Farm Credit Administration

1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

INFORMATIONAL MEMORANDUM

March 14, 2011

To: Chief Executive Officer
All Farm Credit System Institutions

From: Gary K. Van Meter, Acting Director
Office of Regulatory Policy

Gary K. Van Meter

Subject: Accounting and Disclosure of Troubled Debt Restructurings, as required under GAAP

The purpose of this Informational Memorandum (IM) is to provide guidance to Farm Credit System (System) institutions on complying with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) subtopic 310-40, *Troubled Debt Restructurings by Creditors, and* ASC subtopic 470-60, *Troubled Debt Restructurings by Debtors.*[1] This IM also provides guidance on making related disclosures for troubled debt restructurings (TDRs) in reports to shareholders. In response to this IM, System institutions are expected to evaluate their practices related to compliance with Generally Accepted Accounting Principles (GAAP) accounting and disclosure requirements for when a restructured loan is considered to be a TDR.

GAAP Treatment of Troubled Debt Restructurings

Under GAAP, a TDR is a restructuring in which the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider.[2] A TDR is an accounting classification that engenders a special set of accounting rules. Under Farm Credit Administration (FCA) regulation § 621.6(b), "[a] loan is considered formally restructured if it meets the 'troubled debt restructuring' definition set forth in Statement of Financial Accounting Standards No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, as promulgated by the FASB."[3] The determination of whether a restructuring of a debt instrument should be accounted for as a TDR requires consideration of all relevant facts and circumstances surrounding the transaction. Generally, no single characteristic or factor is determinative of whether such restructuring of a debt instrument is a TDR.

In recent periods, there has been an increase in the number of System borrowers that are unable to timely meet their obligations on outstanding loans because of financial pressures. A review of System institutions' financial statements has shown that few loans have been disclosed as TDRs in financial reports. The low number of TDRs disclosed in financial reports

---

[1] The ASC guidance was formerly provided in Statement of Financial Accounting Standards (FAS) No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructuring*, and FAS 114, *Accounting by Creditors for Impairment of a Loan*.

[2] This definition is not to be confused with actions taken for distressed loan restructurings under FCA Borrower Rights regulations.

[3] FCA IM (dated September 3, 2009) states that all references in FCA regulations to specific standards under GAAP are now understood to mean the corresponding reference in the FASB Accounting Standards Codification.

may be the result of System institutions too narrowly interpreting the GAAP accounting and disclosure requirements that apply when a restructured loan is considered to be a TDR. As a result, the FCA believes that the GAAP requirements for identifying and disclosing TDRs should be further clarified for use by the System.

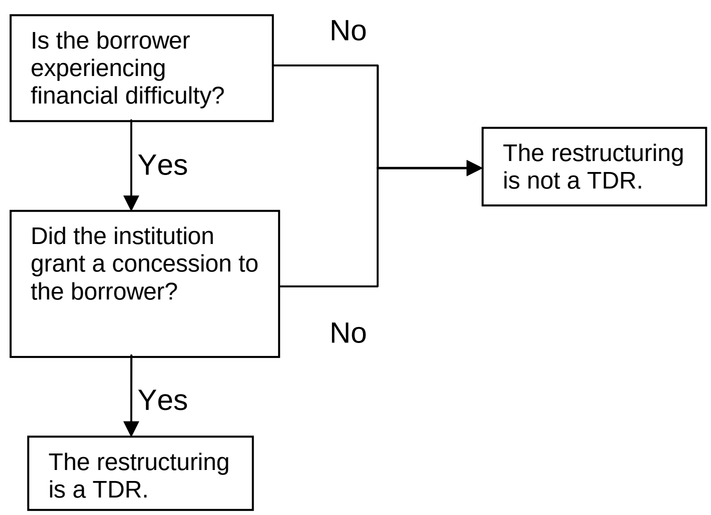
Identifying TDR Actions for Purposes of GAAP

When a borrower experiences financial difficulties before the debt is repaid, the System institution holding the loan(s) may need to recognize an impairment of the debt pursuant to ASC subtopic 310-40.[4] Impairments would be recognized when the present value of the expected future cash flows discounted at the debt's original effective interest rate is less than the recorded investment in the debt. To determine if a loan restructuring is a TDR, the essential questions to ask are:

