Statement of Financial Accounting Standards No. 15

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FAS15 Summary

Accounting by Debtors and Creditors for Troubled Debt Restructurings

June 1977

Financial Accounting Standards Board
of the Financial Accounting Foundation
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Paragraph Numbers

FAS 15: Accounting by Debtors and Creditors for Troubled Debt Restructurings

INTRODUCTION

1. This Statement establishes standards of financial accounting and reporting by the debtor and by the creditor for a troubled debt restructuring. The Statement does not cover accounting for allowances for estimated uncollectible amounts and does not prescribe or proscribe particular methods for estimating amounts of uncollectible receivables.

2. A restructuring of a debt constitutes a *troubled debt restructuring* for purposes of this Statement if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. That concession either stems from an agreement between the creditor and the debtor or is imposed by law or a court. For example, a creditor may restructure the terms of a debt to alleviate the burden of the debtor's near-term cash requirements, and many troubled debt restructurings involve modifying terms to reduce or defer cash payments required of the debtor in the near future to help the debtor attempt to improve its financial condition and eventually be able to pay the creditor. Or, for example, the creditor may accept cash, other assets, or an equity interest in the debtor in satisfaction of the debt though the value received is less than the amount of the debt because the creditor concludes that step will maximize recovery of its investment.[1]

3. Whatever the form of concession granted by the creditor to the debtor in a troubled debt restructuring, the creditor's objective is to make the best of a difficult situation. That is, the creditor expects to obtain more cash or other value from the debtor, or to increase the probability of receipt, by granting the concession than by not granting it.

4. In this Statement, a *receivable* or *payable* (collectively referred to as *debt*) represents a contractual right to receive money or a contractual obligation to pay money on demand or on fixed or determinable dates that is already included as an asset or liability in the creditor's or debtor's balance sheet at the time of the restructuring. Receivables or payables that may be involved in troubled debt restructurings commonly result from lending or borrowing of cash , investing in debt securities that were previously issued, or selling or purchasing goods or services on credit. Examples are accounts receivable or payable, notes, debentures and bonds

(whether those receivables or payables are secured or unsecured and whether they are convertible or nonconvertible), and related accrued interest, if any. Typically, each receivable or payable is negotiated separately, but sometimes two or more receivables or payables are negotiated together. For example, a debtor may negotiate with a group of creditors but sign separate debt instruments with each creditor. For purposes of this Statement, restructuring of each receivable or payable, including those negotiated and restructured jointly, shall be accounted for individually. The substance rather than the form of the receivable or payable shall govern. For example, to a debtor, a bond constitutes one payable even though there are many bondholders.

5. A troubled debt restructuring may include, but is not necessarily limited to, one or a combination of the following:

a. Transfer from the debtor to the creditor of receivables from third parties, real estate, or other assets to satisfy fully or partially a debt (including a transfer resulting from foreclosure or repossession).
b. Issuance or other granting of an equity interest to the creditor by the debtor to satisfy fully or partially a debt unless the equity interest is granted pursuant to existing terms for converting the debt into an equity interest.
c. Modification of terms of a debt, such as one or a combination of:
    1. Reduction (absolute or contingent) of the stated interest rate for the remaining original life of the debt.
    2. Extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk.
    3. Reduction (absolute or contingent) of the face amount or maturity amount of the debt as stated in the instrument or other agreement.
    4. Reduction (absolute or contingent) of accrued interest.

6. Troubled debt restructurings may occur before, at, or after the stated maturity of debt, and time may elapse between the agreement, court order, etc. and the transfer of assets or equity interest, the effective date of new terms, or the occurrence of another event that constitutes consummation of the restructuring. The date of consummation is the *time of the restructuring* in this Statement.

7. A debt restructuring is not necessarily a troubled debt restructuring for purposes of this Statement even if the debtor is experiencing some financial difficulties. For example, a troubled debt restructuring is not involved if (a) the fair value [2] of cash, other assets, or an equity interest accepted by a creditor from a debtor in full satisfaction of its receivable at least equals the creditor's recorded investment in the receivable;[3] (b) the fair value of cash, other assets, or an equity interest transferred by a debtor to a creditor in full settlement of its payable at least equals the debtor's carrying amount of the payable; (c) the creditor 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 so as to maintain a relationship with a debtor that can readily obtain funds from other sources at

the current market interest rate; or (d) the debtor 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 debtors. In general, a debtor that can obtain funds from sources other than the existing creditor at market interest rates at or near those for nontroubled debt is not involved in a troubled debt restructuring. A debtor in a troubled debt restructuring can obtain funds from sources other than the existing creditor in the troubled debt restructuring, if at all, only at effective interest rates (based on market prices) so high that it cannot afford to pay them. Thus, in an attempt to protect as much of its investment as possible, the creditor in a troubled debt restructuring grants a concession to the debtor that it would not otherwise consider.

8. For purposes of this Statement, troubled debt restructurings do not include changes in lease agreements (the accounting is prescribed by *FASB Statement No. 13,* "Accounting for Leases") or employment-related agreements (for example, pension plans and deferred compensation contracts). Nor do troubled debt restructurings include debtors' failures to pay trade accounts according to their terms or creditors' delays in taking legal action to collect overdue amounts of interest and principal, unless they involve an agreement between debtor and creditor to restructure.

9. The Addendum to *APB Opinion No. 2*, "Accounting for the 'Investment Credit'," states that "differences may arise in the application of generally accepted accounting principles as between regulated and nonregulated businesses, because of the effect in regulated businesses of the rate-making process" and discusses the application of generally accepted accounting principles to regulated industries. FASB Statements and Interpretations should therefore be applied to regulated companies that are subject to the rate-making process in accordance with the provisions of the Addendum.

10. This Statement supersedes *FASB Interpretation No. 2,* "Imputing Interest on Debt Arrangements Made under the Federal Bankruptcy Act," and shall be applied to the types of situations that were covered by that Interpretation. Thus, it shall be applied to troubled debt restructurings consummated under reorganization, arrangement, or other provisions of the Federal Bankruptcy Act or other Federal statutes related thereto.[4] It also amends *APB Opinion No. 26,* "Early Extinguishment of Debt," to the extent needed to exclude from that Opinion's scope early extinguishments of debt through troubled debt restructurings.

11. Appendix A provides background information. Appendix B sets forth the basis for the Board's conclusions, including alternatives considered and reasons for accepting some and rejecting others.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Accounting by Debtors

12. A debtor shall account for a troubled debt restructuring according to the type of the restructuring as prescribed in the following paragraphs.

Transfer of Assets in Full Settlement

13. A debtor that transfers its receivables from third parties, real estate, or other assets to a creditor to settle fully a payable shall recognize a gain on restructuring of payables (see paragraph 21). The gain shall be measured by the excess of (i) the carrying amount of the payable settled (the face amount increased or decreased by applicable accrued interest and applicable unamortized premium, discount, finance charges, or issue costs) over (ii) the fair value of the assets transferred to the creditor.[5] The fair value of the assets transferred is the amount that the debtor could reasonably expect to receive for them in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Fair value of assets shall be measured by their market value if an active market for them exists. If no active market exists for the assets transferred but exists for similar assets, the selling prices in that market may be helpful in estimating the fair value of the assets transferred. If no market price is available, a forecast of expected cash flows may aid in estimating the fair value of assets transferred, provided the expected cash flows are discounted at a rate commensurate with the risk involved.[6]

14. A difference between the fair value and the carrying amount of assets transferred to a creditor to settle a payable is a gain or loss on transfer of assets.[7] The debtor shall include that gain or loss in measuring net income for the period of transfer, reported as provided in *APB Opinion No. 30,* "Reporting the Results of Operations."

Grant of Equity Interest in Full Settlement

15. A debtor that issues or otherwise grants an equity interest to a creditor to settle fully a payable shall account for the equity interest at its fair value.[8] The difference between the fair value of the equity interest granted and the carrying amount of the payable settled shall be recognized as a gain on restructuring of payables (see paragraph 21).

Modification of Terms

16. A debtor in a troubled debt restructuring involving only modification of terms of a payable—that is, not involving a transfer of assets or grant of an equity interest—shall account

for the effects of the restructuring prospectively from the time of restructuring, and shall not change the carrying amount of the payable at the time of the restructuring unless the carrying amount exceeds the total future cash payments specified by the new terms.[9] That is, the effects of changes in the amounts or timing (or both) of future cash payments designated as either interest or face amount shall be reflected in future periods.[10] Interest expense shall be computed in a way that a constant effective interest rate is applied to the carrying amount of the payable at the beginning of each period between restructuring and maturity (in substance the "interest" method prescribed by paragraph 15 of *APB Opinion No. 21*). The new effective interest rate shall 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 payable.

17. If, however, the total future cash payments specified by the new terms of a payable, including both payments designated as interest and those designated as face amount, are less than the carrying amount of the payable, the debtor shall reduce the carrying amount to an amount equal to the total future cash payments specified by the new terms and shall recognize a gain on restructuring of payables equal to the amount of the reduction (see paragraph 21).[11] Thereafter, all cash payments under the terms of the payable shall be accounted for as reductions of the carrying amount of the payable, and no interest expense shall be recognized on the payable for any period between the restructuring and maturity of the payable.[12]

18. A debtor shall not recognize a gain on a restructured payable involving indeterminate future cash payments as long as the maximum total future cash payments may exceed the carrying amount of the payable. Amounts designated either as interest or as face amount by the new terms may be payable contingent on a specified event or circumstance (for example, the debtor may be required to pay specified amounts if its financial condition improves to a specified degree within a specified period). To determine whether the debtor shall recognize a gain according to the provisions of paragraphs 16 and 17, those contingent amounts shall be included in the "total future cash payments specified by the new terms" to the extent necessary to prevent recognizing a gain at the time of restructuring that may be offset by future interest expense. Thus, the debtor shall apply paragraph 17 of *FASB Statement No. 5,* "Accounting for Contingencies," in which probability of occurrence of a gain contingency is not a factor, and shall assume that contingent future payments will have to be paid. The same principle applies to amounts of future cash payments that must sometimes be estimated to apply the provisions of paragraphs 16 and 17. For example, if the number of future interest payments is flexible because the face amount and accrued interest is payable on demand or becomes payable on demand, estimates of total future cash payments shall be based on the maximum number of periods possible under the restructured terms.

Combination of Types

19. A troubled debt restructuring may involve partial settlement of a payable by the debtor's transferring assets or granting an equity interest (or both) to the creditor and modification of

terms of the remaining payable.[13] A debtor shall account for a troubled debt restructuring involving a partial settlement and a modification of terms as prescribed in paragraphs 16-18 except that, first, assets transferred or an equity interest granted in that partial settlement shall be measured as prescribed in paragraphs 13 and 15, respectively, and the carrying amount of the payable shall be reduced by the total fair value of those assets or equity interest.[14] A difference between the fair value and the carrying amount of assets transferred to the creditor shall be recognized as a gain or loss on transfer of assets. No gain on restructuring of payables shall be recognized unless the remaining carrying amount of the payable exceeds the total future cash payments (including amounts contingently payable) specified by the terms of the debt remaining unsettled after the restructuring. Future interest expense, if any, shall be determined according to the provisions of paragraphs 16-18.

Related Matters

20. A troubled debt restructuring that is in substance a repossession or foreclosure by the creditor or other transfer of assets to the creditor shall be accounted for according to the provisions of paragraphs 13, 14, and 19.

21. Gains on restructuring of payables determined by applying the provisions of paragraphs 13-20 of this Statement shall be aggregated, included in measuring net income for the period of restructuring, and, if material, classified as an extraordinary item, net of related income tax effect, in accordance with paragraph 8 of *FASB Statement No. 4,* "Reporting Gains and Losses from Extinguishment of Debt."

22. If a troubled debt restructuring involves amounts contingently payable, those contingent amounts shall be recognized as a payable and as interest expense in future periods in accordance with paragraph 8 of *FASB Statement No. 5.* Thus, in general, interest expense for contingent payments shall be recognized in each period in which (a) it is probable that a liability has been incurred and (b) the amount of that liability can be reasonably estimated. Before recognizing a payable and interest expense for amounts contingently payable, however, accrual or payment of those amounts shall be deducted from the carrying amount of the restructured payable to the extent that contingent payments included in "total future cash payments specified by the new terms" prevented recognition of a gain at the time of restructuring (paragraph 18).

23. If amounts of future cash payments must be estimated to apply the provisions of paragraphs 16-18 because future interest payments are expected to fluctuate—for example, the restructured terms may specify the stated interest rate to be the prime interest rate increased by a specified amount or proportion—estimates of maximum total future payments shall be based on the interest rate in effect at the time of the restructuring. Fluctuations in the effective interest rate after the restructuring from changes in the prime rate or other causes shall be accounted for as changes in estimates in the periods the changes occur. However, the accounting for those fluctuations shall not result in recognizing a gain on restructuring that may be offset by future cash payments (paragraphs 18 and 22). Rather, the carrying amount of the restructured payable

shall remain unchanged, and future cash payments shall reduce the carrying amount until the time that any gain recognized cannot be offset by future cash payments.

24. Legal fees and other direct costs that a debtor incurs in granting an equity interest to a creditor in a troubled debt restructuring shall reduce the amount otherwise recorded for that equity interest according to paragraphs 15 and 19. All other direct costs that a debtor incurs to effect a troubled debt restructuring shall be deducted in measuring gain on restructuring of payables or shall be included in expense for the period if no gain on restructuring is recognized.

Disclosure by Debtors

25. A debtor shall disclose, either in the body of the financial statements or in the accompanying notes, the following information about troubled debt restructurings that have occurred during a period for which financial statements are presented:

a. For each restructuring:[15] a description of the principal changes in terms, the major features of settlement, or both.
b. Aggregate gain on restructuring of payables and the related income tax effect (paragraph 21).
c. Aggregate net gain or loss on transfers of assets recognized during the period (paragraphs 14 and 19).
d. Per share amount of the aggregate gain on restructuring of payables, net of related income tax effect.

26. A debtor shall disclose in financial statements for periods after a troubled debt restructuring the extent to which amounts contingently payable are included in the carrying amount of restructured payables pursuant to the provisions of paragraph 18. If required by paragraphs 9-13 of *FASB Statement No. 5,* a debtor shall also disclose in those financial statements total amounts that are contingently payable on restructured payables and the conditions under which those amounts would become payable or would be forgiven.

Accounting by Creditors

27. A creditor shall account for a troubled debt restructuring according to the type of the restructuring as prescribed in the following paragraphs. Paragraphs 28-42 do not apply to a receivable that the creditor is accounting for at market value in accordance with the specialized industry practice (for example, a marketable debt security accounted for at market value by a mutual fund). Estimated cash expected to be received less estimated costs expected to be incurred is not market value in accordance with specialized industry practice as that term is used in this paragraph.

Receipt of Assets in Full Satisfaction

28. A creditor that receives from a debtor in full satisfaction of a receivable either (i) receivables

from third parties, real estate, or other assets or (ii) shares of stock or other evidence of an equity interest in the debtor, or both, shall account for those assets (including an equity interest) at their fair value at the time of the restructuring (see paragraph 13 for how to measure fair value).[16]The excess of (i) the recorded investment in the receivable [17] satisfied over (ii) the fair value of assets received is a loss to be recognized according to paragraph 35.

29. After a troubled debt restructuring, a creditor shall account for assets received in satisfaction of a receivable the same as if the assets had been acquired for cash.

Modification of Terms

30. A creditor in a troubled debt restructuring involving only modification of terms of a receivable—that is, not involving receipt of assets (including an equity interest in the debtor)—shall account for the effects of the restructuring prospectively and shall not change the recorded investment in the receivable at the time of the restructuring unless that amount exceeds the total future cash receipts specified by the new terms.[18] That is, the effects of changes in the amounts or timing (or both) of future cash receipts designated either as interest or as face amount shall be reflected in future periods.[19] Interest income shall be computed in a way that a constant effective interest rate is applied to the recorded investment in the receivable at the beginning of each period between restructuring and maturity (in substance the "interest" method prescribed by paragraph 15 of *APB Opinion No. 21*).[20] The new effective interest rate shall be the discount rate that equates the present value of the future cash receipts specified by the new terms (excluding amounts contingently receivable) with the recorded investment in the receivable.

