

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.gov.au.

Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007
AUSTRALIA

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

Other enquiries

Phone: (03) 9617 7600
E-mail: standard@aaasb.gov.au

COPYRIGHT

© Commonwealth of Australia 2015

This AASB Standard contains IFRS 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 IFRS Foundation at www.ifrs.org.

ISSN 1036-4803

Contents

COMPARISON WITH IAS 23

ACCOUNTING STANDARD
AASB 123 *BORROWING COSTS*

	<i>from paragraph</i>
CORE PRINCIPLE	1
SCOPE	2
DEFINITIONS	5
RECOGNITION	8
Borrowing costs eligible for capitalisation	10
Excess of the carrying amount of the qualifying asset over recoverable amount	16
Commencement of capitalisation	17
Suspension of capitalisation	20
Cessation of capitalisation	22
DISCLOSURE	26
TRANSITIONAL PROVISIONS	Aus26.2
EFFECTIVE DATE	29
WITHDRAWAL OF IAS 23 (REVISED 1993)	30
COMMENCEMENT OF THE LEGISLATIVE INSTRUMENT	Aus30.1
WITHDRAWAL OF AASB PRONOUNCEMENTS	Aus30.2
APPENDIX	
A Australian reduced disclosure requirements	
DELETED IAS 23 TEXT	
BASIS FOR CONCLUSIONS	

AVAILABLE ON THE AASB WEBSITE

Basis for Conclusions on IAS 23

Australian Accounting Standard AASB 123 *Borrowing Costs* is set out in paragraphs 1 – Aus30.2 and Appendix A. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. AASB 123 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation of Standards*, which identifies the Australian Accounting Interpretations, and AASB 1057 *Application of Australian Accounting Standards*. 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.

Comparison with IAS 23

AASB 123 *Borrowing Costs* incorporates IAS 23 *Borrowing Costs* issued by the International Accounting Standards Board (IASB). Australian-specific paragraphs (which are not included in IAS 23) are identified with the prefix “Aus” or “RDR”. Paragraphs that apply only to not-for-profit entities begin by identifying their limited applicability.

Tier 1

For-profit entities complying with AASB 123 also comply with IAS 23.

Not-for-profit entities’ compliance with IAS 23 will depend on whether any “Aus” paragraphs that specifically apply to not-for-profit entities provide additional guidance or contain applicable requirements that are inconsistent with IAS 23.

Tier 2

Entities preparing general purpose financial statements under Australian Accounting Standards – Reduced Disclosure Requirements (Tier 2) will not be in compliance with IFRSs.

AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of reporting requirements.

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 7 August 2015

Kris Peach
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.**
- Aus1.1 **In respect of not-for-profit public sector entities, borrowing costs may be expensed in accordance with paragraph Aus8.1.**

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 within the scope of AASB 141 *Agriculture*; 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 expense calculated using the effective interest method as described in AASB 9;
 - (b) [deleted]
 - (c) [deleted]
 - (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
- (f) bearer plants.

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.**
- Aus8.1 A not-for-profit public sector entity may elect to recognise borrowing costs as an expense in the period in which they are incurred regardless of how the borrowings are applied.**
- Aus8.2 In respect of not-for-profit public sector entities, paragraphs 9–26, 27 and 28 apply only when an entity elects to 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.
- 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.
- Aus26.1 A not-for-profit public sector entity shall disclose the accounting policy adopted for borrowing costs.

Transitional provisions

- Aus26.2 Paragraphs 27 and 28 shall not be applied by an entity that has previously applied AASB 123, unless required to do so by another Standard.
- 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 effective date.
- 28 However, an entity may designate any date before the effective 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

- 29 An entity shall apply the Standard for annual periods beginning on or after 1 January 2018. Earlier application is permitted for periods beginning after 24 July 2014 but before 1 January 2018. If an entity applies the Standard from a date before 1 January 2018, it shall disclose that fact.
- 29A [Deleted by the AASB]
- 29B AASB 2014-7 *Amendments to Australian Accounting Standards arising from AASB 9 (December 2014)*, issued in December 2014, amended paragraph 6 in the previous version of this Standard. An entity shall apply that amendment when it applies AASB 9.

Withdrawal of IAS 23 (revised 1993)

- 30 [Deleted by the AASB]

Commencement of the legislative instrument

- Aus30.1 For legal purposes, this legislative instrument commences on 31 December 2017.

Withdrawal of AASB pronouncements

- Aus30.2 This Standard repeals AASB 123 *Borrowing Costs* issued in June 2007. Despite the repeal, after the time this Standard starts to apply under section 334 of the Corporations Act (either generally or in relation to an individual entity), the repealed Standard continues to apply in relation to any period ending before that time as if the repeal had not occurred.
- [Note: When this Standard applies under section 334 of the Corporations Act (either generally or in relation to an individual entity), it supersedes the application of the repealed Standard.]

Appendix A

Australian reduced disclosure requirements

This appendix is an integral part of the Standard.

- AusA1** Paragraph 26(b) of this Standard does not apply to entities preparing general purpose financial statements under Australian Accounting Standards – Reduced Disclosure Requirements. Entities applying Australian Accounting Standards – Reduced Disclosure Requirements may elect to comply with this excluded requirement.
- AusA2** The requirement that does not apply to entities preparing general purpose financial statements under Australian Accounting Standards – Reduced Disclosure Requirements are also identified in this Standard by shading of the relevant text.

