Statement of Financial Accounting Standards No. 6

FAS6 Status Page
FAS6 Summary

Classification of Short-Term Obligations Expected to Be Refinanced

(an amendment of ARB No. 43, Chapter 3A)

May 1975

Financial Accounting Standards Board
of the Financial Accounting Foundation
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CONTENTS

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INTRODUCTION AND BACKGROUND INFORMATION

1. Some short-term obligations are expected to be refinanced on a long-term basis and, therefore, are not expected to require the use of enterprise working capital during the ensuing fiscal year. Examples include commercial paper, construction loans, and the currently maturing portion of long-term debt. Those obligations have been presented in balance sheets in a number of ways, including the following: (a) classification as current liabilities, (b) classification as long-term liabilities, and (c) presentation as a class of liabilities distinct from both current liabilities and long-term liabilities.

2. For purposes of this Statement, *short-term obligations* are those that are scheduled to mature within one year after the date of an enterprise's balance sheet or, for those enterprises that use the operating cycle concept of working capital described in paragraphs 5 and 7 of Chapter 3A, "Current Assets and Current Liabilities," of *Accounting Research Bulletin (ARB) No. 43,* within an enterprise's operating cycle that is longer than one year. Long-term obligations are those scheduled to mature beyond one year (or the operating cycle, if applicable) from the date of an enterprise's balance sheet. *Refinancing a short-term obligation on a long-term basis* means either replacing it with a long-term obligation or with equity securities or renewing, extending, or replacing it with short-term obligations for an uninterrupted period extending beyond one year (or the operating cycle, if applicable) from the date of an enterprise's balance sheet. Accordingly, despite the fact that the short-term obligation is scheduled to mature during the ensuing fiscal year (or the operating cycle, if applicable), it will not require the use of working capital during that period.

3. Exclusion of some short-term obligations from the current liability classification has been supported by paragraph 8 of Chapter 3A of *ARB No. 43,* which states that the current liability classification "is not intended to include a contractual obligation falling due at an early date which is expected to be refunded." In assessing whether a short-term obligation is "expected to be refunded," enterprise *intent* to refinance on a long-term basis and its *prior ability* to refinance

its short-term obligations have sometimes been considered sufficient for exclusion of the short-term obligation from current liabilities. In other cases, *future ability* to refinance as demonstrated by the existence of an agreement for long-term financing has been viewed as necessary.

4. SEC *Accounting Series Release (ASR) No. 148,* issued November 13, 1973, requires that commercial paper and other short-term debt be classified as a current liability unless (a) the borrower has a noncancelable binding agreement from a creditor to refinance the paper or other short-term debt and (b) the refinancing would extend the maturity date beyond one year (or operating cycle, if longer) and (c) the borrower's intention is to exercise this right.

5. Because of the diverse practices referred to in paragraphs 1 and 3 of this Statement and questions brought to the Board's attention concerning the differences between the criteria in paragraph 8 of Chapter 3A of *ARB No. 43* and those in *ASR No. 148,* the Board concluded that it should examine the criteria for classification of short-term obligations that are expected to be refinanced on a long-term basis.

6. The Board concluded that on the basis of existing data it could make an informed decision on the classification of short-term obligations expected to be refinanced without a public hearing. An Exposure Draft of a proposed Statement on "Classification of Short-Term Obligations Expected to Be Refinanced" was issued on November 11, 1974. Ninety-two letters were received in response to the request for comments. On January 9, 1975, the Board announced that it would not issue a final statement effective for fiscal periods ending December 31, 1974, as had been proposed in the Exposure Draft, to allow additional time for consideration of points raised in the comment letters. Appendix A describes the principal changes from the Exposure Draft and also sets forth the basis for the Board's conclusions, including alternatives considered and reasons for accepting some and rejecting others. Examples of application of this Statement are presented in Appendix B.

APPLICABILITY

7. The balance sheets of most enterprises show separate classifications of current assets and current liabilities (commonly referred to as classified balance sheets) permitting ready determination of working capital. Enterprises in several specialized industries (including broker-dealers and finance, real estate, and stock life insurance companies) for which the current/noncurrent distinction is deemed in practice to have little or no relevance prepare unclassified balance sheets. The standards established by this Statement apply only when an enterprise is preparing a classified balance sheet for financial accounting and reporting purposes.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Classification

8. Short-term obligations arising from transactions in the normal course of business that are due in customary terms shall be classified as current liabilities. Those obligations (as described in the second sentence of paragraph 7 of Chapter 3A of *ARB No. 43*) are "obligations for items which have entered into the operating cycle, such as payables incurred in the acquisition of materials and supplies to be used in the production of goods or in providing services to be offered for sale; collections received in advance of the delivery of goods or performance of services; . . . and debts which arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes."

