

Commitments: Long-Term Obligations Section C32

Sources: FASB Statement 47: FASB Statement 129

[**Note:** A list of Issues discussed by the Emerging Issues Task Force (EITF) that provide supplemental guidance for this section is presented in paragraph .1000.]

SUMMARY

An enterprise shall disclose its commitments under unconditional purchase obligations that are associated with supplier's financing arrangements. Such obligations often are in the form of take-or-pay contracts and throughput contracts. Future payments on long-term borrowings and redeemable stock also shall be disclosed. For long-term unconditional purchase obligations that are associated with suppliers' financing and are not recognized on purchasers' balance sheets, the disclosures include the nature of the obligation, the amount of the fixed and determinable obligation in the aggregate and for each of the next five years, a description of any portion of the obligation that is variable, and the purchases in each year for which an income statement is presented. For long-term unconditional purchase obligations that are associated with suppliers' financing and are recognized on purchasers' balance sheets, payments for each of the next five years shall be disclosed. For long-term borrowings and redeemable stock, the disclosures include maturities and sinking fund requirements (if any) for each of the next five years and redemption requirements for each of the next five years, respectively.

DEFINITION AND SCOPE

.101 [This section specifies disclosures relating to] unconditional purchase obligations typically associated with **project financing arrangements**. [FAS47, ¶1] An unconditional purchase obligation is an obligation to transfer funds in the future for fixed or minimum amounts or quantities of goods or services at fixed or minimum prices (for example, as in **take-or-pay contracts** or **throughput contracts**). An unconditional purchase obligation that has all of the following characteristics shall be disclosed in accordance with paragraph .102 (if not recorded on the purchaser's balance sheet) or in accordance with paragraph .105(a) (if recorded on the purchaser's balance sheet):

- a. Is noncancelable, or cancelable only
 - (1) Upon the occurrence of some remote contingency or
 - (2) With the permission of the other party or
 - (3) If a replacement agreement is signed between the same parties or
 - (4) Upon payment of a penalty in an amount such that continuation of the agreement appears reasonably assured
- b. Was negotiated as part of arranging financing for the facilities that will provide the contracted goods or services or for costs related to those goods or services (for example, carrying costs for contracted goods).¹
- c. Has a remaining term in excess of one year.

Future minimum lease payments under leases that have those characteristics need not be disclosed in accordance with this section if they are disclosed in accordance with Section L10, "Leases." [FAS47, ¶6]

¹ A purchaser [is not required] to investigate whether a supplier used an unconditional purchase obligation to help secure financing, if the purchaser would otherwise be unaware of that fact. [FAS47, ¶17]

UNRECORDED OBLIGATIONS

.102 A purchaser shall disclose unconditional purchase obligations that meet the criteria or paragraph .101 and that have not been recognized on its balance sheet. The disclosures shall include:

- a. The nature and term of the obligation(s)
- b. The amount of the fixed and determinable portion of the obligation(s) as of the date of the latest balance sheet presented in the aggregate and, if determinable, for each of the five succeeding fiscal years (refer to paragraph .103)
- c. The nature of any variable components of the obligation(s)
- d. The amounts purchased under the obligation(s) (for example, the take-or-pay or throughput contract) for each period for which an income statement is presented.

Disclosures of similar or related unconditional purchase obligations may be combined. Those disclosures may be omitted only if the aggregate commitment for all such obligations not disclosed is immaterial. [Disclosures about unconditional purchase obligations that are not subject to the requirement of this section may be required by the provision in Section F25, "Financial Instruments: Disclosure."] [FAS47, ¶7]

.103 Disclosure of the amount of imputed interest necessary to reduce the unconditional purchase obligation(s) to present value is encouraged but not required. The discount rate shall be the effective initial interest rate of the borrowings that financed the facility (or facilities) that will provide the contracted goods or services, if known by the purchaser. If not, the discount rate shall be the **purchaser's incremental borrowing rate** at the date the obligation is entered into. [FAS47, ¶8]

