Board Meeting Handout
Balance Sheet Classification of Debt
June 28, 2017

Meeting Purpose
1. The purpose of this meeting is to provide a summary of the 29 comment letters received in response to the proposed Accounting Standards Update, Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent), which was issued for public comment on January 10, 2017. The comment letter deadline was May 5, 2017. This meeting also will cover a summary of the input from the June 2017 Small Business Advisory Committee (SBAC) meeting. This is an informational and non-decision-making meeting.

2. This handout is organized as follows:
   (a) Topic 1: Issue background
   (b) Topic 2: Comment letter demographics
   (c) Topic 3: Summary of comments received.

<table>
<thead>
<tr>
<th>Questions for the Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Does the Board have questions on the comment letter respondent feedback?</td>
</tr>
<tr>
<td>2. Are there any areas in which the Board would like to staff to conduct further research?</td>
</tr>
<tr>
<td>3. Does the Board agree with the staff's next steps? If not, what would the Board like the next steps to be?</td>
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</tbody>
</table>

Topic 1: Issue Background
3. The amendments in the proposed Update introduce a principle for determining whether a debt arrangement or other instrument within the scope of the proposed amendments should be classified as a noncurrent liability as of the balance sheet date. The proposed principle is that an entity should classify an instrument as noncurrent if either of the following criteria are met as of the balance sheet date:

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.
(a) The liability is contractually due to be settled more than one year (or operating cycle, if longer) after the balance sheet date.

(b) The entity has a contractual right to defer settlement of the liability for at least one year (or operating cycle, if longer) after the balance sheet date.

4. The proposed amendments would continue to require an entity to classify a debt arrangement as a noncurrent liability when there has been a debt covenant violation if the entity receives a waiver of that violation that meets certain conditions before the financial statements are issued (or are available to be issued). That classification is an exception to the proposed principle, but is similar to current generally accepted accounting principles (GAAP). The exception applies to all waivers except for those that result in a troubled debt restructuring (as defined in the Master Glossary of the FASB Accounting Standards Codification®) or those that are accounted for as a debt extinguishment in Subtopic 470-50, Debt—Modifications and Extinguishments. The Board also decided to retain and clarify the probability assessment related to subsequent covenant violations. The proposed amendments also would require an entity to separately present in the balance sheet liabilities that are classified as noncurrent as a result of this exception.

5. The amendments in the proposed Update could shift classification of certain debt arrangements between noncurrent liabilities and current liabilities as compared with current guidance. The existing classification guidance would be superseded by a principle that may differ from existing rules that the proposed amendments would eliminate.

6. One of the most significant changes proposed to the classification would be, for example, to short-term debt that is refinanced on a long-term basis after the balance sheet date. Current guidance requires short-term debt (at the balance sheet date) that is refinanced on a long-term basis (after the balance sheet date but before the financial statements are issued or are available to be issued) to be classified as a noncurrent liability. The proposed amendments would prohibit an entity from considering a subsequent refinancing when determining the classification of debt as of the balance sheet date. Therefore, those debt arrangements would be classified as current liabilities.

7. Another example of a change in classification results from debt that contains subjective acceleration clauses or material adverse change clauses. Current GAAP requires entities to consider the likelihood of acceleration of the due date when determining noncurrent or current classification. The proposed amendments would remove that probability assessment. Instead, the subjective acceleration clause would affect classification of debt only when it is triggered.

8. Stakeholders were asked the following questions in the proposed Update:
(a) **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.

(b) **Question 2:** The scope of the amendments in this proposed Update includes debt arrangements as well as (1) liability-classified mandatorily redeemable financial instruments within the scope of Topic 480, Distinguishing Liabilities from Equity, and (2) 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.

(c) **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.

(d) **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.

(e) **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.

(f) **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.

(g) **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?

**Topic 2: Comment Letter Demographics**

9. The following table provides a summary of the 29 comment letters received by type of respondent:

<table>
<thead>
<tr>
<th>Respondent Type</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting Firm</td>
<td>14</td>
</tr>
<tr>
<td>Association Group</td>
<td>10</td>
</tr>
<tr>
<td>Preparer</td>
<td>5</td>
</tr>
</tbody>
</table>

10. The association group is further broken down as:

<table>
<thead>
<tr>
<th>Respondent Type</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certified Public Accountant (CPA) Society</td>
<td>8</td>
</tr>
<tr>
<td>Other Accounting Society</td>
<td>2</td>
</tr>
</tbody>
</table>

11. The preparers are further broken down by industry in the table below. Of the preparer respondents, there are four public companies and one not-for-profit organization.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communications</td>
<td>1</td>
</tr>
<tr>
<td>Energy/Utility</td>
<td>2</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1</td>
</tr>
<tr>
<td>Real Estate</td>
<td>1</td>
</tr>
</tbody>
</table>

12. No comment letters were received from financial statement users. Consequently, in addition to the user outreach conducted during the deliberations stage of the project, the staff will conduct some limited outreach with users to refresh the original outreach.

**Topic 3: Summary of Comments Received**

13. The summary of comments received is organized as follows:

   (a) Classification principle

\[^{1}\text{Of the accounting firm respondents, 12 serve both public and private companies. The other two accounting firms serve private companies and not-for-profit entities.}\]
(b) Scope
(c) Waivers of debt covenant violations
(d) Separate presentation in a classified balance sheet
(e) Refinancing after the balance sheet date
(f) Disclosures
(g) Implementation guidance and illustrative examples
(h) Time needed to adopt the proposed amendments
(i) Early adoption.

Classification Principle
14. The amendments in the proposed Update include a principle for determining the classification of debt in a classified balance sheet. Proposed paragraph 470-10-45-22 states:

Debt arrangements and other instruments within the scope of this Subtopic (see paragraphs 470-10-15-3 through 15-4) shall be classified as noncurrent liabilities in a classified balance sheet if either of the following criteria is met as of the balance sheet date:

a. The liability is contractually due to be settled more than one year (or operating cycle, if longer) after the balance sheet date.
b. The entity has a contractual right to defer settlement of the liability for at least one year (or operating cycle, if longer) after the balance sheet date.

15. The chart below illustrates the respondents’ positions on whether the proposed principle for classifying debt would simplify the classification guidance in GAAP without diminishing the usefulness of the information provided in the financial statements:
16. There were 25 respondents that commented on the proposed classification principle. Nine respondents, including four accounting firms, two CPA societies, and three preparers agreed with the proposed classification principle noting that the principle provides a clear framework that can be applied to all fact patterns and should provide for consistent conclusions that will be solely based on the contractual terms of the debt arrangement, thereby reducing the cost and complexity of financial reporting.

17. Five accounting firms and one other accounting society conditionally agreed with the proposed classification principle. The conditional agreement was most commonly caused by concerns about how to apply the proposed classification principle to specific fact patterns, the interpretation of certain terms or phrases within the classification principle, and inconsistencies between proposed illustrative examples and the classification principle. The concerns raised by those respondents are more fully described in the following paragraphs.