9. A short-term obligation other than one classified as a current liability in accordance with paragraph 8 shall be excluded from current liabilities only if the conditions in paragraphs 10 and 11 are met.[1]

Intent to Refinance

10. The enterprise intends to *refinance the obligation on a long-term basis* (see paragraph 2).

Ability to Consummate the Refinancing

11. The enterprise's intent to refinance the short-term obligation on a long-term basis is supported by an ability to consummate the refinancing demonstrated in either of the following ways:

a. *Post-balance-sheet-date issuance of a long-term obligation or equity securities.* After the date of an enterprise's balance sheet but before that balance sheet is issued, a long-term obligation or equity securities [2] have been issued for the purpose of refinancing the short-term obligation on a long-term basis; or
b. *Financing agreement.* Before the balance sheet is issued, the enterprise has entered into a financing agreement that clearly permits the enterprise to refinance the short-term obligation on a long-term basis on terms that are readily determinable, and all of the following conditions are met:
   (i) The agreement does not expire within one year (or operating cycle—see paragraph 2) from the date of the enterprise's balance sheet and during that period the agreement is not cancelable by the lender or the prospective lender or investor (and obligations incurred under the agreement are not callable during that period) except for violation

of a provision [3] with which compliance is objectively determinable or measurable.[4]

(ii) No violation of any provision in the financing agreement exists at the balance-sheet date and no available information indicates that a violation has occurred thereafter but prior to the issuance of the balance sheet, or, if one exists at the balance-sheet date or has occurred thereafter, a waiver has been obtained.

(iii) The lender or the prospective lender or investor with which the enterprise has entered into the financing agreement is expected to be financially capable of honoring the agreement.

12. If an enterprise's ability to consummate an intended refinancing of a short-term obligation on a long-term basis is demonstrated by post-balance-sheet-date issuance of a long-term obligation or equity securities (paragraph 11(a)), the amount of the short-term obligation to be excluded from current liabilities shall not exceed the proceeds of the new long-term obligation or the equity securities issued. If ability to refinance is demonstrated by the existence of a financing agreement (paragraph 11(b)), the amount of the short-term obligation to be excluded from current liabilities shall be reduced to the amount available for refinancing under the agreement when the amount available is less than the amount of the short-term obligation. The amount to be excluded shall be reduced further if information (such as restrictions in other agreements or restrictions as to transferability of funds) indicates that funds obtainable under the agreement will not be available to liquidate the short-term obligation. Further, if amounts that could be obtained under the financing agreement fluctuate (for example, in relation to the enterprise's needs, in proportion to the value of collateral, or in accordance with other terms of the agreement), the amount to be excluded from current liabilities shall be limited to a reasonable estimate of the minimum amount expected to be available at any date from the scheduled maturity of the short-term obligation to the end of the fiscal year (or operating cycle—see paragraph 2). If no reasonable estimate can be made, the entire outstanding short-term obligation shall be included in current liabilities.

13. The enterprise may intend to seek an alternative source of financing rather than to exercise its rights under the existing agreement when the short-term obligation becomes due. The enterprise must intend to exercise its rights under the existing agreement, however, if that other source does not become available.[5]

14. Replacement of a short-term obligation with another short-term obligation after the date of the balance sheet but before the balance sheet is issued is not, by itself, sufficient to demonstrate an enterprise's ability to refinance the short-term obligation on a long-term basis. If, for example, the replacement is made under the terms of a revolving credit agreement that provides for renewal or extension of the short-term obligation for an uninterrupted period extending beyond one year (or operating cycle—see paragraph 2) from the date of the balance sheet, the revolving credit agreement must meet the conditions in paragraph 11(b) to justify excluding the short-term obligation from current liabilities. Similarly, if the replacement is a roll-over of commercial paper accompanied by a "stand-by" credit agreement, the stand-by agreement must meet the conditions in paragraph 11(b) to justify excluding the short-term obligation from

current liabilities.

