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No. 2014-14
August 2014

Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40)

Classification of Certain Government-Guaranteed
Mortgage Loans upon Foreclosure

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

Under certain government-sponsored loan guarantee programs, qualifying creditors can extend mortgage loans to borrowers with a guarantee that entitles the creditor to recover all or a portion of the unpaid principal balance from the government if the borrower defaults. The most common government-sponsored programs that provide such guarantees in the United States are those offered by the Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD), and the U.S. Department of Veterans Affairs (VA). The FHA provides a full guarantee of the unpaid principal balance of certain residential and nonresidential mortgage loans. The VA provides a partial guarantee of the unpaid principal balance of certain residential mortgage loans. To make a claim on the guarantee, these government programs generally either require or allow the creditor to convey to the government the real estate property obtained by the creditor upon foreclosure.

Generally accepted accounting principles (GAAP) on troubled debt restructurings provide classification and measurement guidance for situations in which a creditor obtains a debtor's assets in satisfaction of the receivable, including receipt of assets through foreclosure, but do not provide specific guidance on how to classify or measure foreclosed mortgage loans that are government guaranteed.

Currently, there is diversity in practice related to how creditors classify government-guaranteed mortgage loans, including FHA or VA guaranteed loans, upon foreclosure. Some creditors reclassify those loans to real estate consistent with other foreclosed loans that do not have guarantees; others reclassify the loans to other receivables. The objective of this Update is to reduce that diversity by addressing the classification of certain foreclosed mortgage loans held by creditors that are either fully or partially guaranteed under government programs. Greater consistency in classification of such mortgage loans upon foreclosure is expected to provide more decision-useful information about a creditor's foreclosed mortgage loans that are expected to be recovered, at least in part, through government guarantees.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA.

What Are the Main Provisions?

The amendments in this Update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met:

1. The loan has a government guarantee that is not separable from the loan before foreclosure.
2. At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim.
3. At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed.

Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Current GAAP provides classification and measurement guidance for situations in which a creditor obtains a debtor's assets in satisfaction of a receivable, including receipt of assets through foreclosure, but does not provide specific guidance on how to classify and measure foreclosed loans that are government-guaranteed. Current GAAP also does not provide guidance on how to determine the unit of account; that is, whether a single asset should be recognized or whether two separate assets should be recognized (real estate and a guarantee receivable). In practice, most creditors derecognize the loan and recognize a single asset. Some creditors recognize a nonfinancial asset (other real estate owned), while others recognize a financial asset (typically, a guarantee receivable). Regardless of the classification of the asset (or assets), measurement of the asset (or total measurement of the assets) in practice generally represents the amount recoverable under the guarantee. The amendments in this Update should reduce diversity in practice by providing guidance on how to classify and measure certain government-guaranteed mortgage loans upon foreclosure.

When Will the Amendments Be Effective?

The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For all other entities, the amendments in this Update are

effective for annual periods ending after December 15, 2015, and interim periods beginning after December 15, 2015.

An entity should adopt the amendments in this Update using either a prospective transition method or a modified retrospective transition method. For prospective transition, an entity should apply the amendments in this Update to foreclosures that occur after the date of adoption. For modified retrospective transition, an entity should apply the amendments in this Update by means of a cumulative-effect adjustment (through a reclassification to a separate other receivable) as of the beginning of the annual period of adoption. Prior periods should not be adjusted. However, a reporting entity must apply the same method of transition as elected under Accounting Standards Update No. 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. Early adoption, including adoption in an interim period, is permitted if the entity already has adopted Update 2014-04.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS does not contain any guidance specific to the classification of foreclosed mortgage loans that are guaranteed by a government-sponsored program.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–6. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Subtopic 310-10

2. Add paragraph 310-10-40-1A and its related heading, with a link to transition paragraph 310-40-65-3, as follows:

Receivables—Overall

Derecognition

> Classification and Measurement of Certain Government-Guaranteed Mortgage Loans upon Foreclosure

310-10-40-1A For guidance on the classification and measurement of certain government-guaranteed mortgage loans upon foreclosure by a creditor, see paragraphs 310-40-40-7A through 40-7B.

