Exposure Draft

ED 149
May 2006

Proposed Amendments to AASB 123 Borrowing Costs

Prepared by the
Australian Accounting Standards Board

Australian Government

Australian Accounting Standards Board

Commenting on this Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 21 August 2006. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 29 September 2006. Comments should be addressed to:

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A copy of all non-confidential submissions to the AASB will be placed on public record on the AASB website: www.aasb.com.au.

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PREFACE

Background

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards to be applied by:

(a) entities required by the *Corporations Act 2001* to prepare financial reports;

(b) all reporting entities engaged in either for-profit, not-for-profit or public sectors; and

(c) any other entity that prepares general purpose financial reports.

Australian Accounting Standards that apply to annual reporting periods beginning on or after 1 January 2005 include Australian equivalents to International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB).

Although IFRSs are developed to apply to for-profit entities, the AASB has decided to continue to make transaction-neutral accounting standards as between for-profit, not-for-profit private and not-for-profit public sectors. Accordingly, Australian Accounting Standards (including Australian equivalents to IFRSs) generally require the same accounting treatment for similar transactions occurring in both for-profit and not-for-profit entities, including public sector entities. An Australian equivalent to an IFRS uses the corresponding IFRS as the "foundation" Standard to which the AASB adds material detailing its scope and applicability in the Australian environment. Additions are made, where necessary, to broaden the content of the Australian equivalent to an IFRS to cover domestic, regulatory or other issues. In addition to making accounting standards that are Australian equivalents to IFRSs, the AASB also continues to make other Australian Accounting Standards that are specific to the not-for-profit sector, including public sector entities, or that are purely of a domestic nature.

Exposure Drafts

The adoption of IFRSs is an ongoing process. Whenever the IASB issues new or amended IFRSs, the AASB must also consider making new or amended Australian equivalents to those IFRSs.

In developing a new or amended IFRS, the IASB releases an Exposure Draft (ED) of the proposed Standard or amendments for public comment. The AASB generally follows a similar due process prior to making or amending Australian Accounting Standards. In the case of changes proposed by the IASB to IFRSs, the AASB also releases an ED containing those proposed changes and specifically invites comments from Australian constituents on, among other things, whether the implementation of the proposals in an Australian equivalent to an IFRS may be affected by the Australian environment (including the legal and regulatory environment) and whether the proposals are in the best interests of the Australian economy.

Purpose of this Exposure Draft

The purpose of this ED is to invite comments from Australian constituents on proposed amendments to AASB 123 *Borrowing Costs*, which is the Australian equivalent to IAS 23 *Borrowing Costs*.

These proposed amendments are contained in the Exposure Draft of *Borrowing Costs* that was issued by the IASB in May 2006. If these amendments are approved by the IASB, and subsequently by the AASB, they are expected to be applicable from the time that the IASB amendments become effective. The IASB has not yet specified an effective date.

Structure of this Exposure Draft

The AASB has decided to:

(a) reproduce the IASB Exposure Draft of Proposed Amendments to IAS 23 *Borrowing Costs* without amendment as part of this ED;

(b) identify the main changes and the AASB's preliminary views in this Preface; and

(c) seek constituents' views on the proposals.

Application

The proposals in the ED are intended to:

(a) amend AASB 123, issued in July 2004; and

(b) consequentially amend a number of other Australian Accounting Standards. This ED identifies the consequential amendments to various IFRSs that would need to be made to corresponding Australian equivalents to IFRSs.

The existing requirements of these Standards remain operative until superseded by the proposals in this ED.

Application Date

The AASB intends to make the amended AASB 123 and the amendments to other Australian Accounting Standards applicable from the same date as the IASB. The IASB has not yet specified the application date. Earlier application is proposed to be permitted for annual reporting periods beginning on or after the date the amendments are made by the AASB.

Application and Materiality Paragraphs

The AASB intends to include the application and materiality paragraphs (as per the existing AASB 123) in the amended AASB 123.

For the amendments to other Australian Accounting Standards, the application and materiality paragraphs in those Standards will continue to apply.

