FASB Changes Presentation of Debt Issuance Costs

On April 7, 2015, the FASB issued a new Accounting Standards Update (ASU) that intends to simplify the presentation of debt issuance costs. The new standard will more closely align the presentation of debt issuance costs under U.S. GAAP with the presentation under comparable IFRS standards.¹

Key Facts

- Debt issuance costs related to a recognized debt liability will be presented on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts.

- The ASU is effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. It is effective for all other entities for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016.

Key Impact

- The cost of issuing debt will no longer be recorded as a separate asset, except when incurred before receipt of the funding from the associated debt liability.

¹ FASB Accounting Standards Update No. 2015-03, Simplifying the Presentation of Debt Issuance Costs, available at www.fasb.org.
Presentation of Debt Issuance Costs

Under current U.S. GAAP, debt issuance costs are reported on the balance sheet as assets and amortized as interest expense. The ASU requires that they be presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability, which is similar to the presentation of debt discounts or premiums. The costs will continue to be amortized to interest expense using the effective interest method.

Example 1: Presentation of Debt Issuance Costs before and after Adoption

On December 31, 201X, an entity issues a noninterest bearing debt security due in two years, with a face amount of $1,000,000, to an investor for $907,030. On the same date, the entity incurs and pays issuance costs of $25,000 to parties other than the investor.

Presentation of debt issuance costs on December 31, 201X, under the existing standard, and under the new standard are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Existing Standard</th>
<th>New Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt issuance costs (asset)</td>
<td>$25,000</td>
<td>$n/a</td>
</tr>
<tr>
<td>Noninterest bearing note</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Less unamortized discount based on imputed interest rate of 5%</td>
<td>92,970</td>
<td>92,970</td>
</tr>
<tr>
<td>Less unamortized debt issuance costs</td>
<td>n/a</td>
<td>25,000</td>
</tr>
<tr>
<td>Note payable, net</td>
<td>$907,030</td>
<td>$882,030</td>
</tr>
</tbody>
</table>

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KPMG Observations

Presentation of debt issuance costs as a direct deduction from the related debt liability is consistent with the discussion in paragraph 237 of FASB Concepts Statement No. 6. This paragraph states that debt issuance costs are similar to debt discounts and effectively reduce the proceeds of borrowing, which increases the effective interest rate. This discussion also states that debt issuance costs are not assets for the same reason that debt discounts are not because the costs provide no future economic benefit. The presentation required by the new ASU will also improve consistency with IFRS, which requires transaction costs, including third-party costs and creditor fees, to be deducted from the carrying amount of the financial liability and not recorded as separate assets.

The FASB acknowledged that in circumstances in which there is not an associated debt liability amount recorded in the financial statements when the debt issuance costs are incurred (e.g., the costs are incurred before funding is received), they will be reported on the balance sheet as an asset until the debt liability is recorded.

The ASU is limited to simplifying the presentation of debt issuance costs. The recognition and measurement guidance for debt issuance costs is not affected by the ASU. For example, guidance for debt issuance costs in accounting for conversion options (ASC paragraph 470-20-30-13) or accounting for third-party costs of exchange or modification of debt instruments (ASC paragraph 470-50-40-18) has not changed. Entities should continue to track debt issuance costs separately from debt discounts as required by other accounting guidance.

There will be no effect on the income statement upon adoption of the ASU because both debt issuance costs and debt discounts are amortized using the effective interest method, which is unchanged by the ASU.

Transition and Effective Date

The ASU requires retrospective application to all prior periods presented in the financial statements. Upon transition, an entity is required to comply with the applicable disclosures for a change in accounting principle, including the:

- Nature of and reason for the change in accounting principle;
- Transition method;
- Description of the prior-period information that has been retrospectively adjusted; and
- Effect of the change on the financial statement line items (the debt issuance cost asset and the debt liability).

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Public business entities must apply the new requirements in fiscal years beginning after December 15, 2015, and interim periods within those fiscal years.

All other entities must apply the new requirements in fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016.

All entities have the option of adopting the new requirements as of an earlier date for financial statements that have not been previously issued.

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