Statement of Financial Accounting Standards No. 4

Note: This Statement has been completely superseded

FAS4 Status Page
FAS4 Summary

Reporting Gains and Losses from Extinguishment of Debt

an amendment of APB Opinion No. 30

March 1975

Financial Accounting Standards Board
of the Financial Accounting Foundation
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FAS 4: Reporting Gains and Losses from Extinguishment of Debt

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INTRODUCTION AND BACKGROUND INFORMATION

1. *APB Opinion No. 26,* "Early Extinguishment of Debt," became effective for extinguishment of debt occurring on or after January 1, 1973. Paragraph 19 of that Opinion states "that all extinguishments of debt before scheduled maturities are fundamentally alike. The accounting for such transactions should be the same regardless of the means used to achieve the extinguishment." Paragraph 20 of the same Opinion states that "a difference between the reacquisition price and the net carrying amount of the extinguished debt should be recognized currently in income of the period of extinguishment as losses or gains and identified as a separate item.... The criteria in *APB Opinion No. 9* ['Reporting the Results of Operations'] should be used to determine whether the losses or gains are ordinary or extraordinary items. Gains and losses should not be amortized to future periods."

2. *APB Opinion No. 30,* "Reporting the Results of Operations," became effective for events and transactions occurring after September 30, 1973 and superseded *APB Opinion No. 9* with respect to the determination of extraordinary items. *APB Opinion No. 30* and the related Accounting Interpretation issued by the AICPA staff (see *The Journal of Accountancy,* November 1973, pages 82-84) can be read literally to preclude classifying most if not all gains or losses from early extinguishment of debt as an extraordinary item in the income statement. The Board has observed that in those cases coming to its attention where a gain or loss from early extinguishment of debt has been reported in an income statement to which *APB Opinion No. 30* was applicable, the gain or loss was included in income before extraordinary items.

3. Since the effective date of *APB Opinion No. 30,* the Board has had inquiries regarding that Opinion because application of the criteria, especially as illustrated in the related AICPA Accounting Interpretation, appears to preclude classifying gains or losses from most transactions or events as extraordinary items in the income statement. Many respondents to the Board's July 12, 1973 request for views concerning APB Opinions and Accounting Research Bulletins suggested that the conclusions of *APB Opinion No. 26* relating to *early* extinguishment of debt be reconsidered. Since that time, concern also has been expressed to the Board with respect to

the accounting for extinguishment of debt at its *scheduled maturity date or later* because the authoritative accounting pronouncements do not address that issue. In addition, the Securities and Exchange Commission and others have expressed concern to the Board about including gains and losses from extinguishment of debt in the determination of income before extraordinary items in the income statement.

4. The Board considered carefully the suggestions that *APB Opinion No. 26* be reconsidered and concluded that the issues extend beyond APB *Opinion No. 26* and could involve *APB Opinion No. 14,* "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants," and *APB Opinion No. 21,* "Interest on Receivables and Payables," and could extend to exchanges or sales and related purchases of similar monetary assets. The Board concluded that the pervasiveness of those issues makes broad reconsideration of all these Opinions and the other related issues a more comprehensive undertaking than can be accomplished in the near future. The Board also considered carefully the questions raised with respect to *APB Opinion No. 30* and concluded that there is insufficient experience under that Opinion to warrant a general reconsideration of the criteria set forth therein at this time.

5. Prior to the issuance of the Exposure Draft of this Statement, the Board had been considering an Interpretation of *APB Opinion No. 26* that would have specified disclosure requirements regarding gains and losses from extinguishment of debt, but that course of action was changed when it became clear to the Board that the income statement classification of gains or losses on extinguishment of debt also required attention. The Board believes that an immediate response is needed to the concern expressed regarding income statement classification of gains and losses from certain extinguishments of debt. Further, the Board continues to believe that guidelines are needed regarding disclosures related to certain debt extinguishments because a review of a number of financial statements by the FASB staff indicates that disclosures often have been unclear, particularly with regard to the income tax effects.

6. The Board has concluded that on the basis of existing data it can make an informed decision on the narrow issues identified in paragraph 5 without a public hearing and that the effective date and transition requirements set forth in paragraphs 11 and 12 are advisable.

7. This Statement applies to regulated enterprises in accordance with the provisions of the Addendum to APB Opinion No. 2, "Accounting for the 'Investment Credit.'"

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Income Statement Classification

8. Gains and losses from extinguishment of debt that are included in the determination of net income shall be aggregated and, if material,[1] 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.

Disclosure

9. Gains or losses from extinguishment of debt that are classified as extraordinary items should be described sufficiently to enable users of financial statements to evaluate their significance. Accordingly, the following information, to the extent not shown separately on the face of the income statement, shall be disclosed in a single note to the financial statements or adequately cross-referenced if in more than one note:

a. A description of the extinguishment transactions, including the sources of any funds used to extinguish debt if it is practicable to identify the sources.
b. The income tax effect in the period of extinguishment.
c. The per share amount of the aggregate gain or loss net of related income tax effect.