Summary of Main Changes to AASB 123

The Exposure Draft proposes the removal of the option in AASB 123 of recognising borrowing costs immediately as an expense, to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset.

The Board notes that in relation to its work on convergence of Generally Accepted Accounting Principles (GAAP) and Government Financial Statistics (GFS), the immediate expensing of all borrowing costs converges with the GFS treatment. In ED 142 *Financial Reporting of General Government Sectors by Governments* (July 2005) the AASB proposed to require all borrowing costs of the General Government Sector to be expensed in determining the operating results. However, the removal of this option in the Exposure Draft would create a convergence difference between GAAP and GFS.

Notwithstanding the implications for GAAP/GFS convergence, the AASB's preliminary view is to support the IASB's proposals.

Request for Comments

Comments are invited on any of the proposals in the ED, including the questions on the proposed amendments to IAS 23 as listed in the Invitation to Comment sections of the IASB ED.

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 21 August 2006. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 29 September 2006. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Specific Matters for Comment

In addition, the AASB would value comments on:

(a) any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

- (i) not-for-profit entities; and
- (ii) public sector entities;

(b) whether the proposals are in the best interests of the Australian economy.

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Exposure Draft of Proposed

AMENDMENTS TO

IAS 23

BORROWING COSTS

Comments to be received by 29 September 2006

ED 149

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This Exposure Draft of proposed Amendments to IAS 23 *Borrowing Costs* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form as amendments to IAS 1. Comments on the Exposure Draft and the Basis for Conclusions should be submitted in writing so as to be received by **29 September 2006**.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org** or addressed to:

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Introduction

1 This Exposure Draft of Proposed Amendments to IAS 23 *Borrowing Costs* has been published by the International Accounting Standards Board as part of its Short-term Convergence project.

2 The objective of the Short-Term Convergence project (which the Board is undertaking jointly with the Financial Accounting Standards Board (FASB) in the United States) is to reduce differences between International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (US GAAP). The project focuses on differences that can be resolved in a relatively short time and can be addressed outside current and planned major projects. It is one strand of the Board's broader objective of convergence of accounting standards around the world.

3 The proposed amendments to the requirements in IAS 23 for the accounting treatment of borrowing costs result from the Board's consideration of FASB Statement No. 34 *Capitalization of Interest Cost* (SFAS 34). The proposed amendments eliminate the option in IAS 23 of recognising borrowing costs immediately as an expense, to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. The Board concluded that eliminating this option will improve financial reporting and will move closer to the recognition requirements of SFAS 34. The Board has not reconsidered the other provisions of IAS 23.

Invitation to Comment

The International Accounting Standards Board invites comments on the changes to IAS 23 proposed in this Exposure Draft. It would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **29 September 2006**.

Question 1

This Exposure Draft proposes to eliminate the option in IAS 23 of recognising immediately as an expense borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. Do you agree with the proposal? If not, why? What alternative would you propose and why?

Question 2

This Exposure Draft proposes that entities should apply the amendments to borrowing costs for which the commencement date for capitalisation is on or after the effective date. However, an entity would be permitted to designate any date before the effective date and to apply the proposed amendments to borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date. Do you agree with the proposal? If not, why? What alternative would you propose and why?

Proposed Amendments to International Accounting Standard 23 *Borrowing Costs*

In the Standard, paragraphs 2 and 7–9 and the main heading after paragraph 9 are deleted; the objective and paragraphs 6, 12 and 29 are amended and paragraphs 1, 3, 4, 10, 11, 15, 17, 20, 23, 25 and 27 are changed editorially to improve their style (new text is underlined; deleted text is struck through); and paragraphs 3A, 30A, 30B and 31A are added. Paragraph 5 is included here for reference, but no amendment is proposed.

Objective

This~~e objective of this~~ Standard ~~is to prescribe~~ specifies the accounting treatment for borrowing costs. It ~~This Standard generally~~ requires an entity to capitalise ~~the immediate expensing of~~ borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. ~~However, the Standard permits, as an allowed alternative treatment, the capitalisation of~~ The Standard requires an entity to recognise other borrowing costs as an expense ~~that are directly attributable to the acquisition, construction or production of a qualifying asset~~.

