Financial Accounting Standards Board

ORIGINAL PRONOUNCEMENTS

AS AMENDED

Statement of Financial Accounting Standards No. 114

Accounting by Creditors for Impairment of a Loan

an amendment of FASB Statements No. 5 and 15

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an amendment of FASB Statements No. 5 and 15

STATUS

Issued: May 1993

Effective Date: For fiscal years beginning after December 15, 1994

Affects: Amends FAS 5, paragraph 23
Amends prospectively FAS 15, paragraphs 1, 33, 34, and 42
Replaces prospectively FAS 15, paragraph 30
Deletes prospectively FAS 15, paragraphs 31, 32, 35 through 37, 40(a), and 41 and footnotes 18, 19, 21, 24, and 25
Amends FAS 60, paragraph 47
Amends FAS 91, paragraph 14
Supersedes FTB 79-6
Supersedes FTB 79-7

Affected by: Paragraphs 8 and 11 through 15 amended by FAS 118, paragraphs 6(a) through 6(f)
Paragraph 17 replaced by FAS 118, paragraph 6(g)
Paragraphs 18 and 19 deleted by FAS 118, paragraph 6(h)
Paragraph 20 replaced by FAS 118, paragraph 6(i)
Paragraph 65 deleted by FAS 118, paragraph 6(j)

Other Interpretive Pronouncement: FTB 94-1

Other Interpretive Release: FASB *Viewpoints,* "Application of FASB Statements 5 and 114 to a Loan Portfolio," April 12, 1999 (in *Current Text* Section I08)

AICPA Accounting Standards Executive Committee (AcSEC)

Related Pronouncements: SOP 75-2
SOP 93-1
SOP 94-6
SOP 01-6
PB 4
PB 5
PB 6

Issues Discussed by FASB Emerging Issues Task Force (EITF)

Affects: Nullifies EITF Issues No. 87-5 and 89-9 and Topic No. D-37

Interpreted by: Paragraph 13 interpreted by EITF Issue No. 98-13

Related Issues: EITF Issues No. 84-4, 84-19, 85-44, 87-18, 87-19, 94-8, 96-22, and 99-20 and Topic No. D-80

SUMMARY

This Statement addresses the accounting by creditors for impairment of certain loans. It is applicable to all creditors and to all loans, uncollateralized as well as collateralized, except large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, loans that are measured at fair value or at the lower of cost or fair value, leases, and debt securities as defined in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities.* It applies to all loans that are restructured in a troubled debt restructuring involving a modification of terms.

It requires that impaired loans that are within the scope of this Statement be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent.

This Statement amends FASB Statement No. 5, *Accounting for Contingencies,* to clarify that a creditor should evaluate the collectibility of both contractual interest and contractual principal of all receivables when assessing the need for a loss accrual. This Statement also amends FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings,* to require a creditor to measure all loans that are restructured in a troubled debt restructuring involving a modification of terms in accordance with this Statement.

This Statement applies to financial statements for fiscal years beginning after December 15, 1994. Earlier application is encouraged.

Statement of Financial Accounting Standards No. 114

Accounting by Creditors for Impairment of a Loan

an amendment of FASB Statements No. 5 and 15

CONTENTS

INTRODUCTION

1. The FASB was asked by the AICPA's Accounting Standards Executive Committee (AcSEC), the Federal Deposit Insurance Corporation (FDIC), and others to address in what circumstances, if any, a creditor should measure impairment of a loan based on the present (discounted) value of expected future cash flows related to the loan. AcSEC originally addressed the issue of accounting for loan impairment in an effort to reconcile certain AICPA Audit and Accounting Guides for different types of financial institutions, which provide inconsistent guidance for the application of FASB Statement No. 5, *Accounting for Contingencies,* to the loan portfolio of a financial institution. That inconsistent guidance has resulted in significant differences in when and how different types of financial institutions recognize losses for impaired loans.

2. This Statement amends Statement 5 to clarify that a creditor should evaluate the collectibility of both contractual interest and contractual principal of all receivables when assessing the need for a loss accrual.

3. This Statement also amends FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings,* to require creditors to measure all loans that are restructured in a troubled debt restructuring involving a modification of terms in accordance with this Statement.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Definitions and Scope

4. For purposes of this Statement, a loan is a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position. Examples include but are not limited to accounts receivable (with terms exceeding one year) and notes receivable.

5. This Statement applies to all creditors. It addresses the accounting by creditors for impairment of a loan by specifying how allowances for credit losses related to certain loans should be determined. This Statement also addresses the accounting by creditors for all loans that are restructured in a troubled debt restructuring involving a modification of terms of a receivable, except restructurings of loans excluded from the scope of this Statement in paragraph 6(b)–(d), including those involving a receipt of assets in partial satisfaction of a receivable. The term *troubled debt restructuring* is used in this Statement consistent with its use in Statement 15.

6. This Statement applies to all loans that are identified for evaluation, uncollateralized as well as collateralized, except:

a. Large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment. Those loans may include but are not limited to credit card, residential mortgage, and consumer installment loans.
b. Loans that are measured at fair value or at the lower of cost or fair value, for example, in accordance with FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities,* or other specialized industry practice.
c. Leases as defined in FASB Statement No. 13, *Accounting for Leases.*
d. Debt securities as defined in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities.*

7. This Statement does not specify how a creditor should identify loans that are to be evaluated for collectibility.[1] A creditor should apply its normal loan review procedures in making that judgment. This Statement does not address when a creditor should record a direct write-down of an impaired loan, nor does it address how a creditor should assess the overall adequacy of the allowance for credit losses. In addition to the allowance calculated in accordance with this Statement, a creditor should continue to recognize an allowance for credit losses necessary to comply with Statement 5.