31. If, however, the total future cash receipts specified by the new terms of the receivable, including both receipts designated as interest and those designated as face amount, are less than the recorded investment in the receivable before restructuring, the creditor shall reduce the recorded investment in the receivable to an amount equal to the total future cash receipts specified by the new terms. The amount of the reduction is a loss to be recognized according to paragraph 35. Thereafter, all cash receipts by the creditor under the terms of the restructured receivable, whether designated as interest or as face amount, shall be accounted for as recovery of the recorded investment in the receivable, and no interest income shall be recognized on the receivable for any period between the restructuring and maturity of the receivable.[21]

32. A creditor shall recognize a loss on a restructured receivable involving indeterminate future cash receipts unless the minimum future cash receipts specified by the new terms at least equals the recorded investment in the receivable. Amounts designated either as interest or as face amount that are receivable from the debtor may be contingent on a specified event or circumstance (for example, specified amounts may be receivable from the debtor if the debtor's financial condition improves to a specified degree within a specified period). To determine whether the creditor shall recognize a loss according to the provisions of paragraphs 30 and 31, those contingent amounts shall be included in the "total future cash receipts specified by the new terms" only if at the time of restructuring those amounts meet the conditions that would be

applied under the provisions of paragraph 8 of *FASB Statement No. 5* in accruing a loss. That is, a creditor shall recognize a loss unless contingent future cash receipts needed to make total future cash receipts specified by the new terms at least equal to the recorded investment in the receivable both are probable and can be reasonably estimated. The same principle applies to amounts of future cash receipts that must sometimes be estimated to apply the provisions of paragraphs 30 and 31. For example, if the number of interest receipts is flexible because the face amount and accrued interest is collectible on demand or becomes collectible on demand after a specified period, estimates of total future cash receipts should be based on the minimum number of periods possible under the restructured terms.

Combination of Types

33. A troubled debt restructuring may involve receipt of assets (including an equity interest in the debtor) in partial satisfaction of a receivable and a modification of terms of the remaining receivable.[22] A creditor shall account for a troubled debt restructuring involving a partial satisfaction and modification of terms as prescribed in paragraphs 30-32 except that, first, the assets received shall be accounted forat their fair values as prescribed in paragraph 28 and the recorded investment in the receivable shall be reduced by the fair value of the assets received.[23] No loss on the restructuring shall be recognized unless the remaining recorded investment in the receivable exceeds the total future cash receipts specified by the terms of the receivable remaining unsatisfied after the restructuring. Future interest income, if any, shall be determined according to the provisions of paragraphs 30-32.

Related Matters

34. A troubled debt restructuring that is in substance a repossession or foreclosure by the creditor, or in which the creditor otherwise obtains one or more of the debtor's assets in place of all or part of the receivable, shall be accounted for according to the provisions of paragraphs 28 and 33 and, if appropriate, 39.

35. Losses determined by applying the provisions of paragraphs 28-34 of this Statement shall, to the extent that they are not offset against allowances for uncollectible amounts or other valuation accounts, be included in measuring net income for the period of restructuring and reported according to *APB Opinion No. 30*. Although this Statement does not address questions concerning estimating uncollectible amounts or accounting for the related valuation allowance (paragraph 1), it recognizes that creditors use allowances for uncollectible amounts. Thus, a loss from reducing the recorded investment in a receivable may have been recognized before the restructuring by deducting an estimate of uncollectible amounts in measuring net income and increasing an appropriate valuation allowance. If so, a reduction in the recorded investment in the receivable in a troubled debt restructuring is a deduction from the valuation allowance rather than a loss in measuring net income for the period of restructuring. A valuation allowance can also be used to recognize a loss determined by applying paragraphs 28-34 that has not been previously recognized in measuring net income. For example, a creditor with an allowance for uncollectible amounts pertaining to a group of receivables that includes the restructured

receivable may deduct from the allowance the reduction of recorded investment in the restructured receivable and recognize the loss in measuring net income for the period of restructuring by estimating the appropriate allowance for remaining receivables, including the restructured receivable.

36. If a troubled debt restructuring involves amounts contingently receivable, those contingent amounts shall not be recognized as interest income in future periods before they become receivable—that is, they shall not be recognized as interest income before both the contingency has been removed and the interest has been earned.[24] Before recognizing those amounts as interest income, however, they shall be deducted from the recorded investment in the restructured receivable to the extent that contingent receipts included in "total future cash receipts specified by the new terms" avoided recognition of a loss at the time of restructuring (paragraph 32).

37. If amounts of future cash receipts must be estimated to apply the provisions of paragraphs 30-32 because future interest receipts are expected to fluctuate—for example, the restructured terms may specify the stated interest rate to be the prime interest rate increased by a specified amount or proportion—estimates of the minimum total future receipts shall be based on the interest rate in effect at the time of restructuring. Fluctuations in the effective interest rate after the restructuring from changes in the prime rate or other causes shall be accounted for as changes in estimates in the periods the changes occur except that a creditor shall recognize a loss and reduce the recorded investment in a restructured receivable if the interest rate decreases to an extent that the minimum total future cash receipts determined using that interest rate fall below the recorded investment in the receivable at that time.

38. Legal fees and other direct costs incurred by a creditor to effect a troubled debt restructuring shall be included in expense when incurred.

39. A receivable from the sale of assets previously obtained in a troubled debt restructuring shall be accounted for according to *APB Opinion No. 21* regardless of whether the assets were obtained in satisfaction (full or partial) of a receivable to which that Opinion was not intended to apply. A difference, if any, between the amount of the new receivable and the carrying amount of the assets sold is a gain or loss on sale of assets.

Disclosure by Creditors

40. A creditor shall disclose, either in the body of the financial statements or in the accompanying notes, the following information about troubled debt restructurings as of the date of each balance sheet presented:

a. For outstanding receivables whose terms have been modified in troubled debt restructurings, by major category:[25] (i) the aggregate recorded investment; (ii) the gross interest income that would have been recorded in the period then ended if those receivables had been current in accordance with their original terms and had been outstanding throughout the period or since origination, if held for part of the period; and (iii) the amount of interest income on those receivables that was included in net income for the period. A receivable whose terms have been modified need not be included in that disclosure if, subsequent to restructuring, its effective interest rate (paragraph 30) has been equal to or greater than the rate that the creditor was willing to accept for a new receivable with comparable risk.

b. The amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructurings.

41. A financial institution, or other creditor, may appropriately disclose the information prescribed by paragraph 40, by major category, for the aggregate of outstanding reduced-earning and nonearning receivables rather than separately for outstanding receivables whose terms have been modified in troubled debt restructurings.

Substitution or Addition of Debtors

42. A troubled debt restructuring may involve substituting debt of another business enterprise, individual, or government unit [26] for that of the troubled debtor or adding another debtor (for example, as a joint debtor). That kind of restructuring should be accounted for according to its substance. For example, a restructuring in which, after the restructuring, the substitute or additional debtor controls, is controlled by, or is under common control [27] with the original debtor is an example of one that shall be accounted for by the creditor according to the provisions of paragraphs 30-32. Those paragraphs shall also apply to a restructuring in which the substitute or additional debtor and original debtor are related after the restructuring by an agency, trust, or other relationship that in substance earmarks certain of the original debtor's funds or funds flows for the creditor although payments to the creditor may be made by the substitute or additional debtor. In contrast, a restructuring in which the substitute or additional debtor and the original debtor do not have any of the relationships described above after the restructuring shall be accounted for by the creditor according to the provisions of paragraphs 28 and 33.

Effective Date and Transition

43. The preceding paragraphs of this Statement, other than paragraphs 39-41, shall be effective for troubled debt restructurings consummated after December 31, 1977.[28] Earlier application is encouraged for those consummated on or before December 31, 1977 but during fiscal years for which annual financial statements have not previously been issued. The paragraphs shall not be applied to those consummated during fiscal years for which annual financial statements have previously been issued.

44. Paragraph 39 shall be effective for receivables resulting from sales of assets after December 31, 1977 regardless of whether the provisions of this Statement were applied to the

related troubled debt restructuring. Earlier application is encouraged for receivables from sales of assets on or before December 31, 1977 but during fiscal years for which annual financial statements have not previously been issued. It shall not be applied to those from sales of assets during fiscal years for which annual financial statements have previously been issued.

45. The information prescribed by paragraphs 40 and 41 shall be disclosed in financial statements for fiscal years ending after December 15, 1977. Earlier application is encouraged in financial statements for fiscal years ending before December 16, 1977. For the purpose of applying paragraph 40, "receivables whose terms have been modified in troubled debt restructurings" shall encompass not only (a) receivables whose terms have been modified in troubled debt restructurings to which the other provisions of this Statement have been applied in accordance with paragraph 43 but also (b) those whose terms have been modified in earlier restructurings that constitute troubled debt restructurings (paragraphs 2-8) but have been excluded from its other provisions because of the timing of the restructurings.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Gellein and Kirk dissented.

Messrs. Kirk and Gellein dissent because they disagree with the conclusions in paragraphs 16 and 30 (which are also in paragraphs 19 and 33) about prospective treatment of the effect of a reduction of the face amount or maturity amount of debt. They would apply the fair value accounting required in paragraphs 13, 15, and 28 to reductions in the face amount of restructured debt. They point to the incontrovertible fact that a modification of terms that reduces the face amount or interest rate or extends the maturity date, without equivalent consideration, is a relinquishment of rights by the creditor and a corresponding benefit to the debtor, and note that debtors and creditors currently record a reduction in face amount when it occurs. They believe that this Statement takes a backward step in reversing, for the sake of consistency, the practice of current recognition, though not based on fair value. They do not accept the argument implicit in paragraphs 140-144, especially paragraph 144, that consistency in accounting for various modifications of terms should govern. They find no virtue in theoretical consistency if it means now ignoring a substantive consequence of an event—in this case relinquishment of rights—that prior to the issuance of this Statement was being recognized. Messrs. Kirk and Gellein accept prospective recognition of the relinquishment by the creditor and the contra benefit to the debtor associated with interest rate reductions and extensions of maturity dates pending further consideration of other aspects of accounting for interest.

Messrs. Kirk and Gellein believe that their proposal to apply fair value accounting (required in paragraphs 13, 15, and 28 of this Statement) to reduction in the face amount would eliminate a significant difference between the accounting required by this Statement and that required by *APB Opinion No. 26* for debt exchanges that involve changes in the face amount.

They also believe that their proposal would result in a more conventional and understandable measure of gain or loss than that which results from the application of paragraphs 17, 19, 31, and 33. They believe that in situations considered to be recordable events, any gain or loss should be determined by comparing fair value, not an undiscounted amount of future cash flows, with previously recorded amounts.

Messrs. Kirk and Gellein also dissent because of disagreement with the guidelines in paragraph 42 for determining when a restructuring that involves a substitution of debtors is a recordable event. First, they believe that from the viewpoint of the creditor, there is no significant difference between a change from the original debtor to one under or to one not under the same control as the original debtor. To the creditor both are changes to a new and different credit risk that should be accounted for in the same way. Second, they believe the guideline in that paragraph concerning a substitute debtor and original debtor who are "related after the restructuring by an agency, trust, or other relationship that in substance earmarks certain of the original debtor's funds or funds flows for the creditor although payments to the creditor may be made by the substitute...debtor," is an unworkable criterion and is irrelevant if the right, or asset that gives rise to those funds flows, is irrevocably transferred. In the latter event, from the creditor's viewpoint, the transfer changes the risk and, in effect, results in a different asset—similar in substance to that described in paragraph 28. Further, they find insufficient guidance about the kind of relationship between the parties intended to govern. As an example, they disagree with the interpretation of that guideline in paragraph 161 where recent exchanges of bonds of the Municipal Assistance Corporation (the Corporation) for notes of the City of New York (the City) are noted as examples of debt substitutions whose substance to creditors is modification of terms of an existing receivable rather than an acquisition of a new asset. They believe the relationship in that case goes beyond that of an agency, trust, or other relationship that earmarks funds. They note that the Corporation is a corporate governmental agency and an instrumentality of the State of New York (the State), not the City; that bonds of the Corporation do not constitute an enforceable obligation, or a debt, of either the State or the City and neither the State nor the City shall be liable thereon; and that neither the faith and credit nor the taxing power of the State or City is pledged to the payment of principal of or interest on the bonds. They note, too, that the Corporation is empowered to issue and sell bonds and notes and to pay or lend funds received from such sale to the City and to exchange the Corporation's obligations for obligations of the City. Those characteristics in their minds establish sufficient independence of the Corporation from the City to take the exchanges out from under the guidelines of paragraph 42.

Members of the Financial Accounting Standards Board:

Marshall S. Armstrong, *Chairman*
Oscar S. Gellein
Donald J. Kirk
Arthur L. Litke
Robert E. Mays
Robert T. Sprouse

Ralph E. Walters

Appendix A: BACKGROUND INFORMATION

46. There has been a substantial increase in recent years in the number of debtors that are unable to meet their obligations on outstanding debt because of financial difficulties. Sometimes the debtor and the creditor have restructured the debt to enable the debtor to avoid bankruptcy proceedings or other consequences of default, and the number of troubled debt restructurings receiving publicity has also increased. Although many of the most publicized troubled debt restructurings have involved debtors that are real estate companies or real estate investment trusts, debtors in other industries have also been involved in troubled debt restructurings.

47. *APB Opinion No. 26,* "Early Extinguishment of Debt," established the accounting by a debtor for debt extinguished before its scheduled maturity. A number of commentators have observed, however, that not all troubled debt restructurings are "extinguishments" as that term is used in *APB Opinion No. 26*. Also, since many troubled debt restructurings have occurred on or after the scheduled maturity of the debt, questions have arisen about accounting for debt restructurings that are not early extinguishments. It has been suggested that troubled debt restructurings should be considered separately from restructurings, including early extinguishments, that do not involve the economic or legal pressure to restructure on the creditor that characterizes troubled debt restructurings.

48. Concern over the lack of guidance in the authoritative literature on accounting for troubled debt restructurings, accentuated by their increasing number, led to requests that the Financial Accounting Standards Board consider the matter. The Board submitted the question to the Screening Committee on Emerging Problems and weighed its recommendations in deciding to proceed with a project limited in scope to accounting and reporting by a debtor whose debt is restructured in a troubled loan situation. The Board issued an Exposure Draft of a Proposed Statement, "Restructuring of Debt in a Troubled Loan Situation," dated November 7, 1975, and held a public hearing on December 12, 1975. The Board received 63 written responses to the Exposure Draft and heard five oral presentations at the public hearing. A number of respondents objected to the accounting prescribed by the Exposure Draft, but they held divergent views about the appropriate accounting. Major issues of concern centered on (a) whether certain kinds of troubled debt restructurings require reductions of carrying amounts of debt, (b) if they do, whether the effect of the reduction should be included in measuring current net income, be deferred, or be considered a contribution to capital, and (c) whether interest that is contingently payable on restructured debt should be recognized before it becomes payable.

49. During the same period, uncertainties arose about the abilities of some state and local government units to pay their obligations when due. Some of those obligations have also been restructured, for example, by continuing the existing obligation for a designated period at a

reduced interest rate or by substituting obligations with later maturities of the same or a related issuer. Questions about accounting and reporting by creditors for those restructured securities led various individuals and organizations to urge the Board to consider that matter.

50. The Board considered (a) the lack of authoritative guidance and divergent views about accounting and reporting by debtors for troubled debt restructurings and by creditors for restructured securities of state and local government units and (b) the similarities of the issues for debtors and creditors and concluded that the accounting and reporting issues affecting both debtors and creditors should be considered in a single project. The Board therefore announced on January 7, 1976, that it had added to its agenda a project to determine accounting and reporting by both debtors and creditors. At the same time the Board announced that since the new project concerned accounting by both debtors and creditors, the Board would not issue a Statement covering the limited topic of the November 7, 1975 Exposure Draft.