18. One accounting firm noted that the term settlement of the liability in proposed paragraph 470-10-45-22(b) is not defined, and, therefore, its application could result in diversity in practice. First, the accounting firm noted that using the term settlement of the liability could result in the classification of debt as current even if an outflow of an entity’s current assets is not required to settle the debt. Debt arrangements that could be affected include convertible debt instruments that must be settled by converting the debt into the borrower’s own shares when a debt holder exercises the conversion option. If conversion is viewed as a settlement of the liability, a convertible debt instrument that is convertible or becomes convertible at the holder’s option within one year would be classified as current under the proposed amendments. Second, the accounting firm and the other accounting society stated that it is unclear whether the term settlement of the liability should be interpreted to include an extinguishment of debt resulting from a refinancing transaction in Subtopic 470-50 because a debt extinguishment also does not require an outflow of the borrower’s current assets. The accounting firm recommended that the Board consider requiring classification of debt to be determined on the basis of whether current assets are needed to settle a liability. The reason given for considering that approach is because the purpose of classifying assets and liabilities as current or noncurrent is to provide financial statement users with information about an entity’s liquidity.

19. A second accounting firm and the other accounting society noted that the term contractual right to defer settlement in proposed paragraph 470-10-45-22(b) is unclear. Those respondents noted that the term could be interpreted to mean that an entity with a contractual right to refinance an obligation as of the date of the balance sheet could utilize that right to classify a short-term obligation as noncurrent. Those respondents asserted that such interpretation is inconsistent with the proposed amendments that would prohibit an entity from considering a
subsequent refinancing when determining the classification of debt as of the balance sheet date.

20. A third accounting firm stated that while the proposed classification principle would provide a simple model that is easier to apply than current guidance, application issues may arise for certain structures unless clarification is provided for the following:

(a) If a debt arrangement is currently convertible but otherwise due in five years, it is unclear whether the conversion terms should be considered when determining whether the debt is contractually due to be settled within a year. The accounting firm also noted that it is uncertain whether classification would be affected if the convertible debt was settled in cash versus equity.

(b) It is unclear whether the amortization period of sales of future revenues should be considered analogous to the term *settlement* when determining classification.

(c) Paragraph 480-10-25-6 states that the following provisions do not affect the classification of a mandatorily redeemable financial instrument as a liability:

   (i) A term extension option

   (ii) A provision that defers redemption until a specified liquidity level is reached

   (iii) A similar provision that may delay or accelerate the timing of a mandatory redemption.

The accounting firm noted that it is unclear whether those provisions would be considered a contractual right to defer settlement of the liability when determining the classification of the liability.

21. Another accounting firm recommended that the Board clarify the wording of the proposed classification principle and modify certain other aspects of the proposed guidance before finalizing the amendments. That accounting firm asserted that under a literal interpretation of the proposed classification principle, an entity would be required to classify debt as noncurrent in circumstances in which the debt is contractually due to be settled more than one year (or operating cycle, if longer) after the balance sheet date, but the creditor can demand repayment within one year (for example, under a noncontingent put option or demand feature that allows the debt holder to require repayment). Although paragraph 470-10-55-8 of the proposed implementation guidance and paragraph BC15 of the proposed Update implies that debt with a demand or put feature would not meet the criteria for noncurrent classification, the wording of the criterion in proposed paragraph 470-20-45-22(a) focuses on when the arrangement is due to be settled, not on when the lender can demand repayment. The accounting firm recommended that to increase understandability and reduce the risk of diversity or misapplication in practice, the wording of the proposed classification principle should be
modified so that the evaluation of this criterion explicitly considers whether and when the lender can demand repayment of the debt. That is, debt would be classified as noncurrent if it is due to be settled more than one year after the balance sheet date unless the lender would have the unconditional right to demand that the debt be settled at any point during that period.

22. One accounting firm noted that the Master Glossary definition of the term *current liabilities* states that *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 other current liabilities. That accounting firm recommended that to avoid confusion, the Board should explicitly state that the definition of the term *current liabilities* does not apply to debt arrangements within the scope of the debt classification guidance. To the contrary, one other accounting society recommended that the debt classification criteria be expanded to permit noncurrent classification if the debt arrangement does not require payment using current assets, or the creation of other current liabilities.

23. Ten respondents, including 5 accounting firms, 4 CPA societies, and 1 other accounting society opposed the proposed classification principle, noting that it would diminish the usefulness of the financial information provided in the financial statements for the following reasons:

(a) The proposed classification principle is inconsistent with the Master Glossary definition of the term *current liabilities*. Current guidance already includes an underlying principle that is based on that definition. Determining classification of debt solely on the basis of contractual terms is inconsistent with the definition of the term *current liabilities* and ignores the needs of users as evidenced by the Board’s decision to include exceptions to the principle. While the proposed principle might be viewed by some as simplifying the guidance because it would require less management judgment, the proposed principle would not provide information to users that is as relevant and useful as the information provided under current guidance. 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 with more meaningful information because it better reflects the entity’s liquidity.

(b) The proposed classification principle should be broadened to include management’s intentions. The timing of debt payments should not be limited to a legal interpretation, but should be expanded to include the intentions and motives of the parties to the arrangement, as well as changes in the economic, business, and regulatory environment. The consideration of legal rights is an important condition for evaluating the current versus noncurrent classification of debt at the balance sheet date, but should not serve as the sole basis for such determination. Including debts in current liabilities that as of the date the financial statements are issued (or available to be issued) are due in a period greater than
one year from the balance sheet date reduces the usefulness of the information. That is because the current classification does not provide timely information about the characteristics of the debt payments and does not represent whether an entity could meet its obligations. This limitation of the proposed classification principle is made evident by the exception to exclude from current classification long-term debt that is currently due at the balance sheet date because of covenant violations if a waiver is obtained before the financial statements are issued or are available to be issued.

(c) The proposed classification principle could result in less meaningful information on the face of the balance sheet when debt is refinanced after the balance sheet date. Users of the financial statements could obtain information about the refinancing from the footnotes. However, noncurrent classification on the face of the balance sheet would be more transparent to users and would better facilitate their evaluation of the entity's liquidity because 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).

(d) The proposed classification principle should be based on the financial statement issuance date. The most decision-useful information that could be provided to users is information that is based on the most current information as of the date the financial statements are issued (or available to be issued).

(e) The proposed classification principle could add complexity. Current guidance is operational and should not be amended in the interest of simplification. The changes to debt classification resulting from the proposed amendments could have financial implications to certain entities that outweigh improved consistency in financial reporting.

