FASB FINANCIAL ACCOUNTING STANDARDS BOARD

MEMO

Memo No. **1**

Issue Date **June 12, 2025**

Meeting Date **PCC Meeting June 27, 2025**

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Project	**PCC Agenda Priorities**
Project Stage	**Private Company Pre-Agenda Research**
Issue	**Interest Method and Determining the Effective Interest Rate**

Background Information and Memo Purpose

1. During the March 6, 2025, Private Company Council (PCC) meeting, PCC members discussed challenges in applying the subsequent measurement requirements in Topic 835, Interest. The current guidance requires the application of the interest method of loan amortization and states that other methods of amortization may be used if the results obtained are not materially different from those that would result from the interest method.

2. During the March meeting, PCC members discussed whether private company alternatives could be developed to simplify the guidance. For example, PCC members discussed alternatives under which debt issuance costs and/or discounts could be amortized on a straight-line basis (without considering whether the results would be materially different from the interest method). PCC members also discussed an approach in which a private company would recognize interest expense based on the amount that is characterized as interest according to the terms of a loan agreement while amortizing any other amounts (such as debt issuance costs and discounts) through interest expense on a straight-line basis. Following this discussion, the PCC asked the staff to perform additional research on this topic.

3. The purpose of this memo is to provide (a) an update on the staff's research (including outreach) conducted since the March 6, 2025 PCC meeting and (b) preliminary considerations from the staff related to potential private company alternatives to the interest method requirements in Topic 835. In its research update, the staff highlights areas where stakeholders' feedback aligns with feedback received from PCC members. For example, the staff's outreach indicated that, consistent with past PCC feedback, private companies often attempt to amortize loans using a method similar to the straight-line method in which the amounts designated as interest in a loan agreement serve as the starting point for the calculation of interest expense.

Questions for the PCC

1. Does the PCC have any questions or comments on the feedback received from practitioners?
2. Does the PCC have any questions or comments on the staff analysis?
3. Does the PCC want to prioritize additional research related to applying the interest method to cash loans? If so, what additional areas of research should the staff perform to assist the PCC in making an agenda decision?

4. This memo is organized as follows:

   (a) Overview of Current Guidance

   (b) Staff Research: Practitioner Views on Current Guidance

   (c) Staff Research: Practitioner Views on Potential Solutions

   (d) Staff Analysis: Potential Private Company Alternatives

   (e) Next Steps

   (f) Appendix A: Illustration of Alternatives

   (g) Appendix B: Codification References to *Interest Method* and *Effective Interest Rate*

Overview of Current Guidance

Interest, Stated Interest Rates, and the Effective Interest Rate

5. Under Topic 835, the total amount of interest during the entire period of a cash loan generally equals the difference between the actual amount of cash received by the borrower and the total amount agreed to be repaid to the lender.

6. Loans generally have a stated rate of interest, which refers to the rate of interest specified in the loan agreement. However, under GAAP, interest expense is normally calculated based on the carrying amount of a loan and its *effective interest rate* (rather than the stated rate of interest). The effective interest rate is calculated by projecting all the cash flows under the debt terms and solving for the discount rate that equates the present value of the cash flows under the terms to the debt's carrying amount. Therefore, if the carrying amount does not equal the present value of the total loan repayments discounted at the stated interest rate, the effective rate will be different from the stated interest rate. That difference can occur when debt is issued at a discount or premium.

7. For example, for a loan with a face amount of $50,000 and a stated interest rate of 5 percent in which (a) the net proceeds the borrower receives and the debt's initial carrying amount are $40,000, (b) the borrower must pay $2,500 of interest annually, and (c) the borrower must pay $50,000 at the end of three years, the effective interest rate would equal 13.55 percent. That is, the loan is issued at

a discount, which results in the effective interest rate of 13.55 percent being greater than the stated interest rate of 5 percent.

	A	B
1	Calculation of Effective Interest Rate	Cash Outflow (Inflows)
2	Year 0	($40,000)
3	End of Year 1	$2,500
4	End of Year 2	$2,500
5	End of Year 3	$52,500
6		
7	Effective Interest Rate (formula)	**=IRR(B2:B5)**
8	Effective Interest Rate (result)	13.550%

8. The remainder of this section highlights (a) other circumstances in which the stated interest rate may not reflect the market rate of interest and (b) the related requirements in GAAP.

Other Circumstances in Which the Stated Rate Does Not Equal the Effective Interest Rate

9. In the following sections, the staff has summarized other circumstances (besides original issue discounts and premiums) that can cause the stated rate to differ from the effective interest rate.

Debt Issuance Costs

10. Topic 835 requires that debt issuance costs related to a note be reported as a reduction of the carrying amount of the note; therefore, debt issuance costs also can cause the effective interest rate to be different from the stated interest rate. Update 2015-03, *Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, discussed the conceptual reasons for including debt issuance costs in the carrying amount of issued debt based on (now superseded) Concepts Statement No. 6, *Elements of Financial Statements*.

> **BC4.** To simplify the presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from that debt liability, consistent with the presentation of a debt discount. This presentation is consistent with the guidance in Concepts Statement 6, which states that debt issuance costs are similar to a debt discount and in effect reduce the proceeds of borrowing, thereby increasing the effective interest rate. Concepts Statement 6 further states that debt issuance costs are not assets because they provide no future economic benefit.…
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> **BC5.** The Board considered requiring that debt issuance costs be recognized as an expense in the period of borrowing, which is one of the options to account for those costs in Concepts Statement 6. The other option considered was to account for those costs as a valuation account presented as a deduction from the face amount of debt, which is the same as the guidance in the amendments in this Update. The Board rejected the alternative to expense debt issuance costs in the period of the borrowing. The Board concluded that this decision is consistent with the accounting treatment for issuance costs associated with equity instruments as noted in the preceding paragraph. Additionally, the Board concluded that accounting for debt issuance costs as an expense would be inconsistent with the guidance for recognition and measurement of

debt discount or premium and loan origination costs and fees by a lender, which are all deferred and amortized using the interest method.

11. Although paragraphs BC4 and BC5 of Update 2015-03 discuss Concepts Statement No. 6 (which referred to "debt issue cost" explicitly), that Concepts Statement has since been superseded by the issuance of Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, Chapter 4, *Elements of Financial Statements*. The staff notes that Concept Statements, which guide the Board in developing accounting and reporting standards by providing the Board with a common foundation and basic reasoning on which to consider merits of alternatives, no longer explicitly address debt issue costs. Instead, any issues related to debt issue costs would be considered as a part of a standards-level project.

Fees Paid to a Lender

12. Fees paid to a lender (rather than a third-party) reduce the initial carrying amount of the issuer's debt by reducing the net proceeds received. The Master Glossary defines *discount* as the difference between the *net proceeds* received after expenses and the amount repayable at maturity. Similarly, *premium* is defined as the excess of the *net proceeds* received after expenses over the amount repayable at maturity.

Other Rights and Obligations in the Same Offering as a Debt Instrument

13. Topic 835 also states that the effective interest rate may differ from the stated interest rate of a loan because amounts are allocated to other rights and obligations in the debt instrument. For example, paragraph 835-30-25-6 provides guidance describing scenarios in which a loan does not earn the stated rate of interest.

> **835-30-25-6** A note issued solely for cash equal to its face amount is presumed to earn the stated rate of interest. However, in some cases the parties may also exchange unstated (or stated) rights or privileges, which are given accounting recognition by establishing a note discount or premium account. In such instances, the effective interest rate differs from the stated rate.

14. Debt instruments also may be issued with other instruments such as detachable warrants that result in an allocation of net proceeds to the other instruments. For example, paragraph 470-20-25-2 states that proceeds from the sale of a debt instrument with stock warrants should be allocated to the two elements (the debt and the warrants) based on the relative fair values of the debt instrument (on a standalone basis) and the warrants.

> **> Debt Instruments with Detachable Warrants**
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> **470-20-25-2** Proceeds from the sale of a debt instrument with stock purchase warrants (detachable call options) shall be allocated to the two elements based on the relative fair values of the debt instrument without the warrants and of the warrants themselves at time of issuance. The portion of the proceeds so allocated to the warrants shall be accounted for as paid-in capital. The remainder of the proceeds shall be allocated to the debt instrument portion of the transaction. This usually results in a discount (or, occasionally, a reduced premium), which shall be accounted for under Topic 835.

15. Additionally, certain hybrid instruments may contain embedded features that are required to be bifurcated (for example, under the guidance in Topic 815, Derivatives and Hedging). Under Topic 815, the amount allocated to the debt instrument (the host contract) will be reduced by any amounts allocated to the bifurcated derivative. This results in a carrying amount for the issued debt instrument that is less than the proceeds received which, in turn, results in the effective interest rate on the debt being different from the stated rate of interest pursuant to the debt instrument's terms.

