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To the Point

FASB – final guidance

FASB eliminates TDR guidance for creditors and requires enhanced vintage disclosures

The guidance was issued as part of the Board's post-implementation review of its credit losses standard.

What you need to know

- The FASB issued an Accounting Standards Update to eliminate the recognition and measurement guidance on troubled debt restructurings for creditors that have adopted ASC 326 and require them to make enhanced disclosures about loan modifications for borrowers experiencing financial difficulty.
- The new guidance also requires public business entities to present current-period gross write-offs (on a current year-to-date basis for interim-period disclosures) by year of origination in their vintage disclosures.
- For entities that have adopted ASC 326, the guidance is effective for fiscal years beginning after 15 December 2022, and interim periods therein. Early adoption is permitted. Entities that have not yet adopted ASC 326 will apply the new guidance when they adopt ASC 326.

Overview

The Financial Accounting Standards Board (FASB or Board) issued **final guidance**[1] amending Accounting Standards Codification (ASC) 310[2] to eliminate the recognition and measurement guidance for a troubled debt restructuring (TDR) for creditors that have adopted the new credit losses guidance in ASC 326.[3] The guidance also requires public business entities to present gross write-offs by year of origination in their vintage disclosures.

The FASB issued the guidance in response to stakeholder feedback as part of the post-implementation review of its new credit losses standard. Stakeholders said the TDR accounting guidance was no longer relevant because under ASC 326 entities account for full lifetime

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expected credit losses. They also raised questions about whether entities need to present gross write-offs and gross recoveries in vintage disclosures, since the guidance doesn't specifically address this point, but the disclosures are included in an example. Financial statement users told the FASB that information about gross write-offs is valuable.

Key considerations

Creditors' accounting for TDRs

The guidance eliminates the recognition and measurement guidance related to TDRs in ASC 310-40[4] for creditors that have adopted ASC 326. Currently, the guidance requires an entity to determine whether a loan modification represents a TDR. If the modification represents a concession related to a borrower's financial difficulty that a creditor would not have otherwise considered granting, it would be considered a TDR. Any incremental expected loss is recorded on the impaired loan in the allowance for credit losses, and disclosures are required for the remaining term of the loan.

Stakeholders said that once an entity begins applying ASC 326, the required accounting and disclosures for a loan modified in a TDR no longer provide decision-useful information. That's because ASC 326 requires the recognition of lifetime expected credit losses when a loan is originated or acquired, so the effect of many credit losses that occur in loans modified in TDRs is already included in the allowance for credit losses.

The guidance requires a creditor to apply the loan refinancing and restructuring guidance in ASC 310-20[5] (consistent with the accounting for other loan modifications) to determine whether a modification results in a new loan or a continuation of an existing loan. It also requires enhanced disclosures for modifications in the form of interest rate reductions, principal forgiveness, other-than-insignificant payment delays, or term extensions (or combinations thereof) of loans made to borrowers experiencing financial difficulty. Disclosures are required regardless of whether a modification of a loan to a borrower experiencing financial difficulty results in a new loan. The objective of the disclosures is to provide information about the type and magnitude of modifications and the degree of their success in mitigating potential credit losses.

Entities are not required to include in their disclosures modifications that result in only a delay in payment that is insignificant. If a loan had previously been modified, an entity is required to consider only the cumulative effect of modifications made over the previous 12-months when determining whether a delay in payment is insignificant. This is a change from today's guidance, which requires entities to consider the cumulative effect of all past modifications.

The guidance also requires the use of the loan's new effective interest rate when using a discounted cash flow approach for measuring the allowance for credit losses for loans modified and accounted for as a continuation of the original financial asset.

How we see it

The guidance eliminates the "once a TDR, always a TDR" requirement for loan disclosures but requires entities to make disclosures about the performance of modified loans to borrowers experiencing financial difficulty in the 12 months following the modification. Entities will need to make sure they have appropriate processes and controls in place to support these enhanced disclosure requirements.

Vintage disclosures — gross write-offs

The guidance requires public business entities to present in the vintage disclosures current-period gross write-offs (on a current year-to-date basis for interim-period disclosures) by year of origination for financing receivables and net investments in leases. Entities are not required to disclose gross recoveries in the vintage disclosures.

Transition and effective date

For entities that have not yet adopted the guidance in ASC 326, the amendments have the same effective dates and transition requirements as that guidance. For entities that have adopted the guidance in ASC 326, the amendments are effective for fiscal years beginning after 15 December 2022, and interim periods therein. Early adoption of the amendments is permitted for entities that have adopted ASC 326, including adoption in an interim period. If an entity elects to early adopt in an interim period, the guidance should be applied as of the beginning of the fiscal year that includes the interim period. An entity may elect to early adopt the amendments related to TDRs separately from the amendments related to vintage disclosures.

Entities will apply the amendments related to disclosures for loan modifications and the presentation of gross write-offs in the vintage disclosures starting in the period of adoption (i.e., prospectively). Information about modifications made in periods before adoption are not required to be provided.

Entities can elect to adopt the guidance on TDRs using either a prospective or modified retrospective transition. If an entity elects to apply a modified retrospective transition, it will record a cumulative effect adjustment to retained earnings in the period of adoption, representing any change in the allowance for credit losses for loans modified in TDRs under ASC 310-40.

Endnotes:

[1] Accounting Standards Update 2022-02, *Financial Instruments — Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures.*

[2] ASC 310, *Receivables.*

[3] ASC 326, *Financial Instruments — Credit Losses,* was created through the issuance of Accounting Standards Update 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.*

[4] ASC 310-40, *Receivables — Troubled Debt Restructurings by Creditors.*

[5] ASC 310-20, *Receivables — Nonrefundable Fees and Other Costs.*

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