Amendments to Subtopic 310-40

3. Amend paragraph 310-40-40-6 and add paragraphs 310-40-40-7A through 40-7B and their related heading, with a link to transition paragraph 310-40-65-3, as follows: **[Note: The amendment to paragraph 310-40-40-6 is being made to both of the pending content paragraphs because of their different effective dates.]**

Receivables—Troubled Debt Restructurings by Creditors

Derecognition

> Foreclosure

Pending Content:

Transition Date: (P) December 15, 2014; (N) December 15, 2014 | **Transition Guidance:** 310-40-65-2

310-40-40-6 Except in the circumstances described in the following paragraph, a troubled debt restructuring that is in substance a repossession or foreclosure by the creditor, that is, the creditor receives physical possession of the debtor's assets regardless of whether formal foreclosure proceedings take place, or in which the creditor otherwise obtains one or more of the debtor's assets in place of all or part of the receivable, shall be accounted for according to the provisions of paragraphs 310-40-35-7; 310-40-40-2 through 40-4 and; if appropriate, 310-40-40-8. See paragraphs 310-40-40-7A through 40-7B for the classification and measurement of certain government-guaranteed mortgage loans. For guidance on when a creditor shall be considered to have received physical possession (resulting from an in substance repossession or foreclosure) of residential real estate property collateralizing a consumer mortgage loan, see paragraph 310-40-55-10A.

Pending Content:

Transition Date: (P) December 15, 2016; (N) December 15, 2018 | **Transition Guidance:** 606-10-65-1

310-40-40-6 A troubled debt restructuring that is in substance a repossession or foreclosure by the creditor, that is, the creditor receives physical possession of the debtor's assets regardless of whether formal foreclosure proceedings take place, or in which the creditor otherwise obtains one or more of the debtor's assets in place of all or part of the receivable, shall be accounted for according to the provisions of paragraphs 310-40-35-7; 310-40-40-2 through 40-4 and; if appropriate, 310-40-40-8. See paragraphs 310-40-40-7A through 40-7B for the classification and measurement of certain government-guaranteed mortgage loans. For guidance on when a creditor shall be considered to have received physical possession (resulting from an in substance repossession or foreclosure) of residential real estate property collateralizing a consumer mortgage loan, see paragraph 310-40-55-10A.

>> Classification and Measurement of Certain Government-Guaranteed Mortgage Loans upon Foreclosure

310-40-40-7A A guaranteed mortgage loan receivable shall be derecognized and a separate other receivable shall be recognized upon foreclosure (that is, when a creditor receives physical possession of real estate property collateralizing a mortgage loan in accordance with the guidance in paragraph 310-40-40-6) if the following conditions are met:

- a. The loan has a government guarantee that is not separable from the loan before foreclosure.
- b. At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim. A creditor would be considered to have the ability to recover under the guarantee at the time of foreclosure if the creditor determines that it has maintained compliance with the conditions and procedures required by the guarantee program.
- c. At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed.

310-40-40-7B Upon foreclosure, the separate other receivable shall be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor.

4. Add paragraph 310-40-65-3 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2014-14, Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure

310-40-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2014-14, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure*:

- a. The pending content that links to this paragraph shall be effective as follows:
 1. For **public business entities**, for annual periods, and interim periods within those annual periods, beginning after December 15, 2014
 2. For all other entities, for annual periods ending after December 15, 2015, and interim periods beginning after December 15, 2015.
- b. Subject to the consideration in (c), an entity shall apply the pending content that links to this paragraph using either a prospective transition method or a modified retrospective transition method as follows:
 1. For prospective transition, a reporting entity shall apply the pending content that links to this paragraph to foreclosures that occur after the date of adoption
 2. For modified retrospective transition, a reporting entity shall apply the pending content that links to this paragraph by means of a cumulative-effect adjustment (through a reclassification to a separate other receivable) as of the beginning of the annual period of adoption. Prior periods shall not be adjusted.

