18 August 2006

Professor David Boymal FPNA
Chairman
Australian Accounting Standards Board
Level 2
480 Collins Street
Melbourne VIC 3000

Dear David

Re: Borrowing costs

The National Institute of Accountants (NIA) supports the gradual removal of the remaining options in the standards forming a part of the suite of international pronouncements.

We are not supporters of a series of options in accounting standards and as such we encourage the Australian Accounting Standards Board (AASB) to emphasise that removal of options in standards such employee benefits. There is little sense in having three ways of accounting for defined benefit plans embedded in an accounting standard.

Qualified support for the exposure draft

The exposure draft on borrowing costs aims to bring practice as specified in accounting standards in the United States and this contributes to a greater consistency between the reporting frameworks. This is a benefit of the exposure draft's proposals although the standard setter would have had the same impact if the other option, the expensing of borrowing costs, was maintained. We believe this exposure draft goes some way to helping eliminate options in international standards and removes one step in the journey to achieving the removal of reconciliation between international standards and the framework for reporting in the United States.

Whether the answer of capitalisation of borrowing costs as outlined in the exposure draft for qualifying assets is the best possible answer needs further consideration over time. We would expect the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to review this pronouncement at a subsequent period once it has secured the reconciliation relief being sought.

Qualifying assets

The merits of this categorisation need to be questioned over the long term. If it is appropriate to capitalise interest then it should be capitalised in all instances because the act of entering into a financing transaction that places the entity in debt to another party until that same debt is extinguished irrespective of use to which the borrowed funds are used. The attempt to restrict the use of capitalisation in the standard by defining some assets as qualifying assets is an unsatisfactory means by which to prescribe the accounting for borrowing costs. If the accounting is to be applied in a principle-based manner then the notion of a qualifying asset needs to be revisited over time.

Capitalisation of interest

It is argued by some commentators that the cost of a qualifying asset must incorporate the cost of interest as part of the initial historical cost at which the asset is carried in the books of an entity and that capitalisation is the appropriate means of expressing this in the financial statements. We appreciate the argument in favour of capitalisation but consider that there is a lack of logic in capitalisation being restricted to assets that take some time to construct to get to a state in which they can either be used or sold by an enterprise because it can be argued equally that a portion of the historical cost of other assets purchased by the entity includes some element of a financing cost if funds were borrowed to effect the purchase.

We would as a result prefer the notion of expensing to be the answer in the case of borrowing costs until such a time as the IASB and AASB have revisited the concept statements dealing with elements of financial statements to further explore the notion of determining the cost of an asset as at initial recognition.

Standard setting precedent

A comprehensive review of this area is justified at a future time also because the precedent upon which the accounting practices are based now dates back to 1979 when the FASB first issued its pronouncement on the capitalisation of interest costs. It is appropriate to revisit this topic area when the standard setters further examine the conceptual framework.

Please feel free to contact me on the usual contact details should you wish to clarify any points in our correspondence.

Kindest Regards

Tom Ravlic PNA
Policy adviser – Financial Reporting and Governance
National Institute of Accountants