FASB Staff Educational Paper

Topic 470 (Debt): Borrower's Accounting for Debt Modifications

Educational Paper Purpose

1. The FASB staff developed these educational materials to provide stakeholders with a summary and overview of the application of the guidance in Subtopic 470-50, Debt—Modifications and Extinguishments, and Subtopic 470-60, Debt—Troubled Debt Restructurings by Debtors, for borrowers that modify outstanding debt arrangements. The FASB staff understands that many entities have not previously applied the guidance in Subtopics 470-50 and 470-60, but because of the effects of the Coronavirus Disease 2019 (COVID-19) pandemic, there may be increased modifications or exchanges of outstanding debt arrangements. The nature and extent of a debt modification will determine the accounting effects on an entity's statement of operations and statement of financial condition, which could be materially different under the requirements in Subtopics 470-50 and 470-60. Consequently, entities will need to evaluate all facts and circumstances to ensure that the debt modification is appropriately accounted for.

2. For example, modifications to debt arrangements may include any of the following:
   (a) Reduction (including contingent reductions) of the stated interest rate for the remaining term of the debt
   (b) Extension of the maturity date (or dates) at a stated interest rate lower than the current market rate for new debt with similar risk
   (c) Reduction (including contingent reductions) of the face amount or maturity amount of the debt as stated in the debt arrangement or other agreement
   (d) Reduction (including contingent reductions) of accrued, but unpaid, interest.

3. These educational materials are not intended to address all types of debt modifications or exchanges or all accounting guidance in Subtopics 470-50 and 470-60. For example, these materials do not include guidance on the accounting for (a) when a borrower grants an equity interest to the lender as part of a restructuring, (b) convertible debt instruments, (c) embedded conversion features in the debt instrument, or (d) certain fees and costs incurred by the borrower.

4. Instead, these educational materials provide an overview of the accounting guidance for common modifications to and exchanges of debt arrangements and illustrative examples of common debt modifications and exchanges. Entities should consider the specific facts and circumstances of modifications to and exchanges of their debt arrangements to determine the appropriate accounting.

5. The FASB staff developed these educational materials on the basis of the information and feedback received from various stakeholders through the date on which these materials were issued. Official positions of the FASB are determined only after extensive due process and deliberation. The FASB

staff will continue to monitor this unique and evolving situation and communicate with the industry as this situation unfolds, including through additional Accounting Standards Updates, technical inquiries, and other means, as appropriate.

Background

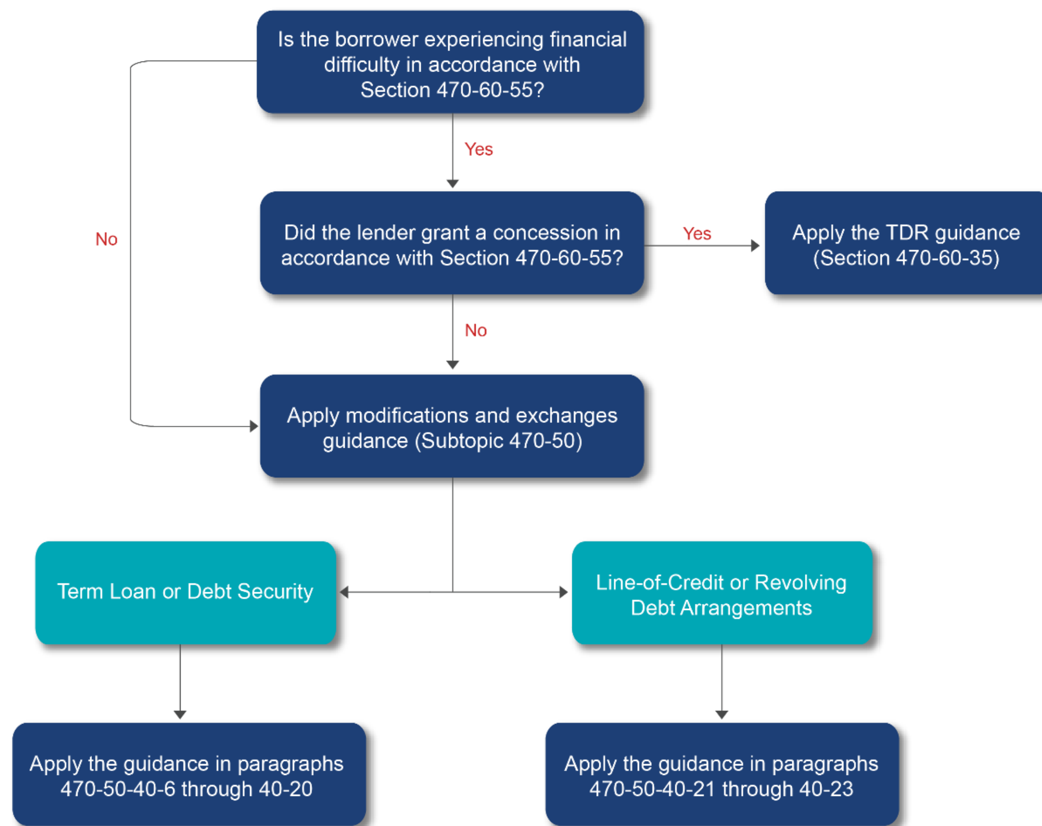
6. Subtopic 470-60 provides guidance on determining whether a modification to or an exchange of a debt arrangement is accounted for as a troubled debt restructuring (TDR), while Subtopic 470-50 provides guidance on determining whether a nontroubled modification or an exchange of debt with the same creditor is accounted for as (a) an extinguishment of the existing debt and issuance of new debt or (b) a modification and continuation of the existing debt.