Scope

1 **An entity shall apply t~~T~~his Standard ~~shall be applied~~ in accounting for borrowing costs.**

2 [Deleted] ~~This Standard supersedes IAS 23 *Capitalisation of Borrowing Costs* approved in 1983.~~

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

3A The Standard shall not be applied to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value, for example a biological asset.

Definitions

4 **~~The following terms are used in t~~This Standard uses the following terms with the meanings specified:**

***Borrowing costs* are interest and other costs ~~incurred by~~ 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.

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 IAS 17 *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~~,~~ and other assets that take a substantial period of time to get ready for their intended use or sale, such as manufacturing plants, power generation facilities, properties that will become self-constructed investment properties once their construction or development is complete and investment properties measured at cost that are being redeveloped. 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 [Deleted] **~~Borrowing costs shall be recognised as an expense in the period in which they are incurred.~~**

8 [Deleted] ~~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 [Deleted] ~~The financial statements shall disclose the accounting policy adopted for borrowing costs.~~

~~Borrowing costs – allowed alternative treatment~~

Recognition

10 **~~Borrowing costs~~ 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. The entity shall recognise other borrowing costs ~~be recognised~~ as an expense in the period in which it incurs them ~~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.~~ An entity shall determine ~~T~~the amount of borrowing costs eligible for capitalisation ~~shall be determined~~ in accordance with this Standard.**

12 ~~Under the allowed alternative treatment, b~~Borrowing costs that are directly attributable to the acquisition, construction or production of a~~n~~ 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. Other borrowing costs are recognised as an expense in the period in which they are incurred. When an entity applies IAS 29 *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.

Paragraphs 13, 14, 16, 18 and 19 are unchanged.

Borrowing costs eligible for capitalisation

15 **To the extent that an entity borrows 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~~ it shall determine~~d~~ 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.**

17 **To the extent that an entity borrows funds ~~are borrowed~~ generally and uses~~d~~ them for the purpose of obtaining a qualifying asset, ~~the amount of borrowing costs eligible for capitalisation shall be~~ it shall determine~~d~~ 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 capitalise~~d~~s during a period shall not exceed the amount of borrowing costs it incurred during that period.**

Commencement of capitalisation

20 **An entity shall begin capitalising ~~The capitalisation of~~ borrowing costs as part of the cost of a qualifying asset ~~shall commence~~ when the entity:**

- **(a)** **incurs expenditures for the asset ~~are being incurred~~;**
- **(b)** **incurs borrowing costs ~~are being incurred~~; and**
- **(c)** **undertakes activities that are necessary to prepare the asset for its intended use or sale ~~are in progress~~.**

Paragraphs 21 and 22 are unchanged.

Suspension of capitalisation

23 **An entity shall suspend ~~C~~capitalisation of borrowing costs ~~shall be suspended~~ during extended periods in which it suspends active development ~~is interrupted~~.**

Paragraph 24 is unchanged.

Cessation of capitalisation

Paragraphs 26 and 28 are unchanged.

25 **An entity shall cease ~~C~~capitalising~~ation of~~ borrowing costs ~~shall cease~~ when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.**

27 **When an entity completes 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~~ 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 ~~are completed~~.**

Disclosure

29 **An entity shall disclose ~~The financial statements shall disclose~~:**

- **(a)** [deleted] ~~**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.**

Paragraphs 30 and 31 are unchanged.

Transitional provisions

30A **When application of the [draft] amendments that delete paragraphs 7–9 constitutes a change in accounting policy, an entity shall apply the amendments to borrowing costs relating to qualifying assets for which it begins capitalisation on or after the effective date.**

30B **However, an entity may designate any date before the effective date and apply the [draft] amendments to borrowing costs relating to all qualifying assets for which it begins capitalisation on or after that date.**

Effective date

31A **An entity shall apply the [draft] amendments that delete paragraphs 7–9 for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is encouraged. If an entity applies the [draft] amendments for a period beginning before [date to be inserted after exposure], it shall disclose that fact.**

Appendix
Amendments to other pronouncements

The amendments in this [draft] appendix shall be applied for annual periods commencing on or after [date to be inserted after exposure]. If an entity applies the proposed amendments to IAS 23 for an earlier annual period, these amendments shall be applied for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

A1 IFRS 1 *First-time Adoption of International Financial Reporting Standards* is amended as described below.

