



Memo No. **4B**

MEMO

Issue Date **December 2, 2024**

Meeting Date **December 17, 2024**

| | | | |
|----------|---|---|--|
| Contacts | Chris Bohdan Mike Lupo Emily Knebel Elizabeth Vautier Lucas Rich | Project Manager Project Manager Practice Fellow Postgraduate Technical Assistant Postgraduate Technical Assistant | (203) 956-5266 (203) 956-5246 (203) 956-3433 (203) 956-3485 (203) 956-3497 |
|----------|---|---|--|

| | |
|---------------|---|
| Project | PCC Agenda Priorities |
| Project Stage | Private Company Pre-Agenda Research |
| Issue | Debt Modifications and Extinguishments |

Background Information and Memo Purpose

1. During the June 24, 2024 Private Company Council (PCC) meeting, PCC members stated that private companies experience challenges in determining whether modification accounting or extinguishment accounting is required when there is a debt modification or exchange.¹ During that meeting, the PCC directed the staff to perform outreach with private company financial statement users to better understand their views about the different financial reporting outcomes that can arise when entities apply Subtopic 470-50, Debt—Modifications and Exchanges, to term loans that are exchanged or modified.
2. During the September 24, 2024 PCC meeting, the staff provided an interim update on its outreach with private company financial statement users. The staff’s outreach focused on whether the current financial reporting outcomes under Subtopic 470-50 are relevant (capable of making a difference) to users’ analyses. As summarized in [PCC Memo 3B](#), Research and Outreach, users generally stated that they did not find that the differences between modification accounting and extinguishment accounting were relevant to their analyses of a private company’s performance and financial position when there is a debt exchange or modification.²
3. During the September meeting, PCC user members agreed with the sentiments shared by users during outreach. PCC preparer and practitioner members highlighted that some private company preparers

¹ Throughout this memo, *extinguishment accounting* refers to the accounting required under paragraph 470-50-40-13 and *modification accounting* refers to the accounting required under paragraphs 470-50-40-14 and 40-15.

² The staff has updated the feedback summary shared with the PCC for the September meeting to incorporate feedback from user outreach conducted after mid-August in Appendix A, Updated User Outreach Summary. This feedback was previously shared verbally during the PCC September meeting.

struggle to apply the guidance in Subtopic 470-50 and commented on potential approaches for providing a private company practical expedient or alternative.

4. As part of next steps, the staff noted during the September PCC meeting that the Emerging Issues Task Force (EITF) had added a project to its agenda to address whether the issuance of new debt that results in the repayment of current debt involving the debtor and multiple creditors should be accounted for as an exchange under Subtopic 470-50 (and, therefore, generally subject to the 10 percent test on a creditor-by-creditor basis) or as an extinguishment under Subtopic 405-20, Liabilities—Extinguishments of Liabilities.
5. The staff also noted that it would begin performing outreach with private company financial statement preparers and practitioners. The PCC confirmed that the research should continue to focus on the guidance in Subtopic 470-50 applicable to term loans that are exchanged or modified.
6. The purpose of this memo is to provide an update on (a) the staff's research (including outreach) conducted since the September 24, 2024 PCC meeting and (b) EITF and Board activities related to the guidance in Subtopic 470-50.³ This memo does not include staff analysis or recommendations. As discussed in the Next Steps section of this memo, because there have been recent standard-setting developments in this area of the guidance, there are several alternative directions the PCC could pursue going forward.

Questions for the PCC

1. Does the PCC have any questions or comments on the feedback received related to the current challenges encountered in applying the existing guidance in Subtopic 470-50?
2. Does the PCC have any questions or comments on the feedback received related to potential private company alternatives and practical expedients?
3. Considering the decisions made by the Board and EITF, how would the PCC like to proceed?
 - (a) Continued exploration of, including potential outreach with other financial statement users and an analysis of the Private Company Decision-Making Framework for, approaches discussed in this memo; potentially with a revised focused on single lender arrangements (the EITF's recommended solution would apply only to multi-lender arrangements)
 - (b) Deferral of additional research on debt modifications and extinguishments pending feedback received on the upcoming proposed accounting standards update of the EITF's recommended solution

³ As of mid-November 2024, additional outreach with financial statement preparers is planned and will be summarized verbally during the December 2024 PCC meeting.

(c) Exploration of other areas of guidance not within the scope of previous research; for example, research efforts could be reallocated to other PCC agenda priorities identified during the December PCC meeting.

7. This memo is organized as follows:
 - (a) Update on EITF Project, Issuance of New Debt to Repay Old Debt
 - (b) Staff Research: Practitioner and Preparer Views on Current Guidance
 - (c) Staff Research: Practitioner and Preparer Views on Potential Solutions
 - (d) Staff Research: Current Disclosure Requirements for Private Companies
 - (e) Next Steps
 - (f) Appendix A: Updated User Outreach Summary
 - (g) Appendix B: Summary of Key Takeaways from Stakeholder Outreach
 - (h) Confidential Appendix C: Summary of Current Guidance on Debt Modifications, Debt Extinguishments, and Other Related Areas

Update on EITF Project, Issuance of New Debt to Repay Old Debt

8. On August 6, 2024, the EITF added a project on the issuance of new debt to repay old debt to its agenda. This issue was discussed by the EITF during its October 28, 2024, meeting.
9. During the October 28, 2024 meeting, the EITF recommended that the Board add a project to its technical agenda for a transaction with multiple creditors that involves the contemporaneous exchange of cash between the same debtor and creditor in connection with the issuance of a new debt obligation and satisfaction of an existing debt obligation by the debtor (a debt exchange transaction). Under the EITF's recommended solution, a debt exchange transaction involving multiple creditors in the new debt would be accounted for separately as an extinguishment of the existing debt obligation and the issuance of new debt when the following conditions are met:
 - (a) The existing debt has been repaid in accordance with its original contractual terms or repurchased at market terms.
 - (b) The new debt was issued at market terms following the issuer's normal marketing process for new debt issuances.
10. The EITF recommended that the amendments be applied prospectively with early adoption permitted. Furthermore, the EITF recommended that the amendments apply to all entities, including private companies and not-for-profit entities.
11. During the November 20, 2024 meeting, the Board added a project to its technical agenda on the issuance of new debt to repay old debt with the EITF's recommended solution and voted to issue an

exposure draft, which is expected to be released in Q1 2025. The project has been renamed, Accounting for Debt Exchanges.

Staff Research: Practitioner and Preparer Views on Current Guidance

Overview of Outreach Conducted

12. Since the September PCC meeting, the staff has conducted outreach with preparers and practitioners to better understand (a) the specific nature of the issues encountered in practice in applying the guidance in Subtopic 470-50 to term loans and (b) those stakeholders' views on potential solutions.
13. As of the end of October 2024, the staff conducted outreach with seven practitioners. These practitioners consisted of the Big 4 firms and three midsize accounting firms.
14. Along with practitioners, the staff conducted outreach with two private company preparers. One of those preparers is a private equity-backed entity in the medical device industry with domestic and international operations. The other preparer is a small domestic entity in the indoor active entertainment industry.
15. During outreach, the staff emphasized that the scope of the current research requested by the PCC relates only to the modifications and exchanges of term loans.

Overall Sentiment Shared in Outreach

16. Overall, practitioners supported a project to clarify and/or simplify the guidance in Subtopic 470-50. Although the staff did not pose any questions to outreach participants about public business entities, practitioners consistently stated that challenges associated with applying of Subtopic 470-50 are not unique to private companies and that public business entities could benefit from improvements as well.
17. As a result, most practitioners indicated that they would prefer that the Board, rather than the PCC, pursue changes to the guidance in Subtopic 470-50.
18. All practitioners noted that both larger and smaller companies encounter issues in accounting for exchanges and modifications of term loans. Some practitioners viewed those issues as being more prevalent for small private companies because the terms in those companies' debt arrangements tend to be less standardized.
19. The staff received consistent feedback that many of the issues with the 10 percent cash flow test stem from a lack of awareness in practice. Practitioners emphasized that in many circumstances, their clients have limited awareness of certain aspects of the guidance because they do not apply the guidance on a regular basis. Some practitioners expressed a view that the current guidance itself is operable when appropriately identified.
20. The staff received mixed feedback from preparers on both the extent of challenges encountered when applying the existing guidance as well as the need for a private company alternative or practical expedient in Subtopic 470-50. One of the two preparers strongly supported a private company

alternative or practical expedient in Subtopic 470-50 and said that they experienced difficulty in performing the 10 percent cash flow test and determining the treatment of costs upon exchange or modification.

