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ACCOUNTING STANDARDS UPDATE

No. 2010-18
April 2010

Receivables (Topic 310)

Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*™

Financial Accounting Standards Board
of the Financial Accounting Foundation

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

Recently there has been an increase in the number of modifications of acquired loans that fall under the scope of the *FASB Accounting Standards Codification*™ Subtopic 310-30, Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality.

Subtopic 310-30 provides guidance on accounting for acquired loans that have evidence of credit deterioration upon acquisition. Paragraph 310-30-15-6 allows acquired assets with *common risk characteristics* to be accounted for in the aggregate as a pool. Upon establishment of the pool, the pool becomes the unit of accounting. When loans are accounted for as a pool, the purchase discount is not allocated to individual loans; thus, all of the loans in the pool accrete at a single pool rate (based on cash flow projections for the pool). Under Subtopic 310-30, the impairment analysis also is performed on the pool as a whole as opposed to each individual loan.

Paragraphs 310-40-15-4 through 15-12 establish the criteria for evaluating whether a loan modification should be classified as a troubled debt restructuring. Specifically, paragraph 310-40-15-5 states that "a restructuring of a debt constitutes a troubled debt restructuring for purposes of this Subtopic 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."

Diversity in practice has developed on whether a loan that is part of a pool of loans accounted for as a single asset should be removed from that pool upon a modification that would constitute a troubled debt restructuring. In the view of certain entities, accounting for troubled debt restructuring does not apply to individual loans within a pool, and modified loans should remain within the pool. In the view of other entities, each modified loan should be evaluated against the troubled debt restructuring criteria, and if the loan modification is a troubled debt restructuring, the modified loan should be removed from the pool and accounted for as a separate asset. The objective of the amendments in this Update is to address the diversity in practice regarding such modifications.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect any entity that acquires loans subject to Subtopic 310-30, that accounts for some or all of those loans within pools, and that subsequently modifies one or more of those loans after acquisition.

What Are the Main Provisions?

Accounting Guidance

As a result of the amendments in this Update, modifications of loans that are accounted for within a pool under Subtopic 310-30 do not result in the removal of those loans from the pool even if the modification of those loans would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if expected cash flows for the pool change.

The amendments in this Update do not affect the accounting for loans under the scope of Subtopic 310-30 that are not accounted for within pools. Loans accounted for individually under Subtopic 310-30 continue to be subject to the troubled debt restructuring accounting provisions within Subtopic 310-40, Receivables—Troubled Debt Restructurings by Creditors.

Disclosures

The amendments in this Update do not require an entity to make additional disclosures. However, the Board currently has on its agenda a project on credit loss disclosures and is expected to consider whether to require additional disclosures for modifications of loans that are accounted for within pools.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The amendments in this Update improve comparability by eliminating diversity in practice about the treatment of modifications of loans accounted for within pools under Subtopic 310-30. Furthermore, the amendments clarify guidance about maintaining the integrity of a pool as the unit of accounting for acquired loans with credit deterioration.

When Will the Amendments Be Effective?

The amendments in this Update are effective for modifications of loans accounted for within pools under Subtopic 310-30 occurring in the first interim or annual period ending on or after July 15, 2010. The amendments are to be applied prospectively. Early application is permitted.

Upon initial adoption of the guidance in this Update, an entity may make a one-time election to terminate accounting for loans as a pool under Subtopic 310-30. This election may be applied on a pool-by-pool basis and does not preclude an entity from applying pool accounting to subsequent acquisitions of loans with credit deterioration.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

No similar issue exists under IFRS because IFRS does not have guidance on troubled debt restructurings.

