

EARLY IMPRESSIONS

FASBs' Proposed Accounting Standard Update (ASU) (Sub-topic 470-50)

Debt—Modifications and Extinguishments



1. FOREWORD

ASC 470-50, “Debt—Modifications and Extinguishments,” provides explicit guidance on how debtors (borrowers) should account for changes to their debt instruments. The core purpose of this subtopic is to determine whether a change in debt terms should be treated as a modification of the existing debt or an extinguishment of the old debt and the issuance of new debt.

ASC 470-50-40-6 through 40-20 provide comprehensive guidance for debtors on how to account for two main scenarios:

1. **Modifications to the terms of existing debt.**
2. **Exchanges of debt instruments with the same creditor.**

This guidance is applicable to all entities and specifically covers the accounting treatment for **contemporaneous exchanges of cash and debt instruments with the same creditor**.

On April 30, 2025, the Financial Accounting Standards Board (FASB) released a proposed Accounting Standards Update (ASU) designed to introduce a new, streamlined approach for determining when a simultaneous exchange of cash and debt instruments between the same borrower and lender should be treated as an extinguishment of debt under ASC 470-50. The ASU introduces new criteria in ASC 470-50-40-9 that, if met, allow the transaction to be accounted for as an extinguishment without applying the 10% cash flow test.

The FASB has been actively addressing complexities and diversity in practice related to debt exchanges, particularly those involving multiple creditors. The proposed amendment aims to simplify the determination of whether certain contemporaneous cash exchanges between a debtor and a creditor should be accounted for as extinguishments. This could introduce a new threshold test that, if met, would mandate extinguishment accounting, potentially reducing the need for the detailed 10% cash flow test in some scenarios.

This publication summarizes the requirements of the proposed ASU on **Accounting for debt exchanges**, which may be relevant for all entities to assess the accounting implications of changes to their debt, ensuring that financial statements accurately reflect the economic substance of these transactions.

We sincerely hope you find the publication informative. We will be happy to participate in any discussions to clarify our views enclosed in the attached publication. We look forward to hearing from you.

Thank you.

Yours faithfully

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2. BACKGROUND

When a debtor pays off a debt with cash, it's generally considered an extinguishment of that debt. However, if a borrower (or their representative) repays existing debt with cash and, at the same time, borrows new debt from the same creditor, the combined impact of these two actions is essentially an exchange of debt instruments. Consequently, these transactions must typically be evaluated together under the guidelines provided in ASC 470-50.

Under the existing guidance, if the terms of an exchanged debt instrument are substantially different from the original debt, the transaction must be accounted for as if the old debt were extinguished and a new debt obligation were issued.

To determine if the terms are "substantially different," a specific quantitative test is used. If the present value of the new debt's cash flows differs by at least 10% from the present value of the original debt's remaining cash flows, the debt is considered substantially different. This evaluation, known as the 10% cash flow test, is applied separately for each individual creditor.

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New debt instrument and existing debt instrument have substantially different terms

- Issuance of a new debt obligation and
- Extinguishment of the existing debt obligation.



- Carrying value of the existing debt instrument is derecognized.
- Fair value of the new debt instrument is recognized.
- Difference is recognized as extinguishment gain or loss.

New debt instrument and existing debt instrument do not have substantially different terms

- Modification of existing debt obligation.



- New effective interest rate (EIR) for the modified debt instrument based on the carrying amount of the existing debt instrument and the revised cash flows.

With the focus on reducing the cost and complexity of debt modification accounting and objective to reduce the diversity in practice in the accounting for an exchange of debt instruments by specifying when the exchange is accounted for as the issuance of a new debt obligation and the extinguishment of the existing debt obligation, the proposed ASU introduces new criteria in ASC 470-50-40-9 that, if met, allow the transaction to be accounted for as an extinguishment without applying the 10% cash flow test.

