

ISSUES PAPER

Due Process – Proposed Amendments to AASB 123

PURPOSE

- 1 Decide the further due process necessary with regards to the proposed amendments to AASB 123 *Borrowing Costs* (June 2007, as amended).

OVERVIEW

- 2 In **Agenda Paper 10.2**, staff recommended that the Board make amendments to AASB 123 to align the accounting for borrowing costs of not-for-profit public sector entities with that required of for-profit entities. This paper has been drafted on the assumption that the Board agrees with the staff recommendation in Agenda Paper 10.2.
- 3 Staff think that the proposed amendment to remove the option in AASB 123 available to not-for-profit public sector entities of recognising borrowing costs immediately as an expense, to the extent that they were directly attributable to the acquisition, construction or production of a qualifying asset, may be regarded as previously having been exposed in Australia for public comment. The Board is asked to consider whether further due process is necessary, or whether the proposed amendment should be finalised without re-exposure.

PREVIOUS RELATED DUE PROCESS

- 4 The AASB has previously made the following documents available for public comment and has held discussions at its public meetings in relation to these documents:
 - AASB ED 149 *Proposed Amendments to AASB 123 Borrowing Costs* (May 2006);
 - IPSASB ED 35 *IPSAS 5 “Borrowing Costs” (Revised 200X)* (September 2008);
 - and
 - AASB ED 176 *Proposed Amendments to Australian Accounting Standards – Borrowing Costs of Not-for-Profit Public Sector Entities* (February 2009).
- 5 Further information about the proposals of these Exposure Drafts, comment letters received by the AASB, and the AASB’s discussions, including with respect to not-for-profit public sector entities, is set out in Appendix 1 to this paper.

STAFF RECOMMENDATION

- 6 Paragraph 50 of the AASB’s Policies and Processes states: “The extent of the due process undertaken by the AASB and the length of the comment period provided for constituents is a matter of judgement and is influenced by the nature and significance of the proposals and their impact on current practice. ...”.¹
- 7 Although, as noted above, Australian constituents have been given various opportunities in the past to comment on the accounting for borrowing costs with

1 A copy of AASB Policies and Processes is available from the AASB website:
http://www.aasb.gov.au/admin/file/content102/c3/Policy_Statement_03-11.pdf

regard to the aspect under review, given the passage of time and having regard to the precedent that would otherwise be set for due process, on balance staff think that further due process is appropriate.

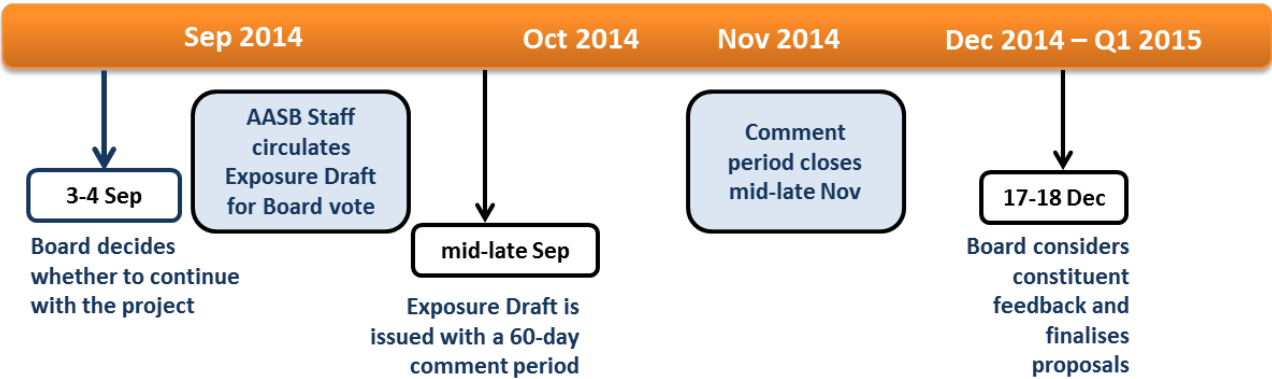
- 8 Accordingly, staff recommend that the Board expose the proposed amendments to AASB 123 for public comment. However, as any Exposure Draft is a re-exposure of previously exposed proposals, staff suggest that the Board consider issuing the Exposure Draft with a shorter 60-day comment period, rather than its usual 90-day comment period.

