



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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**Agenda Item
9**

DATE: October 15, 2007
MEMO TO: Members of the IPSASB
FROM: Juan Zhang
SUBJECT: Updating IPSAS 5, “Borrowing Costs”

OBJECTIVE OF THIS SESSION

To **approve** the Exposure Draft (ED) of proposed amendments to IPSAS 5, “Borrowing Costs”.

AGENDA MATERIAL

Papers

- 9.1 Copy of 17 July Memorandum from Staff
- 9.2 “Cut and Paste” of respondents’ comments
- 9.3 Draft ED of Proposed Amendments to IPSAS 5, “Borrowing Costs” (marked-up)

ACTION REQUIRED

The Board is asked to:

- **Review** the analysis of responses to the question of removal/retention of the expensing option in IPSAS 5;
- **Consider** the “applicable expenditures” issue in IPSAS 5 identified at the July 2007 meeting; and
- **Review and approve** the ED of proposed amendments to IPSAS 5.

BACKGROUND

At the IPSASB’s meeting in July 2007, Staff was asked to develop an issues paper, analyzing the arguments for departing IPSAS 5, “Borrowing Costs” from IAS 23, “Borrowing Costs”. In particular, the issue of whether to remove from IPSAS 5 the option of immediate recognition as an expense of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset was highlighted as an area that needed additional analysis.

Following the July 2007 meeting, staff sought the views of members and technical advisers and the reasons for those views on removal/retention of the expensing option in IPSAS 5 (see Agenda Item 9.1). A response was requested by 3 August 2007. As at the end of August, 15 responses were received. Agenda Item 9.2 provides a “cut and paste” of these responses. Copies of full responses are available from staff on request. Staff’s analysis of the comments

as well as views on the adequacy of the public sector reasons raised for retaining the expensing option are addressed below in this memorandum. As with all summaries and analysis, staff has exercised judgment in classifying responses, and interpreting and presenting the major points by respondents.

Agenda Item 9.3 is a draft ED of proposed amendments to IPSAS 5 for the IPSASB's review and approval at the meeting. The ED reflects the staff view that the expensing option should be removed from IPSAS 5 so as to converge with IAS 23. The changes to IPSAS 5 that reflect the IASB's most recent changes to former IAS 23 and the improvements of other aspects of IPSAS 5 have been marked-up. Necessary text boxes have been included to assist the IPSASB in understanding the rationale for staff proposals. These text boxes will be omitted in the final ED.

In addition, this memorandum considers the "applicable expenditures" issue identified at the July 2007 meeting and provides Staff views.

ANALYSIS OF RESPONSES TO THE EXPENSING ISSUE

General Points

There were diverse opinions on whether to remove the expensing option from a revised IPSAS 5.

5 of the 15 respondents (001, 005, 008, 010 and 011) expressed support for removal of the expensing option. These respondents did not think there are convincing public sector reasons to warrant a departure from IAS 23 by retaining the expensing option in IPSAS 5.

Respondents 001, 005 and 010 commented on the central borrowing issue raised at the July 2007 meeting. Respondents 001 and 005 noted that this is not a problem encountered only by public sector entities. They also noted that existing IPSAS 5 considers this issue and ways to deal with such a situation in its discussion of the capitalization option (paragraphs 22 and 26-29). Respondent 010 drew attention to the "directly attributable" phrase and suggested that borrowing costs are not "directly attributable" and therefore not subject to the capitalization model where the borrowing costs are pooled and separate from the accounting for acquisition, because no attribution of costs is possible.

Consistency with statistical accounting was another issue identified at the July 2007 meeting. Statistical accounting generally treats borrowing costs as an expense. Respondent 001 expressed concern at an implied hierarchy that would treat the requirements of GFS statistical accounting as of higher importance than IFRS and further questioned whether there is a clear policy going forward that the IPSASB will apply the principle that GFS Statistical Accounting requirements take precedence over IFRS-convergence.

Respondent 001 considered that capitalization is the "correct" approach conceptually. Respondent 005 felt that the capitalization model might be even more suitable for the public sector than for the private sector because the concept of "intergenerational equity" should be reflected in public sector financial reporting and because of the long lives of the majority of public sector assets.

7 of the 15 respondents (002, 003, 004, 006, 012, 013 and 015) expressed a general view that the expensing option in IPSAS 5 should be retained and cited public sector reasons in support of this view. Respondents 006 and 013 noted that, if an option was to be removed, they would even support removal of the capitalization option. However, Respondent 006 also expressed a view that while the capitalization of borrowing costs is clearly not applicable for assets measured at fair value/market value it can be applicable for assets measured at historical cost (historical cost is not a measurement basis under statistical accounting).

The other 3 respondents (007, 009 and 014) did not directly express support for, or opposition to, removal of the expensing option. They further addressed the concern raised at the July meeting about how to include borrowing costs in Depreciated Replacement Cost (DRC) if the capitalization of borrowing costs is required as the sole approach under IPSAS 5.

The reasons provided for retaining the expensing option, along with the concerns raised if this option is removed, have been classified into 4 broad areas:

- Difficulties in capitalizing borrowing costs where borrowing is administered centrally;
- Convergence with the statistical bases of financial reporting which generally treats borrowing costs as an expense;
- Practical issue of how to include borrowing costs in Depreciated Replacement Cost (DRC) valuation; and
- Other issues.

These public sector reasons/concerns are analyzed below in order to assess their adequacy to justify a departure from IAS 23.

Analysis of Public Sector Reasons/Concerns

1) Difficulties in capitalizing borrowing costs where borrowing is administered centrally

A number of respondents discussed the difficulties in capitalizing borrowing costs where borrowing is administered centrally.

Respondents 002, 003, 004 and 007 expressed concern about the difficulties of capitalizing borrowing costs where funds are borrowed centrally by a government and then transferred in a variety of ways (by appropriations, loans, grants or equity contributions) to other public sector entities which would actually use the funds to finance the acquisition, construction or production of qualifying assets but would not be charged with interest.

Respondent 006 considered it extremely challenging to determine an appropriate borrowing rate to apply to the acquisition of an individual asset under certain circumstances, such as when borrowing is undertaken generally rather than for specific projects and managed on a portfolio basis. Respondent 014 suggested providing additional implementation guidance on how to determine which rate should be used where borrowing is done only by central government.

While acknowledging that this central borrowing model can also occur in the private sector, especially certain large business enterprise groups, Respondents 006 and 013 commented that such procedures in the public sector would be more widespread and thus higher compliance costs would arise if the capitalization model is mandatory.

Respondents 006 and 013 also noted that under the capitalization model asset values reported on a consolidated basis would differ, in the case of funds borrowed centrally, from those reported for an individual entity. This might lead to confusion and uncertainty for users of financial reports. Respondent 013 further questioned which asset values should, in such circumstances, be used for the disaggregated disclosure of the financial reports of the whole of government for statistical purpose. The first option is to use asset values derived from the individual reporting of consolidated entities. Such values would usually not include capitalized borrowing costs. In the view of Respondent 013, such asset values seem to be more reliable, robust and understandable but would need to be reconciled to total asset values by adjusting for central borrowing costs capitalized. The alternative is to use asset values derived by allocating centrally incurred borrowing costs to individual assets. In the view of Respondent 013, such asset values are more likely to be arbitrary and confusing, and would increase variance from statistical information.

Respondent 012 expressed the view that the expensing option should be maintained as public sector entities usually borrow through a centralized entity which is not subject to market transactions such as the sale of corresponding assets, mergers, acquisition etc. Therefore, the economic nature of the borrowing cost is different in the public sector—it is an out of pocket cost which is usually non-reimbursable and not otherwise affected by market transactions in future periods.

Analysis

As Respondents 001 and 005 indicated, the central borrowing model is not a feature only in the public sector. In its commentary on the capitalization option (paragraphs 22 and 26-29) the current IPSAS 5 has appropriately discussed this difficulty and methods of dealing with such a situation. In accordance with paragraphs 26-29, when a controlling entity borrows funds which are transferred with no allocation of borrowing costs to a controlled entity, no capitalization of borrowing costs occurs at the individual entity level because neither the controlling entity nor the controlled entity would meet the criteria for capitalization of borrowing costs (no borrowing costs incurred or no qualified assets), and capitalization of borrowing costs only occurs in the consolidated statements at the economic entity level if the economic entity meets the required criteria. Paragraph 27 also discusses the case of funds transferred with only partial allocation of borrowing costs to a controlled entity.

Paragraphs 21-25 and 29 of existing IPSAS 5 discuss the determination of the amount of borrowing costs to be capitalized as well as the difficulties related to central borrowing cases. Paragraph 29 specifically discusses the determination of a capitalization rate at the economic entity level and the controlled entity level. Staff considers that these requirements and commentary are sufficient and should apply to both the individual entity level and the economic entity level. Staff is not persuaded that the determination of the

capitalization rate applicable to the consolidated financial statements in the public sector context is more challenging than in the private sector context.

Respondent 010's point of having regard to the "directly attributable" phrase would help allay some reservations about the difficulty in and costs of implementing the capitalization model. In accordance with the principle of IPSAS 5/IAS 23, borrowing costs are eligible for capitalization only in the case where they are directly attributable to the acquisition, constructions or production of a qualifying asset (i.e. where they would have been avoided if the outlays/expenditures on the qualifying asset had not been made). This means capitalization is not implemented where the incurring of borrowing costs is not related to the incurring of the outlays/expenditures on a qualifying asset and capitalization only applies to the situation where a direct link between the borrowing costs and the incurring of the outlays/expenditures on a qualifying asset exists.

It was noted that in the "due process" of revising IAS 23 many respondents argued that the costs of implementing the capitalization model would be burdensome. However, as noted by the IASB, "there is an unavoidable cost of complying with any new financial reporting standard" and "it has not been told that preparers who elected to capitalize borrowing costs under the previous version of IAS 23 found doing so unnecessarily burdensome". The IASB further concluded that the additional benefits in terms of higher comparability, improvements in financial reporting and achieving convergence in principle with US GAAP exceed any additional costs of implementation.

While central borrowing procedures may be more common in the public sector than in the private sector, based on the above analysis, the additional compliance costs for public sector entities would not be significantly different from those for private sector entities as a result of the removal of the expensing option. The additional benefits arising from the removal of the expensing option from IPSAS 5 in terms of higher comparability, improvements in financial reporting and achieving convergence with IFRS justify the additional compliance costs.

In the case of funds borrowed centrally where the capitalization model is adopted, it is acknowledged that the asset value reported on a consolidated basis would differ from that reported on a separate/individual reporting basis. However, in accordance with the consolidation procedures required by IPSAS 6, "Consolidated and Separate Financial Statements", a number of accounting transactions or events can be subject to consolidation treatments that result in the carrying amount of the item in the consolidated financial statements differing from the carrying amount of the same item reported in the separate/individual financial statements e.g. the elimination of surpluses and deficits arising from transactions within the economic entity that are recognized in certain assets, such as inventory and fixed assets. From a technical perspective, when revenues and expenses related to transfers (funded originally by economic-entity-outside borrowings) between entities within the economic entity are eliminated, the funds originally borrowed by the entity which administers borrowings centrally can be regarded as funds borrowed by the economic entity and used directly for acquiring qualifying assets of the economic entity. Therefore, it is reasonable to include the capitalized borrowing costs in qualifying assets at the consolidation level if the economic entity meets the criteria for capitalization.

Turning to the question of which asset value should, in the above circumstances, be used for the disaggregated disclosure of the financial reports of the whole of government for statistical purposes, Staff is of the view that the disclosure of financial information for statistical purposes should comply with the statistical bases of financial reporting. Accounting and statistical bases for reporting financial information have different objectives, and treat some transactions and events differently. There are many issues other than borrowing costs, such as the recognition of costs associated with research and development, the recognition of decommissioning/restoration costs and the measurement of assets, which would result in the asset value under the accrual basis of accounting differing from that under the statistical bases because of the different requirements for dealing with these items. The difference in asset values under the two bases caused by capitalization of borrowing costs is not an adequate public sector reason to justify departure from IFRSs.