(f) The proposed classification principle may result in more debt being classified as current, which has consequences for existing contracts and debt ratios. The construction industry will be greatly affected from an operational standpoint and a cost standpoint. Most states place bid limits on contractors that are based on working capital. On a regular basis, contractors renegotiate debt after the balance sheet date but before the financial statement issuance date to increase their legal bid limits. The implementation of this proposal without consideration of the construction industry could prove to be costly to contractors. The proposal could potentially reduce the size of jobs that contractors can bid on, which would affect the operations of the business. The proposal also could result in increased professional fees. For example, professional fees might be incurred for reviewed financial statements after the refinancing has occurred so that the debt could be more appropriately classified as current. Therefore, the costs of the proposal outweigh the benefits of simplification.
24. One CPA society that opposed the proposed classification principle recommended an alternative principle. That respondent noted that contrary to the proposed classification principle, which is primarily based on contractual terms at the balance sheet date, their alternative principle would be based on a probability approach consistent with the Master Glossary definition of the term *current liabilities*, and is as follows:

> Debt arrangements and other instruments within the scope of...Subtopic [470-10] shall be classified as noncurrent liabilities in a classified balance sheet when it is probable that settlement by the transfer of assets or creation of other current liabilities within one year from the balance sheet date will not occur. [Footnote references omitted.] (CL#18)

25. That CPA society noted the Board could further clarify through explanation or by example that the likelihood of settling debt is not probable when:

(a) The entity has a legal right to defer settlement for more than one year from the balance sheet date and it does not intend to settle the debt by the transfer of assets or creation of a current liability one year from the balance sheet.

(b) After the balance sheet date but before the financial statements are issued (or are available to be issued), the entity obtains the legal right to defer settlement by the transfer of assets or creation of a current liability for more than one year from the balance sheet date and it does not intend to settle the debt by the transfer of assets or creation of a current liability one year from the balance sheet date.

(c) The entity lacks the legal right to defer settlement for more than one year from the balance sheet date only because of a subjective acceleration clause. The lender has not expressed an intent to trigger and has not triggered the subjective acceleration clause as of the date the financial statements are issued (or are available to be issued).

26. Two of the respondents that opposed the proposed classification principle agreed with some of the Private Company Council (PCC) members who supported the retention of current guidance in its entirety (as described in paragraph BC18 of the proposed Update) and suggested that the Board remove the project from its agenda.

27. One accounting firm that opposed the proposed classification principle provided feedback on the proposed removal of the guidance on subjective acceleration clauses and debt classification. The accounting firm stated that notification about noncompliance from the lender should not be the triggering event for a subjective acceleration clause to affect the classification of the related debt. Rather, the triggering event should be the facts and circumstances that give the lender the right to demand payment early under the subjective acceleration clause (for example, in the fourth quarter of a reporting period, a borrower loses an essential customer that accounts for more than 10 percent of the entity's sales).
Scope

28. There were 22 respondents that commented on the scope of the proposed amendments. Fifteen of the 22 respondents agreed that the scope of the proposed amendments is clear and that there are no other instruments that should be included in the scope.

29. Seven respondents (three accounting firms, one other accounting society, two preparers, and a CPA society) conditionally agreed on the scope of the proposed amendments. Clarifications were requested in several areas including trade payables, financing commitment arrangements, finance lease liabilities, obligation to transfer equity, and derivative instruments.

(a) Three respondents recommended that the Board provide clarification on the proposed Master Glossary definition of the term *debt arrangement* because the scope could be interpreted to include normal trade payables that generally arise from a contractual right for a third party to receive consideration on fixed or determinable dates. For example, the proposed definition may include financings that result from payment terms on goods and services related to the borrower’s operating cycle (that is, vendor trade payables). Those respondents noted that the Board should provide clarification if the definition was not intended to include trade payables.

(b) One preparer stated that the proposed definition of the term *debt arrangement* should be clarified or expanded to explicitly include financing commitment arrangements, which are often entered into in advance of the debt maturing. The preparer explained that entities often will enter into a short-term debt arrangement for a construction loan and a financing commitment for “take out” permanent financing at the same time as part of the overall financing plan.

(c) Paragraph BC264 of FASB Accounting Standards Update No. 2016-02, *Leases (Topic 842)* indicates that finance lease liabilities are the equivalent of debt. One accounting firm noted that considering the broad application of the leases standard, it would be helpful for the Board to specify whether finance lease liabilities are within the scope of the proposed amendments.

(d) One accounting firm stated that it is unclear whether an obligation to transfer an entity’s own equity constitutes consideration for the purposes of determining whether an instrument meets the proposed definition of the term *debt arrangement*. Considering that mandatorily redeemable financial instruments and convertible debt are separately discussed in proposed paragraph 470-10-15-4, this does not appear to be the Board’s intent. The Board should specify whether and why other instruments within the scope of Subtopic 480-10, Distinguishing Liabilities from Equity—Overall, such as certain obligations to repurchase equity shares by transferring assets and certain other obligations to issue a variable number of shares, are excluded from the scope of the proposed amendments.
(e) A second preparer suggested that the Board expand the scope to include the classification of derivative instruments.

30. One accounting firm that conditionally agreed with the scope noted that it is unclear how the proposed amendments interact with the requirements of Subtopic 210-10, Balance Sheet—Overall. Specifically, paragraph 210-10-45-12 states that the current liability classification is not intended to include debts to be liquidated by funds that have been accumulated in accounts of a type not properly classified as current assets, or long-term obligations incurred to provide increased amounts of working capital for long periods. The accounting firm recommends that the Board clarify whether an entity might be required to classify a debt arrangement as noncurrent on the basis of the guidance in Subtopic 210-10, even if the arrangement does not qualify as noncurrent under the proposed amendments.

**Waivers of Debt Covenant Violations**

31. There were 26 respondents that provided feedback on the exception to the classification principle for waivers of debt covenant violations received after the reporting date but before the financial statements are issued (or available to be issued). Twenty of those 26 respondents agreed with or accepted the proposed exception to the classification principle. However, many of those respondents suggested that certain proposed conditions within the exception should be removed or amended, as described in the following paragraphs.

**Paragraph 470-10-45-23(b)**

32. Proposed paragraph 470-10-45-23(b) states:

   A waiver of the violation has been obtained by the borrower before the date that the financial statements are issued (or the date that the financial statements are available to be issued). The waiver must be for a period of greater than one year (or operating cycle, if longer) from the balance sheet date.

33. One respondent is concerned that the waiver must be for a period of greater than one year instead of just one year from the balance sheet date, noting that banks and other lenders are reluctant to issue waivers for a year and a day for covenants that are measured periodically and may be subsequently cured or for covenants that are only measured annually. The respondent suggested that the Board consider revising the proposed condition to be more consistent with how the marketplace issues debt waivers so there are no unintended consequences.

34. Two accounting firms indicated that it is unclear whether the Board’s intent is to require the waiver to include both the covenant that was violated at the balance sheet date and its subsequent measurement periods (for example, a current ratio covenant with quarterly compliance requirements) included within the period greater than one year to satisfy the condition in proposed paragraph 470-10-45-23(b).
Paragraph 470-10-45-23(c)

35. Proposed paragraph 470-10-45-23(c) states:

   At the time the waiver is granted, the waiver for the debt arrangement does not result in a modification that is either:

   1. An extinguishment of debt accounted for in accordance with Subtopic 470-50
   2. A troubled debt restructuring accounted for in accordance with Subtopic 470-60.

36. Over 25 percent of the respondents that agreed with or accepted the exception to the classification principle expressed concerns about the condition in proposed paragraph 470-10-45-23(c). Some respondents noted that the condition would increase costs because entities would have to effectively determine the accounting for the transaction even though the accounting outcome would not affect the measurement of the liability at the reporting date and the auditor would have to audit the accounting to be able to issue its report.

