

Accounting Standard

AASB 123
June 2007

Borrowing Costs



Australian Government

**Australian Accounting
Standards Board**

Obtaining a Copy of this Accounting Standard

This Standard is available on the AASB website: www.aasb.com.au.
Alternatively, printed copies of this Standard are available for purchase by contacting:

The Customer Service Officer
Australian Accounting Standards Board
Level 7
600 Bourke Street
Melbourne Victoria
AUSTRALIA

Postal address:
PO Box 204 Collins Street West
Victoria 8007
AUSTRALIA

Phone: (03) 9617 7637
Fax: (03) 9617 7608
E-mail: publications@aaasb.com.au
Website: www.aasb.com.au

Other Enquiries

Phone: (03) 9617 7600
Fax: (03) 9617 7608
E-mail: standard@aaasb.com.au

COPYRIGHT

© 2007 Commonwealth of Australia

This AASB Standard contains International Accounting Standards Committee Foundation copyright material. Reproduction within Australia in unaltered form (retaining this notice) is permitted for personal and non-commercial use subject to the inclusion of an acknowledgment of the source. Requests and enquiries concerning reproduction and rights for commercial purposes within Australia should be addressed to The Director of Finance and Administration, Australian Accounting Standards Board, PO Box 204, Collins Street West, Victoria 8007.

All existing rights in this material are reserved outside Australia. Reproduction outside Australia in unaltered form (retaining this notice) is permitted for personal and non-commercial use only. Further information and requests for authorisation to reproduce for commercial purposes outside Australia should be addressed to the International Accounting Standards Committee Foundation at www.iasb.org.

ISSN 1036-4803

CONTENTS

PREFACE

COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

ACCOUNTING STANDARD AASB 123 *BORROWING COSTS*

	<i>Paragraphs</i>
Core Principle	1
Application	Aus 1.1 – 1.5
Scope	2 – 4
Definitions	5 – 7
Recognition	8 – 9
Borrowing Costs Eligible for Capitalisation	10 – 15
Excess of the Carrying Amount of the Qualifying Asset Over Recoverable Amount	16
Commencement of Capitalisation	17 – 19
Suspension of Capitalisation	20 – 21
Cessation of Capitalisation	22 – 25
Disclosure	26
Transitional Provisions	27 – 28

DELETED IAS 23 TEXT *Page 15*

BASIS FOR CONCLUSIONS ON IAS 23
(available on the AASB website)

Australian Accounting Standard AASB 123 *Borrowing Costs* is set out in paragraphs 1 – 28. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in this Standard are in *italics* the first time they appear in the Standard. AASB 123 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation and Application of Standards*, which identifies the Australian Accounting Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

PREFACE

Reasons for Issuing AASB 123

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's policy of adopting the Standards of the International Accounting Standards Board (IASB) for application to reporting periods beginning on or after 1 January 2005. The AASB has decided it will continue to issue sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. Except for Standards that are specific to the not-for-profit or public sectors or that are of a purely domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, to broaden the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues.

The IASB defines International Financial Reporting Standards (IFRSs) as comprising:

- (a) International Financial Reporting Standards;
- (b) International Accounting Standards; and
- (c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

The Australian equivalents to IFRSs are:

- (a) Accounting Standards issued by the AASB that are equivalent to Standards issued by the IASB, being AASBs 1 – 99 corresponding to the IFRS series and AASBs 101 – 199 corresponding to the IAS series; and
- (b) Interpretations issued by the AASB corresponding to the Interpretations adopted by the IASB, as listed in AASB 1048 *Interpretation and Application of Standards*.

Main Features of this Standard

Application Date

This Standard is applicable to annual reporting periods beginning on or after 1 January 2009, with early adoption permitted for annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009.

Main Requirements

This Standard requires the capitalisation of all borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. Qualifying assets are assets that necessarily take a substantial period of time to get ready for their intended use. All other borrowing costs are immediately recognised as expenses.

Transitional Provisions

When application of this Standard constitutes a change in accounting policy, an entity applies the Standard to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after the application date.

However, an entity may designate any date before the application date and apply the Standard to borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date.

Differences between this Standard and AASB 123 as issued in July 2004

In relation to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset, AASB 123 as issued in July 2004 permitted entities to either:

- (a) immediately recognise them as an expense; or
- (b) capitalise them as part of the carrying amount of a qualifying asset.

Under this Standard, only the capitalisation treatment is permitted.

COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

AASB 123 and IAS 23

AASB 123 is equivalent to IAS 23 *Borrowing Costs* issued by the IASB. Paragraphs that have been added to this Standard (and do not appear in the text of the equivalent IASB Standard) are identified with the prefix “Aus”, followed by the number of the relevant IASB paragraph and decimal numbering. Paragraphs that apply only to not-for-profit entities begin by identifying their limited applicability.

Compliance with IAS 23

For-profit entities that comply with AASB 123 will simultaneously be in compliance with IAS 23. Not-for-profit entities using the added “Aus” paragraphs in the Standard that specifically apply to not-for-profit entities may not be simultaneously complying with IAS 23. Whether a not-for-profit entity will be in compliance with IAS 23 will depend on whether the “Aus” paragraphs provide additional guidance for not-for-profit entities or contain requirements that are inconsistent with the corresponding IASB Standard and will be applied by the not-for-profit entity.

AASB 123 and IPSAS 5

International Public Sector Accounting Standards (IPSASs) are issued by the International Public Sector Accounting Standards Board of the International Federation of Accountants.