51. The Securities and Exchange Commission issued, also on January 7, 1976, *Accounting Series Release No. 188,* "Interpretive Statement by the Commission on Disclosure by Registrants of Holdings of Securities of New York City and Accounting for Securities Subject to Exchange Offer and Moratorium." The Commission did not require a particular accounting method because of the divergent views on accounting for the securities held and "the fact that the Financial Accounting Standards Board has agreed to undertake a study of the accounting problems...with the intention of developing standards which can be applied to year-end statements in 1976."

52. The Board appointed a task force in January 1976 to provide counsel in preparing a Discussion Memorandum. Its sixteen members included individuals from academe, the financial community, industry, law, and public accounting. The Board issued a Discussion Memorandum, "Accounting by Debtors and Creditors When Debt Is Restructured," dated May 11, 1976, comprehending accounting and reporting by debtors and creditors for "any change in the amount or timing of cash payments otherwise required under the terms of the debt at the date of restructuring." It received 894 written responses to the Discussion Memorandum and heard 37 oral presentations at a public hearing on July 27-30, 1976.

53. In addition, the FASB staff reviewed the accounting and reporting practices of a number of debtors and creditors involved in troubled debt restructurings and interviewed a limited number of individuals who were directly associated with some of those restructurings.

54. The Board issued an Exposure Draft of a proposed Statement on "Accounting by Debtors and Creditors for Troubled Debt Restructurings," dated December 30, 1976. It received 96 letters of comment on the Exposure Draft.

Appendix B

BASIS FOR CONCLUSIONS

CONTENTS

Paragraph Numbers

Appendix B: BASIS FOR CONCLUSIONS

55. This Appendix discusses factors deemed significant by members of the Board in reaching the conclusions in this Statement, including various alternatives considered and reasons for accepting some and rejecting others.

SCOPE OF THIS STATEMENT

56. Paragraph 1 states that this Statement establishes standards of financial accounting and reporting by the debtor and by the creditor for a troubled debt restructuring. In contrast, the Discussion Memorandum comprehended all restructurings that changed "the amount or timing of cash payments otherwise required under the terms of the debt at the date of the restructuring." The broader scope of the Discussion Memorandum, which encompassed nontroubled as well as troubled debt restructurings, was due to several factors. The Board considered it necessary to obtain additional information about accounting practices and problems for both troubled and nontroubled debt restructurings. Some respondents to the November 7, 1975 Exposure Draft of a Proposed Statement, "Restructuring of Debt in a Troubled Loan Situation," expressed concern that to apply its guidelines for identifying troubled loan situations would require considerable judgment. Some Task Force members and other commentators advised the Board to comprehend all restructurings accomplished by exchanges of debt for debt or of equity securities for debt that may not be covered by *APB Opinion No. 26*.[29]

57. Most respondents to the Discussion Memorandum that commented on the matter, however, recommended that a Statement at this time should be limited to accounting for troubled debt restructurings. Numerous respondents indicated that restructurings of debt in nontroubled situations present no significant or unusual accounting problems that merit consideration or require new accounting and reporting standards. Many respondents contended that the kinds of major changes that might result from new standards on accounting for all restructurings should be deferred pending progress on the FASB's existing projects on accounting for interest costs and the conceptual framework for financial accounting and reporting. Some respondents argued that a useful distinction between troubled and nontroubled restructurings of debt can be made and that the need to use judgment in some circumstances should not be a deterrent to making that distinction in a Statement. A number of respondents to the Exposure Draft [30] made similar comments.

58. The Board found persuasive the views described in the preceding paragraph and decided to limit the scope of this Statement to troubled debt restructurings. The Board also decided that conclusions in this Statement should not attempt to anticipate results of considering the issues in its Discussion Memorandum, "Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement," dated December 2, 1976. Rather,

the Board believes that, to the extent possible, the accounting for troubled debt restructurings prescribed in this Statement should be consistent and compatible with the existing accounting framework.

59. Paragraph 1 also states that the Statement does not establish standards of financial accounting and reporting for allowances for uncollectible amounts and does not prescribe or proscribe particular methods for estimating amounts of uncollectible receivables. Several respondents to the Exposure Draft urged the Board to adopt the method of accounting for uncollectible amounts based on the net realizable value of collateral property set forth in *Statement of Position 75-2,* "Accounting Practices of Real Estate Investment Trusts," issued June 27, 1975 by the Accounting Standards Division of the American Institute of Certified Public Accountants. Others noted potential conflicts between the Exposure Draft and the AICPA publication and requested clarification. Still others urged the Board to reject the method for estimating amounts of uncollectible receivables in *Statement of Position 75-2.*

60. Since this Statement neither prescribes nor proscribes particular methods for estimating uncollectible amounts of receivables, it takes no position on whether the net realizable value of collateral is a proper basis for estimating allowances for uncollectible amounts of receivables. However, the accounting prescribed in this Statement for assets received in troubled debt restructurings differs from that in *Statement of Position 75-2,* for reasons given in paragraphs 65-105, and the accounting prescribed in this Statement governs.

61. Paragraphs 2-8 identify debt restructurings that fall within the scope of this Statement. This paragraph and the next are intended to clarify further the meaning of *troubled debt restructuring* for purposes of this Statement. The description of a troubled debt restructuring is based generally on that in the November 7, 1975 Exposure Draft, which many respondents to that Exposure Draft and the Discussion Memorandum found satisfactory. It focuses on the economic and legal considerations related to the debtor's financial difficulties that in effect compel the creditor to restructure a receivable in ways more favorable to the debtor than the creditor would otherwise consider. The creditor participates in a troubled debt restructuring because it no longer expects its investment in the receivable to earn the rate of return expected at the time of investment and may view loss of all or part of the investment to be likely unless the receivable is restructured. Thus, a troubled debt restructuring involves a receivable whose risk to the creditor has greatly increased since its acquisition, and if the creditor were not faced with the need to restructure to protect itself, it would require a much higher effective interest rate to invest in the same receivable currently. If the receivable has a market price, the effective interest rate based on that market price will have increased because of that increased risk to the creditor—that is, it will have increased more than market interest rates generally (or fallen less than market rates or increased while interest rates generally have fallen).

62. Although the broad description of a troubled debt restructuring in paragraphs 2-8 includes settlements of debt by transfers of assets and grants of equity interests in debtors, *troubled debt restructuring* refers in particular to modifications of terms intended to continue an

existing debt by making the terms more favorable to the debtor to protect the creditor's investment. For purposes of this Statement, troubled debt restructurings do not include changes in terms resulting in an effective interest rate based on market price of the debt that is comparable to effective interest rates applicable to debt issued by nontroubled debtors, for example, a situation in which a debtor is able to exchange for its outstanding debt new marketable debt with an effective interest rate at or near the market interest rates for debt issued by nontroubled debtors generally. The fact that the debtor can obtain that interest rate only by including a "sweetener," such as a conversion privilege, does not make that transaction a troubled debt restructuring because (a) the debtor is sufficiently strong financially that the kind of economic compulsion on the creditor described earlier is not present, (b) the "sweetener" represents so drastic a change in the terms of the debt that the transaction is in substance the exchange of new debt for outstanding debt rather than merely a modification of terms to continue an existing debt, or (c) some combination of both factors.

63. Some respondents to the Discussion Memorandum advocated that the scope of this Statement specifically exclude restructurings of receivables related to consumer finance activities or to all or certain residential properties. Their reasons focused primarily on the individual insignificance of those receivables in a creditor's financial position and on the cost involved to account for reductions in recorded investments in large numbers of receivables that may be restructured. The Board concluded that accounting for restructurings of those receivables in troubled situations should in general be the same as for other troubled debt restructurings. However, grouping like items or using statistical measures may be appropriate for receivables that are not individually material.

64. Some respondents to the Exposure Draft suggested that the *time of a troubled debt restructuring* be clarified because several dates or events may be involved. The time may be significant in matters relating to recognizing gains or losses from restructuring or to the effective date of the Statement. Paragraph 6 specifies the time of a restructuring to be the date of consummation, that is, the time that assets are transferred, new terms become effective, and the like. A debtor should not recognize a gain on restructuring before consummation of the restructuring; a creditor should record receipt of an asset or equity interest at that date or should formally write down a restructured receivable, but may already have recognized a loss on restructuring through estimated uncollectible amounts.

DIVERGENT VIEWS OF TROUBLED DEBT RESTRUCTURINGS

65. Respondents to the Discussion Memorandum expressed divergent views about the substance of various types of troubled debt restructurings and appropriate accounting for them within the existing accounting framework. Those views fall generally into three categories:

a. All troubled debt restructurings constitute events that are part of continuing efforts by creditors to recover amounts invested and obtain a return on investment despite debtors' financial difficulties; therefore, troubled debt restructurings may require certain disclosures, but usually do not require changes in carrying amounts of payables or recorded investments in receivables or recognition of gains or losses.

b. All debt restructurings, troubled and nontroubled, constitute transactions whose financial effect on assets or liabilities (receivables or payables) should be recognized, including recognition of gains or losses.

c. Accounting for a troubled debt restructuring depends on the characteristics of the restructuring. Some troubled debt restructurings constitute transactions requiring recognition of changes in receivables or payables and related gains or losses; other troubled debt restructurings do not.

Recognition of Changes Not Appropriate

66. Respondents who contended that troubled debt restructurings constitute events for which recognition of changes in assets or liabilities is usually not appropriate within the existing accounting framework generally focused on accounting by creditors. They reasoned that a troubled debt restructuring commonly involves a concession granted unilaterally by the creditor to increase its prospects of recovering the amount invested. The debtor is usually a passive beneficiary of the effects of the restructuring. Troubled debt restructurings typically result from the debtor's financial difficulties that existed before restructuring, and in the existing accounting framework the creditor should have considered the debtor's financial difficulties in estimating an allowance for uncollectible amounts regardless of whether those difficulties were likely to culminate in a restructuring. According to those respondents, the restructuring event in itself has no accounting significance except to sometimes provide more definitive evidence of the effect of the debtor's financial difficulties on the creditor's ability to recover the recorded investment in the receivable.

67. According to that view, the creditor should record no change in a receivable restructured in a troubled debt restructuring and no gain or loss whether the restructuring involves (i) transfer of receivables, real estate, or other noncash assets from the debtor to the creditor to satisfy the receivable, (ii) grant to the creditor of an equity interest in the debtor to satisfy the receivable, (iii) modification of the terms of the receivable, or (iv) some combination of transfer of assets or grant of equity interests (or both) and modification of terms. The normal, expected course of events in a creditor's activities is to invest cash, earn interest on the cash invested, and eventually recover the cash. Although a creditor initiates or agrees to a restructuring to protect the amount invested, not to acquire noncash assets, the creditor may accept noncash assets (including an equity interest) as a necessary intermediate step. The creditor previously held a claim on the debtor's assets, either through a receivable secured by specific collateral or through an unsecured general claim against the debtor's assets. Accepting noncash assets in a restructuring represents the exercise of that claim; the assets stand in the place of the receivable. According to that view, the creditor's recorded investment in the receivable should become the recorded investment in the surrogate assets obtained. Then, since whether the creditor recovers that investment depends on the cash received for the assets that replaced the receivable, recoverability of that recorded investment as a result of obtaining the surrogate assets should be assessed. An expected failure,

if any, to recover all of the recorded investment should be recognized as a loss by the creditor to the extent not previously recognized. However, transfer of the assets to the creditor should not precipitate recognition of a loss that was not inherent in the receivable before the restructuring; at most, the transfer provides evidence of the existence and amount of a loss.

Recognition of Changes Appropriate for All Debt Restructurings

68. Some respondents advocated for virtually all debt restructurings, troubled and nontroubled, the accounting normally required in the existing accounting framework for initial recognition of assets and liabilities. They reasoned that each restructuring is an exchange resulting in a new asset for the creditor or liability for the debtor in place of the old one. According to that view, the presence or absence of financial difficulties does not affect the appropriate accounting for a restructuring; at most, a debtor's financial difficulties may affect the terms of the exchange. Those respondents contended that all assets and liabilities exchanged in debt restructurings should be measured at their fair values at the time of the restructuring by both debtors and creditors. They considered continued use of recorded amounts derived from previous exchange transactions to be inappropriate for restructured receivables and payables because it ignores a current exchange transaction and may ignore gains or losses that have occurred and should be recognized.

Accounting Depends on Circumstances

69. Some respondents contended that the controlling criterion in determining appropriate accounting for a debt restructuring within the existing accounting framework is whether the restructuring involves transfer of resources, obligations, or both between debtor and creditor. According to that view, a troubled debt restructuring involving transfer of resources, obligations, or both should be accounted for the same as other transfers of resources and obligations in the existing accounting framework and may involve recognizing a gain or loss. A troubled debt restructuring involving no transfer of resources or obligations requires no accounting for changes in assets or liabilities, except to recognize losses in accordance with *FASB Statement No. 5*.

70. Some respondents distinguished debt restructurings involving transfers of resources, obligations, or both from those involving no transfers on the basis of whether the debtor transferred assets or granted an equity interest to the creditor to satisfy the debt or the restructuring involved modification of terms only. Other respondents classified modifications of terms involving reduction of face amount of the debt with transfers of assets or grants of equity interests (discussed further in paragraphs 106-155).

Board Conclusions about Recognizing Changes in Assets or Liabilities

71. *APB Statement No. 4,* "Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises," describes relevant parts of the existing accounting framework. That Statement defines "economic resources" as "the scarce means (limited in supply relative to desired uses) available for carrying on economic activities" and identifies "claims to receive money" as an economic resource. It defines "economic obligations" as

"present responsibilities to transfer economic resources or provide services to other entities in the future" and identifies "obligations to pay money" as an economic obligation. It also states that "events that change resources, obligations, and residual interest are the basis for the basic elements of results of operations...and other changes in financial position with which financial accounting is concerned." (See *APB Statement No. 4,* paragraphs 57, 58, and 61.)

72. According to *APB Statement No. 4,* almost all of the events that in the existing accounting framework normally change assets and liabilities and also affect net income for the period of change are either "exchanges" or "nonreciprocal transfers," the two classes that comprise "transfers of resources or obligations to or from other entities." The other classes of events—"external events other than transfers of resources or obligations to or from other entities" (price changes, interest rate changes, technological changes, vandalism, etc.) and "internal events" (production and casualties)—result in revenues or gains only through "exceptions" and result in expenses or losses only because some produce losses by definition or by applying the "modifying convention" of conservatism. (See *APB Statement No. 4,* paragraphs 62 and 180-187.)

73. An exchange is a reciprocal transfer between the enterprise and another entity in which "the enterprise either sacrifices resources or incurs obligations in order to obtain other resources or satisfy other obligations." "Exchanges between the enterprise and other entities (enterprises or individuals) are generally recorded in financial accounting when the transfer of resources or obligations takes place or services are provided." Nonreciprocal transfers are "transfers in one direction of resources or obligations, either from the enterprise to other entities or from other entities to the enterprise." In nonreciprocal transfers between the enterprise and entities other than owners, "one of the two entities is often passive, a mere beneficiary or victim of the other's actions." Nonreciprocal transfers between the enterprise and entities other than owners "are recorded when assets are acquired (except that some noncash assets received as gifts are not recorded), when assets are disposed of or their loss is discovered, or when liabilities come into existence or are discovered." (See *APB Statement No. 4,* paragraphs 62, 181, and 182.)

74. The Board rejected the view that virtually all troubled debt restructurings have the same substance in the existing accounting framework. It therefore rejected both the view that accounting for all troubled debt restructurings should involve recognition of changes in assets or liabilities and perhaps gains and losses and the view that no troubled debt restructurings should require recognition of changes in assets or liabilities or gains or losses.

75. The Board concluded that a troubled debt restructuring that involves transfer of resources or obligations requires accounting for the resources or obligations transferred whether that restructuring involves an exchange transaction or a nonreciprocal transfer. Both kinds of transfers are accounted for in the existing accounting framework on essentially the same basis (exchange price received or paid or fair value received or given). In this Statement, therefore, the Board found it unnecessary to decide whether the transfer of resources and obligations in various types of troubled debt restructurings is reciprocal (an exchange) or nonreciprocal as

those terms are used in paragraph 62 of *APB Statement No. 4*.