Question to Board Members

Q1 Do Board members agree with the staff recommendation that the proposed amendments be exposed for comment for 60 days?

PROPOSED PROJECT PLAN

- 9 If the Board agrees with staff’s recommendation, the proposed project plan would appear as follows, with an amending standard targeted for issue in Q1 2015:



Question to Board Members

Q2 Do Board members have any questions in relation to the AASB staff proposed project plan?

APPENDIX 1

Previous Related Due Process

- 1 This Appendix provides further information about the due process that staff think may be regarded as having been conducted to date in relation to the AASB's current review of the option presently available in AASB 123 for not-for-profit public sector entities to expense all borrowing costs as they are incurred. As noted in the memorandum, there have been three related Exposure Drafts made available for comment in Australia:

- AASB ED 149 *Proposed Amendments to AASB 123 Borrowing Costs* (May 2006);
- IPSASB ED 35 *IPSAS 5 "Borrowing Costs" (Revised 200X)* (September 2008); and
- AASB ED 176 *Proposed Amendments to Australian Accounting Standards – Borrowing Costs of Not-for-Profit Public Sector Entities* (February 2009).

This Appendix discusses the due process that the Board conducted with respect to each of those Exposure Drafts.

AASB ED 149 *Proposed Amendments to AASB 123 Borrowing Costs* (May 2006)

- 2 In May 2006, the AASB issued AASB Exposure Draft ED 149 *Proposed Amendments to AASB 123 Borrowing Costs* for public comment. AASB ED 149 incorporated the International Accounting Standards Board's (IASB) Exposure Draft of the same name, and which proposed amendments which were finalised in the revised IAS 23 *Borrowing Costs* issued in March 2007. In the main, AASB ED 149 proposed the removal of the option then available in AASB 123 (July 2004) of recognising borrowing costs immediately as an expense, to the extent that they were directly attributable to the acquisition, construction or production of a qualifying asset.
- 3 In its Preface to AASB ED 149, the AASB noted, in relation to its work on convergence of Generally Accepted Accounting Principles (GAAP) and Government Financial Statistics (GFS), that the immediate expensing of all borrowing costs converged with the GFS treatment, and that the removal of the option would create a convergence difference between GAAP and GFS. However, notwithstanding the implications for GAAP/GFS harmonisation, the Board also noted that its preliminary view was to support the IASB's proposals. The AASB invited comment on whether there were any regulatory or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to not-for-profit and public sector entities.
- 4 The AASB received eight (8) comment letters on AASB ED 149. Respondents were:
- Australasian Council of Auditors-Generals (ACAG)
 - CPA Australia
 - Deloitte
 - Ernst & Young
 - Group of 100 (G100)
 - Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)
 - National Institute of Accountants (NIA); and

- The Institute of Chartered Accountants in Australia (ICAA).²

The AASB considered these submissions at its meetings in September 2006 and May 2007 in forming its submission to the IASB on the IASB Exposure Draft³, and in finalising a revised AASB 123 *Borrowing Costs*.

- 5 At its meeting in May 2007, the Board had before it an extract from the staff analysis of responses to AASB ED 149 relating to the public sector implications of the proposals (refer Appendix 2). The Board considered whether it should amend the revised IAS 23 (March 2007) for application by not-for-profit entities or governments. An extract from the minutes to the May 2007 AASB Meeting note:

“... The Board considered whether not-for-profit entities should be either required or permitted to immediately recognise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as an expense, particularly in view of the Board’s GAAP/GFS convergence work and the GFS requirement to recognise all borrowing costs as expenses as incurred. In the process the Board reviewed extracts from the collation of comments on ED 149 *Proposed Amendments to AASB 123 Borrowing Costs* (May 2006).