1. Is the borrower experiencing financial difficulty?

2. Has the institution granted a concession to the borrower in response to the financial difficulty?

Both of these questions must be answered in the affirmative for a TDR to exist. This chart summarizes the basic analysis to determine if a loan restructuring is a TDR, which is discussed in further detail below.



a. Identifying Financial Difficulty

As noted above, one critical factor of whether a restructuring is a TDR is that the borrower must be experiencing some type of financial difficulty. The following circumstances represent some of the factors that have been recognized as indicators that a borrower is experiencing financial difficulty for purposes of GAAP.

---

[4] The FASB issued, on October 12, 2010, a proposed Accounting Standards Update (ASU) related to troubled debt restructuring that includes several important clarifications for both debtors and creditors. The ASU, *Clarifications to Accounting for Troubled Debt Restructurings by Creditors,* sets forth criteria for determining when an arrangement between a debtor and creditor rises to the level of a TDR. The ASU, if finalized, is expected to be effective for System institutions for annual periods ending on or after December 15, 2011. The FCA will update this IM, as necessary, to reflect any significant changes in FASB guidance.

- The borrower is currently in default on a loan with any lender.
- The borrower has declared, or is in the process of declaring, bankruptcy.
- There is significant doubt as to whether the borrower's operation will continue to be operational.
- The cash flow forecast indicates that there will be insufficient income to service the debt through maturity.
- Absent the current modification, the borrower cannot obtain funds from sources other than the existing creditors at an effective interest rate *equal to the current market interest rate for similar debt for a non-troubled borrower*.[5]

Once it is determined a borrower is experiencing some type of financial difficulty, it is then necessary to ascertain whether the System institution has granted some type of concession to the borrower.

b. Identifying Financial Concessions

The following items illustrate the types of concessions that a System institution might make on a loan, which could lead to TDR identification:

- Transferring from the borrower to the institution receivables from third parties, real estate, or other assets to fully or partially satisfy a debt (including a transfer resulting from foreclosure or repossession);
- Reducing the stated or effective interest rate for the remaining original life of the debt;
- Extending the maturity date at a stated or effective interest rate which is lower than the current market rate for new debt with similar risk;
- Reducing the face amount or maturity amount of the debt; or
- Reducing accrued interest.[6]

In the context of discussing what constitutes a TDR, it is important to note what *does not* constitute a financial concession. For example, a financial concession is not involved if: 1) cash and collateral, accepted in full satisfaction of the debt, equals or exceeds the recorded debt, 2) cash and collateral accepted as part of the restructuring equals or exceeds the past-due amount, 3) the restructuring action was a reduction of the effective interest rate to current market rates (based on the risk of the loan), which was offered to maintain a lending relationship with the borrower because the borrower could readily obtain funds from other sources at a similar rate, or 4) the debt is restructured at rates reflective of similar debt (maturity date, etc) held by borrowers who are not "troubled."[7] Concessions that result in an *insignificant* delay in the amount of payments contractually due or a shortfall of amount would generally also not constitute a financial concession.

Remember, for TDR accounting purposes, no financial difficulty should be found if the borrower is currently servicing the old debt, can obtain funds to repay the old debt at the current market

---

[5] ASC paragraph 470-60-55-8 (emphasis added). In the proposed ASU clarifying its guidance on TDRs noted above, the FASB provided additional clarification regarding the current market interest rate. Each System institution should also review ASC paragraph 470-60-55-9 in order to properly ascertain whether a borrower is experiencing financial difficulty.

[6] ASC paragraph 310-40-15-9.

[7] ASC paragraph 470-60-15-12.

rate for a nontroubled borrower and the institution agreed to restructure the old debt solely to reflect either (1) a decrease in the current interest rates for the borrower or (2) an increase in the borrower's creditworthiness.

