



# Accounting and Reporting for Loan Modifications Under CECL

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## Introduction

The financial landscape has undergone a significant transformation with the adoption of the Current Expected Credit Loss (CECL) standard. This shift has particularly impacted the way financial institutions account for and report on **loan modifications**, which are often granted to borrowers experiencing financial difficulties. This whitepaper serves as a comprehensive guide for financial professionals, outlining the key objectives, best practices, and regulatory requirements for managing modified loans under the CECL framework.

## Why This Topic Matters

The treatment of loan modifications under CECL is a topic of notable importance due to heightened regulatory scrutiny and the inherent complexities of the new standard. Incorrect accounting and reporting can lead to findings during regulatory audits. The CECL standard mandates a forward-looking approach to estimating credit losses, which requires institutions to incorporate updated contractual terms of modified loans into their allowance calculations. This process necessitates seamless collaboration among different departments, including lending, credit risk, and accounting. A breakdown in communication can lead to inconsistent application of policies and inaccurate financial reporting.

## Understanding What Constitutes a Loan Modification

At its core, a loan modification is a change to the original contractual terms of a loan, mutually agreed upon by the borrower and the lender. Under CECL, a modification is considered significant only when the borrower is experiencing financial distress and the change has a more than insignificant impact on future cash flows. Key types of modifications include:

- **Interest Rate Reductions:** Lowering the rate to ease payment burden.



- **Term Extensions:** Extending the maturity date to reduce monthly payments.
- **Principal Forgiveness:** Writing off a portion of the loan.
- **Payment Delays (Forbearance):** Allowing the borrower to defer or make reduced payments for a set period.

## The Foundational Role of a Modified Loan Policy

To effectively manage loan modifications, an institution must establish a clear and comprehensive policy. A crucial component of this policy may be the inclusion of a **Modification Committee**, which can be composed of members from various departments, including lending, finance, risk management, and legal. This interdisciplinary committee ensures that all aspects of a modification—from credit risk to accounting treatment—are thoroughly vetted. The policy should also include specific underwriting guideline exceptions that may fall outside normal standards, such as those related to debt-to-income or loan-to-value ratios, recognizing the hardship nature of these requests.

The policy must also define what constitutes a borrower experiencing **financial difficulty**. Examples include a debtor currently in payment default, facing bankruptcy, or with insufficient cash flows to service their debt. Furthermore, the policy should specify the conditions that qualify a modification as "more than insignificant." For instance, a term extension of more than three months for a consumer loan or any form of principal forgiveness could be deemed significant, triggering specific accounting and disclosure requirements.

### More Than Insignificant Modification

The following are example conditions that could be applied for determining a significant modification for a borrower having financial difficulties.

Loan Pool	Consumer Loans Under 10-Year Terms <i>Auto, Unsecured, Other Secured</i>	Consumer Loans Greater than 10-Year Terms <i>Real Estate, HELOCs</i>	Commercial Loans <i>Commercial, Commercial LOCs</i>	Commercial Real Estate <i>Multi-Family, Residential Real Estate</i>
<i>Term Extension</i>	Greater than 3 months	Greater than 6 months	Greater than 3 months	Greater than 6 months
<i>Rate Reduction</i>	Any rate reduction			



<i>Principal Forgiveness</i>	Any principal forgiveness
<i>Payment Delay</i>	> 6 months over the life of the loan *
<b>Note:</b> * Unless all payments are cured at the end of the 6-month period	

### Other Modifications

<b>Debt Consolidations</b>	Considered modifications for disclosures if the borrower is having financial difficulties or is past due on any loan.
<b>Annual Skip-a-Pay</b>	Not considered modifications for disclosures if the extension is 31 days or less. Borrowers can have multiple skip-a-pay modifications as long as they do not occur more than once every 12 months.

### Example of Lending Codes

To streamline reporting, institutions can implement a system of **lending codes** to track the type of modifications applied to each loan, which simplifies the data aggregation needed for CECL disclosures.

