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8 April 2009

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Vic 8007

Dear Chairman

ED 176: *Proposed Amendments to Australian Accounting Standards - Borrowing Costs for Not-For-Profit Public Sector Entities*

Ernst & Young (E&Y) is pleased to submit its comments on ED 176: *Proposed Amendments to Australian Accounting Standards - Borrowing Costs for Not-For-Profit Public Sector Entities*.

E&Y supports the objective of the AASB to continue to issue transaction-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. However, the proposed amendments deviate from this objective.

E&Y believes that the AASB should only introduce non-transaction neutral requirements in accounting standards where such changes are supported by the particular circumstances of the not-for-profit sector and result in improved quality of financial reporting. The arguments put forward in the ED 176 do not support this premise as the arguments are based mainly on the approach adopted by the New Zealand Financial Reporting Standards Board (FRSB) and the proposed International Public Sector Accounting Standards Board (IPSASB) Exposure Draft 35 *Borrowing Costs (Revised 200X)*. These arguments do not support that there is a compelling sector-specific reason to propose different accounting treatment for borrowing costs in the not-for-profit public sector nor that the proposed amendment will result in financial reporting that is more relevant to users.

E&Y do however acknowledge that the requirement to capitalise borrowing costs could potentially be costly for not-for-profit public sector entities (NFPPSEs) especially due to the existence of general borrowings and the requirement of AASB 123 *Borrowing Costs (Revised)* to capitalise interest on general borrowings. To alleviate this concern, the Board should consider allowing not-for-profit public sector entities to capitalise borrowing costs incurred on acquisition, construction or production of qualifying assets arising only on specific borrowings. This is similar to the approach in IPSASB Exposure Draft 35.

Therefore, E&Y do not support the proposals in the Exposure Draft for not-for-profit public sector entities, nor do we support the extension of the option to expense or capitalise all borrowing costs to not-for-profit private sector entities.

Our comments on the specific matters outlined in the Exposure Draft are addressed in Appendix A. We would be pleased to discuss our comments further with you. Please contact Charles Feeney on (02) 9248 4665 or Georgina Dellaportas on (03) 9288 8621 if you wish to discuss any of the matters raised in this response.

Yours sincerely

Ernst & Young

Ernst & Young

Appendix A

SPECIFIC MATTERS FOR COMMENT

AASB questions

1. *Is reintroducing the option for not-for-profit public sector entities to expense borrowing costs appropriate?*

We do not believe that reintroducing the option for not-for-profit public sector entities (NFPPSEs) to expense borrowing costs is appropriate. Accounting standards should remain transaction neutral between sectors. Identical transactions should not be accounted for differently simply because one entity is a NFPPSE. Under the proposal, identical qualifying assets whose construction has been financed by debt will therefore have a different cost simply because one entity is a NFPPSE and the other is not.

The arguments given in BC 6 of the amendment are not sufficient justification for introducing standards that are not transaction neutral. In making amendments to standards, the AASB should provide an explanation as to why the proposed amendment will result in financial information that is reliable and more relevant to users - rather than for reasons of convergence with New Zealand or the standards of the IPSASB, as explained in BC 6.

The main argument against the requirement to capitalise borrowing costs by NFPPSEs is that the cost of capitalising borrowing costs would outweigh the benefits to users that would arise from this accounting treatment or the enhanced comparability with entities outside NFPPSEs. ED 35 *IPSAS 5 Borrowing Costs (Revised 200X)* issued by the IPSASB explains this argument as follows:

Borrowings in the public sector are often centralised and the borrowing requirements are determined for the economic entity as a whole. The borrowings may be for investing, financing or operating activities. Also, NFPPSEs may borrow for public policy purposes. Therefore, there would often be little linkage between these types of borrowings and the acquisition, construction or production of qualifying assets. As a result, any accounting system to track directly attributable borrowing costs and their application to qualifying assets is likely to be complex and resource intensive. As a result, the costs incurred in capitalising borrowing costs would likely exceed the related benefits.

For this reason, ED 35 allows an entity the option to capitalise borrowing costs from specific borrowings only. Therefore, in our view, excluding general borrowing costs from the scope of eligible borrowing costs requiring capitalisation would be a more principled solution that the AASB could use to overcome the main concern of NFPPSEs over cost.

Though this does not result in transaction neutral accounting standards, we believe that this would result in financial statements that are more relevant than the proposals in the Exposure Draft.

2. *Should the option also be reintroduced for not-for-profit private sector entities?*

As discussed above, we do not believe that the AASB should issue amendments that result in accounting standards that are not transaction neutral between sectors, unless there are circumstances that render particular requirements misleading or meaningless for a sector or the costs far outweigh the benefits for that sector. Unlike NFPPSEs, where we agree that there are significant costs and practical problems associated with capitalising costs in relation to general borrowings, we do not believe the costs are as significant for not-for-profit entities in the private sector and therefore would not support reintroduction of the option of expensing or capitalisation.

3. *Overall, would the proposals result in financial statements that would be useful to users?*

Finanancial statements are useful to users if they are (among other things) comparable. The Basis of Conclusions of IAS 23 (BC13) noted that requiring entities to capitalise borrowing costs will result in higher comparability and improvements in financial reporting, whereas recognising borrowing costs relating to qualifying assets immediately as an expense does not give a faithful representation of the cost of the asset (BC9).

Therefore, allowing the option to expense or capitalise borrowing costs would not necessarily result in financial statements that would be useful to users.

4. *Are the proposals in the best interests of the Australian economy?*

Given Australia's transaction neutral approach and the fact that the AASB proposals are dissimilar to the AASB 123 and IAS 23 requirements applicable to for-profit entities, we believe that the AASB proposals are not in the best interests of the Australian economy.