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Easy Does It

FASB Simplifies Guidance on Presentation of Debt Issuance Costs

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This *Heads Up* supersedes our April 7, 2015, *Heads Up* on the presentation of debt issuance costs. It contains updates that reflect subsequent discussions with the SEC and FASB staffs related to the accounting for costs associated with revolving-debt arrangements.

Introduction

On April 7, 2015, the FASB issued ASU 2015-03,[1] which changes the presentation of debt issuance costs in financial statements. Under the ASU, an entity presents such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs is reported as interest expense.

Since the ASU's issuance, practitioners have inquired about the appropriate balance sheet presentation of costs incurred in connection with revolving-debt arrangements. At the June 18, 2015, meeting of the FASB's Emerging Issues Task Force (EITF), the SEC staff announced that it would not object to an entity's deferral and presentation of such costs as an asset (see discussion below).

Background

The project on debt issuance cost presentation is part of the FASB's simplification initiative. Launched in June 2014, the initiative is intended to improve U.S. GAAP by reducing costs and complexity while maintaining or enhancing the usefulness of the related financial statement information. Simplification projects are narrow in scope, involve limited changes to U.S. GAAP, and can be completed quickly.

Under current guidance (i.e., ASC 835-30-45-3[2] before the ASU), an entity reports debt issuance costs in the balance sheet as deferred charges (i.e., as an asset).

[1] FASB Accounting Standards Update No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*.

[2] For titles of *FASB Accounting Standards Codification* (ASC or "Codification") references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

Editor's Note: Requiring presentation of debt issuance costs as a direct reduction of the related debt liability (rather than as an asset) is consistent with the presentation of debt discounts under U.S. GAAP. In addition, it converges the guidance in U.S. GAAP with that in IFRSs, under which transaction costs that are directly attributable to the issuance of a financial liability are treated as an adjustment to the initial carrying amount of the liability. It also reflects the SEC staff's views regarding the treatment of equity issuance costs as a reduction of the gross proceeds of an equity offering. Further, it conforms U.S. GAAP to FASB Concepts Statement No. 6,[3] which states, "Debt issue cost is not an asset for the same reason that debt discount is not — it provides no future economic benefit. Debt issue cost in effect reduces the proceeds of borrowing and increases the effective interest rate and thus may be accounted for the same as debt discount."

Key Provisions of the ASU

The ASU specifies that "debt issuance costs related to a note shall be reported in the balance sheet as a direct deduction from the face amount of that note" and that "[a]mortization of debt issuance costs also shall be reported as interest expense." The ASU's Basis for Conclusions observes that in practice, debt issuance costs incurred before the associated funding is received (i.e., before the issuance of the debt liability) are deferred on the balance sheet until that debt liability amount is recorded.

The amendments do not affect the current guidance on the recognition and measurement of debt issuance costs. For example, the costs of issuing convertible debt would not change the calculation of the intrinsic value of an embedded conversion option that represents a beneficial conversion feature under ASC 470-20-30-13. Thus, entities may still need to track debt issuance costs separately from a debt discount.

The example below illustrates how an entity would record debt issuance costs before and after adopting the ASU's guidance.

Example

On January 1, 2015, an entity issues a debt security with a face amount of $10,000,000 to an investor.

On the same date, the entity incurs and pays incremental, direct issuance costs of $50,000 to parties other than the investor. The debt security matures in five years (on December 31, 2020). Before adopting the guidance in the ASU, the entity would record the $50,000 in debt issuance costs on January 1, 2015, as follows:

Journal Entry 1

Cash	$ 10,000,000	
Debt — long term		$ 10,000,000
To record $10,000,000 note payable on January 1, 2015.		

Journal Entry 2

Deferred issuance cost (asset)	$ 50,000	
Cash		$ 50,000
To record $50,000 debt issuance cost on January 1, 2015.		

After adopting the guidance in the ASU, the entity would record the $50,000 in debt issuance costs on January 1, 2015, as follows:

Journal Entry

Cash	$ 9,950,000	
Debt — long term		$ 9,950,000
To record $9,950,000* note payable on January 1, 2015.		

* The $9,950,000 is calculated by netting the $50,000 unamortized debt issuance costs from the note payable amount of $10,000,000.

[3] FASB Concepts Statement No. 6, *Elements of Financial Statements*.

Costs Associated With Revolving-Debt Arrangements

Since the issuance of ASU 2015-03, it has been unclear whether and, if so, how the ASU applies to revolving-debt arrangements.[4] At the EITF's June 18, 2015, meeting, the SEC staff clarified that the ASU does not address debt issuance costs associated with such arrangements and announced that it would "not object to an entity deferring and presenting [such] costs as an asset and subsequently amortizing the . . . costs ratably over the term of the revolving debt arrangement."

Editor's Note: In developing ASU 2015-03, the FASB considered but ultimately decided against providing guidance on the balance sheet presentation of (1) debt issuance costs incurred before a debt liability is recognized (e.g., before the debt proceeds are received) and (2) costs associated with revolving-debt arrangements. In our discussions with the FASB staff, the staff confirmed that the ASU does not address the presentation of issuance costs associated with revolving-debt arrangements. Accordingly, an entity should elect an accounting policy for the presentation of such costs.

While the SEC staff's announcement clarifies that revolving-debt arrangements are outside the scope of ASU 2015-03, it does not address whether the ASU's presentation approach is an acceptable accounting policy for such arrangements and, if so, how an entity should implement such an approach. Under the ASU, an entity would deduct debt issuance costs from the related debt liability. But it is unclear how the entity would present any remaining unamortized debt issuance costs if it repaid the amounts outstanding under the revolving-debt arrangement and still had an option to make new borrowings under the same arrangement. In this case, there would no longer be a liability with which to associate the costs. It is also unclear how the entity would present any remaining unamortized costs if the costs exceeded the amount currently outstanding under the revolving-debt arrangement.

Given the implementation questions associated with application of the ASU's presentation approach to revolving-debt arrangements, as well as questions about the acceptability of such application, we expect that many, if not most, entities will elect to apply the accounting policy outlined by the SEC staff at the June 18, 2015, EITF meeting. Under that policy, an entity presents remaining unamortized debt issuance costs associated with a revolving-debt arrangement as an asset even if the entity currently has a recognized debt liability for amounts outstanding under the arrangement. Further, such costs are amortized over the life of the arrangement even if the entity repays previously drawn amounts.

Effective Date and Transition

For public business entities, the guidance in the ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. For entities other than public business entities, the guidance is effective for fiscal years beginning after December 15, 2015, and interim periods beginning after December 15, 2016. Early adoption is allowed for all entities for financial statements that have not been previously issued. Entities would apply the new guidance retrospectively to all prior periods (i.e., the balance sheet for each period is adjusted).

The ASU requires an entity to "disclose in the first fiscal year after the entity's adoption date, and in the interim periods within the first fiscal year, the following:

1. The nature of and reason for the change in accounting principle
2. The transition method
3. A description of the prior-period information that has been retrospectively adjusted
4. The effect of the change on the financial statement line item (that is, the debt issuance cost asset and the debt liability)."

[4] The Codification Master Glossary defines a line-of-credit or revolving-debt arrangement as follows: "A line-of-credit or revolving-debt arrangement is an agreement that provides the borrower with the option to make multiple borrowings up to a specified maximum amount, to repay portions of previous borrowings, and to then reborrow under the same contract. Line-of-credit and revolving-debt arrangements may include both amounts drawn by the debtor (a debt instrument) and a commitment by the creditor to make additional amounts available to the debtor under predefined terms (a loan commitment)."

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