



**INTERNATIONAL FEDERATION  
OF ACCOUNTANTS**

545 Fifth Avenue, 14th Floor  
New York, New York 10017  
Internet: <http://www.ifac.org>

Tel: (212) 286-9344  
Fax: (212) 286-9570

**Agenda Item**

**7**

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**DATE:** February 20, 2008  
**MEMO TO:** Members of the IPSASB  
**FROM:** Matthew Bohun-Aponte  
**SUBJECT:** Improvements to IPSAS 5, “Borrowing Costs”

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**OBJECTIVE OF THIS SESSION**

To **approve** an exposure draft proposing changes to IPSAS 5, “Borrowing Costs.”

**AGENDA MATERIAL:**

**Papers**

- 7.0.1-7.0.7 Responses from Members
- 7.1 Analysis of Responses from Members;
- 7.2 Cut and paste of member responses;
- 7.3 ED XX, “Proposed Amendments to IPSAS 5, “Borrowing Costs”.

**ACTION REQUIRED**

The IPSASB is asked to:

- **review** the responses of members to Agenda Paper 9 from the November 2007 meeting;
- **review** the staff analysis of the members’ responses; and
- **approve** the Exposure Draft for publication.

**BACKGROUND**

The IPSASB has considered a proposal to amend IPSAS 5, “Borrowing Costs” at its meetings in July and November 2007. The amendments proposed by staff are based on amendments made by the International Accounting Standards Board to IAS 23, “Borrowing Costs”. At both the July and November meetings there was debate amongst members as to the appropriateness of eliminating the benchmark treatment of expensing borrowing costs in the period in which they are incurred. The revised IAS 23 requires that borrowing costs be included in the cost of acquisition of a qualifying asset, and requires entities to allocate entity borrowing costs to qualifying assets unless there is no rational way to do this. A number of members disagreed with this approach, whilst others were supportive of converging IPSAS 5 with IAS 23. At the July meeting members were asked to submit written arguments in favor of their positions.

In November 2007, IPSASB staff presented an analysis of the responses received from members and their technical advisors. The analysis noted that the issues of centralized borrowing, revaluation of assets (especially using the depreciated replacement value

method), convergence with statistical bases of accounting and the achievement of the objectives of public sector financial reporting were the most important issues for members. Members were divided on the issue of whether to retain the expensing of borrowing costs as an option, or whether to move to closer convergence with IAS 23 and require the capitalization of borrowing costs. Staff recommended convergence with IAS 23.

After a vigorous, but inconclusive debate, members who supported the retention of the option to expense borrowing costs were asked to submit their written analyses of the staff position, and to provide a basis for their own position. Staff have received responses from four of these members and from three members who support closer convergence with IAS 23. These responses are attached at item 7.2.

At item 7.0.1-7.0.7, member comments are provided in their entirety. At item 7.1, staff have provided an analysis of the members' responses in the context of the "Guidelines for Modifying IASB Documents" finalized in December 2007. At item 7.2 staff have provided a cut and paste of member comments related to particular issues. Item 7.3 is a draft exposure draft for members' review and approval.

<b>ACTION: Review the analysis in this memo, member responses and draft Exposure Draft, approve the ED for issue.</b>
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**Matthew Bohun-Aponte  
TECHNICAL MANAGER**

Dear Stephenie - Further to the Chair's request to prepare individual responses to the above item after the meeting in Beijing, my comments are as follows:

**A. - Removal / Retention of the expensing option in IPSAS 5**

1. I do NOT agree with the staff's proposal 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. I have reviewed the staff rational for removing this option and I am not convinced that this rational still addresses my concerns 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.

