Chapter 14

ASBE 12 Debt Restructuring

¶14-100 Introduction

Debt restructuring generally occurs when a creditor, for economic or legal reasons, grants a concession to the debtor in relation to the debtor's financial difficulties. For example, the creditor may accept from the debtor fixed assets with a carrying amount that is less than the outstanding amount owed as full settlement of the debt, or may grant extensions of the repayment period of the debt, a reduction of the principal of the debt or interest rate, or both.

ASBE 12 *Debt Restructuring* prescribes the accounting treatment for debt restructuring and the disclosures of related information in the financial statements.

ASBE 12 becomes operative for listed enterprises in China from 1 January 2007. Other enterprises are encouraged to apply its provisions.

ASBE 12 was amended by the Ministry of Finance in 2019 (*Caikuai* [2019] No. 9). It supersedes the previous Standard and becomes effective from 17 June 2019.

¶14-200 Debt restructuring

ASBE 12 defines *debt restructuring* as "a transaction arising from an agreement renegotiated between the creditor and the debtor in respect of the period, amounts or manner in settlement of a debt, etc., as a result of a mutual agreement or a court judgement and there is no change in the transacting parties before or after the transaction"(para 2).

Unlike the previous Standard, ASBE 12 does not emphasise that the debtor must encounter financial difficulties in order for debt restructuring to be considered for accounting purposes under ASBE 12. A debtor is in financial difficulty when the debtor does not have the ability to or is unable to settle its debts according to the original conditions due to its severe operational or financial problems.

Unlike the previous Standard, ASBE 12 applies whether or not a concession is granted by the creditor to the debtor. A concession takes place when the creditor agrees that the debtor encountering financial difficulties can settle the debt at an amount or value that is lower than the carrying amount of the restructured debt at present or in future. The principal situations of concession include, for example, reduction of interest rates, relief of partial amounts of principal of the debt or interest, etc.

Debt restructuring generally includes one or a combination of any of the following methods (para 3):

(a) satisfaction of a debt by a transfer of assets, such as cash, accounts receivable, inventories, long-term equity investments, fixed assets, investment properties, intangible assets and biological assets;

(b) conversion of a debt into equity instruments;

(c) modification of other terms of a debt other than by methods (a) and (b), such as adjustment in the amounts of principal of the debt, change in interest rate, change in repayment period, etc.

ASBE 12 applies to all types of debt restructuring except for the following situations (para 4):

(a) Rights and obligations arising under debt restructuring that are financial instruments. An enterprise should apply ASBE 22 *Recognition and Measurement of Financial Instruments* and ASBE 37 *Presentation of Financial Instruments*.

(b) The formation of a business combination through debt restructuring. This is covered by ASBE 20 *Business Combinations*.

(c) The creditor or the debtor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder. This is accounted for in accordance with relevant ASBEs for equity transactions.

(d) The creditor and the debtor are ultimately controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the creditor or the debtor. This is accounted for in accordance with relevant ASBEs for equity transactions.

¶14-300 Creditor accounting

There are basically two strategies that a debtor might use for the satisfaction of its debt. One strategy is the transfer of assets or the grant of an equity instrument; another is through modification of the existing terms of its debt.

Paragraphs 5 to 9 of ASBE 12 provide the relevant accounting treatment upon a creditor's entrance into a debt restructuring agreement with a debtor.

When a debt is settled by a transfer of assets or by conversion of the debt into equity instruments, the creditor should account for the debt restructuring when the relevant assets meet their definitions and recognition criteria (para 5).

Transfer of assets in full settlement of a debt

When a receivable is settled by a transfer of assets (other than financial assets), the creditor should recognise the assets received initially at cost. The creditor also recognises the difference between the carrying amount of the receivable to be restructured and the fair value of the assets transferred in profit or loss for the period (para 6).

The following example illustrates the relevant accounting treatment where the full satisfaction of the debt is made by a transfer of fixed assets.

Illustration 14.1

AB Enterprise has RMB500,000 accounts receivable from Y Enterprise. Y Enterprise is unable to repay its debts. Upon mutual agreement, AB Enterprise agrees to accept a motor vehicle from Y Enterprise in full satisfaction of the debt. The fair value of the vehicle is RMB360,000. Ignore related tax.