Amendment to Existing Pronouncement

10. This Statement amends *APB Opinion No. 30* only to the extent that classification of gains or losses from extinguishment of debt as an extraordinary item pursuant to the first two sentences of paragraph 8 of this Statement shall be made without regard to the criteria in paragraph 20 of that Opinion.

Effective Date and Transition

11. This Statement shall be effective for extinguishments occurring after March 31, 1975, except that it need not be applied to extinguishments occurring on or after April 1, 1975 pursuant to the terms of an offer or other commitment made prior to that date. Application to *all* extinguishments occurring during a fiscal year in which April 1, 1975 falls is encouraged. Retroactive application to extinguishments occurring in prior fiscal years is encouraged but not required.

12. Although the requirements of this Statement may be applied retroactively, such application is not intended to change the accounting for amounts deferred on refundings of debt that occurred prior to the effective date of *APB Opinion No. 26* or the income statement classification of the amortization of those amounts.

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. Kirk dissented.

Mr. Kirk dissents because he believes that extinguishments of debt are reportable transactions that seldom, if ever, warrant extraordinary item treatment. In many cases, extinguishments are neither unusual nor infrequent. In most cases, they are certainly no more extraordinary than other unusual or infrequent gains and losses for which *APB Opinion No. 30* prohibits extraordinary item classification. That Opinion sharply restricted—for good reasons—the types of gains and losses that may be identified as extraordinary items and reported on a net-of-tax basis, and Mr. Kirk can see no inherent characteristic of debt extinguishments that justifies overriding the criteria in *APB Opinion No. 30.* He believes that disclosures, like those required by paragraph 20 of *APB Opinion No. 26* and paragraph 26 of *APB Opinion No. 30,* are sufficient to prevent a financial statement user from being misled. In his view, accounting standards cannot satisfy everyone's perception of economic reality, but they should at least be logically consistent in their result. Mr. Kirk believes that this Statement fails in that regard and may well encourage piecemeal erosion of APB *Opinion No. 30.*

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: SUMMARY OF CONSIDERATION OF COMMENTS ON EXPOSURE DRAFT

13. In response to the request for comments on the Exposure Draft issued January 31, 1975, the FASB received and considered 120 letters in its deliberations on this Statement. Certain of

the comments and the FASB's consideration of them are summarized in paragraphs 14-17.

14. For a variety of reasons, many respondents recommended that the FASB not adopt the Exposure Draft as a final Statement. Some respondents recommended that *APB Opinion No. 26* and related issues be reconsidered. Others recommended that the criteria for determining extraordinary items as set forth in *APB Opinion No. 30* be reconsidered. The Board concluded not to address these issues for the reasons stated in paragraph 4.

15. Some respondents suggested that the proposals in the Exposure Draft, if adopted, would result in erosion of the criteria in *APB Opinion No. 30* for determining extraordinary items. However, this Statement is neither an amendment nor an interpretation of the criteria for classifying and reporting an event or transaction as an extraordinary item as set forth in paragraph 20 of that Opinion. Rather, the Board is proscribing the application of those criteria to certain extinguishments of debt in the same way that the application of those criteria has been proscribed with respect to the realization of tax benefits from an operating loss carryforward and to certain profits or losses resulting from the disposal of a significant part of the assets or a separable segment acquired in a business combination accounted for as a pooling of interests.[3] The Board recognizes that the application of the criteria in *APB Opinion No. 30* to extinguishments of debt would seldom, if ever, require that resulting gains and losses be classified as extraordinary items. In issuing this Statement requiring that a gain or loss from certain debt extinguishments be classified as an extraordinary item in the income statement, the Board is neither modifying the criteria set forth in that Opinion nor intending to start a piecemeal revision of those criteria. Although as a result of this Statement questions may be raised regarding the application of the criteria for determining extraordinary items pursuant to *APB Opinion No. 30,* the Board has concluded that, on balance, this Statement represents a practical and reasonable solution to the question regarding income statement classification of gains or losses from extinguishment of debt until such time as the broader issues involved can be addressed.

16. Many respondents argued that gains and losses from extinguishment of debt pursuant to sinking-fund requirements should not be required to be classified as extraordinary items. The Board agrees primarily because acquisitions for sinking-fund purposes are made to meet continuing contractual requirements assumed in connection with the incurrence of the debt.

17. In addition to the fact that many respondents recommended that the Exposure Draft not be issued as a final Statement, some respondents objected to the proposal that the Statement be applied retroactively. On further consideration of all the circumstances, the Board concluded that application of the Statement should be required only on a prospective basis although retroactive application is encouraged.

Footnotes

FAS4, Footnote 1— See the first sentence of paragraph 24 of *APB Opinion No. 30*.

FAS4, Footnote 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.

FAS4, Appendix A, Footnote 3— See paragraph 7 of *APB Opinion No. 30.*