2. Even if we made the change as suggested by the staff's proposal, the proposed IPSAS 5 would not be converged with the IASB equivalent. Paragraphs 17 to 21 in the proposed IPSAS 5 are different from the intent of IAS 23. In the proposed IPSAS 5, the revisions appear to restrict the application of the capitalization approach in a group situation, such as a government with many controlled entities, which is not the case in the IAS equivalent. 3. It is my understanding that there are two IASB standards that deal with this issue....one for large enterprises and one for small and medium enterprises. Again, it is my understanding that the IASB standard for small and medium size enterprises allows a choice between expensing or capitalizing interest costs. If so, then we have a dilemma. I would venture to guess that a large number of our constituents fall under the small to medium size enterprises umbrella, as well. Therefore, how would we deal with those constituents if we were to remove the expense option from the proposed IPSAS?

4. My last point deals with the principles we adopted for our " Rules of the Road " on convergence. One of those principles included cost benefit as a reason for considering departure. If we were to accept the IAS standard, I would expect the cost to implement this proposal to exceed the benefit in reporting for the public sector.

**B. - Applicable expenditures issue in IPSAS 5**

1. I concur with the staff's recommendation.

Should you require any further information, please do not hesitate to contact me. Thank you. Rick

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Richard J. Neville, F.C.A.  
Home: (613) 592-7000  
Cell: (613) 513-5563

### ***IPSAS 5 Borrowing Costs PB Response***

I acknowledge the efforts made by staff in complying with the Board's convergence strategy, specifically in reviewing those IPSASs where the IASB has made significant changes to the underlying IAS since the IPSAS was developed. However, I believe that this is a situation where the Board needs to make an exception to its general strategy,

Before I respond directly to the presentation made at the end of the November meeting, I would like to make some initial comments.

Firstly, even if we ignored the disadvantages of abandoning the benchmark expensing option and made the currently proposed changes to the standard, we would still not have an IPSAS standard that was converged with the IASB equivalent. This is because paragraphs 17 to 21 plus additional paragraphs 26, 27 and 28 in IPSAS 5 are different from IAS 23 in ways that result in significant differences in the application of the standard, in that subsidiary entities can ignore indirect borrowing costs that are incurred elsewhere in the economic entity. These existing revisions appear to restrict and simplify the application of the capitalization approach in a group situation, such as a government with many controlled entities. These existing IPSAS 5 differences were presumably introduced to reduce the impact of the capitalization approach, and thus make application of this standard more cost effective.

Regrettably, these changes do not appear to benefit any whole of government entity trying to prepare consolidated financial statements which potentially is still required to make a huge range of consolidation adjustments. Nevertheless these revised/additional IPSAS 5 paragraphs remain and would still result in a non-converged standard. A new reader of the proposed amended standard might also be confused because these paragraphs refer to capitalization in a permissive rather than mandatory way. This is not an argument for currently revising paragraphs 17-21 and removing paragraphs 26 to 28. I do not believe that this should be done without full consideration by the Board, in the same way as the Board retained the exemption of fair valued assets from impairment in the absence of a full review of the standard for assets at fair value.

Secondly, with which IASB standard are we converging? The proposed IASB standard for small and medium enterprises (SME) takes the expensing approach to interest costs. This was apparently decided on a cost benefit approach, but shows that the IASB is not totally wedded to the capitalization of interest costs. I would suggest that many of our constituents, with the possible exception of some national and a few major state or provincial governments are no better resourced with accountants than the typical enterprise that the IASB was considering when it drafted its SME standard. I therefore consider that it would be equally appropriate for IPSASB to converge to the SME standard and remove the capitalization option.

Thirdly, we mustn't lose sight of why IASB convergence is one of our strategies. It was for cost benefit reasons, to enable us to get the maximum out of our standard setting resources by building on and adapting the IASB standards to suit our purposes. It also

has advantages in minimizing the differences and thus increasing the availability of accountants who can work with public sector accounting. Convergence also minimizes possible confusion for readers of the financial statements. However, the proposed convergence of IPSAS 5 offers few of those benefits.