21. The other preparer did not express strong views about a potential private company project. That preparer stated that because of their private equity ownership structure, the outcomes resulting from extinguishment versus modification accounting are not important to their financial statement users and that they have not encountered issues when applying the current guidance for debt exchanges and modifications.

Overview of Topics Discussed in Outreach

22. During outreach, the following topics were discussed with preparers and practitioners.
 - (a) Types of private companies applying the guidance in Subtopic 470-50
 - (b) Challenges applying the 10 percent cash flow test in Subtopic 470-50
 - (c) Determining fair value under extinguishment accounting and determining the effective interest rate under modification accounting
 - (d) Accounting for fees between the debtor and creditor and third-party costs.

Types of Private Companies Applying the Guidance in Subtopic 470-50

23. All practitioners noted that private and public companies of all sizes experience challenges when applying the guidance in Subtopic 470-50. However, practitioners broadly expressed that the significance of the issues encountered by entities varies based on entity size, instrument complexity, and experience in applying the guidance.
24. Four practitioners noted that smaller companies and early-stage companies experience challenges when applying the guidance. Two of those practitioners, expressed that smaller entities experience challenges because they enter into non-standardized debt arrangements.
25. One practitioner noted that early-stage companies may apply the guidance more frequently than larger companies. That practitioner observed that early-stage companies may frequently apply the guidance because they enter into debt arrangements to fund their R&D activities before they are generating consistent cash flows from operations.
26. One practitioner stated that companies that are less effective at managing their debt repayment schedules may apply the guidance more often because they tend to modify their debt arrangements more frequently.
27. Two practitioners noted that companies with more complex debt arrangements encounter difficulties when applying the guidance. Those practitioners observed that smaller companies in the life science

and biotech industries tend to enter into complex debt arrangements (for example, debt that is issued with other freestanding financial instruments or includes embedded features).

28. Two practitioners observed that large companies experience challenges when applying the guidance. Those practitioners noted that large companies may experience challenges more frequently than smaller companies because they enter into multi-lender arrangements more frequently than smaller companies.
29. Two practitioners noted that companies that do not regularly amend debt arrangements often experience challenges when applying the guidance on debt modifications because they are not familiar with its requirements. Of those practitioners, one stated that it would expect a company of any size to experience challenges applying the guidance unless that company restructured its debt on a regular basis.
30. One practitioner noted that debt modifications are common for companies with private equity investors. That practitioner stated that the acquisitive nature of private equity investors increases the frequency of debt modifications for private equity-backed companies.
31. One preparer stated that they have applied the guidance to several significant transactions over the past five years. That preparer noted that they did not encounter significant issues in applying the guidance. However, the preparer noted that their view is based on applying the guidance to less complex debt instruments and that they might have experienced challenges applying the guidance had the debt instruments been more complex.
32. A different preparer stated that they have applied the guidance to two debt transactions and experienced challenges when applying the guidance.

Challenges Applying the 10 Percent Cash Flow Test in Subtopic 470-50

33. Practitioners and preparers noted that there are currently several areas of guidance in Subtopic 470-50 that pose challenges in practice. Specifically, outreach participants highlighted challenges related to the following areas:
 - (a) Limited awareness of the requirements in Subtopic 470-50
 - (b) Prepayments and other terms that affect the 10 percent cash flow test
 - (c) Determining the unit of account when there are transactions with the same lender
 - (d) Applying the 10 percent cash flow test when there is loan syndication
 - (e) Other challenges.

Limited Awareness of the Requirements in Subtopic 470-50

34. Practitioners broadly expressed that companies experience challenges when applying the guidance either because they have limited awareness of Subtopic 470-50 itself or have limited awareness of how to apply the requirements in that guidance.
35. Most practitioners stated that companies experience challenges because they have limited awareness of how to apply the requirements in Subtopic 470-50. Two of those practitioners noted that Subtopic 470-50 is complex and confusing for companies that do not frequently apply the guidance. Two different practitioners expressed that companies are uncertain about how to apply aspects of the 10 percent cash flow test.
36. Preparers provided mixed feedback on the matter. One preparer stated that it hired third-party consultants to assist with the accounting for a debt modification, and those consultants also experienced challenges because they had not previously applied the guidance to a similar transaction. A different preparer stated that it did not experience challenges in identifying or applying the guidance. However, that preparer noted that it had only applied the guidance to less complex debt instruments and utilized accounting firm guides during its analysis.

Prepayments and Other Terms That Affect the 10 Percent Cash Flow Test

37. All practitioners stated that application of the guidance in Subtopic 470-50 frequently results in modification accounting because if any cash flow scenario results in a change in the present value of future cash flows that is less than 10 percent, modification accounting should be applied (even if all other scenarios result in a change greater than 10 percent).
38. Multiple practitioners highlighted that modification accounting is typically required when both the original and modified (or exchanged) debt instruments contain a prepayment option, in part because the likelihood of exercising a prepayment option is not considered in applying the 10 percent cash flow test. Therefore, entities are required to consider a scenario in which the debt is immediately prepaid, and that scenario typically results in a conclusion that the cash flow effect on a present value basis is less than 10 percent.
39. Four practitioners noted that there is lack of awareness in practice related to the mechanics of the 10 percent cash flow test for modifications and exchanges of debt instruments with prepayment terms. However once understood, prepayment terms reduce the complexity in applying the 10 percent cash flow test and typically result in modification accounting.
40. Of those practitioners, three also noted that their clients are generally not aware that contingent payment scenarios with prepayable debt must be considered in conducting the 10 percent cash flow test.

41. A different practitioner stated that their clients experience difficulty in identifying the different cash flow scenarios that must be considered, especially when the debt agreement has customized terms (including prepayment options). That practitioner noted that they have encountered debt modifications or exchanges that require consideration of more than six different cash flow scenarios under the 10 percent cash flow test.
42. Two practitioners stated that there is diversity in practice in whether the 10 percent cash flow test applies when a company has a credit facility containing both a term loan and a revolving credit line and modifies both instruments. That is, those practitioners stated that current guidance does not clearly state whether the term loan and revolving credit line should be considered one unit of account or, instead, should be analyzed separately.
43. Neither preparer brought up any significant issues with prepayment scenarios or other terms affecting the 10 percent cash flow test. However, one preparer described challenges in applying the guidance to a debt agreement in which the entity was required to prepay a proportional amount of the outstanding debt based on the amount of cash generated through operations.

Determining the Unit of Account When There are Transactions with the Same Lender

44. Two practitioners noted difficulties in analyzing a modification or exchange when the issuer has multiple loans outstanding with the same creditor and there are modifications to one or more (but not all) of the loans; the guidance in Subtopic 470-50 does not explicitly address the appropriate unit of account when the same creditor holds multiple debt instruments issued by the reporting entity.
45. Two practitioners noted that multiple loans issued by the same lender are assessed as one arrangement in practice.
46. Another practitioner noted that for companies that have multiple loans with the same lender, modifications are generally negotiated contemporaneously for all arrangements within a master loan agreement. As a result, that practitioner does not perceive challenges in determining the unit of account because they view all loans outstanding with the same lender as a single unit of account.