Amendments to the *FASB Accounting Standards Codification*™

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–10. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Topic 310

2. Amend paragraph 310-30-15-6, with a link to transition paragraph 310-10-65-1, as follows:

Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality

Scope and Scope Exceptions

310-30-15-6 For purposes of applying the recognition, measurement, and disclosure provisions of this Subtopic for loans that are not accounted for as debt securities, investors may aggregate loans acquired in the same fiscal quarter that have **common risk characteristics** and thereby use a composite interest rate and expectation of cash flows expected to be collected for the pool. It is not intended for this aggregation to be analogized for purposes other than this Subtopic. To be eligible for aggregation, each loan first should be determined individually to meet the scope criteria of paragraph 310-30-15-2. After determining that certain acquired loans are within the scope as defined in that paragraph, the investor may evaluate whether such loans have common risk characteristics, thus permitting the aggregation of such loans into one or more pools. The aggregation shall be based on common risk characteristics that include similar credit risk or risk ratings, and one or more predominant risk characteristics. A portion of the total cost of acquired assets shall be assigned to each ~~individual asset~~ <u>unit of accounting</u> acquired on the basis of its relative fair value at the date of acquisition. The excess of the contractually required payments receivable over the investor's **initial investment** (whether **accretable yield** or **nonaccretable difference**) for a specific loan or a pool of loans with one set of common risk characteristics shall not be considered available to offset changes in cash flows expected to be collected from a different loan or an assembled pool of loans with another set of common risk characteristics.

3. Amend paragraph 310-30-35-13, with a link to transition paragraph 310-10-65-1, as follows:

Subsequent Measurement

310-30-35-13 The guidance in this paragraph applies only to loans accounted for as individual loans. See paragraphs 310-30-40-1 through 40-2 for guidance on derecognition of pooled loans. If an investor subsequently refinances or restructures the loan, other than through a troubled debt restructuring, the refinanced or restructured loan shall not be accounted for as a new loan, and this Subtopic, including paragraphs 310-30-35-8 through 35-11, continues to apply. See Subtopic 310-40 for guidance on troubled debt restructurings.

4. Amend paragraph 310-30-40-1, with a link to transition paragraph 310-10-65-1, as follows:

Derecognition

310-30-40-1 Once a pool of loans is assembled, the integrity of the pool shall be maintained. A **loan** shall be removed from a pool of loans only if either of the following conditions is met:

a. The ~~the~~ investor sells, forecloses, or otherwise receives assets in satisfaction of the ~~loan, or~~loan.
b. The ~~the~~ loan is written ~~off, and it shall be removed at its carrying amount.~~off.

A refinancing or restructuring of a loan shall not result in the removal of a loan from a pool.

5. Add paragraph 310-30-40-2, with a link to transition paragraph 310-10-65-1, as follows:

310-30-40-2 A loan removed from a pool in accordance with the preceding paragraph shall be removed at its carrying amount. See paragraph 310-30-35-15 for further guidance on removing a loan from a pool.

6. Amend paragraph 310-40-15-11, with a link to transition paragraph 310-10-65-1, as follows:

Receivables—Troubled Debt Restructurings by Creditors

Scope and Scope Exceptions

310-40-15-11 For purposes of this Subtopic, none of the following are considered troubled debt restructurings:

a. Changes in lease agreements (for guidance, see Topic 840)
b. Changes in employment-related agreements, for example, pension plans and deferred compensation contracts
c. Unless they involve an agreement between debtor and creditor to restructure, either of the following:
   1. Debtors' failures to pay trade accounts according to their terms
   2. Creditors' delays in taking legal action to collect overdue amounts of interest and principal.
d. Modifications of loans within a pool accounted for in accordance with Subtopic 310-30 (see paragraph 310-30-15-6)
e. Changes in expected cash flows of a pool of loans accounted for in accordance with Subtopic 310-30 (see paragraph 310-30-15-6) resulting from the modification of one or more loans within the pool.

7. Add paragraph 310-10-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2010-18, *Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset*

310-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-18, *Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset:*

a. An entity shall apply the pending content that links to this paragraph prospectively for any modification of a loan (or loans) accounted for within a pool occurring in interim or annual periods ending on or after July 15, 2010.
b. Upon adoption of the pending content that links to this paragraph, an entity may make a one-time election to prospectively terminate accounting for loans as a pool. An entity shall apply this election on a pool-by-pool basis. In addition, this election does not preclude an entity from accounting for future loan acquisitions as a pooled unit of accounting in accordance with paragraph 310-30-15-6.
c. Earlier application of the pending content that links to this paragraph is permitted.
d. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period the entity adopts the pending content that links to this paragraph.