Staff does not support the view that the expensing option should be maintained as borrowing costs in the public sector are out of pocket costs which are usually non-reimbursable or otherwise unaffected by market transactions. Any vendor in the market normally tries to seek a price for an asset that covers all the costs incurred, including financing costs incurred during the asset-development phase, irrespective of whether borrowing costs are capitalized or not. In other words, we could not see an explicit link between the capitalization/expensing of borrowing costs and the reimbursable/non-reimbursable nature of borrowing costs. Moreover, the capitalization of borrowing costs would, for both the public sector and the private sector, enhance comparability between assets internally developed and those acquired from third parties, because the purchase price of a completed asset would include financing costs incurred by the third party during the development phase.

Staff therefore does not think that the existence of central borrowing procedures constitutes a sound reason for a different treatment from IAS 23.

2) *Convergence with the statistical bases of financial reporting which generally treats borrowing costs as an expense*

Respondents 002, 004, 006 and 013 were of the view that convergence with the statistical bases of financial reporting, which generally treats borrowing costs as an expense, constitutes a reason for retaining in IPSAS 5 the expensing option. These respondents reiterated the IPSASB's commitment to convergence with statistical bases of financial reporting where appropriate. Respondent 006 noted that the IPSASB Research Report *IPSASs and Statistical Bases of Financial Reporting: An Analysis of Differences and Recommendations for Convergence* (dated January 2005), which mainly reflected the work of the Task Force on Harmonization of Public Sector Accounting (TFHPSA), considered the question of borrowing costs and recommended that "to strengthen convergence, IPSASB should consider removing the option to capitalize" (see item 10.4 of the Matrix page 65).

Respondents 007, 014 and 015 considered it necessary to discuss the issue of convergence with statistical bases while exploring the expensing issue in IPSAS 5. Respondent 015 also noted that the issue for the IPSASB to consider on this point is the relative weighting given to IFRS-convergence and convergence with statistical bases. This may be an issue for the *Rules of the Road* project.

Analysis

Staff is mindful of the IPSASB's commitment to convergence with the statistical bases of financial reporting where appropriate. However, if convergence with the statistical bases is relied upon as a reason for departure from IFRS, a signal would possibly be given to constituents that the IPSASB, in developing its standards, has adopted a principle that convergence with the statistical bases of financial reporting takes precedence over IFRS-convergence. The IPSASB has not adopted this principle. Therefore, it would be inappropriate to use such a commitment as a reason for deviation from IAS 23.

Staff noted that the policy of convergence with statistical bases was strongly supported by Respondent 006. However, this respondent also expressed a view that capitalization of borrowing costs is not applicable for assets measured at fair value/market value but can be applicable for assets measured at historical cost (which is not a measurement basis under statistical accounting). This is a very important point. While revised IAS 23 removed the expensing option it does not require the capitalization model to be used for a qualifying asset measured at fair value (see paragraph 4 of IAS 23). This would mean that IAS 23 limits the capitalization of borrowing costs to qualifying assets measured at cost. Since market value (rather than historical cost) is the measurement basis and also borrowing costs are generally required to be recognized as an expense under the statistical accounting, Staff is of the view that Respondent 006's reservations would be largely addressed if it is accepted in IPSAS 5 that, like IAS 23, assets carried at fair value are outside the scope and the required treatment (capitalization of borrowing costs) only applies to assets carried at historical cost.

3) Practical issue of how to include borrowing costs in Depreciated Replacement Cost (DRC) valuation

The concern about the practicality of including borrowing costs in valuations obtained through the DRC method was raised by Respondents 007, 009, 013, 014 and 015.

Respondent 007 noted that if the expensing option is removed from IPSAS 5 the capitalization model will be required and, therefore, decisions will need to be made as to how to incorporate borrowing costs into DRC which is presently used to determine the revalued carrying amounts of many public sector assets. This respondent set out a series of technical questions to be answered in relation to the inclusion of borrowing costs in DRC valuation. He expressed a concern that, because of the current lack of guidance on this issue, if the expensing option is removed the reliability of DRC valuations would be significantly undermined in situations where preparers would be free to incorporate borrowing costs on any basis they choose. The respondent therefore concluded that the expensing option should not be removed until the relevant technical issues can be properly

explored with the international valuation profession. The respondent also suggested that, similar to the approach in New Zealand Standards, a consequential amendment to IPSAS 17 inserting an explicit link between the capitalization of borrowing costs and the need to incorporate borrowing costs into DRC valuations be made if capitalization of borrowing costs becomes the sole method under IPSAS 5.

Respondent 015 expressed a similar concern about the technical difficulties in including borrowing costs in DRC. Respondent 013 questioned whether DRC should include additional borrowing costs if borrowing costs are capitalized and if so on what basis.

While expressing the above concern Respondent 007 provided a possible solution to it—making it clear in IPSAS 5 that assets carried on the revaluation model are excluded from the scope if the expensing option is removed.

Respondent 013 suggested that there is little benefit in including borrowing costs in the initial cost of a qualifying asset, if that asset is subsequently to be carried at revaluation on a DRC basis.

Respondent 014 highlighted the guidance in New Zealand Standards on how to determine the amount of borrowing costs to be included as a component of DRC and suggested the IPSASB further explore and develop guidance on this issue.

Analysis

DRC is at the bottom of the fair value hierarchy in both IAS 16, “Property, Plant and Equipment” and the equivalent IPSAS 17. It is important to note that, if inclusion of borrowing costs in DRC valuation is an issue as a consequence of removal of the expensing option, it is not a public sector specific issue, although it is likely that DRC revaluation is used more widely in the public sector than in the private sector.

As mentioned above, IAS 23 includes the scope exclusion for “a qualifying asset measured at fair value, for example a biological asset”. Staff has consulted with individual staff from the IASB and obtained an informal view that this scope exclusion in IAS 23 applies to the assets in IAS 16 when they are measured at fair value but does not apply when they are measured at cost. This would mean the scope exclusion in IAS 23 applies to assets carried on revaluation model using DRC since DRC is at the bottom of the fair value hierarchy in IAS 16. Staff does not think there is any public sector specific reason for departure from the scope exclusion in IAS 23. Therefore, consistent with the solution proposed by Respondent 007, staff considers that inclusion in a revised IPSAS 5 of the same scope exclusion as IAS 23 would address the DRC concern.

It would be necessary to make certain changes in wording when transferring the above scope exclusion in IAS 23 to IPSAS 5. Staff proposes something like “a qualifying asset measured at fair value, for example an asset measured at fair value under IPSAS 17” be included in IPSAS 5 as a scope exclusion in response to the concern about DRC (the proposed scope exclusion has been reflected in Agenda Item 9.3).

In regard to the concern over the temporary capitalization of directly attributable borrowing costs for assets measured subsequently on the revaluation model, Staff does not consider this is a public sector specific technical issue. Both IPSAS 17 and IAS 16 specify that an item of property, plant and equipment should be measured at its cost on initial recognition and subsequently be measured on either the cost model or the revaluation model. It may practically be that revaluation occurs more commonly in the public sector than in the private sector but this does not mean public sector entities would incur higher additional compliance costs than private sector entities when using the capitalization method. Staff considers that, if the expensing option is removed from IPSAS 5, the additional benefits in terms of higher comparability for assets measured at cost across public/private sector entities and achieving convergence with IFRS justify the additional compliance costs of capitalizing borrowing costs in the original costs of qualifying assets.

4) Other Issues

Respondents 004, 006 and 013 considered that there are some conceptual reasons for retaining the expensing option.

Respondents 004 and 006 argued that if the expensing option is removed, comparability would not be enhanced because the capital structure of an entity could affect the cost of an asset. Respondent 006 also noted that prescribing the capitalization of borrowing costs seems to run counter to two general tendencies in global accounting development—the movement towards fair value accounting and the need to develop more appropriate performance reporting.

Respondent 013 expressed the view that borrowing costs should be an entity cost not attributable to individual assets. This respondent opposed the attribution of borrowing costs to qualifying assets even for for-profit entities.

Analysis

The same, or similar, conceptual arguments as those of Respondents 004, 006 and 013 were also submitted to the IASB when revising IAS 23. The IASB addresses these arguments in the Basis for Conclusions.

Regarding the comparability argument, the IASB acknowledged that capitalizing borrowing costs does not achieve comparability between assets financed by borrowings and those financed by equity, but concluded that capitalization achieves comparability among all non-equity financed assets, which is an improvement.

Regarding the attribution of borrowing costs, the IASB concluded that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are part of the cost of that asset. The cost of an 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 for acquisition, construction or production of a qualifying asset. The IASB reasoned that the immediate expensing of borrowing costs relating to qualifying assets does not give a faithful representation of the cost of the asset.

In any event, these conceptual reasons are clearly not public sector specific.

Staff Proposal

Based on the above analysis, Staff is of the view that the public sector reasons/concerns raised by respondents are not adequate to warrant a departure from IAS 23 by retaining the expensing option in IPSAS 5. Staff therefore proposes that the ED of proposed amendments to IPSAS 5 (Item 9.3), reflecting the most recent changes to IAS 23, be approved for issuance for public comment.

Action requested: Confirm that there is no public sector specific reason to depart from IAS 23 by retaining the expensing option in IPSAS 5.

THE “APPLICABLE EXPENDITURES” ISSUE IDENTIFIED AT THE JULY 2007 MEETING

Background

At the July 2007 meeting, there was a request from individual members that consideration be given to whether the original decision, when developing existing IPSAS 5, to entirely exclude from paragraph 32 the sentence “Expenditures are reduced by any progress payments received and grants received in connection with the asset (see IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*)” in the corresponding paragraph 18 of IAS 23 is appropriate. The suggestion was that the above sentence should be included in IPSAS 5 but without its reference to IAS 20. The reasons for this were:

- I. Any progress payment or grant received would reduce the expenditures on which borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are incurred; and
- II. Deducting the amount of asset-related grants from the expenditures on which borrowing costs are treated as being incurred in relation to a qualifying asset does not mean the grant would have been deducted from the carrying amount of the qualifying asset (as it could be under an option in IAS 20). In other words, the non-adoption of IAS 20 in IPSASs is irrelevant to the measurement of borrowing costs.

After the meeting, Staff reviewed the IPSASB meeting minutes in relation to the first stage of its standards program. IPSAS 5 was approved for publication at the Merida meeting in January 2000. In the minutes for that meeting Staff was directed to “delete the second sentence as it describes the treatment in IAS 20, consistent with the earlier decision to delete reference to IAS 20 from this paragraph”.

Analysis

Staff considers that the above sentence, along with the reference to IAS 20, was originally deleted in IPSAS 5 because of both conceptual reservations about IAS 20 and the diversity of funding sources in the public sector context.

IAS 20 requires an entity to account for the government grants related to assets either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset. It was noted that the IASB had acknowledged that IAS 20 is flawed and needs to be updated but resource availability had stopped it from doing so in the past. Because of these conceptual reservations, the PSC (the IPSASB's predecessor), when developing IPSAS 5, did not want to endorse a treatment derived from IAS 20, or include a cross reference to IAS 20. In addition, IAS 20 only deals with government grants and government assistance. Many government entities may receive grants from other sources – private companies, multilateral banks, bilateral or multilateral aid agencies etc, and also may receive donations, gifts, bequests etc. The PSC considered it inconsistent to reduce outlays on a qualifying asset by government grants as defined in IAS 20, but not by other grants and other funding sources received in connection with the asset.

The PSC/IPSASB subsequently developed IPSAS 23, "Revenue from Non-Exchange Transactions (Taxes and Transfers)" which establishes broad principles for dealing with all revenue from non-exchange transactions, including taxes and transfers (such as grants, bequests, gifts, donations etc). The approach adopted in IPSAS 23 is quite different from that in IAS 20. Given the development of IPSASs and in response to the above request from the July 2007 meeting, Staff thinks it is worth reconsidering the appropriateness of omitting that entire sentence in IPSAS 5.