Fourthly, in developing our *Rules of the Road* we included cost benefit as a reason for considering departure. I believe that borrowing costs are clearly a circumstance where the cost of applying the IAS changes exceeds the benefit to a public sector reporter.

Fifthly, retaining the option to expense borrowing costs enables those jurisdictions that so choose, an easy path to convergence with statistical reporting. This is of course, also an IPSASB strategy. Even for those jurisdictions for which this strategy is not a priority, expensing borrowing costs reduces the effort, and therefore the cost, of preparing statistical reports for bodies such as the I.M.F.

A further matter to note is that the IASB decision to drop the expensing option remains contentious in the private sector. I understand that the matter has been raised in the European parliament with the intent of disallowing the application of the revised standard in Europe.

Finally, before addressing the November presentation, I must say that I do not find the conceptual arguments put forward for adopting the capitalization of borrowing expenses in constructing an asset to be persuasive. The argument seems to be that if you buy such an asset you would pay the borrowing costs that would be incurred during construction and that therefore for consistency if the entity builds the asset itself and incurs borrowing costs it should also capitalize the borrowing costs. The reality is that a profit seeking construction company will endeavor to obtain a return on its capital whether borrowed or equity, and its success will depend on competition in the market for its services. The capital structure of such an entity is more likely to depend on the capital market and income tax structure of its jurisdiction rather than the type of services it offers. Therefore the borrowing cost analogy is very weak. I also note that the current IASB approach (IFRS 3 revised) disallows capitalization of many incidental acquisition costs that traditionally were capitalized.

## **November Meeting Presentation**

In regard to the presentation made at the end of that meeting I would generally reiterate the points already made in my previous response. It seems that the concerns held by some board members, especially about the negative cost benefit impact of the proposed change, have not been fully accepted. My more specific comments in relation to the slide presentation follow.

### *Central Borrowing Issue*

The first concern addressed is the allocation of central borrowing costs when the funds are distributed to subsidiaries in various ways. As indicated by staff and discussed above

IPSAS 5 diverges from IAS 23 (paragraphs 17 to 21 and 26 to 29) to effectively exempt subsidiaries from most of the impact of an economic entity policy of capitalizing borrowing costs on qualifying assets. What does not seem to be addressed is the application of this policy on the economic entity, for example a whole of Government. To the extent that the economic entity has incurred borrowing costs it will have to apply them to the applicable qualifying assets, with consequent depreciation impacts over many years. To be in compliance the economic entity will be required to maintain a large and very complex set of records and consolidation adjustments. These adjustments will in turn require audit verification. This is a substantial consumption of resources with very little benefit and over time will be prone to errors. In short, a nightmare. Possibly the best solution (other than retaining the expensing option) is to limit the application of paragraph 49 of IPSAS 6 in a way that the intentions of the amendments originally made to IPSAS 5 also are effective on the consolidated economic entity.

The second concern raised in the presentation seems to be where borrowing costs are not directly attributable. IAS 23 (and IPSAS 5 to the extent not exempted by paragraphs 17 to 21 and 26 to 29) addresses this by requiring the use of a weighted average interest rate where borrowings are not directly attributable. This provides an answer, but it is the application of this answer to all expenditures on qualifying assets, especially at the economic entity level, that is the problem. This is because of the large number of qualifying assets in numerous locations and subsidiaries, often in circumstances where the resources to effectively apply accrual accounting are limited.

The third concern, which is where with my experience both in the private sector and government I would refute staff's opinion, is that additional compliance costs for the public sector would not be significantly different, presumably because of the similarity between a government undertaking central borrowing and a company group doing the same. While on the face of it the situations are very similar, the difference in organization and structure between say a listed profit seeking company and a government has a very different outcome. The listed company is only likely to have a few subsidiaries that undertake the construction of qualifying assets. All subsidiary entities will have boards that largely are made up either of board members of the parent entity or of management staff. The entire economic entity will act in a disciplined way and in particular will follow group policies and use common systems that, inter alia, produce regular financial and management reports both for individual entities and the entire group. In such a group, funding of subsidiaries will probably be made in the most tax effective way, but it will also be relatively simple to keep track on different bases for different reporting purposes. Moreover, the qualifying assets concerned will have depreciable lives that rarely exceed two or three decades. Those private sector economic entities affected by this standard generally will have the resources to handle the problem and can probably minimize the cost and impact.