37. Several respondents (three accounting firms, one CPA society, and one other accounting society) noted that it is unclear why waivers that result in a troubled debt restructuring would be included as a condition and suggested that the Board remove the proposed guidance for the following reasons:

   (a) The current guidance does not treat a troubled debt restructuring as an extinguishment. While a modification that qualifies as an extinguishment under Subtopic 470-50 requires the issuer to recognize an extinguishment of the existing debt and record the modified debt at fair value, effectively resulting in the issuance of a new debt instrument, under Subtopic 470-60, Debt—Troubled Debt Restructurings by Debtors, a troubled debt restructuring is not accounted for as an extinguishment of existing debt and a recognition of new debt.

   (b) The troubled debt restructuring may result in debt that is noncurrent. A troubled debt restructuring would not necessarily cause the debt to become due within one year from the balance sheet date (or within the operating cycle, if longer).

   (c) The view expressed by the Board in paragraph BC27 of the proposed Update that waivers that result in a troubled debt restructuring are akin to the issuance of a new debt instrument is inconsistent with the Board’s view expressed in paragraph 76 in the basis for conclusions of FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings (now codified in Subtopic 470-60), which stated:

   The Board also concluded that a troubled debt restructuring that does not involve a transfer of resources of obligations is a continuation of an existing debt. It is neither an event that results in a new asset or liability for accounting purposes nor an event that requires a new measurement of an existing asset or liability.
38. An accounting firm recommended that the Board address how an entity should assess the exception when there are other amendments that occur before the financial statements are issued. The accounting firm suggested that the Board should clarify whether a cumulative assessment of amendments should be considered when evaluating a debt waiver for the classification exception.

39. Two accounting firms explained that debt arrangements may contractually provide borrowers with a period to cure a covenant violation, commonly referred to as a “grace period.” If a covenant violation occurs, debt arrangements with grace periods do not provide the lender with a right to demand repayment of the liability unless the borrower is unable to cure the covenant violation during the grace period. Current guidance states that if it is probable that a violation will be cured within the grace period that prevents the obligation from becoming callable, noncurrent classification is appropriate. The accounting firms noted that the proposed amendments would remove that guidance and that they do not address the classification of debt arrangements with grace periods. Absent further clarification by the Board, the accounting firms noted that the proposed amendments could create diversity in practice about how to classify a debt arrangement when a contractual grace period has been triggered. Therefore, the accounting firms recommend that the Board provide guidance on how an entity should consider debt arrangements with grace periods under the proposed principle.

**Paragraph 470-10-45-23(d)**

40. Proposed paragraph 470-10-45-23(d) states:

   It is not probable that any other covenants in the debt arrangement (for example, other covenants not included in the waiver) will be violated within 12 months (or operating cycle, if longer) from the balance sheet date.

41. Some respondents stated that the condition in proposed paragraph 470-10-45-23(d) contradicts the proposed principle that debt classification should be determined on the basis of contractual terms of the debt arrangement and not on management expectations. Therefore, the Board should consider removing this condition.

42. An accounting firm indicated that the condition in proposed paragraph 470-10-45-23(d) should not be limited to a covenant violation that has occurred at the balance sheet date. Rather, to be consistent with the Master Glossary definition of the term *current liabilities*, the accounting firm noted that the probability assessment should be extended to covenant requirements in all debt arrangements (that is, even debt with no covenant violations).

43. An accounting firm noted that the requirement to assess the probability of future covenant violations would not apply when the lender waives the covenant requirement before the balance sheet date. The accounting firm stated that the timing of when a waiver is received should not affect whether an entity should assess the probability of future covenant violations.
44. Another accounting firm stated that it is unclear what is meant by “other covenants.” For example, a debt arrangement includes several specific covenants, including a minimum current ratio, and all the covenants are measured quarterly. At the balance sheet date, the entity was not in compliance with the minimum current ratio and obtained a waiver from its lender. It is unclear whether the probability assessment of the “other covenants” within the next 12 months would include the quarterly minimum current ratio measurements.

45. Similarly, one other accounting society noted that it is unclear what is meant by “other covenants.” There could be two interpretations:

(a) “Other covenants” includes all covenants in a debt arrangement, including subsequent interim measurement dates for covenants that were violated at the balance sheet date.

(b) “Other covenants” includes only the subsequent interim measurement dates for covenants that were violated at the balance sheet date.

The respondent suggested that the Board clarify the guidance to avoid potential diversity in practice.

**Opposing Views**

46. Six respondents (four accounting firms, one preparer, and one CPA society) disagreed with the proposed exception. Two of those respondents suggested removing the exception. The preparer stated that the proposed amendments should be less prescriptive and should allow entities to use management judgment to determine the classification of debt when waivers are obtained after the reporting date but before the financial statements are issued.

47. Another accounting firm noted that applying this exception would require a forward-looking judgment because an entity must evaluate whether it is probable that other covenants in the debt arrangement would be violated within 12 months from the balance sheet date. The accounting firm stated that the forward-looking evaluation would be inconsistent with the principle underlying the proposed amendments, which focuses on the terms and conditions of the debt arrangement at the balance sheet date (or waiver date, in the case of the exception). The accounting firm further stated that the forward-looking evaluation also is inconsistent with the proposal for evaluating subjective acceleration clauses, which the entity would ignore if the lender does not provide notice as of the balance sheet date. If the Board retains the exception, the accounting firm suggested that the Board remove the forward-looking evaluation to be more consistent with the underlying proposed principle.

48. A CPA society stated that it does not support a principle that requires significant exceptions to meet the objectives of financial reporting from the onset. Furthermore, that CPA society stated that an exception to the classification of debt for waivers of debt covenant violations received after the reporting date but before the financial statements is inappropriate without also
providing an exception for short-term debt that is refinanced on a long-term basis after the balance sheet date.

49. One of the six respondents, an accounting firm, stated that it supports eliminating the exception. That was the Board’s initial preferred approach and would result in an entity classifying debt with a covenant violation (and with no waiver granted by the lender as of the reporting date) as a current liability. The accounting firm asserted that providing an exception to the proposed principle creates unnecessary complexity and costs. The accounting firm noted that the initial preferred approach is similar to that in IAS 1, *Presentation of Financial Statements*, in which debt with a covenant violation at the reporting date is classified as a current liability. The accounting firm asserted that this approach has been used in International Financial Reporting Standards (IFRS) for many years without a negative effect on financial statement users. The accounting firm acknowledged that without an exception to the classification principle, more debt would be classified as current; however, a current classification would better reflect an entity’s financial position at the balance sheet date and clear disclosures would allow users to understand changes that have occurred after the balance sheet date. The accounting firm stated that if the Board retains the exception, the proposed guidance would have limited applicability in practice because lenders rarely provide a waiver for a period greater than one year from the balance sheet date, and in most circumstances, lenders generally will only provide a waiver to the next covenant measurement date, which is typically on a quarterly basis. The accounting firm asserted that even when covenants are measured annually, lenders will only provide a waiver to the next measurement date and not for a period greater than one year from the balance sheet date. The accounting firm stated that it would not expect many entities, including private companies, to qualify for the exception.