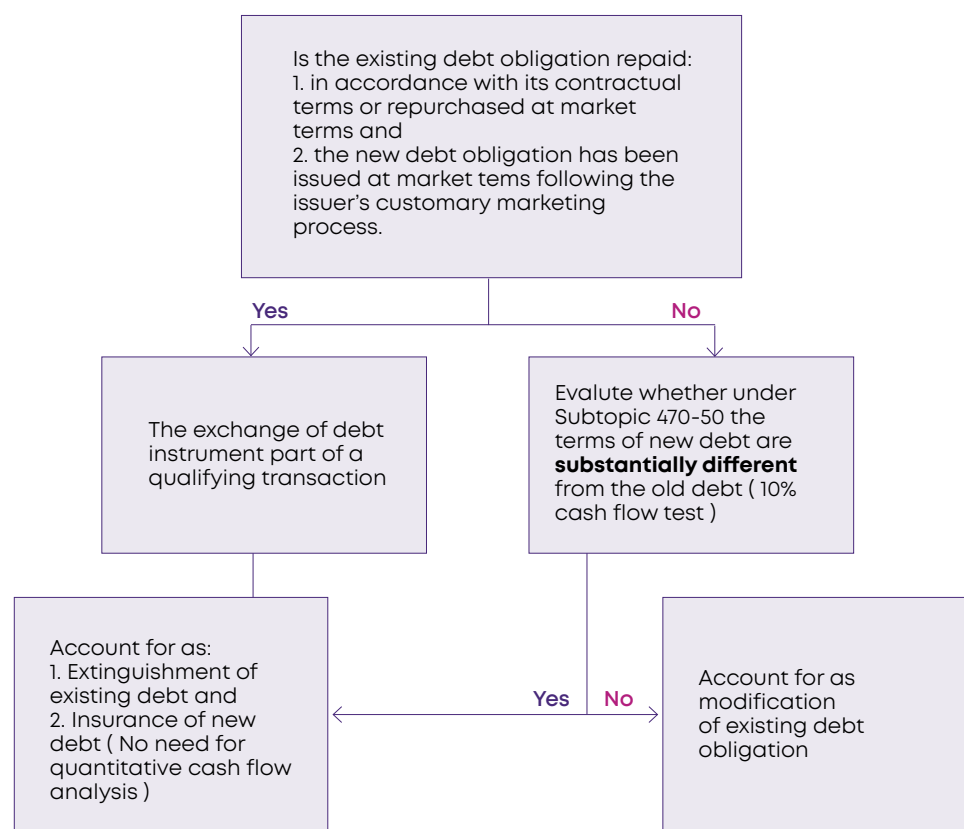
What's not changing?

- Debt Extinguishment Accounting
- Debt Modification Accounting

3. HIGHLIGHTS OF PROPOSED AMENDMENTS TO SUB-TOPIC 470-50

The following flow diagram summarizes the Proposed ASU Implementation Framework:

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A. Applicability

The proposed amendments are applicable under the following conditions:

- An existing debt obligation is settled simultaneously (contemporaneously) as a new debt obligation is issued.
- The funds used to settle the old debt originate from the proceeds of the new debt.
- At least one of the original creditors must also be a participant in the new debt issuance.
- The new debt issuance involves multiple creditors.

B. Main provisions

As per proposed amendment, contemporaneous exchanges of cash between a debtor and a creditor should be accounted for as extinguishments of debt under ASC 470-50 if the following criteria are fulfilled:

01

The new debt obligation has multiple creditors.

02

The existing debt obligation has been repaid in accordance with its contractual terms or repurchased at market terms.

03

The new debt obligation was issued at market terms following the issuer's customary marketing process for new debt issuances.

If these criteria are not satisfied, the issuer should assess a 10% cash flow test to determine whether the exchange constitutes a modification or an extinguishment of the debt.

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New Criteria Are Met:	New Criteria Are Not Met:
Debt exchange must be accounted for as an extinguishment. This means: - The existing debt is derecognized from the balance sheet. - The new debt is recognized at its fair value. - Any difference between the carrying amount of the old debt and the fair value of the new debt (plus/minus related fees and costs) is recognized as a gain or loss on extinguishment in current earnings. The 10% cash flow test would not be applied.	Entity would revert to the existing guidance. This means: Entity would perform the 10% cash flow test on a creditor-by-creditor basis to determine whether the exchange should be accounted for as a modification or an extinguishment.

New Criteria- Key Considerations:

Criteria

1. The New Debt Obligation Has Multiple Creditors

Implementation matters

- New debt obligation that is exchanged for the satisfaction of an existing debt obligation must have multiple creditors.
- This criterion specifically targets debt issuances that involve more than one lender or investor. It's designed to differentiate these transactions from simple one-on-one debt modifications or refinancings with a single creditor.
- **For example:** A company obtaining a new syndicated bank loan from a group of banks, where some of those banks may have been part of the previous syndicate.
- **Contrast:** If the new debt is issued to only a single creditor (even if that creditor was part of a previous multi-creditor arrangement), this criterion would not be met, and the entity would then default back to applying the 10% cash flow test on a creditor-by-creditor basis.