8. Amend paragraph 310-10-00-1, by adding the following item to the table, as follows:

310-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
310-10-65-1	Added	2010-18	04/29/2010

9. Amend paragraph 310-30-00-1, by adding the following items to the table, as follows:

310-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
310-30-15-6	Amended	2010-18	04/29/2010
310-30-35-13	Amended	2010-18	04/29/2010
310-30-40-1	Amended	2010-18	04/29/2010
310-30-40-2	Added	2010-18	04/29/2010

10. Amend paragraph 310-40-00-1, by adding the following item to the table, as follows:

310-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
310-40-15-11	Amended	2010-18	04/29/2010

The amendments in this Update were adopted by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
Thomas J. Linsmeier
Leslie F. Seidman
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force consensus when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information and Conclusions

BC2. Diversity in practice has developed about whether a loan that is part of a pool of loans accounted for as a single asset should be removed from that pool upon a modification that would constitute a troubled debt restructuring. Some entities have not evaluated such modifications under the troubled debt restructuring guidance and have retained the modified loans that remain within the pool. Other entities have evaluated such modifications against the troubled debt restructuring criteria and have removed a loan from the pool if the loan modification is a troubled debt restructuring. The objective of the amendments in this Update is to address the diversity in practice about such modifications.

BC3. At the November 19, 2009 EITF meeting, the Task Force reached a consensus-for-exposure on EITF Issue No. 09-I, "Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset." A proposed Accounting Standards Update (proposed Update) was issued on December 17, 2009, with a comment period that ended on February 12, 2010. Eleven comment letters were received on the proposed Update.

BC4. The Task Force concluded that an entity should not apply the accounting guidance on troubled debt restructurings to loans accounted for within a pool that were initially acquired with credit deterioration. Once a pool is established, individual loans should not be removed from the pool unless the entity sells, forecloses, or otherwise receives assets in satisfaction of the loan or upon write-off of the loan in accordance with paragraph 310-30-40-1. In the Task Force's view, the pool is the unit of accounting, and the pool as a whole cannot be considered a troubled debt restructuring. A troubled debt restructuring is a continuation of the prior loan rather than the creation of a new loan and, accordingly, assets have not been received to satisfy the loan. Substantially all respondents agreed with the Task Force's conclusion.

BC5. The Task Force also noted that to the extent that modifications within a pool caused deterioration in the cash flows expected from the pool, an impairment of the pool would occur under Section 310-30-35. That fact mitigates concerns that not considering these modifications to be troubled debt restructurings could result in delayed recognition of loan impairments.

BC6. The proposed Update asked respondents whether the Task Force should provide guidance on how the carrying value of a loan should be determined upon removal of a loan from a pool when applying Subtopic 310-30. Responses were mixed on whether additional guidance was necessary. The Task Force concluded that further guidance was not necessary because paragraph 310-30-35-15, which states that loans should be removed from the pool in a way that does not impact the accretable yield of the pool, provides a sufficient principle. The Task Force also noted that constituents appeared to be applying reasonable methodologies in making that determination.

BC7. The Task Force decided not to require any recurring disclosures for modified loans that continue to be accounted for as a pool under Subtopic 310-30. The Task Force noted that the Board currently has on its agenda a project on credit loss disclosures and that the Board is expected to consider whether additional disclosures should be provided for modifications of loans including those accounted for within a pool under Subtopic 310-30.

Transition and Effective Date

BC8. The Task Force decided to permit a one-time election to terminate pool accounting on a pool-by-pool basis so that entities that currently evaluate loan modifications within pools for troubled debt restructuring accounting would not have to change their current accounting process. The Task Force also noted that pool accounting is elective in general, so permitting this one-time election does not significantly affect comparability with other entities.

BC9. The Task Force decided that the amendments in this Update should be effective prospectively. The Task Force considered retrospective application but decided that it would be impracticable for entities that had been removing modified loans that were considered troubled debt restructurings from a pool to put those loans back into the pool.

Benefits and Costs

BC10. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC11. The Task Force believes that the amendments in this Update will not involve significant costs because they do not require an analysis of when a modification of a loan within a pool is a troubled debt restructuring and, thus, do not require a calculation of the amount of the loan to be removed from the pool. The guidance in the amendments in this Update will benefit financial statement users by reducing diversity in practice.

Amendments to the XBRL Taxonomy

There are no proposed amendments to the XBRL taxonomy as a result of the amendments in this Update.