> **> Hybrid Instruments That Are Separated**
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> **815-15-30-2** The allocation method that records the embedded derivative at fair value and determines the initial carrying value assigned to the host contract as the difference between the basis of the hybrid instrument and the fair value of the embedded derivative shall be used to determine the carrying values of the host contract component and the embedded derivative component of a hybrid instrument if separate accounting for the embedded derivative is required by this Subtopic. (Note that Section 815-15-25 allows for a fair value election for hybrid financial instruments that otherwise would require bifurcation.)

Troubled Debt Restructurings

16. In a troubled debt restructuring (TDR) involving only a modification of terms of a payable, an entity accounts for the restructuring prospectively. The debt's carrying amount remains unchanged unless it exceeds the total (undiscounted) future cash payments. The characterization of those future payments (as interest or principal) does not affect the required accounting.

17. Subtopic 470-60 states that changes in amounts or timing of future cash payments are reflected in future periods and that interest expense is calculated using a constant effective interest rate applied to the payable's carrying amount at the beginning of each period until maturity. The new effective interest rate is calculated as the discount rate that equates the present value of the restructured future cash payments with the existing payable's carrying amount.

18. Conversely, if the total future cash payments specified by the new terms of a payable (including both payments designated as interest and those designated as face amount) are less than the carrying amount of the payable, the debtor is required to reduce the carrying amount to the amount of the total future cash payments specified by the new terms (with recognition of a gain equal to the amount of the reduction). Thereafter, all cash payments are accounted for as reductions of the carrying amount of the payable, and no interest expense is recognized for any period between the restructuring and maturity of the payable.

19. During the development of FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, some stakeholders favored this approach because "there is no economic basis for distinguishing modification or future cash receipts or payments designated as interest from modification of future cash receipts or payments designated as face amount."

> **124.** According to respondents who emphasized the effect of a troubled debt restructuring on the effective interest rate, *there is no economic basis for distinguishing modifications*

> *of future cash receipts or payments designated as interest from modifications of future cash receipts or payments designated as face amount*. They argued that a creditor in a troubled debt restructuring attempts first to assure recovery of its investment (which is represented in its financial statements by the recorded investment in the receivable) and then to obtain the highest interest income commensurate with the situation. Whether the amounts to be received under the new terms are designated as receipts of interest or receipt of face amount is a minor consideration; the significant question is whether the new terms allow the creditor to recover its investment. [Emphasis added.]

20. The Board indicated that it agreed with those respondents and noted that it "believes that accounting for restructured debt should be based on the substance of the modifications—the effect on cash flows—not on the labels chosen to describe those cash flows."

Modifications and Exchanges

21. Following a debt exchange or modification accounted for under Subtopic 470-50, the stated interest rate and effective interest rate often will not be equal.

22. If modification accounting is applied, the effective interest rate is calculated to equate the present value of the stream of future payments under the terms of the new or modified debt instrument (regardless of whether those future payments are characterized as interest or principal) with the carrying amount of the existing debt.

23. If extinguishment accounting is applied, the carrying amount is based on the fair value of the future cash payments due under the terms of the modified or new instrument. Therefore, the discount rate used to determine the fair value of those payments may not equal the interest rate provided in the terms of the new or modified debt instrument.

Amortization

24. Topic 835 describes several different methods for amortizing any difference between the carrying amount of a loan so that, at the end of the loan term, the difference between the cash proceeds received (net of debt issuance costs) and the cash outflows equal the cumulative interest expense recognized. What primarily distinguishes those methods from one another is the period in which interest expense is recognized and the carrying amounts of the loan at the end of each period between issuance and maturity.

25. The methods listed in Topic 835 include the interest method, rule of 78s, sum of the years' digits, and straight-line methods. Those methods are described further below.

Method	**Description**
Interest method	The method used to arrive at a periodic interest cost (including amortization) that will represent a level effective rate on the sum of the face amount of the debt and (plus or minus) the unamortized premium or discount and expense at the beginning of each period.

Method	Description
Rule of 78s/Sum of years' digits	Methods that use a declining fraction (the denominator of which is determined using a type of sum of years' digits calculation) to determine periodic interest cost.[1]
Straight-line method	Any debt discount or premium and debt issuance costs for a nonamortizing loan are amortized in equal periodic amounts over the life of the debt instrument.[2]

26. Those methods were first listed in APB Opinion No. 12, *Omnibus Opinion—1967,* and in APB Opinion No. 21, *Interest on Receivables and Payables*. APB 21 also noted that the interest method should be used unless the "results obtained are not materially different from those which would result from the 'interest' method" (this guidance was codified in paragraph 835-30-35-4).

27. One of the differences between the interest method and the other methods of amortization is that, at any point in time, the carrying amount under the interest method equals the present value of remaining payments (discounted at the effective interest rate and assuming that all cash receipts or payments occur as specified in the agreement). By contrast, the other methods do not result in a level interest rate being applied to the carrying amount of the loan. Therefore, under those other methods (a) the carrying amounts do not necessarily reflect the present value of the remaining payments and (b) the interest expense recognized may not be proportional with the carrying amount of the loan (because the interest expense is not necessarily calculated based on the carrying loan's carrying amount).

Use of the Effective Interest Rate and Interest Method in Other Areas of GAAP

Disclosure Requirements

28. Paragraph 835-30-45-1A provides requirements for the balance sheet presentation for the discount or premium and debt issuance costs of a note and paragraph 835-30-45-2 states that "the description of the note shall include the *effective interest rate*." [Emphasis added.]

Other Areas of GAAP

29. Apart from the guidance in Topic 835, there are several areas of GAAP that require the calculation of an effective interest rate or require application of the interest method as described in Topic 835. Appendix B provides a list of references to the interest method and the effective interest rate in the Codification.

30. The following are some examples of Topics in GAAP that require the calculation of the effective interest rate and the use of the interest method.

[1] See Deloitte Publication, *Issuer's Accounting for Debt (March 2025)*.

[2] Ibid (Deloitte).

(a) Topic 310, Receivables, provides guidance for a lender, including applying the interest method to accrue interest income on receivables (for example, see paragraph 310-20-35-18).

(b) Topic 326, Financial Instruments—Credit Losses, states that "if an entity estimates expected credit losses using methods that project future principal and interest cash flows (that is, a discounted cash flow method), the entity shall discount expected cash flows at the financial asset's effective interest rate." (See paragraph 326-20-30-4.)

(c) Topic 410, Asset Retirement and Environmental Obligations, requires the use of the interest method for subsequent measurement of asset retirement obligations (see paragraph 410-20-35-5).

(d) Multiple areas in GAAP provide guidance on the application of the interest method to insurance contracts including, Topic 340, Other Assets and Deferred Costs, Topic 720, Expenses, and Topic 944, Financial Services—Insurance. (See Appendix B.)

(e) Topic 606, Revenue, requires that an entity present the effects of financing separately from revenue using the interest method (see paragraph 606-10-32-20).

(f) Topic 842, Leases, requires the application of the interest method for finance leases (for example, see paragraph 842-20-55-37). Operating lease liabilities are measured the same way; however, the calculation is described differently in Topic 842 (see paragraph 842-20-35-3 and see EY Financial Reporting Developments, Lease Accounting (July 2024), which states that "although the subsequent measurement of operating lease liabilities and finance lease liabilities is described differently, the calculation results in the same amount each period").

Staff Research: Practitioner Views on Current Guidance

Overview of Outreach Conducted

31. Since the March PCC meeting, the staff has conducted outreach with practitioners to better understand their (a) experience in practice with the interest method and (b) views on potential private company alternatives in this area. Those practitioners consisted of three mid-size accounting firms and the AICPA's Technical Issues Committee (TIC).

Overall Sentiment Shared in Outreach

32. Most practitioners the staff spoke with questioned whether the PCC should prioritize a project to simplify the amortization of debt issuance costs and/or discounts. While all the practitioners acknowledged that, in practice, private companies generally apply the straight-line method, they generally did not view this area as a high-priority issue in need of a standard setting solution and sometimes raised other areas of the guidance they believed could be improved (for example, the guidance on TDRs in Subtopic 470-60).

33. Practitioners indicated that there can be a variety of reasons why private companies apply the straight-line method: the straight-line method takes less time to calculate, the debt issuance costs and/or discounts are not material, preparers do not know how to apply the interest method, or preparers are unaware of the requirement to apply the interest method.