Recognition of Impairment

8. A loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. As used in this Statement and in Statement 5, as amended, *all amounts due according to the contractual terms* means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement. For a loan that has been restructured in a troubled debt restructuring, *the contractual terms of the loan agreement* refers to the contractual terms specified by the original loan agreement, not the contractual terms specified by the restructuring agreement. This Statement does not specify how a creditor should determine that it is probable that it will be unable to collect all amounts due according to the contractual terms of a loan. A creditor should apply its normal loan review procedures in making that judgment. An insignificant delay or insignificant shortfall in amount of payments does not require application of this Statement. A loan is not impaired during a period of delay in payment if the creditor expects to collect all amounts due including interest accrued at the contractual interest rate for the period of delay. Thus, a demand loan or other loan with no stated maturity is not impaired if the creditor expects to collect all amounts due including interest accrued at the contractual interest rate during the period the loan is outstanding.

9. Usually, a loan whose terms are modified in a troubled debt restructuring already will have been identified as impaired because the condition specified in paragraph 8 will have existed before a formal restructuring. However, if a loan is excluded from the scope of this Statement under paragraph 6(a), a creditor may not have accounted for that loan in accordance with this Statement before the loan was restructured. The creditor shall apply the provisions of this Statement to that loan when it is restructured.

10. The term *probable* is used in this Statement consistent with its use in Statement 5, which defines probable as an area within a range of the likelihood that a future event or events will occur confirming the fact of the loss. That range is from probable to remote, as follows:

> *Probable.* The future event or events are likely to occur.
> *Reasonably possible.* The chance of the future event or events occurring is more than remote but less than likely.
> *Remote.* The chance of the future event or events occurring is slight.

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[1]Sources of information useful in identifying loans for evaluation that are listed in the AICPA's Auditing Procedure Study, *Auditing the Allowance for Credit Losses of Banks,* include a specific materiality criterion; regulatory reports of examination; internally generated listings such as "watch lists," past due reports, overdraft listings, and listings of loans to insiders; management reports of total loan amounts by borrower; historical loss experience by type of loan; loan files lacking current financial data related to borrowers and guarantors; borrowers experiencing problems such as operating losses, marginal working capital, inadequate cash flow, or business interruptions; loans secured by collateral that is not readily marketable or that is susceptible to deterioration in realizable value; loans to borrowers in industries or countries experiencing economic instability; and loan documentation and compliance exception reports.

The term probable is further described in paragraph 84 of Statement 5, which states:

> The conditions for accrual in paragraph 8 [of Statement 5] are not inconsistent with the accounting concept of conservatism. *Those conditions are not intended to be so rigid that they require virtual certainty before a loss is accrued.* [Emphasis added.] They require only that it be *probable* that an asset has been impaired or a liability has been incurred and that the amount of loss be *reasonably* estimable. [Emphasis in original.]

Measurement of Impairment

11. Measuring impairment of a loan requires judgment and estimates, and the eventual outcomes may differ from those estimates. Creditors should have latitude to develop measurement methods that are practical in their circumstances. Paragraphs 12–16 address those measurement methods.

12. Some impaired loans have risk characteristics that are unique to an individual borrower, and the creditor will apply the measurement methods described in paragraphs 13–16 on a loan-by-loan basis. However, some impaired loans may have risk characteristics in common with other impaired loans. A creditor may aggregate those loans and may use historical statistics, such as average recovery period and average amount recovered, along with a composite effective interest rate as a means of measuring impairment of those loans.

13. When a loan is impaired as defined in paragraph 8 of this Statement, a creditor shall measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. Regardless of the measurement method, a creditor shall measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. The creditor may choose a measurement method on a loan-by-loan basis. A creditor shall consider estimated costs to sell, on a discounted basis, in the measure of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan. If the present value of expected future cash flows (or, alternatively, the observable market price of the loan or the fair value of the collateral) is less than the recorded investment in the loan[2] (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a creditor shall recognize an impairment by creating a valuation allowance with a corresponding charge to bad-debt expense or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to bad-debt expense.

14. If a creditor bases its measure of loan impairment on a present value amount, the creditor shall calculate that present value amount based on an estimate of the expected future cash flows of the impaired loan, discounted at the loan's effective interest rate. The effective interest rate of a loan is the rate of return implicit in the loan (that is, the contractual interest rate adjusted for any net deferred loan fees or costs, premium, or discount existing at the origination or acquisition of the loan).[3] The effective interest rate for a loan restructured in a troubled debt restructuring is based on the original contractual rate, not the rate specified in the restructuring agreement. If the loan's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate (for example, the prime rate, the London interbank offered rate, or the U.S. Treasury bill weekly average), that loan's effective interest rate may be calculated based on the factor as it changes over the life of the loan or may be fixed at the rate in effect at the date the loan meets the impairment criterion in paragraph 8. The creditor's choice shall be applied consistently for all loans whose contractual interest rate varies based on subsequent changes in an independent factor. Projections of changes in the factor should not be made for purposes of determining the effective interest rate or estimating expected future cash flows.

[2]The term *recorded investment in the loan* is distinguished from *net carrying amount of the loan* because the latter term is net of a valuation allowance, while the former term is not. The recorded investment in the loan does, however, reflect any direct write-down of the investment.

[3]A loan may be acquired at a discount because of a change in credit quality or rate or both. When a loan is acquired at a discount that relates, at least in part, to the loan's credit quality, the effective interest rate is the discount rate that equates the present value of the investor's estimate of the loan's future cash flows with the purchase price of the loan.

15. If a creditor bases its measure of loan impairment on a present value calculation, the estimates of expected future cash flows shall be the creditor's best estimate based on reasonable and supportable assumptions and projections. All available evidence, including estimated costs to sell if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan, should be considered in developing the estimate of expected future cash flows. The weight given to the evidence should be commensurate with the extent to which the evidence can be verified objectively. If a creditor estimates a range for either the amount or timing of possible cash flows, the likelihood of the possible outcomes shall be considered in determining the best estimate of expected future cash flows.

16. Subsequent to the initial measurement of impairment, if there is a significant change (increase or decrease) in the amount or timing of an impaired loan's expected future cash flows, or if actual cash flows are significantly different from the cash flows previously projected, a creditor shall recalculate the impairment by applying the procedures specified in paragraphs 12–15 and by adjusting the valuation allowance. Similarly, a creditor that measures impairment based on the observable market price of an impaired loan or the fair value of the collateral of an impaired collateral-dependent loan shall adjust the valuation allowance if there is a significant change (increase or decrease) in either of those bases. However, the net carrying amount of the loan shall at no time exceed the recorded investment in the loan.