Applying the 10 Percent Cash Flow Test When There is Loan Syndication

47. Most practitioners highlighted that the application of Subtopic 470-50 is challenging for loan syndications. Furthermore, those practitioners discussed the unintuitive outcomes that can occur under the loan syndication guidance in Subtopic 470-50 because the 10 percent cash flow test, which is applied on a creditor-by-creditor basis, can result in modification accounting by borrowers for some lenders and extinguishment accounting by borrowers for other lenders.
48. Furthermore, three practitioners observed loan syndications in which there are many lenders (sometimes over 20). In those situations, the 10 percent cash flow test is costly and time consuming because it is performed on a creditor-by-creditor basis. One of those practitioners noted that the 10

percent cash flow test would be simplified if a loan syndication was considered a single unit of account, consistent with the guidance in Subtopic 470-50 on loan participation.⁴

49. Two practitioners noted that, given the lack of explicit guidance, diversity in practice exists when determining the number of creditors in a loan syndication when the debt is held by multiple private equity funds that are managed by the same general partner. One of those practitioners pointed out that firm publications generally state that, if the funds are consolidated by the same general partner, the loans held by these funds should be analyzed together under the 10 percent cash flow test as opposed to on a creditor-by-creditor basis. However, that practitioner noted that the funds in those arrangements are rarely consolidated by the general partner. Furthermore, that practitioner observed that in practice, the loans are often analyzed together even if the funds are not consolidated.
50. Two practitioners observed that it can be challenging to determine whether the 10 percent cash flow test should be applied when (a) there are transactions among different lenders within a syndicate and (b) one of the parties to the transaction is also the company's agent in the transaction. One of those practitioners noted that the principal and agent determination is very difficult due to limited guidance in Subtopic 470-50.⁵
51. One practitioner noted that it does not receive many questions about the application of the 10 percent cash flow test to loan syndications but indicated that this could be attributable to a lack of awareness of the requirements in Subtopic 470-50.
52. Two preparers agreed that applying the 10 percent cash flow test is more difficult for syndicated loans than it is in single-lender arrangements. One of those preparers stated that, since their company is owned by private equity investors, they consulted third-party advisors when applying the guidance.

Other Challenges

53. One practitioner highlighted that there is diversity in practice on the treatment of any associated costs when there is a principal paydown that is not pursuant to the terms of the debt.

Determining Fair Value under Extinguishment Accounting and Determining the Effective Interest Rate Under Modification Accounting

Fair Value under Extinguishment Accounting

54. Three practitioners stated that they are not aware of their clients experiencing difficulties with the fair value calculation required when extinguishment accounting is applied under Subtopic 470-50. However, one of those practitioners acknowledged that they do not receive many questions when those calculations are required (because the questions are typically handled directly by the audit engagement

⁴ Under Subtopic 470-50, when there is loan participation, the lead bank (only, rather than participating banks) is treated as the sole creditor under the guidance.

⁵ Paragraph 470-50-55-7 provides guidance on determining whether a third-party intermediary is an agent or a principal.

teams). A different practitioner stated that the requirements for fair value measurement are clear and that preparers generally experience difficulty because they may be unaware of when a fair value calculation is required under Subtopic 470-50.

55. Two practitioners noted that it is easier to perform the required fair value calculation when there is a new lending arrangement (that is, an exchange) as opposed to a modification of terms because an arms-length transaction may be representative of a transaction being conducted at fair value.
56. One practitioner stated that it is not difficult to estimate the fair value of most term loans. However, that practitioner also observed that private companies sometimes enter into loans with conversion features, contingent options, and/or other embedded features. That practitioner noted that such arrangements typically require valuation experts, which is costly, and that this cost can be magnified if entities frequently modify the terms of the debt arrangement.
57. A different practitioner stated that it is not common for a modification or exchange to be accounted for as an extinguishment.
58. One preparer stated that calculating fair value is the most difficult aspect of extinguishment accounting. However, because it has not frequently applied extinguishment accounting when there has been a debt modification or exchange, this has not been a significant issue.

Effective Interest Rate under Modification Accounting

59. Three practitioners highlighted the difficulties that entities sometimes encounter in calculating a new effective interest rate as required under modification accounting.
60. One of those practitioners stated that modification accounting is often more difficult than extinguishment accounting for their clients because of the effective interest rate calculation. Furthermore, that practitioner stated that calculating a new effective interest rate based on the carrying amount of the original debt instrument is not representative of the economics of the arrangement because the previous arrangement should be considered extinguished (and, therefore, should not continue to affect an entity's interest expense calculation after the exchange or modification).
61. Furthermore, two practitioners stated that the effective interest rate calculation is difficult for private companies because many of those entities are unfamiliar with the guidance and do not know how to perform the calculation. Notwithstanding the lack of awareness of the existing requirements, one of those practitioners stated that the guidance is clear and does not need to be clarified.
62. One preparer stated that the effective interest rate under modification accounting is an easy calculation and is not time consuming. That preparer also stated that this calculation is less complex for a company that has simple debt arrangements with limited lender fees. By contrast, another preparer explained that there can be challenges in determining the effective interest rate under modification accounting.

Accounting for Fees Between the Debtor and Creditor and Third-Party Costs

63. Generally, the staff received feedback from practitioners that the accounting for fees between the debtor and creditor, as well as third party costs, is not a particularly challenging area of GAAP. Most practitioners stated that the guidance is clear, and one practitioner stated that most questions received do not require judgment or a consultation with that firm's national office.
64. One practitioner noted that most of their clients understand the different requirements for costs under extinguishment accounting and modification accounting. However, that practitioner noted that there can be difficulty in determining whether certain issuance costs (for example, fees paid to an administrative agent or to the lender's legal counsel) should be treated as lender fees or as third-party costs.
65. Another practitioner stated that they receive questions on third-party costs, especially when a third-party is also a lender. Specifically, that practitioner stated that determining the appropriate allocation of amortized and unamortized fees among lenders in multi-lender arrangements can be challenging.
66. One preparer stated that they have experienced difficulty in determining which parties to an exchange or modification are third parties.⁶ That preparer also noted issues with determining the timing of expensing costs. In their experience, the straight-line method is the easiest, and they recommended a possible practical expedient to allow for the straight-line amortization without having to prove that the outcome is not materially different from what would be required under the interest method.⁷

Staff Research: Preparer and Practitioner Views on Potential Solutions

67. In addition to conducting outreach on challenges in applying the current guidance, the staff also solicited feedback on the direction of a potential project to resolve these challenges, as well as on solutions similar to those discussed in the [June 25, 2024, PCC meeting](#).
68. Specifically, the staff solicited feedback from preparers and practitioners on the following topics:
 - (a) Support for a PCC project to provide a private company alternative or practical expedient
 - (b) Scope of a potential project (including feedback on troubled debt restructurings by debtors, revolving-debt arrangements, and modifications of convertible debt)
 - (c) Alternatives to address the issues identified.

Support for a PCC Project to Provide a Private Company Alternative or Practical Expedient

69. Practitioners and preparers generally supported standard-setting to improve the guidance on debt modifications or exchanges in Subtopic 470-50. However, among those who supported

⁶ Fees paid by the debtor to creditor under paragraph 470-50-40-17 are accounted for differently than costs incurred with third parties under paragraph 470-50-40-18.

⁷ Paragraph 835-30-35-4 states that methods of amortization other than the interest method "may be used if the results obtained are not materially different from those that would result from the interest method."

standard-setting in this area, most stated that they preferred a project that would address the requirements for both private companies and public business entities, rather than only for private companies.

70. Five practitioners noted that both private companies and public companies encounter challenges in applying Subtopic 470-50. Two of those practitioners stated that while they supported the PCC adding a project to its agenda, they would support adding an overall project to the FASB's technical agenda to improve the accounting for debt modifications and exchanges under Subtopic 470-50 instead of a PCC-specific project. Three practitioners did not express support for the PCC adding a project to its agenda because the challenges were pervasive amongst both private and public companies (but indicated that they would support a Board project).
71. One preparer supported a PCC project on Subtopic 470-50, stating that it generally benefits from private company alternatives and practical expedients. A different preparer did not indicate that standard setting was needed in this area; it stated that the guidance on this topic from nonauthoritative sources sufficiently explains the requirements in Subtopic 470-50.