In this case, AB Enterprise (the creditor) would account for the debt restructuring transaction in its books as follows:

		RMB	**RMB**
Dr	Fixed assets — Motor vehicle	360,000	
Dr	Investment income* — Loss on debt restructuring	140,000	
Cr	Accounts receivable — Y Enterprise		500,000

*Under "The Format of Financial Statements for a General Enterprise (*Caikuai* [2019] No. 16)", non-operating expenses no longer includes gain or loss on debt restructuring.

Notes:

If the creditor has made a provision for the impairment of the receivable, it should first offset the difference against the impairment provision, then recognise the net loss in profit or loss for the period.

Assume that AB Enterprise has made a bad debts provision in respect of the amounts due from Y Enterprise for RMB40,000, it would account for the debt restructuring transaction in its books as follows:

		RMB	**RMB**
Dr	Fixed assets — Motor vehicle	360,000	
Dr	Provision for bad debts	40,000	
Dr	Investment income — Loss on debt restructuring	100,000	
Cr	Accounts receivable — Y Enterprise		500,000

ASBE 12 provides further guidance for the cost of assets initially measured as follows (para 6):

(a) the cost of inventories comprises the fair value of assets transferred plus direct attributable costs incurred in bring the inventories to their present location and condition (e.g. taxes, transport, handling, insurance and other direct attributable costs).

(b) the cost of investments in associate and joint venture comprises the fair value of assets transferred plus taxes and other direct attributable costs.

(c) the cost of investment property comprises the fair value of assets transferred plus taxes and other direct attributable costs.

(d) the cost of fixed assets comprises the fair value of assets transferred plus direct attributable costs incurred in bring the assets to their working condition for intended use (e.g. taxes, transport, handling, installation, professional fees and other direct attributable costs).

(e) the cost of biological assets comprises the fair value of assets transferred plus taxes, transport, insurance and other direct attributable costs.

(f) the cost of intangible assets comprises the fair value of assets transferred plus direct attributable costs (e.g. taxes) incurred in preparing the assets for intended use.

Grant of equity instruments in full settlement of a debt

When a receivable is converted into equity investments in associate or joint venture, the creditor should measure cost of initial investment in accordance with the requirements of paragraph 6 (as explained above). The creditor also recognises the difference between the carrying amount of the receivable to be restructured and the fair value of equity investments transferred in profit or loss for the period (para 7).

Illustration 14.2

CD Enterprise has RMB700,000 accounts receivable from W erprise. W Enterprise is in financial difficulty and is unable to repay its debts. Upon mutual agreement, W Enterprise is to issue 400,000 ordinary shares (with a par value of RMB1) to CD Enterprise in full settlement of its debt (ignore related taxes). CD Enterprise has made a bad debts provision in respect of the amounts due from W Enterprise for RMB30,000. The fair value of the ordinary shares of W Enterprise is RMB1.50 per share.

In this case, CD Enterprise (the creditor) would account for the debt restructuring transaction in its books as follows:

		RMB	RMB
Dr	Long-term equity investments — W Enterprise (Investment cost)	600,000	
Dr	Provision for bad debts	30,000	
Dr	Investment income — Loss on debt restructuring	70,000	
Cr	Accounts receivable — W Enterprise		700,000

Modification of other terms of a debt

Modification of other terms of a debt include adjustments such as an extension of the maturity date, reduction of the stated interest rate, reduction of the principal of the debt or reduction of accrued interest on the debt.

The creditor should account for the modification of other terms of a debt in accordance with ASBE 22 *Recognition and Measurement of Financial Instruments* (para 8).

Combination of restructuring methods

A debt restructuring can involve a combination of two or more of the following methods for the satisfaction of a debt:

(a) by a transfer of assets;

(b) conversion of a debt into equity instruments; and

(c) modification of other terms of a debt.

When a receivable is satisfied by multiple assets or group of assets, the creditor should offset the carrying amount of the receivable to be restructured against the amount of financial assets transferred. The creditor then account for the remaining balance of the receivable in proportion to the fair value of respective assets transferred and account for the cost of assets in accordance with paragraph 6. The creditor also recognises the difference between the carrying amount of the receivable to be restructured and the fair value of the assets transferred in profit or loss for the period (para 9).

¶14-400 Debtor accounting

Paragraphs 10 to 13 of ASBE 12 specify the relevant accounting treatment when a debtor enters into a debt restructuring agreement with a creditor.