7. Under Subtopic 470-60, a restructuring of a debt constitutes a TDR if the lender, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. The concession is granted by the lender in an attempt to protect as much of its investment as possible. The lender's objective is to make the best of a difficult situation. That is, the lender expects to obtain more cash or other value from the borrower or to increase the probability of payment by granting the concession than it would have otherwise expected if the concession was not granted. Generally, a borrower that can obtain funds from sources other than the existing lender at market interest rates at or near those for nontroubled debt does not meet the requirement of a TDR. Typically, a borrower in a TDR may be able to obtain funds from sources other than the existing lender in the TDR only at effective interest rates (based upon current market interest rates taking into account the creditworthiness of the borrower) that are much higher.

8. If a modification to or exchange of a debt arrangement is not accounted for as a TDR, the guidance in Subtopic 470-50 would apply to account for the modification to or exchange of the debt arrangement. Under Subtopic 470-50, a modification to or an exchange of debt instruments with the same lender that has substantially different terms is accounted for as a debt extinguishment.

9. If an entity determines that the amended or new debt is not substantially different from the original debt, then the debt is considered modified (not extinguished) and a new effective interest rate should be determined on the basis of the carrying amount of the original debt instrument.

10. The following diagram illustrates the accounting treatment for debt modifications and exchanges:



11. Subtopic 310-40, Receivables—Troubled Debt Restructuring by Creditors, provides guidance on how a lender should evaluate whether a loan restructuring should qualify for TDR accounting by the lender. The staff notes that Subtopics 310-40 and 470-60 provide tests on evaluating whether a modification represents a TDR and that those tests may not result in the same conclusion between a borrower and a lender. A borrower may have a TDR under Subtopic 470-60 even though the related lender does not have a TDR under Subtopic 310-40. The borrower and lender should separately apply the respective guidance to the specific facts and circumstances to determine whether a TDR has occurred.

TDRs

12. Under Subtopic 470-60, a TDR occurs when (a) a borrower is experiencing financial difficulties and (b) a lender grants a concession to the borrower that it would not otherwise consider. However, a debt restructuring is not necessarily a TDR even if the borrower is experiencing some financial difficulties. For example, a TDR does not occur if either:[1]

    (i) The lender reduces the effective interest rate on the debt primarily to reflect a decrease in market interest rates in general or a decrease in the risk to maintain a relationship with a borrower that can readily obtain funds from other sources at the current market interest rate

    (ii) The borrower issues in exchange for its debt new marketable debt having an effective interest rate based on its market price that is at or near the current market interest rates of debt with similar maturity dates and stated interest rates issued by nontroubled borrowers.

[1]See paragraphs 470-60-15-11 through 15-12 for additional circumstances that would not be accounted for as a troubled debt restructuring (TDR).

Determining Whether a Borrower Is Experiencing Financial Difficulties

13. Determining whether a borrower is experiencing financial difficulties may require judgment, depending upon the specific facts and circumstances of the borrower and the environment that it operates in. If the borrower’s creditworthiness (for example, based on the borrower’s credit rating or equivalent, the effects of the original collateral or credit enhancements in the debt or the borrower’s sector risk) has deteriorated since the debt was originally issued, the borrower should evaluate whether it is experiencing financial difficulties.

14. A decline in credit rating from investment grade to noninvestment grade is considered a deterioration in the borrower’s creditworthiness. Conversely, changes in an investment-grade credit rating are not considered a deterioration in the borrower’s creditworthiness for purposes of this evaluation.

15. Paragraph 470-60-55-8 provides the following factors that may indicate that the borrower is experiencing financial difficulties:
    - (a) The borrower is currently in default on any of its debt.
    - (b) The borrower has declared or is in the process of declaring bankruptcy.
    - (c) There is significant doubt on whether the borrower will continue to be a going concern.
    - (d) Currently, the borrower has securities that have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange.
    - (e) Based on estimates and projections that only encompass the current business capabilities, the borrower forecasts that its entity-specific cash flows will be insufficient to service the debt (both interest and principal) in accordance with the contractual terms of the existing agreement through maturity.
    - (f) Absent the current modification, the borrower cannot obtain funds from sources other than the existing lenders at an effective interest rate equal to the current market interest rate for similar debt for a nontroubled borrower.

16. Paragraph 470-60-55-9 states that if both of the following factors are present, they provide determinative evidence that the borrower is not experiencing financial difficulty (and therefore the modification or exchange would not be accounted for as a TDR):
    - (a) The borrower is currently servicing the old debt and can obtain funds to repay the old prepayable debt from sources other than the existing lenders (without regard to the current modification) at an effective interest rate equal to the current market interest rate for a nontroubled borrower.
    - (b) The lender agrees to restructure the old debt solely to reflect a decrease in current market interest rates for the borrower or positive changes in the creditworthiness of the borrower since the debt was originally issued.

17. The presence of either of those factors individually would be an indicator, but not a determinative indicator, that the borrower is not experiencing financial difficulty.

18. If a borrower determines that it is not experiencing financial difficulties, the restructuring is not a TDR and it should apply the debt modification guidance in Subtopic 470-50. If a borrower determines that it is experiencing financial difficulties, it should then determine whether its lender is granting a concession to determine if the restructuring should be accounted for as a TDR.

Determining Whether a Lender Is Granting a Concession

19. A lender is deemed to have granted a concession if the borrower’s effective interest rate on the restructured debt is less than the effective interest rate of the old debt immediately before the restructuring.

20. The effective interest rate of the restructured debt (after giving effect to all the terms of the restructured debt including any new or revised options or warrants, any new or revised guarantees or letters of credit, and so forth) should be calculated as follows:

    (a) First, by projecting all the cash flows under the new terms
    (b) Then, by solving for the discount rate that equates the present value of the cash flows under the new terms to the borrower's current carrying amount of the old debt.

    The carrying amount for this test would include any unamortized premium, discount, issuance costs, accrued interest payable, and so forth (but would exclude any hedging effects, including basis adjustments to the old debt).