- c. An entity shall apply the pending content that links to this paragraph using the same method of transition as elected for application of Accounting Standards Update No. 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, in paragraph 310-40-65-2.
- d. Early adoption, including adoption in an interim period, of the pending content that links to this paragraph is permitted if the entity already has adopted the amendments in Update 2014-04. If an entity early adopts the pending content that links to this paragraph in an interim period using the modified retrospective transition method, any reclassifications shall be reflected as of the beginning of the annual period that includes the interim period.
- e. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period the entity adopts the pending content that links to this paragraph.

5. Amend paragraph 310-10-00-1, by adding the following item to the table, as follows:

310-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
310-10-40-1A	Added	2014-14	08/08/2014

6. Amend paragraph 310-40-00-1, by adding the following items to the table, as follows:

310-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
310-40-40-6	Amended	2014-14	08/08/2014
310-40-40-7A	Added	2014-14	08/08/2014
310-40-40-7B	Added	2014-14	08/08/2014
310-40-65-3	Added	2014-14	08/08/2014

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. Under certain government-sponsored loan guarantee programs, qualifying creditors can extend mortgage loans to borrowers with a guarantee that entitles the creditor to recover all or a portion of the unpaid mortgage principal from the government if the borrower defaults. The most common government-sponsored programs in the United States are those offered by the FHA, which fully guarantees the unpaid principal balance of certain residential and nonresidential mortgage loans, and those offered by the VA, which partially guarantees the unpaid principal balance of residential mortgage loans of eligible veterans. To make a claim on the guarantee, these government programs generally either require or allow the creditor to convey to the government the real estate property obtained by the creditor upon foreclosure.

BC3. GAAP on troubled debt restructurings provides classification and measurement guidance for situations in which a creditor obtains a debtor's assets in satisfaction of the receivable, including receipt of assets through foreclosure, but does not provide specific guidance on how to classify or measure foreclosed mortgage loans that are government guaranteed. In January 2014, the Board issued Update 2014-04 to provide guidance on the timing of reclassification of residential mortgage loans to other real estate owned in the statement of financial position. That Update addresses diversity in practice among creditors related to the timing of reclassification of loans to foreclosed residential real estate but was not intended to address how to classify or measure government-guaranteed mortgage loans upon foreclosure.

BC4. There also is diversity in practice on how creditors classify government-guaranteed mortgage loans, including FHA or VA guaranteed loans, upon foreclosure. Some creditors reclassify those loans to real estate consistent with other loans without guarantees, while others reclassify the loans to other

receivables. The objective of this Update is to reduce diversity by addressing the classification of certain foreclosed mortgage loans held by creditors that are guaranteed under government programs. Greater consistency in classification of such guaranteed mortgage loans upon foreclosure is expected to provide more decision-useful information about a creditor's foreclosed mortgage loans that are expected to be recovered through government guarantees.

BC5. The Board issued a proposed Accounting Standards Update on January 17, 2014, with a comment period that ended on April 30, 2014, and received 12 comment letters on the proposed Update.

Scope

BC6. The guidance in the amendments in this Update apply to a government-guaranteed mortgage loan that meets all of the following conditions: (a) the loan has a government guarantee that is not separable from the loan before foreclosure, (b) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (c) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate property is fixed.

BC7. The Task Force originally considered the characteristics of a fully government-guaranteed residential mortgage loan and concluded that those loans should be classified as a separate other receivable upon foreclosure. Stakeholders commented that the scope should not be limited to residential mortgage loans. The Task Force acknowledged that based on the current government program requirements, the amendments primarily will affect the classification of foreclosed residential mortgage loans. However, the Task Force concluded that the amendments could be readily extended to all fully government-guaranteed mortgage loans because those loans would share similar characteristics.

BC8. Some stakeholders also commented that classifying partially government-guaranteed loans upon foreclosure as a separate other receivable also would be appropriate. The Task Force considered the similarities and differences between fully and partially government-guaranteed loans and decided to expand the scope of the amendments to include certain partially government-guaranteed mortgage loans. To ensure that the scope of the guidance includes not only fully government-guaranteed loans but also other government-guaranteed loans with similar characteristics, the Task Force developed the three scope conditions in the Update.