Paragraphs 9, 12 and 13 are amended and after paragraph 25G a heading and paragraph 25H are inserted, as follows:

9 The transitional provisions in other IFRSs apply to changes in accounting policies made by an entity that already uses IFRSs; they do not apply to a *first-time adopter's* transition to IFRSs, except as specified in paragraphs 25D, 25H, 34A and 34B.

12 This IFRS establishes two categories of exceptions to the principle that an entity's opening IFRS balance sheet shall comply with each IFRS:

(a) paragraphs 13–25~~G~~H grant exemptions from some requirements of other IFRSs.

(b) paragraphs 26–34B prohibit retrospective application of some aspects of other IFRSs.

13 An entity may elect to use one or more of the following exemptions:

(a) …

(k) leases (paragraph 25F); ~~and~~

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(l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G)~~.~~; and

(m) borrowing costs (paragraph 25H).

An entity shall not apply these exemptions by analogy to other items.

Borrowing costs

25H A first-time adopter may apply the transitional provisions set out in paragraphs 30A and 30B of IAS 23 *Borrowing Costs*. In those paragraphs any reference to the effective date shall be interpreted as [date to be inserted after exposure] or the date of transition to IFRSs, whichever is later.

In the Basis for Conclusions, after paragraph BC84 a heading and paragraph BC84A are added as follows:

Borrowing costs

BC84A First-time adopters of IFRSs face problems similar to those facing entities that already use IFRSs, because if an entity has not previously gathered the necessary information for capitalisation of borrowing costs, getting the information retrospectively may be costly. Moreover, although first-time adopters have the option of using fair value as the deemed cost of an asset at transition date, this option is not applicable to all qualifying assets, such as inventories. Furthermore, the Board concluded that the existence of the deemed cost option is not sufficient to justify a more stringent requirement for the application of the proposed amendments for first-time adopters than for existing IFRS users. A more stringent requirement for the adoption of the capitalisation treatment could be justified when IFRS 1 was originally issued because capitalisation was then an option. The requirements for the application of mandatory capitalisation, on the other hand, should be the same for existing users and for first-time adopters. Therefore, the Board decided to amend IFRS 1, allowing first-time adopters transitional provisions equivalent to those available to existing users in [draft] paragraphs 30A and 30B in IAS 23.

In the Implementation Guidance, paragraphs IG23 and IG24 are amended as follows. Paragraph IG25 is deleted.

IG23 On first adopting IFRSs, an entity ~~adopts a policy of~~ begins capitalising borrowing costs (IAS 23) ~~allowed alternative treatment) or not capitalising them (IAS 23 benchmark treatment). The entity applies that policy consistently in its opening IFRS balance sheet and in all periods presented in its first IFRS financial statements~~. In accordance with paragraph 25H of the IFRS, an entity:

(a) capitalises borrowing costs relating to qualifying assets for which it begins capitalisation on or after [date to be inserted after exposure] or the date of transition to IFRSs (whichever is later);

(b) may elect to designate any date before [date to be inserted after exposure] or the date of transition to IFRSs (whichever is later) and to capitalise borrowing costs relating to all qualifying assets for which it begins capitalisation on or after that date.

However, if the entity established a deemed cost for an asset, the entity does not capitalise borrowing costs incurred before the date of the measurement that established the deemed cost.

IG24 ~~Under the allowed alternative treatment,~~ IAS 23 requires disclosure of interest capitalised during the period. Neither IAS 23 nor the IFRS requires disclosure of the cumulative amount capitalised.