Income Recognition

17. This Statement does not address how a creditor should recognize, measure, or display interest income on an impaired loan. Some accounting methods for recognizing income may result in a recorded investment in an impaired loan that is less than the present value of expected future cash flows (or, alternatively, the observable market price of the loan or the fair value of the collateral). In that case, while the loan would meet the definition of an impaired loan in paragraph 8, no additional impairment would be recognized. Those accounting methods include recognition of interest income using a cost-recovery method, a cash-basis method, or some combination of those methods. The recorded investment in an impaired loan also may be less than the present value of expected future cash flows (or, alternatively, the observable market price of the loan or the fair value of the collateral) because the creditor has charged off part of the loan.

18–19. [These paragraphs have been deleted. See Status page.]

Disclosures

20. A creditor shall disclose, either in the body of the financial statements or in the accompanying notes, the following information about loans that meet the definition of an impaired loan in paragraph 8 of this Statement:

a. As of the date of each statement of financial position presented, the total recorded investment in the impaired loans at the end of each period and (1) the amount of that recorded investment for which there is a related allowance for credit losses determined in accordance with this Statement and the amount of that allowance and (2) the amount of that recorded investment for which there is no related allowance for credit losses determined in accordance with this Statement
b. The creditor's policy for recognizing interest income on impaired loans, including how cash receipts are recorded
c. For each period for which results of operations are presented, the average recorded investment in the impaired loans during each period, the related amount of interest income recognized during the time within that period that the loans were impaired, and, unless not practicable, the amount of interest income recognized using a cash-basis method of accounting during the time within that period that the loans were impaired.

Information about an impaired loan that has been restructured in a troubled debt restructuring involving a modification of terms need not be included in the disclosures required by paragraphs 20(a) and 20(c) in years after the restructuring if (i) the restructuring agreement specifies an interest rate equal to or greater than the rate that the creditor was willing to accept at the time of the restructuring for a new loan with comparable risk and (ii) the loan is not impaired based on the terms specified by the restructuring agreement. That exception shall be applied consistently for paragraphs 20(a) and 20(c) to all loans restructured in a troubled debt restructuring that meet the criteria in (i) and (ii).

20A. For each period for which results of operations are presented, a creditor also shall disclose the activity in the total allowance for credit losses related to loans, including the balance in the allowance at the beginning and end of each period, additions charged to operations, direct write-downs charged against the allowance, and recoveries of amounts previously charged off. The total allowance for credit losses related to loans includes those amounts that have been determined in accordance with FASB Statement No. 5, *Accounting for Contingencies,* and with this Statement.

Amendments to Existing Pronouncements

21. The first sentence of paragraph 23 of Statement 5 is replaced by the following:

> If, based on current information and events, it is probable that the enterprise will be unable to collect all amounts due according to the contractual terms of the receivable, the condition in paragraph 8(a) is met. As used here, *all amounts due according to the contractual terms* means that both the contractual interest payments and the contractual principal payments will be collected as scheduled according to the receivable's contractual terms. However, a creditor need not consider an insignificant delay or insignificant shortfall in amount of payments as meeting the condition in paragraph 8(a).

22. Statement 15 is amended prospectively as follows:

a. The second sentence in paragraph 1 is replaced by:

> A creditor in a troubled debt restructuring involving a modification of terms shall account for the restructured loan in accordance with the provisions of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan,* except that a troubled debt restructuring involving a modification of terms before the effective date of Statement 114 may continue to be accounted for and disclosed in accordance with this Statement as long as the restructured loan is not impaired based on the terms of the restructuring agreement.

b. Paragraph 30 is replaced by the following:

> A creditor in a troubled debt restructuring involving only a modification of terms of a receivable—that is, not involving receipt of assets (including an equity interest in the debtor)—shall account for the troubled debt restructuring in accordance with the provisions of Statement 114.

c. In the second sentence of paragraph 33, *paragraphs 30–32* is deleted and replaced by *Statement 114*. The third and fourth sentences are deleted.

d. In paragraph 34, the following is added after *foreclosure by the creditor,*:

> that is, the creditor receives physical possession of the debtor's assets regardless of whether formal foreclosure proceedings take place,

e. In the third sentence of paragraph 42, *according to the provisions of paragraphs 30–32* is replaced by *as prescribed in Statement 114.* In the fourth sentence, *Those paragraphs* is replaced by *That Statement.*

f. Paragraphs 31, 32, 35–37, 40(a), 41, and footnotes 18, 19, 21, 24, and 25 are superseded prospectively. (Refer to paragraph 27 of this Statement.)

23. In the last sentence of paragraph 47 of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* the phrase *realized gains and losses* is replaced by *income as prescribed in FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan.*

24. In the first sentence of paragraph 14 of FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases,* the phrase *for purposes of applying paragraph 30 of that Statement* is deleted.

25. FASB Technical Bulletins No. 79-6, *Valuation Allowances Following Debt Restructuring,* and No. 79-7, *Recoveries of a Previous Writedown under a Troubled Debt Restructuring Involving a Modification of Terms,* are superseded by this Statement.

Effective Date and Transition

26. This Statement shall be effective for financial statements for fiscal years beginning after December 15, 1994. Earlier application is encouraged. Previously issued annual financial statements shall not be restated. Initial application of this Statement shall be as of the beginning of an enterprise's fiscal year (that is, if the Statement is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods of that fiscal year shall be restated).

27. This Statement applies to all troubled debt restructurings involving a modification of terms. However, if a loan that was restructured in a troubled debt restructuring involving a modification of terms before the effective date of this Statement is not impaired based on the terms specified by the restructuring agreement, a creditor may continue to account for the loan in accordance with the provisions of Statement 15 prior to its amendment by this Statement.

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

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

Messrs. Leisenring and Swieringa disagree with the measurement of impaired loans required by paragraphs 13 and 14 of this Statement. They believe that if a loan is impaired, a new direct measurement of the loan at fair value should be recognized. That fair value should be measured by the market value of the loan or similar asset if an active market exists. If no market value is readily available, a creditor should use a forecast of expected future cash flows to estimate the fair value of the impaired loan, provided that those cash flows are discounted at a rate or rates commensurate with the risk involved.