Staff observes that paragraph 32 of current IPSAS 5/paragraph 18 of IAS 23 is a commentary on how to determine the amount of outlays/expenditures on a qualifying asset to which the capitalization rate is applied when computing the amount of borrowing costs to be capitalized where funds are borrowed generally and used for obtaining the asset. In this context, the expenditure-reduced sentence in IAS 23 purports only to determine the expenditures on a qualifying asset used for computation of borrowing costs to be capitalized, not to determine the carrying amount of the qualifying asset which is specified by other IASs. In other words, whichever approach is adopted for accounting for grants in IAS 20/IPSAS 23 is irrelevant to the measurement of borrowing costs to be capitalized in IAS 23/IPSAS 5. The reference to IAS 20 in IAS 23 has an implication only in respect of the definition of grants.

From a technical perspective, where the outlays/expenditures on a qualifying asset are funded by both borrowings and non-borrowing funding sources, it is reasonable to deduct the non-borrowing funding component from the outlays/expenditures to which the capitalization rate is applied when computing the capitalization amount of borrowing costs. For example, Entity A constructs an office building. The total outlay in the period is \$100 million. The central government has provided a cash grant of \$10 million. Entity A has received progress payments of \$60 million. The rest of the outlay is funded by Entity A's general borrowings. In this case, the amount of outlays to which the capitalization rate is applied is \$30 million (\$100 million-\$10 million-\$60 million).

However, given the diversity of asset-related funding sources in the public sector, it would be inappropriate to transfer the key sentence in IAS 23 to IPSAS 5 without any changes. Staff proposes the inclusion in revised IPSAS 5 of a modified sentence like "Outlays are reduced by any progress payments received and assets received subject to stipulations on transferred assets specifying the acquisition of the qualifying asset (see IPSAS 23, "Revenue from Non-

Exchange Transactions (Taxes and Transfers)”). This would enhance convergence with IAS 23, address the concern about the diversity of funding sources in the public sector, and also ensure conceptual consistency between IPSASs.

Staff is of the view that there is no public sector specific reason to warrant continuing exclusion of that key sentence from IPSAS 5, and proposes a modified sentence as set out above be added to paragraph 32 of existing IPSAS 5. The proposed sentence has been reflected in the draft ED at Agenda Item 9.3. As a consequence, the difference between the proposed sentence in IPSAS 5 and the corresponding sentence in IAS 23 has been identified in the “Comparison with IAS 23” and the rationale for this difference has been addressed in the Basis for Conclusions in the draft ED.

Action requested: Confirm that the originally omitted outlay-reduced sentence should be added to paragraph 32 of existing IPSAS 5 in the wording like “Outlays are reduced by any progress payments received and assets received subject to stipulations on transferred assets specifying the acquisition of the qualifying asset (see IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)”).”



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DATE: 17 July 2007
MEMO TO: Members, Technical Advisors and Observers of the IPSASB
FROM: John Stanford/Juan Zhang
SUBJECT: Views on Scope of ED 30, “Impairment of Cash-Generating Assets”
and on Removal of Expensing Option in IPSAS 5, “Borrowing Costs”

PURPOSE OF MEMORANDUM

- **To obtain the views of members and technical advisors and the reasons for those views on:**
 - whether the scope of an IPSAS developed from ED 30, “Impairment of Cash-Generating Assets” should include property, plant and equipment carried on the revaluation model under IPSAS 17, “Property, Plant and Equipment”; and
 - the removal of the option permitting entities to expense borrowing costs directly attributable to qualifying assets in IPSAS 5, “Borrowing Costs”:

Although this memorandum is primarily addressed to Members and TAs the views of Observers are very welcome on any of the issues raised.

ACTION REQUIRED

- The Committee is asked to provide views on these topics to John Stanford (ED 30) at john.stanford@cipfa.org and Juan Zhang (IPSAS 5) at juanzhang@ifac.org by **Friday 3rd August**.

SCOPE OF ED 30, “IMPAIRMENT OF CASH-GENERATING ASSETS”

The major issue to be resolved in the development of an IPSAS based on ED 30, “Impairment of Cash-Generating Assets” is whether assets carried on the revaluation model under IPSAS 17, “Property, Plant and Equipment” should be within the scope (Agenda Item 5). Such assets were excluded from ED 30 with a rationale provided in paragraph BC 4 of the Basis for Conclusions. In his summing up of this agenda item at Montreal the Chairman emphasized that a number of constituents have laid down a challenge to IPSASB to justify the approach in ED 30. The view of the Montreal meeting was that the current rationale, as drafted, is inadequate.

At the Montreal meeting it was agreed that Staff should seek the views of Members, and TAs as to whether such assets should be within the scope and, as importantly, their reasons for supporting their position. It is not intended at this stage to reopen the scope of IPSAS 21, “Impairment of Non-Cash-Generating Assets”, although this might be addressed later.

At the Montreal meeting it was also decided to defer discussion of the further issue of whether the following items should be within the scope:

- biological assets related to agricultural activity that are measured at fair value less estimated point-of-sale costs; and
- non-current assets (or disposal groups) held for sale in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations.

Members and TAs are invited to comment on whether they think that these items should be within the scope of an IPSAS and to provide their arguments in support of, or against, inclusion.

A few Members have already provided Staff with written views subsequent to the Montreal meeting. Staff is grateful for their very prompt responses. Members, who have already provided views, are asked to ignore this section of the memorandum unless they want to modify or expand on views that have already been expressed.

REMOVAL OF OPTION OF EXPENSING BORROWING COSTS IN IPSAS 5, “BORROWING COSTS”

In discussions about the updating of IPSAS 5, “Borrowing Costs” (Agenda Item 7) at the meeting in Montreal, Staff was asked to prepare an issues paper for consideration at the Beijing meeting in November 2007.

The issues paper will outline a variety of public sector specific reasons for departing from the current version of IAS 23 by retaining in IPSAS 5 the option of immediate recognition as an expense of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. The paper will also provide a Staff analysis and view on whether these reasons are adequate to warrant the departure.

To assist in making the issues paper as comprehensive as possible, Staff wishes to obtain inputs from Members/TAs. If you support a departure from IAS 23 by retaining in IPSAS 5 the expensing option, can you please send the rationale for your views to Staff. If you agree with convergence with IAS 23 by removing from IPSAS 5 the expensing option, or if you have other alternatives in dealing with this matter, could you please also let Staff know and provide your reasons.

**IPSAS 5, “Borrowing Costs”-- Removing/Retaining the Expensing Option
“Cut and Paste” Analysis of Responses**

I. Those supporting the removal of expensing option from IPSAS 5

001 Gwenda Jensen

I am writing in support of deleting the option of expensing borrowing costs. The reasons for this view are as follows:

- 1) The existence of options in standards generally is something to be avoided in order to support comparability of statements and same treatment of the same event/transaction.
- 2) The IASB equivalent standard dealing with borrowing costs no longer allows the expense option, so deleting this option promotes 'appropriate' convergence with IASB
- 3) Capitalization is the 'correct' approach conceptually
- 4) There are no convincing public sector reasons to differ from the IASB. One 'public sector' reason raised at the Board meeting were that it is difficult to allocate borrowing costs to individual entities when borrowing is done centrally. This is a problem also encountered by private sector organizations (therefore not a public sector specific difference) and there are ways to overcome it. The present IPSAS 5 in its discussion of the capitalization option discusses this difficulty and ways to overcome it. A second reason is that GGS Statistical accounting requires that such costs be expensed. I am somewhat concerned at the implied hierarchy of importance that would treat the requirements of GGS Statistical accounting as of higher importance than IFRS. Where might this lead? As far as I understand the Board's aims they do not include convergence with GGS Statistical accounting, while there is an aim to avoid unnecessary differences with IFRS with a view to appropriate convergence between IFRS and IPSAS. (Perhaps there was something that I missed by not being able to attend the March meeting and this issue of GGS Statistical accounting relevance has already been discussed?)
- 5) Difficult to understand decisions by the IPSASB reflect on the quality of both IPSAS and the IPSASB. (See below.)

Further comment on (5):

We at the United Nations System are operating a full compliance approach to IPSAS adoption (no exceptions, unlike most governments). It is important therefore that our accountants have early warning where possible of likely future changes to IPSAS, so that they can ensure that their systems are compatible and that the likely impact of new standards are known. Last year, my team warned everyone that it was likely that the 'expense' option would disappear from IPSAS 5 when that standard was next 'improved,' because that option had been removed from the IFRS-equivalent standard and the IPSASB operates a policy of IFRS convergence, unless there are public sector specific reasons for a difference. A UN System-wide policy to apply the 'capitalize borrowing costs' options has been approved.

Standard setter predictability is arguably a criteria of standard setting quality - adherence to stated guiding principles and conceptual frameworks support a sense that the decision making is not 'arbitrary' and can be predicted - it reduces the costs of compliance. If the IPSASB now decides not to delete the expense option, this will not present a practical difficulty for us, but the immediate question asked by UN System accountants will be 'what is the basis for that decision?' There is a risk of a negative impression of the IPSASB as not predictable in its standard setting, and of

choosing to continue with (arguably) poor accounting, by retaining an option already rejected by the IASB.

From a simple technical point of view, this particular issue of borrowing costs does not seem important enough to spend a lot of time on. But from this perception view and from the view of IPSASB decision-making predictability, a decision not to delete the expense option is somewhat more of a concern. If there is a clear decision going forward from here that the IPSASB will apply the principle that GGS Statistical accounting requirements take precedence over IFRS-convergence then that would restore predictability (but create some concerns about what it would mean in practice!). We would adjust and work with that IPSASB decision.

005 Tadashi Sekikawa

I support for the removal of an option of expensing borrowing cost for the following reasons:

- There are no rational reasons to depart from the requirements in new IAS 23
- Public sector entities seems even more suitable for adopting capitalization model than private sector entities because; a) “equity among generation” that would be required in public sector financial reporting may orient capitalization model, and b) Majority of assets are long-lived nature and may be suitable for capitalization model
- During our discussion at Montreal, different method to raise fund in public sector (e.g. the central government issues national bonds and transfer funds to other levels of government entities) seemed to be most prevailing reasons to insist the retention of expensing model. However, I do not think the difference of fund raising method warrant the departure from IAS 23. Paragraphs 26 to 29 of the existing IPSAS 4 have appropriately treated such a situation, that is; no capitalization of borrowing cost entity level because there is no borrowing cost incurred or no qualified assets, and capitalization of borrowing cost in consolidated statements at economic entity level.

008-Frans Van Schaik

We agree with the convergence of IPSAS 5 with IAS 23. We are in favour of the removal of the option of expensing borrowing costs.

010-Ian Carruthers

I do not know of a reason to depart from IAS 23 and retain in IPSAS 5 the option of immediate expensing of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. The key to this may be in the 'directly attributable' phrase; ie, in UK government departments and (most) NDPBs the borrowing costs will be pooled and separate from the accounting for acquisition, thus there is no attribution possible. Where bodies do make a direct link then I cannot think of a sound accounting reason for a different treatment from IAS 23.

011-Tom Henry Olsen/Harald Brandsas

We can't see any significant public sector reasons for having a public sector reporting different from IAS 23. The discussion in last meeting seems to be quite similar to the discussion in Europe this year whether Europe should endorse the changed IAS 23 because some people feel requiring capitalization is “against the European good”. We don't see neither the European nor the public sector reasons for having a different treatment than IAS 23.

II. Those expressing a general view of retaining the expensing option in IPSAS 5

002 Hong Lou/Hongxia Li

Accordingly, we suggest that the option of expensing borrowing costs in IPSAS 5 be retained as it were.

003 Richard Neville

My rationale for leaving the option of immediate recognition of an expense of the borrowing costs in IPSAS 5 is ...

004 Erna Swart

We believe there are public sector specific reasons not to accept the amendments that were made to the IAS equivalent of IPSAS 5.