IG25 [Deleted] ~~IAS 23 contains transitional provisions that encourage retrospective application, but permit an entity that adopts the allowed alternative treatment to capitalise (prospectively) only those borrowing costs incurred after the effective date of IAS 23 that meet the criteria for capitalisation. However, if a first-time adopter adopts the IAS 23 allowed alternative treatment, the IFRS requires retrospective application of that treatment, even for periods before the effective date of IAS 23 (paragraph 9 of the IFRS).~~

A2 In IAS 1 *Presentation of Financial Statements* paragraph 110 is amended as follows:

110 In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in the reported financial performance and financial position. Disclosure of particular accounting policies is especially useful to users when those policies are selected from alternatives allowed in Standards and Interpretations. An example is disclosure of whether a venturer recognises its interest in a jointly controlled entity using proportionate consolidation or the equity method (see IAS 31 *Interests in Joint Ventures*). Some Standards specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow. For example, IAS 16 requires disclosure of the measurement bases used for classes of property, plant and equipment. ~~IAS 23 *Borrowing Costs* requires disclosure of whether borrowing costs are recognised immediately as an expense or capitalised as part of the cost of qualifying assets.~~

A3 In IAS 7 *Cash Flow Statements* paragraph 32 is amended as follows:

32 The total amount of interest paid during a period is disclosed in the cash flow statement whether it has been recognised as an expense in the income statement or capitalised in accordance with ~~the allowed alternative treatment in~~ IAS 23 *Borrowing Costs*.

A4 In IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, Example 2 of Implementation Guidance is deleted.

A5 In IAS 11 *Construction Contracts*, paragraph 18 is amended as follows:

18 Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:

(a) insurance;

(b) costs of design and technical assistance that are not directly related to a specific contract; and

(c) construction overheads.

Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll. Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs ~~when the contractor adopts the allowed alternative treatment in~~ if they meet the requirements of IAS 23 *Borrowing Costs*.

A6 In IAS 16 *Property, Plant and Equipment*, paragraph 23 is amended as follows:

23 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is recognised in the carrying amount of the item in accordance with ~~the allowed alternative treatment in~~ IAS 23.

A7 In IAS 38 *Intangible Assets*, paragraph 32 is amended as follows:

32 If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with ~~the capitalisation treatment permitted in~~ IAS 23 *Borrowing Costs*.

A8 IFRIC Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* is amended as described below.

Paragraph 8 is amended as follows:

8 The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. ~~The allowed alternative treatment of c~~Capitalisation under IAS 23 is not permitted.

In the Basis for Conclusions, the second sentence of paragraph BC26 is footnoted as follows:

BC26 The IFRIC considered whether the unwinding of the discount is a borrowing cost for the purposes of IAS 23 *Borrowing Costs*. This question arises because if the unwinding of the discount rate were deemed a borrowing cost for the purposes of IAS 23, in certain circumstances this amount might be capitalised under the allowed alternative treatment of capitalisation.* ...

* In [date to be inserted after exposure], IAS 23 was amended to require the previously allowed alternative treatment of capitalisation. Capitalisation of borrowing costs for a qualifying asset becomes the only accounting treatment. That amendment does not affect the reasoning set out in this paragraph.

Basis for Conclusions of Proposed Amendments to IAS 23 *Borrowing Costs*

This Basis for Conclusions accompanies, but is not part of, the draft Amendments.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in the Exposure Draft of Proposed Amendments to IAS 23 *Borrowing Costs*. Individual Board members gave greater weight to some factors than to others.

BC2 The proposed amendments to IAS 23 result from the Board's Short-term Convergence project. The objective of the project is to reduce differences between IFRSs and US generally accepted accounting principles (US GAAP) that are capable of resolution in a relatively short time and can be addressed outside current and planned major projects. The proposed amendments are principally concerned with the elimination of one of the two treatments that exist for borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. The application of only one method will enhance comparability. In addition, for the reasons set out below, the Board decided to eliminate the option of immediate recognition of such borrowing costs as an expense. It believes this would result in an improvement in financial reporting as well as achieving convergence in principle with US GAAP.

