No. 2025-05
1 May 2025

To the Point

FASB — proposed guidance

FASB proposes guidance on accounting for certain debt exchanges

The proposal would reduce the cost and complexity of accounting for certain debt exchanges.

What you need to know

- The FASB proposed requiring entities to account for certain exchanges of debt instruments as the issuance of a new debt obligation and the extinguishment of an existing one when certain conditions are met.
- The proposal would apply to transactions that involve the contemporaneous exchange of cash between the same debtor and creditor in connection with the issuance of a new debt obligation with multiple creditors and the satisfaction of an existing debt obligation.
- Entities would apply the guidance prospectively to exchanges of debt instruments that occur on or after the initial date of application. Early adoption would be permitted.
- Comments are due by 30 May 2025.

Overview

The Financial Accounting Standard Board (FASB or Board) proposed **amendments**[1] that would require entities to account for certain exchanges of debt instruments as the issuance of a new debt obligation and the extinguishment of an existing debt obligation when certain conditions are met. The proposal would apply to transactions that involve the contemporaneous exchange of cash between the same debtor and creditor in connection with the issuance of a new debt obligation with multiple creditors and the satisfaction of existing debt.

The proposal, which is based on a consensus-for-exposure of the Emerging Issues Task Force (EITF), is intended to address issues that stakeholders encountered when applying the guidance in Accounting Standards Codification (ASC) 470-50[2] to determine whether such exchanges should be accounted for as a modification of the existing debt obligation or as the issuance of a new debt obligation and the extinguishment of the existing debt (i.e., a debt extinguishment).

Currently, debt modifications or exchanges are considered debt extinguishments with gains or losses recognized in current earnings if the terms of the new instrument and original instrument are substantially different (i.e., the present value of the cash flows under the terms of the new instrument is at least 10% different from the present value of the remaining cash flows under the terms of the original instrument). This is commonly referred to as the 10% test.

If the terms are substantially different, the original debt is derecognized, and the new debt is initially recorded at fair value, with the difference recognized as an extinguishment gain or loss. This assessment is performed on a creditor-by-creditor basis. Modifications or exchanges that are not considered extinguishments are accounted for prospectively as yield adjustments, based on the revised terms. That is, no gain or loss is recognized.

The proposal would require extinguishment accounting for debt exchanges that meet certain conditions.

Stakeholders have said that application of the 10% test often results in a debt exchange being accounted for as a modification, which does not reflect the transaction's economics when the issuance of the new debt and contemporaneous settlement of the existing debt are independent transactions. In addition, since the test is performed on a creditor-by-creditor basis, it often results in different accounting outcomes. That is, the effective interest rates reflected in a debtor's financial statements for creditors that only participate in the new debt are different from the rates for creditors that also participated in the existing debt, which is not intuitive.

Stakeholders also expressed concerns with the cost and complexity of applying the guidance in ASC 470-50 to these debt exchanges.

Key considerations

The proposed guidance would apply to all contemporaneous exchanges of cash between the same debtor and creditor in connection with the issuance of a new debt obligation with multiple creditors and the satisfaction of an existing debt obligation. Entities would account for the debt exchange as an extinguishment of the existing debt and the issuance of new debt if the following conditions were met:

- The existing obligation has been repaid in accordance with the contractual terms or repurchased at market terms.
- The new debt obligation was issued at market terms following the issuer's customary marketing process.

The Board noted in the Background Information and Basis for Conclusions that the EITF had concluded the conditions above would (1) demonstrate that the repayment of the existing debt is independent from the issuance of the new debt and (2) support accounting for the repayment of the existing debt as an extinguishment.

The Board also said that the term "customary marketing process" is meant to demonstrate that the debtor negotiated with parties other than its existing creditors. While this process could differ based on the facts and circumstances of a transaction, some Board members believe that the debtor soliciting new creditors for the new debt or the debtor following a marketing process similar to the one it has used for previous debt issuances are examples of a customary marketing process.

A debtor would not perform the 10% test if the debt exchange met the proposed conditions. Instead, the exchange transaction would be accounted for as a debt extinguishment.

The proposal would only apply to transactions with multiple creditors in the new debt instrument. The EITF concluded it would be challenging to demonstrate that the settlement of an existing obligation and the issuance of the new obligation were not negotiated collectively if there was only one creditor, and that creditor participates in both the existing debt instrument and the new debt instrument.

As such, if the new debt obligation has only one creditor or the transaction does not meet the required conditions, the debtor would evaluate the exchange under ASC 470-50 to determine whether the instruments have substantially different terms and would be accounted for as a modification or extinguishment.

How we see it

- The proposal would change how entities account for certain debt exchanges involving multiple creditors (e.g., loan syndications), since they would be required to apply extinguishment accounting if an exchange meets the proposed conditions, even if that exchange would be considered a modification under the current model in ASC 470-50.
- The proposal is expected to reduce diversity in practice in the accounting for certain exchanges of debt instruments and improve the decision usefulness of information provided to investors.

Effective date and transition

Entities would be required to apply the guidance prospectively to exchanges of debt instruments that occur on or after the initial date of application. Early adoption would be permitted. Entities would also be required to disclose in the period of adoption the nature and reason for the change in accounting principle. The FASB will determine the effective date after it considers stakeholder feedback on the proposal.

Endnotes:

1 Proposed Accounting Standard Update, *Debt — Modifications and Extinguishments (Subtopic 470-50) and Liabilities — Extinguishments of Liabilities (Subtopic 405-20) — Accounting for Debt Exchanges*.

2 ASC 470-50, *Debt — Modifications and Extinguishments*.