50. An accounting firm stated that it is unclear how removing the exception would adversely affect private companies. That accounting firm also suggested that the Board remove the proposed exception. However, if the Board retains the exception, the accounting firm recommended the following amendments:

(a) Remove proposed paragraph 470-10-45-23(c), which would require an entity to determine whether the waiver results in an extinguishment of debt or a troubled debt restructuring. Although the proposed exception is generally consistent with current guidance, the requirement for entities to analyze waivers obtained after the balance sheet date would be costly and require auditors to perform additional procedures. The accounting firm noted that it views debt extinguishments and troubled debt restructurings as akin to a refinancing, which is a Type 2 nonrecognized subsequent event and, therefore, should be excluded from considering the classification of debt at the balance sheet date.
(b) Amend proposed paragraph 470-10-45-23(d) such that it would only require an entity to evaluate the probability of whether the same or a more restrictive covenant would be violated 12 months from the balance sheet date. The accounting firm asserted that requiring entities to assess the probability of violating every covenant in a debt agreement to meet the exception would be costly and would add complexity to the classification guidance. Furthermore, a similar assessment is not required under current guidance and, therefore, would be a significant change from current practice.

Cost of the Proposed Exception

51. Seventeen of the 26 respondents directly commented on whether including this exception would reduce the cost of applying the proposed guidance. Half of those respondents indicated that inclusion of the exception would be cost neutral compared with current guidance. A couple of respondents noted that there would be increased costs to comply with the new guidance if no exception was provided. Several respondents stated that the cost of applying the new guidance would be greater than applying current guidance because of the requirement to determine whether there is an extinguishment of debt or a troubled debt restructuring. One respondent stated that the level and extent of cost reductions would vary by entity and its financing terms and covenants. Another respondent stated that providing an exception to the classification principle creates unnecessary costs and complexity.

Separate Presentation in a Classified Balance Sheet

52. Many respondents disagreed with the proposed presentation requirements. Of the 24 respondents that commented about the proposed 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, only 6 respondents (2 accounting firms, 1 other accounting society, and 3 CPA societies) agreed that separate presentation would provide decision-useful information. Two of those six respondents also recommended that the Board provide an exception for short-term debt that is refinanced on a long-term basis after the balance sheet and require separate line item presentation of such debt.

53. One accounting firm conditionally agreed with the proposed amendments and noted that the separate presentation could provide decision-useful information. However, the accounting firm noted that the proposed presentation requirement is not significantly different from a requirement to classify that debt as a current liability such that an exception to the proposed principle is warranted.

54. There were 16 of 24 respondents that disagreed with the proposed presentation for the following reasons:
(a) Separate presentation of debt that has been reclassified because of a waiver does not provide decision-useful information and adds unnecessary complexity to the balance sheet. The proposed disclosure requirements in paragraph 470-10-50-6 would provide users with adequate information about an entity's covenant violation.

(b) Current versus noncurrent classification of liabilities on the balance sheet is most relevant to users 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 compared with other debt that is classified as noncurrent. Information about why the debt is classified as noncurrent is most appropriately included in the footnotes.

(c) Presenting additional line items on the balance sheet does not provide financial statement users with greater transparency about the nature of the debt. If the classification principles are clear and concise, disaggregating different types of long-term debt on the balance sheet on the basis of the reason why they were classified as noncurrent does not provide meaningful information. Separate presentation could result in balance sheets that are too detailed and harder to read.

(d) There is no required separate presentation for debt with a waiver that is obtained before the balance sheet date. The intent of the proposed separate presentation is to highlight the application of the exception that would not have otherwise permitted the classification of the debt as noncurrent. If separate presentation is required, it would be more appropriate to require all debt that has a covenant violation to be presented separately regardless of whether a waiver was obtained before year-end, obtained after year-end, or not obtained at all.

(e) There is a risk that by having separate presentation on the balance sheet there will be confusion about whether certain debt instruments are subordinated to others and the relative liquidity of the debt, which is not representative of actual differences between debt instruments.

(f) Separate line item presentation would be, in effect, equivalent to questioning whether such debt should be classified as noncurrent.

(g) Entities should have the option to disclose the balance sheet classification as opposed to presenting a separate line item in a classified balance sheet. A footnote would provide sufficient information.

Refinancing after the Balance Sheet

55. There were 26 respondents that commented on the proposed amendments that would require an entity to classify as a current liability a debt arrangement that is short term at the balance
sheet date but refinanced as long-term debt after the balance sheet date but before the financial statements are issued.

56. There were 15 respondents (5 accounting firms, 7 CPA societies, 2 preparers, and 1 other accounting society) that disagreed with the proposed amendments and requested that the Board consider noncurrent classification for short-term debt that is refinanced as long-term debt after the balance sheet date but before the financial statements are issued (or available to be issued).

57. Multiple respondents stated that the proposed amendments would fail to present a debt classification that is relevant to the entity’s actual debt arrangement at the time of the issuance of the financial statements. The usefulness of information to the users of financial statements would be greatly diminished if the Board were to require classification to be determined on the basis of contractual terms in a debt arrangement that are no longer relevant. The most current information about the status of a debt arrangement presents far more decision-useful information.

58. One preparer stated that presenting short-term debt that is refinanced on a long-term basis after the balance sheet date as current is misleading and not a true representation of the actual use of working capital. This misleading presentation is more evident when the debt is classified as current but the related asset securing the debt (for example, a security instrument for mortgaged debt) is classified on the balance sheet as noncurrent, resulting in an inaccurate current ratio.

59. One CPA society noted that the classification of short-term debt that is refinanced on a long-term basis after the balance sheet date should be determined by evaluating individual facts and circumstances, rather than by applying an overall presumption that all refinancing transactions are the same. In many circumstances, various factors and processes involved in the refinancing of debt take place over an extended period and require the involvement of third parties. Lenders, legal advisors, and others that are outside of an entity’s control frequently cause the debt refinancing to be finalized after the balance sheet date but before the financial statements are issued (or available to be issued). The CPA society asserted that in many situations, those conditions existed at and before the balance sheet date and that the final refinancing arrangement is the culmination of business and legal negotiations that existed over a relatively long period.

60. Two preparers disagreed with the Board’s conclusion that a subsequent refinancing does not provide evidence about conditions that existed at the balance sheet date (Type 2 nonrecognized subsequent event). In their view, an entity’s intent and ability to refinance its debt are both significant conditions that exist at the balance sheet date that are important to users, and, therefore, the intent and ability to refinance debt should continue to be considered
when determining the classification of short-term debt that is refinanced as long-term debt after the balance sheet date.

61. Several respondents (one accounting firm, one other accounting society, and two CPA societies) stated that the guidance for subsequent events should not be the driving factor in the classification of short-term debt that is refinanced as long-term debt after the balance sheet date for the following reasons:

(a) Classification does not reflect information at financial statement issuance. One CPA society stated that while a refinancing meets the criteria of a nonrecognized subsequent event, the resulting current classification reduces the usefulness of the information because it does not provide timely information about the characteristics of the debt payments at the time the financial statements are issued. Consequently, the CPA society recommended a separate principle for which debt classification is subjective and an estimate that would, in part, separate the analysis from the subsequent events guidance. Alternatively, the CPA society noted that it would support an exception for refinancings consistent with the exception for obtaining debt covenant waivers because there is no significant decision-useful distinction between those two events.

