May 3, 2017

Ms. Susan M. Cosper  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

File Reference No. 2017-200

Dear Ms. Cosper:

RSM US LLP is pleased to provide feedback on the proposed Accounting Standards Update (ASU), Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent). We appreciate the opportunity to provide comment, and we support the Board’s efforts to simplify the balance sheet classification of debt. For our comments on the proposed ASU, please refer to our responses to the specific questions posed therein. We also provide additional comments for your consideration related to Case C of Example 1 and the effects of subjective acceleration clauses on the classification of debt.

Responses to Questions for Respondents

**Question 1:** Paragraph 470-10-45-22 includes a principle for classifying debt as a noncurrent liability in a classified balance sheet. Would the proposed principle simplify the classification guidance in GAAP without diminishing the usefulness of the information provided in the financial statements? Is the proposed principle clear? Why or why not? Please explain and suggest alternatives.

In general, we believe one of the benefits of a classified balance sheet is to help users of the financial statements understand and evaluate an entity’s liquidity. Under the proposed ASU, there will be situations in which debt will be classified as current, when in substance the debt does not meet the definition of current liabilities in the Master Glossary of the Accounting Standards Codification (ASC) and is inconsistent with the concept in ASC 210-10-45-12, which is that current liabilities are not intended to include debts that will be funded or extinguished using accounts that are not considered current assets. We believe classifying debt as current when current assets will be used to repay the debt within 12 months of the balance sheet date (or the operating cycle, if longer) would provide users of the financial statements with more meaningful information because it better reflects the entity’s liquidity. While we understand the point made in paragraph BC15 of the proposed ASU that if an entity has debt due in six months, it would be unreasonable for management to assert that the debt is a noncurrent liability on the basis of its expectation, we believe noncurrent classification would be appropriate if management’s expectation is confirmed after the balance sheet date, but before the financial statements are issued (or available to be issued), through the consummation of long-term refinancing. We believe not taking the confirmation of management’s expectations into consideration in this situation places too much emphasis on form over substance. While we understand that users of the financial statements could obtain information about the refinancing from the footnotes, we believe noncurrent classification on the face of the balance sheet would be more transparent to users.
and better facilitate their evaluation of the entity’s liquidity given that they would otherwise most likely
make manual adjustments to reclassify as noncurrent the short-term debt refinanced with long-term
debt after the balance sheet date, but before the financial statements were issued (or available to be
issued).

We believe applying the Board’s principle with the following exceptions should result in providing the
users of the financial statements with the most meaningful information: (a) the debt covenant violation
exception proposed by the Board (see our responses to Questions 3 and 4) and (b) an additional
exception for short-term debt refinanced with long-term debt after the balance sheet date, but before
the balance sheet is issued (or available to be issued) (see our response to Question 5).

**Question 2:** The scope of the amendments in this proposed Update includes debt arrangements as well
as (a) liability-classified mandatorily redeemable financial instruments within the scope of Topic 480,
Distinguishing Liabilities from Equity, and (b) debt with conversion and other options that are within the
scope of Subtopic 470-20, Debt—Debt with Conversion and Other Options. Is the scope of the proposed
amendments clear? Why or why not? Are there any other instruments that should be included within the
scope of the proposed amendments? If so, please explain.

We agree that the scope of the proposed amendments is clear. We also agree that liability-classified
mandatorily redeemable financial instruments within the scope of ASC 480 and debt with conversion
and other options within the scope of ASC 470-20 should be classified using the same guidance
generally used to classify debt. However, it is not clear how the proposed principle should be applied
to debt convertible within one year of the balance sheet date. As such, we believe an example
illustrating application of the proposed principle to debt convertible within one year of the balance
sheet date should be provided to avoid diversity in practice.

**Question 3:** Paragraph 470-10-45-23 includes an exception to the classification principle for waivers of
debt covenant violations received after the reporting date but before the financial statements are issued
(or are available to be issued). Will including this exception reduce the cost of the proposed
amendments? Why or why not? Please explain and suggest alternatives.