Messrs. Leisenring and Swieringa disagree that this Statement has improved the information provided to users about impaired loans by eliminating inconsistencies in the accounting for those loans by different types of creditors for similar loans (paragraph 33). Paragraph 13 permits three different measures of impairment to be used by a given creditor for similar loans. The measures based on an observable market price of the loan or the fair value of the collateral of an impaired collateral-dependent loan are inconsistent with the Board's objective to measure only the loss due to credit deterioration (paragraph 51). Those two measurements reflect changes in market rates of interest or other factors that may cause a change in the fair value of an impaired loan. Messrs. Leisenring and Swieringa believe that a fair value objective or notion should underlie the measurement of all loan impairments. An impaired loan is a risky asset. Not only are expected future cash flows likely to differ from contractual amounts, there is risk that they will differ from actual future cash flows, in some cases dramatically. They believe that measuring that risky asset at its fair value provides the most relevant information about expected future cash flows and the riskiness of those cash flows.

Messrs. Leisenring and Swieringa also disagree with the requirement in paragraph 14 to discount expected future cash flows at the loan's effective interest rate if a creditor chooses to measure an impaired loan using a present value amount. As suggested above, they believe that expected future cash flows of an impaired loan should be discounted at market interest rates that reflect current economic events and conditions and that are commensurate with the risks involved; that is, current rates that would be charged under current conditions for a new loan with similar terms and expected future cash flows rather than at the loan's historical effective interest rate. The historical effective interest rate reflects the risk characteristics of the loan at the time it was originated or acquired, but not at the time it is impaired. In addition, they believe that use of an historical effective interest rate would overstate the charge to bad-debt expense if the effective rate is higher than current market rates. They believe that the charge to income for impairment losses should not exceed the charge to income that would be necessary for the net carrying amount to equal the loan's fair value.

Messrs. Leisenring and Swieringa disagree with the Board's conclusions about a troubled debt restructuring involving a modification of terms as defined in paragraph 5(c) of Statement 15. They believe that if a troubled loan is formally restructured, the terms of the original loan agreement and the loan's historical effective interest rate cease to be relevant and that the loan should be remeasured at fair value to reflect the risk characteristics of the loan and the market conditions at the time of the restructuring.

Finally, Mr. Leisenring disagrees with the conclusion in paragraph 27 that allows loans that were restructured before the effective date of this Statement and are not impaired based on the terms of the restructuring agreement to be accounted for in accordance with Statement 15. Mr. Leisenring believes that loans that were restructured prior to the effective date of this Statement should be remeasured at the market rate of interest in effect at the time the loan was restructured. If it is not practicable to determine the market rate in effect at that time, the current market rate of interest could be used.

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*	Victor H. Brown	A. Clarence Sampson
Joseph V. Anania	James J. Leisenring	Robert J. Swieringa
	Robert H. Northcutt	

Appendix

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS

Paragraph Numbers

Appendix

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

28. This appendix summarizes considerations that were deemed significant by Board members in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

29. An FASB Exposure Draft, *Accounting by Creditors for Impairment of a Loan,* was issued for public comment in June 1992. The Board received approximately 160 comment letters, and 17 organizations and individuals presented their views during a public

hearing held on November 3 and 9, 1992. Also, four entities participated in a field test of the provisions of the Exposure Draft. Members of the Board visited six other entities to discuss the provisions of the Exposure Draft with chief executive officers, chief financial officers, and credit officers. The field test results and the results of the meetings, which are confidential at the entities' request, were useful to the Board during its deliberations of the issues addressed by this Statement.

Background Information

30. The Board accelerated part of the financial instruments project to address in what circumstances, if any, a creditor should measure the impairment of a loan based on the present value of expected future cash flows related to the loan. This acceleration was undertaken in part at the urging of AcSEC. AcSEC had previously considered this issue as part of a proposed Statement of Position that also considered how to determine whether collateral for a loan has been in-substance foreclosed and how to account for foreclosed assets. (AcSEC's consideration resulted in Practice Bulletin No. 7, *Criteria for Determining Whether Collateral for a Loan Has Been In-Substance Foreclosed,* and AICPA Statement of Position 92-3, *Accounting for Foreclosed Assets.*) However, AcSEC informed the Board that it could not develop a solution to the loan impairment issue that would achieve consensus and requested the Board to resolve the issue.

31. AcSEC originally undertook its deliberations in an effort to reconcile the inconsistent guidance existing in certain AICPA Audit and Accounting Guides. The Guides address, among other things, the application of Statement 5 to a financial institution's loan portfolio. The most significant inconsistency in the guidance relates to the inclusion of interest in the valuation of troubled loans. The AICPA Audit and Accounting Guide, *Audits of Savings Institutions,* and AICPA Statement of Position 75-2, *Accounting Practices of Real Estate Investment Trusts,* call for interest to be included in the measurement of troubled loans—a discounted cash flow concept—but other AICPA Guides are silent on that point. This inconsistent guidance led to different accounting among the different types of financial institutions. The Securities and Exchange Commission, the Federal Home Loan Bank Board, and the FDIC also urged reconciliation of this diverse guidance.

Benefits and Costs

32. The FASB's mission statement charges the Board to determine that a proposed standard will fill a significant need and that the costs it imposes, compared with possible alternatives, will be justified in relation to the overall benefits. Fulfilling that charge can be problematic since there is no common gauge by which to judge objectively the costs to implement a standard against the need to report consistent, comparable, and reliable information in financial statements. The challenge is amplified because the costs to implement a new standard are not borne directly by some of those who derive the benefits of improved reporting. In establishing standards that are cost-effective, the Board must balance the diverse and often conflicting needs of a wide cross section of constituents.

33. The Board determined that the information provided to users about impaired loans could be improved by eliminating inconsistencies in the accounting among different types of creditors for similar loans. As discussed in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* providing comparable financial information enables users to identify similarities in and differences between two sets of economic events. Therefore, to the extent that similar loans are subject to the same requirements for measuring impaired loans, financial reporting would be improved.