76. The Board also concluded that a troubled debt restructuring that does not involve a transfer of resources or obligations is a continuation of an existing debt. It is neither an event that results in a new asset or liability for accounting purposes nor an event that requires a new measurement of an existing asset or liability.

77. The Board noted that guidance regarding the types of troubled debt restructurings that involve transfers of resources, obligations, or both is sparse in existing accounting pronouncements, and various views exist. The Board concluded that to the extent a troubled debt restructuring involves (i) transfer of receivables, real estate, or other assets from debtor to creditor to satisfy debt or (ii) grant to the creditor of an equity interest in the debtor to satisfy debt (or a combination of both), a transfer of resources or obligations has occurred that in the existing accounting framework should be accounted for at fair value. The debtor has given up assets or granted an equity interest to settle a payable, and the creditor has received the assets or equity interest in satisfaction of a receivable. In contrast, to the extent a troubled debt restructuring involves only modification of terms of continuing debt, no transfer of resources or obligations has occurred. The substance of troubled debt restructurings involving modifications of continuing debt is discussed in paragraphs 106-155.

78. Several respondents to the Exposure Draft disagreed with the Board's distinction between troubled debt restructurings involving transfers of assets or grants of equity interests in debtors and those involving only modifications of terms. Some respondents wished to have fewer kinds of troubled debt restructurings accounted for as transactions between debtors and creditors and thus disagreed with the Exposure Draft's conclusions on accounting for transfers of assets; their views are noted in the next section. Others wished to account for more kinds of troubled debt restructurings as transactions between debtors and creditors and thus disagreed with the Exposure Draft's conclusions on accounting for modifications of terms; their views are noted in paragraphs 150-153.

ACCOUNTING FOR RESTRUCTURINGS INVOLVING TRANSFERS

Accounting by Debtors and Creditors for Transfer of Assets

Concept of Fair Value

79. Some respondents to the Exposure Draft continued to argue that all troubled debt restructurings should be accounted for as modifications of terms of debt and that none should be accounted for as transfers of assets (paragraphs 66 and 67). Others accepted the need to account for some troubled debt restructurings as asset transfers but held that obtaining assets through foreclosure or repossession under terms included in lending agreements should be distinguished from obtaining assets in exchange for cash or in other "asset swaps." They contended that (a) only the form of the asset is changed by foreclosure or repossession, (b) the substance of a

secured loan is that the lender may choose either to postpone receipt of cash or take the asset to optimize cash receipts and recovery of its investment, and (c) foreclosure or repossession is not the completion of a lending transaction but merely a step in the transaction that begins with lending cash and ends with collecting cash.

80. The Board rejected those arguments for the reasons given in paragraphs 71-77, emphasizing that an event in which (a) an asset is transferred between debtor and creditor, (b) the creditor relinquishes all or part of its claim against the debtor, and (c) the debtor is absolved of all or part of its obligation to the creditor is the kind of event that is the basis of accounting under the existing transaction-based accounting framework. To fail to recognize an event that fits the usual description of a transaction and to recognize only the lending and collection of cash as transactions would significantly change the existing accounting framework.

81. Use of the fair value of an asset transferred to measure the debtor's gain on restructuring and gain or loss on the asset's disposal or the creditor's cost of acquisition is not adopting some kind of "current value accounting." On the contrary, that use of fair value is common practice within the existing accounting framework. Paragraph 13 of this Statement explains briefly the meaning of *fair value* and refers to *APB Opinions No. 16, No. 21,* and *No. 29,* which use *fair value* in the same way and provide guidance about determining fair values within the existing accounting framework. The term *fair value* is used in essentially the same way as *market value* was used in the Discussion Memorandum to denote a possible attribute to be measured at the time a debt is restructured. *Fair value* is defined in paragraph 181 of *APB Statement No. 4* as "the approximation of exchange price in transfers in which money or money claims are not involved." Although a "money claim" is necessarily involved in transferring assets to settle a payable in a troubled debt restructuring, the troubled circumstances in which the transfer occurs make it obvious that the amount of the "money claim" does not establish an exchange price. Determining fair value of the assets transferred in a troubled debt restructuring is usually necessary to approximate an exchange price for the same reasons that determining fair value is necessary to account for transfers of assets in nonmonetary transactions (*APB Opinion No. 29*).

82. That point is emphasized in this Appendix because some respondents to the Exposure Draft apparently misunderstood the concept of fair value (paragraph 11 of the Exposure Draft and paragraph 13 of this Statement) and the discounting of expected cash flows specified in those paragraphs. Paragraph 13 permits discounting of expected cash flows from an asset transferred or received in a troubled debt restructuring to be used to estimate fair value only if no market prices are available either for the asset or for similar assets. The sole purpose of discounting cash flows in that paragraph is to estimate a current market price as if the asset were being sold by the debtor to the creditor for cash. That estimated market price provides the equivalent of a sale price on which the debtor can base measurement of a gain on restructuring and a gain or loss on disposal of the asset and the equivalent of a purchase price on which the creditor can measure the acquisition cost of the asset. To approximate a market price, the estimate of fair value should use cash flows and discounting in the same way the marketplace does to set prices—in essence, the marketplace discounts expected future cash flows from a

particular asset "at a rate commensurate with the risk involved" in holding the asset. An individual assessment of expected cash flows and risk may differ from what the marketplace's assessment would be, but the procedure is the same.

83. In contrast to the purpose of paragraph 13, *AICPA Statement of Position No. 75-2* [31] is concerned with different measures—net realizable value to a creditor of a receivable secured by real property and net realizable value of repossessed or foreclosed property. Its method of accounting for assets obtained by foreclosure or repossession thus differs from the method specified in this Statement. It proposes discounting expected cash flows at a rate based on the creditor's "cost of money" to measure the "holding cost" of the asset until its realizable value is collected in cash. The concept of fair value in paragraph 13 does not involve questions of whether interest is a "holding cost" or "period cost" because it is concerned with estimating market price, not net realizable value, however defined. Accounting for transfers of assets in troubled debt restructurings and for the assets after transfer is, of course, governed by this Statement.

84. Several respondents to the Exposure Draft suggested that the Statement should explicitly state that troubled debt restructurings that are in substance transfers of assets should be accounted for according to that substance. The Board agreed that a restructuring may be in substance a foreclosure, repossession, or other transfer of assets even though formal foreclosure or repossession proceedings are not involved. Thus, the Statement requires accounting for a transfer of assets if, for example, the creditor obtains control or ownership (or substantially all of the benefits and risks incident to ownership) of one or more assets of the debtor and the debtor is wholly or partially relieved of the obligations under the debt, or if both the debt and one or more assets of the debtor are transferred to another debtor that is controlled by the creditor.

Debtor's Recognition of Gain or Loss

85. Responses to the November 7, 1975 Exposure Draft, the May 11, 1976 Discussion Memorandum, and the Exposure Draft included two general procedures for a debtor to account for a gain or loss from a troubled debt restructuring involving a transfer of assets to settle a payable:

a. The debtor recognizes a difference, if any, between the carrying amount of assets transferred and the carrying amount of the payable settled as a gain on restructuring of a payable.
b. The debtor (1) recognizes a difference, if any, between the fair value and carrying amount of assets transferred as a gain or loss on transfer of assets and (2) recognizes a difference, if any, between the fair value of assets transferred and the carrying amount of the payable settled, as a gain on restructuring of a payable.

86. Some respondents contended that debtors should not recognize the difference between the carrying amount and fair value of assets transferred to settle a payable as a gain or loss on assets. Instead, the net difference, if any, between the carrying amount of assets transferred and the

carrying amount of a payable settled should be recognized as a gain or loss on restructuring of a payable. They argued that to measure the fair value of assets transferred would be costly and subjective in certain circumstances and that distinctions in the debtor's income statement between a gain or loss on disposition of assets and a gain on settlement of payables in the same troubled debt restructuring would probably not be helpful and might be arbitrary.

87. Other respondents who addressed the question emphasized the desirability of being able to assess separately the debtor's performance with respect to the transferred assets. They suggested that measuring the fair values of the transferred assets is essential to that assessment and conveys significant information that is obscured if fair values are not measured. For example, the fair values of some assets transferred (such as real estate) may often exceed their carrying amounts, while the fair values of other assets transferred (such as receivables) may sometimes be less than their face amounts. In the existing accounting framework, the first kind of difference is not recognized before disposal of the asset, but the second kind of difference is likely to have been recognized before restructuring by some debtors but not recognized by others for various reasons. Failure to include a gain or loss for the difference between the fair values and carrying amounts of assets transferred in troubled debt restructurings is likely to obscure differences and similarities between restructurings, according to that view, and respondents who advocated separate recognition of a debtor's gains or losses on assets transferred and gains on restructuring argued that separate recognition is required to provide consistent information about a single debtor for different periods and comparable information about different debtors for the same periods. The need for separate recognition is accentuated if gains and losses on transfer of assets are classed differently from gains on restructuring in the debtor's income statement (that is, if the latter are classified as extraordinary items).

88. The Board concluded that the fair value of the assets transferred in a troubled debt restructuring constitutes the best measure of the debtor's sacrifice to settle the payable and therefore that the fair value of assets transferred should be used to measure the gain on restructuring of the payable. In the existing accounting framework, gains, and losses on certain kinds of noncurrent assets, are usually recognized on assets only when the assets are sold or otherwise disposed of. For many assets, that gain or loss on sale or disposal is the only indication of whether the enterprise did well or poorly by having the asset. That indication is lost if the gain or loss on disposition is buried in a gain on restructuring of troubled debt, and the effect of the restructuring itself is also obscured. Further, unless fair value of the asset transferred is used to account for the transaction, the proportion of a payable settled by the transfer can usually be determined only by arbitrary and complicated allocations if the transfer settles only part of the payable and the terms are modified on the remainder (paragraph 19).

89. Since a gain or loss recognized by a debtor on the assets transferred to settle a payable in a troubled debt restructuring is closely related to a gain recognized by a debtor on restructuring of a payable, the Board concluded that the aggregate amount of each should be disclosed for restructurings that have occurred during a period for which financial statements are presented (paragraph 25).

Creditor's Subsequent Accounting

90. The Board considered two proposals for a creditor's accounting for assets received in full satisfaction of a receivable in a troubled debt restructuring: (a) the creditor accounts for the assets received at their fair value and recognizes as a loss a difference, if any, between the total fair value of assets received and the recorded investment in the receivable satisfied or (b) the creditor accounts for the assets received at the recorded investment in the receivable satisfied and recognizes no loss. Those alternatives are described in paragraphs 65-70, and the Board's reasons for adopting the first proposal are given in paragraphs 71-78.

91. Several respondents to the Exposure Draft requested guidance on a creditor's accounting after a troubled debt restructuring for assets received in the restructuring. Some asked the Board to require or permit creditors to accrue interest on all assets acquired through repossession or foreclosure. In response, paragraph 29 states that "after a troubled debt restructuring, a creditor shall account for assets received in satisfaction of a receivable the same as if the assets had been acquired for cash." The fair value at the time of transfer of an asset transferred to a creditor in a troubled debt restructuring is a measure of its cost to the creditor and generally remains its carrying amount (except for depreciation or amortization) until sale or other disposition if the asset is inventory, land, building, equipment, or other nonmonetary asset. That is, under the present accounting framework, interest is accrued only on some receivables and other monetary assets. Except for the effects of a few specialized rules that permit interest cost to be added to the cost of some assets under construction, etc., interest is not accrued on nonmonetary assets. That framework governs accounting for assets acquired in a troubled debt restructuring. The method of accounting for assets received through foreclosure, repossession, or other asset transfer to satisfy a receivable proposed by *Statement of Position 75-2* is not compatible with the accounting specified in this Statement.

Debtor's Accounting for Grant of Equity Interest

92. The Board considered three proposals for a debtor's accounting for an equity interest granted to a creditor to settle a payable in a troubled debt restructuring:

a. The debtor directly increases its owners' equity by the fair value of the equity interest granted [32] and recognizes the difference between that fair value and the carrying amount of the payable settled as a gain included in measuring net income.
b. Same as (a) except that the resulting gain is included directly in the owners' equity of the debtor.
c. The debtor directly increases its owners' equity by the carrying amount of the payable settled, recognizing no gain.

93. Respondents favoring use of fair value to record a grant of an equity interest contended that the increase in the owners' equity of the debtor as a result of a troubled debt restructuring should be measured by the consideration received for the equity interest granted, not by the

carrying amount of the payable settled because that carrying amount has no current economic significance. They also contended that a separate measure of a gain on restructuring of payables provides useful information.

94. Among those who advocated use of fair value to record an equity interest granted to settle debt in a troubled debt restructuring and recognition of a resulting gain on restructuring, some advocated including that gain in measuring net income and others advocated including it directly in the debtor's equity accounts. Those favoring inclusion in net income argued that all gains from troubled debt restructurings are components of net income whether they arise from transfer of assets or grant of equity interests. Those favoring direct inclusion in owners' equity argued that, to the extent an equity interest is involved, the restructuring is a capital transaction and gains resulting from capital transactions should be recognized as direct increases in paid-in or contributed owners' equity rather than as components of net income.

95. Those who advocated that the debtor's increase in equity for an equity interest granted should be the carrying amount of the debt settled also argued that granting an equity interest is essentially a capital transaction to which the notion of a gain does not apply. That solution was proposed in the November 7, 1975 Exposure Draft. Advocates of that view noted that paragraph 187 of *APB Statement No. 4* states that, among other sources, increases in owners' equity arise from investments in an enterprise by its owners. According to that view, a creditor that accepts an equity interest in the debtor in satisfaction of a receivable becomes an owner; the debtor's measure of the owners' investment is the carrying amount of the payable settled.

96. After considering the comments received in response to the November 7, 1975 Exposure Draft, the May 11, 1976 Discussion Memorandum, and the Exposure Draft, the Board concluded that a debtor should record an equity interest in the debtor granted to a creditor to settle a payable in a troubled debt restructuring at its fair value, and the difference between that fair value and the carrying amount of the payable settled should be recognized as a gain in measuring net income. The Board recognizes that, for some debtors involved in troubled debt restructurings, estimating either fair value of the equity interest granted or the fair value of the payable settled may be difficult. That estimate is necessary, however, to measure separately the consideration received for the equity interest and the gain on restructuring. To include the gain on restructuring in contributed equity would violate a clear principle for accounting for issues of stock—capital stock issued is recorded at the fair value of the consideration received (*APB Statement No. 4,* paragraph 182). The consideration received for the stock issued in that kind of troubled debt restructuring is cancellation of the payable (or part of it), but the fair value of the consideration received is not measured by the carrying amount of the payable. Whether the consideration received is measured by the fair value of the stock issued or the fair value of the payable cancelled, the consideration is less than the carrying amount of the payable. To record the stock issued at the carrying amount of the payable thus results in recording the stock at an amount in excess of the consideration received; to include the gain in restructuring in contributed equity instead of net income gives the same result.

97. To recognize a gain on restructuring acknowledges that the creditor accepted something less than the carrying amount of the payable to settle it. Since that is the essential result whether the restructuring is in the form of a transfer of assets from debtor to creditor or the form of a grant to the creditor of an equity interest in the debtor, the Board believes that essentially the same accounting applies in the existing accounting framework to both kinds of restructurings. Although the creditor becomes an owner of the debtor to the extent that the creditor accepts an equity interest in the debtor, that is a consequence of the kind of consideration used to settle a payable in a restructuring. The restructuring itself is an agreement between a debtor and a creditor, and the gain to the debtor results because the creditor accepted less consideration than the carrying amount of the debt.

