ACCOUNTING STANDARD **AASB 123**
July 2004

Borrowing Costs

Australian Government

Australian Accounting
Standards Board

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Australian Accounting Standard AASB 123 *Borrowing Costs* is set out in paragraphs Aus1.1 – 29. All the paragraphs have equal authority. 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*.

When considering the issue of an Australian equivalent to IAS 23 *Borrowing Costs*, the AASB noted it is one of the rare cases where the benefits of permitting the options within an IASB standard are greater than the detriment. The majority of respondents to ED 111 *Request for Comment on IAS 23 Borrowing Costs* (May 2003) supported introduction of the choice in IAS 23, between expensing all borrowing costs and the alternative treatment, 'capitalise some and expense the rest' (compatible with US requirements and the only treatment permitted in AASB 1036 *Borrowing Costs*). If only one treatment were to be allowed, the majority of respondents preferred expensing, not the then-current Australian policy. Expensing was strongly supported in public sector submissions as important in promoting GFS/GAAP convergence. Accordingly, allowing the option in AASB 123 gives compatibility with IAS 23 and introduces the treatment preferred by constituents without requiring an abrupt change from current practice.

Main Features of this Standard

Application Date

This Standard is applicable to annual reporting periods beginning on or after 1 January 2005. To promote comparability among the financial reports of Australian entities, early adoption of this Standard is not permitted.

First-time Application and Comparatives

Application of this Standard will begin in the first annual reporting period beginning on or after 1 January 2005 in the context of adopting all Australian equivalents to IFRSs. The requirements of AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, the Australian equivalent of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, must be observed. AASB 1 requires prior period information, presented as comparative information, to be restated as if the requirements of this Standard had always applied. This differs from previous Australian requirements where changes in accounting policies did not require the restatement of the income statement and balance sheet of the preceding period.

Main Requirements

This Standard permits a choice between two treatments of borrowing costs. The treatment prescribed in AASB 1036 (capitalisation of borrowing costs related to qualifying assets) is continued in this Standard as the alternative to the benchmark treatment. The benchmark treatment is to expense all borrowing costs in the period incurred.

In this Standard, the terms “borrowing costs” and “qualifying asset” are defined in paragraph 4. The disclosures required are specified separately for each permitted treatment of borrowing costs.

For those entities that choose not to expense all borrowing costs, this Standard requires:

(a) capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset;

(b) recognition as an expense in the period incurred of all borrowing costs not capitalised in accordance with (a); and

(c) cessation or suspension of capitalisation in specified circumstances.

Adoption of this Standard does not constitute a change in accounting policy for an entity that adopts this Standard and continues the capitalising policy it followed under AASB 1036.

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

Entities that comply with AASB 123 will simultaneously be in compliance with IAS 23.

AASB 123 and IPSAS 5

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

IPSAS 5 *Borrowing Costs* (May 2000) is drawn primarily from 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 standard to accounting by public sector entities; and

(b) IPSAS 5 contains a different set of definitions of technical terms from AASB 123 (paragraph 4).

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 15 July 2004

D.G. Boymal
Chair – AASB

ACCOUNTING STANDARD AASB 123

BORROWING COSTS

Objective

The objective of this Standard is to prescribe the accounting treatment for borrowing costs. This Standard generally requires the immediate expensing of borrowing costs. However, the Standard permits, as an allowed alternative treatment, the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

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 2005.

Aus1.3 This Standard shall not be applied to annual reporting periods beginning before 1 January 2005.

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:

(a) AASB 1036 *Borrowing Costs* as notified in the *Commonwealth of Australia Gazette* No S 532, 16 December 1997; and

(b) AAS 34 *Borrowing Costs* as issued in December 1997.

Aus1.6 Both AASB 1036 and AAS 34 remain applicable until superseded by this Standard.

Aus1.7 Notice of this Standard was published in the *Commonwealth of Australia Gazette* No S 294, 22 July 2004.

Aus1.8 An entity shall recognise and disclose borrowing costs using either:

(a) the benchmark treatment in paragraphs 7 to 9; or

(b) the allowed alternative treatment in paragraphs 10 to 29.

Aus1.9 Adoption of this Standard and continued use of the allowed alternative does not constitute a change in accounting policy for Australian reporting entities that previously complied with AASB 1036.

Scope

1. This Standard shall be applied in accounting for borrowing costs.

2. [Deleted by the AASB]

3. This Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.

Definitions

4. The following terms are used in this Standard with the meanings specified.

***Borrowing costs* are interest and other costs incurred by an entity 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.

5. 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.

6. Examples of qualifying assets are inventories that require a substantial period of time to bring them to a saleable condition, manufacturing plants, power generation facilities and investment properties. Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Borrowing Costs – Benchmark Treatment

Recognition

7. Borrowing costs shall be recognised as an expense in the period in which they are incurred.

8. Under the benchmark treatment borrowing costs are recognised as an expense in the period in which they are incurred regardless of how the borrowings are applied.

Disclosure

9. The financial report shall disclose the accounting policy adopted for borrowing costs.

Borrowing Costs – Allowed Alternative Treatment

Recognition

10. Borrowing costs shall be recognised as an expense in the period in which they are incurred, except to the extent that they are capitalised in accordance with paragraph 11.

11. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation shall be determined in accordance with this Standard.

12. Under the allowed alternative treatment, borrowing costs that are directly attributable to the acquisition, construction or production of an 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. Other borrowing costs are recognised as an expense in the period in which they are incurred.

Borrowing Costs Eligible for Capitalisation

13. 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.

14. 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.

15. To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset shall be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

16. 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.

17. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation shall be determined 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 capitalised during a period shall not exceed the amount of borrowing costs incurred during that period.

18. 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

19. 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 Australian Accounting Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Australian Accounting Standards.

Commencement of Capitalisation

20. The capitalisation of borrowing costs as part of the cost of a qualifying asset shall commence when:

(a) **expenditures for the asset are being incurred;**

(b) **borrowing costs are being incurred; and**

(c) **activities that are necessary to prepare the asset for its intended use or sale are in progress.**

21. 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.

Aus21.1 In respect of not-for-profit entities, the reduction described in paragraph 21 is not required, because AASB 120 does not apply to not-for-profit entities.

22. 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

23. **Capitalisation of borrowing costs shall be suspended during extended periods in which active development is interrupted.**

24. Borrowing costs may be incurred during an extended period in which the activities necessary to prepare an asset for its intended use or sale are interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalisation. However, capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalisation of borrowing costs is also not suspended 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 needed for inventories to mature or the extended period during which high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.

Cessation of Capitalisation

25. Capitalisation of borrowing costs shall cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

26. 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.

27. When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation of borrowing costs shall cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.

28. 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

29. The financial report shall disclose:

(a) the accounting policy adopted for borrowing costs;

(b) the amount of borrowing costs capitalised during the period; and

(c) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Transitional Provisions

30. [Deleted by the AASB]

Effective Date of IAS 23

31. [Deleted by the AASB]