(b) Subsequent events guidance should not apply to presentation. The other accounting society noted that debt refinancings are different from the examples provided in Topic 855, Subsequent Events, and that the emphasis in Topic 855 is on the proper recognition and measurement of income and expenses rather than on classification in a balance sheet.

(c) An exception for refinancings provides better liquidity information. The accounting firm stated that while a case 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 a confirmation of facts and circumstances that existed at the balance sheet date, classifying the related debt as current or noncurrent should not be based on whether the refinancing is a recognized or nonrecognized subsequent event. Rather, the accounting firm and a CPA society stated that an exception to the proposed principle should be provided that requires noncurrent classification of short-term debt refinanced as long-term debt after the balance sheet date but before the financial statements are issued (or available to be issued) because an exception would convey more meaningful information about the entity’s liquidity to the users of the financial statements.

62. Multiple respondents noted that the proposed guidance for short-term debt that is refinanced as long-term debt after the balance sheet date is inconsistent with the proposed guidance on waivers of a debt covenant violation obtained after the balance sheet date although there are similar facts and circumstances. Those respondents asserted that the two situations are essentially the same; that is, debt arrangements have changed after the balance sheet date
but before the issuance of the financial statements. However, in one circumstance, the debt would be required to be classified as current, and in the other circumstance, the debt would be required to be classified as noncurrent. The inconsistent application of similar facts adversely impairs the usefulness of the financial statements.

63. A preparer and one other accounting society noted that they agree with paragraph 23 of the basis for conclusions in FASB Statement No. 6, *Classification of Short-Term Obligations Expected to be Refinanced*, which states that:

> ...the scheduled maturity date of an obligation is not necessarily indicative of the point in time at which that obligation will require the use of the enterprise’s funds. Inclusion of all short-term obligations within the current liability classification ignores the fact that enterprises, for sound economic reasons, often use commercial paper and other short-term debt instruments as means of long-term financing or that they often replace the currently maturing portion of long-term debt with other long-term debt.

The preparer noted that its experience supports the Board’s original view because when there is intent and ability to refinance debt, the decision to refinance the debt is driven by an assessment of various economic and other factors and management’s judgment on the most beneficial time to refinance. The preparer asserted that the timing of an entity’s application of those factors should not be the ultimate driver behind the classification of debt when clear, objective evidence points to the existence of such factors at the balance sheet date.

64. Additionally, the preparer indicated that removing the classification guidance on the intent and ability to refinance debt will reduce comparability among financial statements by distorting working capital calculations that are based on amounts reported in the balance sheet and will add complexity to a simple calculation. Furthermore, the preparer stated that rating agencies and other sophisticated financial statement users would adjust their financial statement analyses for subsequently refinanced debt, which increases complexity and decreases the relevance of the balance sheet. Conversely, less sophisticated users may not make such adjustments and would be led to a different conclusion of an entity’s working capital and other ratios. For those reasons, the preparer noted that this aspect of the proposed amendments does not meet the Board’s goal to reduce cost and complexity while maintaining or improving the usefulness of the information provided to users of the financial statements.

65. Three accounting firms asserted that contrary to the proposed current classification, requiring noncurrent classification of short-term debt that is refinanced as long-term debt after the balance sheet date would be consistent with the Master Glossary definition of the term *current liabilities* because the refinanced debt would be reasonably expected not to require the use of current assets.

66. The one other accounting society noted that certain licensing agencies and other lenders are primarily concerned with an entity maintaining certain ratios from amounts strictly derived from
information on the balance sheet, income statement, and statement of cash flows. The proposed guidance could result in unintended consequences to entities that would now be required to present refinanced debt as current. Therefore, the Board should consider retaining the guidance for noncurrent classification when short-term debt is refinanced on a long-term basis after the balance sheet date.

67. Eight of the 26 respondents (6 accounting firms, 1 preparer, and 1 CPA society) agreed with the proposed amendments noting that the refinancing of a short-term obligation after the balance sheet date but before the financial statements are issued is a nonrecognized subsequent event. Therefore, that obligation should be classified as a current liability. Those respondents also noted that classifying debt that is refinanced after the balance sheet as a current liability is consistent with the proposed classification principle.

68. Three of the 26 respondents, all accounting firms, conditionally agreed with the proposed amendments. One accounting firm commented that it is unclear whether the proposed amendments conflict with the Master Glossary definition of the term current liabilities because in many cases, short-term debt that is refinanced on a long-term basis after the balance sheet may not represent an obligation that is liquidated using existing resources properly classifiable as current assets or the creation of other current liabilities.

69. A second accounting firm that conditionally agreed stated that the proposed amendments do not clearly explain how a contractual right to refinance (for example, a financing commitment) that exists at the balance sheet date affects classification. The accounting firm noted that it is important for the Board to clarify how the borrower should assess a right to refinance under the proposed amendments when such a right exists at the balance sheet date to determine debt classification because entities often borrow under short-term arrangements backed by long-term standby credit agreements.

Private Company Specific Feedback—Refinancing After the Balance Sheet Date

70. One accounting firm supported the proposed amendments for public companies, but not for entities other than public business entities. That accounting firm stated that it understands the concerns raised by private companies during outreach and recognizes that private companies may be most significantly burdened by the removal of the current guidance because their financial statements are typically only issued on an annual basis. For example, if a private company has short-term debt as of the balance sheet date that is refinanced on a long-term basis in the first quarter, the debt will be presented as current in the annual financial statements until the following year-end. A public company, on the other hand, would only classify the refinanced debt as noncurrent in its first quarter interim financial statements. The accounting firm noted that while the current guidance on short-term obligations expected to be refinanced conflicts with the overall proposed classification principle, the current guidance is not difficult
to apply and does not create any misunderstanding of a company's liquidity. The accounting firm stated that providing a private company alternative to the classification principle for a refinancing completed after the balance sheet date but before the financial statements are available for issuance would not add significant complexity to the model or be misleading to financial statement users.

71. Three accounting firms and a CPA society that disagreed with the proposed amendments specifically provided feedback about the effect of the proposed amendments on entities other than public business entities. The CPA society stated that the proposed amendments would be burdensome for private companies, requiring allocation of limited resources to going concern evaluations, additional footnote disclosures, and explaining to financial statement users why the entity is not at risk of failing to meet its current obligations. One of the three accounting firms asserted that the proposed amendments would have a detrimental effect on those entities' financial ratios and that refinancings are essential to management's budgeting and cash flow decisions. The second accounting firm noted that it is not practical for private companies to refinance debt before the balance sheet date because some lenders prefer to renew debt after they obtain draft financial statements, which allows the lender to avoid including more restrictive covenants in the debt arrangement and to minimize the cost to the entity. Under the proposed amendments, 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.