By contrast, governments may have scores of subsidiary entities, with many of them constructing qualifying assets with depreciable lives of many decades. Although there will be a need to follow the general policies of government, many of these entities will have been set up deliberately with local, largely independent management boards. They

are likely to have independent accounting resources and systems. And of course there is independence, competition and often inconsistency of reporting between departments and portfolio entities reflecting independence and equality between ministers under the Westminster system. Accounting and management systems in many jurisdictions reflect local and departmental reporting requirements, with occasional population of a summarized chart of accounts for whole of government reporting. Funding to departments is by means of parliamentary appropriation from a central fund without concern whether the fund holds monies from taxes or borrowed funds. The departments in turn either spend the appropriations or pass them on as grants. They may also allow subsidiary entities to borrow, usually from a central agency. Any system of accounts and records to track directly and indirectly attributable borrowing costs, their application to qualifying assets, and the subsequent depreciation impacts would be complex, resource demanding and costly.

To partially overcome this problem the existing IPSAS 5 revisions to paragraphs 17 to 21 and addition of paragraphs 26 to 28 simplify the application of this standard to subsidiary entities, although in a way that results in inconsistency with IAS 23. However a problem remains when preparing a consolidated financial report at the whole of government (WoG) level. If you just consolidate the individual entities as they stand (which I think is the best approach, but probably needs clarification of the application of paragraph 49 of IPSASB 6) then borrowing costs at the WoG level will not have been applied to qualifying assets with consequential interest expense and depreciation impacts. Consequently unless paragraph 49 of IPSAS 6 does not apply, you will not be in compliance with the proposed IPSAS 5 with potential serious consequences including audit qualification. As an alternative you may set up a vast structure of notional lending, capitalization and depreciation accounts and supporting records as previously discussed so that on consolidation into the WoG position the results and position of qualifying assets that are in subsidiary entities following IPSAS 5 can be adjusted to reflect the borrowing costs at the WoG level. Apart from being very demanding of scarce accounting resources, very likely to go wrong over the decades it would have to operate, and confusing for any reader who wondered why two hospitals were at one figure in their local entity accounts but another in the WoG accounts, this second alternative seems to be completely contrary to the intention underlying the original changes to paragraphs 17 to 21 and 26 to 28 in IPSAS 5!

#### *Convergence with statistical bases*

Staff acknowledge this as a concern, but consider it inappropriate to rely on it as a reason for departure from IFRS. I don't see why, given that convergence with GFS is also a strategy of IPSASB. I disagree with staff's conclusion. Our strategy of convergence with IFRS is to obtain cost and efficiency benefits for both the board and our users, not to converge whatever the circumstances. Continuation of the existing choice easily enables GFS convergence which would be beneficial to a number of jurisdictions.

Staff also considers that the impact of the difference is minimized because their analysis is that assets at fair value are excluded. This is a weak argument, both because a small

difference is still a difference and because I am not sure that the non application to revalued assets is as presented. See below

*Assets at valuation, particularly when the basis is depreciated replacement cost*

I disagree with the analysis presented that this standard is not applicable to assets that subsequent to acquisition are measured on a revalued basis, and therefore it minimizes the effect of borrowing costs. My understanding is that the staff of the Australian ASB queried the application with relevant IASB staff who confirmed that, during the construction stage, assets under IAS 16 are on a cost basis and therefore borrowing costs apply. This coincides with my interpretation of the impacts of IAS 16 and IAS 23, which I believe is supported by IAS 23 BC4 as quoted. Consequently the compliance pain remains during the construction stage, and afterwards at least until the asset is subsequently revalued, which could be several years.