RECORDED OBLIGATIONS AND REDEEMABLE STOCK

.104 Certain unconditional purchase obligations are presently recorded as liabilities on purchasers' balance sheets with the related assets also recognized. This section does not alter that accounting treatment or the treatment of future unconditional purchase obligations that are substantially the same as those obligations already recorded as liabilities with related assets, nor does it suggest that disclosure is an appropriate substitute for accounting recognition if the substance of an arrangement is the acquisition of an asset and incurrence of a liability. [FAS47, ¶9]

.105 The following information shall be disclosed for each of the five years following the date of the latest balance sheet presented:

- a. The aggregate amount of payments for unconditional purchase obligations that meet the criteria of paragraph .101 and that have been recognized on the purchaser's balance sheet
- b. The combined aggregate amount of maturities and sinking fund requirements for all long-term borrowings [FAS47, ¶10]
- c. The amount of redemption requirements, separately by issue or combined, for all issues of capital stock that are redeemable at fixed or determinable prices on fixed or determinable dates in each of the five years following the date of the latest statement of financial position presented. [FAS129, ¶8]

ILLUSTRATIONS OF THE APPLICATION OF THIS SECTION TO COMMON ARRANGEMENTS

EXAMPLE 1:

.106 B Company has entered into a throughput agreement with a manufacturing plant providing that B will submit specified quantities of a chemical (representing a portion of plant capacity) for processing through the plant each period while the debt used to finance the plant remains outstanding. B's processing charges are intended to be sufficient to cover a proportional share of fixed and variable operating expenses and debt service of the plant. If, however, the processing charges do not cover such operating expenses and debt service, B must advance additional funds to cover a specified percentage of operating expenses and debt service. Such additional funds are considered advance payments for future throughput. [FAS47, ¶24]

.107 B's unconditional obligation to pay a specified percentage of the plant's fixed operating expenses and debt service is fixed and determinable, while the amount of variable operating expenses that B is obligated to pay will vary depending on plant operations and economic conditions. [FAS47, ¶25]

.108 B's disclosure might be as follows:

To secure access to facilities to process chemical X, the company has signed a processing agreement with a chemical company allowing B Company to submit 100,000 tons for processing annually for 20 years. Under the terms of the agreement, B Company may be required to advance funds against future processing charges if the chemical company is unable to meet its financial obligations. The aggregate amount of required payments at December 31, 19X1 is as follows (in thousands):

19X2	\$10,000
19X3	10,000
19X4	9,000
19X5	8,000
19X6	8,000
Later years	<u>100,000</u>
Total	145,000
Less: Amount representing interest	<u>(45,000)</u>
Total at present value	<u>\$100,000</u>

In addition, the company is required to pay a proportional share of the variable operating expenses of the plant. The company's total processing charges under the agreement in each of the past 3 years have been \$12 million. [FAS47, ¶26]

EXAMPLE 2:

.109 C Company has entered into a throughput agreement with a natural gas pipeline providing that C will provide specified quantities of natural gas (representing a portion of capacity) for transportation through the pipeline each period while the debt used to finance the pipeline remains outstanding. The tariff approved by the Federal Energy Regulatory Commission contains two portions, a demand charge and a commodity charge. The demand charge is computed to cover debt service, depreciation, and certain expected expenses. The commodity charge is intended to cover other expenses and provide a return on the pipeline enterprise's investment. C Company must pay the demand charge based on the contracted quantity regardless of actual quantities shipped, while the commodity charge is applied to actual quantities shipped. Accordingly, the demand charge multiplied by the contracted quantity represents a fixed and determinable payment. [FAS47, ¶27]

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.110 C's disclosure might be as follows:

C Company has signed an agreement providing for the availability of needed pipeline transportation capacity through 1990. Under that agreement, the enterprise must make specified minimum payments monthly. The aggregate amount of such required payments at December 31, 19X1, is as follows (in thousands):

