FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: October 14, 2014
Comments Due: December 15, 2014

Interest—Imputation of Interest (Subtopic 835-30)

Simplifying the Presentation of Debt Issuance Cost

This Exposure Draft of a proposed Accounting Standards Update of Subtopic 835-30 is issued by the Board for public comment. Comments can be provided using the electronic feedback form available on the FASB website. Written comments should be addressed to:

Technical Director
File Reference No. 2014-250

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by December 15, 2014. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. 2014-250
- Sending written comments to "Technical Director, File Reference No. 2014-250, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Do not send responses by fax.

All comments received are part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

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FASB FINANCIAL ACCOUNTING STANDARDS BOARD

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update) and What Are the Main Provisions?

The Board is issuing this proposed Update as part of its initiative to reduce complexity in accounting standards (the Simplification Initiative). The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements.

The Board received feedback that having different balance sheet presentation requirements for debt issuance cost and debt discount or premium creates unnecessary complexity. Recognizing debt issuance cost as a deferred charge (that is, an asset) also is different from the guidance in International Financial Reporting Standards (IFRS), which requires that transaction costs, including third-party costs and creditor fees, be deducted from the carrying value of the financial liability and not recorded as separate assets. In addition, the requirement to recognize debt issuance costs as deferred charges conflicts with the guidance in FASB Concepts Statement No. 6, *Elements of Financial Statements*, which states that debt issuance costs are similar to debt discounts and in effect reduce the proceeds of borrowing, thereby increasing the effective interest rate. Concepts Statement 6 further states that debt issuance costs cannot be an asset because they provide no future economic benefit.

To simplify presentation of debt issuance costs, the amendments in this proposed Update would require that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs would not be affected by the amendments in this proposed Update.

What Are the Transition Requirements and When Would the Amendments Be Effective?

The proposed guidance would be adopted on a retrospective basis, wherein the balance sheet of each individual period presented would be adjusted to reflect the period-specific effects of applying the new guidance.

Upon transition, an entity would be required to comply with the applicable disclosures for a change in an accounting principle. These disclosures would include the nature of and reason for the change in accounting principle, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on the financial statement line items (that is, debt issuance cost asset and the debt liability).

The effective date will be determined after the Board considers stakeholder feedback on the proposed Update.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Should debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts? If not, why?

Question 2: Should the proposed guidance be applied on a retrospective basis?

Question 3: How much time will be necessary to adopt the amendments in this proposed Update? Should the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities?

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2 and 3. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 835-30

2. Amend paragraphs 835-30-45-1 through 45-1A, 835-30-45-3, and 835-30-55-8, with a link to transition paragraph 835-30-65-1, as follows:

Interest—Imputation of Interest

Other Presentation Matters

835-30-45-1 The guidance in this Section does not apply to the amortization of premium and discount and the debt issuance costs of <u>assets and </u>liabilities that are reported at fair value.

835-30-45-1A The **discount** or **premium** resulting from the determination of present value in cash or noncash transactions is not an asset or liability separable from the note that gives rise to it. Therefore, the discount or premium shall be reported in the balance sheet as a direct deduction from or addition to the face amount of the note. <u>Similarly, issue costs shall be reported in the balance sheet as a direct deduction from the face amount of the note. The discount, premium, or issue costs</u>~~It~~ shall not be classified as a deferred charge or deferred credit.

835-30-45-2 The description of the note shall include the effective interest rate. The face amount shall also be disclosed in the financial statements or in the notes to the statements.

835-30-45-3 Amortization of discount or premium <u>and issue costs</u> shall be reported as interest expense<u> or income</u>. ~~Issue costs shall be reported in the balance sheet as deferred charges.~~

835-30-45-4 See Example 2 (paragraph 835-30-55-8) for illustrations of balance sheet presentation of a discount on a note.

Implementation Guidance and Illustrations

> Illustrations

> > Example 2: Balance Sheet Presentation of Discounted Notes

835-30-55-8 This Example is an illustration of the guidance in paragraphs 835-30-45-1 through 45-3 related to the balance sheet presentation of notes that are discounted.