Transfer of assets in full settlement of a debt

When a debt is settled by a transfer of assets, the debtor should derecognise the debt (i.e. remove the debt from its balance sheet) when the relevant assets and the settlement of debt meet the derecogniton criteria (para 10). The debtor should apply paragraph 12 of ASBE 22 *Recognition and Measurement of Financial Instruments* and derecognise the debt only when the present obligation specified in the contract is discharged.

The debtor should recognise the difference between the carrying amount of the debt and carrying amount of assets transferred in profit or loss for the period (para 10).

The *Application Guidance* requires the difference to be recognised in "Other Income". There is no need to distinguish the difference between gain/loss on disposal of assets and gain/loss on debt restructuring.

Illustration 14.3

Assume AB Enterprise and Y Enterprise in Illustration 14.1

In this case, Y Enterprise (the debtor) should first transfer the motor vehicle's cost and accumulated depreciation to its "Fixed assets disposal" account to arrive at the transferred vehicle's carrying amount. Then, since the carrying amount of the vehicle transferred is greater than the carrying amount of the debt, the difference is recognised as a gain on debt restructuring in profit or loss for the period.

Y Enterprise would account for the debt restructuring transaction in its books as follows:

		RMB	RMB
Dr	Fixed assets disposal	400,000	
Dr	Accumulated depreciation	50,000	
Cr	Fixed assets — Motor vehicle		450,000
And			
Dr	Accounts payable — AB Enterprise	500,000	
Cr	Fixed assets disposal		400,000
Cr	Other income — Gain on debt restructuring		100,000

Note:

The debtor should not treat the satisfaction of a debt by a transfer of inventories as a sale. *Revenue* is defined in ASBE 14 *Revenue* as the gross inflow of economic benefits derived by an enterprise from the course of the ordinary activities that results in increases in owners' equity, other than those relating to capital contributions from owners. Debt restructuring generally does not fall within the ordinary activities of an enterprise. The debtor should recognise the difference between the carrying amount of the debt and carrying amount of inventories transferred in "other income" in accordance with paragraph 10.

Grant of equity instruments in full settlement of a debt

When a debt is settled by conversion of the debt into equity instruments, the debtor should remove the debt from its balance sheet when the settlement of debt meet the derecogniton criteria (para 11).

ASBE 12 provides that the debtor should measure the initial cost of equity instruments at fair value, except where the fair value of equity instruments cannot be measured reliably, then the fair value of debt is to be used. The debtor also recognises the difference between the carrying amount of the debt and the amount of equity instruments recognised in profit or loss for the period (para 11).

Illustration 14.4

Assume CD Enterprise and X Enterprise in Illustration 14.2

W Enterprise would account for the granting of equity instruments and debt restructuring transaction in its books in accordance with paragraph 11 as follows:

		RMB	RMB
Dr	Accounts payable — CD Enterprise	700,000	
Cr	Capital stock — CD Enterprise (400,000 × RMB1)		400,000
Cr	Capital surplus — Premium on capital stock (400,000 × RMB1.50 – RMB400,000)		200,000
Cr	Investment income — Gain on debt restructuring (RMB700,000 – RMB600,000)		100,000

Modification of other terms of a debt

ASBE 12 provides that the debtor should account for the modification of other terms of a debt in accordance with ASBE 22 *Recognition and Measurement of Financial Instruments* and ASBE 37 *Presentation of Financial Instruments* (para 12).

Combination of restructuring methods

When a debt is satisfied by multiple assets or group of assets, the debtor should recognise and measure equity instruments and restructured debts in accordance with the requirements of paragraphs 11 and 12. The debtor also recognises the difference between the carrying amount of the debt and the sum of (a) equity instruments and (b) restructured debt in profit or loss for the period (para 13).

¶14-500 Disclosures

The creditors should disclose in the notes the following information relating to debt restructuring (para 14):

(a) the carrying amount of the debt and gain or loss on debt restructuring by category in respect of each method of restructuring; and

(b) the increased amount of equity investments in associate or joint venture and the proportion of the investment to the total amount of shares in associate or joint venture.

The debtors should disclose in the notes the following information relating to debt restructuring (para 15):

(a) the carrying amount of the debt and gain or loss on debt restructuring by category in respect of each method of restructuring; and

(b) the increased amount of paid-in capital (or stock) etc. of owners' (stockholders') equity arising from debt restructuring.