Single or No Modification	Combination of Two Modifications	Multiple Modifications
0 = No modification	5 = TE + IRR	11 = TE + IRR + PF
1 = Term Extension (TE)	6 = TE + PF	12 = TE + IRR + PD
2 = Interest Rate Reduction (IRR)	7 = TE + PD	13 = TE + PF + PD
3 = Principal Forgiveness (PF)	8 = IRR + PF	14 = IRR + PF + PD
4 = Payment Delay (PD)	9 = IRR + PD	15 = TE + IRR + PF + PD
	10 = PF + PD	

## Accounting and Evaluation Under the CECL Framework

The CECL model has fundamentally changed how modified loans are treated. Under the previous incurred loss model, a **Troubled Debt Restructuring (TDR)** was a separate classification with

specific accounting rules, often resulting in an immediate impairment charge. CECL eliminates this separate classification, simplifying the process. A modified loan generally remains in its original pool for calculating the Allowance for Credit Losses (ACL). The expected credit losses are simply included in the pool's forward-looking, lifetime loss calculation.

However, there are two key exceptions. If a modified loan enters **foreclosure or is reasonably expected to go into foreclosure**, it must be evaluated using the **collateral-dependent method**, where the expected loss is based on the fair market value of the underlying collateral. Additionally, an institution can choose to individually evaluate a modified loan if its risk profile is significantly different from its pool. This provides flexibility, allowing institutions to use the collateral-dependent method as a practical expedient when the most reliable expectation of loss is the collateral's fair market value. This shift from the prior TDR guidance to a more integrated, forward-looking approach is a cornerstone of the CECL standard.

## The Critical Role of Documentation

Accurate and thorough documentation is the linchpin that connects the lending and accounting functions. It is the first line of defense in an audit, proving that modifications were handled consistently and in compliance with internal and external regulations. The accounting team relies on this documentation to accurately classify the loan and prepare the required disclosures. Key documents to maintain include:

- **Modification Agreements:** The legally binding document detailing the new terms.
- **Underwriting Analysis and Approval Memos:** Internal analysis and formal approval from the Modification Committee.
- **Borrower Communication:** Records of all correspondence, including emails, letters, and signed agreements.
- **Updated Financial Information:** The most recent financial statements or tax returns used to assess the borrower's condition.

## Meeting CECL Disclosure Requirements

The CECL standard has replaced the old TDR disclosures with a new set of broader disclosure requirements. The purpose is to provide a transparent view of an institution's modification activity and its impact on credit losses. Relevant accounting standards, such as ASC 310 and ASC 326, guide these requirements.



Institutions must disclose the total volume of modifications granted to borrowers in financial difficulty, segmented by modification type. They must also explain the **financial effect of these modifications** on the ACL. A crucial disclosure is the **amortized cost basis of modified financing receivables that subsequently defaulted**, which helps investors gauge the effectiveness of the modifications. Finally, institutions must present the **payment status of modified loans**, segmented by categories such as current, 30-89 days past due, and 90+ days past due. These disclosures provide a clear and current snapshot of the modified portfolio's performance, reinforcing the transparent and forward-looking nature of the CECL standard.

## Conclusion

In conclusion, navigating the accounting and reporting for loan modifications under the CECL framework requires a strategic and integrated approach. By establishing a robust **Modification Committee**, defining clear policies for what constitutes financial difficulty and a significant modification, and ensuring meticulous documentation, financial institutions can effectively manage the complexities of CECL. The new standard, while eliminating the separate TDR classification, demands a forward-looking perspective where modified loans are seamlessly integrated into the overall allowance calculation. Adhering to the specific disclosure requirements, which provide transparency into the volume, financial effect, and performance of modified loans, is not just a matter of compliance but a key to building trust with regulators and investors. Ultimately, a well-defined and consistently executed policy for loan modifications under CECL is essential for maintaining a strong financial position and demonstrating sound risk management practices.

If you would like to learn more about loan modifications under CECL, check out our course [\*\*CECL and Loan Modifications: Accounting, Evaluation, and Disclosure\*\*](#).