



Troubled Debt Restructurings (TDRs) and Debt Modifications and Extinguishments

FASB—IASB Education Meeting

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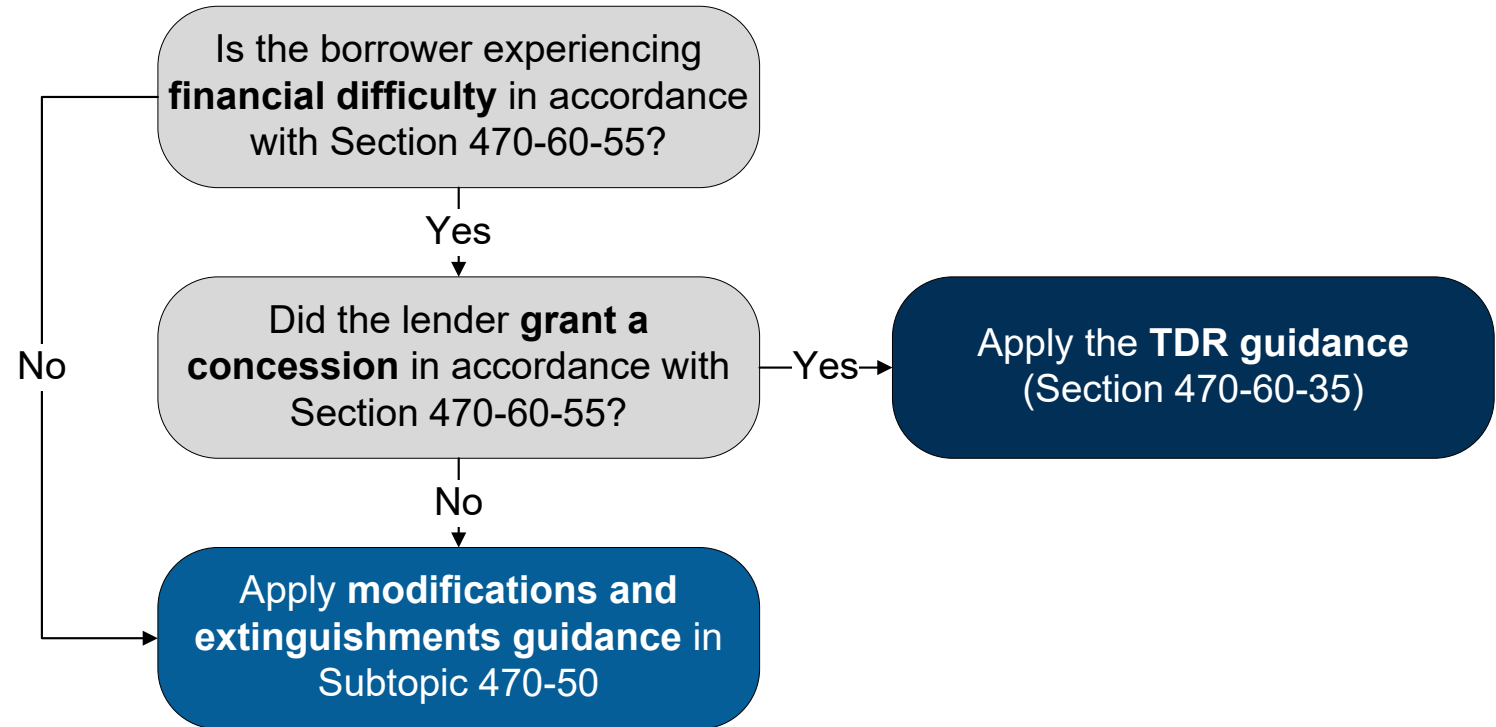
Overview of Feedback on Current Challenges in Practice

- The FASB received feedback on debt modifications, extinguishments, and TDRs from:
 - The Private Company Council (PCC) and PCC Working Group
 - Comment letters to the 2025 Invitation to Comment, *Agenda Consultation*
 - Feedback received on the Board's project on Accounting for Debt Exchanges
 - Recent outreach.
- Overview of feedback on challenges in current guidance
 - Many practitioners say that the **TDR guidance produces unintuitive outcomes and should be eliminated** (some also noted that the TDR evaluation can be complex to perform).
 - Practitioners also note that **Subtopic 470-50, Debt—Modification and Extinguishments, is complex and produces predominantly modification accounting outcomes** (which also can be unintuitive).