72. The third accounting firm acknowledged that existing guidance that requires noncurrent classification of short-term debt refinanced after the balance sheet date can create problems. Specifically, the timing of when financial statements are issued during a refinancing could result in different balance sheet classifications for two borrowers with otherwise similar fact patterns. The accounting firm noted that management of private companies could delay issuance of financial statements to avoid short-term classification of their debt; however, the accounting firm maintains that its private company clients negotiate with lenders in good faith and do not intentionally manipulate their balance sheets or delay issuance of their financial statements. The accounting firm stated that while classifying debt that is refinanced after the balance sheet date as current on the balance sheet would be consistent with the proposed classification principle, the balance sheet should reflect the true liquidity of the entity as of the date the financial statements are issued or available to be issued.

Disclosures

73. The amendments in the proposed Update include a requirement to disclose information about events of default. Proposed paragraph 470-10-50-6 states:
Events of default include violations of a loan covenant and triggers of a **subjective acceleration clause** (for example, when the borrower is notified by the lender of noncompliance). An entity shall disclose the following information about any events of default:

a. An explanation of the deficiency  
b. The amount of obligations subject to the default  
c. The terms of the waiver (including period of the waiver, if applicable)  
d. A description of the course of action that the entity has taken, or that it proposes to take, to remedy the deficiency.

74. Of the 21 respondents that commented on the proposed disclosures, 13 respondents agreed that the proposed disclosures would provide decision-useful information.

75. Seven respondents (five accounting firms, one CPA society, and one preparer) conditionally agreed with the proposed disclosures and suggested that the Board make improvements. Two accounting firms stated that the Board should consider requiring disclosures about the existence of subjective acceleration clauses before those clauses are triggered because such disclosures would provide decision-useful information to users. The preparer suggested that the Board allow flexibility in disclosing entity-specific relevant information about the default rather than require a prescriptive list of disclosures.

76. Five of those seven respondents suggested that the Board clarify or provide additional guidance on certain aspects of the proposed disclosures, as described below.

(a) Two accounting firms and one CPA society noted that it is unclear what is meant by *deficiency* in proposed paragraph 470-10-50-6(a) and suggested that the Board clarify whether deficiency refers to the event of default. One of those respondents also suggested that the Board clarify the level of information that is required by the disclosure. For example, did the Board intend for an entity to disclose a covenant’s threshold (for example, working capital ratio of 2.5), or is disclosure about the nature of the covenant appropriate (for example, the entity is subject to a working capital covenant)?

(b) Two accounting firms and one CPA society noted that it is unclear what disclosure would be required by proposed paragraph 470-10-50-60(d). For example, could an entity satisfy the disclosure requirement by stating that it has obtained or intends to obtain a waiver for the violated covenant, or did the Board intend for an entity to provide information about management’s plans to resolve the violated covenant to be more consistent with the disclosures required by Subtopic 205-40, Presentation of Financial Statements—Going Concern?

(c) One accounting firm suggested that the Board clarify the circumstances that constitute a trigger of a subjective acceleration clause. The accounting firm asserted that it is unclear whether the only trigger is when the borrower is notified by the lender of noncompliance.
77. One accounting firm disagreed with the proposed disclosures, noting that such disclosures may be unfairly burdensome to small- and medium-sized entities.

Implementation Guidance and Illustrative Examples

78. The proposed Update did not include a question about implementation guidance and illustrative examples. However, many respondents indicated that this is an area that needs improvement.

79. Several respondents requested that the Board provide implementation guidance and illustrative examples on how to apply the proposed classification principle to the following:

(a) Debt convertible within one year of the balance sheet date.

(b) Debt arrangements that require mandatory prepayment when the entity meets excess cash flow thresholds.

(c) Debt arrangements with unknown principal cash flows at the balance sheet date (for example, debt arrangements involving a sale of future revenues).

(d) Debt arrangements in which payments may be accelerated by events outside the control of the entity and its lender. For example, oil and gas entities often use reserve-based revolving lines of credit governed by a borrowing base, which is typically calculated by multiplying the volume of oil and gas by the commodity price. Upon the stated recalculation or redetermination date, if amounts outstanding under a revolving line of credit exceed the borrowing base, the excess generally will be due and payable within a short period following the borrowing base redetermination date.

(e) Hybrid instruments when the host and the embedded derivative are accounted for separately but presented as a single line item in a classified balance sheet.

(f) Related party debt arrangements without a specific due date.

80. One accounting firm also suggested that the Board retain the fact patterns in the examples that would be removed by the proposed amendments to illustrate how the proposed classification principle would be applied to those common fact patterns.

81. Another accounting firm recommended that an additional case be added to Example 1 (paragraphs 470-10-55-2 through 55-3F) to reinforce the application of the proposed guidance on the exception to the debt classification principle for waivers of debt covenant violations obtained after the reporting date but before the financial statements are issued.

82. Five respondents, including four accounting firms and one other accounting society, provided feedback on Example 2 (paragraphs 470-10-55-7 through 55-9), as follows:

(a) The Board should clarify how a borrower should assess a right to refinance. The ability to classify debt as noncurrent on the basis of a potential refinancing after the balance sheet
date as illustrated in Example 2 appears inconsistent with the view that nonrecognized subsequent events (for example, a post-balance-sheet refinancing) should not affect the classification of debt as of the balance sheet date. Therefore, it would be important for the Board to clarify how a borrower should assess a right to refinance under the proposed principle in paragraph 470-10-45-22(b) when such a right exists at the balance sheet date to determine debt classification.

(b) The conclusion illustrated in paragraph 470-10-55-9 appears to be an exception to or inconsistent with the proposed principle in paragraph 470-10-45-22(b), which states that the entity has a contractual right to defer settlement of the liability for at least one year (or operating cycle, if longer) after the balance sheet date. It is unclear how a refinancing with a different lender, which would be accounted for as an extinguishment, would meet that criteria. It appears that in Example 2, the Board does not consider the extinguishment to be a settlement of a liability; rather, the Board considers the right to refinance with a different lender to be a contractual right to defer settlement of the liability.

(c) The ability to classify debt as noncurrent simply on the basis of a letter-of-credit arrangement with a different lender is inconsistent with the criteria proposed in paragraph 470-10-45-23(c) on debt covenant waivers. That criteria requires noncurrent classification unless the waiver results in a modification of the debt arrangement that would be accounted for as an extinguishment. That is, a waiver that results in an extinguishment would cause a debt arrangement to be classified as current. As illustrated in Example 2, debt that is refinanced in a transaction that would be accounted for as an extinguishment of existing debt and a recognition of new debt would be classified differently from debt extinguished in a modification related to a covenant waiver, although the debt in both cases would be extinguished without the use of current assets.

(d) Example 2 illustrates that entering into a letter of credit on or before the balance sheet date would result in the classification of short-term obligations as noncurrent. The Board should amend the proposed classification principle to explicitly state that result and specify the characteristics that a letter-of-credit or similar financing arrangement would need to possess for the debt to be classified as noncurrent.

(e) In Example 2, it does not appear that an entity must have the intent to use the financing agreement to refinance the short-term debt. Rather, it appears that the entity would be able to arbitrarily reclassify current debt to noncurrent, which does not depict the entity's liquidity at the balance sheet date. The respondents encouraged the Board to reconsider whether the borrower’s intent to use the financing agreement should continue to be a requirement to classify the otherwise current liability as noncurrent. Furthermore, the respondents noted that while an additional requirement related to intent would be a departure from a pure
contractual approach, the mere existence of a long-term financing agreement with another party is insufficient justification for reclassification.