Disclosure

15. A total of current liabilities shall be presented in classified balance sheets. If a short-term obligation is excluded from current liabilities pursuant to the provisions of this Statement, the notes to the financial statements shall include a general description of the financing agreement and the terms of any new obligation incurred or expected to be incurred or equity securities issued or expected to be issued as a result of a refinancing.

Amendments to Existing Pronouncement

16. The Board's conclusions require deletion of the following words from the second sentence of paragraph 8 of Chapter 3A, *ARB No. 43: a contractual obligation falling due at an early date which is expected to be refunded, or.* Footnote 4 and the reference to it in paragraph 8 of Chapter 3A are also deleted.

Effective Date and Transition

17. The provisions of this Statement shall be effective December 31, 1975 and shall apply to balance sheets dated on or after that date and to related statements of changes in financial position. Reclassification in financial statements for periods ending prior to December 31, 1975 is permitted but not required.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of six members of the Financial Accounting Standards Board. Mr. Mays dissented.

Mr. Mays dissents because this Statement permits the exclusion of short-term obligations from current liabilities under circumstances in which, in his view, such exclusion is unwarranted. He believes that the criteria for exclusion set forth in the Statement tend to blur rather than to sharpen the accounting concept of working capital.

He is of the opinion that more restrictive criteria would result in a more meaningful portrayal of current and long-term cash requirements. He believes that information concerning management's ability and intent to refinance certain of its obligations can be communicated in financial statements by footnote disclosure or by disclosures within the current liabilities section of the balance sheet. However, those considerations, while important, should not be permitted to obscure the nature of the obligations themselves.

In Mr. Mays's opinion, classification of an obligation as a current liability or as a long-term liability should be based on the maturity date of the obligation, and only in exceptional circumstances should the existence of a financing agreement affect that classification. Those circumstances would be (1) the agreement is noncancelable by the lender (whereas the Statement provides for reclassification even though the lender may cancel if a provision of the agreement is violated); and (2) the agreement is entered into for the stated purpose of refinancing the particular short-term obligation (whereas the Statement requires merely that the agreement not prohibit such refinancing); and (3) the enterprise fully intends to refinance the obligation on a long-term basis under the agreement (whereas the Statement provides for reclassification even if the enterprise intends to seek other sources of financing).

In Mr. Mays's view, since the Statement permits general lines of bank credit to be used to justify the exclusion of unrelated short-term debt from current liabilities, logic would suggest that any solvent corporation with sufficient unused borrowing capacity should be permitted to exclude from current liabilities any kind of short-term obligation that it intends to refinance on a long-term basis. While not in agreement with the criteria that the Statement establishes, given those criteria, he sees no logical basis for denying their application to any short-term obligation, including those payables for which reclassification is ruled out by paragraph 8 of the Statement.

Members of the Financial Accounting Standards Board:

Marshall S. Armstrong, *Chairman*
Oscar S. Gellein
Donald J. Kirk
Arthur L. Litke
Robert E. Mays
Walter Schuetze
Robert T. Sprouse

Appendix A: BASIS FOR CONCLUSIONS

18. This Appendix discusses factors deemed significant by members of the Board in reaching the conclusions in this Statement. Individual Board members gave greater weight to some factors than to others. The Appendix also sets forth suggestions made by those responding to the Exposure Draft and reasons for accepting some and rejecting others.

SCOPE OF THIS STATEMENT

19. Some respondents indicated that the Exposure Draft appeared to require all enterprises to prepare a classified balance sheet regardless of normal industry practice or other justification for adopting a balance sheet format that does not identify current assets and current liabilities. The question of whether it is appropriate for an enterprise to present an unclassified balance sheet is beyond the scope of this Statement. Accordingly, paragraph 7 indicates that the standards established by this Statement apply only if an enterprise is preparing a classified balance sheet.

20. The Board also concluded that it should not, as part of this project, re-examine the accounting concept of working capital described in detail in Chapter 3A of *ARB No. 43.* Paragraph 7 of Chapter 3A defines current liabilities as those whose liquidation "is reasonably expected to require the use of existing resources properly classified as current assets, or the creation of other current liabilities." That paragraph goes on to say that the current liabilities classification "is intended to include obligations for items which have entered into the operating cycle . . . and debts which arise from operations directly related to the operating cycle. . . ." Accordingly, paragraph 8 of this Statement requires that short-term obligations arising from transactions in the normal course of business that are to be paid in customary terms shall be included in current liabilities. On the other hand, short-term obligations arising from the acquisition or construction of noncurrent assets would be excluded from current liabilities if the conditions in paragraphs 10 and 11 are met. Similarly, short-term obligations not directly related to the operating cycle—for example, a note given to a supplier to replace an account payable that originally arose in the normal course of business and had been due in customary terms—would be excluded if the conditions in paragraphs 10 and 11 are met. This Statement does not specify disclosures relating to short-term obligations that are *included* in current liabilities, although the Statement does make explicit that a total of current liabilities shall be presented in classified balance sheets (see paragraph 15).