Scope of a Potential Project

72. In the September meeting, PCC members agreed on a limited scope for debt modification research. While troubled debt restructuring (TDR) and revolving lines of credit were discussed, the PCC ultimately decided to focus on term loans. The staff highlights that it could assist the PCC with research in these areas (however, it would need to solicit feedback from stakeholders specific to these issues because the challenges associated with applying these areas of guidance may differ from those encountered when applying the guidance in Subtopic 470-50 to term loans).
73. In conducting outreach, the staff emphasized that the current scope of research was focused on accounting for modifications and exchanges of term loans under Subtopic 470-50. However, the staff also posed broad questions and received feedback on whether practitioners and preparers have identified issues in other related areas of guidance that the PCC should address in a potential project.

Troubled Debt Restructurings

74. The staff received consistent feedback from practitioners that the guidance in Subtopic 470-60, Troubled Debt Restructurings by Debtors, should be addressed whether through a PCC project or a Board project.
75. Three practitioners highlighted that the TDR guidance must be considered before Subtopic 470-50 can be applied and questioned whether the guidance on debt modifications and exchanges should be simplified without also addressing the requirements in Subtopic 470-60. Those practitioners also noted that both Subtopics currently require the application of a quantitative test.

76. One of those practitioners stated that there are similarities between the TDR requirements and the 10 percent cash flow test for exchanges and modifications in Subtopic 470-50. Both quantitative assessments require an entity to identify the related cash flows and may require an entity to determine the effective interest rate under the new terms using the existing debt's carrying amount.⁸ Some practitioners stated that they receive questions on TDRs in poor macroeconomic environments and questions on modifications to expand credit facilities in positive macroeconomic environments.
77. Separately, two practitioners stated that while the guidance in Subtopic 470-60 is complicated and should be addressed, they would prefer the Board (rather than the PCC) take on a project related to TDRs. One of those two practitioners stated that they would support a Board project to address the guidance in both Subtopic 470-60 and Subtopic 470-50.
78. In contrast to practitioners, the staff received feedback from preparers that addressing the TDR guidance is not critical. One preparer supported addressing the issues in Subtopic 470-60 after a potential PCC project on Subtopic 470-50. That preparer acknowledged the need for amendments to the guidance in both Subtopics but stated that, since private companies encounter more modifications and exchanges that do not qualify as a TDR, the guidance in Subtopic 470-50 is more pervasive.
79. Another preparer noted issues with the TDR guidance but did not support adding it to the scope of a potential PCC project. In that preparer's view, the issues for TDRs are less pervasive than the issues under Subtopic 470-50 because the guidance in Subtopic 470-60 for TDRs only applies when the lender has granted a concession.

Revolving Debt Arrangements

80. Most practitioners stated that the PCC should not expand the scope of a potential project to include revolving debt arrangements.
81. Two practitioners stated that the revolving debt arrangement guidance does not create significant difficulties in practice. Furthermore, one of those practitioners noted that the questions they receive related to revolving debt arrangements are typically less complex than questions related to term debt or TDRs.
82. Although not discussed in the context of the scope of a potential PCC project, two practitioners noted that some entities struggle to apply the guidance when a credit facility consists of both term debt and a revolving debt arrangement.
83. Neither preparer recommended expanding the scope of the potential PCC project to include revolving debt arrangements.

⁸ Paragraph 470-60-55-10 may require that an entity calculate the effective borrowing rate of the restructured debt by projecting all the cash flows under the new terms and solving for the discount rate that equates the present value of the cash flows under the new terms to the debtor's current carrying amount of the old debt.

Guidance in Subtopic 470-50 Applicable to Convertible Debt

84. If a convertible debt instrument is exchanged or modified, in addition to applying the 10 percent cash flow test, Subtopic 470-50 also requires an entity to assess whether any changes to an embedded conversion option result in extinguishment accounting. That guidance requires both (a) application of a separate 10 percent cash flow test based on the change in the fair value of the embedded conversion option and (b) consideration of whether a substantive conversion option was added or eliminated.
85. The staff did not receive feedback from practitioners indicating that there should be changes to the requirements for exchanges or modifications of convertible debt in Subtopic 470-50. Three practitioners stated that the guidance for embedded conversion features is clear. One practitioner stated that its clients do not modify convertible debt as frequently as nonconvertible debt. A different practitioner indicated that they do not receive a high volume of questions on how the guidance in Subtopic 470-50 should be applied to convertible debt instruments.
86. One practitioner stated that there is diversity in practice in how the guidance in Subtopic 470-50 applies to convertible debt instruments that have a bifurcated conversion option but that this issue has become less prominent following the issuance of Update No. 2020-06, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*.
87. While they did not recommend addressing guidance on embedded conversion options as part of a potential PCC project, one practitioner stated that measuring the fair value of debt becomes more difficult when an entity issues instruments with embedded features.
88. Neither preparer indicated that there should be changes to the requirements for exchanges or modifications of convertible debt under Subtopic 470-50.

Alternatives to Address the Issues Identified

Overall

89. During outreach conducted with preparers and practitioners, the staff solicited feedback on the following potential private company practical expedients and alternatives.
 - (a) Private company alternative: entity-wide election to account for all exchanges and modifications using extinguishment accounting
 - (b) Private company alternative: entity-wide election to account for all exchanges and modifications using modification accounting
 - (c) Private company practical expedient: replace 10 percent cash flow test with a qualitative assessment

(d) Private company alternative: entity-wide election to account for transactions on an instrument-by-instrument basis rather than a creditor-by-creditor basis

90. Generally, the staff received mixed feedback from preparers and practitioners about their preference for a private company alternative or practical expedient for debt modifications and exchanges.

Private Company Alternative (Entity-Wide Election to Account for all Exchanges and Modifications Using Extinguishment Accounting)

Overall Sentiment

91. Practitioners and preparers provided mixed feedback on a private company alternative that would permit an entity to make an entity-wide election to account for all exchanges and modifications using extinguishment accounting. Some practitioners explained that applying extinguishment accounting in more circumstances would improve financial reporting because the outcomes are intuitive. Furthermore, those practitioners did not anticipate that entities would experience significant difficulties in determining the fair value of the new debt instrument under extinguishment accounting. However, some practitioners noted that extinguishment accounting could result in increased costs for private company preparers.

Perceived Advantages

92. One practitioner stated that extinguishment accounting better represents the economics of an exchange or modification compared to modification accounting because the new debt is recorded at fair value. Another practitioner stated that a private company alternative based on extinguishment accounting would (a) be less difficult to apply than modification accounting and (b) result in understandable financial reporting outcomes. Two practitioners noted that they have not encountered preparers who experienced difficulty in determining the fair value of the new debt when extinguishment accounting applies because many modifications and exchanges of term loans are arm's length transactions that provide evidence of fair value.

93. Another practitioner explained that this private company alternative would align the financial reporting outcomes with the current outcomes for debt exchange transactions that involve the debtor repaying the debt outstanding to an existing creditor that does not participate in the new debt arrangement (which may occur in the refinancing of a loan syndication). That practitioner also stated that, when extinguishment accounting is applied to multi-lender exchanges or modifications, new lenders are often involved, and par value typically approximates fair value.

94. One practitioner noted that they would prefer a private company alternative based on extinguishment accounting rather than modification accounting because applying extinguishment accounting to more transactions would resolve certain practice issues. Those issues include unit-of-account questions involving (a) transactions among lenders, (b) loan participation versus loan syndications, and (c) modifications of a term loan and a revolving line of credit. That practitioner noted that these questions

would be unresolved under a private company alternative that permitted an entity to elect to apply modification accounting to its exchanges and modifications.