21. Although considered rare, if there is persuasive evidence that the decrease in the effective interest rate is solely because of a factor that is not captured in the mathematical calculation (for example, additional collateral), the lender may not have granted a concession and the modification or exchange should be evaluated on the basis of the substance of the modification.

22. In certain situations, a borrower may have recently restructured its debt and is currently restructuring that debt again. In determining the new effective interest rate of the restructured debt (after giving effect to all the terms of the restructured debt, including any new or revised options or warrants, any new or revised guarantees or letters of credit, and so forth), an entity should:

    (a) First, project all the cash flows under the new terms
    (b) Then, solve for the discount rate that equates the present value of the cash flows under the new terms to the borrower's previous carrying amount of the debt immediately preceding the earlier restructuring
    (c) Finally, compare the effective interest rate of the restructured debt with the effective interest rate of the debt immediately preceding the earlier restructuring for purposes of determining whether the lender granted a concession (that is, whether the effective borrowing rate decreased).

23. If a borrower determines that the effective interest rate of the restructured debt is less than the debt's effective interest rate immediately preceding the earlier restructuring, the lender has granted a concession.

Accounting for TDRs

24. For a TDR that involves only modification of terms of a debt arrangement,[2] the accounting depends upon whether the total undiscounted future cash payments specified by the new terms are greater or less than the carrying amount of the debt at the time of the restructuring.

25. Total future cash payments include all the following:

    (a) Amounts designated as either principal or interest by the new terms of the arrangement.
    (b) Related accrued interest at the time of the restructuring that continues to be payable under the new terms.
    (c) Amounts designated either as principal or interest by the new terms that may be contingently payable on a specified event or circumstance (for example, the borrower may be required to pay specified amounts if its financial condition improves to a specified degree within a specified period). In determining those amounts, an entity should assume that any contingent future payment will have to be paid.
    (d) The principal and accrued interest that is payable on demand, or could become payable on demand, assuming the maximum number of periods possible under the restructured terms.

[2] For other types of TDRs, such as transferring assets or issuing an equity interest to a lender to satisfy the borrower's obligation, an entity should consider the relevant guidance in Subtopic 470-60, Debt—Troubled Debt Restructurings by Debtors.

26. If the total of undiscounted future cash payments specified by the new terms of the debt is greater than the carrying amount of the debt, the borrower accounts for the effects of the restructuring prospectively from the time of restructuring (that is, the effects of changes in the amounts or timing [or both]) of future cash payments that are designated as either interest or principal that should be reflected in future periods. In doing so, the borrower both:

    (a) Does not change the carrying amount of the debt at the time of the restructuring
    (b) Determines a new effective interest rate that equates the present value of the future cash payments specified by the new terms (excluding amounts contingently payable) with the carrying amount of the debt.

27. Interest expense is computed in a way such that a constant effective interest rate is applied to the carrying amount of the debt at the beginning of each period between restructuring and maturity (in substance, the interest method prescribed by paragraphs 835-30-35-2 and 835-30-35-4 through 35-5).

28. If the total undiscounted future cash payments specified by the new terms of a payable, including both payments designated as principal and interest, are less than the carrying amount of the debt, the borrower should both:

    (a) Reduce the carrying amount to an amount equal to the total undiscounted future cash payments specified by the new terms
    (b) Recognize a gain on restructuring equal to the amount of that reduction.

29. A borrower should not recognize a gain on restructured debt involving indeterminate future cash payments as long as the maximum total future cash payments could exceed the carrying amount of the debt. Consequently, for any amounts under the new terms of the debt arrangement that may be contingently payable on a specified event or circumstance, an entity should assume that any contingent future payment will have to be paid.

30. Thereafter, all cash payments under the terms of the debt should be accounted for as reductions of the carrying amount of the debt and no interest expense should be recognized on the debt for any period between the restructuring and the maturity date. The only exception is to recognize interest expense related to amounts contingently payable under the new terms of the debt arrangement according to paragraph 470-60-35-10.

31. For a TDR involving a debt instrument with a variable interest rate (for example, the restructured terms may specify the stated interest rate to be the prime interest rate plus a specified amount or proportion), the amounts of future cash payments must be estimated as the maximum total future payments based on the interest rate in effect at the time of the restructuring. Fluctuations in the variable interest rate after the restructuring should be accounted for as changes in estimates in the periods in which the changes occur.

32. Similar to estimating amounts that are contingently payable on a specified event or circumstance, the accounting for fluctuations of future interest payments should not result in recognizing a gain on restructuring that may potentially be offset by future interest expense. Rather, the carrying amount of the restructured payable should remain unchanged on the modification date, and future cash payments should reduce the carrying amount until the time that any gain recognized cannot be offset by future interest expense.

33. The following table provides a general summary of the accounting for a TDR that involves only modification of terms of a debt arrangement:

If future undiscounted cash flows (including contingent payments) are:

Greater than or equal to the net carrying value of the original debt, then:

1. Do not change the carrying amount of the debt at the time of the restructuring (that is, no gain recognized).
2. Calculate a new effective interest rate. The new effective interest rate will be the discount rate that equates the present value of the future cash payments specified by the new terms (excluding amounts contingently payable) with the carrying amount of the debt.
3. Prospectively recognize interest expense such that a constant effective interest rate is applied to the carrying amount of the debt at the beginning of each period between restructuring and maturity, consistent with the interest method.

Less than the net carrying value of the original debt, then:

1. Reduce the carrying amount of the debt to an amount equal to the total future undiscounted cash payments specified by the new terms of the debt arrangement.
2. Recognize a gain on restructuring of debt equal to the amount of the reduction determined in (1).
3. Cash payments under the terms of the debt will be accounted for as reductions of the carrying amount of the debt.
4. No interest expense should be recognized on the debt for any period between the restructuring and maturity of the debt.