(f) The Board should clarify whether the letter-of-credit issuer is acting as an agent or a principal of the debtor. In situations in which the letter-of-credit issuer is acting as an agent on behalf of the debtor, noncurrent classification would not be appropriate. Under current GAAP, the refinancing of debt with a different lender (or with the same lender but on substantially different terms) by the debtor or a third-party intermediary acting on behalf of the debtor is not accounted for as a deferral of the settlement of the liability, but as a debt extinguishment. If the letter-of-credit issuer is acting as a principal and acquires the debt instruments from the holders for cash, the transaction would be viewed as a transfer between debt holders. In that circumstance, noncurrent classification of the debt would be appropriate (provided that the terms of the debt arrangement with the letter-of-credit issuer are not substantially different) because the transaction would have no effect on the issuer’s accounting.

83. Two accounting firms commented on proposed Example 8 (paragraphs 470-10-55-41 through 55-43). One of those accounting firms noted that the proposed guidance in Example 8 consists of simplified examples and does not address other situations about subjective acceleration clauses that commonly arise in practice (for example, lenders notifying borrowers of noncompliance with a material adverse change clause after the balance sheet date but before the financial statements are issued, or lenders waiving a material adverse clause). Therefore, that accounting firm recommended that the Board provide additional illustrative examples. A second accounting firm stated that Example 8 appears to indicate that a subjective acceleration clause would not be considered for classification or disclosure purposes until the lender has received information and notified the borrower that a subjective acceleration clause has been triggered. The accounting firm recommended that the Board consider requiring the borrower to disclose the existence of the subjective acceleration clauses before they are triggered to provide clearer and more transparent information to financial statement users.

Time Needed to Adopt Amendments

84. There were 21 respondents that commented on implementation period. Fifteen respondents indicated that entities would not need a significant amount of time to adopt the new guidance. Two of those 15 respondents suggested a 1- to 2-year transition period while another respondent noted that an effective date for public business entities should be for periods beginning no earlier than 2019. Two other respondents stated that the new guidance should
be effective upon issuance or soon after issuance of a final standard so that users receive information that is consistent across entities.

85. One other accounting society noted that if the proposed amendments become final guidance, then a significant amount of time will be needed by entities to understand the implications of the guidance. Financial statement users such as creditors, regulators, and licensing agencies may be required to reconfigure their application and compliance processes to address the proposed amendments. Specifically, the classification of debt at the balance sheet date on the basis of contractual terms may no longer represent the actual maturity at the time of the issuance of the financial statements. The changes in classification resulting from the proposed amendments would need to be incorporated into the processes of users that base their credit and investment decisions solely on ratios and numerical thresholds derived from amounts presented on the balance sheet, income statement, and the statement of cash flows.

86. Four respondents, including two accounting firms and two CPA societies, stated that the amount of time necessary to adopt the new guidance could be significant, particularly if the Board retains the proposed amendments on short-term debt that is refinanced on a long-term basis after the balance sheet date. Those respondents provided the following reasons as a basis for their feedback:

(a) New processes and internal controls for accounting and disclosure would need to be developed.

(b) Entities would need time to prepare additional disclosures as part of the subsequent events footnote about refinancing that occurs after the balance sheet date.

(c) Entities may need to evaluate their debt arrangements and have discussions with lenders about those arrangements and their debt covenants before implementing the new guidance.

(d) Entities may need to renegotiate covenants in other debt arrangements that will be violated as a result of classifying short-term debt that was refinanced as long-term debt after the balance sheet date as a current liability.

87. Lastly, one accounting firm noted that it would defer to financial statement preparers about the time needed to implement the new guidance, but would recommend the same effective date for all entities.

88. There were 14 respondents that commented on whether the amount of time needed to implement the new guidance by entities other than public business entities should be different from the amount of time needed by public business entities. Four respondents said that entities other than public business entities should have more implementation time so they can learn and observe from public business entity implementation and communicate with financial
statement users. Ten respondents said that entities other than public business entities should not need additional implementation time.

89. One accounting firm that did not directly comment on the time needed by entities other than public business entities to implement the new guidance recommended that if the Board establishes different effective dates for public business entities and other than public business entities, an entity’s status should not be determined by the Master Glossary definition of the term *public business entity*, but instead on whether the entity files financial statements with the U.S. Securities and Exchange Commission (SEC). The accounting firm noted that determining the effective date on the basis of the Master Glossary definition of the term *public business entity* would result in unnecessary complexity for public entities with equity method investees that do not file with the SEC but that are considered public business entities by the investor for financial statement purposes.

**Early Adoption**

90. There were 16 respondents that directly commented on whether early adoption should be permitted. All of those respondents supported early adoption. One of those respondents noted that if the final amendments are effective shortly after issuance, there is no need to provide for early adoption. Another respondent that did not directly comment on whether early adoption should be permitted stated that the guidance should be effective upon issuance so that there is consistency in financial reporting.

**Discussion at the June 2017 Small Business Advisory Committee (SBAC) Meeting**

91. At their June 2017 meeting, SBAC members discussed the proposed principle, short-term debt that is refinanced as long-term debt after the balance sheet date, waivers of debt covenant violations, and the time needed to adopt the new guidance.

92. Several SBAC members indicated that classifying debt on the basis of contractual terms is the simplest approach; however, some SBAC members expressed concerns about the proposed amendments. Some SBAC members noted that the proposed classification principle is inconsistent with the Master Glossary definition of the term *current liabilities*.

93. Several SBAC members provided feedback on the proposed amendments that would require an entity to classify as a current liability a debt arrangement that is short term at the balance sheet date but refinanced as long-term debt after the balance sheet date but before the financial statements are issued. Some SBAC members asserted that a current classification could make it more difficult for users to effectively analyze liquidity. Two SBAC members who are financial statement users commented that they would evaluate subsequent events (such as short-term debt that is refinanced as long-term debt after the balance sheet date) and adjust their financial statement analyses to reflect the debt’s status as of the financial statement issuance date.
Short-term debt that is refinanced as long-term debt after the balance sheet date would be considered noncurrent debt. Those users also noted that although the proposed classification principle is more consistent from a conceptual standpoint, sophisticated users would make adjustments to debt classification on the basis of information provided in the footnotes and other relevant facts and circumstances. Therefore, given the continued need for adjustments, there may not be a significant benefit from some of the proposed changes in this project. Those users also noted that the proposed changes could be misleading for less sophisticated financial statement users that may not evaluate subsequent events and, therefore, may not make adjustments when analyzing financial statements.

94. Many SBAC members agreed with the proposed exception to the classification principle for waivers of debt covenant violations received after the reporting date but before the financial statements are issued. Those members supported the Board’s basis for conclusions for the exception, which relates to the practical limitations that companies face in receiving debt waivers. Lastly, some SBAC members noted that adequate time to adopt the new guidance should be provided so that entities are able to evaluate and renegotiate debt arrangements, with some SBAC members noting that a year would be sufficient.