Perceived Disadvantages

95. One practitioner stated that while a private company alternative based on extinguishment accounting would simplify the analysis performed under Subtopic 470-50, the costs may not outweigh the benefits. That practitioner noted that the fair value determination for complex debt arrangements (for example, debt arrangements with embedded features) can be costly, particularly if debt is modified frequently. Furthermore, another practitioner acknowledged that this private company alternative could result in increased costs if nominal changes to a debt agreement required an entity to apply extinguishment accounting.
96. One preparer also explained that, in their view, the reduction in costs under this approach would be nominal. That preparer also stated that this private company alternative would make the guidance on modifications in Subtopic 470-50 inconsistent with other areas of the Codification. For example, that preparer stated that the modification framework in Topic 606—Revenue from Contracts with Customers and Topic 842—Leases, distinguishes between new contracts and modifications and current contracts whereas this private company alternative would not make that distinction.
97. Several practitioners commented on potential disadvantages of permitting extinguishment accounting for more transactions. One practitioner acknowledged that extinguishment accounting can result in an entity recognizing gains and losses through earnings that are attributable to changes in the reporting entity's own creditworthiness. However, that practitioner acknowledged that an extinguishment gain or loss may not affect a private company financial statement user's capital allocation decisions.
98. Another practitioner noted that extinguishment accounting could have unintended consequences for GAAP interest expense. That practitioner stated that most term debt is issued at or near its par value. Therefore, GAAP interest expense often approximates cash interest expense because the unamortized discount or premium is not significant. That practitioner noted that under this private company alternative, GAAP interest expense may no longer approximate cash interest costs because the fair value of the debt (which affects the effective interest rate) can differ from the cash received for the original debt instrument.

Private Company Alternative (Entity-Wide Election to Account for all Exchanges and Modifications Using Modification Accounting)

Overall Sentiment

99. Practitioners and preparers provided mixed feedback on a private company alternative that would permit an entity to make an entity-wide election to account for all exchanges and modifications using modification accounting. Some practitioners noted that this private company alternative would align with the current outcomes under Subtopic 470-50. Additionally, a preparer expressed support for this

private company alternative because it explained that the financial reporting outcomes are understood by users and the entity's executive management. However, other practitioners noted that modification accounting could result in counterintuitive financial reporting outcomes for certain transactions.

Perceived Advantages

100. One practitioner noted that the financial reporting outcomes under Subtopic 470-50 often result in modification accounting. Therefore, a private company alternative using modification accounting would result in financial reporting outcomes that are consistent with existing practice while being less difficult to apply than the 10 percent cash flow test. Another practitioner expressed support for this private company alternative, particularly when a debt modification occurs with the same lender.

Perceived Disadvantages

101. A practitioner and a preparer noted that the financial reporting outcomes under this private company alternative would not reflect the economics of the transaction if that transaction would result in a debt extinguishment under the current guidance in Subtopic 470-50. Those stakeholders explained that, for example, calculating interest expense using the carrying amount of the original debt instrument can result in an effective interest rate that would be significantly different from an entity's borrowing rate had it issued new debt.

102. One practitioner stated that a private company alternative based on modification accounting would result in increased complexity compared to a private company alternative using extinguishment accounting because an entity would be required to recalculate its effective interest rate in more circumstances, which can be challenging in practice.⁹ Based on their experience, that practitioner stated that preparers prefer an extinguishment outcome because it is easier to apply in practice. Another practitioner also noted practice issues in performing the effective interest rate calculation.

Private Company Practical Expedient (Replace 10 Percent Cash Flow Test with a Qualitative Assessment)

Overall Sentiment

103. Preparers and practitioners provided mixed feedback on a potential practical expedient that would replace the existing 10 percent cash flow test with a qualitative assessment of whether an exchange or modification has resulted in "significant changes to the expected timing and amount of cash flows."

104. Some practitioners and a preparer noted that this approach could simplify the requirements in Subtopic 470-50 when there has been a modification or an exchange.

⁹ However, a different practitioner highlighted that, in some circumstances, an entity may be required to calculate an effective interest rate when applying the existing requirements for TDRs in Subtopic 470-60 (which is required to be assessed before the guidance in Subtopic 470-50 is applied).

105. However, other practitioners and a different preparer raised concerns that (a) any conclusions reached under this approach would be difficult to audit, (b) entities would fall back on a quantitative test to support the conclusions reached under a qualitative assessment, or (c) without detailed guidance, it would be unclear whether certain terms (for example, on prepayment options and contingent terms) would be considered in the same manner under the qualitative assessment as they currently are when the 10 percent cash flow test is applied.
106. A few practitioners highlighted that other areas of existing guidance include a qualitative assessment. One of the practitioners asked whether a potential qualitative approach could use those areas of guidance as a starting point. The other areas of guidance mentioned include the following.
- (a) The assessment required in Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs, on loan refinancing or restructuring to determine whether a loan should be accounted for as a new loan or as a modification (from the perspective of the *lender*). Under this guidance, after the lender has assessed both the restructured loan's effective interest rate and has applied the 10 percent cash flow test in Subtopic 470-50, the creditor may be required to qualitatively "evaluate whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification."
 - (b) An [SEC Staff Speech](#) on accounting for amendments to or exchanges of preferred stock.

Perceived Advantages

107. One preparer explained that utilizing qualitative factors for determining whether extinguishment or modification accounting is required could be preferable to a private company alternative to account for all transactions as either a modification or an extinguishment. Specifically, that preparer disagreed with an alternative under which all exchanges and modifications would apply a single accounting model and noted that an advantage of a qualitative assessment is that the guidance would continue to differentiate between a substantively new arrangement and an in-substance modification to an existing arrangement.
108. One practitioner asked whether replacing the guidance in Subtopic 470-50 with an assessment based on the guidance in Subtopic 310-20 could potentially resolve the existing issues in practice.
109. One practitioner stated that there could be advantages to layering a qualitative approach onto one of the potential private company alternatives. For example, under an entity-wide election to account for all exchanges and modifications using modification accounting, financial reporting outcomes could be enhanced if the guidance permitted an entity to qualitatively assess whether the facts and circumstances indicate that the terms of exchanged or modified debt have changed so significantly that extinguishment accounting should be applied.
110. Another practitioner who provided mixed feedback on this potential approach indicated that a qualitative approach could share similarities to the existing guidance in Subtopic 310-20.

Perceived Disadvantages

111. Most practitioners and a preparer expressed concerns that it would be difficult to audit the conclusions reached by private companies under a qualitative approach. Those practitioners noted that applying a qualitative approach would require more judgment than is necessary under current guidance (which provides a 10 percent bright-line threshold).
112. One preparer expressed concerns that, because of the degree of judgement involved, there would be increased uncertainty about whether their auditor would accept their conclusion that modification accounting or extinguishment accounting should be applied to certain transactions (particularly when a conclusion is made at interim before the auditors begin their fieldwork). The preparer noted that in those cases, there can be additional complexity if the auditors request additional support for their conclusions (or disagree with its conclusion) when the auditor is performing year-end audit procedures.
113. One practitioner stated they did not view a potential qualitative assessment favorably because, instead of reducing complexity, it would potentially introduce different complexity. That practitioner noted that, under current guidance in Subtopic 470-50, they understand what areas require the application of judgment to reach a conclusion. However, the introduction of a new model could raise questions about whether certain assumptions that are currently applied under the 10 percent cash flow test would carry over to the qualitative assessment. For example, the 10 percent cash flow test currently requires the evaluation of multiple scenarios to determine whether any of those scenarios provide a result of less than 10 percent. A single scenario with a result of less than 10 percent requires the borrower to apply modification accounting. Therefore, if both the original and the modified debt have a prepayment option, modification accounting is likely to be required. That practitioner asked whether terms (such as a prepayment term) would need to be considered similarly under a qualitative model or whether an entity would be permitted (or required) to consider the likelihood that a particular term or option will be exercised. That practitioner also expressed concerns about the operability of a qualitative assessment on a creditor-by-creditor basis in a multi-lender scenario.
114. Most practitioners expressed concerns about auditability of a qualitative assessment. Among other challenges, those practitioners stated that it would not be clear under this approach whether entities would be required (or permitted) to fall back on the existing 10 percent cash flow test to determine whether an exchange or modification results in significantly different terms. They also expressed concerns that, in many scenarios, it will not be obvious when an exchange or modification would result in extinguishment accounting or modification accounting unless the 10 percent cash flow test were applied.
115. Two of those practitioners indicated that, under current guidance, some entities effectively apply a qualitative assessment when it is obvious that the answer would result in modification accounting (for example, because the loan is prepayable both before and after the exchange or modification). One of

those practitioners questioned whether a qualitative substitute for the 10 percent would represent an improvement over the current guidance.

116. Another practitioner cited the existing qualitative assessment for goodwill impairment that was introduced in Update No. 2011-08, *Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, as an example of current guidance that provides for a qualitative assessment but is difficult to audit.