Modifications and Extinguishments

34. For modifications that are not accounted for as TDRs, an entity should consider the guidance in Subtopic 470-50 for determining whether, for accounting purposes, a modification or extinguishment has occurred. If an entity enters into a debt arrangement with a different lender and concurrently satisfies[3] its existing debt arrangement with the original, unrelated lender, that transaction is accounted for as an extinguishment of the existing debt and an issuance of new debt.

35. The following circumstances in which an entity modifies or exchanges debt agreements with the same lender would result in the debt transaction being accounted for as an extinguishment (assuming the transaction is not accounted for as a TDR):

    (a) If a borrower exchanges debt arrangements with its current lender with substantially different terms, that transaction is deemed to be a debt extinguishment.
    (b) If a borrower makes a substantial modification to the terms of an existing debt arrangement, that modification could achieve the same economic effect as an exchange of a debt arrangement and, therefore, would be accounted for like an extinguishment.

36. If an entity determines that the original and new debt instruments are substantially different, the new debt instrument would be initially recorded at fair value, and that amount should be used to determine the debt extinguishment gain or loss to be recognized and the effective interest rate of the new debt instrument. Interest expense would be accounted for under the interest method using the new effective interest rate.

[3]An entity should evaluate the criteria in paragraph 405-20-40-1 to determine when to derecognize its existing debt arrangement.

37. If an entity determines that the original and new debt instruments are not substantially different, then a new effective interest rate should be determined on the basis of the carrying amount of the original debt instrument[4] and the revised cash flows. Interest expense would be accounted for under the interest method using the new effective interest rate prospectively.

Determining Whether a Substantial Modification Has Occurred—Term Debt

38. A substantial modification has occurred when an exchange of debt arrangements between a borrower and a lender or a modification of a debt arrangement by a borrower and a lender results in the present value of cash flows under the terms of the new debt arrangement being at least 10 percent different from the present value of the remaining cash flows under the terms of the original arrangement at the modification date.

39. If the terms of a debt arrangement are changed or modified and the cash flow effect on a present value basis is less than 10 percent, the debt arrangements are not considered to be substantially different.[5]

40. Paragraph 470-50-40-12 provides the following guidance that an entity should use to calculate the present value of the cash flows for purposes of applying the 10 percent cash flow test:

    (a) The cash flows of the new debt arrangement include all cash flows specified by the terms of the new debt arrangement plus any amounts paid by the borrower to the lender, less any amounts received by the borrower from the lender as part of the exchange or modification.
    (b) If the original debt arrangement or the new debt arrangement has a floating interest rate, then the variable rate in effect at the date of the exchange or modification should be used to calculate the cash flows of the variable-rate arrangement.
    (c) If either the new debt arrangement or the original debt arrangement is callable or puttable, then separate cash flow analyses should be performed assuming exercise and nonexercise of the call or put. The cash flow assumptions that generate the smaller change would be the basis for determining whether the 10 percent threshold is met.
    (d) If the debt arrangement contains contingent payment terms or unusual interest rate terms, judgment should be used to determine the appropriate cash flows.
    (e) The discount rate to be used to calculate the present value of the cash flows is the effective interest rate, for accounting purposes, of the original debt arrangement.
    (f) If within a year of the current transaction the debt has been exchanged or modified without being deemed to be substantially different, then the debt terms that existed a year ago should be used to determine whether the current exchange or modification is substantially different.
    (g) The change in the fair value of an embedded conversion option resulting from an exchange of debt arrangements or a modification in the terms of an existing debt arrangement should not be included in the 10 percent cash flow test. Rather, a separate test should be performed by comparing the change in the fair value of the embedded conversion option with the carrying amount of the original debt arrangement immediately before the modification, as specified in paragraph 470-50-40-10(a).[6]

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[4] If applicable, the carrying amount also should be adjusted for an increase, but not a decrease, in the fair value of an embedded conversion option calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange.

[5] There are exceptions to this conclusion within Subtopic 470-50, Debt—Modifications and Extinguishments, in certain circumstances involving embedded conversion options. The guidance does not address modifications or exchanges of debt instruments in circumstances in which the embedded conversion option is separately accounted for as a derivative under Topic 815, Derivatives and Hedging, before the modification, after the modification, or both before and after the modification.

[6] This guidance does not address modifications or exchanges of debt instruments in circumstances in which the embedded conversion option is separately accounted for as a derivative under Topic 815 before the modification, after the modification, or both before and after the modification.

Line-of-Credit or Revolving Debt Arrangements

41. Because of the nature of line-of-credit or revolving debt arrangements, specific guidance is provided to account for modifications to or exchanges of line-of-credit or revolving debt arrangements resulting in either a new line-of-credit or revolving debt arrangement or in a traditional term-debt arrangement.

42. To make that determination, the borrower compares the product of the remaining term and the maximum available credit of the old arrangement (this product is referred to as the borrowing capacity) with the borrowing capacity of the new arrangement.

43. If the borrowing capacity of the new arrangement is greater than or equal to the borrowing capacity of the old arrangement, then any unamortized deferred costs, any fees paid to the lender, and any third-party costs incurred should be deferred and amortized over the term of the new arrangement.

44. If the borrowing capacity of the new arrangement is less than the borrowing capacity of the old arrangement, then:
    (a) Any fees paid to the lender and any third-party costs incurred should be deferred and amortized over the term of the new arrangement.
    (b) Any unamortized deferred costs relating to the old arrangement at the time of the change should be written off in proportion to the decrease in borrowing capacity of the old arrangement. The remaining unamortized deferred costs relating to the old arrangement should be deferred and amortized over the term of the new arrangement.