TDRs for Borrowers: Overview of Current GAAP

Guidance for TDRs was established by **FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*** (issued 1977):

- When issued, TDR guidance applicable to **both the creditor and the debtor**
- **Accounting Standards Update No. 2022-02, *Financial Instruments—Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures***, **eliminated TDRs for creditors**
- **EITF Issue No. 02-4**, “Determining Whether a Debtor’s Modification or Exchange of Debt Instruments Is within the Scope of FASB Statement No. 15,” clarified that a TDR occurs when both (a) the borrower is experiencing financial difficulties and (b) the lender grants a concession.



TDRs for Borrowers: Accounting Outcomes (Undiscounted Cash Flows < Carrying Amount)

- If, following a TDR, **undiscounted future cash flows are less than original net carrying amount:**

- Carrying amount is reduced to amount of undiscounted future cash flows:
 - Amount of reduction is recognized as a restructuring gain
 - Restructuring gain reduced by direct costs.
- **No subsequent interest expense is recognized:** subsequent payments reduce carrying amount instead
- Specialized guidance for treatment of any contingent payments

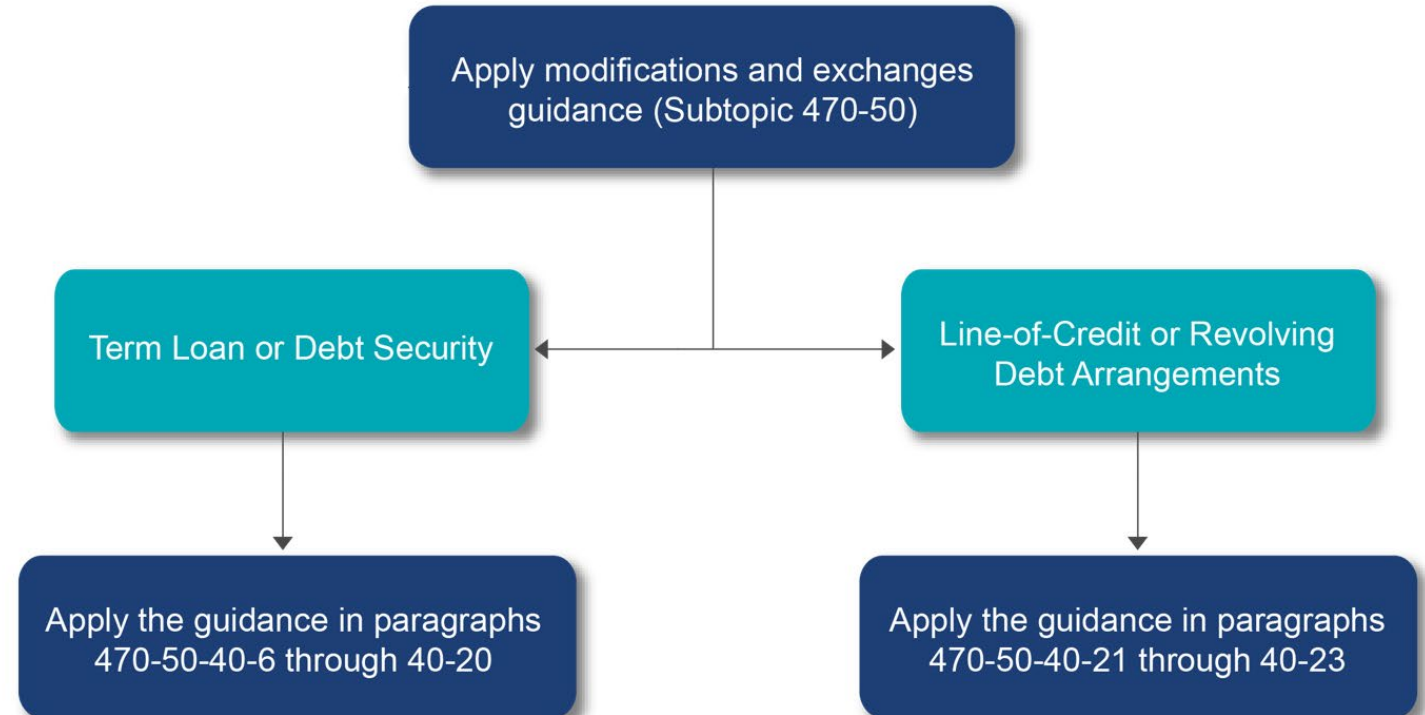
Carrying amount (pre-restructuring)	\$100,000 ^a
Principal forgiven (upon restructuring)	<u>(35,000)</u>
Principal due (as restructured)	65,000
Undiscounted cash flows (at 12%)	96,200 ^b
Gain on restructuring	^{a - b} \$3,800