Deleted IAS 23 text

Deleted IAS 23 text is not part of AASB 123.

- 29A Paragraph 6 was amended by *Improvements to IFRSs* issued in May 2008. An entity shall apply that amendment for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.
- 30 This Standard supersedes IAS 23 *Borrowing Costs* revised in 1993.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, AASB 123.

Background

- BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in this Standard. Individual Board members gave greater weight to some factors than to others.
- BC2 Before the mandatory application date of revised AASB 123 *Borrowing Costs* in 2009, the Board conducted a review of the requirement in AASB 123 for not-for-profit entities to 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. As a result of that review, in April 2009 the Board issued AASB 2009-1 *Amendments to Australian Accounting Standards – Borrowing Costs of Not-for-Profit Public Sector Entities*. AASB 2009-1 amended AASB 123 to allow not-for-profit public sector entities to expense borrowing costs as incurred, regardless of how the borrowings are applied.
- BC3 The Board intended for the relief granted under AASB 2009-1 to be of an interim nature pending the outcome of:
- (a) the work of the New Zealand Financial Reporting Standards Board (FRSB)¹ on the relationship between depreciated replacement cost and borrowing costs, in which the AASB agreed to participate;
 - (b) the AASB and FRSB work on developing a Process for Modifying, or Introducing Additional Requirements to, IFRSs for PBE/NFP; and
 - (c) the International Public Sector Accounting Standards Board's (IPSASB's) Borrowing Costs project.
- BC4 In March 2011, the AASB decided to reactivate its project on the application of AASB 123 by not-for-profit public sector entities, and evaluate the election for not-for-profit public sector entities to expense immediately all borrowing costs against its *Process for Modifying IFRSs for PBE/NFP* ('Process').
- BC5 In September 2014, the Board discussed the modification for not-for-profit public sector entities to expense borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset against its *Process*. The Board noted that the International Valuation Standards Council issued Technical Information Paper 2 *The Cost Approach for Tangible Assets* in April 2012, which includes discussion of inputs included in a model based on the cost approach, and that the IPSASB's Borrowing Cost project was on hold pending completion of the IPSASB's Conceptual Framework project.
- BC6 The Board noted that it would not be appropriate for the accounting for borrowing costs of not-for-profit public sector entities to differ from that of for-profit entities merely because the Board may favour a different treatment conceptually. The Board confirmed that departure from the requirements of IAS 23 *Borrowing Costs* should only be permitted where not-for-profit specific reasons for departure exist.
- BC7 The Board decided, on evaluation of IAS 23 against its *Process*, that the modification for not-for-profit public sector entities should be retained in AASB 123. The Board decided to add a Basis for Conclusions to AASB 123 to reflect its conclusions in this regard.

Significant issues

GAAP/GFS convergence

- BC8 The Board weighed its policy on GAAP/GFS harmonisation against its policy of transaction neutrality, noting that requiring not-for-profit public sector entities to 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 would create a further difference between Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS). The Board considered the costs of tracking reconciling differences over the useful life of the assets, and noted that public sector infrastructure assets may have a longer useful life than most assets held by private sector entities.

¹ The FRSB has since been succeeded by the New Zealand Accounting Standards Board (NZASB).

Borrowing by not-for-profit public sector entities

- BC9 The Board discussed the nature of borrowing in the public sector. The Board observed that borrowing can be related to funding government activities or, in the case of the Commonwealth and depending on the economic circumstances, might have a public policy purpose such as supporting a domestic bond market.
- BC10 The Board noted that Australian governments generally use centralised borrowing agencies and the distribution of borrowings to government departments or other agencies could take a different form to the initial debt raising, and that there may be little nexus between centralised borrowings and the individual qualifying assets in a government entity. Similarities in the use of centralised borrowing activities between the Australian government and large private sector entities were considered. The Board also noted that the level of complexity in terms of the number of lines of credit and the number of group entities responsible for acquiring or constructing qualifying assets is likely to be greater than that of the for-profit sector.
- BC11 However, the Board also observed that the Standard envisages that entities may borrow centrally and acknowledges that this can create difficulties for determining whether a direct relationship between particular borrowings and a qualifying asset exists, and that the exercise of judgement would be required in such situations.

Measurement of property, plant and equipment by not-for-profit public sector entities

- BC12 The Board discussed the prevailing practice in the Australian not-for-profit public sector of revaluing property, plant and equipment subsequent to initial measurement and recognition. The Board noted that the relatively brief time for which government-constructed assets would be qualifying assets that are measured at cost means that any benefit from including capitalising borrowing costs in the initial measurement of an asset would be very limited, as capitalising borrowing costs is consistent with a cost measurement model. This is particularly the case in the context of long-lived assets such as infrastructure assets, on the basis that the relative time for which an asset is likely to be measured at fair value would be significantly longer than the time for which the asset is under construction (and measured at cost).

Balance of costs and benefits

- BC13 The Board concluded that it is appropriate to depart from its policy of transaction neutrality for cost-benefit reasons. The Board considered that the costs of requiring not-for-profit public sector entities to capitalise borrowing costs associated with qualifying assets would generally be at least as great as they are for private sector entities, but that any benefits would not be as great due to the prevalence in the public sector of the practice of revaluing property, plant and equipment to fair value.
- BC14 The Board observed that the relief in paragraphs Aus8.1 and Aus8.2 does not prevent a not-for-profit public sector entity from adopting an accounting policy of capitalising borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.