Examples

45. To illustrate the guidance in Subtopics 470-50 and 470-60, the FASB staff has developed the following examples. These examples are not all inclusive and do not indicate that the factors detailed in the conclusions of each example should always be of primary significance when concluding whether a restructuring is a TDR. Every fact pattern requires judgment and a thorough analysis of all factors listed in paragraph 470-60-55-8.

Example 1—TDR, No Gain Recognized

46. On January 1, 20X1, Borrower B enters into a $500,000 term loan that is not prepayable with Bank N that has an annual coupon of 5 percent due quarterly and principal due upon maturity on December 31, 20X5. Near the time the term loan was issued to Borrower B, term loan and debt issuances for investment grade public companies in a similar industry to Borrower B had similar terms and conditions. On the basis of its estimates and projections of its industry and the broader economy and considering its current business capabilities, Borrower B concludes that its cash flows will be sufficient to service the debt through December 31, 20X5. On the basis of those factors, Borrower B concludes that its debt should be classified similar to investment grade.

47. During the first quarter of 20X3, a global pandemic ensues that has broad and pervasive effects on the macroeconomy and Borrower B's cash flows. Borrower B is uncertain on whether it can continue to service the interest payments at the current interest rate so it decides to refinance its existing term loan and begins discussions with various banks, including Bank N, to obtain a new five-year term loan. Borrower B receives an offer from Bank N to modify the arrangement such that the term loan matures on March 31, 20X8, with a reduced interest rate of 4 percent. Borrower B receives offers from different lenders for a five-year term loan with an interest rate of 7 percent with other similar terms and conditions to its existing arrangement.

48. Near the same time as negotiating a new term loan, the public companies for which Borrower B initially used as peer companies to evaluate its credit rating issued debt and term loans that were rated as

noninvestment grade. Furthermore, those debt and term loan issuances by peer companies were similar to the five-year term loan with an interest rate of 7 percent that was offered to Borrower B by various lenders.

49. Additionally, because of the pandemic conditions, Borrower B is unable to conclude that its cash flows will be sufficient to service its existing debt through December 31, 20X5.

50. On April 1, 20X3, Borrower B and Bank N modify the term loan to (a) forgive all accrued interest of ($6,250), (b) extend the maturity to March 31, 20X8, and (c) adjust the annual interest rate to 4 percent.

51. On the basis of the factors described in paragraphs 46–49 and analyses of the other factors within paragraph 470-60-55-8, Borrower B concludes that it is experiencing financial difficulties. Consequently, Borrower B needs to determine whether it has received a concession from Bank N in accordance with paragraph 470-60-55-10. Borrower B compares the effective interest rate on the new debt with the effective interest rate on the old debt.

	Old Debt	**Restructured Debt**
Principal	$500,000	$500,000
Annual interest	$25,000	$20,000
Annual periods remaining	2.75	5.00
Carrying value of debt premodification	$506,250	
Stated interest rate	5.00%	4.00%
Effective interest rate	5.00%	3.72%*

*The effective interest rate on the restructured debt is slightly below the stated rate of 4 percent due to forgiving the accrued and unpaid interest of $6,250 at the date of restructuring.

52. Borrower B concludes that a TDR has occurred because it is experiencing financial difficulties and was provided a concession by Bank N. Borrower B considers the guidance in paragraphs 470-60-35-5 through 35-6 and projects the following contractual cash flow payments.

Annual period ending	3/31/20X4	3/31/20X5	3/31/20X6	3/31/20X7	3/31/20X8	Total
Interest	$20,000	$20,000	$20,000	$20,000	$20,000	$100,000
Principal					$500,000	$500,000
Total						$600,000
Carrying amount of loan at modification						$506,250

53. Because the total future cash payments under the new terms ($600,000) exceeds the carrying amount of the loans at modification ($506,250), the effects of the restructuring are accounted for prospectively. That is, interest expense is adjusted on a prospective basis at an annual rate of 3.72 percent.

Example 2—TDR, Gain Recognized

54. On July 1, 20X1, Borrower E enters into a $250,000 term loan that is not prepayable with Bank Y that has an annual coupon of 5 percent due quarterly and principal due upon maturity on June 30, 20X6. During the first quarter of 20X3, a global pandemic ensues that has broad and pervasive effects on the macroeconomy and Borrower E's industry. In the second quarter of 20X3, Borrower E considers its estimates and projections of its sales, industry sales, and the broader macroeconomic indicators and concludes that it will not have sufficient cash flows to service the interest and principal payments on its existing debt.

55. On July 1, 20X3, Borrower E and Bank Y modify the term loan, and Bank Y forgives $50,000 in principal. The loan retains the 5 percent quarterly interest payments, and Borrower E has paid the accrued

interest through June 30, 20X3. On the basis of the factors described in paragraph 54, Borrower E concludes that it is experiencing financial difficulties. Consequently, Borrower E needs to determine whether it has received a concession from Bank Y in accordance with paragraph 470-60-55-10. Borrower E compares the effective interest rate on the new debt with the effective interest rate on the old debt.

	Old Debt	Restructured Debt
Principal	$250,000	$200,000
Annual interest	$12,500	$10,000
Annual periods remaining	3.00	3.00
Carrying value of debt premodification	$250,000	
Effective interest rate	5.00%	-2.86%

56. The negative effective interest rate on the modified debt is the result of the principal forgiveness. Because the effective interest rate on the modified debt is below the effective interest rate on the debt before modification, Borrower E concludes that Bank Y has granted a concession. Borrower E concludes that a TDR has occurred because it is experiencing financial difficulties and was provided a concession by Bank Y. Borrower E considers the guidance in paragraphs 470-60-35-5 through 35-6 and projects the following modified contractual cash flow payments (undiscounted).

