Statement of Financial Accounting Standards No. 64

Note: This Statement has been completely superseded

FAS64 Status Page
FAS64 Summary

Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements

an amendment of FASB Statement No. 4

September 1982

Financial Accounting Standards Board
of the Financial Accounting Foundation
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FAS 64: Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements

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FAS 64 Summary

This Statement amends FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt,* so that (a) gains and losses from extinguishments of debt made to satisfy sinking-fund requirements that an enterprise must meet within one year of the date of the extinguishment are not required to be classified as extraordinary items and (b) the classification of gains and losses from extinguishments of debt made to satisfy sinking-fund requirements are to be determined without regard to the means used to achieve the extinguishment.

INTRODUCTION

1. The FASB has been requested to reconsider two provisions of FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*, regarding the classification of gains and losses from extinguishments of debt made to satisfy current or future sinking-fund requirements. Paragraph 8 of Statement 4 states:

> Gains and losses from extinguishment of debt that are included in the determination of net income shall be aggregated and, if material,... classified as an extraordinary item, net of related income tax effect. That conclusion shall apply whether an extinguishment is early or at scheduled maturity date or later. The conclusion does not apply, however, to gains or losses from cash purchases of debt made to satisfy current or future sinking-fund requirements.[2] Those gains and losses shall be aggregated and the amount shall be identified as a separate item.
>
> [2]Some obligations to acquire debt have the essential characteristics of sinking-fund requirements, and resulting gains or losses are not required to be classified as extraordinary items. For example,

if an enterprise is required each year to purchase a certain percentage of its outstanding bonds before their scheduled maturity, the gain or loss from such purchase is not required to be classified as an extraordinary item. Debt maturing serially, however, does not have the characteristics of sinking-fund requirements, and gain or loss from extinguishment of serial debt shall be classified as an extraordinary item.

2. With respect to the requirements of paragraph 8, the FASB has been asked:

a. Whether gains and losses from extinguishments of debt made to satisfy future sinking-fund requirements are exempt from the extraordinary-item classification requirement of Statement 4 regardless of when in the future those sinking-fund requirements have to be met
b. Whether the exemption from extraordinary-item classification also should apply to gains and losses resulting from noncash extinguishments of debt made to satisfy sinking-fund requirements

3. The Board has concluded that the exemption from the general extraordinary-item classification requirement of Statement 4 should be limited to gains and losses from extinguishments of debt made to satisfy sinking-fund requirements that an enterprise must meet within one year of the date of the extinguishment. The Board also has decided that the classification of gains and losses from extinguishments of debt made to satisfy sinking-fund requirements shall be determined without regard to the means used to achieve the extinguishment. Accordingly, gains and losses resulting from noncash extinguishments of debt made to satisfy sinking-fund requirements shall be classified in the same manner as gains and losses from cash extinguishments.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Amendment to FASB Statement No. 4

4. The third sentence of paragraph 8 of Statement 4 and the first sentence of footnote 2 to that paragraph are amended to read as follows:

> The conclusion does not apply, however, to gains or losses from extinguishments of debt made to satisfy sinking-fund requirements that an enterprise must meet within one year of the date of the extinguishment.[2]
>
> [2]Some obligations to acquire debt have the essential characteristics of sinking-fund requirements, and resulting gains or losses are not required to be classified as extraordinary items if the obligations must be met within one year of the date of the extinguishment.

Effective Date and Transition

5. This Statement shall be effective for extinguishments of debt occurring after September 30, 1982 with earlier application encouraged in annual financial statements that have not previously been issued. The provisions of this Statement shall not be applied retroactively to previously issued annual financial statements.

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

This Statement was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix: BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

6. As stated in paragraph 2, the Board was asked (a) whether gains and losses from extinguishments of debt made to satisfy future sinking-fund requirements are exempt from the extraordinary-item classification requirement of Statement 4 regardless of when in the future those sinking-fund requirements have to be met and (b) whether the exemption from extraordinary-item classification also should apply to gains and losses resulting from noncash extinguishments of debt made to satisfy sinking-fund requirements.

7. The Board has been advised that diverse accounting practices have developed as a result of different interpretations of the phrase *future sinking-fund requirements* in paragraph 8. Some have interpreted that paragraph to exempt all gains and losses from extinguishments of debt subject to future sinking-fund requirements from the extraordinary-item classification requirement regardless of when in the future those requirements have to be met. Others, however, have interpreted that phrase to mean only those future sinking-fund requirements that have to be met in the near future. In the Exposure Draft, the Board proposed that the exemption be limited to gains and losses from extinguishments of debt made to satisfy sinking-fund

requirements that an enterprise must meet within the next year.