Classification of Debtor's Gain on Restructuring

98. Alternatives considered by the Board for classifying gain on a troubled debt restructuring in the debtor's financial statements were that the gain is: (a) always included in measuring net income in accordance with *APB Opinion No. 30,* (b) always included in measuring net income as an extraordinary item, and (c) always included as a direct addition to paid-in capital. Most respondents addressing the question recommended classifying a gain on restructuring debt as an extraordinary item, primarily because they perceived it to be similar to gains or losses on extinguishment of debt that, according to *FASB Statement No. 4,* shall be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. Some respondents recommended classifying the gain as a direct increase in paid-in capital, contending that since the gain results from a unilateral action by the creditor, the debtor has in effect received a contribution to equity from the creditor.

99. The Board concluded that a gain on restructuring (net of related income tax effect), if material, should always be classified as an extraordinary item in measuring the debtor's net income. The Board recognized that to apply the criteria in *APB Opinion No. 30* to a particular debtor's gain on restructuring would not necessarily result in its classification as an extraordinary item. The Board concluded, however, that a gain on restructuring of a payable in a troubled debt restructuring is indistinguishable from a gain or loss on other extinguishments of debt, and the same classification in financial statements is appropriate. Since *FASB Statement No. 4* classifies a gain or loss on extinguishment of debt as an extraordinary item, the classification is appropriate for a gain on restructuring of a payable.

100. Some respondents suggested that "legal fees and other direct costs that a debtor incurs in granting an equity interest to a creditor in a troubled debt restructuring" (paragraph 24) always be included as extraordinary items whether or not the debtor recognizes a gain on restructuring. Issuing equity interests is not an extraordinary event for a business enterprise, however, and related costs are not extraordinary items under any existing authoritative literature. Deducting those costs from the proceeds of issue has been customary practice, and this Statement does not change that custom. But only costs of issuing the equity interest may be accounted for that way. All other direct costs of a troubled debt restructuring are expenses of the period of restructuring

but shall be deducted from a gain, if any, on restructuring.

Creditor's Accounting for Loss on Restructuring

101. Some respondents to the Discussion Memorandum, especially financial institutions, indicated that they hold and manage broad groups of earning assets (primarily loans and investments) as portfolios rather than as individual assets. According to them, their primary consideration in making a new loan or investment is to recover the amount invested, and the rate of return on the amount invested is a secondary consideration. Although one objective is to obtain an appropriate rate of return for the particular credit risk, changes in market conditions and general economic conditions as well as changes affecting the individual asset or debtor may cause the actual return from a loan or investment to vary from that originally anticipated. Therefore, the objective is to maintain a portfolio with an average yield that provides an adequate margin over the cost of funds and that has risk, maturity, marketability, and liquidity characteristics that are appropriate for the particular institution. To achieve that objective, the contractual rate of return required on individual loans and investments must include a factor to offset the probability that some of them will become nonearning assets, some will ultimately recover amounts invested only with difficulty, and some will involve loss of at least a portion of the amounts invested.

102. The financial difficulties of a debtor that lead to a troubled debt restructuring usually require the creditor to consider those difficulties carefully in determining whether to recognize a loss on the existing receivable. Typically, before restructuring occurs, the creditor has determined the need for a related allowance for uncollectible amounts in light of those difficulties. An allowance for uncollectible amounts may have been based on individual receivables, on groups of similar receivables without necessarily attempting to identify particular receivables that may prove uncollectible, or both. The creditor typically has numerous lending transactions and expects loan losses to recur as a consequence of customary and continuing business activities. Almost all respondents who commented on the classification of a creditor's loss on restructuring recommended that the loss be accounted for in a manner consistent with the enterprise's method of accounting for other losses related to its receivables. Usually that involves recognizing specific losses as they are identified and periodically adjusting the allowance for uncollectible amounts based on an assessment of its adequacy for losses not yet specifically identified. Respondents recommended that the net effect of recognizing specific losses and adjusting the valuation allowance be included in measuring net income in accordance with the provisions of *APB Opinion No. 30.*

103. The Board considered the varied frequency and significance for creditors of troubled debt restructurings in the light of the discussion in *APB Opinion No. 30,* and agreed that (a) a creditor should account for a loss from a troubled debt restructuring in the same manner as a creditor's other losses on receivables (that is, as deductions in measuring net income or as reductions of an allowance for uncollectible amounts), and (b) *APB Opinion No. 30* should apply to losses on restructuring that are included in measuring net income.

Creditor's Sale of Assets Received in Restructuring

104. A creditor whose customary business activities include lending may sell an asset that was previously acquired in a troubled debt restructuring. The consideration received in that sale may be represented, in whole or in part, by a receivable. The Board considered whether a receivable received in that way is exempt from the provisions of APB Opinion No. 21 because paragraph 3(d) of that Opinion states that, except for one paragraph, the Opinion does not apply to several kinds of receivables or payables or activities, including "the customary cash lending activities and demand or savings deposit activities of financial institutions whose primary business is lending money." Some respondents to the Exposure Draft held that acquiring and disposing of those assets is part of "the customary cash lending activities" of certain financial institutions.

105. The "lending activities" referred to in paragraph 3(d) of *APB Opinion No. 21* are modified by the words "customary" and "cash," and the Board concluded that the sale of an asset, such as real estate, by a financial institution is distinguishable from its customary cash lending activities. The view that the customary cash lending activities of a financial institution include repossession or foreclosure and resale of assets is part of the argument that repossessions and foreclosures are not transactions to be accounted for but merely changes in the form of the asset (paragraphs 66, 67, and 79-84). The Board rejected that contention and also rejected this part of it. *APB Opinion No. 21* focuses primarily on the possible misstatement of the exchange price (sale price or purchase price) in an exchange of a noncash asset for a receivable or payable, with consequent misstatement in the period of the transaction of gain or loss on sale or acquisition cost and misstatement in later periods of interest income or interest expense. The resale of repossessed or foreclosed assets is that kind of transaction and involves the same questions. Accordingly, the Board concluded that a receivable resulting from sale of an asset received in a troubled debt restructuring is covered by that Opinion, including paragraph 12, which prescribes the measurement of a note (receivable) exchanged "for property, goods, or service in a bargained transaction entered into at arm's length."

ACCOUNTING FOR RESTRUCTURINGS INVOLVING MODIFICATION OF TERMS

Background Information

106. A creditor holds a receivable with the expectation that the future cash receipts, both those designated as interest and those designated as face amount, specified by the terms of the agreement will provide a return of the creditor's investment in that receivable and a return on the investment (interest income).[33] That essential nature of a creditor's investment in a receivable is the same whether the creditor invested cash (for example, a cash loan to a debtor or a cash purchase of debt securities) or exchanged assets or services (for example, a sale of the creditor's services, product, or other assets) for the receivable.

107. Similarly, a debtor expects the future cash payments specified by the terms of a payable to

include a cost (interest expense) for the privilege of deferring repayment of funds borrowed or deferring payment for goods or services acquired. The essential nature of a debtor's payable is the same whether the debtor received cash in exchange for the payable (for example, a cash loan or the issue of debt securities for cash) or received other assets or services (for example, a purchase of services, materials, or other assets from the creditor).

108. The difference between the amount a creditor invests in a receivable and the amount it receives from the debtor's payments of interest and face amount is the return on the investment (interest income) for the entire period the receivable is held. Similarly, the difference between the amount a debtor receives and the amount it pays for interest and face amount is the cost of deferring payment (interest expense) for the entire period the payable is outstanding. The question that must be answered to account for a debt (a receivable or payable) and related interest is how that total interest income or expense is to be allocated to the accounting periods comprising the entire period that the receivable is held or the payable is outstanding.

109. That allocation of interest income or expense to periods is normally accomplished in present accounting practice by the interest method, which measures the interest income or expense of each period by applying the effective interest rate implicit in the debt to the amount of the debt at the beginning of the period, assuming that all cash receipts or payments will occur as specified in the agreement. The effective interest rate implicit in the debt may be the same as or different from the interest rate stated in the agreement (the stated interest rate). The effective and stated rates are the same if the amount invested or borrowed equals the face amount; the rates differ if the amount invested or borrowed is greater or less than the face amount.

110. Thus, the recorded investment in a receivable or the carrying amount of a payable, both at the time of the originating transaction and at the beginning of each period comprising the entire period a receivable is held or a payable is outstanding, is the sum of the present values of (a) the amounts of periodic future cash receipts or payments that are designated as interest and (b) the face amount of cash due at maturity, both discounted at the effective interest rate implicit in the debt. If the effective interest rate differs from the stated interest rate, the recorded investment in the receivable or carrying amount of the payable in financial statements is the face amount plus unamortized premium or less unamortized discount, and that amount is used to measure the interest income or expense, as described in the preceding paragraph.

111. Numerous references to and descriptions of the concepts and procedures referred to in paragraphs 108-110 are found in the pronouncements of the Accounting Principles Board and the Financial Accounting Standards Board, for example, on accounting for leases *(FASB Statement No. 13);* accounting for the cost of pension plans *(APB Opinion No. 8);* accounting for interest on receivables and payables *(APB Opinions No. 12 and No. 21);* accounting for early extinguishment of debt *(APB Opinion No. 26);* recording receivables and payables of a company acquired in a business combination (*APB Opinion No. 16,* paragraphs 87-89); and translating receivables and payables denominated in a foreign currency (*FASB Statement No. 8,* paragraph 39).

112. Pronouncements of the Accounting Principles Board also include several specific statements of broad principle. They include: "The general principles to apply the historical-cost basis of accounting to an acquisition of an asset depend on the nature of the transaction:. . . b. An asset acquired by incurring liabilities is recorded at cost—that is, at the present value of the amounts to be paid" (*APB Opinion No. 16,* paragraph 67); "Conceptually, a liability is measured at the amount of cash to be paid discounted to the time the liability is incurred" (*APB Statement No. 4,* paragraph 181 [M-1C]; and ". . . upon issuance, a bond is valued at (1) the present value of the future coupon interest payments plus (2) the present value of the future principal payments (face amount). . . .discounted at the prevailing market rate of interest. . . at the date of issuance of the debt" and ". . . the difference between the present value and the face amount should be treated as discount or premium and amortized as interest expense or income over the life of the note in such a way as to result in a constant rate of interest when applied to the amount outstanding at the beginning of any given period. This is the 'interest' method described in and supported by paragraphs 16 and 17 of *APB Opinion No. 12*" (*APB Opinion No. 21,* paragraphs 18 [Appendix] and 15).

Kinds of Modifications and Accounting Issues

113. Agreements between a creditor and a debtor that modify the terms of an existing debt may affect (i) only the *timing* of future cash receipts or payments specified by the agreement—the timing of periodic interest, the maturity date, or both, (ii) only the *amounts* of cash to be received or paid—the amounts of interest, face amount, or both, or (iii) *both* timing and amounts of cash to be received or paid.

114. Two major issues arise in accounting for an existing debt whose terms are modified in a troubled debt restructuring. One issue involves whether to: (a) continue the same recorded investment for the receivable or carrying amount for the payable and recognize the effects of the new terms prospectively as reduced interest income or expense or (b) recognize a loss or gain by changing the recorded amount. The interest method (paragraph 109) is used in both (a) and (b) to allocate interest income or expense to periods between restructuring and maturity, but in general, the implicit annual interest rate will be higher, and the resulting interest income or expense will be larger in each of the remaining periods, if a loss (creditor) or gain (debtor) is recognized at the time of a troubled debt restructuring, as in (b), than if the effects of the new terms are recognized prospectively, as in (a).

115. The other issue involves two related questions: Should the same accounting (either (a) or (b) in paragraph 114) apply both to modifications of *timing* and to modifications of *amounts* to be received or paid under the agreement? And should the same accounting apply both to modifications of *interest* and to modifications of *face amount?* The following paragraphs explain and illustrate those issues and summarize the arguments advanced for various proposed solutions.

116. Modifications of terms that affect only the *timing* of amounts to be received or paid do not

change the total amount to be received or paid. However, changes in timing of the amounts to be received or paid on a debt change its present value determined by discounting at the prerestructuring effective interest rate or a current market interest rate or change the effective interest rate needed to discount the amounts to the prerestructuring present value (recorded investment in receivable or carrying amount of payable) or market value. Modifications that affect only the *amount* of interest or face amount (or both unless they are exactly offsetting) to be received or paid change total amounts as well as present values, effective interest rates, or both. Modifications of *both timing and amount* to be received or paid combine those effects. A hypothetical case illustrates those kinds of modifications and their effects.

117. A creditor holds a receivable calling for receipt of $100 at the end of each year for five more years and receipt of the $1,000 face amount at the end of those five years. The stated interest rate is 10 percent, compounded annually. The recorded investment in the receivable is $1,000, and the effective annual interest rate implicit in the investment is also 10 percent. If all amounts are received as agreed, the creditor will receive total interest income of $500—the difference between the total amount to be received ($1,500) and the recorded investment in the receivable ($1,000)—and the effective interest rate on the $1,000 investment will be 10 percent. However, the terms of the receivable are to be modified in a troubled debt restructuring. The four modifications that follow are examples of the three kinds of modifications described in paragraphs 113 and 116 (change in amount of interest and change in face amount are both illustrated; change in timing of face amount raises no issues different from change in timing of interest and is not illustrated):

1. *Timing of interest only*—Terms modified to defer collection of interest until the receivable matures (a single collection of $500 at the end of five years is substituted for five annual collections at $100).
2. *Amount of interest only*—Terms modified to leave unchanged the timing of interest and the timing and amount of the face amount but reduce the annual interest from $100 to $60.
3. *Amount of face amount only*—Terms modified to leave unchanged the amounts and timing of interest but reduce the face amount to $800 due at the end of five years.
4. *Both timing of interest and amount of face amount*—Terms modified to defer collection of interest until the receivable matures and reduce the face amount to $800 (modifications 1 and 3 combined).

118. The following chart lists several factual observations that can be made about the effects on the creditor's receivable of each of those restructurings. In general, the same observations apply to the debtor's payable.

	Before Modification	Modification 1 (Timing Only)	Modification 2 (Amount of Interest Only)	Modification 3 (Amount of Face Amount Only)	Modification 4 (Timing and Amount)
Observation:					
a. Amount by which total cash receipts specified by the terms exceed recorded investment in the receivable:					
Interest	$ 500	$ 500	$ 300	$ 500	$ 500
Face amount	1,000	1,000	1,000	800	800
Total cash receipts	$1,500	$1,500	$1,300	$1,300	$1,300
Recorded investment	1,000	1,000	1,000	1,000	1,000
Excess of specified cash receipts over recorded investment	$ 500	$ 500	$ 300	$ 300	$ 300
b. Effective interest rate on the recorded investment ($1,000)	10.0%	8.5%	6.0%	6.5%	5.4%
c. Present value of the total cash receipts discounted at the prerestructuring effective interest rate (10%)	$1,000	$ 931	$ 848	$ 876	$ 807
d. Present value of the total cash receipts discounted at the current market interest rate (assumed to be 12%)	$ 928	$ 851	$ 784	$ 814	$ 738
e. Face amount specified by the terms	$1,000	$1,000	$1,000	$ 800	$ 800

Alternatives Considered

119. Proposals for accounting for troubled debt restructurings tend to focus on the various observations (paragraph 118) about the effects of modifying the terms of a debt.

a. Some respondents focused on the effect of a troubled debt restructuring on the effective interest rate (observation (b)). They would not reduce the recorded investment in a receivable or carrying amount of a payable and recognize a loss (creditor) or gain (debtor) as long as the new terms did not result in a negative effective interest rate on the recorded investment or carrying amount—that is, as long as the total future cash receipts or payments specified by the new terms (including both amounts designated as interest and the amount designated as face amount) at least equaled the recorded investment or carrying amount (observation (a)). Thus, they would recognize no loss or gain for any of the four modifications in the illustration in paragraphs 117 and 118.
b. Some respondents focused on the effect of a troubled debt restructuring on the face amount of the debt (observation (e)). They would not reduce the recorded investment in a receivable or carrying amount of a payable as long as the restructuring modified only the timing or amount of designated interest or the timing of the designated face amount, but would recognize a loss (creditor) or gain (debtor) if restructuring reduced the face amount of the debt. Thus, they would recognize a loss or gain for modifications 3 and 4 in the illustration.
c. Some respondents focused on the effect of a troubled debt restructuring on the present value of the debt discounted at the effective interest rate before restructuring (observation (c)). They would reduce the recorded investment in a receivable or carrying amount of a payable to the present value of the total future cash receipts or payments under the new terms discounted at the prerestructuring effective interest rate and recognize a loss (creditor) or gain (debtor) equal to the reduction. Thus, they would recognize a loss or gain for each of the modifications in the illustration.
d. Some respondents focused on the fair or market value of the debt after a troubled debt restructuring. They would account for each restructuring as an exchange of debt, recording a new receivable or payable at its fair or market value and recognizing a loss (creditor) or gain (debtor) for the difference between that fair or market value and the recorded investment or carrying amount of the receivable or payable replaced. Thus, they would recognize a loss or gain for each of the modifications in the illustration.