We agree with the intent of the exception provided in ASC 470-10-45-23. However, we believe
conditions (b) and (d) of that paragraph should be clarified to allow for their consistent application. To
illustrate, assume a debt agreement provides for several specific covenants, one of which is a
minimum current ratio. Further, assume all the covenants are measured quarterly, and the entity was
not in compliance with the current ratio covenant as of yearend. Because of the use of the verbiage
“any other covenants” in condition (d), it is not clear whether the current ratio covenant would have to
be waived as of yearend and the next four subsequent quarterly measurement periods to satisfy
condition (b) or whether the subsequent quarterly current ratio computations would be considered
“other covenants” in evaluating condition (d). While we do not believe it was your intent, because
condition (b) does not address violations expected after the balance sheet date and condition (d)
focuses on violations of “any other covenants” [emphasis added] within 12 months (or the operating
cycle, if longer) from the balance sheet date, we believe some may inappropriately conclude that
noncurrent classification is appropriate when the waiver letter does not cover expected violations of
the same specific covenant within 12 months (or the operating cycle, if longer) of the balance sheet
date.
In addition, to reinforce how the exception should be applied in these situations, we believe a new case should be added to Example 1, which would be based on the facts in Case A, with the following exceptions:

- The covenant that was violated at the balance sheet date is specified (e.g., maintaining a minimum debt-to-equity ratio).
- The borrower expects to violate the minimum debt-to-equity ratio at one or more of the periodic or ongoing covenant compliance dates that occur within 12 months (or the operating cycle, if longer) of the balance sheet date.
- The lender either: (a) only waives the minimum debt-to-equity ratio covenant violation that occurred at the balance sheet date, in which case the debt would be classified as current based on the application of the exception (as revised) or (b) waives the minimum debt-to-equity ratio covenant violation that occurred at the balance sheet date as well as the violation(s) of that covenant expected to occur at one or more of the periodic or ongoing covenant compliance dates that occur within 12 months (or the operating cycle, if longer) of the balance sheet date, in which case the debt would be classified as noncurrent based on the application of the exception (as revised).

With respect to any potential cost reduction resulting from the proposed exception, we believe inclusion of the proposed exception will be cost neutral compared to the guidance currently in ASC 470-10-45. However, we believe there would be additional costs to comply with the proposed ASU without the exception because of the more formalized interim financial reporting process many entities would need to implement to be in a position to try to obtain a waiver for a debt covenant violation before the balance sheet date for an expected violation of that covenant at the balance sheet date.

**Question 4:** Paragraph 470-10-45-24 would require separate 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 (or are available to be issued). Does separate presentation of this amount provide decision-useful information for those using the financial statements? Why or why not? Please explain and suggest alternatives.

We do not believe the standard should require separate presentation of debt classified as a noncurrent liability because of a waiver of a debt covenant violation received after the balance sheet date, but before the financial statements are issued (or available to be issued). While paragraph BC26 of the proposed ASU indicates it is an important enough event to justify separate presentation of the debt, the basis on which the importance of this event was evaluated is not clear to us. We believe the current vs. noncurrent classification of liabilities on the balance sheet is most relevant to users of the financial statements from a liquidity perspective. Separate presentation of debt classified as noncurrent because of a debt waiver does not provide a different picture of the entity’s liquidity. We believe information about why the debt is classified as noncurrent is most appropriately included in the footnotes.
**Question 5:** The proposed amendments would require an entity to classify as a current liability a debt arrangement that is short-term debt (at the balance sheet date) but that is subsequently refinanced as long-term debt (after the balance sheet date but before the financial statements are issued). That would result in more current liabilities and less noncurrent liabilities, as compared with current GAAP. Do you agree that these refinancings are nonrecognized subsequent events? If not, please explain why and suggest alternatives.

While we believe a case potentially could be made that certain refinancings occurring after the balance sheet date, but before the financial statements are issued (or available to be issued), are confirming facts and circumstances that existed at the balance sheet date (i.e., recognized subsequent events if classification is based on meeting the definition of a current liability and it was probable at the balance sheet date that the debt would be refinanced), we do not believe that whether the refinancing is a recognized or nonrecognized subsequent event should be the basis for classifying the related debt as current or noncurrent. Instead, we believe an exception to the proposed principle in ASC 470-10-45-22 should be provided that requires noncurrent classification of short-term debt refinanced with long-term debt after the balance sheet date, but before the financial statements are issued (or available to be issued). We believe providing such an exception would convey more meaningful information about the entity’s liquidity to the users of the financial statements and would also result in what is reflected in current liabilities being consistent with the definition of current liabilities, as discussed further in our response to Question 1.