006 Eduardo Barredo-Capelot

We would not have a positive opinion on the subject. We believe that there is no urgency to amend IPSAS 5 so to align it to IAS 23, despite the costs of deviations between IAS-IPSAS this entails, because of both conceptual and procedural issues.

For the reasons below, we believe that the expensing option in IPSAS 5 should be retained, and, were it to be possible, we would even encourage the expensing of borrowing costs as the sole approach permissible under IPSAS 5, following the recommendation (item 10.4 of the Matrix page 65) included in the IPSASB Research Report dated January 2005 *IPSASs and Statistical Bases of Financial Reporting: An Analysis of Differences and Recommendations for Convergence*.

However, and separately, to the extent that historical costs is permitted or prescribed as a valuation of assets method (which is not the case in statistical standards), then borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset might also be included in the valuation of these assets.

012-Andreas Bergmann

In my view, we should maintain the expensing option, as...

013-Peter Batten

As indicated at the last meeting I am strongly in favor of retaining the option to expense borrowing costs. In fact if an option was to be removed I would support removal of the option to capitalise borrowing costs.

015-Jim Paul

Do not conform the principles in IPSAS 5 to those in IAS 23 (revised)

We think there is a public-sector-specific reason not to require capitalisation of borrowing costs. It relates to internally constructed assets measured on the fair value basis using depreciated replacement cost (DRC).

III. Reasons provided for retaining the expensing option or concerns raised if this option is removed

Reason/Concern 1 -- Difficulties in capitalizing borrowing costs where borrowing is administered centrally

002 Hong Lou/Hongxia Li

Compared to private sector, it is a common practice that governments borrow money centrally. Therefore, it is, in many cases, impracticable in allocating borrowing costs to specific qualified assets.

003 Richard Neville

My rationale for leaving the option of immediate recognition of an expense of the borrowing costs in IPSAS 5 is that in the public sector....unlike in the private sector....the borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset is NOT always in the same department or even known by the department concerned. Financial resources are transferred by appropriations or votes and cover only the direct materials involved in the acquisition, construction or production of a qualifying asset. The borrowing costs are assumed by the Treasury or Department of Finance and never allocated back to departments based on their capital acquisitions. Therefore, where this does occur, the borrowing costs should be expensed and such an option should exist. Where the borrowing costs are clearly known and defined, the other option of capitalizing them should be exercised.

004 Erna Swart

Central borrowing by a government is transferred to departments and other spheres of government in the form of transfer payments and grants. No loans are made and interest is not charged.

006 Eduardo Barredo-Capelot

Comparability. We would also observe that many governments undertake borrowing in a centralised way. They do not generally borrow for specific projects, and manage their portfolio of debt to minimise their overall borrowing costs (for example the balance between short and long term securities). It seems extremely challenging to determine an appropriate borrowing rate to apply to the acquisition of an individual asset, taking account of all of these factors. Whilst the same type of centralised borrowing might be seen in certain large private enterprise groups, the phenomenon in government would appear to be deeper and more widespread. In total, there seems to be a genuine risk of having a serious heterogeneity of expenditure measurement. We also note that economists are often keen to relate interest expenditure to the stock of debts and monitor this indicator closely, as part of efficiency measurement of Treasury activities as well as a component for their forecasting.

Unresolved difficulties: consolidation. An amended IPSAS 5 would need to address more in substance the issue of the proper conduct of consolidation, in case of capitalization of borrowing costs when the borrowing is conducted between two public units, with the apparent implication that the valuation of assets would be changed depending on the consolidation status of the financial report, which seems rather odd.

007-Greg Schollum

However, this will not fully deal with other concerns raised by members in Montreal in relation to divergence from statistical bases of reporting, and the difficulties of capitalising interest in a public sector context where often debt is managed centrally, and such debt is not ascribed to subsidiary entity level. I believe these continue to be real issues even if the DRC concern I have expressed can be dealt with by the scope exclusion of revalued assets.

012-Andreas Bergmann

In my view, we should maintain the expensing option, as public sector entities usually borrow through a centralized entity (i.e. treasury, infrastructure ministry) which is - unlike private sector entities - not subject to market transactions such as the sale of corresponding assets, mergers, acquisition, leveraged buyouts etc. In many jurisdictions, they are not even allowed to sell a qualifying asset or an entity holding it. Thus the economic nature of the borrowing cost is different in public sector. It is an out of pocket cost which is usually non-reimbursable or otherwise affected by market transactions in future periods. In the rare case of a more liberal environment, the option of allocating the cost over several periods is still there.

013-Peter Batten

Structural impacts on Financial Reporting. The private sector generally only prepares general purpose financial reports for the consolidated entity. Therefore the allocation of borrowing costs to qualifying assets is relatively straightforward. Even where there are a number of divisions or subsidiaries, the entity can decide whether it allocates borrowing costs for management purposes, or just allocates them centrally to qualifying assets as a consolidation adjustment. Either way, outside users only see one set of numbers. By contrast the public sector prepares general purpose financial reports complying with accounting standards for many, often hundreds of, entities. These reports are prepared for accountability reasons or for the information of local communities. 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, which will be reflected in their individual financial reports, will vary and will depend on a mixture of their history and current practice. Their attribution of borrowing costs to qualifying assets is very unlikely to match the attribution that would apply on a consolidated government basis. Therefore the assets that are reported on a consolidated basis are unlikely to match the asset values reported in individual reporting entities, thus leading to confusion and uncertainty for users of the financial reports. Any attempt to allocate borrowing costs incurred on a central basis for qualifying assets to individual entities would be highly complex and expensive, may not even be legally permissible, and would give little benefit.

Disaggregated reporting. In addition to the multiplicity of individual entity financial reports prepared as discussed above, it can be reasonably argued that there is value for the user of whole of government financial reports in disaggregating these reports between the general government (budget) sector and other (government business units) sectors, with assets and expenses in the former sector further disaggregated by government business purpose consistent with those used for statistical purposes. Withdrawal of the expensing option would raise the question of which asset values should be used for disaggregation disclosure? Those collected from the consolidation of applicable subsidiary entities (which usually would not have any borrowings and so no capitalised borrowing costs), which would seem to be the more reliable, robust and understandable by users, or those values derived by allocating centrally incurred borrowing costs to individual assets. Disclosure of the former would need to be reconciled to total asset values by adjusting for central borrowing costs capitalised. The latter is more likely to be arbitrary, confusing, and would increase variance from statistical information.

014- Annette Davis

It may be useful to consider implementation guidance, particularly as it appears that this will be a change in accounting policy for many public sector entities. For example, how to determine which rate should be used where borrowing is done only by central government, whether the rate should vary depending upon the type of asset, eg construction of a road or hospital, how it may affect the consolidated financial statements of a government department compared with the whole of government accounts.

Reason/Concern 2 — Convergence with the statistical bases which generally treats borrowing costs as an expense

002 Hong Lou/Hongxia Li

If, like some members illustrated in Montreal meeting, that IMF statistical report requires governments to expense borrowing costs, the IPSASB has to balance both convergence objectives to reduce apparent conflicts with either of standards. Impracticability in public sector practice and possible conflict with government statistical reporting constitute a public sector specific reason for departure from requirements in IFRSs.

004 Erna Swart

We believe there are public sector specific reasons not to accept the amendments that were made to the IAS equivalent of IPSAS 5. These include the following:

.....

- We have an agreement to harmonise with GFS, which requires expensing of borrowing costs.

006 Eduardo Barredo-Capelot

Whereas we value the convergence of standards and are prepared to bear some of the costs attached, we note that aside from the IASB/FASB and from the IASB/IPSASB convergences, an important convergence particularly relevant for the public sector is the accounting/statistics convergence.

As you know, there has been a strong encouragement, most notably by the IPSASB, for an harmonisation of approaches wherever appropriate, between the accounting and the statistical standards, owing to the fact that users prove to be disturbed with deviations and that government accounting data are also extensively used as inputs to preparation of economic accounts by statisticians. This convergence has been enquired by the Task Force on Harmonisation of Public Sector Accounts (TFHPSA).

The European System of national accounts (ESA95) and the worldwide System of National Accounts (SNA93) both treat borrowing costs as expenses of the unit during the period in which they accrue. Thus interest, which is perceived as a "property income", is recorded in the economic accounts as accruing continuously over time to the creditor on the amount of principal outstanding. Interest is not directly capitalised into the value of assets.

We note that the IPSASB Research Report *IPSASs and Statistical Bases of Financial Reporting: An Analysis of Differences and Recommendations for Convergence* (dated January 2005), which mainly reflected the work of the TFHPSA, considered the question of borrowing costs and recommended that "to strengthen convergence, IPSASB should consider removing the option to capitalize" – see item 10.4 of the Matrix page 65.

In this context, we would also have some concern as to whether a proper balance was reached by IASB when considering the advantage with SFAS versus the conceptual soundness for IAS change. We also note that the consultation process was substantially abbreviated, and it appears that both the change (and SFAS 34 itself) would not have been adopted without noticeable opposition.

Transparency. It would seem that retaining the option of expensing borrowing costs, and perhaps even requiring the expensing of borrowing costs, would ensure that all borrowing costs are appropriately reported in the face of the reporting statement, in line with economic accounts treatment, thereby ensuring a full transparency of government expenditure and also providing a direct link for source data for statisticians.

007-Greg Schollum

However, this will not fully deal with other concerns raised by members in Montreal in relation to divergence from statistical bases of reporting, and the difficulties of capitalising interest in a public sector context where often debt is managed centrally, and such debt is not ascribed to subsidiary entity level. I believe these continue to be real issues even if the DRC concern I have expressed can be dealt with by the scope exclusion of revalued assets.

013-Peter Batten

GFS/GAAP Convergence. IPSASB has committed to convergence with government finance statistics where appropriate. Interest costs are expensed in the GFS system, so requiring capitalisation of borrowing costs on qualifying assets would be to introduce a further difference between the two systems

014- Annette Davis

In its latest strategy document, IPSASB has a policy of supporting "the convergence of accounting and statistical bases of financial reporting where appropriate." I think that the issues paper needs to comment on this, particularly as the statistical bases of reporting that I am aware of expense borrowing costs, eg Australia, where its accounting standards board (the AASB) has a similar policy to that of IPSASB in converging financial reporting and statistical bases of reporting.

015-Jim Paul

Another factor that should be considered when deciding whether to prohibit expensing borrowing costs is convergence with statistical bases.

The strategic themes in the IPSASB's Strategy and Operational Plan 2007-2009 includes "convergence with statistical bases where appropriate". Under Government Financial Statistics, borrowing costs generally are treated as an immediate expense—a treatment no longer permitted under IAS 23 *Borrowing Costs*.

The issue for the IPSASB to consider on this point is the relative weighting it should give to IFRS convergence/meeting the qualitative characteristics (on one hand) and to convergence with statistical bases (on the other). This could be an issue for the *Rules of the Road*.

Reason/Concern 3 — Practical issue of how to include borrowing costs in Depreciated Replacement Cost (DRC) valuation

007-Greg Schollum

At the IPSASB meeting in Montreal I expressed concern at the staff recommendation to remove the expensing option from IPSAS-5 on the basis of a recent change to IAS-23 by the IASB. While acknowledging the very real concerns expressed by other members, my main concern is with the practicality of requiring capitalisation in the public sector context, because of the flow on effect to revaluations of public sector assets and the current lack of guidance as to how borrowing costs should be incorporated into asset valuations.

This flow on effect arises because in situations where borrowing costs are capitalised, such borrowing costs also need to be incorporated into asset revaluations or impairments will arise (all other things being equal). In effect, if an entity capitalises borrowing costs but doesn't then incorporate borrowing costs into any subsequent asset revaluation, this will negate the borrowing costs being capitalised in the first place.