As a separate matter, I think that there are also concerns about the measurement of revalued assets. For many government assets this is measured on a depreciated replacement cost basis. If the governments policy is to capitalize borrowing costs on construction, to what extent should borrowing costs be included in the measurement of depreciated replacement cost? I'm not sure that the scope exclusion proposed to be transferred from IAS 23 overcomes this issue, but I would be interested to hear from members with more expertise in this area.

Finally, as discussed above I have concerns about the conceptual arguments and do not think that they are fully addressed in the basis of conclusions. They don't seem to have been overwhelming when the IASB drafted the SME standard. It's noteworthy that the expensing option was headed "Benchmark Treatment" in previous versions of IAS 23.

## **Conclusion**

I am strongly opposed to the proposal to eliminate the expensing option. My reasons may be summarized as:

- Cost and resource impact of application in public sector environment and structures
- IPSAS 5 and IAS 23 would still not be fully converged
- IFRS convergence is a strategy for effective standard setting, not an end in itself
- IFRS [draft] SME standard applies expensing
- GFS convergence is also very important
- Conceptual basis for capitalization doubtful
- Arguments that exclusions for revalued assets and subsidiaries minimize the impact of the proposal are not convincing
- Uncertainties about the impact it would have on the measurement of depreciated replacement cost.



**Peter Batten**

Dear Stephenie,

We still owe you a response in respect of agenda item 9 from the Beijing meeting, i.e. the proposed removal of the expensing option from IPSAS 5. We have reviewed the analysis by staff in the mean time. However, we are still of the view that there are public sector specific reasons to depart from the revised IAS 23. Therefore we still oppose the removal of the expensing option.

Looking at the particular arguments:

(i) Central borrowing: We are of the view that central borrowing has a different notion in the public sector. While private sector enterprises centralize the financing function mainly to offer the investors/lenders a strategic package, the public sector does so mainly to save cost and perhaps improve compliance. From the investor's perspective it's usually not an investment into strategic activities, but a risk free lending to a prime borrower. Thus, both from the preparer's and the user's perspective, the situation is different from private sector. Perhaps, at least from the preparer's perspective, it's more similar to the SME situation, in which also IAS retains the expensing option.

In our view, also the consequences for consolidated and separate financial statements would be critical in the public sector. There is strong resistance against consolidation in the public sector. By increasing the complexity in this area, we would certainly jeopardize our goal of whole of government reporting. We think the compliance with IAS 23 is not worth putting this more fundamental goal at risk.

(ii) Convergence with statistical basis: We think that GFS is one of the most obvious public sector specific reason to depart from IAS/IFRS. The staff proposal scoping out assets at fair value makes things even more cumbersome, as GFS does not measure at fair value in any particular case. Thus the staff proposal would greatly increase complexity as it creates yet another category of assets and liabilities which needs different treatment.

Bottom line we see many disadvantages of the proposed removal and very little if any advantage of doing so. Thus we clearly support the retention of expensing option.

Best regards,

Andreas.

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Prof Andreas Bergmann, Dr oec  
Director  
Zurich University of Applied Sciences  
Institute of Public Management  
Tel +41 58 934 7964  
Fax +41 58 935 7964  
[andreas.bergmann@zhaw.ch](mailto:andreas.bergmann@zhaw.ch)  
[www.ivm.zhaw.ch](http://www.ivm.zhaw.ch)  
Zurich University of Applied Sciences  
Institute of Public Management  
St. Georgenstrasse 70  
P.O. Box 958  
CH-8401 Winterthur/Switzerland  
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## **MEMO**

|         |                                  |
|---------|----------------------------------|
| To      | Stephenie Fox                    |
| From    | Greg Schollum                    |
| Date    | 24 January 2008                  |
| Subject | <b>IPSAS 5 - BORROWING COSTS</b> |

