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FASB Simplifies Presentation of Debt Issuance Costs

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Life science companies often use debt instruments to help finance their business. The Financial Accounting Standards Board (FASB) adopted a pronouncement to clarify how debt issuance costs should be accounted for in private or public company's financial statements.

In April 2015, the FASB issued Accounting Standards Update (ASU) No. 2015-03, Interest – Imputation of Interest (Subtopic 835-30, simplifying the Presentation of Debt Issuance Costs). This ASU amends paragraphs 835-30-45-1 through 45-1A, 835-30-45-3 through 45-4, and 835-30-55-8 and requires that debt issuance costs related to debt, be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts.

Background

When a company enters into debt, the goal is to benefit from the proceeds from the debt issuance. Debt agreements often contain provisions that reduce the net proceeds from face value of the debt which are referred to as debt issuance costs. Debt issuance costs include:

1. Fees, commissions paid to investment bankers, lawyers, auditors and/or regulators associated with issuing debt.
2. Equity instruments issued in conjunction with the debt as additional incentives for the lender to enter into the arrangement. These equity instruments are often in the form of warrants to purchase stock of the company at an agreed upon price.

This ASU clarifies whether debt issuance costs are the debtor's assets.

What Are the Major Changes Resulting From the ASU?

Debt issuance costs are no longer considered to be assets, but instead are to be presented in the balance sheet as a direct reduction from the carrying amount of the debt liability.

The ASU cited the following rationale in making its determination:

1. The reason for changing standards for debt issuance costs accounting is that the different balance sheet presentations of debt issuance costs cause the presentation to be overly complex
    1. Both issuance costs and debt discounts reduce the proceeds of debt, increasing the effective interest rate.
    2. Some entities present debt issuance costs and other companies present a debt discount.
2. Changing the different treatment that were characteristically the same promotes consistency. The ASU brings clarity to accounting for debt issue costs.
3. Treating debt issuance costs as deferred charges is different from IFRS

When Does ASU Become Effective?

For public entities, these amendments are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years.

For all other entities, these amendments are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016.

Early adoption of the amendments in this ASU is permitted for financial statements that have not been previously issued.

Helpful Implementation Reminders:

1. Companies should apply this guidance on a retrospective basis – note that there should be no profit and loss impact of the transition to the new guidance because this is a balance sheet reclassification.
2. Each reporting period should be assessed for applicable disclosures, including changes in accounting principle.
3. Companies should remember that ASU 2015-03 does not address presentation of debt issuance costs related to line-of-credit arrangements. According to ASU 2015-15, companies are allowed to defer such costs as an asset and subsequently amortize these costs ratably over the term of the arrangement.

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