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May 3, 2017

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Proposed Accounting Standards Update, Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent) (File Reference No. 2017-200)

Dear Technical Director:

We appreciate the opportunity to comment on the proposed ASU, Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent).

We support the Board's objective to identify, evaluate and improve areas of GAAP in which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to financial statement users. With respect to this proposal, we believe the Board should more clearly explain the change in the underlying principle that has been used historically in GAAP. We also suggest certain clarifications that would increase consistency in applying the proposal.

This cover letter summarizes our key observations. Appendix I provides our detailed responses to the Board's questions for respondents. Appendix II describes our other observations.

A different principles-based approach

The proposal states that the Board is seeking to replace the "current, fact-specific guidance with an overarching, cohesive principle". We believe the fact-specific guidance in current GAAP actually is based on a cohesive underlying principle, albeit a different underlying principle from the one that the Board is proposing.

The underlying principle in current GAAP is based on the definition of current liabilities in the Master Glossary and informs financial statement users about whether the entity expects to use current assets to satisfy its existing debt obligations. The definition states, "Current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities."

The Board proposes to replace this principle with one under which classification would be based on the contractual terms of the debt arrangement as of the balance sheet date. While the proposed ASU may require less management judgment in applying the classification guidance, we believe the exception that the Board would allow to the proposed underlying principle would introduce a level of complexity.

If the Board finalizes this proposal as issued, we believe that the Board should revise the definition of current liabilities in the Master Glossary to align with the new principle.

Use of judgment in current GAAP

The phrase "unless facts and circumstances indicate otherwise" in paragraph 470-10-45-1 of current GAAP is used in practice to allow management judgment in determining whether debt should be classified as noncurrent or current (i.e. in view of all relevant facts and circumstances, is it reasonable for management to expect that it will not need to use current assets to satisfy the obligation). Because the proposed ASU focuses exclusively on circumstances that exist at the balance sheet date (with the exception of covenant waivers), the resulting debt classification could be seen as counterintuitive and/or misleading to financial statement users in some situations.

For example, assume an entity has outstanding debt that is contractually due in 10 years. As of the balance sheet date (December 31, 20X6), there are no violations of objectively-determinable covenants, but the entity files for bankruptcy one week before the financial statements are issued (February 20, 20X7). The proposed ASU would require the debt to be classified as noncurrent. In this situation, it may be more transparent to some financial statement users for the debt to be classified as current to reflect the subsequent bankruptcy filing because the underlying conditions that resulted in the bankruptcy filing existed as of the balance sheet date.

Exception to proposed principle

The proposed ASU would provide an exception to the principle that an entity classifies debt as noncurrent only when it is due more than one year (or operating cycle, if longer) after the balance sheet date or the entity has a contractual right at the balance sheet date to defer settlement of the liability for at least one year (or operating cycle, if longer) after that date. The exception addresses debt for which an entity has violated an objectively-determinable covenant as of the balance sheet date. To meet the exception proposed in paragraph 470-10-45-23, not only must an entity obtain a waiver before issuing its financial statements (or making them available for issuance), an entity also must apply judgment to evaluate whether it is probable that it will violate other objectively-determinable covenants in the next 12 months (or operating cycle, if longer) from the balance sheet date (proposed paragraph 470-10-45-23(d)).

We believe that applying this exception would require a forward-looking judgment and would be inconsistent with the principle underlying the proposed ASU, which focuses on the terms and conditions of the contract at the balance sheet date (or waiver date, in the case of the exception).

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This forward-looking judgment also is inconsistent with the proposal for evaluating subjective covenant provisions (e.g. material adverse change clauses), which the entity would ignore as long as the lender has not provided notice as of the balance sheet date. If the Board retains the exception for waivers of violations of objectively-determinable covenants in the final ASU, we recommend the Board remove this forward-looking judgment to be more consistent with the underlying principle described in the proposal.

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If you have questions about our comments or wish to discuss the matters addressed in this comment letter, please contact Kimber Bascom at (212) 909-5664 or kbascom@kpmg.com, Patrick Garguilo at (212) 954-2852 or pgarguilo@kpmg.com or Paul Munter at (212) 909-5567 or pmunter@kpmg.com.

Sincerely,

Handwritten signature of KPMG LLP in black ink.

KPMG LLP

Appendix I – Responses to the Board’s Questions

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.