BC3 The Board considered whether to seek convergence on the detailed requirements for the capitalisation of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. However, the Board noted recent statements by the US Securities and Exchange Commission (SEC) and the European Commission that the IASB and FASB should focus their short-term convergence effort on eliminating major differences between IFRSs and US GAAP. For their purposes, convergence

on the detailed aspects of accounting treatments is not necessary. The Board further noted that both IAS 23 and SFAS 34 *Capitalization of Interest Cost* were developed some years ago. Consequently, neither set of specific provisions may be regarded as being of a clearly higher quality than the other. Therefore, the Board concluded that it should not spend time and resources considering aspects of IAS 23 beyond the choice between capitalisation and immediate recognition as an expense.

Amendments to the scope

BC4 Biological assets and other qualifying assets such as investment properties that are being redeveloped measured at fair value are excluded from the scope of IAS 23 as amended. The Board noted that capitalisation of borrowing costs must be limited to qualifying assets measured on a cost basis. If an asset is measured at fair value, that asset's measurement will not be affected by the amount of borrowing costs incurred during its construction or production period. For such assets, requirements on how to account for borrowing costs are unnecessary, as paragraphs B61 and B62 of the Basis for Conclusions on IAS 41 *Agriculture* explain.

Elimination of the option of immediate recognition as an expense of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset

BC5 IAS 23 currently permits two treatments for accounting for borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. They can be capitalised or, alternatively, immediately recognised as an expense. The US standard, SFAS 34 *Capitalization of Interest Cost*, requires the capitalisation of such borrowing costs.

BC6 Elimination of the option of immediate recognition as an expense would achieve closer alignment and higher comparability with the required treatment under US GAAP. The Board also noted the following arguments supporting capitalisation.

BC7 Historical cost is defined by the *Framework* (paragraph 100(a)) as follows: '… the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition.' According to paragraph 16(b) of IAS 16 *Property, Plant and Equipment*, the cost of an asset on initial recognition comprises all costs directly attributable to bringing the asset to the location and condition necessary for it to be ready for its intended use. This conclusion may be generalised to any other asset, such as inventory, that requires a substantial period of time to make it ready for its intended use or sale.

BC8 The historical cost of an asset that is developed over a period of time is initially recognised at the point when the asset meets the conditions to be ready for its intended use or sale. Therefore, the cost of the asset must include all the costs necessarily incurred up to that point.

BC9 During the period an asset is under development, the expenditures for the resources used must be financed. Financing has a cost. The Board concluded the cost of the asset should include all costs necessarily incurred to get the asset ready for its intended use or sale, including the cost incurred in financing the expenditures as a part of the asset's acquisition cost.

BC10 If the completed asset were purchased from a third party, ie if the third party had borne the financing costs, the selling price would include the finance costs incurred by the third party during the development phase. As a result, the capitalisation of borrowing costs enhances comparability between assets that are internally developed and those acquired from third parties. The Board does not expect capitalising borrowing costs to impose an unduly burdensome cost on entities. The Board argues that the additional benefits in terms of higher comparability, improvements to financial reporting and achieving convergence in principle with US GAAP will exceed any additional costs.

BC11 Therefore, the Board concluded that the option to recognise borrowing costs immediately as an expense should be removed from IAS 23.

IASB Exposure Draft May 2006

Effective date and transition

BC12 Development of a qualifying asset may take a long time. Additionally, some assets currently in use may have undergone and completed their production or construction process many years ago. If the entity has been following the accounting policy of immediately recognising borrowing costs as an expense, the costs of gathering the information required to capitalise them retrospectively and to adjust the carrying amount of the asset may exceed the potential benefits. Hence, the Board decided to require prospective application.

BC13 The Board noted that the proposed amendments would result in information that is more comparable between entities. On that basis, the Board concluded that if an entity wished to apply the amendments from any date before the effective date, users of the entity's financial statements would receive more useful and comparable information than previously.

BC14 Therefore, the draft amendments propose to permit entities to apply the amendments from any designated date before the effective date. However, if an entity applies the amendments from such an earlier date, it should apply the amendments to all qualifying assets for which the commencement date for capitalisation is on or after that designated date. The Board does not expect the proposed transitional arrangements to cause an undue burden of cost.