Private Company Alternative: Entity-Wide Election to Account for Transactions on an Instrument-by-Instrument Basis Rather than a Creditor-by-Creditor Basis

Staff Note

117. The outreach conducted on a potential private company alternative to account for transactions on an instrument-by-instrument (rather than a creditor-by-creditor) basis was conducted before the October 28, 2024, EITF meeting and before the Board tentatively decided to issue an exposure draft with the EITF's recommendation.

Overall Sentiment

118. Practitioners provided mixed feedback on a potential private company alternative to account for modifications and exchanges on an instrument-by-instrument basis (instead of on a creditor-by-creditor basis). Some highlighted that an instrument-by-instrument approach could simplify the application of Subtopic 470-50 to syndicated loans or to other arrangements in which there are multiple lenders. However, practitioners also expressed concerns that applying the guidance on an instrument-by-instrument basis could introduce new challenges if some, but not all, lenders are different following the modification or exchange of a syndicated loan. Moreover, some practitioners disagreed with permitting entities to not consider all debt arrangements outstanding between a lender and borrower when applying the guidance in Subtopic 470-50.

Perceived Advantages

119. Two preparers noted that this approach could help to promote consistent treatment across multiple lenders when a debt instrument is exchanged or modified and could reduce the costs associated with applying the existing guidance.
120. One practitioner stated that this approach could potentially simplify the analysis required when applying Subtopic 470-50. Specifically, that practitioner noted that an instrument-by-instrument approach could address the challenges that entities encounter under the current guidance when they have a debt instrument held by multiple lenders and, following an exchange or modification, some of the same lenders are also holders of the exchanged or modified debt instruments even though the existing lenders are acquiring the modified or exchanged debt instruments at the same terms as new lenders.

121. A different practitioner stated that being able to apply the guidance on an instrument-by-instrument basis could reduce complexity in applying the guidance in Subtopic 470-50, particularly in syndications with 50 or more lenders.
122. Another practitioner was supportive of applying the guidance on an instrument-by-instrument basis when there is loan syndication because it would better align the accounting outcomes with how an arrangement is viewed by financial statement users. That practitioner stated that if a loan is syndicated, a user might be indifferent to which entities are the creditors both before and after an exchange or modification. That practitioner also noted that an instrument-by-instrument approach would align the guidance on loan syndications with the current guidance for loan participations in Subtopic 470-50.

Perceived Disadvantages

123. One practitioner noted that there could be scenarios in which it would continue to be necessary to perform to apply the guidance in Subtopic 470-50 on a creditor-by-creditor basis. For example, that practitioner stated that multiple debt instruments from the same issuer are sometimes held by one lender and those parties may negotiate modifications to some, but not all, of the debt instruments outstanding. In that case, the practitioner explained that it may be important to consider the arrangement on a creditor-by-creditor basis because the lender may agree to changes in one arrangement in exchange for additional benefits conveyed through a different arrangement with the same issuer.
124. Several practitioners indicated that permitting or requiring application on an instrument-by-instrument basis would raise questions about how the 10 percent cash flow test in Subtopic 470-50 would apply to a syndicated loan. One of those practitioners highlighted that the members of the syndicate in a loan rarely stay the same. Therefore, in a scenario in which half of the creditors are syndicate members both before and after the exchange or modification, it would be unclear whether an entity would need to apply to the 10 percent cash flow test in Subtopic 470-50 to the whole arrangement. That practitioner emphasized that this approach could create new issues that are not currently encountered in practice.
125. Two practitioners indicated that if the creditor(s) is (are) the same before and after the debt is exchanged or modified, then the guidance could be operable, but also expressed concerns about whether this approach would be operable if the terms of the exchange or modification are not the same for each creditor.
126. One of those practitioners also questioned the scope of a potential instrument-by-instrument election. As an example, that practitioner asked whether entities would be able to apply this election if there were originally 20 syndicate members and, following modification or exchange, only a single original syndicate member remained. That practitioner also noted that, if such an election were permitted, it could result in significantly different accounting outcomes when compared with current guidance

because, under current guidance, a modification or exchange in which most creditors change would result in extinguishment accounting for at least part of the transaction.

127. A different practitioner indicated that additional criteria would need to be developed to limit the application of an election to apply the guidance in Subtopic 470-50 on an instrument-by-instrument basis rather than a creditor-by-creditor basis. That practitioner highlighted that lenders manage their exposure to an individual borrower in contemplation of all debt instruments and commitments outstanding with the borrower. Therefore, unless there are no negotiations occurring directly between the lender and borrower as part of a modification or exchange (for example, because the modified or exchanged debt instruments are widely held), all the outstanding instruments between the two parties should be considered when applying the requirements in Subtopic 470-50.

Staff Research: Current Disclosure Requirements for Private Companies When There is an Exchange or Modification

Disclosure Requirements for Private Companies When There is an Exchange or Modification

128. During the September PCC meeting, the FASB Chair suggested that the PCC consider the existing debt disclosure requirements for private companies because they may be different from those required for public business entities.

129. Therefore, the staff conducted research on how the existing debt disclosure requirements for public business entities compare to those required for private companies (additionally, the guidance on debt disclosures is also summarized in materials prepared to assist the PCC in its discussion of agenda priorities). The staff focused on disclosures that could provide additional information about debt modifications and exchanges.

130. The following table summarizes the *widely applicable*¹⁰ debt disclosure requirements for all entities, including private companies and non-SEC registrants. The table also highlights the incremental debt disclosure requirements for public companies pursuant to SEC guidance that private companies are *not* required to disclose.

| Related Guidance | Disclosures all (including private) companies are required to provide | Disclosures only public and SEC registrants are required to provide (not private companies) | Related Guidance |
|------------------|--|--|----------------------|
| 470-10-50-1 | Aggregate amount of long-term borrowings for each of the five years following the date of the latest balance sheet presented | Character of each long-term debt, interest rate, maturity date, any payment contingencies, indication of | S-X Rule 5-02. 22(a) |

¹⁰ This table excludes certain disclosures, including those specific to (a) default debt, covenant violations, and waivers under S-X Rule 4-08(c), (b) short-term obligations expected to be refinanced, (c) subjective acceleration clauses, (d) convertible debt, (e) fair value information (because these disclosure requirements are for public business entities), (f) guarantor disclosures (because these disclosures requirements only apply to certain SEC registrants that guarantee public debt), and (g) fair value option liabilities.

| Related Guidance | Disclosures all (including private) companies are required to provide | Disclosures only public and SEC registrants are required to provide (not private companies) | Related Guidance |
|------------------|---|--|---|
| | | priority, and basis for conversion (if applicable) | See paragraph 210-10-S99-1.22(a) |
| 835-30-45-2 | Effective interest rate and the face amount | Amount and terms of unused commitments for long-term financing arrangements that would be disclosed if used ¹¹ | S-X Rule 5-02.22(b) See paragraph 210-10-S99-1.22(b) |
| 470-10-50-5 | Pertinent rights and privileges of various securities outstanding (significant terms) | Weighted average interest rate on short-term borrowings outstanding as of each balance sheet date | S-X Rule 5-02.19(b) See paragraph 210-10-S99-1.19(b) |
| 440-10-50-1 | Commitments related to debt arrangements | Unrelated to the 10% cash flows test, if an entity has a significant change in debt, they must disclose information about the outstanding amount since the last reporting period | S-X Rule 4-08(f) See paragraph 235-10-S99-1(f) |

Next Steps

131. Since the September 2024 PCC meeting, there have been several developments that could affect the direction of a potential PCC project on debt modifications and extinguishments. Those developments include the Board's decisions during its November 20, 2024 meeting in which it tentatively decided to issue a proposed accounting standards update based on the EITF's recommended solution. Moreover, there has been additional information received through the staff's outreach on the issue encountered by private companies in practice.

132. The staff notes that there are several paths the PCC could pursue as part of next steps in light of the recent developments. The staff has listed some of the potential approaches that the PCC could explore below.