8. Paragraph 8 of Statement 4 specifically exempts from the extraordinary-item classification requirement those gains or losses resulting from *cash purchases* of debt made to satisfy current or future sinking-fund requirements. Those raising this question believe that the method of achieving the extinguishment should not determine the manner in which the resulting gains and losses are classified in the financial statements. They point out that APB Opinion No. 26, *Early Extinguishment of Debt,* indicates that all extinguishments of debt before scheduled maturities are fundamentally alike and that the accounting for such transactions should be the same regardless of the means used to achieve the extinguishment. They believe that similar reasoning should be adopted in paragraph 8 of Statement 4 and that the classification of gains and losses resulting from extinguishments of debt made to satisfy sinking-fund requirements should not be based on the means used to effect the extinguishments. The Board agrees and deleted the reference to "cash purchases" in the third sentence of paragraph 8 of Statement 4.

9. An Exposure Draft of a proposed Statement, *Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements,* was issued on February 23, 1982. The Board received 90 letters of comment in response to the Exposure Draft. Certain of the comments received and the Board's consideration of them, including various alternatives considered and reasons for accepting some and rejecting others, are discussed in the remaining paragraphs.

10. Many respondents to the Exposure Draft opposed issuance of a final Statement because they believe the extraordinary-item criteria in APB Opinion No. 30, *Reporting the Results of Operations,* are preferable to the provisions of Statement 4 for purposes of classifying gains and losses resulting from the extinguishment of all forms of debt. Those respondents recommended that the Board rescind, or consider rescinding, Statement 4 rather than proceeding with the proposal in the Exposure Draft. The Board notes that the general issue of how to report components of comprehensive income is being considered in the Board's conceptual framework project on reporting income, cash flows, and financial position of business enterprises. The Board has concluded that the general requirement of Statement 4 (extraordinary-item classification of gains and losses from extinguishment of debt) should not be reconsidered until that conceptual framework project is completed.

11. Other respondents opposed the proposed amendment because they view it as a major extension of Statement 4. They viewed Statement 4 as removing all *nonsinking-fund* debt extinguishments from the classification criteria of Opinion 30, and they now view the proposed amendment as removing many *sinking-fund* debt extinguishments from those same criteria. They believe that the criteria of Opinion 30 should continue to be applied to gains and losses resulting from the extinguishment of sinking-fund debt. The Board believes that the exemption from extraordinary-item classification is appropriate in circumstances in which an enterprise extinguishes debt annually to meet its pending sinking-fund requirements. The Board notes, however, that extinguishments of debt made in anticipation of future sinking-fund requirements are not required to be made currently to meet continuing contractual requirements. Instead, the

Board believes those extinguishments are similar in nature to extinguishments of debt not subject to sinking-fund requirements for which resulting gains and losses must be classified as extraordinary items. The Board recognizes, however, that, as a practical matter, an enterprise may extinguish debt somewhat in advance of a sinking-fund due date to satisfy the requirement at that date.

12. Many respondents stated that the proposed one-year time frame is too restrictive and could have adverse economic effects and suggested the time frame be extended. They argued that such a one-year limitation may induce enterprises to delay purchases of sinking-fund debt until one year from the due date to avoid extraordinary-item classification of resulting gains and losses. They point out that sinking-fund debt often is extinguished several years in advance of its due date to take advantage of temporary changes in interest rates and believe that such a policy is a prudent and normal business practice that should not be discouraged by an accounting standard. Other respondents noted that some sinking-fund debt issues are held primarily by a small number of institutional investors and are not widely traded. Those respondents point out that the market price of sinking-fund debt will rise to a level higher than would prevail in a free market situation as the sinking fund due date approaches. They believe enterprises need flexibility to minimize the costs of their sinking-fund repurchase programs and also that the proposed amendment would, in effect, impair that flexibility. Those respondents who opposed the one-year time frame suggested various alternative limitations. Most recommended a three-year limitation.

13. The Board was not persuaded by the arguments summarized in the previous paragraph. The Board believes gains and losses from extinguishments of sinking-fund debt should be exempt from extraordinary-item classification only if those sinking-fund requirements for which the debt was acquired must be met currently. The Board acknowledges that an enterprise may determine that extinguishment of several years' sinking-fund requirements or an entire sinking-fund debt issue is advisable in the circumstances. However, the Board does not believe that fact should affect the classification of the resulting gains or losses. Further, several Board members rejected the arguments in paragraph 12 because they believe the sinking-fund exemption in Statement 4 should be eliminated completely.

14. The Board concluded that it can reach an informed decision on the basis of existing information without a public hearing and that the effective date and transition specified in paragraph 5 are advisable in the circumstances.