

Simplifying the Balance Sheet Classification of Debt — FASB Moves Forward to an Exposure Draft

Yesterday, the FASB met to continue the discussion of its simplification project on the balance sheet classification of debt. The Board reconfirmed previous tentative decisions with certain refinements and directed its staff to draft a proposed Accounting Standards Update (ASU) for vote by written ballot.

Background

The current debt classification guidance in ASC 470-10¹ consists of an assortment of fact-specific rules and exceptions, the application of which varies depending on multiple factors. The Board's tentative approach would replace the current fact-specific guidance with a unified principle for determining the classification of debt as either current or noncurrent.

Overview of Tentative Approach

The Board's tentative approach would include the following proposals:

- *Classification principle* — As of the financial reporting date, an entity would classify a debt arrangement as noncurrent if either (1) the liability is contractually due to be settled more than 12 months after the balance sheet date or (2) the entity has a contractual right to defer settlement of the liability for at least 12 months after the balance sheet date.
- *Covenant violations* — As an exception to the classification principle, an entity would not classify debt as current solely because of a debt covenant violation if it has received a covenant waiver after the balance sheet date, but before the financial statements are issued. Entities would be required to present separately on the balance sheet the portion of debt that is classified as noncurrent as a result of the waiver exception.
- *Subjective acceleration clauses (SACs) and debt covenants* — SACs and covenants within long-term obligations affect the classification of the debt only when triggered or violated, in which case disclosure of the SAC or covenant would be required.
- *Probability assessment* — At its meeting, the Board decided to clarify the application of the probability assessment that is associated with the waiver exception. Entities would be required to assess whether a violation of any other covenant not covered by the waiver is probable within 12 months from the reporting date. If this is the case, the related debt would be required to be classified as current.
- *Refinancing of short-term obligations* — Short-term obligations that are refinanced on a long-term basis after the financial reporting date, but before the financial statements are issued, would be classified within current liabilities.

Editor's Note: Under the Board's tentative approach, some liabilities that are classified as noncurrent under existing U.S. GAAP would be classified as current, and other liabilities that are classified as current under existing U.S. GAAP would be classified as noncurrent. For example, as a result of the proposed change to the treatment of the refinancing of short-term obligations, an entity would not be allowed to consider refinancing events after the financial reporting date but before the financial statements are issued. Thus, such debt obligations would be classified as current liabilities as of the financial reporting date. Entities should consider the timing of refinancing plans and the potential effect on the classification of short-term obligations.

¹ FASB Accounting Standards Codification Subtopic 470-10, *Debt: Overall*.

Effective Date and Transition

The Board will determine an effective date for the guidance after it considers feedback on the proposed ASU. The proposal would require entities to adopt the new guidance prospectively, with early adoption allowed.

Next Steps

The proposed ASU is expected to be released in December 2016 or early January 2017. The comment period is expected to end no earlier than May 5, 2017.

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