BALANCE SHEET CLASSIFICATION

21. The alternative solutions considered by the Board with regard to the question of how to classify a short-term obligation that is expected to be refinanced on a long-term basis (see paragraph 2) ranged between:

a. A *strict maturity-date* approach under which all obligations scheduled to mature within one year (or, in certain cases, within an enterprise's operating cycle) would be classified as current liabilities regardless of any intention to refinance on a long-term basis.
b. An approach based *solely* on management's intention to seek refinancing on a long-term basis without requiring evidence of the enterprise's ability to do so.

22. The Board also considered alternatives within that range. Those alternatives all require that the *intent* of the enterprise to refinance a short-term obligation on a long-term basis be demonstrated by an *ability* to consummate the refinancing, but they differ in terms of the conditions required to demonstrate that ability.

23. The Board rejected a strict maturity-date approach because 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. Borrowings under long-term revolving credit agreements and borrowings backed by long-term stand-by credit agreements are commonplace. A strict maturity-date approach would deny that these borrowings are sometimes, in substance, long-term financing. That approach would also result in a major change in the concept of current liabilities described in paragraph 7 of Chapter 3A of *ARB No. 43* as "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."

24. The Board also rejected classification based solely on an enterprise's intention to seek refinancing on a long-term basis. The Board concluded that intent, while essential, is insufficient to justify excluding a short-term obligation from current liabilities. The intent of an enterprise is an essential condition because without intent to refinance there is a presumption that liquidation of the short-term obligation would require the use of current assets or the creation of other current liabilities. The existence of a financing agreement, even one that requires that funds obtained thereunder be used to liquidate the short-term obligation, is irrelevant if the enterprise does not intend to refinance on a long-term basis. In the Board's judgment, however, intent alone does not provide sufficiently objective evidence to overcome the presumption that a short-term obligation will require the use of funds at its scheduled maturity date. The intent must be supported by a demonstrated ability to carry out that intent.

25. The two conditions set forth in this Statement for exclusion of a short-term obligation from current liabilities—intent and ability—are essentially the same as the requirements proposed in the Exposure Draft. That draft had proposed that a short-term obligation be classified as a current liability unless all of the following conditions were met:

a. The borrower has a noncancelable binding agreement to refinance the obligation from a source reasonably expected to be financially capable of honoring the agreement.
b. The maturity date of the new obligation expected to be incurred by the borrower as a result of the refinancing under the agreement will be more than one year from the date of the financial statements.
c. The borrower intends to exercise its rights under the agreement.

26. Many respondents to the Exposure Draft indicated that the requirement of a "noncancelable binding agreement" was unrealistic because lenders generally do not make unqualified commitments. Financing agreements often include provisions that could restrict borrowing under the agreement. As indicated by the conditions in paragraphs 11(b)(i) and 11(b)(ii) of this Statement, the inclusion of a restrictive covenant, representation, warranty, or other provision in a financing agreement does not prevent a short-term obligation from being excluded from current liabilities provided that compliance with the provision can be objectively determined or measured and provided that there is no evidence of a violation for which a waiver has not been obtained. In the Board's view, inability to objectively determine or measure compliance, or the existence of a violation of a provision for which a waiver has not been

obtained, raises a serious doubt about the enterprise's ability to consummate an intended refinancing to avoid the use of working capital and, consequently, requires classification of the short-term obligation as a current liability. The existence of a situation that permits the lender to cancel the agreement or otherwise to prevent the enterprise from exercising its rights thereunder after expiration of a grace period or after notice to the enterprise or both is also considered a violation of a provision that will, in the absence of a waiver, require classification of the short-term obligation as a current liability.