- (a) Continued exploration of, including potential outreach with other financial statement users and an analysis of the Private Company Decision-Making Framework for, approaches discussed in

¹¹ Note, under the amendments in Update No. 2023-06, *Disclosure Improvements: Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, paragraph 470-10-50-6 would require similar disclosure for all entities (including private companies). The effective date for each amendment in Update 2023-06 will be the date on which the SEC's removal of that related disclosure from Regulation S-X or Regulation S-K becomes effective, with early adoption prohibited. For all entities, if by June 30, 2027, the SEC has not removed the applicable requirement from Regulation S-X or Regulation S-K, the pending content of the related amendment will be removed from the Codification and will not become effective for any entity.

this memo; potentially with a revised focus on single-lender arrangements (the EITF's recommended solution would apply only to multi-lender arrangements)

- (b) Deferral of additional research on debt modifications and extinguishments pending feedback received on the upcoming proposed accounting standards update of the EITF's recommended solution
- (c) Exploration of other areas of guidance not within the scope of previous research; for example, research efforts could be reallocated to other PCC agenda priorities identified during the December 2024 PCC meeting.

Appendix A: Updated User Outreach Summary

A1. The purpose of this Appendix is to provide an update on the private company financial statement user outreach summary originally provided to the PCC during its September 2024 meeting. This Appendix includes all of the feedback previously summarized in the [PCC Memo](#) prepared for the September meeting while also incorporating feedback from an additional financial statement user that was provided during outreach that occurred in late August (the previous PCC memo captured outreach conducted through mid-August). The sentiments shared by this additional user were consistent with those shared in outreach by other users.

Overview of Outreach Participants and Materials

A2. The staff conducted outreach with five private company financial statement users. Those users were credit officers at financial institutions of various sizes, ranging from a community-based bank to an international financial institution. One of those users is a current PCC member.

A3. One user noted that they gathered perspective from other individuals who work for the same financial institution through a standing meeting among 30 employees, including credit approvers and underwriters. Therefore, the outreach received from that user reflects both that user's views as well as the views shared with that user by others within their organization.

A4. During outreach, users were asked for their views on the following:

- (a) Presentation and disclosure of a gain or loss when application of Subtopic 470-50 results in a debt extinguishment
- (b) Recognition of the new debt instrument at fair value when application of Subtopic 470-50 results in a debt extinguishment
- (c) Treatment of costs (for example, fees paid to or received from lender(s) or third-party costs) when there has been a modification or an exchange under Subtopic 470-50
- (d) Computation of interest expense following a modification or an exchange under Subtopic 470-50
- (e) Importance of comparability in financial reporting outcomes from the application of Subtopic 470-50 when making credit and lending decisions.

A5. The staff supplemented the users' questions by providing the following two illustrative examples of a modified term loan:

- (a) In one example, the modified term loan would not be deemed to be substantially different under Subtopic 470-50 because the change in the present value of the cash flows under the terms of the new debt instrument was less than 10 percent different from the present value of the

remaining cash flows under the terms of the original instrument. Therefore, that modification would not be required to be accounted for as an extinguishment under existing guidance.

(b) In the other example, the modified term loan would be deemed to be substantially different because the change in the present value of the cash flows under the terms of the new debt instrument was greater than 10 percent different from the present value of the remaining cash flows under the terms of the original instrument. Therefore, that modification would be accounted for as an extinguishment.

A6. The staff's questions referenced the examples to help illustrate the effect that applying extinguishment accounting would have on the presentation, balance sheet, and income statement of the borrower.

Overall Sentiment

A7. The staff received consistent feedback as part of the outreach performed. Users noted that the financial reporting outcomes under Subtopic 470-50 generally do not affect their capital allocation decisions.

A8. Users stated that capital allocation decisions are based upon the borrower's or prospective borrower's ability to pay its debt obligations through its cash flows and that the financial reporting outcomes under Subtopic 470-50 generally do not affect those decisions.

A9. Users emphasized the importance of information provided in the notes to financial statements to understand the terms of an entity's existing debt arrangements, particularly when a debt arrangement is new or modified.

Presentation and Disclosure of an Extinguishment Gain or Loss

Existing Requirements

A10. When the application of Subtopic 470-50 results in a debt extinguishment, the original debt is derecognized and a gain or loss is recognized equal to the difference between the carrying value of the original debt and the fair value of the new debt. GAAP currently requires the gain or loss recognized upon extinguishment to be presented as a separate financial statement line item or disclosed within the notes to financial statements.

User Outreach

A11. Users stated that the presentation and disclosure of an extinguishment gain or loss does not affect their capital allocation decisions because they are focused on the borrower's available cash flows to service its debt.

A12. One user stated that a borrower's available cash flows to service its debt is calculated based on a borrower's contractual cash flows, adjusted for interest costs.¹² That amount is then divided by its

¹² See paragraphs A24 to A25 for further discussion of the effect that modification accounting and extinguishment accounting have on interest expense in subsequent periods.

annualized cash principal and interest payments. Therefore, its key metrics may not be influenced by an entity recognizing an extinguishment gain or loss.

- A13. Users generally expressed that any extinguishment gain or loss is considered a “one-time” event that is disregarded when making capital allocation decisions because it either relates to financing activities for which the user is directly involved and/or because it is expected to be nonrecurring. For example, one user stated that lenders would adjust their models to neutralize the effects of extinguishment losses on EBITDA and that an extinguishment loss would not affect the amount of capital they would commit to the borrower or their willingness to commit capital to the borrower.
- A14. Users noted that they rely on the notes to financial statements to understand the contractual cash flows related to an entity’s borrowings. One user stated that the notes to financial statements are more important than the amounts presented on the face of the financial statements for purposes of this analysis.
- A15. Another user noted that they rely on information in the notes to financial statements or otherwise provided by management to understand the effect of any debt modifications on a borrower’s contractual cash flows, including whether a debt instrument’s maturity dates had been extended or contractual interest rates changed.
- A16. One user emphasized the importance of audited or reviewed financial statements with a focus specifically on the statement of cash flows. That user stated that they look to the supplemental disclosure of cash paid for interest within the statement of cash flows to analyze a borrower’s ability to service its debt through future cash flows.

Recognition of a New Debt Instrument at Fair Value

Existing Requirements

- A17. If the new or modified debt instrument is deemed to be substantially different (that is, the application of Subtopic 470-50 results in an extinguishment of the original debt), the fair value of the new debt (adjusted for certain costs) becomes the new carrying amount of the debt instrument.

User Outreach

- A18. Three users expressed the view that measuring a new debt instrument at fair value generally does not affect their capital allocation decisions. Two users stated that they are focused on an entity’s ability to pay its debt obligations through its future cash flows and that the remeasurement of an existing liability does not necessarily imply a change in contractual cash flows. One user did not support recognizing the new debt instrument at fair value because a new fair value measurement can create difficulty for users in understanding the changes that have occurred as a result of the modification since there may not be any changes to the contractual cash flows. A different user indicated that contemporaneous exchanges of cash are common when there is an exchange transaction and indicated that this would

tend to increase the differences between the carrying amount of a debt instrument under modification accounting and extinguishment accounting. However, that user did not state whether that difference would affect their capital allocation decisions.

A19. Another user emphasized that their capital allocation decisions are based upon the debt instrument's principal amount rather than its fair value. That user also noted that many immaterial debt modifications occurred during the COVID-19 pandemic. They stated that if *all* debt modifications were required to apply extinguishment accounting and recognize a new debt instrument at fair value, the costs to do so may be prohibitive.

A20. One user supported measuring the new debt instrument at fair value following a modification or exchange. They stated that measuring the new or modified debt instrument at fair value enables them to understand the debtor's future obligations and more accurately depicts a debtor's financial condition. However, they acknowledged that the materiality of a debt modification would affect their preference for the accounting treatment in certain circumstances.

Treatment of Costs

Existing Requirements

A21. When application of Subtopic 470-50 results in a debt extinguishment, any remaining costs included in the original debt's carrying amount are included in determining the gain or loss.

User Outreach

A22. One user stated that the costs included in the original debt's net carrying amount are less relevant because they normally issue debt at par value.