However, currently within IPSASs there is no explicit link between capitalising borrowing costs and the need to incorporate borrowing costs into DRC valuations. In New Zealand we have such a link by inclusion in our Property, Plant and Equipment standard of the following paragraph:
"Borrowing costs that would be embodied in the fair value of the asset is included as a component of depreciated replacement cost. The inclusion of such an amount as a component of depreciated replacement cost is consistent with the principle underlying the inclusion in the initial cost of an asset of borrowing costs eligible for capitalisation as required by NZ IAS 23. The amount to be included as a component of depreciated replacement cost is determined on the basis of the average debt-to-equity

ratio and average cost of debt applicable to entities undertaking the same activities as the entity reporting.”

If the IPSASB decides to require capitalisation of borrowing costs, we will need to consider a similar consequential amendment to IPSAS-17.

The revaluation issue

Most public sector assets which are carried at fair value are revalued using Depreciated Replacement Cost (DRC). DRC is at the bottom of the fair value hierarchy, and represents the most appropriate valuation method for assets which are non-cash generating (most public sector assets are non-cash generating). If the IPSASB removes the expensing option for borrowing costs, the Board will be requiring capitalisation and, thereby, requiring the inclusion in DRC valuations of borrowing costs (unless borrowing costs associated with revalued assets are excluded from the scope of IPSAS-5 which I refer to later in this memo). The problem is that there is currently no, or little, guidance as to how borrowing costs should be incorporated into DRC valuations. Because of the lack of guidance, there is a very real prospect that unless suitable guidance can be developed the reliability of DRC valuations will be significantly undermined in a situation where preparers will be free to incorporate borrowing costs on any basis they choose. This is clearly not desirable and will cause significant problems for the audit of DRC valuations, and will undermine the credibility of information produced in accordance with IPSAS.

In my view, some of the questions to be answered in relation to incorporation of borrowing costs into DRC valuations include:

Is the amount for borrowing costs an entity specific assessment, or an assessment based on other entities in the public sector environment?

If it is entity specific, how should existing debt be ascribed to the entity's various assets?

If it isn't entity specific, how meaningful is the application of an industry norm for the debt/equity ratio to be applied?

What constitutes an industry? (e.g. what is an industry at a whole of Government level?)

Is it 'gross' or 'net' debt of the entity or industry norm to be applied?

Is the amount of borrowing costs incorporated into a DRC valuation limited to the amount capitalised by the entity during construction?

What time period should be assumed for capitalisation for large network infrastructure assets, e.g. the state highway network or national rail network?

No doubt there are further questions which need to be addressed in any guidance on incorporating borrowing costs into DRC valuations. Such guidance if it could be developed could usefully be incorporated into IPSASs as part of guidance on fair value using depreciated replacement cost.

In the meantime, until these issues can be properly explored with the international valuation profession, the IPSASB should not consider removing the expensing option. As I explained in Montreal, in New Zealand our standard setter (FRSB) has decided that the expensing should be removed for public sector entities, notwithstanding there is currently little guidance in relation to incorporation of borrowing costs into DRC valuations, and there do not appear to be answers to questions such as those identified above. I expect this to cause significant problems for the NZ public sector. I am therefore concerned to ensure that the IPSASB does not follow the same path.

Scope of IPSAS-5

As I explained at the meeting in Montreal, my concerns about the lack of guidance in relation to the incorporation of borrowing costs will be dealt with if it is clear in IPSAS-5 that entities with an accounting policy to revalue assets are excluded from the scope of the standard.

009-David Bean

Regarding the issue of the removal of the option of expensing borrowing costs, I found that the arguments presented by Greg Schollum at the Montreal meeting to be quite compelling.

013-Peter Batten

Revaluations. Although the private sector often applies a cost basis to classes of physical assets, the public sector typically regularly revalues its physical assets on a basis of depreciated replacement cost. Consequently any borrowing cost included in the original cost of a qualifying asset would soon be replaced, rendering the information only of any value between when it is first put into use and when it is first revalued. This seems little benefit for the problems incurred. This also raises the question, if borrowing costs are capitalised, should depreciated replacement cost include additional borrowing costs? If so, whose and on what basis?

014- Annette Davis

Valuation issues

- It would be helpful if the issues paper discussed consequential issues that arise after the cessation of the capitalisation of borrowing costs for PPE that is held at valuation under IPSAS 17 (IAS 16), in particular where an asset is held at depreciated replacement cost (DRC). The current NZ guidance is contained in the *N.Z. Infrastructure Asset Valuation & Depreciation Guidelines – Version 2.0, 2006*, note that it repeats a NZ only paragraph that has been added to NZ IAS 16 Property, Plant and Equipment. It states:

“Where an entity capitalizes borrowing costs in accordance with the allowed alternative treatment in NZ IAS 23 “Borrowing Costs” then, to the extent that the valuer considers that these costs would ordinarily form part of the fair value of the asset, external borrowing costs during the period of construction are to be included in the valuation. That is, that the valuer considers the type of replacement work that is being carried out is of a size that would normally be expected to be funded by external borrowing. Typically, borrowing costs should be accounted for in major infrastructure assets involving significant sums and having a construction period greater than one year.

NZ IAS 16, paragraph 33.14 states:

“The amount to be included as a component of depreciated replacement cost is determined on the basis of the average debt-to-equity ratio and average cost of debt applicable to entities undertaking the same activities as the entity reporting.”

Therefore borrowing costs are calculated at a rate which reflects the standard (or market) levels of debt and interest rates obtainable by a notional or hypothetical owner (i.e. an owner of similar assets). However, consideration should also be given to the actual rates specific to the owner of the asset to the extent that these are considered typical of the market. The intention is that the borrowing costs are the amounts that would be “captured” in the fair value of the asset if a market value existed.”

- It may be useful to include in the issues paper a section on current valuation guidelines from the ISVC on how borrowing costs may impact upon subsequent valuation of assets so that constituents' are informed as to how this accounting policy change could affect other areas of the balance sheet.

015-Jim Paul

DRC is used to measure the fair value of various infrastructure assets operated by public sector entities. For internally constructed assets, the costs of the assets' components are necessarily incurred over a period of time. If those assets are measured on the fair value basis using DRC, these costs of components should bear an interest charge from when they are incurred until when the asset is completed. This applies regardless of whether the prices of the components changed between incurrence date and completion date.

The reason why those component costs should bear an interest charge is that, if the internally constructed asset could be acquired in a single current transaction, the vendor (external constructor) would seek to recover the cost of the components (plus a profit margin) *and the interest cost necessarily incurred by developing the asset over time*. Including borrowing costs in DRC reflects a view that the process of internal construction by the reporting entity creates a new asset, which is different in value from the sum of its components.

The main problem:

Private sector entities tend not to measure internally constructed assets at DRC. Public sector entities tend to expense borrowing costs in respect of internally constructed assets. Thus, there exists little guidance or experience on how to measure the amount of borrowing costs to include in a DRC.

Significant unresolved issues regarding how to measure the borrowing costs included in DRC include:

- Estimating the typical period over which interest would be capitalised—in practice, the timing of incurrence of component costs can vary significantly (according to when funds become available).
- Estimating the type of financing that would typically be used. (The market participant, i.e., vendor, would be hypothetical, because the asset is internally constructed due to its specialised nature.)
- Achieving consistency of valuation of borrowing costs within a group of entities (each of which might borrow at a different rate).

Temporary capitalisation (minor issue)

For qualifying assets that are measured using the fair value basis and for which fair value is not determined using DRC, some argue that prohibiting immediate expensing of borrowing costs requires temporary capitalisation of directly attributable borrowing costs for these assets, which gives rise to preparation costs that exceed the related benefits.

They make this interpretation because IAS 16 requires all items of property, plant and equipment to initially be measured at cost, which would include directly attributable borrowing costs. This is despite IAS 23 saying “an entity is not required to apply this Standard to borrowing costs directly attributable to the acquisition, construction or production of ... a qualifying asset measured at fair value ...” (paragraph 4).

AASB staff thinks the IPSASB should clarify with the IASB whether the preceding comments correctly interpret the interaction of IAS 16 and IAS 23. In any event, this is not a public sector

specific problem, even though, in the private sector, it might largely be a non-issue because revaluation occurs infrequently. In the public sector, it might largely be a non-issue because the fair value of many assets revalued by public sector entities would be determined using DRC.

Other Reasons

004 Erna Swart

The source of funding will result in two identical assets being recognized at different costs. For example, a school built with funds borrowed would be a qualifying asset, and one would need to capitalize the borrowing cost. The cost of a school funded by a grant or a donation would not include any borrowing cost.

006 Eduardo Barredo-Capelot

Selectivity. The capitalizing of actual borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset implies valuing assets differently depending on their financing, which seems somewhat odd. We wonder whether the opportunity cost of general debt financing or even of equity financing should not also be considered, if the costs of finance directly attributable are to be considered.

New trends. More importantly, the soundness of prescribing the capitalization of borrowing costs in some circumstances would need to be considered in the context of two important other projects/trends in the accounting sphere: the movement towards fair value accounting and the need to reflect on a more appropriate performance reporting (both existing in statistical sphere it might be argued).

Market/fair valuation. We wonder to what extent the change in consideration relates only (or not?) to cases where the assets are valued at historical costs, and not when these are valued at market value (as it is the cases under statistical standards).

1. Why should the valuation of assets be a consideration for the measurement of expenditure (particularly for finance costs)?
2. The motivation for change (except for the convergence to SFAF 34) clearly focuses on a need to include borrowing costs in the valuation of assets when asset are measured on an historical costs basis. This motivation is clearly not applicable to fair valuation models.

In this respect the development of performance reporting distinguishing more systematically income before re-measurement and re-measurement, as well as operating versus financing sections, might help in renovating IPSAS 5 (and IAS 23) in a way that might conciliate various views. Clearly from our view, borrowing costs are of a nature of income before re-measurement in financing. (Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset might also feature in the reporting statement such as under re-measurement or elsewhere.)

013-Peter Batten

Finally, I consider borrowing costs to be an entity cost, not attributable to individual assets. What is the robust justification for applying it to qualifying assets and not to all assets, with an offset to liabilities. I personally oppose the attribution of borrowing costs to qualifying assets even for for-profit entities.

An example to support my assertion that borrowing costs are not relevant to the cost of the qualifying assets is as follows. Consider three public access hospitals to be built in different parts of a large country. The construction and running of these hospitals is a state responsibility, although ultimately

in reality they will be funded from the tax revenues of the central government. The three hospitals are in similar climatic conditions and have similar size and use criteria, so the design and construction contract tender is won for each of them by the same multinational construction company, based on a hospital that it has recently built in the country and is in successful operation. Allowing for slight site differences the construction cost and payment schedule is essentially the same.

However, the financial structure of the three acquiring entities is different. The first is a not-for-profit religious order that receives a grant from the state government in order to construct the hospital. It is thus fully funded and does not incur any borrowing costs. The second is a new hospital board incorporated especially to acquire and run the new hospital. It's state government arranges a specific interest bearing loan for the entity, with draw-downs arranged to match the expected payments over the multi year construction period. The third hospital is acquired by a multi-hospital district agency. It receives all inclusive funding for its existing hospitals, so it has a cash surplus which will cover the first half of the construction payments. It only has to undertake borrowings during the second half of the construction phase. If capitalisation of borrowing costs is required, then each of these hospitals will finish up with a different capital cost and subsequent depreciation charges, and yet in substance the cost of each hospital is identical.

Exposure Draft XX

MM YYYY

Comments are requested by MM DD, XXXX

*Proposed International Public Sector Accounting
Standard*

Amendments to IPSAS 5, “Borrowing Costs”



International Federation
of Accountants

REQUEST FOR COMMENTS

The International Public Sector Accounting Standards Board, an independent standard-setting body within the International Federation of Accountants (IFAC), approved this Exposure Draft, *Proposed Amendments to IPSAS 5, "Borrowing costs"*, for publication in MM, YYYY. The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by email, so that they will be received by **MM DD, YYYY**. All comments will be considered a matter of public record. Comments should be addressed to:

The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
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Email responses should be sent to: publicsectorpubs@ifac.org

Copies of this exposure draft may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

ACKNOWLEDGMENT

This Exposure Draft of an amended International Public Sector Accounting Standard is drawn primarily from International Accounting Standard IAS 23 (revised in 2007), "Borrowing Costs" published by the International Accounting Standards Board (IASB). Extracts from IAS 23 are reproduced in this publication of the International Public Sector Accounting Standards Board of the International Federation of Accountants with the permission of the International Accounting Standards Committee Foundation (IASCF).