BC9. First, the Task Force determined that the government guarantee should not be separable from the loan before foreclosure, as is the case with the FHA and VA programs. Second, the Task Force concluded that at the time of foreclosure the creditor should have the intent and ability to recover under the government guarantee on the basis of the view that the accounting should not be

determined based on the mere existence of the guarantee. The Task Force determined that the creditor also must have the intent to convey the real estate property because with that intent the creditor is expected to make a claim for cash rather than be responsible for marketing the real estate property for sale. A creditor would be considered to have the ability to recover under the guarantee at the time of foreclosure if the creditor determines that it has maintained compliance with the conditions and procedures required by the guarantee program such that there is no uncertainty about the eligibility to make a claim. The Task Force decided that without such intent and ability, reporting entities should not be subject to the provisions of this Update even if there is a government guarantee on the loan.

BC10. Third, the Task Force determined that upon foreclosure the creditor should not be exposed to changes in the fair value of the real estate. With a partially government-guaranteed mortgage loan, the fair value of the real estate property collateralizing the loan may affect the amount of the unpaid principal balance that the creditor will recover under the guarantee. The Task Force acknowledged that creditors have different exposure to loan loss between fully government-guaranteed loans and partially government-guaranteed loans. However, if the creditor is not exposed to changes in the fair value of the real estate property after foreclosure, the exposure to loss after foreclosure is the same for both fully government-guaranteed and partially government-guaranteed loans and therefore similar classification is appropriate. Thus, the Task Force decided to expand the scope of this Update but added a third criterion to require that any portion of the guarantee claim that is determined on the basis of the fair value of the real estate property be fixed (that is, the real estate property has been appraised for purposes of the claim).

Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure

BC11. The Task Force decided that a creditor should reclassify a government-guaranteed mortgage loan within the scope of this Update to a separate other receivable at the time of foreclosure. The Task Force determined that classification as a receivable is appropriate if, upon foreclosure, the creditor intends to convey the real estate, has the intent and ability to collect through the guarantee, and is no longer exposed to changes in the fair value of the real estate (the claim to cash is fixed). A creditor would make that determination at the time of foreclosure and not reclassify to a separate other receivable if the conditions are met after foreclosure.

BC12. The Task Force considered several alternatives for classification. The Task Force considered whether upon foreclosure a creditor should separately recognize foreclosed real estate (for example, other real estate owned) measured at the fair value of the real estate less costs to sell in accordance with

Subtopic 310-40 and a separate guarantee receivable measured as the difference between the carrying value of the real estate and the amount recoverable under the guarantee. The Task Force also considered whether the loan should be reclassified to other real estate owned as a single unit of account and measured on the basis of the amount expected to be recovered under the guarantee.

BC13. The Task Force acknowledged that the creditor receives title to the real estate but noted that it is acting in a manner similar to an agent for the guarantor when it conveys the property after foreclosure. Because the creditor is not exposed to changes in the fair value of the real estate after foreclosure, any classification as real estate would not be the best reflection of the economics. Furthermore, the Task Force noted that because the loan would likely not have been extended without the guarantee and the creditor intends to make a claim on the guarantee, the government guarantee and the mortgage loan, which are not separable before foreclosure, should be recognized as a single unit of account both before foreclosure (as the guarantee and the loan) and after foreclosure (as the guarantee and the real estate).

BC14. The Task Force also considered, but rejected, an alternative that would have required entities not to derecognize the loan at the time of foreclosure. The Task Force concluded that to the extent of the guarantee, the asset held by the creditor no longer represents a loan upon foreclosure because the counterparty has changed from the original borrower to the guarantor. At the point of foreclosure, the creditor can no longer look to the borrower to recover on the guaranteed portion of the loan but instead will look to the guarantor. Accordingly, the Task Force decided that the amount of the loan balance expected to be recovered from the guarantor should be reclassified to a separate other receivable at the time of foreclosure.