The following paragraphs summarize those four views and their variations.

Change in Effective Rate View

120. Some respondents emphasized that, in the absence of a transfer of resources or obligations, the existing accounting framework does not require losses to be recognized or permit gains to be recognized because of events that affect only future profitability of an investment but do not affect the recoverability of the investment itself. They contended that

applying that principle to troubled debt restructurings means that no loss or gain should be recognized on a debt because of modification of terms of debt unless part of the recorded investment in a receivable is not recoverable or part of the carrying amount of a payable will not be paid under the new terms. In their view, a creditor should recognize a loss to the extent that the total future cash receipts specified by the new terms is less than the recorded investment in the receivable, and a debtor should recognize a gain to the extent that the total future cash payments specified by the new terms is less than the carrying amount of the payable.

121. According to that view, if the recorded investment in a receivable is recoverable or the carrying amount of a payable is to be paid under the new terms,[34] interest income or expense is allocated to the periods between restructuring and maturity of the debt by using the reduced effective interest rate that is implicit in the difference between the recorded investment or carrying amount before (and after) restructuring and the future cash receipts or payments specified by the new terms. If a loss or gain is recognized at the time of restructuring, the recorded investment or carrying amount equals the total future cash receipts or payments, and no interest income or expense is allocated to the remaining periods between restructuring and maturity.

122. Some of those respondents contended that the amount invested by a creditor in a receivable has some of the characteristics of, and is analogous to, an investment in plant, property, intangibles, and similar assets sometimes called "capital assets." According to that analogy, modifying the terms of receivables in troubled debt restructurings is similar to modifying selling prices of products produced by those capital assets; the modifications affect the profitability of those assets but are not recorded in the existing accounting framework unless they result in an inability to recover the investment in the assets. That capital asset analogy leads its proponents to accounting for troubled debt restructurings that is essentially the same as that described in paragraphs 120 and 121.

123. Certain respondents who supported the views described in paragraphs 120-122 argued that the resulting accounting not only is required by the existing accounting framework but also accurately describes a troubled debt restructuring involving only modification of terms. They held that, unless the effective interest rate on a debt becomes negative in a troubled debt restructuring, the essential effect of modifying terms is to reduce the effective interest rate on the debt—that is, to decrease the effective rate of return to the creditor and to decrease the effective cost to the debtor of deferring payment. For example, some responding financial analysts argued that to disclose the creditor's new effective interest rate on restructured receivables would be more useful for their purposes than for the creditor to report a loss on restructuring and then show those receivables to be earning the prerestructuring interest rate, the current market interest rate, or some other rate higher than the effective rate on the recorded investment in a receivable before restructuring.

124. According to respondents who emphasized the effect of a troubled debt restructuring on the effective interest rate, there is no economic basis for distinguishing modifications of future

cash receipts or payments designated as interest from modifications of future cash receipts or payments designated as face amount. They argued that a creditor in a troubled debt restructuring attempts first to assure recovery of its investment (which is represented in its financial statements by the recorded investment in the receivable) and then to obtain the highest interest income commensurate with the situation. Whether the amounts to be received under the new terms are designated as receipts of interest or receipt of face amount is a minor consideration; the significant question is whether the new terms allow the creditor to recover its investment.

125. According to that view, since numerous combinations of receipts or payments designated as interest and face amount can be structured to produce a particular present value or effective interest rate, to base accounting on that distinction is likely to result in questionable, if not indefensible, financial reporting. The creditor in a troubled debt restructuring may have considerable flexibility in designating a proportion of the future receipts or payments under the new terms as interest and designating another proportion as face amount. If those designations were to dictate the accounting, a creditor desiring to recognize a loss on restructuring and to recognize higher interest income for later periods could restructure terms in one way, while a creditor desiring to avoid recognizing a loss on restructuring and to recognize lower interest income for later periods could restructure the terms in another way, even though the underlying cash receipts specified by the new terms were the same, both in timing and amount, for both creditors. A creditor desiring to recognize a gain on restructuring could conceivably increase the amount designated as face amount to an amount higher than the present recorded investment and reduce the amounts designated as receipt of interest; a debtor might agree to that arrangement if it were financially troubled at the time of restructuring but expected to be able to pay the higher face amount later.

Change in Face Amount View

126. Some respondents distinguished modifications of face amounts from modifications affecting only amounts or timing of receipts or payments designated as interest or timing of the maturity date. They would neither reduce recorded investment in a receivable or carrying amount of a payable nor recognize loss or gain in a troubled debt restructuring if a modification of terms of a debt changed only the *amounts or timing* of receipts or payments designated as interest or changed the *timing* of receipts or payments designated as face amount. They held, however, that if a troubled debt restructuring *reduces the face amount* of a debt, the creditor should recognize a loss, and the debtor should recognize a gain.[35]

127. To record a modification of terms involving reduction of face amount of a debt, proponents of that view would reduce the recorded investment in the receivable or carrying amount of the payable by the same proportion as the reduction of the face amount and recognize a loss (creditor) or gain (debtor) for that amount. If the restructuring changed the effective interest rate on the remaining recorded investment or carrying amount, they would allocate interest income or expense to the remaining periods between restructuring and maturity using that new effective interest rate. That rate would be implicit in the difference between the new

recorded investment in the receivable or carrying amount of the payable and the future cash receipts or payments specified by the new terms. That rate would be higher for a debt whose face amount had been reduced, and would therefore result in more interest income or expense for those periods, than the rate described in paragraph 121.

128. Respondents who distinguished between modifications of terms that change the face amount of a debt and other kinds of modifications generally agreed with the view expressed in paragraphs 120 and 122 that the existing accounting framework does not recognize losses or gains from events that change the profitability of existing assets but requires a loss to be recognized if the event causes part or all of an investment in an asset to become unrecoverable. Those respondents gave several reasons for concluding that reduction of face amount of a debt in a troubled debt restructuring requires proportionate reduction of the recorded investment in the receivable or carrying amount of the payable and recognition of a resulting loss or gain.

129. Some respondents who favored accounting based on a distinction between modifications of face amount and other modifications argued that to the extent that the face amount of a debt is reduced, the debtor-creditor relationship has been terminated, and the accounting should recognize that termination. In other words, the face amount adjusted by a premium or discount, if any, measured in the market at the time a receivable or payable was created is recognized in the existing accounting framework as an asset for the creditor or liability for the debtor; reducing that face amount therefore reduces an asset or liability proportionately, and the reduction must be recognized. In their view, to the extent the face amount is reduced, a transfer of resources or obligations occurs.

130. Some respondents described the analogy between a creditor's investment in a receivable and an investment in "capital assets" that is noted in paragraph 122 and contended that reductions of face amounts of receivables in troubled debt restructurings are analogous to events that reduce the amount, rather than the future profitability, of capital assets. Both they and the respondents whose view is described in the preceding paragraph held that the act of reducing the face amount showed that the creditor and debtor agreed that the receivable and payable had been decreased.

131. Some respondents contended in effect that accounting for receivables and payables in the existing accounting framework is based on the face amount of a receivable or payable, or perhaps on the face amount plus a premium or minus a discount at the date of acquisition or issue, and a change in the face amount is a change in an asset (receivable) or liability (payable). They implicitly assumed or concluded that the present value concepts described in the pronouncements noted in paragraphs 111 and 112 did not apply to receivables or payables involved in troubled debt restructurings. Thus, they contended that the distinction between the face amount due at maturity and the amounts designated as interest to be received or paid periodically until maturity is vital in determining proper accounting for a troubled debt restructuring. According to that view, the face amount due at maturity (sometimes referred to as the "principal") is the basis of the recorded investment in a receivable or carrying amount of a

payable; that investment or carrying amount does not include the present value of future receipts or payments designated as interest. That is, a creditor or debtor records the face amount (perhaps increased by premium or decreased by discount) when a receivable is obtained or a payable is incurred, and no value is ascribed in the accounts to rights to receive or obligations to pay amounts designated as interest; rather, cash receipts or payments designated as interest are recognized in the accounts only as they become receivable or payable in future periods. Some respondents holding that view added that to record a loss (creditor) or gain (debtor) because future cash receipts or payments designated as interest are modified in a troubled debt restructuring would represent abandonment of the existing historical cost framework and constitute piecemeal implementation of current value accounting.

132. Several respondents who supported the views described in paragraphs 126-131 held that the accounting required by those views is presently used, at least by some financial institutions. Some banker respondents indicated that troubled debt restructurings involving reductions in face amount or "principal" are exceedingly rare, but that most bankers would probably recognize a loss of "principal" in recording one in which their institution was the creditor.

133. Differences between the view that focuses on the effect of a troubled debt restructuring on face amount (paragraphs 126-132) and the view that focuses on its effect on the effective interest rate (paragraphs 120-125) pertain wholly to troubled debt restructurings that reduce the amount designated as face amount. Both views lead to the same accounting for troubled debt restructurings involving other kinds of modification of terms.

Present Value at Prerestructuring Rate View

134. Some respondents contended that accounting for troubled debt restructurings should recognize the revised pattern of cash receipts or payments under the new terms of the restructured debt. That is, they would continue to use the effective interest rate established when the receivable was acquired or payable was incurred and would reduce the recorded investment or carrying amount to the present value of the future cash receipts or payments specified by the new terms.

135. Those respondents in effect supported the accounting proposed in the FASB Exposure Draft, "Restructuring of Debt in a Troubled Loan Situation" (November 7, 1975): a debtor should account for a troubled debt restructuring that involves modification of terms of debt by adjusting the carrying amount of the payable to the present value of the cash payments (both those designated as interest and those designated as face amount) required of the debtor after restructuring, discounted at the prerestructuring effective interest rate, and recognizing a gain on restructuring of the payable equal to the difference, if any, between that present value and the carrying amount of the payable before restructuring (paragraph 6 of that Exposure Draft). Since a troubled debt restructuring almost invariably involves stretching out or deferring the debtor's payments, and may involve reducing amounts due as well, the present value of a restructured payable is almost invariably less than its carrying amount (both are determined by discounting at

the same interest rate); a debtor would thus normally recognize a gain on the restructuring. The November 7, 1975 Exposure Draft dealt only with accounting by debtors, but if the counterpart accounting were adopted by creditors, the creditor would normally recognize a loss equal to the difference between its recorded investment in the receivable before restructuring and the present value at the prerestructuring effective interest rate. Interest expense or income in future periods would continue to be based on the prerestructuring interest rate.

136. Some respondents who held the view described in paragraphs 134 and 135 agreed with the view in paragraphs 124 and 125 that no economic basis exists for distinguishing between modifications of face amounts and other kinds of modifications. The major difference between the two views is that the accounting for one view (paragraphs 134 and 135) retains the same effective interest rate as before restructuring and changes the present value of the future cash receipts or payments specified by the new terms, while the other view (paragraphs 124 and 125) retains the same present value as before restructuring (the recorded investment in a receivable or carrying amount of a payable) [36] and changes the effective interest rate for the periods remaining between restructuring and maturity.

Fair Value View

137. Some respondents contended that modifying terms in a troubled debt restructuring results in an exchange of new debt for the previous debt. The new debt should be recorded at its fair value—usually the present value of the future cash receipts or payments specified by the new terms (whether designated as interest or face amount) discounted at the current market rate of interest for receivables or payables with similar terms and risk characteristics. Those respondents contended that every debt restructuring is an exchange transaction (paragraph 68), and they would recognize a loss (creditor) and gain (debtor) to the extent of the difference between the recorded investment in the receivable or carrying amount of the payable before restructuring and the fair value of the receivable or payable after restructuring. Interest income and expense in future periods would be based on the market rate of interest at the time of restructuring.

138. Respondents who supported the view just described agreed that designations of amounts as face amount or interest should not determine whether a loss or gain should be recognized (paragraphs 124 and 125) because only the amounts and timing of cash receipts or payments, and not their names, affect the present value of a receivable or payable. They disagreed with other respondents by contending that the current market interest rate—which gives the fair value of a receivable or payable—should be used because an exchange transaction had occurred.[37]

139. Some of the responding financial analysts indicated a preference for accounting that does not use a current interest rate to determine whether a creditor should recognize a loss in a troubled debt restructuring involving modification of terms. According to them, to use a current interest rate to discount future cash receipts only for receivables that have been restructured would not result in meaningful information about the earning potential of a creditor's entire loan

or investment portfolio and might be confusing because receivables that were not restructured would continue to reflect the various historical interest rates at the time of each investment.

Conclusions on Modification of Terms

140. After considering the information received in connection with (i) the Exposure Draft, "Restructuring of Debt in a Troubled Loan Situation" (November 7, 1975), and the public hearing based on it (paragraph 48), (ii) the Discussion Memorandum, "Accounting By Debtors and Creditors When Debt Is Restructured" (May 11, 1976), and the public hearing based on it (paragraph 52), and (iii) the Exposure Draft, the Board concluded that the substance of all modifications of a debt in a troubled debt restructuring is essentially the same whether they are modifications of timing, modifications of amounts designated as interest, or modifications of amounts designated as face amounts. All of those kinds of modifications affect future cash receipts or payments and therefore affect (a) the creditor's total return on the receivable, its effective interest rate, or both and (b) the debtor's total cost on the payable, its effective interest rate, or both. The Board believes that accounting for restructured debt should be based on the substance of the modifications—the effect on cash flows—not on the labels chosen to describe those cash flows.

141. The Board thus rejected views that modifications involving changes in face amounts should be distinguished from and accounted for differently from modifications involving amounts of future cash receipts or payments designated as interest and modifications involving timing of future cash receipts or payments. The major reason for that rejection is given in the preceding paragraph: the substance of a troubled debt restructuring lies in its effect on the *timing and amounts* of cash receipts or payments due in the future. Whether an amount due at a particular time is described as face amount or interest is of no consequence to either the present value of the receivable or payable or its effective interest rate.

142. The Board considered the views described in paragraphs 129-132 and rejected them to the extent they conflict with the Board's conclusions. In the Board's view, a debtor-creditor relationship is described by the entire agreement between the debtor and creditor and not merely by the face amount of the debt. Changes in that relationship therefore encompass changes in timing and changes in amounts designated as interest as well as changes in an amount designated as face amount. The same reasoning applies to the analogy between debt and investment in "capital assets." A reduction in a troubled debt restructuring of an amount designated as face amount is not, in the Board's view, analogous to the loss or destruction of a portion of a capital asset. Indeed, the economic impact of reducing an amount designated as face amount is essentially the same as that of reducing by the same amount an amount designated as interest that is due at the same time. Thus, although an analogy between investment in a receivable and investment in a capital asset may have merit, an analogy between an amount designated as the face amount of a receivable and the physical entirety of a capital asset does not.

143. The Board also rejected the view that accounting is based on the face amount or

"principal" in the existing accounting framework. That view is not consistent with the weight of the pronouncements noted in paragraphs 111 and 112 to the effect that the recorded investment in a receivable or carrying amount of a payable is the present value of the future cash receipts or payments specified by the terms of the debt discounted at the effective interest rate that is implicit in the debt at its inception. That accounting explicitly excludes from the recorded investment in a receivable or carrying amount of a payable the interest income or expense to be recognized in future periods. The interest method recognizes that interest income or expense as a constant percent (the effective interest rate) of the recorded investment or carrying amount at the beginning of each future period as the interest income or expense becomes receivable or payable. The method is not a "current value method" as that term is generally used in the accounting literature, unless the effective interest rate used to determine present value and interest income or expense each period is the current market interest rate for the period.