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ED XX OF PROPOSED AMENDMENTS TO IPSAS 5, “BORROWING COSTS”

CONTENTS

| | |
|--|------|
| | Page |
| Introduction | |
| Request for Comments | |
| Summary of Main Changes to IPSAS 5 | |
| Proposed Amended Text | |

INTRODUCTION

Introduction to the International Public Sector Accounting Standards

The International Federation of Accountants' International Public Sector Accounting Standards Board (IPSASB) develops accounting standards for public sector entities referred to as International Public Sector Accounting Standards (IPSASs). The IPSASB recognizes the significant benefits of achieving consistent and comparable financial information across jurisdictions and it believes that the IPSASs play a key role in enabling these benefits to be realized. The IPSASB strongly encourages governments and national standard-setters to engage in the development of its Standards by commenting on the proposals set out in Exposure Drafts.

The IPSASB issues IPSASs dealing with financial reporting under the cash basis of accounting and the accrual basis of accounting. The accrual basis IPSASs are based on the International Financial Reporting Standards (IFRSs), issued by the International Accounting Standards Board (IASB), where the requirements of those Standards are applicable to the public sector. They also deal with public sector specific financial reporting issues that are not dealt with in IFRSs.

The adoption of IPSASs by governments will improve both the quality and comparability of financial information reported by public sector entities around the world. The IPSASB recognizes the right of governments and national standard-setters to establish accounting standards and guidelines for financial reporting in their jurisdictions. The IPSASB encourages the adoption of IPSASs and the harmonization of national requirements with IPSASs. Financial statements should be described as complying with IPSASs only if they comply with all the requirements of each applicable IPSAS.

Due Process and Timetable

An important part of the process of developing IPSASs is for the IPSASB to receive comments on the proposals set out in Exposure Drafts from governments, public sector entities, auditors, standard-setters and other parties with an interest in public sector financial reporting. Accordingly, each proposed IPSAS is first released as an Exposure Draft, inviting interested parties to provide their comments. Exposure Drafts will usually have a comment period of four months, although longer periods may be used for certain Exposure Drafts. Upon the closure of the comment period, the IPSASB will consider the comments received on the Exposure Draft and may modify the proposed IPSAS in the light of the comments received before proceeding to issue a final Standard.

Background and Purpose of the Exposure Draft

In late 1997, the IPSASB's predecessor – the Public Sector Committee (PSC)¹ – commenced a program for the development of IPSASs based on International Accounting Standards (IASs) on issue at August 1997, or their subsequently revised versions, to the extent the requirement of the IASs are relevant for the public sector. The IPSASs maintained the requirements, structure and text of the IASs unless there was a public sector specific reason for a departure. The first phase of the standards development program was completed in late 2002.

In late 2003, as a consequence of the IASB's General Improvements Project, the PSC initiated its General Improvements Project with the objective of updating 11 IPSASs to converge with improved equivalent IASs issued in December 2003. The 11 improved IPSASs, not including IPSAS 5, "Borrowing Costs", were approved by the IPSASB in November 2006 and were issued in December 2006.

In early 2007, the IPSASB initiated, subsequent to its General Improvements Project completed in 2006, a continuous improvements project to update existing IPSASs to converge with the latest related IFRSs to the extent appropriate for the public sector. As part of the project, the IPSASB reviewed the IASB's amendments to IAS 23, "Borrowing Costs" issued in March 2007.

¹ The PSC was reconstituted as the IPSASB by the IFAC Board in November 2004.

The objective of this Exposure Draft is to update IPSAS 5 (2000) to reflect the IASB's amendments to IAS 23 in March 2007. The IASB's revision to IAS 23 resulted from its Short-term Convergence project being conducted jointly with the Financial Accounting Standards Board (FASB) in the United States. The Short-term Convergence project is aimed at reducing differences between IFRSs and the US Generally Accepted Accounting Principles (GAAP) that are capable of resolution in a relatively short time and can be addressed outside major projects. The major change made to the former IAS 23 (1993) is to eliminate the option of immediate recognition as an expense of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. However, revised IAS 23 does not require an entity to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value or inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis.

Until the proposed IPSAS 5 becomes effective, the requirements of the current version of IPSAS 5 remain in force.

Presentation of the Proposed Amendments to IPSAS 5

The Exposure Draft presents a marked-up copy of the full text of IPSAS 5. The proposed changes reflecting the IASB's most recent changes to former IAS 23 and a few improvements of other aspects of IPSAS 5, are identified in marked-up. In addition, compared to the former IPSAS 5, the proposed amended IPSAS 5 includes additional sections of "Introduction", "Appendix: Amendments to Other IPSASs", "Basis for Conclusions", "Amendments to Guidance on Other IPSASs" and "Table of Concordance".

REQUEST FOR COMMENTS

The Exposure Draft proposes amendments to IPSAS 5. Comments are invited on the proposals in this Exposure Draft by MM DD, YYYY. The IPSASB invites comments on all the changes proposed in the Exposure Draft, and would particularly welcome comments to the question set out in the “Specific Matter for Comment” section. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Specific Matter for Comment

The IPSASB would particularly value comments on the following question:

1. This Exposure Draft proposes to eliminate the option in IPSAS 5 of recognizing 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?

SUMMARY OF MAIN CHANGES TO IPSAS 5 BORROWING COSTS

The main changes proposed are:

Equal Authority Rubric

- To replace the previous introductory paragraph with a boxed equal authority rubric similar to those contained in the 11 improved IPSASs issued in December 2006.

Core Principle

- To replace the previous “objective” section with “core principle” section (see paragraph 1), number this section as part of the standard and change this section from plain type to bold type.

Scope

- To include in paragraph 6 a scope exclusion. An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:
 - (a) a qualifying asset measured at fair value, for example an asset measured at fair value under IPSAS 17; or
 - (b) inventories that are produced in large quantities on a repetitive basis.

Previously, IPSAS 5 did not have the similar scope exclusion.

Definitions

- In paragraph 7:
 - to remove the following unnecessary definitions: “accrual basis”, “assets”, “cash”, “contributions from owners”, “distributions to owners”, “economic entity”, “expenses”, “government business enterprise”, “liabilities”, “net assets/equity” and “revenue”. Accordingly, the definition guidance (paragraphs 7-12 in existing IPSAS 5) has also been deleted.
 - to change editorially the definition of “borrowing costs” and “qualifying asset”.
- In paragraph 9:
 - to amend the examples of the term “qualifying assets”. The amended examples include “intangible assets” and “investment properties”.
 - to clarify that financial assets, and inventories that are produced over a short period of time are not qualifying assets. The words “other investments” and “those assets” used in previous IPSAS 5 have now been replaced with the words “financial assets” and “inventories” respectively.

Recognition

- To remove the option of immediate recognition as an expense of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. An entity is now required to capitalize such borrowing costs as part of the cost of that qualifying asset as set out in paragraph 10.

Previously, IPSAS 5 specified two accounting treatments for the recognition of borrowing costs directly attributable to the acquisition, construction or production of a

qualifying asset --- a benchmark treatment and an allowed alternative treatment. The benchmark treatment required such borrowing costs to be recognized as an expense. The allowed alternative treatment required such borrowing costs to be recognized as part of the cost of that qualifying asset.

- To clarify in paragraph 11 that when an entity applies IPSAS 10, “Financial Reporting in Hyperinflationary Economies” it recognizes as an expense the part of borrowing costs that compensates for inflation during the same period in accordance with paragraph 24 of that Standard. Previously, IPSAS 5 did not contain this clarification.
- To amend paragraph 21 to ensure consistency with other IPSASs. The amended paragraph would:
 - replace the previous words “international and/or national accounting standards” with the words “International Public Sector Accounting Standards”; and
 - add the words “(or recoverable service amount)” after the words “recoverable amount”.
- To insert a sentence of “Outlays are reduced by any progress payments received and assets received subject to stipulations on transferred assets specifying the acquisition of the qualifying asset (see IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)”)” after the first sentence in paragraph 23.
- To change editorially paragraphs 14, 16, 22, 25-27 and 29.

Disclosure

- To remove the requirement for disclosure of the accounting policy adopted for borrowing costs.

Transitional Provisions

- To require in paragraph 32 an entity to apply this standard to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after the effective date when application of the standard constitutes a change in accounting policy. Previously, for such a change in accounting policy, IPSAS 5 generally encouraged an entity to adjust its financial statements in accordance with IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” and permitted, as an alternative, entities following the allowed alternative treatment to capitalize only those borrowing costs incurred after the effective date of this standard which meet the criteria for capitalization.
- To include a transitional provision that an entity may designate any date before the effective date and apply the standard to borrowing costs relating to all qualifying assets for which the commencement date for capitalization is on or after that date. Previously, IPSAS 5 did not include such provision.

Other Changes

- To include an “Introduction” section.

- To include an authoritative appendix of amendments to other IPSASs that will be impacted as a result of the proposals in this IPSAS.
- To include the Basis for Conclusions.
- To include a list of amendments to guidance on other IPSASs that will be impacted as a result of the proposals in this IPSAS.
- To amend the “Comparison with IAS 23” to identify additional departures from IAS 23.

**PROPOSED AMENDED TEXT
IPSAS 5—BORROWING COSTS
CONTENTS**

| | Paragraph |
|--|-----------------------|
| <u>Introduction</u> | <u>IN1-12</u> |
| Objective <u>Core Principle</u> | <u>1</u> |
| Scope | 12-46 |
| Definitions | 57-139 |
| Borrowing Costs | <u>68</u> |
| <u>Economic Entity</u> | 7-9 |
| <u>Future Economic Benefits or Service Potential</u> | <u>10</u> |
| <u>Government Business Enterprises</u> | <u>11</u> |
| <u>Net Assets/Equity</u> | <u>12</u> |
| Qualifying Assets | <u>139</u> |
| Borrowing Costs — Benchmark Treatment | 14-16 |
| <u>Recognition</u> | <u>14-15</u> |
| <u>Disclosure</u> | <u>16</u> |
| Borrowing Costs — Allowed Alternative Treatment | 17-39 |
| — Recognition | 17-10-2030 |
| Borrowing Costs Eligible for Capitalization | 21-12-2920 |
| Excess of the Carrying Amount of the Qualifying Asset Over Recoverable Amount | <u>3021</u> |
| Commencement of Capitalization | 31-22-3324 |
| Suspension of Capitalization | 34-25-3526 |
| Cessation of Capitalization | 36-27-3930 |
| Disclosure | <u>4031</u> |
| Transitional Provisions | 41-32-33 |
| Effective Date | 42-34-4335 |
| <u>Withdrawal of IPSAS 5 (issued 2000)</u> | <u>36</u> |
| <u>Appendix: Amendments to Other IPSASs</u> | |
| <u>Basis for Conclusions</u> | |
| <u>Amendments to Guidance on Other IPSASs</u> | |
| <u>Table of Concordance</u> | |
| Comparison with IAS 23 | |

International Public Sector Accounting Standard 5, “Borrowing Costs” (IPSAS 5) is set out in paragraphs 1-36 and the Appendix. All the paragraphs have equal authority. IPSAS 5 should be read in the context of its core principle and the Basis for Conclusions, the “Preface to the International Public Sector Accounting Standards”. IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

~~*The standards, which have been set in bold, should be read in the context of the commentary paragraphs in this Standard which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.*~~

Introduction

IN1. International Public Sector Accounting Standard (IPSAS) 5, “Borrowing Costs,” replaces IPSAS 5, “Borrowing Costs” (issued May 2000), and should be applied for annual reporting periods beginning on or after MM DD, YYYY. Earlier application is encouraged.

