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FASB Issues ASU to Update Requirements for Troubled Debt Restructurings and Vintage Disclosures

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Introduction

On March 31, 2022, the FASB issued ASU 2022-02,[1] which eliminates the accounting guidance on troubled debt restructurings (TDRs) for creditors in ASC 310-40[2] and amends the guidance on "vintage disclosures" to require disclosure of current-period gross write-offs by year of origination. The ASU also updates the requirements related to accounting for credit losses under ASC 326 and adds enhanced disclosures for creditors with respect to loan refinancings and restructurings for borrowers experiencing financial difficulty.

Background

As part of its postimplementation review process, the Board conducted outreach with stakeholders who have adopted ASU 2016-13.[3] During that outreach, stakeholders raised concerns that ASU 2016-13, which replaced the incurred loss impairment methodology with the current expected credit loss (CECL) methodology, had reduced the usefulness of the recognition, measurement, and disclosure requirements related to TDRs. Those stakeholders argued that the costs of applying the TDR guidance incurred by preparers who have adopted ASU 2016-13 exceeded the benefits provided to financial statement users.

[1] FASB Accounting Standards Update (ASU) No. 2022-02, *Troubled Debt Restructurings and Vintage Disclosures*.
[2] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the FASB Accounting Standards Codification."
[3] FASB Accounting Standards Update No. 2016-13, *Measurement of Credit Losses on Financial Instruments*.

In addition, stakeholders noted inconsistencies between the disclosure requirements in ASC 326-20-50-6 and the example included in the implementation guidance in ASC 326-20-55-79 related to the presentation of gross write-offs and gross recoveries for receivables by year of origination. In issuing ASU 2022-02, the Board aims to eliminate such inconsistencies by amending both ASC 326-20-50-6 and ASC 326-20-55-79 to require the disclosure of gross write-offs in the current period by year of origination.

Main Provisions of ASU 2022-02

Troubled Debt Restructurings by Creditors

ASU 2022-02 supersedes the accounting guidance for TDRs for creditors in ASC 310-40 in its entirety and requires entities to evaluate all receivable modifications under ASC 310-20-35-9 through 35-11 to determine whether a modification made to a borrower results in a new loan or a continuation of the existing loan. The ASU also amends other subtopics to remove references to TDRs for creditors.

In addition to the elimination of TDR guidance, an entity that has adopted ASU 2022-02 no longer considers renewals, modifications, and extensions that result from reasonably expected TDRs in their calculation of the allowance for credit losses in accordance with ASC 326-20. In removing this requirement, the ASU notes that "it is not the Board's intent to require that an entity reverse the effect of any extensions, renewals, and modifications on receivables with borrowers experiencing financial difficulty in considering historical loss data used in estimating the allowance for credit losses."[4] Further, if an entity employs a discounted cash flow (DCF) method to calculate the allowance for credit losses, it will be required to use a postmodification-derived effective interest rate as part of its calculation in accordance with ASC 326-20-30-4.

Connecting the Dots

Under the CECL model, an entity generally has flexibility when choosing a method to determine credit losses (e.g., a DCF method, loss-rate method, or probability-of-default method). However, the FASB previously indicated that a DCF method (or reconcilable method) should be used if the TDR involves a concession that can only be measured by using a DCF method (or reconcilable method), such as an interest rate concession. Under ASU 2022-02, an entity is no longer required to use a DCF method (or reconcilable method) to measure the allowance for credit losses as a result of a modification or restructuring with a borrower experiencing financial difficulty.

In addition to the new measurement guidance, the ASU requires new disclosures for receivables for which there has been a modification in their contractual cash flows because borrowers are experiencing financial difficulties. Modifications in the contractual cash flows of a receivable are defined as principal forgiveness, interest rate reductions, other-than-insignificant-payment delays, or term extensions under ASC 310-10-50-39. Under the ASU, a term extension excludes covenant waivers and modifications of contingent acceleration clauses. Furthermore, the Board indicated that "collateral substitutions, or the addition of a guarantor, will not be captured in the disclosure enhancements."[5]

For receivables for which there has been a modification in their contractual cash flows, ASU 2022-02 requires disclosure, by class of financing receivable, of the types of modifications, the financial effects of those modifications, and the performance of these modified receivables (through a 12-month trailing period after the modification).

[4] See paragraph BC24 of ASU 2022-02.
[5] See paragraph BC28 of ASU 2022-02.

Under the ASU, entities must also provide disclosures of receivables that (1) had a payment default during the current period and (2) had modifications to the contractual cash flows within the 12 months before the default. The disclosures must show, by class of financing receivable, the type of contractual change that the modification provided and the defaulted amount.

As noted in ASU 2022-02, a delay in payment that is considered insignificant is not required to be included in the disclosures stated above; however, if the receivable has been previously restructured, an entity should consider all restructurings within the past 12 months to determine the insignificance of the delay in payment.

Connecting the Dots

The enhanced disclosures required by the ASU may be different from an entity's historical TDR disclosures because the scope of the new disclosures is not dependent upon whether the entity has provided a concession to a borrower experiencing financial difficulty. Instead, an entity will need to evaluate whether a modification or restructuring with a borrower experiencing financial difficulty results in principal forgiveness, an interest rate reduction, an other-than-insignificant-payment delay, or a term extension. These disclosures are required regardless of whether the refinancing or restructuring is accounted for as a new loan under ASC 310-20-35-9 through 35-11. As a result, an entity may need to update its internal controls and processes to comply with the new requirements.

Vintage Disclosures — Gross Write-Offs

ASU 2022-02 amends ASC 326-20-50-6 to require public business entities to disclose gross write-offs recorded in the current period, on a year-to-date basis, by year of origination in the vintage disclosures. This disclosure should cover each of the previous five annual periods starting with the date of the financial statements and, for the annual periods before that, an aggregate total. However, upon adoption of the ASU, an entity would not provide the previous five annual periods of gross write-offs. The FASB decided that disclosure of gross write-offs would instead be applied on a prospective transition basis so that preparers can "build" the five-annual-period disclosure over time.

Effective Dates and Transition

Effective Dates

For entities that have already adopted ASU 2016-13, the amendments in ASU 2022-02 are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years.

For entities that have not yet adopted ASU 2016-13, the amendments in ASU 2022-02 are effective upon adoption of ASU 2016-13.

Entities are permitted to early adopt these amendments, including adoption in any interim period, provided that the amendments are adopted as of the beginning of the annual reporting period that includes the interim period of adoption.

In addition, entities are permitted to elect to early adopt the amendments related to TDR accounting and related disclosure enhancements separately from the amendments related to the vintage disclosures.

Transition

Entities may elect to apply the updated guidance on TDR recognition and measurement by using a modified retrospective transition method, which would result in a cumulative-effect adjustment to retained earnings, or to adopt the amendments prospectively. If an entity elects to adopt the updated guidance on TDR recognition and measurement prospectively, the guidance should be applied to modifications occurring after the date of adoption. The amendments on TDR disclosures and vintage disclosures should be adopted prospectively.

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