Annual period ending	6/30/20X4	6/30/20X5	6/30/20X6	Total
Interest	$10,000	$10,000	$10,000	$30,000
Principal			$200,000	$200,000
Total				$230,000
Carrying amount of loan at modification				$250,000

57. Because the total future cash payments under the new terms ($230,000) is less than the carrying amount ($250,000), Borrower E should:
    (a) Reduce the carrying amount of the debt to $230,000
    (b) Recognize a gain of $20,000.

58. Thereafter, all cash payments under the terms of the debt should be accounted for as reductions of the carrying amount of the debt, and no interest expense should be recognized on the debt for any period between the restructuring date and the maturity date.

Example 3—Modification of Prepayable Term Debt

59. On January 1, 20X1, Borrower F enters into a $750,000 five-year term loan with Bank Z. The loan has a 10 percent annual coupon payable quarterly and is prepayable at any time with no prepayment penalty. Borrower F incurred $10,000 in fees to obtain the debt.

60. During the first quarter of 20X3, a global pandemic ensues that has broad and pervasive effects on the macroeconomy and Borrower F's industry. As a result of the global pandemic, current market interest rates across asset classes have declined broadly since the term loan was originated. Borrower F manufactures personal protective equipment and has experienced significant growth in orders. To free up working capital to use in production, Borrower F decides to refinance its term debt with Bank Z. On April 1, 20X3, Borrower F and Bank Z enter into a new five-year term loan with a 6 percent annual coupon payable quarterly. The loan is still prepayable at any time, but Bank Z has added a 2 percent prepayment penalty. Borrower F paid $15,000 in fees to Bank Z to refinance.

61. Borrower F considers all the factors within Section 470-60-55, and on the basis of the detailed analysis concluded that it was not experiencing financial difficulty and, therefore, the modification is not deemed to be a TDR . Borrower F must now determine whether the new debt arrangement with Bank Z should be accounted for as a modification of existing debt or an extinguishment of old debt and an issuance of new debt by assessing the cash flows of the two instruments.

62. Because both term loans are prepayable at any time, Borrower F considers the guidance in paragraph 470-50-40-12(c) that states that if either the new debt arrangement or the original debt arrangement is callable or puttable, then separate cash flow analyses should be performed assuming exercise and nonexercise of the call or put. The cash flow assumptions that generate the smaller change would be the basis for determining whether the 10 percent threshold is met.

63. Borrower F first analyzes the cash flows assuming the debt is prepaid on the modification date. Because it is a Day 1 cash flow, there is no discounting.

Premodification cash flows	
Fees paid to lender	N/A
Repayment of principal	$750,000
Prepayment penalty	N/A
Total cash flows—premodification	$750,000
Postmodification cash flows	
Fees paid to lender	$15,000
Repayment of principal	$750,000
Prepayment penalty (2%)	$15,000
Total cash flows—postmodification	$780,000
Total change in cash flows ($)	$30,000
Total change in cash flows (%)	4%

64. On the basis of the cash flows in paragraph 63, Borrower F concludes that the terms of the refinanced debt are not substantially different and therefore are accounted for as a modification. Borrower F capitalizes the fees paid to Bank Z to refinance and determines the new effective interest rate using the premodification carrying value of the debt, net of the capitalized and deferred refinancing fees.

Example 4—Nontroubled Debt Restructuring, Terms Not Substantially Different

65. On January 1, 20X1, Borrower C enters into a $500,000 term loan that is not prepayable with Bank O that has an annual coupon of 5 percent due annually and principal due upon maturity on December 31, 20X5.

66. During the first quarter of 20X3, a global pandemic ensues that has broad and pervasive effects on the macroeconomy and Borrower C's industry. As a result of the global pandemic, current market interest rates across asset classes broadly have declined since the term loan was originated. To mitigate any potential liquidity needs in the future, Borrower C decides to refinance its existing term loan and begins discussions with various banks, including Bank O, to obtain a new five-year term loan. Borrower C receives an offer from Bank O to modify the arrangement such that the term loan matures on December 31, 20X7, with a reduced interest rate of 4 percent. Borrower C receives offers from different lenders for a five-year term loan with an interest rate at, or near, 4 percent.

67. On April 1, 20X3, Borrower C and Bank O modify the term loan to (a) extend the maturity to March 31, 20X8, and (b) adjust the annual interest rate to 4 percent, payable on March 31 annually. Additionally,

as part of the restructuring Borrower C paid the accrued interest through March 31, 20X3, on the existing debt arrangement.

68. Because Borrower C received offers from different lenders with the same or nearly the same terms, Borrower C concludes that the refinancing of the loan with Bank O represents current market interest rates and is an indicator of a nontroubled borrowing.

69. Additionally, Borrower C considers its estimates and projections of its sales, industry sales, and the broader macroeconomic indicators and concludes that it will have sufficient cash flows to service its existing debt. Although Borrower C expects declines in future revenue (and therefore cash flows), Borrower C considers its current liquidity combined with its financial planning analysis and recent going concern analysis and concludes that it will continue to have adequate liquidity to continue operations though the global pandemic.

70. Consequently, Borrower C concludes that it is not experiencing financial difficulty and ,therefore, the modification is not deemed to be a TDR.

71. Borrower C then considers the guidance in Subtopic 470-50 to account for the modification of the term loan. Borrower C considers the guidance in paragraph 470-50-40-9 involving the contemporaneous exchanges of cash between the same borrower and lender in connection with the issuance of a new debt obligation and satisfaction of an existing debt obligation. Specifically, the guidance notes that if the modification arrangements have substantially different terms, the exchange would be accounted for as an extinguishment of the old debt and issuance of new debt. Otherwise, the modification would be accounted for as a continuation of the existing debt.

72. Borrower C also considers the guidance in paragraph 470-50-40-10 to determine if the "substantially different" criterion has been met. Borrower C evaluates whether the present value of the cash flows under the terms of the new debt arrangement is at least 10 percent different from the present value of the remaining cash flows under the terms of the original arrangement. Borrower C performs the following analysis.