144. The Board noted the argument that current practice in some financial institutions is to record losses based on reductions in troubled debt restructurings of amounts designated as face amount. The Board also noted that several respondents indicated that modifications of terms of that kind almost never occur. Presumably, a creditor would generally prefer to alleviate the debtor's cash difficulties by deferring payment of the amount designated as face amount rather than by reducing it because deferring payment preserves a creditor's maximum claim in the event of the debtor's bankruptcy. The Board decided that accounting for reductions in troubled debt restructurings of amounts designated as face amounts, although occurring only rarely, should be made consistent with accounting for other modifications of future cash receipts or payments in troubled debt restructurings and with the accounting pronouncements referred to in paragraphs 111 and 112.

145. The Board also considered the views described in paragraphs 134-139 and rejected them to the extent they conflict with the Board's conclusions. The Board concluded that since a troubled debt restructuring involving modification of terms of debt does not involve transfers of resources or obligations (paragraph 77), restructured debt should continue to be accounted for in the existing accounting framework, on the basis of the recorded investment in the receivable or carrying amount of the payable before the restructuring. The effective interest rate on that debt should be determined by the relation of the recorded investment in the receivable or carrying amount of the payable and the future cash receipts or payments specified by the new terms of the debt.

146. To introduce the current market interest rate to provide a new measure of the recorded investment in a restructured receivable or carrying amount of a restructured payable is inappropriate in the existing accounting framework in the absence of a transfer of resources or obligations, that is, if only the terms of a debt are modified in a troubled debt restructuring. Moreover, since the new terms are not negotiated on the basis of the current market rates of interest, there is little or no reason to believe that a current market rate of interest applied to the restructured debt reflects the effective return to the creditor or the effective cost to the debtor. On the contrary, the circumstances of a troubled debt restructuring give every reason to believe

that, except by coincidence, it does not. Similarly, there is little or no reason to believe that a restructured debt continues to earn or cost the same effective interest rate as before the restructuring. The restructuring reflected the creditor's recognition that its investment in the receivable no longer could earn that rate and that a lower effective rate was inevitable. In other words, the effect of the restructuring was to decrease the effective interest rate on a continuing debt, and the accounting should show that result.

147. The Board found persuasive the arguments that a creditor in a troubled debt restructuring is interested in protecting its unrecovered investment (represented in the accounts by the recorded investment in the receivable) and, if possible, obtaining a return. To the creditor, therefore, the effect of a restructuring that provides for recovery of the investment is to reduce the rate of return (the effective interest rate) between the restructuring and maturity. Similarly, the effect of that kind of restructuring to the debtor is to reduce the cost of credit (the effective interest rate) between the restructuring and maturity.

148. Thus, the Board concluded that no loss (creditor) or gain (debtor) should be recognized in a troubled debt restructuring if the total future cash receipts or payments (whether designated as interest or face amount) specified by the new terms at least equals the recorded investment or carrying amount of the debt before the restructuring. The creditor should reduce the recorded investment in the receivable and recognize a loss and the debtor should reduce the carrying amount of the payable and recognize a gain to the extent that the recorded investment or carrying amount exceeds the total cash receipts or payments specified by the new terms. Some respondents to the Exposure Draft apparently misunderstood the reason for using *total* future cash receipts or payments to compare with the recorded investment in a receivable or the carrying amount of a payable to determine whether to recognize a loss or gain on restructuring. Some wondered if the failure to discount the future cash flows implied changes in pronouncements that require discounting or de-emphasis or abandonment by the Board of discounting methods. On the contrary, the Statement is based solidly on the need to consider the effect of interest. Indeed, the Board's conclusion is that a troubled debt restructuring affects primarily the effective interest rate and results in no loss or gain as long as the effective rate does not fall below zero. It requires recognition of a loss to prevent the effective rate from falling below zero. The effective interest rate inherent in the unrecovered receivable or unpaid payable and the cash flows specified by the modified terms is then used to recognize interest income or interest expense between restructuring and maturity.

149. The Board also concluded that the fair values of assets transferred or equity interest granted in partial settlement of debt in a troubled debt restructuring should be accounted for the same as a partial cash payment. The recorded investment in the receivable or carrying amount of the payable should be reduced by the amount of cash or fair value transferred, and the remaining receivable or payable should be accounted for the same as a modification of terms. That accounting avoids basing losses or gains on restructuring on arbitrary allocations otherwise required to determine the amount of a receivable satisfied or payable settled by transfer of assets or grant of an equity interest.

150. Several respondents to the Exposure Draft disagreed with its proposed conclusions on accounting for modifications of terms in troubled debt restructurings. One group, which favored accounting for all troubled debt restructurings at fair value as exchanges of debt, criticized the Exposure Draft for failing to recognize losses and gains from decreases in present values of receivables and payables, for being inconsistent with *APB Opinions No. 21* and *No. 26,* and for elevating form over substance. Another group, which agreed with the Exposure Draft except for restructurings in which face amounts of receivables are reduced, criticized it for failing to recognize losses and gains from decreases in face amounts, for changing existing practice, and for elevating form over substance. Both views are discussed individually in earlier paragraphs (126-139) and are there shown to be virtually opposite views to each other, but they have some similarities when compared to the accounting in the Exposure Draft and this Statement.

151. For example, both criticisms of the Exposure Draft noted in the preceding paragraph result from rejection of fundamental conclusions in the Exposure Draft. Thus, respondents who favor accounting for all troubled debt restructurings as exchanges of debt disagreed with the conclusions that "a troubled debt restructuring that does not involve a transfer of resources or obligations is a continuation of an existing debt" and "to the extent that a troubled debt restructuring involves only a modification of terms of continuing debt, no transfer of resources or obligations has occurred" (paragraphs 76 and 77). Respondents with that view presumably saw troubled debt restructurings as of the same essence as exchanges covered by *APB Opinions No. 21* and *No. 26* and found the Exposure Draft inconsistent with those Opinions. If, however, the conclusions quoted earlier in this paragraph are accepted, modifications of terms of continuing debt are different in substance from exchanges of resources or obligations, and the Exposure Draft is consistent with the Opinions.

152. Similarly, some respondents who favor recognizing losses and gains from reducing face amounts in troubled debt restructurings disagreed with the conclusion that "the substance of all modifications of a debt in a troubled debt restructuring is essentially the same whether they are modifications of timing, modifications of amounts designated as interest, or modifications of amounts designated as face amounts" (paragraph 140). That is, they think that financial institutions' customary distinctions between principal and interest have more substance than the effects of modifications on future cash flows, although they admit that changes in practice would be minimal because few troubled debt restructurings involve changes in face amounts (paragraph 144).

153. The fact that elevating form over substance is a criticism common to the arguments of respondents who fundamentally disagreed with the Exposure Draft emphasizes that various views on proper accounting depend on varying perceptions of the substance of modification of terms in a troubled debt restructuring. The preceding paragraphs note three different views of that substance: the view on which the Exposure Draft and this Statement are based and two other views that differ significantly not only from the view adopted but from each other. The Board carefully analyzed all three views before issuing the Exposure Draft and decided on one of them

for the reasons stated in paragraphs 106-152.

154. Some respondents who agreed generally with the accounting for modifications of terms specified in the Exposure Draft and some who preferred to recognize debtors' gains and creditors' losses from decreases in face amounts expressed concern that a debtor's prepayment may result in recognizing a creditor's loss in the wrong period (they are silent about a debtor's gain). That is, if a debtor may prepay a reduced face amount without penalty, total future cash receipts may actually be less than the recorded investment in the receivable even though the total future amounts specified by the restructured terms are at least equal to the recorded investment, and no loss is recognized by the creditor at the time of restructuring under paragraph 16. The loss would be recorded in the period of prepayment rather than the period of restructuring. They propose that a creditor be required to recognize a loss on restructuring in the period of restructuring to the extent that a reduction of face amount is not protected by a prepayment penalty.

155. This Statement does not include that kind of test based on prepayment penalties. The proposed test rests on the assumption that a loss resulting from prepayment necessarily is a loss on restructuring, and that presumption is questionable. At the time of restructuring, the most probable estimate of future cash receipts is usually that the debtor will not prepay, even if there is no prepayment penalty, because (a) prepayment of a debt with a relatively low effective interest rate is to the creditor's advantage, not the debtor's, (b) initiative for prepayment lies wholly with the debtor, and (c) the debtor is clearly unable to prepay at the time of a troubled debt restructuring and may never be able to prepay. If that most probable estimate later proves incorrect, and the debtor does prepay, a change of estimate should be recorded in the period of prepayment.

CREDITOR'S ACCOUNTING FOR SUBSTITUTION OR ADDITION OF DEBTORS

156. A change between the Exposure Draft and this Statement is that the Exposure Draft dealt with substitutions of debtors only if the debtors were government units. Several respondents to the Exposure Draft suggested that the principles developed there applied to substitutions or additions of nongovernment debtors as well.

157. The general principle developed in earlier paragraphs is that the accounting for a troubled debt restructuring depends on its substance. The issues raised if a creditor in a troubled debt restructuring accepts, or is required to accept, a new receivable from a different debtor to replace an existing receivable from a debtor experiencing financial difficulties pertains to the circumstances, if any, in which the substitution or addition is in substance similar to a transfer of assets to satisfy a receivable and the circumstances, if any, in which that kind of restructuring is in substance similar to a modification of terms only.

158. One view expressed by respondents was that the substitution of a receivable from a different debtor for an existing receivable or the addition of another debtor is always a

transaction requiring accounting by the creditor for a new asset at its fair value, recognizing gain or loss to the extent that the fair value of the new asset differs from the recorded investment in the receivable it replaces. To some proponents, that view holds regardless of the relationship between the original debtor and the new debtor.

159. Another view expressed was that the kind of substitution involved in each restructuring must be considered, and the accounting depends on the relationship between the original and new debtors and between the original and new terms.

160. The Board rejected the view that the substitution or addition of a new debtor is always a transaction requiring recognition of a new asset by the creditor. In some troubled debt restructurings, the substitution or addition may be primarily a matter of form while the underlying debtor-creditor relationship, though modified, essentially continues. For example, to enhance the likelihood that the modified terms of a troubled debt restructuring will be fulfilled, a new legal entity may be created to serve as a custodian or trustee to collect designated revenues and disburse the cash received in accordance with the new debt agreement. The role of that new unit may be similar to that of a sinking fund trustee in an untroubled debt situation. The source of the funds required to fulfill the agreement may be the same, but some or all of those funds may be earmarked to meet specific obligations under the agreement. Similarly, if the new debtor controls, is controlled by, or is under common control with the original debtor, the substance of the relationship is not changed. Each troubled debt restructuring involving a substitution or addition of a debtor should be carefully examined to determine whether the substitution or addition is primarily a matter of form to facilitate compliance with modified terms or primarily a matter of substance.

161. The Board considers the exchanges of bonds of the Municipal Assistance Corporation (Corporation) for notes of the City of New York (City) described in recent exchange offers [38] to be examples of troubled debt restructurings whose substance to creditors for accounting purposes is a modification of the terms of an existing receivable rather than an acquisition of a new asset (receivable). According to those exchange offers:

> The Corporation...was created in June 1975...for the purposes of assisting the City in providing essential services to its inhabitants without interruption and in creating investor confidence in the soundness of the obligations of the City. To carry out such purposes, the Corporation is empowered, among other things, to issue and sell bonds and notes and to pay or lend funds received from such sale to the City and to exchange the Corporation's obligations for obligations of the City.[39]

The Board's understanding is that: (a) the Corporation receives its funds to meet debt service requirements and operating expenses from tax allocations from New York State's collections of Sales Taxes imposed by the State within the City, Stock Transfer Taxes, and Per Capita Aid (revenue sources previously available to the City); (b) Tax and Per Capita Aid amounts not allocated to the Corporation for its requirements are available to the City under the terms of the applicable statutes; and (c) the primary purpose in creating the Corporation was to enhance the likelihood that the City's debt will be paid, not to introduce new economic resources and activities.

RELATED MATTERS

162. Several respondents commenting on accounting for contingent future cash payments or receipts indicated a need for some clarification of the accounting described in the Exposure Draft. Accounting for contingent payments or receipts is complicated because it involves four separate situations—(1) accounting by the debtor at the time of restructuring, (2) accounting by the debtor after the time of restructuring, (3) accounting by the creditor at the time of restructuring, and (4) accounting by the creditor after the time of restructuring. It is further complicated because the view of both debtor and creditor shift between "gain" contingencies and "loss" contingencies as the accounting shifts from the time of restructuring to after the time of restructuring. The accounting in the Exposure Draft and this Statement is governed by the following general principles:

a. Paragraph 17 (gain contingencies) of *FASB Statement No. 5* governs a debtor's accounting for contingent cash payments at the time of restructuring (paragraph 18) and a creditor's accounting for contingent cash receipts after the time of restructuring (paragraph 36). Since gain contingencies are not recognized until a gain is realized, (1) a *debtor* should not recognize a gain at the time of restructuring that may be offset by future contingent payments, which is equivalent to assuming that contingent future payments will be paid, and (2) a *creditor* should not recognize contingent cash receipts as interest income until they become unconditionally receivable, that is, until both the contingency has been removed and the interest has been earned.
b. Paragraph 8 (loss contingencies) of *FASB Statement No. 5* governs a debtor's accounting for contingent cash payments after the time of restructuring (paragraph 22) and a creditor's accounting for contingent cash receipts at the time of restructuring (paragraph 32). Since two conditions must be met to recognize an estimated loss, (1) a *debtor* should recognize an interest expense and payable for contingent payments when it is probable that a liability has been incurred and the amount can be reasonably estimated, and (2) a *creditor* should recognize a loss unless offsetting contingent cash receipts are probable and the amount can be reasonably estimated. Contingent cash receipts are unlikely to be probable at the time of restructuring.

163. The principles described in the preceding paragraph also apply to other situations in which future cash payments or receipts must be estimated to apply the provisions of the Statement, for example, future interest payments or receipts that are expected to fluctuate because they are based on the prime interest rate or indeterminate total interest payments or receipts because the debt is payable or collectible on demand or becomes payable or collectible on demand after a specified period (paragraphs 18 and 32).

DISCLOSURE

Disclosure by Debtors

164. Most respondents to the Discussion Memorandum commenting on disclosure by debtors for restructurings advocated essentially the disclosure prescribed for gains or losses from extinguishment of debt in *FASB Statement No. 4*. Paragraph 99 gives the Board's reasons for adopting for gains on troubled debt restructurings the guidelines for income statement classification prescribed in that Statement for gains from extinguishment of debt. Since troubled debt restructurings for which gains are recognized and extinguishments of debts thus use the same guidelines for income statement classification and are similar for disclosure purposes, the Board concluded that the kind of information prescribed in paragraph 9 of *FASB Statement No. 4* is generally appropriate for disclosing troubled debt restructurings involving recognition of gains. Since some of those restructurings involve transfers of assets to creditors to settle payables, the Board believes that it is appropriate also to disclose the aggregate net gain or loss recognized on transfers of assets. However, since several respondents to the Exposure Draft indicated that problems would arise in attempting to determine when a debtor's current difficulties began and perhaps in obtaining amounts of earlier losses, this Statement omits a requirement in the Exposure Draft to disclose also "the aggregate loss, if any, recognized on those assets in earlier periods in connection with the debtor's current financial difficulties."

165. Restructurings not involving recognition of gain or loss at the time of restructuring usually modify the timing, amounts, or both, of interest or face amount the debtor is to pay under the debt's terms (paragraphs 16-18). In the Board's view, the principal changes in terms should be disclosed to permit an understanding of the financial effects of those modifications.