27. The Board has concluded that exclusion of a short-term obligation from current liabilities should not be precluded as long as the financing agreement *clearly permits* the enterprise to replace the short-term obligation with a long-term obligation or with equity securities or to renew, extend, or replace the short-term obligation with another short-term obligation for an uninterrupted period extending beyond one year (or operating cycle). The Board considered and rejected the proposal that a short-term obligation should be excluded from current liabilities only if a financing agreement is *specifically linked* to the short-term obligation, either by specifically permitting or requiring that funds obtained thereunder be used to liquidate the short-term obligation. In the Board's judgment, that proposal places undue emphasis on the form of an agreement rather than on its substance. It is neither practicable nor realistic to trace specific funds to their ultimate use. The financial position of an enterprise that has refinanced under a linked agreement will be indistinguishable from the financial position of an enterprise that has entered into the same transactions under an agreement that is not linked but clearly permits refinancing the short-term obligation. Moreover, whether or not a financing agreement is specifically linked to a particular short-term obligation, the enterprise is not precluded from issuing another short-term obligation at approximately the same time as the old obligation is refinanced under the agreement. The potential effect of such a transaction can be avoided only if a strict maturity-date approach is adopted, but the Board rejected that alternative for the reasons stated in paragraph 23. The Board believes that the requirement in paragraph 10 that the enterprise intend to refinance on a long-term basis and thus not to use working capital to repay the maturing short-term obligation more closely comports with the spirit of this Statement and Chapter 3A of *ARB No. 43* than would a requirement for specific linkage.

28. Respondents to the Exposure Draft indicated that many enterprises enter into agreements that assure their ability to refinance short-term obligations although they might not intend to exercise their rights under the agreement if an alternative source of financing becomes available. One of the conditions in the Exposure Draft was that the enterprise intend to exercise its rights under the agreement (see paragraph 25(c)). A footnote in the Exposure Draft indicated that this condition would be met if the enterprise intended to exercise its rights under the agreement when the short-term obligations could not continue to be refinanced on a short-term basis. Respondents asked the Board to clarify the intent of the condition in the Exposure Draft and the related footnote. The Board believes that the justification for excluding a short-term obligation from current liabilities is not negated simply because an enterprise may intend to seek a more advantageous source of financing (including, perhaps, short-term financing) than that provided under the financing agreement in existence when the balance sheet is issued. However, the

condition in paragraph 11(b)(i) requires that the agreement extend beyond one year (or operating cycle) from the date of the enterprise's balance sheet to demonstrate clearly the enterprise's ability to avoid using working capital to repay the short-term obligation. Moreover, paragraph 13 requires that the enterprise intend to exercise its rights under the agreement if another source of financing does not become available.

29. A number of respondents to the Exposure Draft asked whether events occurring after the date of the balance sheet but before the balance sheet is issued should be considered in assessing an enterprise's ability to consummate the refinancing of a short-term obligation on a long-term basis. In particular, the two types of post-balance-sheet-date events cited were (a) actual issuance of a long-term obligation or equity securities for the purpose of refinancing the short-term obligation on a long-term basis and (b) entering into a financing agreement after the balance-sheet date but before the balance sheet is issued. In the Board's judgment, both of those types of post-balance-sheet-date events should be considered in determining liability classification and in assessing an enterprise's ability to consummate an intended refinancing, and they are explicitly provided for in paragraphs 11(a) and 11(b).

30. Several respondents to the Exposure Draft asked whether a short-term obligation could be excluded from current liabilities if it is intended to be replaced (or, in fact, has been replaced after the balance sheet date) by issuing equity securities. A short-term obligation will not require the use of working capital regardless of whether refinancing on a long-term basis is accomplished by issuing debt securities or equity securities. Accordingly, *refinancing on a long-term basis* is defined in paragraph 2 to include issuance of equity securities, and a short-term obligation intended to be refinanced in that manner would be excluded from current liabilities if the conditions in paragraphs 10 and 11 are met. Although it is appropriate to exclude the short-term obligation from current liabilities when those conditions are met, the Board concluded that it is not appropriate to include the short-term obligation in owners' equity (see footnote 2 to paragraph 11(a)). The intent of an enterprise to refinance a short-term obligation on a long-term basis and its ability to do so relate to the question of whether the obligation is expected to require the use of working capital, not whether it is a liability. The obligation is a liability and not owners' equity at the date of the balance sheet.

EFFECTIVE DATE AND TRANSITION

31. Many respondents opposed the proposal in the Exposure Draft that balance sheets for dates prior to the effective date of the Statement be restated to conform to the provisions of the Statement. They indicated that restatement would not achieve comparability of balance sheets for dates prior to the effective date of the Statement with balance sheets for subsequent dates because of the new conditions established by paragraph 11. After considering all of the circumstances, the Board concluded that prospective application of this Statement is appropriate, with restatement permitted but not required, and that the effective date in paragraph 17 is advisable.

