IPSASB ED35 sub 1

Department of Treasury and Finance

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Dear Mr Porter Bruce

COMMENTS ON IPSASB ED 35 IPSAS 5 *BORROWING COSTS*

I am attaching for your information, a copy of the Heads of Treasuries Accounting and Reporting Advisory Committee's comments to the International Public Sector Accounting Standards Board on Exposure Draft 35 IPSAS *5 Borrowing Costs*. HoTARAC has strongly supported the proposals in ED 35.

HoTARAC notes that the current AASB 123 *Borrowing* Costs will require all borrowing costs directly attributable to qualifying assets to be capitalised for reporting periods beginning on or after 1 January 2009. HoTARAC does not believe this treatment is appropriate for the not-for-profit public sector, and has written separately to you requesting deferment of the withdrawal of the option to expense borrowing costs. HoTARAC firmly believes that for public sector/not-for-profit entities it would be prudent to delay withdrawal of the expense option in AASB 123 until the IPSASB has made a final determination on expensing borrowing costs and the AASB has fully appraised its impact. This would avoid the need for a further change in accounting policy for public sector entities should the AASB consider and adopt any future IPSASB policy to reinstate the option.

HoTARAC also recommends that the AASB reviews the ED 35 proposals (and HoTARAC's comments on them) as part of its Project on the *Criteria for Modifying IFRSs for Not-for-Profit Entities*. We believe that the AASB's proposed criteria should be reviewed against existing and possible additional not-for-profit paragraphs, including the IPSAS borrowing cost modifications. This review should also consider possible modifications to Australian Accounting Standards to address difficulties associated with consolidating for-profit entities into not-for-profit entities (assuming different borrowing cost policies apply to for-profit and not-for-profit entities).

Attachment A

COMMENTS ON EXPOSURE DRAFT 35
IPSAS 5 "BORROWING COSTS" (REVISED 200X)

1. Specific matter for comment

ED 35 proposes that borrowing costs be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets; and that in such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with this proposal? Please provide your rationale for agreeing or disagreeing with this proposal?

Subject to the other comments in section 2(a) and 2(c) below, HoTARAC strongly supports this proposal. In coming to this view, HoTARAC gives particular weight to the following factors.

(a) *The nature of borrowing and other funding in the public sector*

HoTARAC concurs with the views expressed in paragraphs BC5 to BC8 of ED 35 concerning the problems associated with attributing borrowing costs to assets in the public sector.

In the Australian public sector, while the Government usually raises taxes and borrows funds on a central basis, it will distribute these funds to departments and other subsidiary entities in a variety of ways, including appropriations, grants, loans and equity contributions. Consequently, the funding position of each subsidiary entity, reflected in its individual financial reports, will vary depending on a mixture of historic and current practice.

For public policy purposes, the Australian Government undertakes centralised borrowing to create a bond market, not to fund asset acquisitions. Asset acquisitions are funded from current and previous operating surpluses. Australian State and Territory Governments, on the other hand, may undertake borrowings on top of their Consolidated Revenue Funds, which is then used to fund expenditure across the whole-of-government. There is no nexus between borrowings at a central agency level and individual qualifying assets at the government entity level.

HoTARAC concurs with the view in paragraph BC9 that capitalisation of borrowing costs should be permitted in those cases where a public sector entity borrows specifically to finance the acquisition, construction or production of a qualifying asset. HoTARAC agrees that cost-benefit and relevance considerations need to be considered when making a decision in this regard. However, see also the comments in section 2(c) below.

HoTARAC notes that the clear disclosure of the amount of public debt interest is a key international performance indicator for the public sector. Capitalisation of interest is less consistent with this.

Further, the rationale for capitalisation of interest is for product costing and pricing purposes, and was developed in line with management accounting for for-profit entities. This motivation is not necessarily present in the public sector.

(c) *Stronger arguments for allowing the capitalisation option*

HoTARAC suggests that the argument for having an option (rather than a requirement) to capitalise specifically incurred borrowing costs needs to be strengthened. The cost benefit reasons given in the Basis for Conclusions for not allowing borrowing costs arising on "general borrowings" to be capitalised are clear, but the reasons for the optional rather than mandatory treatment of "specifically incurred" borrowing costs are not as clear. This needs to be further addressed.

(d) *Whole-of-government inconsistencies*

Application of the proposed IPSAS 5 may result in difficulties on consolidation at the whole-of-government level, where the whole-of-government includes some for-profit entities that are subject to the IAS 23 requirement to capitalise borrowing costs. Where not-for-profit public sector entities elect to expense all borrowing costs, this will be inconsistent with the treatment of for-profit public sector entities, controlled by the same Government that will be required to capitalise borrowing costs where they are directly attributable to qualifying assets.

To resolve this issue, one Australian jurisdiction suggests that IPSAS 6 *Consolidated and Separate Financial Statements* should be amended to clarify that dissimilar accounting policies are permitted on consolidation, where they are required by particular Accounting Standards.

3. Editorial Comments

Paragraph 16
The beginning of the last sentence of this paragraph is a little unclear i.e. which are the "both cases" referred to, given the three preceding sentences? Some minor re-wording is recommended to make this clearer.

Paragraph 17
To clarify the presumed intent, it is recommended that the last part of the sentence be re-worded to read: "... actual borrowing costs incurred on that borrowing during the reporting period less any investment income ... ". There could otherwise be confusion as to whether this is referring to the construction period or the reporting period.

Paragraph 22
Given the specific definition of "separate financial statements" under AASB 127 *Consolidated and Separate Financial Statements*, it is recommended that the term "separate financial statements" be replaced by "own financial statements" in the second and third sentences. The context of paragraph 22 does not appear to relate to "separate" financial statements as defined in AASB 127.

Paragraph 28
To clarify the presumed intent of the third sentence, it is recommended that it be amended to read " ... during a period when it carries out substantial technical and administrative work specifically for the construction or production of the qualifying asset. "