Period	Cash Flows
Restructuring date	\$0
Year 1 "Interest"	7,800
Year 2 "Interest"	7,800
Year 3 "Interest"	7,800
Year 4 "Interest + Principal"	<u>72,800</u>
Total	\$96,200

	Debit	Credit
Upon restructuring		
Debt	\$3,800	
Gain		\$3,800
Year 1-3 payment		
Debt	\$7,800	
Cash		\$7,800
Year 4 payment		
Debt	\$72,800	
Cash		\$72,800

Debt Modifications and Extinguishments: Overview of Current GAAP

- For **term loans**, Subtopic 470-50 requires that the borrower assess whether the exchange of a debt instrument results in debt terms that are “*substantially different.*”
- For **line-of-credit or revolving debt arrangements** with the same creditor, the borrower’s accounting for a modification or exchange requires an analysis of its borrowing capacity.



The 10% Cash Flow Test (Term Loans)

Determining if modified or exchanged debt is *substantially different*:

- **“The 10% cash flow test”**: Substantially different if the present value of the new debt instrument is at least 10% different from present value of the remaining cash flows under terms of the original debt instrument.
- However, if old or new instrument is callable or puttable, the 10% test must be run under both exercise and nonexercise scenarios, using *whichever produces the smaller change*.
- Applied on a **creditor-by-creditor basis**:
 - e.g., in loan syndication, separate unit of account (10% calculation) for each individual creditor in the syndicate.

Debt Modifications and Extinguishments (Term Loans): Overview of Current GAAP

Terms Are “Substantially Different”

Extinguishment Accounting

- Original debt is derecognized.
- **Recognize gain/loss** equal to difference between the original debt’s carrying amount and **new debt’s fair value**.
 - **Note:** Existing requirements for public business entities require fair value of debt to be disclosed for interim and annual reporting periods (even if extinguishment accounting is not applied).
- Fees paid to/received from lender(s): included in determining the debt extinguishment gain or loss.
- Fees paid to third parties: included in new debt carrying amount and amortized.

Terms Are Not “Substantially Different”

Modification Accounting

- The new **effective interest rate calculated** is based on original debt’s carrying amount.
- **No extinguishment gain/loss** is recognized.
- Fees are paid to/received from lender(s): included in carrying amount and amortized through interest expense.
- Fees are paid to third parties: expensed as incurred.

Overview of 2025 ITC Feedback

Overall Feedback from 2025 ITC

- **Nineteen stakeholders** provided feedback on TDRs or debt modifications and extinguishments.

TDR Feedback

- **Mixed Prioritization:** Some noted TDRs were a top priority due to unnecessary complexity; others noted that it was a low priority because the guidance is well understood.
- **Limited Prevalence:** Restructurings often do not result in TDR accounting, although it is more common during economic downturns.
- **Decision Usefulness Concerns:** When undiscounted cash payments fall below the carrying amount, TDR guidance requires gain recognition and no future interest expense (even on interest-bearing debt), which stakeholders say does not reflect economic substance.
- **Fair Value Measurement:** Some said that they do not experience significant challenges in determining fair value of restructured debt; others noted it could be challenging for private companies and entities without publicly traded debt (establishing an appropriate market rate for a borrower experiencing financial difficulty may be difficult).

Debt Modifications and Extinguishments Feedback

- Application challenges include the 10% cash flow test for non-prepayable debt, fee allocation in modifications of syndicated debt, and lender-by-lender application of the 10% cash flow test.
- Stakeholders provided varying suggestions for improvements (see next slide).

Overview of Suggested Changes

Changes Suggested for TDRs (*Comment Letters and Past Outreach*)

- Eliminate the TDR guidance
- Simplify the determination of whether a transaction is a TDR (e.g., whether a borrower is experiencing financial difficulty)
- Changing the accounting model for a TDR (which can result in zero interest expense recognized after restructuring)

Changes Suggested for Debt Modifications and Extinguishments (*Comment Letters and Past Outreach*)

- Eliminate the 10% cash flow test (with a model based on modification accounting, extinguishment accounting, or a “principles-based framework”)
- Other targeted improvements

Thank You