Accounting for TDR Actions

If a debt restructuring is a TDR, the debt is by definition impaired and it must be evaluated and reported according to ASC section 310-10-35. This means the institution will at least quarterly measure any loss on the TDR to determine its collectability and the estimated credit loss. Next, in accordance with FCA regulation § 621.6(a), the TDR usually would be classified as nonaccrual. Once classified as nonaccrual, and if the ultimate collectability of the debt as a whole or in part is in doubt, the interest income on the loan(s) would be recognized under FCA regulation § 621.8. In addition, it is incumbent on the System institution to document in the borrower's loan file the institution's determination whether or not the borrower is experiencing financial difficulties and whether the modification is a concession.

Those debts classified as nonaccrual and determined not to be fully collectible with earned, but uncollected, interest accrued in the current fiscal year must have the interest "reversed" from income. Also, any interest accrued in prior fiscal years must be charged off against the allowance for loan losses (ALL). In addition, any payment received on such loans should first be applied to the recorded debt to eliminate the doubt of collectability.

A TDR debt may be reinstated to accrual status when all the requirements of FCA regulation § 621.9 are met.

Disclosure of TDR Actions

Each System institution is required by FCA regulation § 621.12 to file reports of its condition and performance (Call Reports) with the FCA. For purposes of the Call Report, a TDR is usually treated the same as all other nonaccrual loans and, as such, must be reported in the Call Report as a nonaccrual loan. Similarly, in its financial statements, each System institution is required by FCA regulation § 621.10 to make periodic disclosure to its shareholders, investors and FCA of the credit risks within its loan portfolio. In compliance with this regulation and GAAP, each System institution must disclose all TDRs in its financial statements.

All financial statements, whether to the FCA or shareholders, must be in accordance with GAAP, unless otherwise directed by statute or regulation. Under GAAP, disclosure of TDRs that are impaired loans in the body of an institution's financial statements—or in the accompanying notes—includes:

- Total recorded investment in the impaired loans at the end of each period.
- Amount of total recorded investment in the impaired loans for which there is a related ALL.
- Amount of total recorded investment in the impaired loans for which there is no related ALL.
- Creditor's policy for recognizing interest income on impaired loans, including how cash receipts are recorded.
- Average recorded investment in the impaired loans during each period presented.

- Related amount of interest income recognized during the time within each period presented that the loans were impaired.
- Amount of interest income recognized using a cash-basis method of accounting during the time within each period presented that the loans were impaired, if practical.
- Amount of commitments, if any, to a borrower in a TDR agreement.[8]

In July, 2010, the FASB issued ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses,* which slightly modifies some of these existing disclosure requirements and also provides for certain new disclosures. In addition to the above required disclosures and other disclosures not specific to TDRs, ASU 2010-20 adds the following two new disclosure requirements for impaired loans:

- Entity's policy for determining which loans it assesses for impairment under ASC section 310-10-35.
- Factors considered in determining that the loan is impaired.

The effective date of ASU 2010-20 will coincide with the effective date of the proposed ASU clarifying the accounting for TDRs. These disclosures are presented as of the date of each financial statement and the financial position it represents. However, information about an impaired loan restructured in a TDR that involved a modification of terms does not need to be disclosed in the years after the restructuring if both 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 the loan is not impaired based on the terms specified by the restructuring agreement.

Institutions are reminded that the loan-to-value limitation for long-term real estate mortgage loans specified in FCA regulation § 614.4200(b)(1) and the maturity and amortization limitations set forth in Part 614, subpart A of FCA regulations do not apply to TDRs that are not "new loans."[9] Finally, System institutions are reminded that for every TDR they enter into, they must exercise safe, sound, and prudent lending practices.

If you have any questions about this memorandum, please contact your designated examiner-in-charge, Paul Gibbs, Senior Accountant, Office of Regulatory Policy, at (703) 883-4203 (gibbsp@fca.gov), or Gary Van Meter, Acting Director, Office of Regulatory Policy, at (703) 883-4026 (vanmeterg@fca.gov).

cc: Federal Farm Credit Banks Funding Corporation
All System Service Corporations

[8] ASC section 310-10-50-15 and ASC subtopic 310-40-50.
[9] A "new loan" for purposes of accounting for TDRs is a loan concession that includes the advancement of new funds.