Whether creditors belonging to the same consolidated group or otherwise are under common control should be considered multiple creditors?

The proposed ASU does not provide guidance on how to treat creditors under common control or in the same consolidated group, so the debtor must use judgment, typically treating such creditors as a single entity when controlled by the same parent.

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Criteria

2. The Existing Debt Obligation Has Been Repaid in Accordance with Its Contractual Terms or Repurchased at Market Terms

Implementation matters

- This criterion focuses on how the old debt is retired. It implies that the decision to repay the existing debt is a separate, independent event, not just a renegotiation of terms with existing lenders.
- **“Repaid in accordance with its contractual terms”:** This refers to situations where the debtor exercises a right explicitly granted in the original debt agreement to prepay or call the debt. For instance, if the original bond indenture allowed the company to redeem the bonds at a certain price on or after a specific date, the company does so.
- **“Repurchased at market terms”:** This refers to situations where the debtor buys back the existing debt, for example, through a tender offer, at a price that reflects current market conditions for that debt, rather than a negotiated price designed to facilitate a modification. The terms of the repurchase should be consistent with what other holders of similar debt would expect in the market.
- **Contrast:** If the existing debt is cancelled or renegotiated in a way that is not at market terms or as per its original contractual terms (e.g., a direct negotiation with a specific lender resulting in a non-market price or waiver of terms), this criterion would likely not be met.



- In our view, this criterion aims to demonstrate the “independence” of the old debt’s retirement from the issuance of the new debt. If the existing debt is repaid as per its established terms or at a fair market price, it strengthens the argument that the old debt is truly gone, and a new, distinct financing arrangement has been entered into.
- It avoids situations where a “modification” is disguised as an “extinguishment” through a contrived repayment.

Criteria

3. The New Debt Was Issued at Market Terms Following the Issuer’s Customary Marketing Process for New Debt Issuances

Implementation matters

- This criterion emphasizes that the new debt is genuinely new, reflecting prevailing market conditions and offered through a standard, arms-length process.
 - **“Issued at market terms”:** The interest rate, maturity, covenants, and other terms of the new debt should be consistent with what similar companies would receive for similar debt in the current market. This implies that the new debt wasn’t given special, below-market terms to incentivize existing creditors to participate.
 - **“Following the issuer’s customary marketing process for new debt issuances”:** This refers to the standard procedures a company uses when raising new capital from the market. This could include:
 - Conducting a “debt roadshow” to present to potential investors.
 - Setting up an electronic data room for due diligence by prospective lenders.
 - Running a competitive bidding process among banks for a syndicated loan.
- **For example:** A company approaches several banks to bid on a new term loan, and the winning bid reflects competitive market rates.
- **Contrast:** If the new debt is directly negotiated with only the existing creditors without a broader market process, or if the terms are preferential to those creditors (or disadvantageous to the issuer) in a way that doesn’t reflect market pricing, this criterion would likely not be met.



In our view, this criterion reinforces the “new debt” aspect of the transaction. If the new debt is issued like any other new market financing, it suggests an independent borrowing decision rather than a continuation or reshaping of an existing arrangement. It provides evidence that the issuer actively sought new capital in the market, rather than simply tweaking an existing loan with current lenders.

In summary, these three criteria aim to identify situations where a company is essentially performing two distinct transactions: (1) repaying its old debt, and (2) issuing new debt in a standard market transaction. When these conditions are met, the FASB believes the economic substance points strongly to an extinguishment, making the detailed 10% cash flow test unnecessary for these specific multi-creditor scenarios.

C. Effective Date and Transition Method

01 Effective date

The FASB has not yet established an effective date for the proposed amendments.

02 Transition method

The amendments in this proposed ASU would be applied prospectively to exchanges of debt instruments that occur on or after the initial date of application. Early adoption would be permitted.

03 Transition disclosure

The proposed amendments would require a transition disclosure outlining the nature and reason for the change in accounting principle to be included in the interim and annual reporting periods of adoption (if applicable).

04 Applicability

The proposed amendments shall apply to all entities.

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D. Illustrative Example (Hypothetical)

Consider a borrower with an existing USD 10 million loan that negotiates new terms with the same lender, which include a lower interest rate, an extended maturity date, and the addition of a conversion feature.