34. Most practitioners also stated that they did not believe that changes to the required method of loan amortization would generally affect the decision-usefulness of information provided to investors because investors generally rely on metrics that exclude interest expense (for example, earnings before interest, taxes, depreciation, and amortization [EBITDA]) or rely on understanding the contractual terms of the cash outflows under the debt arrangements instead of the information provided in the borrower's financial statements. Therefore, although practitioners questioned whether this issue represented an area that the PCC or Board should prioritize, none expressed strong opposition to developing private company simplifications in this area.

35. One practitioner also questioned why changes to the interest method would be limited to only private companies and explained that the challenges encountered in practice also affected public business entities.

Overview of Topics Discussed in Outreach

36. During outreach, the following topics related to the application of current guidance were discussed with practitioners:

    (a) Causes of differences between stated interest rates and effective interest rates

    (b) Application of the interest method and straight-line method.

Causes of Differences Between Stated Interest Rates and Effective Interest Rates

37. Practitioners generally indicated that it is common for the effective interest rate and stated interest rate on cash loans to differ. For example, one practitioner specifically noted that entities generally need to calculate the effective interest rate to appropriately apply the interest method because almost every issued debt instrument will have at least one of the following: (a) an original issue discount (OID), (b) debt issuance costs, (c) a bifurcated derivative, or (d) detachable warrants to which value has to be allocated. Therefore, that practitioner indicated that it is rare for an instrument to have an effective interest rate that perfectly equals the stated interest rate.

38. Practitioners indicated that the most common causes of differences between the stated interest rate and effective interest rate included debt issuance costs and fees paid to lenders/OIDs. However, those practitioners generally noted that these transactions generally did not lead to significant differences between the stated interest rate and the effective interest rate.

39. However, practitioners also highlighted that when private companies issue debt instruments with warrants, the differences between the stated interest rate and the effective interest rate can be

significant. For example, one practitioner indicated that warrants, when issued with debt, are often allocated a significant amount of the proceeds received and that it has observed scenarios in which the fair value of the warrants issued exceeds the amount of proceeds received.

40. Three practitioners similarly noted that while debt instruments issued by private companies typically do not have embedded derivatives that are bifurcated, when bifurcated derivatives are present, they often lead to significant differences between the stated interest rate and the effective interest rate.

41. Furthermore, some practitioners noted that application of the guidance on exchanges and modifications under Subtopic 470-50 and/or the TDR guidance in Subtopic 470-60 also can result in differences between the stated interest rate and the effective interest rate.

Application of the Interest Method and Straight-Line Method

42. Consistent with feedback previously shared by some PCC members, practitioners generally indicated that private company (and some public company) preparers often amortize cash loans using the straight-line method (or using a method similar to the straight-line method with the contractual interest used as a starting point). Therefore, auditors generally test whether the difference between the straight-line method and the interest method is material (and therefore, whether the preparer is following the guidance in Topic 835 stating that other methods of amortization may be used if the results obtained are not materially different from those that would result from the interest method).

43. One practitioner noted that they rarely see the interest method applied correctly in practice. This practitioner explained that they often see clients either using the straight-line method or making errors in applying the interest method.

44. Similarly, another practitioner indicated that its private company clients either recognize interest expense based on the amortization table provided in the loan agreement or use the straight-line method. That practitioner noted that it works with its clients to determine whether the results produced by the straight-line method are materially different from those that would be produced by the interest method and that the differences are seldom material. That practitioner also observed that, typically, its clients generally disclose that they are applying the straight-line method for loan amortization and that the straight-line method is often a reasonable approximation of the results that would be obtained under the interest method.

45. A different practitioner noted that, while they do not receive inquiries at the national office level on the application of the interest method, in their experiences at the audit team level, entities frequently attempt to amortize cash loans using the straight-line method.

46. Another practitioner stated that its clients generally do not have difficulty applying the interest method and highlighted that it can provide education, if necessary, to help its audit teams and clients understand how to apply the interest method. The practitioner emphasized that there is a wide variety of publicly

available resources that explain how to apply the interest method including instructional videos available on video streaming platforms that are free to access. That practitioner observed that the straight-line method may be preferred because it is simpler and less challenging to apply. However, the practitioner also stated that questions on this issue are rarely escalated to its national office and, therefore, it may not have optimal visibility into the issues encountered in practice.

Staff Research: Practitioner Views on Potential Solutions

Overview of Alternatives to Address the Issues Identified

47. During outreach conducted with practitioners, the staff solicited feedback on the following potential private company alternatives. The staff considers those to represent private company alternatives rather than practical expedients.[3]

    (a) Alternative A (Contractual Interest with Straight-Line Amortization)—Election[4] to calculate interest expense as follows:

        (i) Amounts designated in the loan agreement as interest

        (ii) +/ − Amortization of debt discount or premium on a *straight-line basis* (including any debt discount or premium arising from bifurcation at issuance)

        (iii) +/ − Amortization of debt issuance costs on a *straight-line basis*

    (b) Alternative B (Straight-Line Amortization of Debt Issuance Costs)—Election to calculate interest expense as follows:

        (i) Amounts designated in the loan agreement as interest

        (ii) +/ − Amortization of debt discount or premium using the *interest method* (including any debt discount or premium arising from bifurcation at issuance)

        (iii) +/ − Amortization of debt issuance costs on a *straight-line basis.*

48. During the March 2025 PCC meeting, two PCC members expressed interest in pursuing a “contractual interest method” while amortizing any other amounts (such as debt issuance costs and discounts) on a straight-line basis. Alternative A would align with this approach. The staff thinks this method is clearer about how it would apply to amortizing loans than a method that was simply referred to as the “straight-line method.”

[3] Practical expedients are defined in the Private Company Decision Making Framework as “a more cost-effective way of achieving the same or a similar accounting or reporting objective.” The staff does not think that these approaches attempt to achieve the same objective as the interest method, because they do not attempt to establish a level interest rate at a loan’s inception and apply that rate throughout the duration of the loan, while taking all relevant costs into account.

[4] Depending on the PCC’s interest in prioritizing a project on this issue, the staff would provide an analysis in the future as to whether each election should be an entity-wide or instrument-by-instrument election.

49. Additionally, during a PCC Education Session conducted in February 2025, one PCC member suggested continuing to apply the interest method while "straight-lining other related costs." Therefore, the staff developed Alternative B to better understand whether permitting the application of the straight-line method specifically to debt issuance costs would provide relief to private company stakeholders.

50. Illustrations of the application of those alternatives are included in Appendix A.

51. For the purpose of soliciting outreach feedback, the staff assumed that those alternatives would only relate to liabilities (that is, those alternatives would not affect the requirements for a lender or investor in debt securities).

Alternative A (Contractual Interest with Straight-Line Amortization)

52. Practitioners provided mixed feedback on Alternative A. Two practitioners indicated that, if the PCC pursued a private company alternative in this area, they would prefer Alternative A because it best reflects how preparers currently amortize loans under current guidance and, therefore, most directly address any challenges encountered in practice. That is, they noted that Alternative A could benefit practice because it may eliminate the need for preparers and practitioners to determine whether the results using the straight-line method are materially different from those that would result from the interest method.

53. The other practitioners the staff conducted outreach with agreed that Alternative A would be more straightforward to apply than the interest method and would align with how private company preparers often attempt to amortize loans in practice.

54. However, one of those practitioners expressed concerns that Alternative A would affect financial reporting outcomes if entities were permitted to apply it to all debt arrangements, regardless of materiality. For example, the practitioner noted that there are some instances under Alternative A in which an entity could arrive at a "highly unreasonable answer" and that the PCC would need to consider guidance to limit the application of this alternative in those circumstances. Specifically, that practitioner expressed concern that, in a scenario in which the stated interest rate differed significantly from the effective rate (particularly when an instrument was issued with warrants or has a bifurcated derivative), interest expense recognized in each period would bear little relationship to the carrying amount of the debt. The practitioner also discussed the potential for structuring under Alternative A because the calculation is influenced by the *amount designated in the loan as interest*. Therefore, that practitioner indicated its preference for approaches other than Alternative A (although it also reiterated that it did not think this was a significant issue that the PCC needed to address).

55. Similarly, the other practitioner that acknowledged Alternative A would align well with current practice indicated that it may be unnecessary because entities already apply a similar method and that this practice does not cause any significant difficulties. The practitioner emphasized that it did not believe

that addressing issues related to the interest method should be prioritized by the PCC, particularly when considering other challenges that exist in applying the GAAP requirements for debt arrangements.

