

Australian Accounting Standards Board

Rejected Issue – Not Taken onto the UIG Agenda

Direct Costs Affecting a Financial Instrument's Effective Interest Rate

(September 2005)

The Issue

Accounting Standard AASB 139 *Financial Instruments: Recognition and Measurement* (paragraph 43) requires that the initial measurement of a financial asset not at fair value through profit or loss is at its fair value plus transaction costs that are directly attributable to the acquisition of the financial asset. AASB 139.9 defines “transaction costs” as incremental costs that are directly attributable to the acquisition of a financial asset, and states that an incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

The subsequent measurement of loans and receivables and held-to-maturity investments is at amortised cost, using the effective interest method (AASB 139.46). This method is defined in AASB 139.9. The calculation of the amortised cost includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

Origination fees are dealt with in AASB 118 *Revenue*, Appendix paragraph 14(a)(i). Origination fees received by an entity relating to the creation or acquisition of a financial asset (not at fair value through profit or loss) are an integral part of generating an involvement with the resulting financial instrument and, together with the related direct costs, are deferred and recognised as an adjustment to the effective interest rate.

The issue is whether a “related direct cost” can be deferred and recognised as an adjustment to the effective interest rate when that direct cost is not incremental. Is the deferral of non-incremental related direct costs as an adjustment to the effective interest rate inconsistent with the requirements of AASB 139 relating to transaction costs?

Reasons for Not Adding the Issue to the UIG's Agenda

At its September 2005 meeting, the AASB decided not to add this project to the Urgent Issues Group's agenda on the grounds that:

- (a) AASB 139 allows only costs that are incremental to be included in determining the effective interest rate; other costs that are not incremental are excluded, even if they are related to the origination fee; and
- (b) the Appendix guidance in AASB 118 does not override the specific requirements of AASB 139.