166. Paragraph 26, specifying disclosure of the extent to which inclusion of contingent future cash receipts prevented recognizing a gain on restructuring was added in response to suggestions by respondents to the Exposure Draft. The Board agreed that information would be useful in assessing the relation between future cash payments and future interest expenses of the debtor.

Disclosure by Creditors

167. Most banking and other financial institutions responding to the Discussion Memorandum that commented on disclosure by creditors argued against separate disclosures about restructured receivables. They emphasized that to be the most meaningful to financial statement users information about receivables should disclose the interest rate characteristics of each broad group of earning assets (primarily loan or investment portfolios), by major category. They argued that information limited to receivables that have been restructured would not only be less meaningful than information about entire portfolios of receivables but also could be confusing because the same information is also needed about other receivables, particularly those that are earning no return but have not been restructured (nonearning receivables). Several of those

institutions referred to the requirements of the Securities and Exchange Commission and of the banking regulatory agencies, which recently became effective, both concerning disclosure about categories of loan and investment portfolios—including their maturities, interest rates, and nonearning loans and investments—and the allowance for uncollectible amounts. They indicated that those requirements provide adequate information about the financial effects of restructurings, troubled or nontroubled. Financial analysts responding also recommended disclosure focusing on the characteristics of each broad group of earning assets. They expressed a desire for information about past and expected yields of entire portfolios, by major category, to enable them to make informed judgments about recent and prospective earnings performance.

168. Some respondents to the Discussion Memorandum that are not financial institutions recommended that the Board require information to be disclosed about each significant troubled debt restructuring in the period that it occurs, primarily the terms of the restructuring, gain or loss recognized, if any, and the related income tax effect. Most of those respondents focused on individual receivables rather than on groups of receivables and proposed that debtors and creditors disclose similar information.

169. The Board concluded that the information prescribed by paragraph 40 should be disclosed, by major category, for outstanding receivables whose terms have been modified in troubled debt restructurings. The information may be disclosed either separately for those receivables or as part of the disclosure about reduced-earning and nonearning receivables. The Board believes that the appropriate format for that disclosure depends primarily on the characteristics and number of receivables, including the proportion of those receivables that have reduced earning potential. It believes the argument has merit that the most meaningful disclosure about earnings potential for a financial institution typically should focus on entire portfolios of receivables, by major category, rather than only on receivables that have been restructured in troubled situations, but the Board acknowledges that determining appropriate disclosure for receivables in general is beyond the scope of this Statement. Accordingly, paragraphs 40 and 41 specify types of information that shall be disclosed and permit that information to be provided by major category for the aggregate of outstanding reduced-earning and nonearning receivables, by major category for outstanding receivables whose terms have been modified in troubled debt restructurings, or for each significant outstanding receivable that has been so restructured, depending on the circumstances.

170. This Statement contains three changes from the Exposure Draft concerning disclosure by creditors, all made in response to comments or suggestions from respondents to the Exposure Draft and all in paragraph 40, which was paragraph 34 of the Exposure Draft: (1) disclosure of information more in conformity with SEC Guides 61 and 3 [40] replaces disclosure of the weighted average effective interest rate and the range of maturities, (2) disclosure of the allowance for uncollectible amounts or other valuation allowance applicable to restructured receivables is deleted, and (3) disclosure of a commitment to lend additional funds to debtors owing restructured receivables is added.

171. Disclosure of commitments to lend additional funds was chosen instead of a penalty suggested by some respondents to the Exposure Draft. They expressed concern that a creditor might avoid recognizing a loss under paragraphs 30-32 by restructuring a troubled receivable in a way that the specified future cash receipts exceed the recorded investment in the receivable and then agree to lend funds to the debtor to meet those terms. They proposed that irrevocable commitments to lend to the debtor be included in the creditor's recorded investment to determine whether the creditor should recognize a loss at the time of restructuring. Since that test is equivalent to saying that a creditor must recognize a loss unless the restructured terms provide not only for recovery of the outstanding receivable but also for recovery of future loans to the same debtor (because future cash receipts from future loans are ignored), the test is excessively punitive. The Board decided that disclosure of those commitments is adequate. That disclosure may already be required by paragraphs 18 and 19 of *FASB Statement No. 5,* but paragraph 40(b) makes the disclosure explicit.

172. Some respondents who advocated that the scope of this Statement exclude restructurings of receivables related to consumer financing activities or to all or certain residential properties (paragraph 63) also argued that, if those restructurings were embraced by this Statement, applicable requirements for disclosure would likely be burdensome and not very meaningful to financial statement users. They point out that the accounting, including information normally disclosed in financial statements or in other reports, for those types of receivables has been tailored to fit special characteristics of the receivables, such as large numbers of relatively small balances, interest rates fixed by state law rather than in a fluctuating market, and numerous accounts on which collections are past due. The Board noted the special characteristics of those types of receivables and, since the scope of this Statement does not encompass appropriate disclosure for receivables generally, concluded that paragraphs 40 and 41 should not necessarily apply to those types of receivables that have been restructured.

ACCOUNTING SYMMETRY BETWEEN DEBTORS AND CREDITORS

173. The Discussion Memorandum contained several questions on whether particular accounting by debtors and creditors should be symmetrical. Most respondents considered a criterion of symmetry between debtors and creditors an insignificant factor in accounting for troubled debt restructurings. Many noted that existing accounting principles for accounting by creditors for receivables after their initial recording and for recognizing losses already differ from those for accounting by debtors for payables and for recognizing gains. Some respondents also noted that differences usually exist between the debtor and creditor in a particular restructuring (for example, differences in the industry or industries in which they are involved, in their financial viability, and in the significance and frequency of that kind of event for them). The accounting for troubled debt restructurings prescribed in this Statement is symmetrical between debtors and creditors in most matters. However, the Board considered the types of differences described above, among other factors, in concluding that different accounting is appropriate for debtors and creditors in matters such as classifying gains or losses recognized at the time of troubled debt restructurings, accounting for contingent interest, and disclosing

information about troubled debt restructurings.

EFFECTIVE DATE AND TRANSITION

174. The Board concluded that prospective application of this Statement is appropriate and that the effective dates in paragraphs 43-45 are advisable. In the Board's view, comparability of financial statements would not be greatly enhanced by restating past, nonrecurring troubled debt restructurings. Further, difficulties in retroactive application of the provisions of this Statement include identifying restructurings for which fair values would need to be determined and determining those fair values. A number of enterprises that in recent years have had several restructurings of those types would be unlikely to have information available to restate retroactively.

Footnotes

FAS15, Footnote 1--Although troubled debt that is fully satisfied by foreclosure, repossession, or other transfer of assets or by grant of equity securities by the debtor is, in a technical sense, not restructured, that kind of event is included in the term *troubled debt restructuring* in this Statement.

FAS15, Footnote 2--Defined in paragraph 13.

FAS15, Footnote 3--Defined in footnote 17.

FAS15, Footnote 4--This Statement does not apply, however, if under provisions of those Federal statutes or in a quasi-reorganization or corporate readjustment (*ARB No. 43,* Chapter 7, Section A, "Quasi-Reorganization or Corporate Readjustment...") with which a troubled debt restructuring coincides, the debtor restates its liabilities generally.

FAS15, Footnote 5--Paragraphs 13, 15, and 19 indicate that the fair value of assets transferred or the fair value of an equity interest granted shall be used in accounting for a settlement of a payable in a troubled debt restructuring. That guidance is not intended to preclude using the fair value of the payable settled if more clearly evident than the fair value of the assets transferred or of the equity interest granted in a full settlement of a payable (paragraphs 13 and 15). (See paragraph 67 of *APB Opinion No. 16,* "Business Combinations.") However, in a partial settlement of a payable (paragraph 19), the fair value of the assets transferred or of the equity interest granted shall be used in all cases to avoid the need to allocate the fair value of the payable between the part settled and the part still outstanding.

FAS15, Footnote 6--Some factors that may be relevant in estimating the fair value of various kinds of assets are described inparagraphs 88 and 89 of *APB Opinion No. 16,* paragraphs 12-14 of *APB Opinion No. 21,* "Interest on Receivables and Payables," and paragraph 25 of *APB Opinion No. 29,* "Accounting for Nonmonetary Transactions."

FAS15, Footnote 7--The carrying amount of a receivable encompasses not only unamortized premium, discount, acquisition costs, and the like but also an allowance for uncollectible amounts and other "valuation" accounts, if any. A loss on transferring receivables to creditors may therefore have been wholly or partially recognized in measuring net income before the transfer and be wholly or partly a reduction of a valuation account rather than a gain or loss in measuring net income for the period of the transfer.

FAS15, Footnote 8--See footnote 5.

FAS15, Footnote 9--In this Statement, *total future cash payments* includes related accrued interest, if any, at the time of the restructuring that continues to be payable under the new terms.

FAS15, Footnote 10--All or a portion of the carrying amount of the payable at the time of the restructuring may need to be reclassified in the balance sheet because of changes in the terms, for example, a change in the amount of the payable due within one year after the date of the debtor's balance sheet. A troubled debt restructuring of a short-term obligation after the date of a debtor's balance sheet but before that balance sheet is issued may affect the classification of that obligation in accordance with *FASB Statement No. 6*, "Classification of Short-Term Obligations Expected to Be Refinanced."

FAS15, Footnote 11--If the carrying amount of the payable comprises several accounts (for example, face amount, accrued interest, and unamortized premium, discount, finance charges, and issue costs) that are to be continued after the restructuring, some possibly being combined, the reduction in carrying amount may need to be allocated among the remaining accounts in proportion to the previous balances. However, the debtor may choose to carry the amount designated as face amount by the new terms in a separate account and adjust another account accordingly.

FAS15, Footnote 12--The only exception is to recognize interest expense according to paragraph 22.

FAS15, Footnote 13--Even if the stated terms of the remaining payable, for example, the stated interest rate and the maturity date or dates, are not changed in connection with the transfer of assets or grant of an equity interest, the restructuring shall be accounted for as prescribed by paragraph 19.

FAS15, Footnote 14--If cash is paid in a partial settlement of a payable in a troubled debt restructuring, the carrying amount of the payable shall be reduced by the amount of cash paid.

FAS15, Footnote 15--Separate restructurings within a fiscal period for the same category of payables (for example, accounts payable or subordinated debentures) may be grouped for disclosure purposes.

FAS15, Footnote 16--Paragraphs 28 and 33 indicate that the fair value of assets received shall be used in accounting for satisfaction of a receivable in a troubled debt restructuring. That guidance is not intended to preclude using the fair value of the receivable satisfied if more clearly evident than the fair value of the assets received in full satisfaction of a receivable (paragraph 28). (See paragraph 67 of *APB Opinion No. 16.*) However, in a partial satisfaction of a receivable (paragraph 33), the fair value of the assets received shall be used in all cases to avoid the need to allocate the fair value of the receivable between the part satisfied and the part still outstanding.

FAS15, Footnote 17--*Recorded investment in the receivable* is used in paragraphs 28-41 instead of *carrying amount of the receivable* because the latter is net of an allowance for estimated uncollectible amounts or other "valuation" account, if any, while the former is not. The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.

FAS15, Footnote 18--In this Statement, total future cash receipts includes related accrued interest, if any, at the time of the restructuring that continues to be receivable under the new terms. Uncertainty of collection of noncontingent amounts specified by the new terms (see paragraph 32 for inclusion of contingent amounts) is not a factor in applying paragraphs 30-32 but should, of course, be considered in accounting for allowances for uncollectible amounts.

FAS15, Footnote 19--All or a portion of the recorded investment in the receivable at the time of restructuring may need to be reclassified in the balance sheet because of changes in the terms.

FAS15, Footnote 20--Some creditors--for example, finance companies (*AICPA Industry Audit Guide*, "Audits of Finance Companies," Chapter 2)--use methods that recognize less revenue in early periods of a receivable than does the "interest" method. The accounting for restructured receivables described in this Statement is not intended to change creditors' methods of recognizing revenue to require a different method for restructured receivables from that for other receivables.

FAS15, Footnote 21--The only exception is to recognize interest income according to paragraph 36.

FAS15, Footnote 22--Even if the stated terms of the remaining receivable, for example, the stated interest rate and the maturity date or dates, are not changed in connection with the receipt of assets (including an equity interest in the debtor), the restructuring shall be accounted for as prescribed by paragraph 33.

FAS15, Footnote 23--If cash is received in a partial satisfaction of a receivable, the recorded investment in the receivable shall be reduced by the amount of cash received.

FAS15, Footnote 24--*FASB Statement No. 5,* paragraph 17 (which continued without reconsideration certain provisions of ARB No. 50, "Contingencies"), states, in part: "Contingencies that might result in gains usually are not reflected in the accounts since to do so might be to recognize revenue prior to its realization."

FAS15, Footnote 25--The appropriate major categories depend on various factors, including the industry or industries in which the creditor is involved. For example, for a commercial banking enterprise, at a minimum, the appropriate categories are investments in debt securities and loans. Information need not be disclosed, however, for non-interest-bearing trade receivables; loans to individuals for household, family, and other personal expenditures; and real estate loans secured by one-to-four family residential properties.

FAS15, Footnote 26--Government units include, but are not limited to, states, counties, townships, municipalities, school districts, authorities, and commissions. See page 4 of *AICPA Industry Audit Guide,* "Audits of State and Local Governmental Units."

FAS15, Footnote 27--"Control" in this paragraph has the meaning described in paragraph 3(c) of *APB Opinion No. 18,* "The Equity Method of Accounting for Investments in Common Stock": "The usual condition for control is ownership of a majority (over 50%) of the outstanding voting stock. The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders or by court decree."

FAS15, Footnote 28--For an enterprise having a fiscal year of 52 or 53 weeks ending in the last seven days in December or the first seven days in January, references to December 31, 1977 in paragraphs 43 and 44 shall mean the date in December 1977 or January 1978 on which the fiscal year ends.

FAS15, Appendix B, Footnote 29--See paragraph 47 of this Statement.

FAS15, Appendix B, Footnote 30--References to "Exposure Draft" in this Appendix are to "Accounting by Debtors and Creditors for Troubled Debt Restructurings," dated December 30, 1976, unless the reference specifically identifies the earlier Exposure Draft, "Restructurings of Debt in a Troubled Loan Situation," dated November 7, 1975.

FAS15, Appendix B, Footnote 31--See paragraphs 59 and 60 of this Statement.

FAS15, Appendix B, Footnote 32--"Fair value" in this context normally means the fair value of the liability satisfied or the fair value of the equity interest granted, whichever is the more clearly evident (*APB Opinion No. 16,* paragraph 67 and APB Statement No. 4, paragraph 182).

FAS15, Appendix B, Footnote 33--The terms of some short-term receivables and payables (for example, trade accounts receivable or payable) may not be expected to result in interest income or interest expense to the creditor or debtor except as it may be implicit in the transaction (for example, implicit in the price of a product sold or purchased on account).

FAS15, Appendix B, Footnote 34--The likelihood of collection of the amounts specified by the new terms of a receivable should, of course, be assessed in determining allowances for estimated uncollectible amounts.

FAS15, Appendix B, Footnote 35--Some proponents of this view opposed recognizing gains from troubled debt restructurings not involving transfers of assets or grants of equity interests.

FAS15, Appendix B, Footnote 36--Unless the restructuring causes the effective interest rate to fall below zero.

FAS15, Appendix B, Footnote 37--Some respondents contended that the fair value of the receivable or payable after restructuring should be measured by discounting the future cash flows specified by the new terms at the cost of capital to the creditor or debtor, as appropriate.

FAS15, Appendix B, Footnote 38--Municipal Assistance Corporation for the City of New York, "Exchange Offer[s] to Holders of Certain Short-Term Notes of the City of New York," November 26, 1975, May 21, 1976, and March 22, 1977.

FAS15, Appendix B, Footnote 39--Municipal Assistance Corporation for the City of New York, "Exchange Offer to Holders of Certain Short-Term Notes of the City of New York," November 26, 1975, p. 15.

FAS15, Appendix B, Footnote 40--SEC, *Securities Exchange Act of 1934* Release No. 12748, "Guides for Statistical Disclosure by Bank Holding Companies," August 31, 1976.