34. The benefits of eliminating inconsistencies in the accounting among different types of creditors come with a cost to some creditors—principally, the incremental cost of developing, implementing, and maintaining a measurement and reporting system to generate the required present values, observable market prices, or fair value of the collateral of collateral-dependent loans. However, the Board believes the cost of implementing this standard will be minimized because the Statement does not specify how a creditor should identify loans that are to be evaluated for collectibility or how a creditor should determine that it is probable that it will be unable to collect all amounts due according to the loan's contractual terms. Rather, the Statement provides that a creditor should apply its normal loan review procedures in making those judgments. In addition, the Board believes that prescribing a loan's effective interest rate as the appropriate discount rate will minimize implementation costs because that rate is readily available.

35. Application of judgment to determine expected future cash flows may be complex, but that complex-

ity is the unavoidable result of the need for information about the effect of impaired loans on a creditor's financial position and results of operations. Practical decisions, such as permitting a creditor to recognize an observable market price of the loan or the fair value of the collateral of a collateral-dependent loan as alternatives to discounting and eliminating the proposed requirement in the Exposure Draft to recognize separately the two components of the change in present value, were made to reduce the cost and complexity of applying this Statement. Additionally, permitting a creditor to aggregate loans and use historical experience in calculating the present value of expected future cash flows also may reduce the cost and complexity of applying this Statement. The Board believes that the benefits of this Statement will exceed the costs of implementation.

Definitions and Scope

36. The Board believes that accounting for impaired loans should be consistent among all creditors and for all types of lending except for loans that are measured at fair value or at the lower of cost or fair value in accordance with specialized industry practice. (For example, Statement 65 specifies that mortgage loans held for sale should be accounted for at the lower of cost or market value, and venture capital investment companies generally account for loans at fair value.) Fair value accounting or the lower of cost or fair value accounting obviates the need for accounting guidance for impairment associated with those loans.

37. The Board was unable to identify any compelling reasons to support a conclusion that the lending process for consumer, mortgage, commercial, and other loans, whether uncollateralized or collateralized, is fundamentally different. Neither was the Board able to identify any compelling reasons to suggest that different types of creditors should account for impaired loans differently or that financial statement users for a particular industry or size of entity would be better served by accounting that differs from that of other creditors.

38. The Board concluded that this Statement should not apply to large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment. In situations in which all or a portion of a loan portfolio consists of a large number of small-dollar-value homogeneous loans (such as consumer installment loans, residential mortgages, or credit card loans), creditors typically use a formula based on various factors to estimate an allowance for loan losses. Those factors include past loss experience, recent economic events and current conditions, and portfolio delinquency rates. The Board recognizes the established practice of using a formula approach for estimating losses related to these types of loans and does not intend for this Statement to change that approach. The Board presumes that while a formula approach does not explicitly discount expected future cash flows, it results in a measure of impairment that implicitly discounts expected future cash flows.

39. The Exposure Draft would have applied to all loans that are individually and specifically evaluated for impairment but not to loans that are accounted for at fair value or at the lower of cost or fair value. It also did not address large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment. Some respondents said that it was unclear whether the Exposure Draft applied to medium-balance loans. By deleting the reference to loans that are individually and specifically evaluated for impairment, the Board clarified that the only loans it did not intend to address were large groups of smaller-balance loans that are collectively evaluated for impairment. This Statement does not apply to leases or debt securities.

Recognition of Impairment

Discounted or Undiscounted Measurement of Impairment

40. An assumption inherent in a creditor's statement of financial position prepared in accordance with generally accepted accounting principles is that the reported amounts of assets will be recovered. However, as discussed in paragraph 31, different types of creditors have applied the guidance in Statement 5 about collectibility of receivables differently in measuring the amount of loan impairment. Some creditors have recognized impairment of a loan only when *undiscounted* expected future cash inflows are less than the loan's net carrying amount. Others have recognized impairment when *discounted* expected future cash inflows are less than the loan's net carrying amount.

41. The threshold issue is whether impaired loans should be carried at discounted or undiscounted amounts. The Board observed that a creditor's recorded investment in a loan both at origination and subsequently during the life of the loan, as long as the loan performs according to its contractual terms, is the sum of the present values of the future cash flows

that are designated as interest and the future cash flows that are designated as principal, including any amount due at maturity, discounted at the effective interest rate implicit in the loan. The effective interest rate implicit in the loan may be the same as or may differ from the interest rate stated in the agreement. If the effective interest rate differs from the stated interest rate, the recorded investment in the loan is the face amount plus net deferred loan costs and unamortized premium or less net deferred loan fees and unamortized discount.

42. The Board concluded that a loan that becomes impaired should continue to be carried at an amount that considers the present value of all expected future cash flows, in a manner consistent with the loan's measurement before it became impaired. The Board concluded that because loans are recorded originally at discounted amounts, the ongoing assessment for impairment should be made in a similar manner.

43. The Board recognizes that expected future cash flows from impaired loans are usually uncertain and creditors will be required to exercise significant judgment in developing the estimates of expected future cash flows. The Board believes that existing methods of measuring impaired loans and determining the adequacy of the allowance for credit losses already consider the uncertainty of expected future cash flows. The Board concluded that this uncertainty of expected future cash flows is not a valid reason to ignore discounting and that failure to measure impaired loans on a discounted basis would not only be inconsistent with the manner in which unimpaired loans are measured but also would inappropriately ignore the time value of money. If impaired loans were measured on an undiscounted basis, two loans could be carried at the same amount although one is performing fully and the other is a loan for which no cash flows are expected to be received for several years. In the Board's view, this is an unreasonable result both in terms of the appropriate measure of the two loans in the statement of financial position and in terms of the appropriate measurement of the event of impairment.

44. Some respondents interpreted the Exposure Draft to require an estimate of a specific amount of expected future cash flows for each impaired loan for each reporting period. The Board clarified this Statement to indicate that estimates of expected future cash flows may represent a creditor's best estimate within a range of possibilities.