- **Under current GAAP**, the borrower would assess whether the present value of future cash flows under the new terms differs by more than 10% compared to the old terms. If the difference exceeds 10%, the transaction would be treated as an extinguishment of debt.
- **Under the proposed guidance**, the borrower would evaluate whether the economic substance of the new loan is 'substantially different.' This would take into account factors such as the introduction of the conversion option and the modified risk profile. If the changes are deemed "substantially different," extinguishment accounting would apply. This would require derecognizing the old debt and recognizing the new loan at fair value.

In this scenario, the proposed guidance offers a more flexible, principles-based approach that allows a clearer assessment of the transaction's true economic substance, especially when significant features such as a conversion option are added.

To illustrate the practical implications of the proposed ASU, FASB, through May 30, 2025, sought stakeholder feedback on scenarios where the new guidance would replace the rigid 10% test with a more principles-based assessment focused on economic substance.

Debt Exchanges ASU: Summary of Comment Letters and Critical Themes

Theme	What Was Said	Why It Matters	Repercussions if Not Addressed
Lack of Clarity in Key Terms e.g., “multiple creditors,” “market terms,” “customary marketing process”	The proposed guidance includes undefined or vaguely defined terms, leading to uncertainty in application.	Clear, consistently interpretable definitions are essential to ensure uniform accounting treatment and avoid subjective application.	- Diversity in practice and inconsistent financial reporting. - Potential audit disputes and increased compliance burden. - Opens the door to interpretation-based structuring.
Limited Applicability of the ASU	The ASU addresses a narrow fact pattern, which may not capture common debt restructuring scenarios, especially in private markets.	Without broader coverage, the benefits of simplification and cost reduction are constrained to a small subset of transactions.	- Limited practical benefit across reporting entities. - Continued complexity and need for the 10% test in most refinancings. - Missed opportunity for systemic improvement.
Structuring Risk Due to “Multiple Creditors” Criteria	There is concern that minor or artificial creditor participation could be used to qualify a transaction for extinguishment accounting.	Preventing form-over-substance outcomes is key to preserving the integrity of financial reporting.	- Risk of earnings manipulation through engineered extinguishments. - Undermines comparability across economically similar transactions. - Regulatory scrutiny due to potential abuse.
Unclear Fee and Sweetener Treatment	Questions remain about how to treat transaction fees and whether instruments with warrants or equity kickers qualify as “at market.”	These elements affect cost capitalization and effective interest rate calculations, which are fundamental to debt accounting.	- Inconsistent application of fee and cost guidance. - Misstatement of borrowing costs or net proceeds. - Increased valuation complexity and audit friction
Redundancy and Ambiguity of “Customary Marketing Process”	The requirement may be duplicative or impractical, particularly for privately negotiated or non-syndicated debt.	If market terms are already assessed, the marketing process requirement may add cost without enhancing accounting quality.	- Additional burden on preparers without added clarity. - May unintentionally exclude qualifying transactions. - Creates grey areas for enforcement and interpretation.

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4. Uniquus' PERSPECTIVE

The proposed ASU reflects a step in the right direction, toward simplifying complex debt accounting and better aligning form with substance. By eliminating the 10% cash flow test in certain refinancing scenarios involving multiple creditors and market-based terms, the standard reduces compliance costs and improves the relevance of financial reporting.

In essence, the proposed ASU introduces a higher-level “threshold test.” If a debt exchange meets this threshold, it automatically triggers extinguishment accounting, simplifying the process and potentially leading to more extinguishments being recognized compared to current practice, especially in syndicated loan scenarios. However, it stops short of addressing broader inconsistencies in ASC 470-50 and introduces interpretive uncertainty around key terms like “multiple creditors,” “market terms,” and “customary marketing process.” This ambiguity will require robust technical judgment, enhanced documentation, and strengthened internal controls to ensure consistent application.

From a consulting standpoint, the ASU presents a clear opportunity for Uniquus to add value. We can assist clients in assessing the applicability of the new guidance, particularly in complex or syndicated refinancing situations. Uniquus is also well-positioned to develop tailored templates for evaluating whether debt exchanges meet the “market terms” condition and what constitutes a “customary marketing process” for different types of issuers. In addition, we can support clients in updating their internal policies and documentation practices to ensure compliance and audit readiness.

In conclusion, while the ASU simplifies accounting in a targeted area, its success hinges on preparers' ability to navigate judgment-heavy elements. As clients begin evaluating the impact on their debt modification strategies, Uniquus can play a key role in guiding implementation, reducing interpretive risk, and promoting consistency in financial reporting outcomes.

For more information on the FASB's decision, see the [press release](#) on the FASB's Web site.

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