IPSAS 5 *Borrowing Costs* (May 2000) is drawn primarily from the 1993 version of IAS 23. The main differences between IPSAS 5 and AASB 123 are:

- (a) commentary additional to that in AASB 123 has been included in IPSAS 5 to clarify the applicability of the standards to accounting by public sector entities;
- (b) in relation to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset, IPSAS 5 permits entities to either:
 - (i) immediately recognise them as an expense; or

- (ii) capitalise them as part of the carrying amount of a qualifying asset.

Under this Standard, only the capitalisation treatment is permitted;

- (c) IPSAS 5 uses different terminology, in certain instances, from AASB 123. The most significant examples are the use of the terms 'revenue', 'statement of financial performance', 'statement of financial position' and 'net assets/equity' in IPSAS 5. The equivalent terms in AASB 123 are 'income', 'income statement', 'balance sheet' and 'equity'; and
- (d) IPSAS 5 contains a different set of definitions of technical terms from AASB 123 (paragraph 5).

ACCOUNTING STANDARD AASB 123

The Australian Accounting Standards Board makes Accounting Standard AASB 123 *Borrowing Costs* under section 334 of the *Corporations Act 2001*.

Dated 14 June 2007

D.G. Boymal
Chair – AASB

ACCOUNTING STANDARD AASB 123

BORROWING COSTS

Core Principle

- 1** Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

Application

- Aus1.1** This Standard applies to:
- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
 - (b) general purpose financial reports of each other reporting entity; and
 - (c) financial reports that are, or are held out to be, general purpose financial reports.
- Aus1.2** This Standard applies to annual reporting periods beginning on or after 1 January 2009.
- Aus1.3** This Standard may be applied to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009. When an entity applies this Standard to such an annual reporting period, it shall disclose that fact.
- Aus1.4** The requirements specified in this Standard apply to the financial report where information resulting from their

application is material in accordance with AASB 1031 *Materiality*.

Aus1.5 When applicable, this Standard supersedes AASB 123 *Borrowing Costs* as notified in the *Commonwealth of Australia Gazette* No S 294, 22 July 2004.

Scope

- 2 An entity shall apply this Standard in accounting for borrowing costs.
- 3 The Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.
- 4 An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:
 - (a) a qualifying asset measured at fair value, for example a biological asset; or
 - (b) inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis.

Definitions

- 5 This Standard uses the following terms with the meanings specified:

***Borrowing costs* are interest and other costs that an entity incurs in connection with the borrowing of funds.**

***A qualifying asset* is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.**
- 6 Borrowing costs may include:
 - (a) interest on bank overdrafts and short-term and long-term borrowings;
 - (b) amortisation of discounts or premiums relating to borrowings;
 - (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

- (d) finance charges in respect of finance leases recognised in accordance with AASB 117 *Leases*; and
 - (e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
- 7 Depending on the circumstances, any of the following may be qualifying assets:
- (a) inventories
 - (b) manufacturing plants
 - (c) power generation facilities
 - (d) intangible assets
 - (e) investment properties.

Financial assets, and inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

Recognition

- 8 **An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them.**
- 9 Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset. Such borrowing costs are capitalised as part of the cost of the asset when it is probable that they will result in future economic benefits to the entity and the costs can be measured reliably. When an entity applies AASB 129 *Financial Reporting in Hyperinflationary Economies*, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period in accordance with paragraph 21 of that Standard.

Borrowing Costs Eligible for Capitalisation

- 10 The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. When an entity borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.
- 11 It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an entity is co-ordinated centrally. Difficulties also arise when a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other entities in the group. Other complications arise through the use of loans denominated in or linked to foreign currencies, when the group operates in highly inflationary economies, and from fluctuations in exchange rates. As a result, the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgement is required.
- 12 To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.**
- 13 The financing arrangements for a qualifying asset may result in an entity obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.
- 14 To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made**

specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

- 15 In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.

Excess of the Carrying Amount of the Qualifying Asset Over Recoverable Amount

- 16 When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Standards.

Commencement of Capitalisation

- 17 **An entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:**
- (a) **it incurs expenditures for the asset;**
 - (b) **it incurs borrowing costs; and**
 - (c) **it undertakes activities that are necessary to prepare the asset for its intended use or sale.**
- 18 Expenditures on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditures are reduced by any progress payments received and grants received in connection with the asset (see AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*). The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalisation rate is applied in that period.

- 19 The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits prior to the commencement of the physical construction. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

Suspension of Capitalisation

- 20 **An entity shall suspend capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset.**
- 21 An entity may incur borrowing costs during an extended period in which it suspends the activities necessary to prepare an asset for its intended use or sale. Such costs are costs of holding partially completed assets and do not qualify for capitalisation. However, an entity does not normally suspend capitalising borrowing costs during a period when it carries out substantial technical and administrative work. An entity also does not suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographical region involved.

Cessation of Capitalisation

- 22 **An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.**
- 23 An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

- 24** When an entity completes the construction of a qualifying asset in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.
- 25 A business park comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being usable while construction continues on other parts. An example of a qualifying asset that needs to be complete before any part can be used is an industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

Disclosure

- 26** An entity shall disclose:
- (a) the amount of borrowing costs capitalised during the period; and
 - (b) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Transitional Provisions

- 27** When application of this Standard constitutes a change in accounting policy, an entity shall apply the Standard to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after the application date.
- 28** However, an entity may designate any date before the application date and apply the Standard to borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date.

Effective Date of IAS 23

- 29 [Deleted by the AASB]

Withdrawal of IAS 23 (revised 1993)

- 30 [Deleted by the AASB]

DELETED IAS 23 TEXT

Deleted IAS 23 text is not part of AASB 123.

Paragraph 29

An entity shall apply the Standard for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the Standard from a date before 1 January 2009, it shall disclose that fact.

Paragraph 30

This Standard supersedes IAS 23 *Borrowing Costs* revised in 1993.