The Board decided that, in this particular case, there is not sufficient reason for treating not-for-profit entities in a manner different from for-profit entities and that its policy of sector neutrality should prevail. Accordingly, the Board agreed to adopt the revised IAS 23 as a revised AASB 123 in respect of both for-profit entities and not-for-profit entities without amendment. ...”

- 6 A revised AASB 123 was made by the AASB on 14 June 2007.

IPSASB ED 35 *IPSAS 5 “Borrowing Costs” (Revised 200X) (September 2008)*

- 7 In September 2008, the International Public Sector Accounting Standards Board (IPSASB) issued IPSASB Exposure Draft ED 35 *IPSAS 5 “Borrowing Costs” (Revised 200X)*. The ED contained proposals to revise the May 2000 version of International Public Sector Accounting Standard IPSAS 5 following the issue of IAS 23 in March 2007, and formed part of the IPSASB’s continuous improvements project to update existing IPSASs to converge with the latest related IFRSs to the extent appropriate for the public sector.
- 8 IPSASB ED 35 differed significantly from IAS 23 (March 2007) as the IPSASB decided that it was inappropriate to require public sector entities to capitalise borrowing costs. The ED proposed retaining the option to allow entities to capitalise borrowing costs, but amending IPSAS 5 to only permit borrowing costs that are ‘specifically incurred’ (rather than the broader ‘directly attributable’) for the acquisition, construction or production of a qualifying asset to be capitalised. The

2 AASB ED 149 comment letters are available from <http://www.aasb.gov.au/Archive/Work-in-progress-documents.aspx>.

3 Refer http://www.aasb.gov.au/admin/file/content106/c2/IASB_ED_IAS23_submission.pdf for the AASB comment letter on the IASB Exposure Draft.

IPSASB's reasons for departing from the requirements of IAS 23 were explained in the ED's Basis for Conclusions.^{4,5}

- 9 Australian constituents were invited to respond to the AASB on IPSASB ED 35 by 1 December 2008. The AASB received one (1) comment letter, which it considered in formulating its submission to the IPSASB.
- 10 The AASB discussed IPSASB ED 35 at its meetings in November 2008 and December 2008. The AASB submission to the IPSASB expressed support for the IPSASB modifying IAS 23 to reflect not-for-profit public sector circumstances, but did not support the IPSASB's departure from IAS 23 by introducing the option described in paragraph 8 above. The AASB was concerned that the IPSASB had not, per IPSASB guidelines for modifying IFRSs, identified sufficient public sector specific reasons for departing from IAS 23. (The AASB submission also indicated that it did not at that time conceptually support treating borrowing costs differently from other financing costs, and that it believed that the weight of the conceptual arguments supported the view that borrowing costs are period costs that should be immediately expensed.)⁶
- 11 The IPSASB received mixed responses to IPSASB ED 35 and agreed that it would be inappropriate to develop a Standard that reflects the ED's proposals. It agreed that certain issues should be explored further by corresponding directly with all respondents. Accordingly, in March 2009, IPSASB staff wrote to the AASB seeking the AASB's views on the appropriate accounting for borrowing costs. The AASB discussed its draft response to the IPSASB at its April 2009 meeting, and responded in a letter dated 29 April 2009 acknowledging the difficulties faced by the IPSASB, but expressing its (reluctant) preference for consistency with IAS 23, noting that the AASB had been unable to identify public sector specific reasons for treating borrowing costs specifically incurred by a public sector entity for obtaining a qualifying asset differently from private sector for-profit entities.⁷
- 12 The IPSASB subsequently decided to defer its revision of IPSAS 5 until completion of its Conceptual Framework, expected in Q4 2014.