As requested at the November IPSASB meeting in Beijing, I comment below on the staff analysis of the proposed update to IPSAS 5 *Borrowing Costs*:

### **Background:**

- The IPSASB has an existing IPSAS in place which, while based on IAS 23, is different in certain respects.
- The existing IPSAS 5 includes options to either expense or capitalise borrowing costs.
- Staff are proposing that the expense option is removed, consistent with the IASB's decision to remove that option.
- The IPSASB has developed a policy position (yet to be finally approved) in relation to the circumstances when the IPSASB considers it appropriate to depart from the IASB position ("Rules of the Road").
- Initial feedback from members, as analysed by staff in the November 2007 agenda papers, is mixed with strongly held views expressed for both the retention of the expensing option and the elimination of the expense option.
- A sufficient majority of the IPSASB will be needed to approve an amended IPSAS 5, consistent with the IPSASB's standard operating procedures.

### **Summary**

In my view, there are sound reasons for departing from IAS 23 and retaining the expensing option within IPSAS 5. The Board's 'Rules of the Road' guidelines identify 4 criteria for helping to determine whether a public sector issue warrants departure. As explained below, I believe there are significant issues with the application of at least 2 of these criteria in this case (criterion 3 and 4). These concerns are exacerbated by the fact that in many jurisdictions (including New Zealand) most public sector assets are revalued. I, therefore, believe that collectively there are clear public sector reasons to retain the expensing option and thereby depart from the IASB document.

Also, although on the face of it attractive, I disagree with the staff analysis in relation to the interpretation of the scope issue, i.e. I don't believe the IASB has scoped out all revalued assets from the scope of IAS 23. Therefore, if all revalued assets are to be scoped out of IPSAS 5, the IPSASB needs to acknowledge that this is a change from the position in the IASB document, i.e. this in itself would be a departure from IAS 23, which would need to be justified on the basis of the 'Rules of the Road' guidelines.

### **Are there public sector issues that warrant departure?**

In determining whether there is a public sector issue that warrants a departure from an IASB document, the Rules of the Road guidelines indicate that the following should be considered:

#### **Criterion (1) Where applying the international accounting standards/interpretations would mean the objectives of public sector financial reporting would not be met**

I have serious reservations about whether compulsory capitalisation of borrowing costs will mean the objectives of public sector financial reporting will be met. It makes no sense to me that an entity's assets are suddenly worth more because that entity has debt, compared with an entity with no debt, i.e. I have trouble with the notion that the more debt an entity has, the more its assets are supposedly worth (particularly in the public sector environment where there are typically no markets to determine most assets values)!

In my view, it is questionable that capitalisation of borrowing costs is the 'correct' approach conceptually, given the variation in capital structures in public entities around the world. To adjust asset values for only a portion of the funding associated with those assets (i.e. debt but not equity) is likely to lead to significant inconsistencies in application.

I prefer the view that the raising of capital and use of that capital should be uncoupled.

#### **Criterion 2 Where applying the international accounting standards/interpretations would affect the accountability to stakeholders**

Compulsory capitalisation will, in my view, create perverse incentives for public entities to in effect "borrow to pay for the groceries", as it may be difficult politically for public entities to justify setting rates and taxes at levels above what is required to fund the operating expenses of the entity (which will of course exclude the interest cost that has been capitalised but this interest needs to be funded).

Entities can only borrow to pay the interest for so long before such a financial management practice comes unstuck. To, in effect, encourage this behaviour seems inconsistent with good public sector management.

**Criterion 3    Where applying the international accounting standards/interpretations would mean the qualitative characteristics of public sector financial reporting would not be met**

In my view, two qualitative characteristics (reliability and comparability) will be compromised by the compulsory capitalisation of borrowing costs.

Reliability will be compromised as compulsory capitalisation of borrowing costs will also mean compulsory inclusion of borrowing costs into revaluations of these assets. 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.