Original Term Loan

Period ending	12/31/20X3	12/31/20X4	12/31/20X5	Total
Remaining payments	$25,000	$25,000	$525,000	$575,000
Discounted*	$24,102	$22,954	$459,194	$506,250†

*In accordance with paragraph 470-50-40-12(e), the discount rate used to calculate the present value of cash flows is the effective interest rate of the original term loan of 5 percent.

†Agrees to the carrying amount of the loan of $500,000 in principal and $6,250 of accrued interest.

New Term Loan

Period ending	3/31/20X3	3/31/20X4	3/31/20X5	3/31/20X6	3/31/20X7	3/31/20X8	Total
Remaining payments	$6,250	$20,000	$20,000	$20,000	$20,000	$520,000	$606,250
Discounted*	$6,250	$19,048	$18,141	$17,277	$16,452	$407,325	$484,492

*In accordance with paragraph 470-50-40-12(e), the discount rate used to calculate the present value of cash flows is the effective interest rate of the original term loan of 5 percent.

Present value of cash flows on the original term loan	$506,250
Present value of cash flows on the new term loan	$484,484
Change in present value of cash flows	$21,579
Percentage change	4.3%

73. Because the present value of the cash flows under the terms of the new term loan is less than 10 percent different from the present value of the remaining cash flows under the terms of the original term loan, the modification is not deemed to be substantially different from the original term loan. Therefore, a new effective interest rate will be determined on the basis of the carrying amount of the original debt arrangement and the revised cash flows.

Example 5—Nontroubled Debt Restructuring, Terms Substantially Different

74. Assume similar facts as in Example 4, except that the interest rate offered to Borrower C is 3 percent (assume this rate also was observed in offers from other lenders). Additionally, Borrower C wants to increase the principal amount borrowed. On April 1, 20X3, Borrower C and Bank O modify the term loan to (a) extend the maturity to March 31, 20X8, (b) adjust the annual interest rate to 3 percent, and (c) increase the principal amount to $1,000,000. Additionally, Borrower C paid the accrued interest through March 31, 20X3, on the existing debt arrangement ($6,250) as part of the restructuring.

75. Those changes do not affect Borrower C's previous conclusions that there will be sufficient cash flows to service the debt. Borrower C concludes that it is not experiencing financial difficultly and, therefore, the modification is not deemed to be a TDR.

76. Similar to Example 4, Borrower C must now determine whether the new debt arrangement with Bank O should be accounted for as a modification of existing debt or an extinguishment of old debt and an issuance of new debt. Borrower C again considers the guidance in paragraph 470-50-40-10 to determine if the "substantially different" criterion has been met. Borrower C evaluates whether the present value of the cash flows under the terms of the new debt arrangement is at least 10 percent different from the present value of the remaining cash flows under the terms of the original arrangement. Borrower C performs the following analysis.

Original Term Loan

Period ending	12/31/20X3	12/31/20X4	12/31/20X5	Total
Remaining payments	$25,000	$25,000	$525,000	$575,000
Discounted*	$24,102	$22,954	$459,194	$506,250

*In accordance with paragraph 470-50-40-12(e), the discount rate used to calculate the present value of cash flows is the effective interest rate of the original term loan of 5 percent.

New Term Loan

Period ending	4/1/20X3†	3/31/20X4	3/31/20X5	3/31/20X6	3/31/20X7	3/31/20X8	Total
Remaining cash flows	$(493,750)	$30,000	$30,000	$30,000	$30,000	$1,030,000	$656,250
Discounted*	$(493,750)	$28,571	$27,211	$25,915	$24,681	$807,032	$419,660

*In accordance with paragraph 470-50-40-12(e), the discount rate used to calculate the present value of cash flows is the effective interest rate of the original term loan of 5 percent.

†In accordance with paragraph 470-50-40-12(a), Borrower C incorporated the additional $500,000 cash inflows received on April 1, 20X3, net of the $6,250 of accrued interest paid as part of the restructuring. That amount is not discounted because it is a Day 1 cash flow.

Present value of cash flows on the original term loan	$506,250
Present value of cash flows on the new term loan	$419,660
Change in present value of cash flows	$86,590
Percentage change	17.1%

77. Because the present value of the cash flows under the terms of the new term loan is greater than a 10 percent difference from the present value of the remaining cash flows under the terms of the original term loan, Borrower C determines that the original debt instrument and the new debt instrument are substantially different. The new debt instrument will be initially recorded at fair value, and that amount should be used to determine the debt extinguishment gain or loss to be recognized. Interest expense will be accounted for prospectively under the interest method using the new effective interest rate.

Example 6—Financial Difficulties but No Lender Concession, Nontroubled Debt

78. On June 30, 20X1, Borrower D enters a $350,000 term loan that is not prepayable with Bank X that has an annual coupon of 5 percent due quarterly and principal due upon maturity on December 31, 20X3.

79. During the first quarter of 20X3, a global pandemic ensues that has broad and pervasive effects on the macroeconomy and Borrower D's industry. Pandemic conditions continue throughout the second quarter of 20X3. Borrower D considers its estimates and projections of its sales, industry sales, and the broader macroeconomic indicators and concludes that it will not have sufficient cash flows to service its existing debt.

80. To mitigate the projected shortfall in liquidity, Borrower D decides to request a three-month extension to its existing term loan from Bank X. On July 1, 20X3, Borrower D and Bank X modify the term loan to extend the maturity to March 31, 20X4. The loan will retain the 5 percent annual interest rate payable quarterly.

81. On the basis of the factors described in paragraphs 78–80, Borrower D concludes that it is experiencing financial difficulties. Consequently, Borrower D needs to determine whether it has received a concession from Bank X in accordance with paragraph 470-60-55-10. Borrower D compares the effective interest rate on the new debt with the effective interest rate on the old debt.