AASB ED 176 Proposed Amendments to Australian Accounting Standards – Borrowing Costs of Not-for-Profit Public Sector Entities (February 2009)

- 13 At its December 2008 meeting, the AASB also considered a letter from HoTARAC seeking deferral of the removal of the option to expense borrowing costs for public sector not-for-profit entities. The Board discussed the merits of the HoTARAC request and agreed that, on balance, interim deferral would be appropriate for the reasons ultimately set out in AASB 2009-1 *Amendments to Australian Accounting Standards – Borrowing Costs of Not-for-Profit Public Sector Entities*. The Board discussed sweep issues related to the proposed amendments to reintroduce the 'immediate expense' option at its February 2009 meeting, including consideration of

4 Refer http://www.aasb.gov.au/admin/file/content105/c9/IPSASB_ED35_IPSAS_5_Borrowing_Costs.pdf for a copy of IPSASB ED 35.

5 Staff considered the IPSASB's reasons as part of its analysis in Agenda Paper 10.2.

6 Refer http://www.aasb.gov.au/admin/file/content106/c2/IPSASB_ED35_submission.pdf for the AASB submission to IPSAS ED 35.

7 A copy of the AASB response is available at <http://www.ifac.org/sites/default/files/meetings/files/4740.pdf>

whether further due process was warranted. Staff noted that as the AASB was responding to a request from one constituent primarily representing public sector preparers, arguably other constituents such as public sector auditors and users and those in the private not-for-profit sector should be consulted.

- 14 The AASB issued AASB ED 176 for comment in February 2009. In the main, the Exposure Draft proposed amending AASB 123 to reintroduce the option to expense borrowing costs in respect of not-for-profit public sector entities. The AASB received six (6) comment letters to the ED. Respondents were:

- ACAG
- David Maxwell
- Ernst & Young
- HoTARAC
- Joint Accounting Bodies (CPA Australia, ICAA and NIA)
- PricewaterhouseCoopers

The submissions indicated general support for reintroducing the ‘immediate expense’ option for not-for-profit public sector entities. One respondent disagreed with the proposals as it did not consider the reasons set out in the Basis for Conclusions to AASB ED 176 to be sufficient justification for introducing standards that were not transaction neutral. The AASB considered these submissions at its meeting in April 2009 and agreed to make the proposed amendments to AASB 123 (as issued in June 2007).

- 15 The AASB issued AASB 2009-1 in April 2009, reintroducing the ‘immediate expense’ option into AASB 123 for not-for-profit public sector entities. The Preface to the Amending Standard includes language that acknowledges that the relief is of an interim nature.

APPENDIX 2

Extract from Staff Analysis of Submissions on ED 149 (included as part of Agenda Paper 12.A1.2 at September 2006 AASB Meeting)

Public Sector Implications

The expense option enables public sector entities to account for borrowing costs in the same manner as current GFS requirements. ACAG, HoTARAC, EY and ICAA note that the adoption of the proposals contained within ED 149 would create further inconsistencies between Australian GAAP and GFS. Where there is a choice in accounting policy, most State legislators will mandate a specific option be chosen. ACAG notes that, in regard to AASB 123, most public sector entities are required to expense borrowing costs in the period incurred in an attempt to provide consistency across government and harmonise with GFS.

HoTARAC raises a number of other issues relevant to the public sector, including:

- GFS requires the majority of public sector assets to be held at fair value. Paragraph 3A of ED 149 specifically excludes assets held at fair value from the required accounting treatment. However, it is not clear how to account for borrowing costs as an asset moves from being a qualifying asset to its initial recognition. As fair value on initial recognition is generally the same as its cost, does fair value include borrowings costs irrespective of the exclusion under 3A? This issue is likely to arise for any asset that falls under the requirements of AASB 116 *Property, Plant and Equipment*.
- It may be particularly difficult in a public sector context to identify a direct relationship between specific borrowings and a qualifying asset, which could result in departments disclosing assets at a different cost from the same qualifying asset in the whole-of-government report.