45. Some respondents suggested that impaired loans could be aggregated as a means of measuring the present value of the expected future cash flows. In the Board's view, some impaired loans have risk characteristics that are unique to the borrower, and it is appropriate to measure those impaired loans on a loan-by-loan basis. However, some impaired loans may have risk characteristics in common with other impaired loans. The Board concluded that it is appropriate to use aggregation techniques in measuring those impaired loans at the present value of the expected future cash flows. Past experience with loans with similar risk characteristics may provide an indication of the average time it takes to work out an impaired loan and the average amount the creditor will recover. The Board concluded that making estimates of the expected future cash flows and calculating the present value of the expected future cash flows based on the creditor's experience with loans with similar risk characteristics is consistent with the requirement for a creditor to make its best estimate of expected future cash flows. The Board acknowledges that actual cash flows will seldom, if ever, be exactly the same in timing and amount as the projections of expected future cash flows.

46. This Statement requires that a creditor consider estimated costs to sell, on a discounted basis, in the creditor's measure of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan. For example, if repayment of a loan is dependent on the sale of the collateral, a creditor that uses a discounted cash flow method to measure impairment should reduce its estimate of expected future cash flows by its estimates of costs to sell. Likewise, if a creditor uses the fair value of the collateral to measure impairment of a collateral-dependent loan and repayment or satisfaction of a loan is dependent on the sale of the collateral, the fair value of the collateral should be adjusted to consider estimated costs to sell. However, if repayment or satisfaction of the loan is dependent only on the operation, rather than the sale, of the collateral, the measure of impairment would not incorporate estimated costs to sell the collateral.

47. The Board's conclusion that impaired loans should be carried at discounted amounts is not intended to signal a similar conclusion in the Board's project on accounting for impairment of long-lived assets. Loans and long-lived assets are similar in that both are intended to be cash-generating assets and both are subject to impairment. However, basic differences between loans and long-lived assets may or

may not lead the Board to different conclusions about discounting in the project on impairment of long-lived assets.

48. The Board observed that other standard-setting organizations also have concluded that it is appropriate to measure impaired loans based on discounted expected future cash flows. In November 1992, the Canadian Institute of Chartered Accountants issued an Exposure Draft, *Impaired Loans,* which proposes that an impaired loan or group of loans be measured as the estimated future cash flows discounted at the effective interest rate inherent in the loan agreement. At its March 1993 meeting, the International Accounting Standards Committee (IASC) considered comments received on E40, *Financial Instruments.* The IASC concluded that its final standard on financial instruments should indicate that the carrying amount of an impaired financial asset (including impaired and restructured loans) should be the present value of the estimated future cash flows discounted at the effective interest rate.

49. The Board also considered whether the loss threshold for recognition of loan impairment should be changed from the Statement 5 definition of probable to some other threshold. The United States General Accounting Office asserted in its April 1991 report, *Failed Banks: Accounting and Auditing Reforms Urgently Needed,* that "'probable' . . . has, in the case of banks, come to mean 'virtually certain,' rather than 'more likely than not,'" and "the 'probable' requirement as it is sometimes applied has unduly delayed loss recognition . . . of problem assets." The Board did not intend "probable" to mean "virtually certain to occur." The Statement 5 definition of probable states that "the future event or events are *likely to occur*" (emphasis added). The Board recognizes that application of the term probable in practice requires judgment, and to clarify its intent the Board has reiterated the guidance in paragraph 84 of Statement 5 in paragraph 10 of this Statement. The term probable is used in this Statement consistent with its use in Statement 5. This Statement does not specify how a creditor should determine that it is probable that it will be unable to collect all amounts due according to a loan's contractual terms.

Appropriate Discount Rate

50. This Statement specifies that when a loan is impaired, a creditor should measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate. As a practical expedient, a creditor may measure impairment based on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. The Board understands that estimates of expected future cash flows from impaired loans require judgment and that the eventual outcomes may differ from those estimates. The Board does not believe that the judgment inherent in the estimates is a valid reason to ignore discounting. However, the Board does believe that the judgment inherent in the estimates is sufficient to permit the use of observable market price or fair value of the collateral of a collateral-dependent loan as practical alternatives to the present value of expected future cash flows discounted at the loan's effective rate.

51. The Board concluded that a loan impairment measurement should reflect only a deterioration of credit quality, which is evidenced by a decrease in the estimate of expected future cash flows to be received from the loan. The Board believes that the measure of an impaired loan should recognize the change in the net carrying amount of the loan based on new information about expected future cash flows rather than record a new direct measurement. The Board, therefore, concluded that the loan impairment measurement should not reflect changes in market rates of interest that may cause a change in the fair value of an impaired loan.

52. Because the Board believes that only the loss due to credit deterioration should be measured, the Board concluded that the expected future cash flows should be discounted at the loan's effective interest rate. The effective interest rate of a loan is the rate of return implicit in the loan (that is, the contractual interest rate adjusted for any net deferred loan fees or costs, premium, or discount). The Board observed that the recorded amount of an unimpaired loan, as long as the loan performs according to its contractual terms, is the present value of the contractual future cash inflows—both those designated as principal and as interest—discounted at the loan's historical or effective interest rate. Thus, the measurement basis for an impaired loan will be the same as the measurement basis for the same loan before it became impaired. As a practical expedient, the Board concluded that for a loan whose stated rate varies based on subsequent changes in an independent factor, creditors should be permitted to fix the rate at the rate in effect at the date the loan meets the impairment criterion.

53. Some respondents suggested that creditors be permitted to recognize an observable market price of

the loan or the fair value of the collateral of an impaired collateral-dependent loan as alternatives to discounting. Some respondents suggested that creditors be required to recognize the fair value of the collateral if a loan is collateral dependent. For regulatory reporting purposes, banks and other depository institutions are required to recognize the fair value of the collateral of an impaired collateral-dependent loan. As a practical expedient, the Board decided to permit a creditor to recognize an observable market price for the loan or the fair value of the collateral of a collateral-dependent loan as alternatives to estimating and discounting the expected future cash flows for the loan. The Board expects that the measurement method for an individual impaired loan would be applied consistently to that loan and that a change in method would be justified by a change in circumstance.