BC15. One Task Force member disagreed with the conclusion in this Update because in that Task Force member's view certain aspects of it are inconsistent with the conclusions the Task Force reached in Update 2014-04. In Update 2014-04, the Task Force concluded that a creditor should not derecognize a mortgage loan and recognize real estate until a transaction occurs that conveys legal title of the real estate to the creditor. That is, a creditor would not recognize the real estate until it has obtained control of the real estate, despite potentially having significant exposure to the risks and rewards of the real estate at an earlier point. In contrast, the conclusion in this Update is not based on the creditor's recognizing the asset it currently has control over or title to, but, rather, on whether and when the exposure to the risks and rewards of the real estate passes to the guarantor. It is also partially based on the assertion that, with respect to holding title to the real estate, the creditor is acting in a manner similar to an agent for the guarantor. The Task Force member questioned whether that assertion can be sustained for some of the arrangements within the scope of this Update, particularly those involving partial guarantees, because in that Task Force member's view the agency assertion can only be sustained if both before

and after foreclosure the creditor has no exposure to changes in the fair value of the real estate property.

Disclosures

BC16. The Task Force considered whether entities should be required to disclose the full amount expected to be received under the guarantee and the fair value (less cost to sell) of the real estate collateralizing the government-guaranteed loans. The Task Force decided that such recurring disclosures would not be relevant, and thus not decision useful, because the creditor is not exposed to the changes in the fair value of the real estate after the foreclosure. The Task Force also noted that this disclosure requirement would be inconsistent with the basis for the decision to require reclassification of the foreclosed loan to receivables rather than to real estate.

Transition and Effective Date

BC17. The Task Force decided that the amendments in this Update should be applied using either (a) a prospective transition method or (b) a modified retrospective transition method by means of a cumulative-effect adjustment (through a reclassification to a separate other receivable) as of the beginning of the annual reporting period for which the guidance is effective. However, an entity must use the method of transition as elected under Update 2014-04 (that is, either prospective or modified retrospective).

BC18. The Task Force also considered whether to require a full retrospective transition method of application. A full retrospective transition method generally achieves the greatest consistency of reported information across reporting periods. However, in this case, the Task Force observed that because a portion of the loans addressed in this Update will be a subset of the loans addressed by Update 2014-04, applying this guidance to periods before the period that Update 2014-04 is applied could result in reclassification of certain foreclosed real estate that should not have been initially reclassified out of loans. Therefore, the Task Force concluded that aligning the transition methods for this Update and Update 2014-04 would achieve greater consistency in reported information and would reduce complexity in the initial application of the amendments in this Update. For those reasons, the Task Force decided to permit early adoption only if the entity has already adopted Update 2014-04. Because this Update should only affect balance sheet classification, the Task Force also decided to permit early adoption in any interim period as long as the changes are made as of the beginning of the annual period in which the interim period is included.

BC19. The Task Force decided that the effective date provides sufficient time for all reporting entities to comply with the amendments in this Update and should be aligned with Update 2014-04. After considering the guidance in the

Private Company Decision-Making Framework, the Task Force concluded that entities other than public business entities should not be required to apply the amendments in an interim period in the year of adoption. However, the Task Force concluded that an additional delay in the effective date for nonpublic entities was unnecessary because the amendments only affect balance sheet classification.

Benefits and Costs

BC20. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC21. The Task Force determined that costs generally should be minimal for creditors because the guidance only affects balance sheet classification; however, it acknowledged that there could be some incremental costs for a creditor to determine what government-guaranteed mortgage loans are within the scope of this Update. For example, if a creditor decides upon foreclosure not to convey the real estate property but still has the intent and ability to make a claim on the guarantee, the loan would not be included within the scope of this Update. The Task Force concluded that regardless of the accounting guidance, a creditor must generally make a loan-by-loan determination of whether to convey the property. Therefore, making that same determination for the accounting classification should not introduce significant additional costs to implement the guidance in this Update.

BC22. Based on the overall assessment of the costs and benefits, the Task Force does not anticipate that entities will incur significant costs as a result of the amendments in this Update because the amendments primarily relate to classification and therefore do not require significant judgments with respect to recognition and measurement. The amendments provide the benefit of improving application of GAAP by resolving diversity in practice in classifying foreclosed loans within the scope of this Update. The amendments also have the potential to reduce cost by eliminating uncertainty in the underlying accounting guidance.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*[®] in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). Those changes, which will be incorporated into the proposed 2015 UGT, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process starting in September 2014.