Alternative B (Straight-Line Amortization of Debt Issuance Costs)

56. Practitioners also provided mixed feedback on Alternative B. One practitioner stated that it would prefer Alternative B to Alternative A because it did not think that straight-line amortization of only debt issuance costs would result in financial reporting outcomes that were inconsistent with the economics of the arrangement. That practitioner also noted that in many instances debt issuance costs are the only factor producing a difference between the stated interest rate and the effective interest rate and, therefore, Alternative B would apply to a relatively large population of private companies and transactions. However, that practitioner also said it was unclear as to the extent to which Alternative B would significantly reduce complexity. That practitioner acknowledged that the benefits of this approach could be limited because debt issuance costs are typically not material.

57. Other practitioners indicated that the benefits of electing Alternative B would not justify the costs.

58. For example, one of those practitioners highlighted that under Alternative B, the challenges related to private companies applying the straight-line method to amortize many debt discounts would persist. That practitioner also indicated that, in some instances, Alternative B, by differentiating the amortization methods required for different sources of debt discounts, would potentially create new complexity. For example, it could necessitate that preparers keep a separate schedule (or a separate column in spreadsheet software) for amortizing the debt issuance costs and for amortizing any other discount or premium. That practitioner also highlighted that debt issuance costs do not tend to be significant.

59. Similarly, another practitioner indicated that debt issuance costs are often not significant relative to other factors that can result in the stated rate differing from the effective rate.

Other Considerations

Scope and Interaction with Other Areas of Guidance

60. The staff also solicited feedback on the use of the effective interest rate and interest method in other areas of GAAP, including those described beginning in paragraph 28, and whether the practitioners think that a private company alternative permitting the use of the straight-line method should be extended to those other areas.

61. Practitioners generally agreed that any private company alternative permitting the straight-line method should be limited to debt and did not indicate that there was a need to alter any of the other areas of GAAP.

62. One practitioner noted that some entities that have applied the straight-line method have struggled to determine the effective rate on a loan as part of applying the 10 percent test in Subtopic 470-50. A different practitioner stated that, in applying the TDR guidance in Subtopic 470-60 or the 10 percent

cash flow test in Subtopic 470-50, preparers would not necessarily need to know the original effective interest rate, only the effective interest rate immediately preceding the debt modification which could be calculated if the straight-line amortization method was used prior to the modification or exchange (and, therefore, a straight-line alternative that did not change the requirements in those other areas of GAAP would not be problematic).

63. The staff also asked one practitioner how entities meet the requirement to disclose the effective interest rate in Topic 835 while simultaneously applying the straight-line method in practice. That practitioner indicated that entities would calculate an effective interest rate upon issuing a debt instrument but then would not use the calculated effective interest rate to amortize the loan (the calculation would be performed only for the purpose of satisfying the disclosure requirement).

Other Alternatives Raised by Practitioners

64. The practitioners the staff spoke with did not indicate that there were other alternatives that the PCC should consider.

Staff Analysis: Potential Private Company Alternatives

Overall

65. On the basis of practitioner outreach performed to date, the staff thinks it is unclear whether there is a sufficiently pervasive need to improve GAAP and whether any of the alternatives considered in this memo are likely to justify the expected costs of change.

66. The staff expects that a private company alternative to the interest method would primarily benefit private company auditors because practitioners indicated that the evaluation of whether the results are materially different under the straight-line method and interest method is typically performed by auditors. Therefore, if a private company alternative was provided (particularly Alternative A), auditors would be able to bypass the evaluation of whether outcomes under the straight-line method are materially different from outcomes under the interest method. However, the practitioners the staff spoke with stated that they did not have significant concerns with current practice and did not recommend that the PCC or Board prioritize a project to address this issue.

67. Additionally, the staff has several concerns about the potential alternatives that are discussed in greater detail below.

Alternative A (Contractual Interest with Straight-Line Amortization)

68. While the staff understands from outreach discussions that a method similar to Alternative A is currently applied in practice by many private companies when the difference between the straight-line method and the interest method is immaterial. However, the staff thinks there would be drawbacks to explicitly permitting straight-line loan amortization for private companies when the difference between the

straight-line method and the interest method is material. Specifically, the staff has concerns about the potential effect on the decision-usefulness of private company financial statements and thinks it is unclear whether the benefits of Alternative A would justify the costs of change.

Potential Effect on Decision-Usefulness of Private Company Financial Statements

69. One of the staff's concerns with Alternative A is that in instances in which the proceeds received are materially different from the face amount of the debt instrument (due to either bifurcation of an embedded feature or a significant discount or premium), the interest expense recognized under Alternative A may not be proportionate to the carrying amount of the debt.

70. That scenario is illustrated in Example 3 in Appendix A, which shows the difference in interest expense between the interest method and Alternative A for a five-year debt instrument issued at a discount of $31,800 (approximately 24 percent of the face amount of the instrument). In that example, at the beginning of the life of the instrument the interest expense for Alternative A is equal to approximately 7 percent of the carrying amount. However, at the end of the life of the instrument, the interest expense is equal to approximately 36 percent of the carrying amount. This is contrasted by the interest method under which interest expense would be equal to 11.2 percent of the carrying amount throughout the life of the debt instrument.

71. Examples 2 and 3 in Appendix A also demonstrate that the financial reporting outcomes under Alternative A could be affected significantly by how debt agreements *label* future cash flows. To illustrate that issue, the staff highlights that the timing of cash flows under Examples 2 and 3 are identical (the only difference is how those cash flows are described in the loan agreement). However, under Alternative A, the financial reporting outcomes for Examples 2 and 3 would be significantly different. Accordingly, the staff has concerns that the accounting under Alternative A would be influenced by labels that are chosen to describe future cash flows and thinks this could lead to unintuitive outcomes and could create structuring opportunities that do not exist under current GAAP.

Whether the Potential Benefits Would Justify the Costs of Change

72. The staff acknowledges that because Alternative A aligns with the method used by private companies in practice, there are many scenarios in which Alternative A would not significantly affect financial reporting outcomes because it would produce outcomes materially similar to the interest method. However, in those scenarios the staff also questions whether Alternative A would represent a significant improvement from current guidance. That is, the staff questions whether significant benefits will be realized in practice by explicitly permitting what many private companies are already doing.

73. Moreover, the staff believes that any benefits in those scenarios could be further diminished if the PCC choses to limit the application of Alternative A to exclude certain types of debt (such as debt issued with warrants or containing a bifurcated derivative) in an effort to address the issues raised in paragraphs 70 and 71 (as was suggested by a practitioner in outreach). That is, if entities had to apply

detailed scoping guidance to determine whether they are eligible to apply Alternative A, it is possible that Alternative A could become more complex and costly to apply than current guidance.

Alternative B (Straight-Line Amortization of Debt Issuance Costs)

74. Although the staff thinks that Alternative B is less likely to negatively affect financial reporting outcomes, it is unclear whether the benefit of allowing the straight-line amortization of debt issuance costs would justify the costs of change.

Potential Effect on Decision-Usefulness of Private Company Financial Statements

75. The staff understands from outreach that debt issuance costs are not typically material and, therefore, entities often conclude that the use of the straight-line method of amortizing debt issuance costs is acceptable under current GAAP.

76. Furthermore, because debt issuance costs are not typically material, there is less potential for Alternative B to result in the same type of unintuitive outcomes and structuring opportunities that could arise under Alternative A. For example, the interest expense under Alternative B would generally remain strongly correlated to the debt's carrying amount when the debt issuance costs are not highly material because under Alternative B, any residual discount or premium would be amortized using the interest method.

77. Moreover, because Alternative B only affects debt issuance costs, the staff expects that it may be less challenging to develop a scope for Alternative B than for Alternative A. For example, the staff thinks the same scope that applied to the amendments in Update 2015-03 (which simplified the presentation of debt issuance costs) could serve as a starting point for the scope of Alternative B.

Whether the Potential Benefits Would Justify the Costs of Change

78. However, the feedback received from practitioners generally indicated that Alternative B would not provide for a significant private company simplification of the current guidance. Practitioners also expressed concerns that Alternative B could introduce complexities (for example, related to tracking debt issuance costs separately from all other sources of a debt discount or premium) that do not exist under current guidance. Similarly, the staff thinks that the benefits of Alternative B would generally be limited to scenarios in which the *only* cause of a difference between the carrying amount and the face amount is debt issuance costs.

Next Steps

79. The staff will seek direction from the PCC on next steps during the June 2025 PCC meeting.

Appendix A: Illustration of Alternatives

Illustrative Example 1—Loan with Five-Year Bullet Maturity (Discount)

A1. A 5-year $100,000 debt instrument was issued for net proceeds of $90,000 (debt issuance costs of $3,000) and has a stated coupon rate of 10 percent per annum, payable annually in arrears. The principal is due at the end of five years.