A23. As noted in paragraph A8, users stated that they are focused on a borrower's ability to pay its debt obligations through its cash flows. Therefore, users stated that the treatment of costs under Subtopic 470-50 is generally viewed as immaterial and, accordingly, does not affect their capital allocation decisions. Three users noted that they view those costs as "one-time" in nature and, therefore, they are excluded from their credit and lending decisions.

Computation of Interest Expense

Existing Requirements

A24. If the new or modified debt instrument is deemed to be substantially different (that is, the application of Subtopic 470-50 results in an extinguishment of the original debt), a new effective interest rate is computed based on the new debt's net carrying amount and its future cash flows.

A25. However, if the new or modified debt instrument is not deemed to be substantially different, a new effective interest rate is computed based on the adjusted net carrying amount of the original debt and the revised cash flows. Therefore, when a modification or exchange is not accounted for as an

extinguishment of the original debt, any remaining costs (including debt issuance costs or a debt discount or premium) are amortized as an adjustment to interest expense over the remaining term of the modified or exchanged debt instrument.

User Outreach

A26. Users stated that they are focused on cash interest expense instead of the interest expense computed under the interest method in Subtopic 835-30, Interest—Imputation of Interest. As noted in paragraph A8, users indicated that they focus on the borrower's ability to pay its debt obligations, including cash interest payments, through its cash flows. Therefore, users explained that the effect on interest expense from applying the modifications and extinguishments guidance in Subtopic 470-50 does not affect capital allocation decisions.

A27. As noted in paragraph A16, one user noted that they look to the supplemental disclosure of cash paid for interest in the statement of cash flows to understand the borrower's ability to service its debt through future cash flows. That user also stated that the effect on interest expense is viewed as a timing difference and that they were not concerned about that potential timing difference. That is, the gain or loss recognized immediately in earnings under extinguishment accounting is eventually amortized into earnings over time if a modification or exchange has occurred and extinguishment accounting is not applied.

A28. One user stated that, although it is not common, a significant difference between cash interest and interest expense could be difficult for some users involved in the credit approval process to understand. However, that user expressed the view that this generally would not affect capital allocation decisions.

Importance of Comparability

Background Information: Transaction-by-Transaction Policy Election

A29. The staff asked users for their views on whether comparable financial reporting outcomes from the application of Subtopic 470-50 is important in making capital allocation decisions.

A30. Specifically, the staff asked users (a) whether decision-useful information would be diminished if borrowers could make an accounting election for debt modifications and exchanges (that is, to always apply extinguishment accounting or always apply modification accounting) and (b) whether such an election should be made on a transaction-by-transaction basis (a transaction-by-transaction accounting policy election).

User Outreach: Transaction-by-Transaction versus Entity-Wide Policy Election

A31. Three users expressed a preference for an entity-wide accounting policy election, whereby an entity would elect to apply extinguishment accounting (or elect to apply modification accounting) for all debt modifications and exchanges. Those users expressed the view that consistency could eliminate any confusion among users about why similar transactions result in different financial reporting outcomes.

One user indicated that it did not strongly oppose a transaction-by-transaction policy election. However, that user highlighted it could encounter challenges if such a policy election were permitted.

A32. Two users expressed concerns that a transaction-by-transaction policy election could lead to earnings management or other structuring opportunities within a borrower's financial statements. For example, one user expressed a concern that a borrower could elect to apply extinguishment accounting for modifications and exchanges that would result in gains and elect not to apply extinguishment accounting for transactions that would result in losses. The other user explained that while it expected to be able to adjust its models to consider the effect of a potential transaction-by-transaction policy election, having to do so could increase the costs of analyzing an entity's financial statements.

A33. One user noted that they would prefer it if a borrower were to elect a consistent accounting policy when applying Subtopic 470-50. However, that user stated that they did not have a strong preference for either an entity-wide accounting policy election or a transaction-by-transaction accounting policy election.

Background Information: Comparability with Refinancing through a Different Lender

A34. In addition, the staff asked users for their views on whether comparability was important when evaluating debt modifications that involve new lenders versus current lenders. The staff explained that a refinancing that involves a new lender typically results in extinguishment accounting under Topic 405, Liabilities, whereas a refinancing that involves current lenders is typically evaluated through the guidance in Subtopic 470-50.

User Outreach: Comparability with Refinancing through a Different Lender

A35. Two users stated that they would prefer a consistent accounting conclusion when evaluating debt modifications that involve new lenders versus current lenders. For example, one of those users noted that they do not support situations in which an entity accounts for two economically similar transactions differently. A different user expressed the view that they prefer consistent accounting conclusions when possible because it increases comparability and reduces structuring opportunities. However, that user also noted that comparability and consistency were not critical.

A36. Two other users stated that a consistent accounting conclusion when evaluating debt modifications among different lenders was not necessary in order to make capital allocation decisions given that those decisions are based upon the individual borrower's ability to pay its debt obligations through its cash flows rather than whether the transaction is accounted for as an extinguishment.

A37. In addition, all users noted that they did not evaluate the financial statements differently for a current borrower versus a prospective borrower. One user emphasized the importance of the notes to financial statements in instances in which they are unable to ask questions directly to the borrower.

Appendix B: Summary of Key Takeaways from Stakeholder Outreach

B1. For ease of reference, this Appendix summarizes the key takeaways from recent stakeholder outreach.

Key Takeaways

B2. Outreach feedback and the staff's research of existing guidance indicate that the guidance in Topic 470-50 represents a complex area of GAAP that could be improved through standard-setting.

B3. Overall, practitioners supported a project to clarify and/or simplify the guidance in Subtopic 470-50. However, practitioners consistently stated that challenges associated with applying Subtopic 470-50 are not unique to private companies and that public business entities could benefit from improvements as well.

B4. The staff received mixed feedback from preparers on both the extent of challenges encountered when applying the existing guidance as well as the need for a private company alternative or practical expedient in Subtopic 470-50.

B5. Some stakeholders stated that standard-setting should first focus on the guidance in Subtopic 470-50, while others indicated that the guidance on TDRs in Subtopic 470-60 should also be considered or should be considered first. Most stakeholders suggested that standard-setting should be considered for both public business entities and private companies (rather than only for private companies).

B6. The challenges identified in applying the guidance in Topic 470-50 ranged from limited awareness of the requirements to applying the guidance to multi-lender arrangements.

B7. Some important issues identified may be addressed by the Board project on accounting for debt exchanges. However, other issues related to modifications and single-lender arrangements (not currently in scope of the Board's project) were also raised.

B8. The nature of private company debt ranges from relatively simple to highly complex. Feedback received in outreach indicated that the presence of outside investors, being a startup entity, and being a pre-revenue entity is often associated with complex arrangements and/or more frequent debt modifications. Stakeholders indicated that the guidance in Subtopic 470-50 is more difficult to apply to complex or bespoke debt instruments.

B9. In past staff outreach, private company investors have noted that they tend to focus on an entity's cash flows associated with an entity's debt arrangements as opposed to whether a transaction is accounted for as a modification or exchange. Furthermore, investors highlighted the importance of robust disclosures when there is a debt modification or exchange.

B10. Stakeholders provided mixed feedback on each of the private alternatives and practical expedients discussed.

- B11. Some preferred a private company alternative to account for all exchanges and modifications as an extinguishment because the outcomes are intuitive and because few entities experience difficulty calculating the fair value of the new (or modified) debt instrument. However, some were concerned about increases in costs under this approach.
- B12. Stakeholders also provided mixed feedback on a private company alternative to account for all exchanges and modifications using modification accounting. Some supported this approach because it would align with the current outcomes under Subtopic 470-50. However, among other drawbacks highlighted, some noted that modification accounting could result in a calculated effective interest rate that is not consistent with the rate an entity would borrow at if it issued new debt.
- B13. Stakeholders also provided mixed feedback about a practical expedient to apply a qualitative approach instead of the 10 percent cash flow test. Stakeholders similarly provided mixed feedback about an approach to apply the guidance on an instrument-by-instrument basis.
- B14. Scoping (which transactions would be subject to a potential private company alternative or practical expedient) could significantly affect the potential costs and benefits of each alternative.