While we appreciate the argument in support of not providing the exception that entities could seek and obtain refinancing for debt that will otherwise be classified as current at an upcoming balance sheet date before that balance sheet date, we do not believe it would be practical in many situations to do so, especially for smaller private entities. It has been our experience that some lenders prefer to renew debt after they obtain drafts of the annual financial statements, which allows them to avoid including more restrictive covenants in the debt agreements (thus reducing the cost). Under the proposed ASU, these lenders would have to rely on interim financial information to renew the debt, which could either preclude the entity from renewing the debt before the balance sheet date or increase the effort and cost associated with renewing the debt. As discussed in our responses to earlier questions, we do not believe the users of the financial statements would benefit from current classification of short-term debt refinanced after the balance sheet date, but before the financial statements are issued (or available to be issued), provided the subsequent refinancing is transparently disclosed in the footnotes.

We also believe changing the classification of short-term debt refinanced with long-term debt after the balance sheet date, but before the financial statements are issued (or available to be issued), from noncurrent to current could have significant hidden costs. For example, it is not unusual for debt agreements to include covenants focused on the current ratio, and unless there is a significant delay in the effective date of the new guidance, entities could incur significant costs with their lenders to obtain covenant waivers or amend other debt agreements prior to their maturity dates.

**Question 6:** Paragraph 470-10-50-6 provides new disclosure requirements. Do the proposed disclosure requirements provide decision-useful information? If not, please explain why and suggest alternatives.

We believe the proposed disclosure requirements in ASC 470-10-50-6 provide decision-useful information.
Question 7: How much time would be necessary to adopt the proposed amendments? Would the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Do you agree that early adoption should be permitted?

If the additional exception discussed in our response to Question 5 is provided for short-term debt refinanced with long-term debt after the balance sheet date, but before the financial statements are issued (or available to be issued), we believe relatively little time would be needed to adopt the proposed ASU given that prospective transition is proposed. If that exception is not provided, we believe one to two years would be needed to adopt the proposed ASU. We believe entities may need this time to adjust their timeline for obtaining refinancing for debt that will be classified as current at the next annual balance sheet date and (or) renegotiate covenants in other debt agreements that will be violated if they are no longer able to classify short-term debt as noncurrent when the short-term debt was refinanced with long-term debt after the balance sheet date, but before the financial statements were issued (or available to be issued).

We do not believe different effective dates are warranted for public business entities and entities other than public business entities.

We agree that early adoption should be permitted.

Additional Comments

We provide additional comments for your consideration below related to Case C of Example 1 and the effects of subjective acceleration clauses on the classification of debt.

Case C of Example 1

Case C of Example 1 indicates the debt was modified to increase the interest rate in connection with the borrower obtaining the waiver letter. We believe a fact should be added to indicate that the debt is not prepayable. Otherwise, based on the guidance in ASC 470-50-40-12(c), it is unclear how an increase in the interest rate changed the present value of the cash flows by at least 10 percent.

Subjective acceleration clauses

Case B of Example 8 in the proposed ASU indicates long-term debt with a material adverse change clause (i.e., subjective acceleration clause) should be classified as current debt at the balance sheet date upon notification from the lender before the balance sheet date that it is opting to exercise its rights to call the debt early under the material adverse change clause. Presumably, if the entity had not received notification from the lender before the balance sheet date, the debt would have continued to be classified as noncurrent (assuming it would otherwise have been classified as noncurrent). This example essentially defines lender notification as the triggering event for current classification when a subjective acceleration clause is included in debt that would otherwise be classified as noncurrent. In addition, an example provided in ASC 470-10-50-6 of a triggering event for a subjective acceleration clause is when the borrower is notified by the lender of noncompliance.

We do not believe notification about noncompliance from the lender should be the triggering event for a subjective acceleration clause to affect the classification of the related debt. We believe the triggering event should be the facts and circumstances that give the lender the right to call the debt early under the subjective acceleration clause. For example, in Case B of Example 8, we believe the triggering event is the borrower’s loss of an essential customer that accounts for more than 10 percent of the entity’s sales. We do not believe classification of the debt should hinge on whether the entity is notified about
noncompliance by the lender before or after the balance sheet date. We believe notification after the balance sheet date is confirming facts and circumstances that existed as of the balance sheet date. If the lender does not provide notification of noncompliance before the financial statements are issued (or available to be issued), we believe the debt should be classified as current only if it is probable that the lender will provide such notification based on the facts and circumstances that existed at the balance sheet date.

We appreciate this opportunity to provide feedback on the proposed ASU and would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Rick Day at 563.888.4017 or Richard Stuart at 203.905.5027.

Sincerely,

RSM US LLP