19X2	\$5,000
19X3	5,000
19X4	5,000
19X5	4,000
19X6	4,000
Later years	<u>26,000</u>
Total	<u>49,000</u>
Less: Amount representing interest	<u>(9,000)</u>
Total at present value	40,000

In addition, the enterprise is required to pay additional amounts depending on actual quantities shipped under the agreement. The enterprise's total payments under the agreement were (in thousands) \$6,000 in 19W9 and \$5,500 both in 19X0 and in 19X1. [FAS47, ¶28]

EXAMPLE 3:

.111 A subsidiary of F Company has entered into a take-or-pay contract with an ammonia plant. F's subsidiary is obligated to purchase 50 percent of the planned capacity production of the plant each period while the debt used to finance the plant remains outstanding. The monthly payment equals the sum of 50 percent of raw material costs, operating expenses, depreciation, interest on the debt used to finance the plant, and a return on the owner's equity investment. [FAS47, ¶29]

.112 F's disclosure might be as follows:

To assure a long-term supply, one of the enterprise's subsidiaries has contracted to purchase half the output of an ammonia plant through the year 2005 and to make minimum annual payments as follows, whether or not it is able to take delivery (in thousands):

19X2 through 19X6 (\$6,000 per annum)	\$30,000
Later years	<u>120,000</u>
Total	<u>150,000</u>
Less: Amount representing interest	<u>(65,000)</u>
Total at present value	85,000

In addition, the subsidiary must reimburse the owner of the plant for a proportional share of raw-material costs and operating expenses of the plant. The subsidiary's total purchases under the agreement were (in thousands) \$7,000, \$7,100 and \$7,200 in 19W9, 19X0, and 19X1, respectively. [FAS47, ¶30]

EXAMPLE 4:

.113 D Company has outstanding two long-term borrowings and one issue of preferred stock with mandatory redemption requirements. The first borrowing is a \$100 million sinking fund debenture with annual sinking fund payments of \$10 million in 19X2, 19X3, and 19X4, \$15 million in 19X5 and 19X6 and \$20 million in 19X7 and 19X8. The second borrowing is a \$50 million note due in 19X5. The \$30 million issue of preferred stock requires a 5 percent annual cumulative sinking fund payment of \$1.5 million until retired. [FAS47, ¶31]

.114 D's disclosures might be as follows:

Maturities and sinking fund requirements on long-term debt and sinking fund requirements on preferred stock subject to mandatory redemption are as follows (in thousands):

	<u>Long-Term Debt</u>	<u>Preferred Stock</u>
19X2	\$10,000	\$1,500
19X3	10,000	1,500
19X4	10,000	1,500
19X5	65,000	1,500
19X6	<u>15,000</u>	<u>1,500</u>

[FAS47, ¶32]

GLOSSARY

.401 **Project financing arrangement.** The financing of a major capital project in which the lender looks principally to the cash flows and earnings of the project as the source of funds for repayment and to the assets of the project as collateral for the loan. The general credit of the project entity is usually not a significant factor, either because the entity is an enterprise without other assets or because the financing is without direct recourse to the owner(s) of the enterprise. [FAS47, ¶23]

.402 **Purchaser's incremental borrowing rate.** The rate that, at the inception of an unconditional purchase obligation, the purchaser would have incurred to borrow over a similar term the funds necessary to discharge the obligation. [FAS47, ¶23]

.403 **Take-or-pay contract.** An agreement between a purchaser and a seller that provides for the purchaser to pay specified amounts periodically in return for products or services. The purchaser must make specified minimum payments even if it does not take delivery of the contracted products or services. [FAS47, ¶23]

.404 **Throughput contract.** An agreement between a shipper (processor) and the owner of a transportation facility (such as an oil or natural gas pipeline or a ship) or a manufacturing facility that provides for the shipper (processor) to pay specified amounts periodically in return for the transportation (processing) of a product. The shipper (processor) is obligated to provide specified minimum quantities to be transported (processed) in each period and is required to make cash payments even if it does not provide the contracted quantities. [FAS47, ¶23]