A2. A comparison of the interest method, Alternative A, and Alternative B is included below.

Interest Method		Effective Rate	12.83%	
Date	Pmt (net of $3K debt issue costs)	Interest Expense	Carry Amt Increase (Decrease)	Carrying Amount
0	$ (90,000)	$ -	$ -	$ 90,000
1	$ 10,000	$ 11,548	$ 1,548	$ 91,548
2	$ 10,000	$ 11,747	$ 1,747	$ 93,295
3	$ 10,000	$ 11,971	$ 1,971	$ 95,266
4	$ 10,000	$ 12,224	$ 2,224	$ 97,491
5	$ 110,000	$ 12,509	$ (97,491)	$ 0

Alternative A		A	B	C	A + B + C		
Date	Pmt (net of $3K debt issue costs)	Amounts Designated as Interest	Discount ($7k) Amortization	Debt Issuance Cost ($3k) Amortization	Interest Expense	Carry Amt Increase (Decrease)	Carrying Amount
0	$ (90,000)	$ -	$ -	$ -	$ -	$ -	$ 90,000
1	$ 10,000	$ 10,000	$ 1,400	$ 600	$ 12,000	$ 2,000	$ 92,000
2	$ 10,000	$ 10,000	$ 1,400	$ 600	$ 12,000	$ 2,000	$ 94,000
3	$ 10,000	$ 10,000	$ 1,400	$ 600	$ 12,000	$ 2,000	$ 96,000
4	$ 10,000	$ 10,000	$ 1,400	$ 600	$ 12,000	$ 2,000	$ 98,000
5	$ 110,000	$ 10,000	$ 1,400	$ 600	$ 12,000	$ (98,000)	$ -

Alternative B		A	B	C	A + B + C	Effective Rate	11.94%
Date	Pmt (net of $3K debt issue costs)	Amounts Designated as Interest	Discount ($7k) Amortization	Debt Issuance Cost ($3k) Amortization	Interest Expense	Carry Amt Increase (Decrease)	Carrying Amount
0	$ (90,000)	$ -	$ -	$ -	$ -	$ -	$ 90,000
1	$ 10,000	$ 10,000	$ 1,103	$ 600	$ 11,703	$ 1,703	$ 91,703
2	$ 10,000	$ 10,000	$ 1,235	$ 600	$ 11,835	$ 1,835	$ 93,538
3	$ 10,000	$ 10,000	$ 1,382	$ 600	$ 11,982	$ 1,982	$ 95,520
4	$ 10,000	$ 10,000	$ 1,547	$ 600	$ 12,147	$ 2,147	$ 97,668
5	$ 110,000	$ 10,000	$ 1,732	$ 600	$ 12,332	$ (97,668)	$ 0

Illustrative Example 2—Amortizing Five-Year loan (no discount or premium)

A3. A 5-year $100,000 debt instrument was issued for net proceeds of $97,000 (debt issuance costs of $3,000) with a stated interest rate of 10 percent per annum payable in equal annual installments.

A4. A comparison of the interest method, Alternative A, and Alternative B is included below. In this example, Alternatives A and B result in the same pattern of amortization.

Interest Method		Effective Rate	11.20%	
Date	Pmt (net of $3K debt issue costs)	Interest Expense	Carry Amt Increase (Decrease)	Carrying Amount
0	$ (97,000)	$ -	$ -	$ 97,000
1	$ 26,380	$ 10,867	$ (15,512)	$ 81,488
2	$ 26,380	$ 9,129	$ (17,250)	$ 64,237
3	$ 26,380	$ 7,197	$ (19,183)	$ 45,054
4	$ 26,380	$ 5,048	$ (21,332)	$ 23,722
5	$ 26,380	$ 2,658	$ (23,722)	$ (0)

Alternative A		A	B	C	A + B + C		
Date	Pmt (net of $3K debt issue costs)	Amounts Designated as Interest	Discount ($0k) Amortization	Debt Issuance Cost ($3k) Amortization	Interest Expense	Carry Amt Increase (Decrease)	Carrying Amount
0	$ (97,000)	$ -	$ -	$ -	$ -	$ -	$ 97,000
1	$ 26,380	$ 10,000	$ -	$ 600	$ 10,600	$ (15,780)	$ 81,220
2	$ 26,380	$ 8,362	$ -	$ 600	$ 8,962	$ (17,418)	$ 63,803
3	$ 26,380	$ 6,560	$ -	$ 600	$ 7,160	$ (19,219)	$ 44,583
4	$ 26,380	$ 4,578	$ -	$ 600	$ 5,178	$ (21,201)	$ 23,382
5	$ 26,380	$ 2,398	$ -	$ 600	$ 2,998	$ (23,382)	$ (0)

Alternative B		A	B	C	A + B + C	Effective Rate	10%
Date	Pmt (net of $3K debt issue costs)	Amounts Designated as Interest	Discount ($0k) Amortization	Debt Issuance Cost ($3k) Amortization	Interest Expense	Carry Amt Increase (Decrease)	Carrying Amount
0	$ (97,000)	$ -	$ -	$ -	$ -	$ -	$ 97,000
1	$ 26,380	$ 10,000	$ -	$ 600	$ 10,600	$ (15,780)	$ 81,220
2	$ 26,380	$ 8,362	$ -	$ 600	$ 8,962	$ (17,418)	$ 63,803
3	$ 26,380	$ 6,560	$ -	$ 600	$ 7,160	$ (19,219)	$ 44,583
4	$ 26,380	$ 4,578	$ -	$ 600	$ 5,178	$ (21,201)	$ 23,382
5	$ 26,380	$ 2,398	$ -	$ 600	$ 2,998	$ (23,382)	$ (0)

Illustrative Example 3—Amortizing Five-Year Loan, No Repayments Are Characterized as Interest

A5. A 5-year $131,900 debt instrument that was issued for net proceeds of $97,500 (debt issuance costs of $3,000) with stated interest rate of 0 percent per annum payable in equal annual installments of $26,380.

A6. The cash flows in this example are identical to the cash flows in Example 2.

A7. A comparison of the interest method, Alternative A, and Alternative B is included below. The interest method and Alternative B produce the same outcome in Example 2 and Example 3, while Alternative A produces different outcomes because of how the terms are structured differently in Example 2 and Example 3.

Interest Method		Effective Rate		11.20%
Date	Pmt (net of $3K debt issue costs)	Interest Expense	Carry Amt Increase (Decrease)	Carrying Amount
0	$ (97,000)	$ -	$ -	$ 97,000
1	$ 26,380	$ 10,867	$ (15,512)	$ 81,488
2	$ 26,380	$ 9,129	$ (17,250)	$ 64,237
3	$ 26,380	$ 7,197	$ (19,183)	$ 45,054
4	$ 26,380	$ 5,048	$ (21,332)	$ 23,722
5	$ 26,380	$ 2,658	$ (23,722)	$ (0)

Alternative A		A	B	C	A + B + C		
Date	Pmt (net of $3K debt issue costs)	Amounts Designated as Interest	Discount ($31.8K) Amortization	Debt Issuance Cost ($3k) Amortization	Interest Expense	Carry Amt Increase (Decrease)	Carrying Amount
0	$ (97,000)	$ -	$ -	$ -	$ -	$ -	$ 97,000
1	$ 26,380	$ -	$ 6,380	$ 600	$ 6,980	$ (19,400)	$ 77,600
2	$ 26,380	$ -	$ 6,380	$ 600	$ 6,980	$ (19,400)	$ 58,200
3	$ 26,380	$ -	$ 6,380	$ 600	$ 6,980	$ (19,400)	$ 38,800
4	$ 26,380	$ -	$ 6,380	$ 600	$ 6,980	$ (19,400)	$ 19,400
5	$ 26,380	$ -	$ 6,380	$ 600	$ 6,980	$ (19,400)	$ -

Alternative B		A	B	C	A + B + C		
Date	Pmt (net of $3K debt issue costs)	Amounts Designated as Interest	Discount ($31.8K) Amortization	Debt Issuance Cost ($3k) Amortization	Interest Expense	Carry Amt Increase (Decrease)	Carrying Amount
0	$ (97,000)	$ -	$ -	$ -	$ -	$ -	$ 97,000
1	$ 26,380	$ -	$ 10,000	$ 600	$ 10,600	$ (15,780)	$ 81,220
2	$ 26,380	$ -	$ 8,362	$ 600	$ 8,962	$ (17,418)	$ 63,803
3	$ 26,380	$ -	$ 6,560	$ 600	$ 7,160	$ (19,219)	$ 44,583
4	$ 26,380	$ -	$ 4,578	$ 600	$ 5,178	$ (21,201)	$ 23,382
5	$ 26,380	$ -	$ 2,398	$ 600	$ 2,998	$ (23,382)	$ 0

Appendix B: Codification References to *Interest Method* and *Effective Interest Rate*

Included below are references to the interest method and the effective interest rate in GAAP excluding SEC guidance, certain industry specific areas of guidance, and illustrative examples.