	~~December 31~~	
	~~*1970*~~	~~*1969*~~
~~*Presentation 1—Discount presented in caption*~~		
~~NOTE RECEIVABLE FROM SALE OF PROPERTY:~~		
~~$1,000,000 face amount, noninterest bearing, due December 31, 1975 (less unamortized discount based on imputed interest rate of 8%—1970, $320,000; 1969, $370,000)~~	~~$ 680,000~~	~~$ 630,000~~
~~*Presentation 2—Discount presented separately*~~		
~~NOTE RECEIVABLE FROM SALE OF PROPERTY:~~		
~~Noninterest bearing note due December 31, 1975~~	~~$ 1,000,000~~	~~$ 1,000,000~~
~~Less unamortized discount based on imputed interest rate of 8%~~	~~320,000~~	~~370,000~~
~~Note receivable less unamortized discount~~	~~$ 680,000~~	~~$ 630,000~~
~~*Presentation 3—Several notes involved*~~		
~~LONG-TERM DEBT (Note 1):~~		
~~Principal amount~~	~~$ 24,000,000~~	~~$ 24,000,000~~
~~Less unamortized discount~~	~~2,070,000~~	~~2,192,000~~
~~Long-term debt less unamortized discount~~	~~$ 21,930,000~~	~~$ 21,808,000~~

~~*Note 1—Long-Term Debt*~~

~~Long-term debt at December 31, 1970 consisted of the following:~~

	~~*Principal*~~	~~*Unamortized Discount*~~
~~6% subordinated debentures, due 1984 (discount is based on imputed interestrate of 7%)~~	~~$ 20,000,000~~	~~$ 1,750,000~~
~~6 1/2% bank loan, due 1973~~	~~3,000,000~~	~~-~~
~~Noninterest bearing note issued in connection with acquisition of property, due 1975 (discount is based on imputed interest rate of 8%)~~	~~1,000,000~~	~~320,000~~
~~Total~~	~~$ 24,000,000~~	~~$ 2,070,000~~

[For ease of readability, the newly added table is not underlined.]

	December 31	
	20X2	**20X1**
Presentation 1—Discount presented in caption		
NOTE RECEIVABLE FROM SALE OF PROPERTY:		
$1,000,000 face amount, noninterest bearing, due December 31, 20X9 (less unamortized discount based on imputed interest rate of 8%—20X2, $320,000; 20X1, $370,000)	$ 680,000	$ 630,000
Presentation 2—Discount presented separately		
NOTE RECEIVABLE FROM SALE OF PROPERTY:		
Noninterest bearing note due December 31, 20X9	$ 1,000,000	$ 1,000,000
Less unamortized discount based on imputed interest rate of 8%	320,000	370,000
Note receivable less unamortized discount	$ 680,000	$ 630,000
Presentation 3—Several notes involved		
LONG-TERM DEBT (Note 1):		
Principal amount	$ 24,200,000	$ 24,200,000
Less unamortized discount and issue cost	2,680,000	2,792,000
Long-term debt less unamortized discount and issue cost	$ 21,520,000	$ 21,408,000

Note 1—Long-Term Debt
Long-term debt at December 31, 20X2 consisted of the following:

	Principal	**Unamortized Discount**	**Unamortized Issue Cost**
6% subordinated debentures, due 20X9 (discount is based on imputed interest rate of 7%)	$ 20,000,000	$ 1,750,000	$ 400,000
6½% bank loan, due 20X7	3,000,000	-	120,000
Noninterest bearing note issued in connection with acquisition of property, due 20X9 (discount is based on imputed interest rate of 8%)	1,200,000	350,000	60,000
Total	$ 24,200,000	$ 2,100,000	$ 580,000

3. Add paragraph 835-30-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2014-XX, *Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Cost*