	Old Debt	**Restructured Debt**
Principal	$350,000	$350,000
Annual interest	$17,500	$17,500
Annual periods remaining	0.50	0.75
Carrying value of debt premodification	$350,000	
Stated interest rate	5.00%	5.00%
Effective interest	4.98%	4.99%

82. Because Borrower D continues to pay the same stated interest rate with the same frequency, the effective interest on the old debt and the restructured debt are the same. The effective rate on the new debt is slightly higher because of the time value of money factored into the discounting calculations. Consequently, Bank X has not granted a concession and, despite the financial difficulties experienced by Borrower D, the modification is not deemed to be a TDR.

83. Borrower D must now determine whether the modified debt arrangement with Bank X should be accounted for as a modification of existing debt or an extinguishment of old debt and an issuance of new debt. Borrower D considers the guidance in paragraph 470-50-40-10 to determine if the "substantially different" criterion has been met. Borrower D evaluates whether the present value of the cash flows under the terms of the new debt arrangement is at least 10 percent different from the present

value of the remaining cash flows under the terms of the original arrangement. Because Borrower D continues to pay interest at the same interest rate—just over an extended term—the present value of the cash flows are approximately the same both premodification and postmodification.

84. Because the present value of the cash flows under the terms of the new term loan is less than a 10 percent difference from the present value of the remaining cash flows under the terms of the original term loan, the modification is not deemed to be substantially different from the original term loan. Therefore, a new effective interest rate will be determined on the basis of the carrying amount of the original debt arrangement and the revised cash flows.

Example 7—Multiple Modifications within a 12-Month Period

85. Continuing the fact pattern from Example 6 (see paragraphs 78–84), pandemic conditions continue through the third quarter of 20X3. Borrower D continues to experience declines in cash flows and wants to further extend the maturity date of the term loan another six months. On October 1, 20X3, Borrower D and Bank X modify the term loan to extend the maturity to September 30, 20X4. The loan will retain the 5 percent annual interest rate, but all interest payments will be deferred to the maturity date instead of paid quarterly.

86. On the basis of the continuation of factors noted in Example 6, Borrower D continues to experience financial difficulties. Because the term loan was recently restructured (within the last 12 months), to determine if Bank X has granted a concession in accordance with paragraph 470-60-55-14 the effective borrowing rate of the restructured debt should be compared with the effective borrowing rate of the debt immediately preceding the earlier restructuring for purposes of determining whether the creditor granted a concession. Furthermore, the effective borrowing rate of the restructured debt should be calculated by projecting all the cash flows under the new terms and solving for the discount rate that equates the present value of the cash flows under the new terms to the previous carrying amount of the debt immediately preceding the earlier restructuring.

	Old Debt*	**Restructured Debt**
Principal	$350,000	$350,000
Annual interest	$17,500	$17,500
Annual periods remaining	0.50	1.00
Carrying value of debt premodification	$350,000	
Stated interest rate	5.00%	5.00%
Effective interest rate	4.98%	4.92%

*The old debt consists of the original terms before the initial extension of the maturity date.

87. While the stated interest rate may not have changed, the effect of deferring the interest payments over the extension period has resulted in a lower effective interest rate for the restructured debt. Consequently, Bank X has granted a concession and, therefore, that modification is deemed to be a TDR.

88. Borrower D considers the guidance in paragraphs 470-60-35-5 through 35-6 and projects the following modified contractual cash flow payments (undiscounted).

Quarterly period ending	12/31/20X3	3/31/20X4	6/30/20X4	9/30/20X4	Total
Interest	$4,375	$4,375	$4,375	$4,375	$17,500
Principal				$350,000	$350,000
Total					$367,500
Carrying amount of loan at modification					$350,000

89. Because the total future cash payments under the new terms ($367,500) exceed the carrying amount ($350,000), the effects of the restructuring are accounted for prospectively. No gain is recognized, and interest expense is adjusted on a prospective basis.

Example 8—Nontroubled Debt Restructuring, Modification of a Line of Credit

90. On January 1, 20X1, Borrower F has a $750,000 revolving line of credit from Bank Z that matures on December 31, 20X3. Borrower F paid $10,000 in fees to Bank Z in connection with the issuance of the line of credit.

91. During the first quarter of 20X3, a global pandemic ensues that has broad and pervasive effects on the macroeconomy and Borrower F's industry. Borrower F manufactures personal protective equipment and has experienced significant growth in orders. It needs additional liquidity to purchase raw materials. Borrower F approaches Bank Z to expand the borrowing limit and extend the maturity on the revolving line of credit. Borrower F receives an offer from Bank Z to modify the arrangement such that as of April 1, 20X3, (a) the maturity date on the line of credit is extended to December 31, 20X4, and (b) the borrowing limit is raised to $900,000. Borrower F pays $10,000 in fees to Bank Z in connection with the restructuring. There are $3,750 in issuance fees that are capitalized and unamortized in connection with the original issuance of the line of credit.

92. In accordance with paragraph 470-50-40-21, Borrower F must compare the borrowing capacities on the original line of credit with the modified line of credit to determine the appropriate accounting. The borrowing capacities on the two facilities is computed as follows.

	Original Line of Credit	**Restructured Line of Credit**
Maximum available credit (A)	$750,000	$900,000
Remaining term (B)	0.75	1.75
Borrowing capacity (A x B)	$562,500	$1,575,000

93. Because the borrowing capacity on the restructured line of credit is greater than the original, the issuance fees of $10,000 paid on April 1, 20X3, are combined with the unamortized fees of $3,750 from the original line of credit. The total of $13,750 in capitalized issuance fees are amortized over the new term of the restructured arrangement.

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