



CAQ Alert #2008-90 – December 23, 2008

DEAR CENTER MEMBERS

CAQ Issues White Paper: Application of SFAS 114 to Modifications of Residential Mortgage Loans that Qualify as Troubled Debt Restructurings

On December 23, 2008 the [Center for Audit Quality](#) (CAQ) issued a [white paper](#) entitled *Application of Statement of Financial Accounting Standards No. 114 (SFAS 114) to Modifications of Residential Mortgage Loans that Qualify as Troubled Debt Restructurings*.

The objective of this paper is to assist preparers and auditors by discussing questions related to the application of existing generally accepted accounting principles (GAAP) associated with the application of [SFAS 114](#), *Accounting by Creditors for Impairment of a Loan—an Amendment of FASB Statements No. 5 and 15*.

Recently, the accounting for loan modifications has become a significant issue for many entities due to an increased volume of modifications of residential mortgage loans to borrowers experiencing financial difficulty. Such loan modifications usually qualify as “troubled debt restructurings.” As a result, questions have arisen about the application of SFAS 114 to modifications of residential mortgage loans that qualify as troubled debt restructurings.

Paragraph 6(a) of SFAS 114 specifically excludes “large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment,” such as residential mortgages, from the scope of its provisions related to accounting for impairments. However, SFAS 114 also states that if a loan that initially is excluded from the scope of SFAS 114 is subsequently modified in a “troubled debt restructuring,” then it becomes subject to SFAS 114 upon restructuring. Also, certain loans that are not considered to be included in “larger groups of smaller-balance homogenous loans that are collectively evaluated for impairment” are also subject to SFAS 114.

The white paper describes key provisions of SFAS 114, and presents questions and answers about the application of SFAS 114 to modifications of residential mortgage loans that qualify as troubled debt restructurings. The white paper has been prepared by a working group of the CAQ Professional Practice Executive Committee. The working group also included representatives of the Mortgage Bankers Association. Although this nonauthoritative paper highlights certain issues that have arisen about the accounting for loan modifications, it does not establish new GAAP and is not intended to serve as a substitute for relevant authoritative accounting standards. Rather, it is intended to articulate certain existing requirements of GAAP literature as well as common accounting practices related to the specific issues discussed, with the objective of helping preparers and auditors understand the application of existing GAAP to residential mortgage loans.

The CAQ shared earlier drafts of the white paper with various industry trade organizations and received comments from many of them, or from their members, which have been considered in improving the white paper.

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