Topic	Paragraph Reference	Text
Topic 220, Income Statement--Reporting Comprehensive Income	220-10-55-27	[Case B: Available-for-Sale Debt Securities] The following before-tax entries would be made to record the purchase, accrue interest (using the **effective interest method** based on cost), recognize the change in fair value, and record the sale.
Topic 230, Statement of Cash Flows	230-10-45-15	All of the following are cash outflows for financing activities… …b. Repayments of amounts borrowed, including the portion of the repayments made to settle zero-coupon debt instruments that is attributable to the principal or the portion of the repayments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to the principal.
Topic 230, Statement of Cash Flows	230-10-45-17	All of the following are cash outflows for operating activities: …d. Cash payments to lenders and other creditors for interest, including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to accreted interest related to the debt discount. For all other debt instruments, an issuer shall not bifurcate cash payments to lenders and other creditors at settlement for amounts attributable to accreted interest related to the debt discount, nor classify such amounts as cash outflows for operating activities.
Topic 230, Statement of Cash Flows	230-10-45-25	In reporting cash flows from operating activities, entities are encouraged to report major classes of gross cash receipts and gross cash payments and their arithmetic sum—the net cash flow from operating activities (the direct method)…. Entities that do so shall, at a minimum, separately report the following classes of operating cash receipts and payments: ...e. Interest paid, including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to accreted interest related to the debt discount
Topic 230, Statement of Cash Flows	230-10-50-2	If the indirect method is used, amounts of interest paid (net of amounts capitalized), including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to accreted interest related to the debt discount, shall be disclosed.

Topic	Paragraph Reference	Text
Topic 310, Receivables	310-10-05-7	Rebates represent refunds of portions of the precomputed finance charges on installment loans or trade receivables, if applicable, that occur when payments are made ahead of schedule. Rebate calculations generally are governed by state laws and may differ from unamortized finance charges on installment loans or trade receivables because many states require rebate calculations to be based on the Rule of 78s or other methods instead of the **interest method**.
Topic 310, Receivables	310-10-25-11	Accrual of interest income on installment loans or trade receivables shall not be affected by the possibility that rebates may be calculated on a method different from the **interest method**, except that the possibility of rebates affects the accounting resulting from the application of paragraph 310-20-35-18(a). Differences between rebate calculations and accrual of interest income merely adjust original estimates of interest income and shall be recognized in income when loans or trade receivables are prepaid or renewed.
Topic 310, Receivables	310-10-50-45	In evaluating whether the debtor is experiencing financial difficulties for the purpose of the disclosure requirements in paragraphs 310-10-50-42 through 50-44, a creditor shall consider the following indicators: …f. Without the current modification, the debtor cannot obtain funds from sources other than the existing creditors at an **effective interest rate** equal to the current market interest rate for similar debt for a nontroubled debtor.
Topic 310, Receivables	310-20-35-16	Paragraph 310-20-30-5 explains that, in applying the provisions of this Subtopic to loans purchased as a group, the purchaser may allocate the initial investment to the individual loans or may account for the initial investment in the aggregate. The cash flows provided by the underlying loan contracts shall be used to apply the **interest method**, except as set forth in paragraph 310-20-35-26. If prepayments are not anticipated pursuant to that paragraph and prepayments occur or a portion of the purchased loans is sold, a proportionate amount of the related deferred fees and purchase premium or discount shall be recognized in income so that the effective interest rate on the remaining portion of loans continues unchanged.
Topic 310, Receivables	310-20-35-16	Paragraph 310-20-30-5 explains that, in applying the provisions of this Subtopic to loans purchased as a group, the purchaser may allocate the initial investment to the individual loans or may account for the initial investment in the aggregate. The cash flows provided by the underlying loan contracts shall be used to apply the **interest method**, except as set forth in paragraph 310-20-35-26. If prepayments are not anticipated pursuant to that paragraph and prepayments occur or a portion of the purchased loans is sold, a proportionate amount of the related deferred fees and purchase premium or discount shall be recognized in income so that the **effective interest** rate on the remaining portion of loans continues unchanged.

Topic	Paragraph Reference	Text
Topic 310, Receivables	310-20-35-18	Net fees or costs that are required to be recognized as yield adjustments over the life of the related loan(s) shall be recognized by the **interest method** except as set forth in paragraphs 310-20-35-21 through 35-24. The objective of the **interest method** is to arrive at periodic interest income (including recognition of fees and costs) at a constant effective yield on the net investment in the receivable (that is, the principal amount of the receivable adjusted by unamortized fees or costs and purchase premium or discount). The difference between the periodic interest income so determined and the stated interest on the outstanding principal amount of the receivable is the amount of periodic amortization. See paragraphs 835-30-35-2 through 35-5 for guidance concerning the **interest method**. Under the provisions of this Subtopic, the **interest method** shall be applied as follows when the stated interest rate is not constant throughout the term of the loan: a. If the loan's stated interest rate increases during the term of the loan (so that interest accrued under the **interest method** in early periods would exceed interest at the stated rate), interest income shall not be recognized to the extent that the net investment in the loan would increase to an amount greater than the amount at which the borrower could settle the obligation…. b. If the loan's stated interest rate decreases during the term of the loan, the stated periodic interest received early in the term of the loan would exceed the periodic interest income that is calculated under the **interest method**. In that circumstance, the excess shall be deferred and recognized in those future periods when the constant effective yield under the **interest method** exceeds the stated interest rate.…
Topic 310, Receivables	310-20-35-23	For revolving lines of credit (or similar loan arrangements), the net fees or costs shall be recognized in income on a straight-line basis over the period the revolving line of credit is active, assuming that borrowings are outstanding for the maximum term provided in the loan contract. If the borrower pays all borrowings and cannot reborrow under the contract, any unamortized net fees or costs shall be recognized in income upon payment. The **interest method** shall be applied to recognize net unamortized fees or costs when the loan agreement provides a schedule for payment and no additional borrowings are provided for under the agreement.
Topic 310, Receivables	310-20-35-24	For example, if the loan agreement provides the borrower with the option to convert a one-year revolving line of credit to a five-year term loan, during the term of the revolving line of credit the lender would recognize the net fees or costs as income on a straight-line basis using the combined life of the revolving line of credit and term loan. If the borrower elects to convert the line of credit to a term loan, the lender would recognize the unamortized net fees or costs as an adjustment of yield using the **interest method**. If the revolving line of credit expires and borrowings are extinguished, the unamortized net fees or costs would be recognized in income upon payment.

Topic	Paragraph Reference	Text
Topic 310, Receivables	310-20-35-26	Except as stated in the following sentence, the calculation of the constant effective yield necessary to apply the **interest method** shall use the payment terms required by the loan contract, and prepayments of principal shall not be anticipated to shorten the loan term. If the entity holds a large number of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated, the entity may consider estimates of future principal prepayments in the calculation of the constant effective yield necessary to apply the **interest method**. If the entity anticipates prepayments in applying the **interest method** and a difference arises between the prepayments anticipated and actual prepayments received, the entity shall recalculate the effective yield to reflect actual payments to date and anticipated future payments. The net investment in the loans shall be adjusted to the amount that would have existed had the new effective yield been applied since the acquisition of the loans. The investment in the loans shall be adjusted to the new balance with a corresponding charge or credit to interest income.
Topic 320, Investments - Debt Securities	320-10-35-40	Entities shall use the retrospective **interest method** for recognizing income on structured note securities that are classified as available-for-sale or held-to-maturity debt securities and that meet any of the following conditions… a. Either the contractual principal amount of the note to be paid at maturity or the original investment amount is at risk (for other than failure of the borrower to pay the contractual amounts due)…. b. The note's return on investment is subject to variability (other than due to credit rating changes of the borrower) because of either of the following: 1. There is no stated coupon rate or the stated coupon is not fixed or prespecified, and the variation in the return on investment or coupon rate is not a constant percentage of, or in the same direction as, changes in market-based interest rates or interest rate index…. 2. The variable or fixed coupon rate is below market rates of interest for traditional notes of comparable maturity and a portion of the potential yield (for example, upside potential for principal) is based on the occurrence of future events or circumstances…. c. The contractual maturity of the bond is based on a specific index or on the occurrence of specific events or circumstances outside the control of the parties to the transaction, excluding the passage of time or events that result in normal covenant violations. Examples of instruments that meet this condition include index amortizing notes and notes that base contractual maturity on the price of oil.