Reasons for Revising IPSAS 5

IN2. The International Public Sector Accounting Standards Board developed this revised IPSAS 5 as a response to the International Accounting Standards Board’s amendments to International Accounting Standard (IAS) 23, “Borrowing Costs” in March 2007 and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. The revision to IPSAS 5 reflects those changes made to the former IAS 23 as a consequence of the IASB’s amendments to IAS 23 in March 2007, and also a few improvements of other aspects of IPSAS 5.

Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 5 are described below.

Scope

IN5. The Standard does not require an entity to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:

- (a) a qualifying asset measured at fair value, for example an asset measured at fair value under IPSAS 17; or
- (b) inventories that are produced in large quantities on a repetitive basis.

Definitions

IN6. The Standard:

- Modifies the definition of “Borrowing Costs” and “qualifying asset”;
- Removes the following unnecessary terms: “accrual basis”, “assets”, “cash”, “contributions from owners”, “distributions to owners”, “economic entity”, “expenses”, “government business enterprise”, “liabilities”, “net assets/equity” and “revenue”. These terms are defined in other IPSASs and are reproduced in the “Glossary of Defined Terms IPSASs 1-24”;
- Includes “intangible assets” and “investment properties” as the examples of the term “qualifying assets” and clarifies that financial assets and inventories that are produced over a short period of time are not qualifying assets.

Recognition

IN7. The Standard removes the previous option of immediate recognition as an expense of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. The Standard now requires an entity to capitalize such borrowing costs as part of the cost of that qualifying asset.

IN8. The Standard clarifies that when an entity applies IPSAS 10, “Financial Reporting in Hyperinflationary Economies” it recognizes as an expense the part of borrowing costs that compensates for inflation during the same period in accordance with paragraph 24 of that Standard. Previously, IPSAS 5 did not contain this clarification.

IN9. The Standard requires that the outlays on a qualifying asset to which the capitalization rate is applied, are reduced by any progress payments received and assets received subject to stipulations on transferred assets specifying the acquisition of the qualifying asset (see IPSAS 23, “Revenue

from Non-Exchange Transactions (Taxes and Transfers)”). Previously, IPSAS 5 did not contain this requirement.

IN10. Paragraphs 14, 16, 22, 25-27 and 29 have editorially been modified.

Disclosure

IN11. The Standard removes the previous requirement for disclosure of the accounting policy adopted for borrowing costs.

Transitional Provisions

IN12. The Standard requires an entity to apply this standard to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after the effective date when application of the standard constitutes a change in accounting policy. Previously, for such a change in accounting policy, an entity is generally encouraged to adjust its financial statements in accordance with IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” and is permitted, as an alternative, to capitalize only those borrowing costs incurred after the effective date of this standard which meet the criteria for capitalization.

IN13. The Standard provides a new transitional provision that an entity may designate any date before the effective date and apply the standard to borrowing costs relating to all qualifying assets for which the commencement date for capitalization is on or after that date.

ObjectiveCore Principle

1. ~~This Standard prescribes 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 capitalization of B~~ borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense.

Scope

- ~~1.2.~~ An entity that prepares and presents financial statements under the accrual basis of accounting shall apply t~~This Standard should be applied~~ in accounting for borrowing costs.
- ~~2.3.~~ This Standard applies to all public sector entities other than Government Business Enterprises.
- ~~3.4.~~ The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements”.
- ~~4.5.~~ ~~Theis~~ Standard does not deal with the actual or imputed cost of net assets/equity. Where jurisdictions apply a capital charge to individual entities, judgment will need to be exercised to determine whether the charge meets the definition of borrowing costs or whether it should be treated as an actual or imputed cost of net assets/equity.
6. An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:
 - (a) a qualifying asset measured at fair value, for example an asset measured at fair value under IPSAS 17 ; or
 - (b) inventories that are produced in large quantities on a repetitive basis.

This Para is drawn from Para 4 of IAS 23. The wording of (a) and (b) is slightly different from IASB’s. The equivalent wording in IAS 23 is:

- (a) a qualifying asset measured at fair value, for example a biological asset; or
- (b) inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis.

Staff has changed the example in (a) considering the IPSASB has not dealt with biological assets and also in response to the DRC concern as addressed in the memorandum (Item 9.0). Staff has also changed the wording of (b) as exiting IPSAS 5 uses “produced” (see Para 9) instead of “manufactured, or otherwise produced” that is used in IAS 23.

Definitions

- ~~5.7.~~ ~~The following terms are used in t~~This Standard uses the following terms with the meanings specified:

Accrual basis means a basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.

Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

Borrowing costs are interest and other ~~expense~~costs incurred by that an entity incurs in connection with the borrowing of funds.

~~Cash comprises cash on hand and demand deposits.~~

~~Contributions from owners means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:~~

- ~~(a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or~~
- ~~(b) Can be sold, exchanged, transferred or redeemed.~~

~~Distributions to owners means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.~~

~~Economic entity means a group of entities comprising a controlling entity and one or more controlled entities.~~

~~Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.~~

~~Government Business Enterprise means an entity that has all the following characteristics:~~

- ~~(a) Is an entity with the power to contract in its own name;~~
- ~~(b) Has been assigned the financial and operational authority to carry on a business;~~
- ~~(c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;~~
- ~~(d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and~~
- ~~(e) Is controlled by a public sector entity.~~

~~Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.~~

~~Net assets/equity is the residual interest in the assets of the entity after deducting all its liabilities.~~

~~A Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale or distribution (non-exchange transactions).~~

~~Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.~~

Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meaning as in those other Standards, and are reproduced in the Glossary of Defined Terms published separately.

Borrowing Costs

6.8. Borrowing costs may include:

- (a) Interest on bank overdrafts and short-term and long-term borrowings;

- (b) Amortization of discounts or premiums relating to borrowings;
- (c) Amortization of ancillary costs incurred in connection with the arrangement of borrowings;
- (d) Finance charges in respect of finance leases recognized in accordance with IPSAS 13, "Leases"; and
- (e) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Economic Entity

- ~~7. The term "economic entity" is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.~~
- ~~8. Other terms sometimes used to refer to an economic entity include "administrative entity," "financial entity," "consolidated entity" and "group."~~
- ~~9. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.~~

Future Economic Benefits or Service Potential

- ~~10. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity's objectives but which do not directly generate net cash inflows are often described as embodying "service potential." Assets that are used to generate net cash inflows are often described as embodying "future economic benefits." To encompass all the purposes to which assets may be put, this Standard uses the term "future economic benefits or service potential" to describe the essential characteristic of assets.~~

Government Business Enterprises

- ~~11. Government Business Enterprises (GBEs) include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. IPSAS 6, "Consolidated and Separate Financial Statements" provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.~~

Net Assets/Equity

- ~~12. "Net assets/equity" is the term used in this Standard to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.~~

Qualifying Assets

- ~~13.9. Examples of qualifying assets are~~Depending on the circumstances, any of the following may be qualifying assets:
 - (a) Inventories
 - (b) Office buildings;
 - (c) Hospitals;
 - (d) Infrastructure assets such as roads, bridges

(e) ~~Land~~ power generation facilities;

(f) ~~Intangible assets and inventories that require a substantial period of time to bring them to a condition ready for use or sale~~

(g) ~~Investment properties.~~

~~Financial assets, Other investments, and those assets/inventories that are routinely produced over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale or distribution (non-exchange transactions) when acquired also are not qualifying assets.~~

~~Borrowing Costs—Benchmark Treatment~~

~~Recognition~~

~~14. Borrowing costs should be recognized as an expense in the period in which they are incurred.~~

~~15. Under the benchmark treatment, borrowing costs are recognized as an expense in the period in which they are incurred, regardless of how the borrowings are applied.~~

~~Disclosure~~

~~16. The financial statements should disclose the accounting policy adopted for borrowing costs.~~

~~Borrowing Costs—Allowed Alternative Treatment~~

~~Recognition~~

~~17.10. Borrowing costs An entity should 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. An entity shall recognise other borrowing costs be recognized as an expense in the period in which it incurs them they are incurred, except to the extent that they are capitalized in accordance with paragraph 18.~~

~~18. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard.~~

~~19.11. Under the allowed alternative treatment, b~~ Borrowing costs that are directly attributable to the acquisition, construction or production of an qualifying asset are included in the cost of that asset. Such borrowing costs are capitalized as part of the cost of the asset when it is probable that they will result in future economic benefits or service potential to the entity and the costs can be measured reliably. ~~When an entity applies IPSAS 10, “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 24 of that Standard~~ Other borrowing costs are recognized as an expense in the period in which they are incurred.

~~20. Where an entity adopts the allowed alternative treatment, that treatment should be applied consistently to all borrowing costs that are directly attributable to the acquisition, construction or production of all qualifying assets of the entity.~~

~~Borrowing Costs Eligible for Capitalization~~

~~24.12.~~ 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 outlays 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.

~~22.13.~~ 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 an economic entity uses a range of debt instruments to borrow funds at varying rates of interest, and transfers those funds on various bases to other entities in the economic entity. Funds which have been borrowed centrally may be transferred to other entities within the economic entity as a loan, a grant or a capital injection. Such transfers may be interest-free or require that only a portion of the actual interest cost be recovered. Other complications arise through the use of loans denominated in or linked to foreign currencies, when the economic entity 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 judgment is required.

23.14. 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 capitalization on that asset should be~~ the entity shall determine 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.

24.15. 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 outlays on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their outlay on the qualifying asset. In determining the amount of borrowing costs eligible for capitalization during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.

25.16. To the extent that ~~funds are~~ an entity borrows funds generally and ~~used~~ use them for the purpose of obtaining a qualifying asset, ~~the entity shall the amount of borrowing costs eligible for capitalization should be determined~~ the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the outlays on that asset. The capitalization rate ~~should~~ 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 capitalizes~~ it incurred during that period should not exceed the amount of borrowing costs it incurred during that period.

26.17. Only those borrowing costs applicable to the borrowings of the entity may be capitalized. When a controlling entity borrows funds which are passed on to a controlled entity with no, or only partial, allocation of borrowing costs, the controlled entity may capitalize only those borrowing costs which it itself has incurred. Where a controlled entity receives an interest-free capital contribution or capital grant, it will not incur any borrowing costs and consequently will not capitalize any such costs.

27.18. When a controlling entity transfers funds at partial cost to a controlled entity, the controlled entity may capitalize that portion of borrowing costs which it itself has incurred. In the financial statements of the economic entity, the full amount of borrowing costs can be capitalized to the qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalized by the controlled entity.

28.19. When a controlling entity has transferred funds at no cost to a controlled entity, neither the controlling entity nor the controlled entity would meet the criteria for capitalization of borrowing costs. However, if the economic entity met the criteria for capitalization of borrowing costs, it would be able to capitalize the borrowing costs to the qualifying asset in its financial statements.

29.20. In some circumstances, it is appropriate to include all borrowings of the controlling entity and its controlled entities when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each controlled entity 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

~~30.21.~~ When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount (or recoverable service amount) or net realizable value, the carrying amount is written down or written off in accordance with the requirements of other ~~international and/or national accounting standards~~ International Public Sector Accounting Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other standards.

The changes to this Para do not reflect the IASB's changes to IAS 23. Given that IPSAS 12, "Inventories," IPSAS 21, "Impairment of Non-Cash Generating Assets" and the proposed IPSAS on Impairment of Cash-Generating Assets provide the requirements of the write-down or write-off of the carrying amount of qualifying assets, staff proposes that the term "international and/or national accounting standards" be replaced with "International Public Sector Accounting Standards". It is also proposed that the words "(or recoverable service amount)" be inserted after the words "recoverable amount" to ensure consistency with IPSAS 21.