The problem is that there is currently no guidance as to how the borrowing cost component should be incorporated into assessments of fair value of most public sector assets. As most public sector assets that are revalued are done so on the basis of Depreciated Replacement Cost (DRC), appropriate guidance needs to be developed which is consistent with the notion of DRC, i.e. reflecting the remaining service potential embodied in the asset.

I am aware that DRC is sometimes used by profit oriented entities (e.g. GBEs and private sector entities) to revalue assets, but such valuations are carried out in the context of a cash flow based valuation cap. On the other hand, DRC valuations for public sector entities other than GBEs do not have a cross check to a cash flow based valuation figure, as the assets are non cash generating. This increases the risk that DRC may no longer represent a good proxy for fair value.

There is therefore 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.

Also, comparability will be compromised because of the numerous capital structures (i.e. debt/equity ratios) which exist among public sector entities around the world. The only way to enhance comparability would be to require expensing rather than prohibit it.

**Criterion 4    Where the cost of applying the international accounting standards/ interpretations exceeds the benefit**

There is no doubt in my mind that significant additional costs will be incurred in the public sector environment with no increase in the benefit, during:

- the initial interest capitalisation process, particularly for whole of Government reporting where centralised borrowing is the norm and the borrowing is not ascribed at a lower level of reporting entity;
- incorporation into DRC valuations of a component for capitalised interest (i.e. additional costs incurred by valuers, preparers and auditors).

When faced with the current options to either expense or capitalise, very few public sector entities currently capitalise borrowing costs. This is no co-incidence in my view.

### **Why the scope of IPSAS 5 is not the same as IAS 23**

IAS 23 currently scopes out qualifying assets measured at fair value (e.g. biological assets) and IPSASB staff have, after 'informally' checking with IASB staff, concluded that this means any asset carried at fair value is scoped out of IAS 23.

Institute staff in New Zealand and AASB staff in Australia have separately concluded that the scope exclusion in IAS 23 relates only to those assets that were initially recognised at fair value as opposed to assets such as property, plant and equipment which are initially recognised at cost and subsequently revalued. Entities with assets initially recognised at cost would typically capitalise borrowing costs as part of accumulating the cost of those assets prior to any revaluation.

I suspect that if IPSASB staff more 'formally' check with IASB staff, it will become clear that the IASB had no intention of scoping out all revalued assets from IAS 23. (If this remains the IPSASB staff view, I suggest more formally checking with the IASB prior to the Toronto meeting).

Therefore, I don't believe that we can simply scope all revalued assets out of IPSAS 5 unless the IPSASB clearly acknowledges that that is a departure from the IASB position or unless the IASB formally acknowledges all revalued assets are scoped out of IAS 23.

Then the question has to be asked, if we are consciously departing from the IASB position, why would we not just retain the expensing option?

I would be happy to discuss any of the above matters if that would be helpful.



Greg Schollum  
NZ Member

## **Memo**

To           IPSASB Staff  
From       Thomas van Tiel and Frans van Schaik  
Date       5 February 2008  
Subject    **IPSAS 5 - Borrowing Costs**

### **Response to Analysis of Expensing Issue**

#### 1. Difficulties in capitalizing borrowing costs where borrowing is administered centrally

In general we agree with staff's analysis and the conclusion that central borrowing administration does not lead to a different treatment from IAS 23. We would like to make the following observations:

- In respect of the phrase 'directly attributable' we do not think that pooling of borrowing costs is a sufficient reason to conclude that there is no direct link between the borrowing costs and the incurring of the outlays. Our interpretation of paragraph
- In the Netherlands most municipalities have been using the capitalization approach for many years in combination with generally borrowed and centrally administered funds, even though they are not obliged to. This doesn't seem to be onerous, nor does it have difficult audit implications.

