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Today's News

FASB News

Banks, Credit Unions Can Use Flexible Approach for Recording Interest Income on Loan Modifications
Topic(s): FASB, Disclosure, Debt, Risk, GAAP, Interpretive Guidance, Financial Reporting, Financial Management

Summary: Banks and credit unions have some wiggle room under FASB rules when reporting interest income on loans modified as a result of the coronavirus (COVID-19) economic stimulus package, an issue critical to earnings. FASB's senior staff clarified on April 8, 2020, that financial institutions can continue to recognize interest income during the deferment period, or the loan payment holiday.

By Denise Lugo

Banks and credit unions have some wiggle room under FASB rules when reporting interest income on loans modified as a result of the coronavirus (COVID-19) economic stimulus package, an issue critical to earnings.

FASB staff members were asked to clarify how interest income should be recognized on a loan payment holiday, a transaction that allows borrowers to temporarily stop payments for a period of time. Interest would not accrue while the loan payment holiday is in effect.

Companies would apply FASB ASC 310-20, Non-refundable Fees and Other Costs, and account for the modification as the continuation of the original lending arrangement, FASB's Acting Technical Director Shayne Kuhaneck said during April 8, 2020, board discussions. It would not be accounted for as a new lending arrangement and therefore the modification would not be accounted for as an extinguishment of the original loan and the recognition of a new loan.

Kuhaneck said it would be appropriate for an institution to continue to recognize interest income during the deferment period or the loan payment holiday.

The topic lands banks in uncharted waters. It is especially critical to the sector because the majority of what they earn for revenue is interest income on their loans.

Under the Coronavirus Aid, Relief and Economic Security (CARES) Act, banks are encouraged to work with borrowers to defer payments over a reasonable period of time.

Under normal circumstances financial institutions would have had to consider whether the deferral is a troubled debt restructuring and apply ASC 310-40, Troubled Debt Restructuring by Creditors. Those rules have certain accounting and financial reporting implications. Companies, for example, would need to continue to recognize interest income.

“Normally they would not be able to recognize interest income if they allowed a borrower to not make their payments for a period of time,” Jeff Skaggs, principal of Baker Newman Noyes, a tax and accounting CPA firm, said on April 15. “So it’s very important for them to understand if they can recognize interest income during deferments related to the CARES Act,” he said. “And it’s unclear within the current FASB GAAP whether they would be allowed to do that because this type of scenario has never been contemplated before.”

Though the issue FASB addressed is specific to a scenario where interest will not accrue during the payment deferral period, financial institutions can apply the same logic when interest will continue to accrue, Skaggs said.

“It is our view that it is appropriate for an institution to recognize interest income during the deferment period based on the revised remaining cash flows, whether interest will accrue or not based on the terms of the modification,” he said. “If interest is not forgiven during the deferral period, there may not be a significant difference between the original effective interest rate and the revised effective interest rate for many loans.”

This difference may be significant enough for an institution to consider revising the effective interest rate used for the loan on a prospective basis, said Skaggs. “Based on the expected volume of modifications related to COVID-19, it will be important for the finance and lending functions to have a good process in place to assess whether this difference is significant based on the terms of the modified loans,” he said.

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