Topic	Paragraph Reference	Text
Topic 326, Financial Instruments--Credit Losses	326-20-30-4	If an entity estimates expected credit losses using methods that project future principal and interest cash flows (that is, a discounted cash flow method), the entity shall discount expected cash flows at the financial asset's effective **interest rate**. When a discounted cash flow method is applied, the allowance for credit losses shall reflect the difference between the amortized cost basis and the present value of the expected cash flows…. If the financial asset's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that financial asset's **effective interest rate** (used to discount expected cash flows as described in this paragraph) shall be calculated based on the factor as it changes over the life of the financial asset…. If the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall use the same projections in determining the **effective interest rate** used to discount those cash flows. In addition, if the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall adjust the **effective interest rate** used to discount expected cash flows to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments in accordance with paragraph 326-20-30-4A….
Topic 326, Financial Instruments--Credit Losses	326-20-30-4A	As an accounting policy election for each class of financing receivable or major security type, an entity may adjust the **effective interest rate** used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments.
Topic 326, Financial Instruments--Credit Losses	326-20-55-8	This Subtopic requires that an entity recognize an allowance for credit losses on net investment in leases recognized by a lessor in accordance with Topic 842 on leases. An entity should include the unguaranteed residual asset with the lease receivable, net of any deferred selling profit, if applicable (that is, the net investment in the lease). When measuring expected credit losses on net investment in leases, the lease term should be used as the contractual term. When measuring expected credit losses on net investment in leases using a discounted cash flow method, the discount rate used in measuring the lease receivable under Topic 842 should be used in place of the **effective interest rate**.
Topic 326, Financial Instruments--Credit Losses	326-30-35-11	If the security's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that security's **effective interest rate** (used to discount expected cash flows as described in paragraph 326-30-35-7) may be calculated based on the factor as it changes over the life of the security or is projected to change over the life of the security, or may be fixed at the rate in effect at the date an entity determines that the security has a credit loss as determined in accordance with paragraphs 326-30-35-1 through 35-2…. If the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall use the same projections in determining the **effective interest rate** used to discount those cash flows. In addition, if the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall adjust the **effective interest rate** used to discount expected cash flows to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments in accordance with paragraph 326-30-35-7A….

Topic	Paragraph Reference	Text
Topic 326, Financial Instruments--Credit Losses	326-30-35-7	In determining whether a credit loss exists, an entity shall consider the factors in paragraphs 326-30-55-1 through 55-4 and use its best estimate of the present value of cash flows expected to be collected from the debt security. One way of estimating that amount would be to consider the methodology described in paragraphs 326-30-35-8 through 35-10. Briefly, the entity would discount the expected cash flows at the **effective interest rate** implicit in the security at the date of acquisition.
Topic 326, Financial Instruments--Credit Losses	326-30-35-7A	As an accounting policy election for each major security type of debt securities classified as available-for-sale securities, an entity may adjust the **effective interest rate** used to discount expected cash flows to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments.
Topic 410, Liabilities - Asset Retirement and Environmental Obligations	410-20-35-5	An entity shall measure changes in the liability for an asset retirement obligation due to passage of time by applying an **interest method** of allocation to the amount of the liability at the beginning of the period. The interest rate used to measure that change shall be the credit-adjusted risk-free rate that existed when the liability, or portion thereof, was initially measured. That amount shall be recognized as an increase in the carrying amount of the liability and as an expense classified as accretion expense. Paragraph 835-20-15-7 states that accretion expense related to exit costs and asset retirement obligations shall not be considered to be interest cost for purposes of applying Subtopic 835-20.
Topic 470, Debt	470-10-35-2	The borrower's periodic interest cost shall be determined using the **interest method** based on the estimated outstanding term of the debt. In estimating the term of the debt, the borrower shall consider its plans, ability, and intent to service the debt. Debt issue costs shall be amortized over the same period used in the interest cost determination. The term-extending provisions of the debt instrument should be analyzed to determine whether those provisions constitute an embedded derivative that warrants separate accounting as a derivative under Subtopic 815-10.
Topic 470, Debt	470-10-35-3	Amounts recorded as debt shall be amortized under the **interest method** (see Subtopic 835-30) and amounts recorded as deferred income shall be amortized under the units-of-revenue method.
Topic 470, Debt	470-20-50-1F	An entity shall disclose the following information about interest recognized for each period for which a statement of financial performance is presented:a. The **effective interest rate** for the periodb. The amount of interest recognized for the period disaggregated by both of the following (see Example 12 [paragraph 470-20-55-69D] for an illustration of this disclosure requirement): 1. The contractual interest expense 2. The amortization of the premium, discount, or issuance costs.
Topic 470, Debt	470-30-35-1	The debt discount shall be amortized by the **interest method**, using the **effective interest rate.**
Topic 470, Debt	470-30-35-5	The revised debt discount shall be amortized prospectively, using the **effective interest rate**.

Topic	Paragraph Reference	Text
Topic 470, Debt	470-50-40-12	The following guidance shall be used to calculate the present value of the cash flows for purposes of applying the 10 percent cash flow test described in paragraph 470-50-40-10: …e. The discount rate to be used to calculate the present value of the cash flows is the **effective interest rate**, for accounting purposes, of the original debt instrument.…
Topic 470, Debt	470-50-40-14	If it is determined that the original and new debt instruments are not substantially different, then a new **effective interest rate** shall be determined based on the carrying amount of the original debt instrument, adjusted for an increase (but not a decrease) in the fair value of an embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) resulting from the modification, and the revised cash flows.
Topic 470, Debt	470-50-40-17	Fees paid by the debtor to the creditor or received by the debtor from the creditor (fees may be received by the debtor from the creditor to cancel a call option held by the debtor or to extend a no-call period) as part of the exchange or modification shall be accounted for as follows: a. If the exchange or modification is to be accounted for in the same manner as a debt extinguishment and the new debt instrument is initially recorded at fair value, then the fees paid or received shall be associated with the extinguishment of the old debt instrument and included in determining the debt extinguishment gain or loss to be recognized. b. If the exchange or modification is not to be accounted for in the same manner as a debt extinguishment, then the fees shall be associated with the replacement or modified debt instrument and, along with any existing unamortized premium or discount, amortized as an adjustment of interest expense over the remaining term of the replacement or modified debt instrument using the **interest method**.For fees between the debtor and creditor for exchanges of or modifications to line-of-credit or revolving-debt arrangements, see paragraph 470-50-40-21.
Topic 470, Debt	470-50-40-18	Costs incurred with third parties directly related to the exchange or modification (such as legal fees) shall be accounted for as follows: a. If the exchange or modification is to be accounted for in the same manner as a debt extinguishment and the new debt instrument is initially recorded at fair value, then the costs shall be associated with the new debt instrument and amortized over the term of the new debt instrument using **the interest method** in a manner similar to debt issue costs.…
Topic 470, Debt	470-60-10-2	All of those kinds of modifications affect future cash receipts or payments and therefore affect both of the following: a. The creditor's total return on the receivable, its **effective interest rate**, or both b. The debtor's total cost on the payable, its **effective interest rate**, or both.