54. The Board concluded that impairment of a loan is not an event that should result in a new direct measurement of the loan at fair value at the date impairment is recognized. Under that approach, an impaired loan's expected future cash flows would be discounted at a market interest rate commensurate with the risks involved to arrive at a measure of the loan's fair value. Noting that unimpaired loans are not carried at fair value after origination, the Board concluded that loan impairment should be recognized based solely on deterioration of credit quality evidenced by a decrease in expected future cash flows rather than on changes in both expected future cash flows and other current economic events, such as changes in interest rates. In addition, the Board observed that if a market rate were specified, questions could be raised about whether a new measurement would be required if the creditor's estimate of expected future cash flows remained constant but current market interest rates changed.

55. Some respondents observed that fair value is widely used in a variety of situations and could be implemented with minimal cost to financial statement preparers because it is consistent with the values disclosed in accordance with FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*. The Board noted that many creditors make the disclosures required under Statement 107 on a portfolio basis; they do not make separate disclosures for impaired loans. Furthermore, the Board understands that there are practical difficulties in determining a market rate for an impaired loan.

56. The Board also considered whether an impaired loan's expected future cash flows should be discounted at the creditor's cost-of-funds interest rate. A cost-of-funds interest rate would reflect the time value of money to a specific creditor and would reflect the creditor's cost to carry an impaired loan (a cost-recovery notion). Under that approach, interest would be one of a creditor's costs to carry an impaired loan. This method is consistent with current requirements of the AICPA Guide on savings institutions and SOP 75-2, which require discounting at a rate that would correspond to an expected average rate to be paid during the estimated holding period. The Board believes that impairment should be measured by looking only at the loan and that a loan's net carrying amount should not be affected by the credit standing of the creditor and the interest rate it pays on its debt or by whether the creditor has outstanding debt.

57. The Board also considered whether an impaired loan's expected future cash flows should be discounted at a risk-free interest rate. A risk-free interest rate would reflect at least the minimum interest that could have been earned if the funds were not invested in the impaired loan. The Board concluded that the risk-free rate has no relationship to the impaired loan being measured and, therefore, would be an irrelevant discount rate to use in measuring an impaired loan.

Income Recognition

58. When an asset is carried on a discounted basis, the present value of expected future cash flows will increase from one reporting period to the next as a result of the passage of time (assuming that the timing and amount of expected future cash flows remain constant). The change in present value from one reporting period to the next may result not only from the passage of time but also from changes in estimates of the timing or amount of expected future cash flows. Similarly, the observable market price of an impaired loan or the fair value of the collateral of an impaired collateral-dependent loan may change from one reporting period to the next. Because the Board believes that the net carrying amount of an impaired loan should be the present value of expected future cash flows (or the observable market price or the fair value of the collateral) not only at the date at which impairment initially is recognized but also at each subsequent reporting period, the Board concluded that changes in that measure should be recognized.

59. The Exposure Draft would have required the change in present value attributable to the passage of

time to be reported as interest income and the change in present value, if any, attributable to changes in the amount or timing of expected future cash flows to be reported as bad-debt expense or as a reduction in the amount of bad-debt expense that otherwise would be reported. Some respondents stated that the change in present value attributable to the passage of time should be reported as a reduction of bad-debt expense because that approach could be implemented with less cost to financial statement preparers. The Board concluded that a creditor that measures impairment based on the present value of expected future cash flows should be permitted to report the entire change in present value as bad-debt expense but that a creditor that wishes to report the change in present value attributable to the passage of time as interest income should not be proscribed from doing so. Because some financial analysts indicated that knowing that information is important, the Board concluded that creditors that choose the latter alternative should disclose the amount of interest income that represents the change in present value attributable to the passage of time. For practical reasons, the Board concluded that changes in observable market prices or the fair value of the collateral should be reported as bad-debt expense or a reduction in bad-debt expense.

60. The Board considered and rejected an approach under which the change in present value would be reported as a separate amount such as "accrual of interest on impaired loans" because that presentation does not identify the reason for the change in present value. The Board reasoned that changes in a present-value-based measurement of loan impairment must be either interest or part of bad-debt expense.

61. The Board also considered whether loan impairment should be recorded through a valuation allowance or through a direct write-down that would establish a new cost basis for the impaired loan. The Board concluded that because of the subjectivity inherent in the valuation of an impaired loan and because estimates of the timing and amount of an impaired loan's cash flows, an observable market price, or the fair value of the collateral may change, impairment should be recorded through a valuation allowance that subsequently may change to reflect changes in the measure of the impaired loan. However, the net carrying amount of the loan shall at no time exceed the recorded investment in the loan.

Troubled Debt Restructurings

62. The Exposure Draft would have required a formal loan restructuring (a troubled debt restructuring involving a modification of terms as defined in paragraph 5(c) of Statement 15) to be remeasured at a current fair value to recognize that the terms of the original loan agreement cease to be relevant. Some respondents indicated that a troubled debt restructuring does not result in a new loan but rather represents part of a creditor's ongoing effort to recover its investment in the original loan. Therefore, the interest rate used to discount expected future cash flows on a restructured loan should be the same interest rate used to discount expected future cash flows on an impaired loan. Some respondents stated that requiring a different interest rate to discount the expected future cash flows on impaired loans and restructured loans would give creditors the incentive to accelerate or delay the timing of a troubled debt restructuring to achieve an accounting result. Some respondents stated that the Board would have to provide guidance on when a restructuring had occurred in substance. Based on those considerations, the Board concluded that it is appropriate to use the effective interest rate in the original loan agreement to discount the expected future cash flows on an impaired loan and a restructured loan.

63. The Board recognizes that this Statement introduces asymmetry between creditors' and debtors' accounting for troubled debt restructurings involving a modification of terms. However, the Board concluded that this Statement should address only creditors' accounting and that debtors' accounting should not be considered because expanding the scope of this Statement to address debtors' accounting likely would delay issuance of the final Statement.

Disclosures

64. The Board believes that the financial statement disclosures required by this Statement provide information that is useful in understanding a creditor's accounting for impaired loans. The Board concluded that the recorded investment in the impaired loans, the total allowance for credit losses related to those impaired loans, an analysis of the activity in a creditor's allowance for credit losses account, and the creditor's income recognition policy are information relevant to financial statement users. The Board also concluded that the disclosures previously required by paragraphs 40(a) and 41 of Statement 15 are no longer necessary because all loans that are restructured in troubled debt restructurings will meet the

definition of impairment and, therefore, will be subject to the disclosure requirements of paragraph 20 of this Statement except as discussed in the following paragraph.