835-30-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2014-XX, *Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Cost:*

a. The pending content that links to this paragraph shall be effective for annual periods, and interim periods within those annual periods, beginning after [date to be inserted after exposure].
b. An entity shall apply the pending content that links to this paragraph retrospectively to all prior periods.
c. An entity shall disclose in the first annual period after the entity's adoption date, and in the interim periods within the first annual period, the following:
    1. The nature of and reason for the change in accounting principle
    2. The transition method

3. <u>A description of the prior-period information that has been retrospectively adjusted</u>
4. <u>The effect of the change on the financial statement line item (that is, the debt issuance cost asset and the debt liability).</u>

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

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

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The Board is issuing this proposed Update as part of its initiative to reduce complexity in accounting standards (the Simplification Initiative). The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of the financial statements.

Presentation

BC3. To simplify the presentation of debt issuance costs, the amendments in this proposed Update would require that debt issuance costs be presented in the balance sheet as a direct deduction from the debt liability, consistent with the presentation of a debt discount or premium. This presentation also would be 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. This presentation also would improve consistency with IFRS that requires transaction costs, including third-party costs and creditor fees, be deducted from the carrying value of the financial liability and not recorded as separate assets. The Board acknowledges that in circumstances in which the debt issuance costs do not have an associated debt liability amount recorded in the financial statements (for example, the costs incurred before the funding being received on a debt liability), those costs would be reported in the balance sheet as deferred charges until that debt liability amount is recorded.

BC4. 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 such 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 this proposed Update. The Board rejected the alternative to expense a debt issuance cost in the period of the borrowing. The Board concluded that this decision is consistent with the accounting treatment for issue costs associated with equity instruments in which equity issuance costs are deferred and charged against the gross proceeds of the offering rather than being considered an expense (paragraph 340-10-S99-1). Additionally, the Board concluded that accounting for a deferred issuance cost as an expense would be inconsistent with the guidance for recognition and measurement of debt discount or premium and loan origination costs and fees, which are all deferred and amortized using the interest method.

BC5. The Board concluded that the guidance in this proposed Update is limited to simplifying the presentation of debt issuance costs. The recognition and measurement guidance for debt issuance costs would not be affected by the amendments in this proposed Update (for example, guidance for debt issuance costs in accounting for conversion options [paragraph 470-20-30-13] or the accounting for the third-party costs of exchange or modification of debt instruments [paragraph 470-50-40-18]).

BC6. The Board concluded that the guidance in other Codification Topics that require debt issuance cost to be accounted for differently than debt discount has a different underlying basis. The guidance in this proposed Update is limited to clarifying whether the debt issuance costs are the debtor's assets. The Board acknowledged that entities would continue to track debt issuance costs separately from debt discount considering the guidance in other Codification Topics.

Effective Date and Transition

BC7. The Board will decide on the effective date after it considers stakeholders' feedback on how much time they believe would be necessary to adopt the proposed amendments.

BC8. The Board decided that the amendments in this proposed Update would be applied retrospectively to all prior periods presented in the financial statements. The Board concluded that a retrospective transition would enhance the interperiod comparability of the financial information. Additionally, because the information on debt issuance cost already is available in the financial statements, requiring retrospective application would not require an entity to incur significant costs for adopting the proposed amendments. In reaching the conclusion to require retrospective application, the Board also considered that because both debt issuance cost and debt discount are amortized using the effective interest method, there would be no effect on the income statement upon adoption of the proposed amendments.

BC9. The Board decided that an entity would be required to provide the applicable disclosures for a change in an accounting principle upon transition. Those disclosures would include the nature of and reason for the change in accounting principle, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on the financial statement line items (that is, debt issuance cost asset and the debt liability).

Benefits and Costs

BC10. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC11. The Board does not anticipate that entities will incur significant costs as a result of the amendments in this proposed Update. The Board anticipates that the amendments in the proposed Update would reduce complexity by allowing consistent presentation of debt issuance cost and debt discount or premium.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). We welcome comments on these proposed changes to the UGT at the ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the UGT will be made available for public comment at www.fasb.org and finalized as part of the annual release process.