contractual right to defer settlement. BC34 notes this would increase the cost and complexity of determining how to classify debt and if the liquidity provider is financially capable of honoring the arrangement. We believe the cost associated with determining the classification of debt and whether the liquidity provider is financially capable is insignificant in comparison to the costs that the entity would incur to refinance its existing VRDOs in order to retain its long-term treatment of debt.

In conclusion, we are supportive of the contractual linkage approach as it is a practical solution which is consistent with the accounting standards. The underlying LOC or SPBA should be considered as it is an integral part of the contractual arrangement which changes the economics of the VRDO. The proposed change would not simplify the understanding of the entity’s liquidity and financial statement economics by a user of the financial statements, and it would be costly to entities wanting to retain their long-term debt classification as they would be required to refinance their existing VRDO financing arrangements.