65. [This paragraph has been deleted. See Status page.]

66. The Exposure Draft would have required a creditor to disclose reversals of the allowance for interest (that is, the change in present value attributable to the passage of time) and reversals of the allowance attributable to increases in estimates of expected future cash flows. The Board agreed with respondents who indicated that the information might be excessive for a creditor that recognizes income in accordance with paragraph 17(b) and should not be required. The Board agreed with respondents who said that a creditor that recognizes interest income in accordance with paragraph 17(a) should disclose the amount of interest income that is accrued on the net carrying amount of an impaired loan.

67. Additionally, paragraph 21 of the Exposure Draft reiterated a disclosure requirement that already exists under paragraph 32 of FASB Statement No. 95, *Statement of Cash Flows;* that paragraph, but not the requirement in Statement 95, was deleted and is not repeated in this Statement.

Amendments to Existing Pronouncements

68. The impairment recognition criterion in paragraph 8 of this Statement is similar to that of paragraph 23 of Statement 5, which describes the application of the Statement 5 conditions for accrual of loss contingencies to the collectibility of all receivables. That paragraph states that ". . . based on available information, it is probable that the enterprise will be unable to collect all amounts due." The Board recognizes that in practice, "all amounts due" has not always been interpreted to include both the future contractual interest and the contractual principal of a loan. Thus, this Statement amends paragraph 23 of Statement 5 to clarify that "all amounts due" refers to both principal and interest. The Board believes this is the appropriate interpretation because, as illustrated in Appendix A of APB Opinion No. 21, *Interest on Receivables and Payables,* the recorded amount of a loan is the present value of the contractual principal and interest cash flows discounted at the loan's effective interest rate. While this Statement requires a creditor to consider collectibility of both principal and interest for all receivables, it specifies the method to be used to measure impairment only for impaired loans that are within the scope of this Statement.

69. After considering comments received, the Board decided that when a creditor determines that foreclosure is probable, a creditor should remeasure the loan at the fair value of the collateral so that loss recognition is not delayed until actual foreclosure. The Board believes that the requirement in this Statement to discount expected future cash flows will reduce the amount of loss that would be recognized when foreclosure is probable compared with the loss that would be recognized for the same loan under the current undiscounted measure of loan losses. However, the requirement to discount may not preclude the need to recognize additional loss when foreclosure is probable because estimates of expected future cash flows are not remeasured using a market rate and because estimates of expected future cash flows may change when a creditor determines that foreclosure is probable.

70. This Statement amends paragraph 34 of Statement 15 to clarify the applicability of that paragraph. Paragraph 34 was intended to apply to a narrow set of circumstances; that is, a troubled debt restructuring or other circumstance in which a debtor surrendered property to the creditor and the creditor was in possession of the asset with or without having to go through formal foreclosure procedures. Paragraph 84 of the basis for conclusions in Statement 15 states, "The Board agreed that a restructuring may be in substance a foreclosure, repossession, or other transfer of assets even though formal foreclosure or repossession proceedings are not involved." The amendment to paragraph 34 of Statement 15 clarifies that intent.

71. The Board recognizes that in practice paragraph 34 of Statement 15 and the term *in-substance foreclosure* are applied in situations other than troubled debt restructurings or situations in which a debtor surrenders property to the creditor. Under the SEC's Financial Reporting Release No. 28, *Accounting for Loan Losses by Registrants Engaged in Lending Activities,* and Practice Bulletin 7, a creditor is required to account for the operations of the collateral underlying some loans, even though the creditor has not taken possession of collateral, as if foreclosure had occurred. The Board recognizes the practical problems of accounting for the operations of an asset the creditor does not possess and concluded, therefore, that a loan for which foreclosure is probable should continue to be accounted for as a loan.

Effective Date and Transition

72. The Board decided to prohibit retroactive application of the Statement. Because the measurement of impaired loans is based on estimates that are likely to change, the Board questioned the relevance of restatement. The Board recognizes the benefits of comparative financial statements, but it questions the ability of a creditor to "re-create" historical estimates of the timing and amounts of cash flows, the observable market price, or the fair value of the collateral that would be necessary for restatement. For those reasons, the Board concluded that retroactive application of the Statement should be prohibited. The Board also discussed accounting for loans that were restructured in troubled debt restructurings before the effective date of this Statement. The Exposure Draft would have applied to all loans restructured before the effective date. Some respondents indicated that the final Statement should not apply to restructurings before the effective date because those transactions were entered into based on the accounting rules at the time. Some respondents said that previously restructured loans should be accounted for under the final Statement only if they are currently or subsequently impaired based on the restructured terms or subsequently are restructured again. The Board concluded that troubled debt restructurings before the effective date of this Statement are required to be accounted for in accordance with this Statement only if the restructured loans are impaired; that is, if they are not performing in accordance with the contractual terms of the restructuring agreement.

73. Some respondents requested a one-year delay in the effective date to give them time to develop techniques for estimating expected future cash flows and to develop systems to calculate present value. Bank regulators also requested a one-year delay so that their examiners could be adequately trained. The Board believes that changes made to the provisions of the Exposure Draft—in particular, permitting creditors to recognize the observable market price of the loan or the fair value of the collateral of a collateral-dependent loan and permitting use of aggregation techniques—will minimize the implementation burden. However, the Board decided to delay the effective date proposed in the Exposure Draft.

74. The Exposure Draft would have required a creditor to report the effect of initially applying this Statement as the effect of a change in accounting principle in a manner similar to the cumulative effect of a change in accounting principle as described in paragraph 20 of APB Opinion No. 20, *Accounting Changes.* The Board decided that the cost of isolating a "cumulative effect" would exceed the related benefit of that information and that a creditor should report the effect of initially applying this Statement as bad-debt expense or as an adjustment to bad-debt expense in accordance with paragraph 13. This Statement does not preclude a creditor from disclosing in the notes to the financial statements the effect of initially applying this Statement if the creditor believes it is practical to do so.