The proposal states that the Board is seeking to replace the “current, fact-specific guidance with an overarching, cohesive principle”. We believe the fact-specific guidance in current GAAP actually is based on a cohesive underlying principle that the Board proposes to replace with a different principle.

The underlying principle in current GAAP is based on the definition of current liabilities in the Master Glossary and informs financial statement users about whether the entity expects to use current assets to satisfy its existing debt obligations. While some may view the proposed principle as simplifying the guidance because it requires less management judgment, we are not certain the proposed principle would provide information to financial statement users that is as relevant and useful as the information provided under the current principle. However, if the Board finalizes the proposal as issued, we believe it should amend the definition of current liabilities to align it with its proposed principle.

Additionally, the proposal would delete a number of examples from current GAAP. We believe it would be useful to retain the fact pattern in the examples to illustrate how the proposed principle would be applied to those common fact patterns. In addition, we encourage the Board to consider adding an example for debt that requires mandatory prepayment when the issuer meets excess cash flow thresholds.

For example, an entity issues debt that requires full repayment at the end of its seven-year contractual term. The debt instrument includes an excess cash flow provision that requires the entity to make a mandatory prepayment of the debt equal to a certain percent of its ‘excess cash flow’ at the end of each calendar year. The entity measures its excess cash flow at each year-end. It would be helpful to clarify whether the entity would classify a portion of the debt as current under the proposal if the excess cash flow threshold (a) is met as of a quarter-end and (b) is not met at quarter-end but is forecasted to be met within a year of the quarter-end balance sheet date.

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.

The scope of the amendments is clear and we do not believe other instruments should be included within the scope.

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 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 believe preparers and users are best able to comment on whether the exception for waivers of debt covenant violations would reduce the costs of applying the proposed amendments. However, in evaluating the costs of the proposal, the Board should consider not only the potential reduction in cost for preparers, but also the potential increase in costs to users who may need to perform additional analyses when evaluating the entity's liquidity position.

Question 4:

Paragraph 470-10-45-24 would require separate presentation in a classified balance sheet for debt that is classified as noncurrent 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 believe users are best able to comment on whether separate presentation of debt that is classified as noncurrent because of waivers obtained for objectively-determinable covenant violations provides decision-useful information.

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 refinances are nonrecognized subsequent events? If not, please explain why and suggest alternatives.

We agree that classifying debt that is refinanced before the financial statements are issued as current is consistent with the proposed principle, which is different from the underlying principle in current GAAP.

Question 6:

Paragraphs 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.

While the proposed disclosure requirements would provide decision-useful information, we believe that it also would be useful for financial statement users to have disclosures about the existence of subjective acceleration clauses before those clauses are triggered.

We also believe the Board should clarify the proposed disclosure requirements in paragraph 470-10-50-6 as marked:

Events of default include (a) violations of loan covenants and (b) triggers of a subjective acceleration clause (for example, when the borrower is notified by the lender of noncompliance). In the period in which an event of default occurs, an entity shall disclose the following 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?

We are not aware of reasons why entities other than public business entities would need additional time to implement the proposed amendments. Further, we believe that the proposed amendments should be effective soon after the Board issues a final ASU so that financial statement users receive information that is consistent from one entity to another. If the final ASU is effective shortly after it is issued, there would not be a need to provide for early adoption. If the final ASU is not effective soon after it is issued, we believe early adoption should be permitted.

Appendix II – Other Observations

Example 2 of the Implementation Guidance

In Paragraph 470-10-55-8, the Board should replace the term ‘short-term liabilities’ with ‘current liabilities’.

The conclusion illustrated in paragraph 470-10-55-9 appears to contradict the proposed ASU by deleting paragraph 470-10-45-14. We understand that it is the Board’s intent that a financing agreement put in place that extends beyond one year and that would ‘replace’ existing debt otherwise classified as current, would not affect the classification of the existing debt. Example 2 appears to illustrate an exception to that principle. Additionally, it is not clear how the maturity date of the letter-of-credit arrangement is relevant to the classification of the redeemable bond. We recommend that the Board resolve the inconsistency or clarify how the letter-of-credit arrangement is relevant in the analysis.

Example 8 of the Implementation Guidance

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. We recommend that the Board consider requiring the borrower to disclose the existence of subjective acceleration clauses before they are triggered, to provide clearer and more transparent information to financial statement users.