Appendix B: EXAMPLES OF APPLICATION OF THIS STATEMENT

32. The following examples provide guidance for applying this Statement. It should be recognized that these examples do not comprehend all possible circumstances and do not include all the disclosures that would typically be made regarding long-term debt or current liabilities.

GENERAL ASSUMPTIONS

33. The assumptions on which the examples are based are:

a. ABC Company's fiscal year-end is December 31, 19x5.
b. The date of issuance of the December 31, 19x5 financial statements is March 31, 19x6; the Company's practice is to issue a classified balance sheet.
c. At December 31, 19x5, short-term obligations include $5,000,000 representing the portion of 6% long-term debt maturing in February 19x6 and $3,000,000 of 9% notes payable issued in November 19x5 and maturing in July 19x6.
d. The Company intends to refinance on a long-term basis both the current maturity of long-term debt and the 9% notes payable.
e. Accounts other than the long-term debt maturing in February 19x6 and the notes payable maturing in July 19x6 are:

Current assets	$30,000,000
Other assets	$50,000,000
Accounts payable and accruals	$10,000,000
Other long-term debt	$25,000,000
Shareholders' equity	$37,000,000

f. Unless otherwise indicated, the examples also assume that the lender or prospective lender is expected to be capable of honoring the agreement, that there is no evidence of a violation of any provision, and that the terms of borrowings available under the agreement are readily determinable.

EXAMPLE 1

34. The Company negotiates a financing agreement with a commercial bank in December 19x5 for a maximum borrowing of $8,000,000 at any time through 19x7 with the following terms:

a. Borrowings are available at ABC Company's request for such purposes as it deems appropriate and will mature three years from the date of borrowing.
b. Amounts borrowed will bear interest at the bank's prime rate.
c. An annual commitment fee of 1/2 of 1% is payable on the difference between the amount borrowed and $8,000,000.
d. The agreement is cancelable by the lender only if:
   (i) The Company's working capital, excluding borrowings under the agreement, falls below $10,000,000.
   (ii) The Company becomes obligated under lease agreements to pay an annual rental in excess of $1,000,000.
   (iii) Treasury stock is acquired without the prior approval of the prospective lender.
   (iv) The Company guarantees indebtedness of unaffiliated persons in excess of $500,000.

35. The enterprise's intention to refinance meets the condition specified by paragraph 10. Compliance with the provisions listed in paragraph 34(d) is objectively determinable or measurable; therefore, the condition specified by paragraph 11(b)(i) is met. The proceeds of borrowings under the agreement are clearly available for the liquidation of the 9% notes payable and the long-term debt maturing in February 19x6. Both obligations, therefore, would be classified as other than current liabilities.

36. Following are the liability section of ABC Company's balance sheet at December 31, 19x5 and the related footnote disclosures required by this Statement, based on the information in paragraphs 33 and 34. Because the balance sheet is issued subsequent to the February 19x6 maturity of the long-term debt, the footnote describes the refinancing of that obligation.

	December 31, 19X5
Current Liabilities:	
Accounts payable and accruals	$10,000,000
Total Current Liabilities	10,000,000
Long-Term Debt:	
9% notes payable (Note A)	3,000,000*
6% debt due February 19x6 (Note A)	5,000,000*
Other long-term debt	25,000,000
Total Long-Term Debt	33,000,000
Total Liabilities	$43,000,000

*These obligations may also be shown in captions distinct from both current liabilities and long-term debt, such as "Interim Debt," "Short-Term Debt Expected to Be Refinanced," and "Intermediate Debt."

Note A

The Company has entered into a financing agreement with a commercial bank that permits the Company to borrow at any time through 19x7 up to $8,000,000 at the bank's prime rate of interest. The Company must pay an annual commitment fee of 1/2 of 1% of the unused portion of the commitment. Borrowings under the financing agreement mature three years after the date of the loan. Among other things, the agreement prohibits the acquisition of treasury stock without prior approval by the bank, requires maintenance of working capital of $10,000,000 exclusive of borrowings under the agreement, and limits the annual rental under lease agreements to $1,000,000. In February 19x6, the Company borrowed $5,000,000 at 8% and liquidated the 6% long-term debt, and it intends to borrow additional funds available under the agreement to refinance the 9% notes payable maturing in July 19x6.