Topic	Paragraph Reference	Text
Topic 470, Debt	470-60-15-12	A debt restructuring is not necessarily a troubled debt restructuring for purposes of this Subtopic even if the debtor is experiencing some financial difficulties. For example, a troubled debt restructuring is not involved if any of the following circumstances exist: …c. The creditor reduces the **effective interest rate** on the debt primarily to reflect a decrease in market interest rates in general or a decrease in the risk so as to maintain a relationship with a debtor that can readily obtain funds from other sources at the current market interest rate. d. The debtor issues in exchange for its debt new marketable debt having an **effective interest rate** based on its market price that is at or near the current market interest rates of debt with similar maturity dates and stated interest rates issued by nontroubled debtors.
Topic 470, Debt	470-60-35-11	If amounts of future cash payments must be estimated to apply the provisions of paragraphs 470-60-35-5 through 35-7 because future interest payments are expected to fluctuate—for example, the restructured terms may specify the stated interest rate to be the prime interest rate increased by a specified amount or proportion—estimates of maximum total future payments shall be based on the interest rate in effect at the time of the restructuring. Fluctuations in the **effective interest rate** after the restructuring from changes in the prime rate or other causes shall be accounted for as changes in estimates in the periods in which the changes occur. However, the accounting for those fluctuations shall not result in recognizing a gain on restructuring that may be offset by future cash payments (see the preceding paragraph and paragraph 470-60-35-7). Rather, the carrying amount of the restructured payable shall remain unchanged, and future cash payments shall reduce the carrying amount until the time that any gain recognized cannot be offset by future cash payments.
Topic 470, Debt	470-60-35-5	A debtor in a troubled debt restructuring involving only modification of terms of a payable—that is, not involving a transfer of assets or grant of an equity interest—shall account for the effects of the restructuring prospectively from the time of restructuring, and shall not change the carrying amount of the payable at the time of the restructuring unless the carrying amount exceeds the total future cash payments specified by the new terms. Total future cash payments includes related accrued interest, if any, at the time of the restructuring that continues to be payable under the new terms. That is, the effects of changes in the amounts or timing (or both) of future cash payments designated as either interest or face amount shall be reflected in future periods. Interest expense shall be computed in a way such that a constant **effective interest rate** is applied to the carrying amount of the payable at the beginning of each period between restructuring and maturity (in substance the **interest method** prescribed by paragraphs 835-30-35-2 and 835-30-35-4 through 35-5). The new **effective interest rate** shall be the discount rate that equates the present value of the future cash payments specified by the new terms (excluding amounts contingently payable) with the carrying amount of the payable.
Topic 606, Revenue from Contracts with Customers	606-10-32-20	An entity shall present the effects of financing (interest income or interest expense) separately from revenue from contracts with customers in the statement of comprehensive income (statement of activities). Interest income or interest expense is recognized only to the extent that a contract asset (or receivable) or a contract liability is recognized in accounting for a contract with a customer. In accounting for the effects of the time value of money, an entity also shall consider the subsequent measurement guidance in Subtopic 835-30, specifically the guidance in paragraphs 835-30-45-1A through 45-3 on presentation of the discount and premium in the financial statements and the guidance in paragraphs 835-30-55-2 through 55-3 on the application of the **interest method**.

Topic	Paragraph Reference	Text
Topic 720, Expenses	720-20-35-2	If the amounts and timing of the insurance recoveries can be reasonably estimated, the deferred gain shall be amortized using the **interest method** over the estimated period over which the entity expects to recover substantially all amounts due under the terms of the insurance contract. If the amounts and timing of the insurance recoveries cannot be reasonably estimated, then the proportion of actual recoveries to total estimated recoveries shall be used to determine the amount of the amortization.
Topic 815, Derivatives and Hedging	815-15-55-210	Because the portion of this instrument relating to the periodic interest payments denominated in a foreign currency is subject to the requirement in Topic 830 to recognize the foreign currency transaction gain or loss in earnings, the instrument should not be considered as containing an embedded foreign currency derivative instrument pursuant to paragraph 815-15-15-5. In this circumstance, the U.S. entity has the dollar as the functional currency and is making interest payments in a foreign currency. Remeasurement of the liability is required using future equivalent dollar interest payments determined by the current spot exchange rate and discounted at the historical **effective interest rate**.
Topic 815, Derivatives and Hedging	815-15-55-27	A standard put bond has all of the following characteristics: a. A debtor issues a contract comprising a bond and a written put option. b. The option allows the investor to put the bond back to the debtor at a specific date in exchange for the bond's par value. c. In exchange for giving the investor the right to redeem the bond at par before maturity, the debtor pays a lower **effective interest rate** than would be demanded for a nonputtable bond.
Topic 815, Derivatives and Hedging	815-20-55-151	Schedule 2 provides the amount of cost attributed to each period for each forward contract. Each period's cost is determined based on applying the interest method to each forward contract.
Topic 815, Derivatives and Hedging	815-25-35-11	This Subtopic implicitly affects the measurement of credit losses under Subtopic 326-20 on financial instruments measured at amortized cost by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted amortized cost basis in a hedged loan. Paragraph 326-20-55-9 requires that, when the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis. That paragraph states that the adjustment under fair value hedge accounting for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's amortized cost basis. As discussed in that paragraph, the loan's original **effective interest rate** becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's amortized cost basis be adjusted for hedge accounting before the requirements of Subtopic 326-20 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted amortized cost basis….

Topic	Paragraph Reference	Text
Topic 815, Derivatives and Hedging	815-30-35-9	For a single cash flow hedge that encompasses the variability of functional-currency-equivalent cash flows attributable to foreign exchange risk related to the settlement of a foreign-currency-denominated receivable or payable resulting from a forecasted sale or purchase on credit, the guidance in paragraph 815-30-35-3 is applied as follows: …b. The functional currency interest rate implicit in the hedging relationship as a result of entering into the forward contract is used to determine the amount of cost or income to be ascribed to each period of the hedging relationship. The cash flow hedging model for recognized foreign-currency-denominated assets and liabilities requires use of the **interest method** at the inception of the hedging relationship to determine the amount of cost or income to be ascribed to each relevant period of the hedging relationship. […]
Topic 835, Interest-Imputation of Interest	835-30-15-3	With the exception of guidance in paragraphs 835-30-45-1A through 45-3 addressing the presentation of discount and premium in the financial statements, which is applicable in all circumstances, and the guidance in paragraphs 835-30-55-2 through 55-3 regarding the application of the **interest method**, the guidance in this Subtopic does not apply to the following: …e. Transactions where interest rates are affected by the tax attributes or legal restrictions prescribed by a governmental agency (for example, industrial revenue bonds, tax exempt obligations, government guaranteed obligations, income tax settlements)….
Topic 835, Interest	835-30-25-5	The total amount of interest during the entire period of a cash loan is generally measured by the difference between the actual amount of cash received by the borrower and the total amount agreed to be repaid to the lender. The difference between the face amount and the proceeds upon issuance is shown as either discount or premium. For example, if a bond is issued at a discount or premium, such discount or premium is recognized in accounting for the original issue. The coupon or stated interest rate is not regarded as the effective yield or market rate. Moreover, if a long-term non-interest-bearing note or bond is issued, its net proceeds are less than face amount and an **effective interest rate** is based on its fair value upon issuance.
Topic 835, Interest	835-30-25-6	A note issued solely for cash equal to its face amount is presumed to earn the stated rate of interest. However, in some cases the parties may also exchange unstated (or stated) rights or privileges, which are given accounting recognition by establishing a note discount or premium account. In such instances, the **effective interest rate** differs from the stated rate. For example, an entity may lend a supplier cash that is to be repaid five years hence with no stated interest. Such a non-interest-bearing loan may be partial consideration under a purchase contract for supplier products at lower than the prevailing market prices. In this circumstance, the difference between the present value of the receivable and the cash loaned to the supplier is appropriately regarded as an addition to the cost of products purchased during the contract term. The note discount shall be amortized as interest income over the five-year life of the note, as required by Section 835-30-35.
Topic 835, Interest-Imputation of Interest	835-30-35-2	With respect to a note for which the imputation of interest is required, the difference between the present value and the face amount shall be treated as discount or premium and amortized as interest expense or income over the life of the note in such a way as to result in a constant rate of interest when applied to the amount outstanding at the beginning of any given period. This is the **interest method.**

Topic	Paragraph Reference	Text
Topic 835, Interest-Imputation of Interest	835-30-35-4	Other methods of amortization may be used if the results obtained are not materially different from those that would result from the **interest method**.
Topic 835, Interest	835-30-50-1	Paragraph 835-30-45-1A provides requirements for the balance sheet presentation for the discount or premium and debt issuance costs of a note. The description of the note shall include the **effective interest rate**. The face amount of the note also shall be presented in the financial statements or disclosed in the notes to financial statements. (See paragraph 835-30-45-2.)
Topic 842, Leases	842-20-55-27	Lessee depreciates its owned assets on a straight-line basis. Therefore, the right-of-use asset would be amortized on a straight-line basis over the 10-year lease term. The lease liability is increased to reflect the Year 1 interest on the lease liability in accordance with the interest method. As such, in Year 1 of the lease, Lessee recognizes the amortization expense of $40,702 ($407,017 ÷ 10) and the interest expense of $20,076 (5.87% × $342,017).
Topic 842, Leases	842-20-55-37	Lessee depreciates its owned assets on a straight-line basis. Therefore, the right-of-use asset will be amortized on a straight-line basis over the lease term. The lease liability will be reduced in accordance with the **interest method**. As such, in Year 7 (the first year following the remeasurement), Lessee recognizes amortization expense of $37,114 ($334,023 ÷ 9) and interest expense of $23,896 (7.83% × $305,189).