Commencement of Capitalization

~~31.22.~~ ~~The capitalization of~~ An entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date should commence when the entity first meets all of the following conditions:

- (a) Outlays it incurs outlays for the asset ~~are being incurred;~~
- (b) Borrowing it incurs borrowing costs ~~are being incurred;~~ and
- (c) Activities it undertakes activities that are necessary to prepare the asset for its intended use or sale or distribution (non-exchange transactions) ~~are in progress.~~

~~32.23.~~ Outlays on a qualifying asset include only those outlays that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Outlays are reduced by any progress payments received and assets received subject to stipulations on transferred assets specifying the acquisition of the qualifying asset (see IPSAS 23, "Revenue from Non-Exchange Transactions (Taxes and Transfers)"). The average carrying amount of the asset during a period, including borrowing costs previously capitalized, is normally a reasonable approximation of the outlays to which the capitalization rate is applied in that period.

The insertion of the above sentence does not reflect the IASB's changes to IAS 23. The reason for this insertion is addressed in the memorandum (Item 9.0).

~~33.24.~~ The activities necessary to prepare the asset for its intended use or sale or distribution (non-exchange transactions) 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. 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 capitalized 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 capitalization.

Suspension of Capitalization

~~34.25.~~ ~~Capitalization~~ An entity shall suspend capitalization of borrowing costs ~~should be suspended~~ during extended periods in which it suspends active development of a qualifying asset ~~is interrupted, and expensed.~~

~~35.26. Borrowing~~ An entity may incur borrowing costs ~~may be incurred~~ during an extended period in which ~~it suspends~~ the activities necessary to prepare an asset for its intended use or sale ~~or distribution (non-exchange transactions) are interrupted~~. Such costs are costs of holding partially completed assets and do not qualify for capitalization. However, ~~an entity does not normally suspend capitalising~~ capitalization of borrowing costs ~~is not normally suspended~~ during a period when ~~it carries out~~ substantial technical and administrative work ~~is being carried out~~. ~~An entity also does not suspend capitalising~~ Capitalization 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 ~~or distribution (non-exchange transactions)~~. For example, capitalization continues during ~~an extended period needed for inventories to mature or an~~ the extended period ~~during which~~ that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographical region involved.

Cessation of Capitalization

~~36.27. Capitalization~~ An entity shall cease capitalising of borrowing costs ~~should cease~~ when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale ~~or distribution (non-exchange transactions) are complete~~.

~~37.28.~~ An asset is normally ready for its intended use or sale ~~or distribution (non-exchange transactions)~~ 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 is outstanding, this indicates that substantially all the activities are complete.

~~38.29.~~ 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, ~~capitalization of borrowing costs~~ the entity ~~should~~ shall cease ~~capitalizing borrowing costs~~ when it ~~completes~~ substantially all the activities necessary to prepare that part for its intended use or sale ~~or distribution (non-exchange transactions) are completed~~.

~~39.30.~~ An office development 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 used while construction continues on other parts. Examples of qualifying assets that need to be complete before any part can be used include an operating theatre in a hospital when all construction must be complete before the theatre may be used; a sewage treatment plant where several processes are carried out in sequence at different parts of the plant; and a bridge forming part of a highway.

Disclosure

~~40.31. The financial statements~~ An entity ~~should~~ all disclose:

- (a) ~~The accounting policy adopted for borrowing costs;~~
- (b) The amount of borrowing costs capitalized during the period; and
- (c) The capitalization rate used to determine the amount of borrowing costs eligible for capitalization (when it was necessary to apply a capitalization rate to funds borrowed generally).

Transitional Provisions

~~32. When application of this Standard constitutes a change in accounting policy, an entity shall apply the Standard to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after the effective date.~~

~~33. However, an entity may designate any date before the effective date and apply the Standard to borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date.~~

- ~~41. When the adoption of this Standard constitutes a change in accounting policy, an entity is encouraged to adjust its financial statements in accordance with IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" Alternatively, entities following the allowed alternative treatment should capitalize only those borrowing costs incurred after the effective date of this Standard which meet the criteria for capitalization.~~

Effective Date

- ~~42.34. This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after July 1, 2001. Earlier application is encouraged. An entity shall apply the Standard for annual periods beginning on or after MM DD, YYYY. Earlier application is permitted. If an entity applies the Standard from a date before MM DD, YYYY it shall disclose that fact.~~
- 43.35. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Withdrawal of IPSAS 5 (issued 2000)

36. This standard supersedes IPSAS 5, "Borrowing Costs" issued in 2000.

This section, Amendments to Other IPSASs, is newly added as part of this standard following the IPSASB's policy. Only the relevant Paras in other IPSASs that are impacted as a result of the proposals in this standard are shown up in marked-up format.

Appendix

Amendments to Other IPSASs

The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after MM DD, YYYY. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

- A1. In IPSAS 1, "Presentation of Financial Statement," the last sentence of paragraph 134 is deleted.
- A2. In IPSAS 2, "Cash Flow Statements," paragraph 41 is amended to read as follows:
- 41 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 statement of financial performance or capitalised in accordance with ~~the allowed alternative treatment in~~ IPSAS 5, "Borrowing Costs".
- A3. In IPSAS 11, "Construction Contracts," paragraph 26 is amended to read as follows:
- 26 Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:
- (a) Insurance;
 - (b) Costs of design 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 IPSAS 5, "Borrowing Costs."~~
- A4. In IPSAS 17, "Property, Plant and Equipment," paragraph 37 is amended to read as follows:
- 37 The cost of an item of property, plant and equipment is the cash price equivalent or, for an item referred to in paragraph 27, its fair value 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 ~~recognized in the carrying amount of the item~~capitalised in accordance with ~~the allowed alternative treatment in~~ IPSAS 5.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 5, “Borrowing Costs.” This Basis for Conclusions only notes the IPSASB’s reasons for departing from provisions of the related International Accounting Standard.

Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)’s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB’s work program. The IPSASB’s policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the ‘comparison with IFRS’ included in each IPSAS.
- BC3. IPSAS 5, “Borrowing Costs”, issued in May 2000, was based on IAS 23, “Borrowing Costs” (revised in 1993). In March 2007, the IASB issued a revised version of IAS 23 superseding the version of 1993. The IASB’s revision to IAS 23 resulted from its Short-term Convergence project being conducted jointly with the Financial Accounting Standards Board (FASB) in the United States. The Short-term Convergence project is aimed at reducing differences between IFRSs and the US Generally Accepted Accounting Principles (GAAP) that are capable of resolution in a relatively short time and can be addressed outside major projects. The major change made to the former IAS 23 (1993) is to eliminate the option of immediate recognition as an expense of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset.
- BC4. In early 2007, the IPSASB initiated, subsequent to its General Improvements Project completed in 2006, a continuous improvements project to update existing IPSASs to converge with the latest related IFRSs to the extent appropriate for the public sector. As part of the project, the IPSASB reviewed the IASB’s amendments to IAS 23 issued in March 2007 and generally concurred with the IASB’s reasons for amending the IAS and with the amendments made. (The IASB’s Basis for Conclusions are not reproduced here. Subscribers to the IASB’s *Comprehensive Subscription Service* can view the Basis for Conclusions on the IASB’s website at www.iasb.org)
- BC5. IPSAS 5 varies from IAS 23 in some limited cases. This Basis for Conclusions explains the public sector specific reasons for these departures.

Outlay(s)

- BC6. IPSAS 5 uses the term “outlay(s)” to replace the equivalent term “expenditure(s)” in IAS 23. The term “expenditures” in IAS 23 refers to those expenditures that

result in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. However, the term “expenditure” has a narrower meaning in the public sector context, referring specifically to payments of cash.

Applicable Outlays

- BC7. In its discussion about the expenditures on a qualifying asset to which the capitalization rate is applied, IAS 23 requires expenditures to be reduced by any progress payments received and grants received in connection with the asset as defined in IAS 20, “Accounting for Government Grants and Disclosure of Government Assistance”. In addition to government grants as defined in IAS 20, public sector entities may receive a variety of other funding sources and use them specifically to obtain a qualifying asset. For example, many government entities may receive grants from private companies, multilateral banks, bilateral or multilateral aid agencies etc, and also may receive donations, gifts, bequests etc. The IPSASB was of the view that, in the public sector context, it would be inconsistent to reduce outlays on a qualifying asset by government grants, but not by other grants and other funding sources received in connection with the qualifying asset.
- BC8. IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)” establishes broad principles for dealing with all revenue from non-exchange transactions, including taxes and transfers (such as grants, bequests, gifts, donations etc). The IPSASB concluded that, in IPSAS 5, the outlays on a qualifying asset to which the capitalization rate is applied, should be reduced by any progress payments received and assets received subject to stipulations on transferred assets specifying the acquisition of the qualifying asset as described in IPSAS 23. This is reflected in paragraph 23.

This section, “Amendments to Guidance on Other IPSASs”, is new. In the revised IAS 23, “Amendments to Guidance on Other Pronouncements” (not part of the standard and without effective date for it), is separately listed and distinguished from “Amendments to Other pronouncementment” (as part of the standard and with an effective date for it).

Amendments to Guidance on Other IPSASs

The following amendments to guidance on other IPSASs are necessary in order to ensure consistency with the revised IPSAS 5.

IGA1 In the Guidance on Implementing IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors,” Example 2 is deleted.

Table of Concordance

This table shows how the contents of the superseded version of IPSAS 5 and the current version of IPSAS 5 correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

| Superseded IPSAS 5 paragraphs | Current IPSAS 5 paragraph |
|--|--|
| Objective | 1 |
| 1 | 2 |
| 2 | 3 |
| 3 | 4 |
| 4 | 5 |
| 5 | 7 |
| 6 | 8 |
| 7 | None |
| 8 | None |
| 9 | None |
| 10 | None |
| 11 | None |
| 12 | None |
| 13 | 9 |
| 14 | None |
| 15 | None |
| 16 | None |

| Superseded IPSAS 5 paragraphs | Current IPSAS 5 paragraph |
|--|--|
| 17 | 10 |
| 18 | None |
| 19 | 11 |
| 20 | None |
| 21 | 12 |
| 22 | 13 |
| 23 | 14 |
| 24 | 15 |
| 25 | 16 |
| 26 | 17 |
| 27 | 18 |
| 28 | 19 |
| 29 | 20 |
| 30 | 21 |
| 31 | 22 |
| 32 | 23 |
| 33 | 24 |

| Superseded IPSAS 5 paragraphs | Current IPSAS 5 paragraph |
|--|--|
| 34 | 25 |
| 35 | 26 |
| 36 | 27 |
| 37 | 28 |
| 38 | 29 |
| 39 | 30 |
| 40 | 31 |
| 41 | 32 |
| 42 | 34 |
| 43 | 35 |
| None | 6 |
| None | 33 |
| None | 36 |

Comparison with IAS 23

International Public Sector Accounting Standard (IPSAS) 5, “Borrowing Costs” is drawn primarily from International Accounting Standard (IAS) 23, “Borrowing Costs” (revised in 2007). The main differences between IPSAS 5 and IAS 23 are as follows:

- Commentary additional to that in IAS 23 has been included in paragraphs 13, 17-19, 30 and 35 of IPSAS 5 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 5 uses different terminology, in certain instances, from IAS 23. The most significant examples are the use of the terms “entity,” “revenue,” “statement of financial performance,” “statement of financial position” and “net assets/equity.” “economic entity,” “controlling entity” and “controlled entity” in IPSAS 5. The equivalent terms in IAS 23 are “enterprise,” “income,” “income statement,” “balance sheet” and “equity.” “group,” “parent” and “subsidiary.”
- IPSAS 5 uses the term “outlay(s)” to replace the equivalent term “expenditure(s)” in IAS 23.
- In determining the outlays on a qualifying asset to which the capitalization rate is applied, IPSAS 5 requires outlays to be reduced by any progress payments received and assets received subject to stipulations on transferred assets specifying the acquisition of the qualifying asset. IAS 23 requires expenditures to be reduced only by progress payments received and government grants received in connection with the asset.
- IPSAS 5 contains a different set of definitions of technical terms from IAS 23 (paragraph 5).