EXAMPLE 2

37. A foreign subsidiary of the enterprise negotiates a financing agreement with its local bank in December 19x5. Funds are available to the subsidiary for its unrestricted use, including loans to affiliated companies; other terms are identical to those cited in paragraph 34. Local laws prohibit the transfer of funds outside the country.

38. The requirement of paragraph 11(b)(i) is met because compliance with the provisions of the agreement is objectively determinable or measurable. Because of the laws prohibiting the transfer of funds, however, the proceeds from borrowings under the agreement are not available for liquidation of the debt maturing in February and July 19x6. Accordingly, both the 6% debt maturing in February 19x6 and the 9% notes payable maturing in July 19x6 would be classified as current liabilities.

EXAMPLE 3

39. Assume that instead of utilizing the agreement cited in paragraph 34, the Company issues $8,000,000 of ten-year debentures to the public in January 19x6. The Company intends to use the proceeds to liquidate the $5,000,000 debt maturing February 19x6 and the $3,000,000 of 9% notes payable maturing July 19x6. In addition, assume the debt maturing February 19x6 is paid prior to the issuance of the balance sheet, and the remaining proceeds from the sale of debentures are invested in a U.S. Treasury note maturing the same day as the 9% notes payable.

40. Since the Company refinanced the long-term debt maturing in February 19x6 in a manner that meets the conditions set forth in paragraph 11 of this Statement, that obligation would be excluded from current liabilities. In addition, the 9% notes payable maturing in July 19x6 would also be excluded because the Company has obtained funds expressly intended to be used to liquidate those notes and not intended to be used in current operations. In balance sheets after

the date of sale of the debentures and before the maturity date of the notes payable, the Company would exclude the notes payable from current liabilities if the U.S. Treasury note is excluded from current assets (see paragraph 6 of Chapter 3A of *ARB No. 43,* which is not altered by this Statement).

41. If the debentures had been sold prior to January 1, 19x6, the $8,000,000 of obligations to be paid would be excluded from current liabilities in the balance sheet at that date if the $8,000,000 in funds were excluded from current assets.

42. If, instead of issuing the ten-year debentures, the Company had issued $8,000,000 of equity securities and all other facts in this example remained unchanged, both the 6% debt due February 19x6 and the 9% notes payable due July 19x6 would be classified as liabilities other than current liabilities, such as "Indebtedness Due in 19x6 Refinanced in January 19x6."

EXAMPLE 4

43. In December 19x5 the Company negotiates a revolving credit agreement providing for unrestricted borrowings up to $10,000,000. Borrowings will bear interest at 1% over the prevailing prime rate of the bank with which the agreement is arranged but in any event not less than 8%, will have stated maturities of ninety days, and will be continuously renewable for ninety-day periods at the Company's option for three years provided there is compliance with the terms of the agreement. Provisions of the agreement are similar to those cited in paragraph 34(d). Further, the enterprise intends to renew obligations incurred under the agreement for a period extending beyond one year from the balance-sheet date. There are no outstanding borrowings under the agreement at December 31, 19x5.

44. In this instance, the long-term debt maturing in February 19x6 and the 9% notes payable maturing in July 19x6 would be excluded from current liabilities because the Company consummated a financing agreement meeting the conditions set forth in paragraph 11(b) prior to the issuance of the balance sheet.

EXAMPLE 5

45. Assume that the agreement cited in Example 4 included an additional provision limiting the amount to be borrowed by the Company to the amount of its inventory, which is pledged as collateral and is expected to range between a high of $8,000,000 during the second quarter of 19x6 and a low of $4,000,000 during the fourth quarter of 19x6.

46. The terms of the agreement comply with the conditions required by this Statement; however, because the minimum amount expected to be available from February to December 19x6 is $4,000,000, only that amount of short-term obligations can be excluded from current

liabilities (see paragraph 12). Whether the obligation to be excluded is a portion of the currently maturing long-term debt or some portions of both it and the 9% notes payable depends on the intended timing of the borrowing.

47. If the Company intended to refinance only the 9% notes payable due July 19x6 and the amount of its inventory is expected to reach a low of approximately $2,000,000 during the second quarter of 19x6 but be at least $3,000,000 in July 19x6 and thereafter during 19x6, the $3,000,000 9% notes payable would be excluded from current liabilities at December 31, 19x5 (see paragraph 12).

