Interpretation of the Emerging Accounting Issues Working Group

INT 03-05: EITF 01-7: Creditor's Accounting for a Modification or Exchange of Debt Instruments

ISSUE NULLIFIED BY SSAP NO. 91R AND SSAP NO. 103

INT 03-05 Dates Discussed

March 9, 2003; June 22, 2003; March 3, 2012; August 31, 2012

INT 03-05 References

SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)
SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 91R)
SSAP No. 103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 103)

INT 03-05 Issue

1. When a creditor and a debtor agree to modify the terms of an existing debt instrument or to exchange debt instruments (other than in a troubled debt restructuring), each must determine whether the modification or exchange should be accounted for as (a) the creation of a new debt instrument and the extinguishment of the original debt instrument or (b) the continuation of the original debt instrument (as modified). Guidance for making that determination is provided for creditors in *FASB Statement No. 91*, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91) and for debtors in *EITF No. 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments* (EITF 96-19).

Debtor Accounting

2. EITF 96-19 requires a debtor to account for a modification of the terms of an existing debt instrument or an exchange of debt instruments (other than a troubled debt restructuring) as an extinguishment of the original debt instrument if the new debt instrument is substantially different from the existing debt instrument. EITF 96-19 provides the following definition of substantially different:

> From the debtor's perspective, an exchange of debt instruments between or a modification of a debt instrument by a debtor and a creditor in a nontroubled debt situation is deemed to have been accomplished with debt instruments that are substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument.
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> EITF 96-19 also provides guidance for use in calculating the present value of the cash flows for purposes of applying the 10 percent test.

Creditor Accounting

3. Paragraph 12 of FAS 91 states that:

> If the terms of the new loan resulting from a loan refinancing or restructuring other than a troubled debt restructuring are at least as favorable to the lender as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring a loan with the lender, the refinanced loan shall be accounted for as a new loan. This condition would be met if the new loan's effective yield is at least equal to the effective yield for such loans. Any unamortized net fees or costs and any prepayment penalties from the original loan shall be recognized in interest income when the new loan is granted.

4. Paragraph 13 of FAS 91 states that if "the refinancing or restructuring does not meet the condition set forth in paragraph 12 or if only minor modifications are made to the original loan contract, the unamortized net fees or costs from the original loan and any prepayment penalties shall be carried forward as a part of the net investment in the new loan". Thus, FAS 91 requires a creditor to account for the modified debt instrument as a new debt instrument if the following two criteria are met: (a) the modified debt instrument's effective yield is at least equal to the effective yield for a comparable loan to a debtor with similar collection risks who is not refinancing or restructuring and (b) modifications of the original debt instrument are more than minor. However, FAS 91 and the related interpretive literature do not provide factors to be considered or criteria to be used in evaluating whether a modification of a debt instrument is more than minor.

5. The foregoing provisions of FAS 91 preclude a creditor from accounting for a loan refinancing or restructuring as a new debt instrument if the terms of the new loan are not at least as favorable to the lender as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring. In those fact patterns, the definition of minor is irrelevant. Accordingly, those fact patterns are not within the scope of this Issue. Consistent with the scope of FAS 91, this Issue only applies to transactions between a creditor and a debtor.

6. The accounting issue is how a creditor should evaluate whether a modification of the terms of a debt instrument as a result of a refinancing or restructuring (other than a troubled debt restructuring) is more than minor under paragraph 13 of FAS 91.

INT 03-05 Discussion

7. Per *EITF 01-7, Creditor’s Accounting for a Modification or Exchange of Debt Instruments* (EITF 01-7):

> The Task Force reached a consensus that a modification of a debt instrument should be considered more than minor under paragraph 13 of Statement 91 if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument. The Task Force reached a consensus that if the difference between the present value of the cash flows under the terms of the new debt instrument and the present value of the remaining cash flows under the terms of the original debt instrument is less than 10 percent, a creditor should evaluate whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification.
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> The Task Force reached a consensus that the guidance in Issue 96-19 should be used to calculate the present value of the cash flows for purposes of applying the 10 percent test.

8. The working group reached a consensus to adopt the consensus position of EITF 01-7.

INT 03-05 Status

9. No further discussion is planned.