EXAMPLE 6

48. In lieu of the facts given in paragraphs 33(c) and 33(d), assume that during 19x5 the Company entered into a contract to have a warehouse built. The warehouse is expected to be financed by issuance of the Company's commercial paper. In addition, the Company negotiated a stand-by agreement with a commercial bank that provides for maximum borrowings equal to the expected cost of the warehouse, which will be pledged as collateral. The agreement also requires that the proceeds from the sale of commercial paper be used to pay construction costs. Borrowings may be made under the agreement only if the Company is unable to issue new commercial paper. The proceeds of borrowings must be used to retire outstanding commercial paper and to liquidate additional liabilities incurred in the construction of the warehouse. At December 31, 19x5 the Company has $7,000,000 of commercial paper outstanding and $1,000,000 of unpaid construction costs resulting from a progress billing through December 31.

49. Because the commercial paper will be refinanced on a long-term basis, either by uninterrupted renewal or, failing that, by a borrowing under the agreement, the commercial paper would be excluded from current liabilities. The $1,000,000 liability for the unpaid progress billing results from the construction of a noncurrent asset and will be refinanced on the same basis as the commercial paper and, therefore, it would also be excluded from current liabilities (see paragraphs 8 and 20).

EXAMPLE 7

50. Following are two methods of presenting liabilities in ABC Company's balance sheet at December 31, 19x5 assuming the Company intends to refinance the 6% debt maturing in February 19x6 and the 9% notes payable maturing in July 19x6 but has not met the conditions required by this Statement to exclude those obligations from current liabilities.

Alternative 1

	December 31, 19X5
Current Liabilities:	
Accounts payable and accruals	$10,000,000
Notes payable, due July 19x6	3,000,000
6% debt due February 19x6	5,000,000
Total Current Liabilities	18,000,000
Long-Term Debt	25,000,000
Total Liabilities	$43,000,000

Alternative 2

		December 31, 19X5
Current Liabilities:		
Accounts payable and accruals		$10,000,000
Short-term debt expected to be refinanced:		
Notes payable, due July 19x6	$3,000,000	
6% debt due February 19x6	5,000,000	8,000,000
Total Current Liabilities		18,000,000
Long-Term Debt		25,000,000
Total Liabilities		$43,000,000

Footnotes

FAS6, Footnote 1--Paragraph 8 of Chapter 3A, *ARB No. 43,* describes a circumstance, unaffected by this Statement, in which obligations maturing within one year would be excluded from current liabilities as follows: "The current liability classification, however, is not intended to include . . . debts to be liquidated by funds which have been accumulated in accounts of a type not properly classified as current assets. . . ." Footnote 1 to paragraph 6(a) of Chapter 3A, *ARB No. 43,* describes another circumstance, also unaffected by this Statement. Under that paragraph, "funds that are clearly to be used in the near future for liquidation of long-term debts, payments to sinking funds, or for similar purposes should . . . be excluded from current assets. However, where such funds are considered to offset maturing debt which has properly been set up as a current liability, they may be included within the current asset classification." Accordingly, funds obtained on a long-term basis prior to the balance sheet date would be excluded from current assets if the obligation to be liquidated is excluded from current liabilities.

FAS6, Footnote 2--If equity securities have been issued, the short-term obligation, although excluded from current liabilities, shall not be included in owners' equity.

FAS6, Footnote 3--For purposes of this Statement, *violation of a provision* means failure to meet a condition set forth in the agreement or breach or violation of a provision such as a restrictive covenant, representation, or warranty, whether or not a grace period is allowed or the lender is required to give notice.

FAS6, Footnote 4--Financing agreements cancelable for violation of a provision that can be evaluated differently by the parties to the agreement (such as "a material adverse change" or "failure to maintain satisfactory operations") do not comply with this condition.

FAS6, Footnote 5--The intent to exercise may not be present if the terms of the agreement contain conditions or permit the prospective lender or investor to establish conditions, such as interest rates or collateral requirements, that are unreasonable to the enterprise.

FAS6, Appendix B, Footnote *--These obligations may also be shown in captions distinct from both current liabilities and long-term debt, such as "Interim Debt," "Short-Term Debt Expected to be Refinanced," and "Intermediate Debt."

FAS6, Appendix B, Footnote *--These obligations may also be shown in captions distinct from both current liabilities and long-term debt, such as "Interim Debt," "Short-Term Debt Expected to be Refinanced," and "Intermediate Debt."