#### 2. Convergence with statistical bases of financial reporting which generally treats borrowing costs as an expense

We agree with staff's analysis that there is no convergence issue here. Market value is the measurement basis under statistical accounting and application of IPSAS 5 (as well as IAS 23) is not required for qualifying assets measured at fair value. Furthermore, in our opinion convergence with IFRS takes precedence over convergence with statistical bases of financial reporting.

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

We agree with staff's proposal to exclude from the scope qualifying assets carried measured at fair value.

**4. Other Issues**

- a. In our opinion conceptually the capitalization option is the only right treatment of borrowing costs. An example (adapted from Peter Batten's examples) to illustrate this: Consider two 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 two hospitals are in similar climatic conditions and have similar size and use criteria. The design and construction contract tender is won for both of them by a different multinational construction company. Allowing for slight site differences the construction cost is essentially the same. The financial structure of the three acquiring entities is essentially the same.

However, the construction company for the first hospital has an efficient construction process, allowing for a two year building period and a two year payment schedule. The construction company for the second hospital has a less efficient construction process, requiring a three year building period and a three year payment schedule.

If expensing of borrowing costs is allowed, then each of these hospitals will finish up with the same depreciation charges, and yet in substance the cost of each hospital is different.

Additionally, if the construction company for the first hospital charges slightly more construction costs, the first hospital may even finish up with higher depreciation charges, even though the overall costs of the hospital may be less because of the tighter payment schedule.

- b. Some might argue that even if the expensing option is removed from the standard we would still not have an IPSAS that is converged with the IAS 23. The commentary in paragraphs 17 through 19 of IPSAS 5 (agenda item 9.3 Beijing meeting) is different from IAS 23. In our view this additional commentary is justified by public sector specific reasons. We do not think that this is a sufficient reason to retain the expensing option in IPSAS 5. By removing the expensing option IPSAS 5 is again converged with IAS 23 as it was before the IASB revised IAS 23 in 2007.



5. In conclusion

We confirm that there is no public sector specific reason to depart from IAS 23 by retaining the expensing option in IPSAS 5.

**Response to Analysis of ‘Applicable Expenditures’ Issue**

We agree that a sentence based on IAS 23 should be added to IPSAS 5. However, we would like staff to explain why the word ‘stipulation’ is used instead of ‘condition’.

Example: A government receives a grant subject to restrictions specifying the acquisition of an asset. Why should the government deduct the received grant when determining the amount to which the capitalization rate is applied? You could easily argue that the government didn’t use the grant for acquiring the asset altogether. Only a grant subject to a condition specifying the acquisition of an asset is an objective indication that the grant is indeed used to acquire the asset otherwise the grant would have to be returned to the grantor.

**Comments on Removal of Option of  
Expensing Borrowing Cost in IPSAS 5**

**Tadashi Sekikawa  
Japanese Member of IPSASB**

I still retain my view expressed in my letter before the Beijing meeting (supportive of removal of expensing option). However, I think that IPSASB should issue a short consultation paper to make a final decision rather than directly issue an exposure draft as proposed in the agenda paper 9 of the Beijing meeting. The consultation paper would indicate our preliminary view together with discussion of issues raised. Minority views (alternative views may be present in the consultation paper if we do not occlude to our preliminary view).

I also have following comments agenda paper for the Beijing meeting.

1. I do not think that scope exclusion of asset measured under the revaluation model would be a good solution. Current IPSAS 17 (and current IAS 16) have an existing unresolved issue how to apply DRC approach, i.e. whether a DRC notion include normal assumed borrowing cost or not. (My preliminary view is that DRC does include assumed borrowing cost, but I have not a firm idea how to calculate it) Preferable approach is treating the issue directly. Since this is also an issue in IAS 16, I propose to seek their view on the matter.
2. I doubt appropriateness of IASB's staff informal views that the scope exclusion of IAS 23 applies to the asset revalued under IAS 16. BC 4 of IAS 23 imply that IASB scoped out such asset because the bottom line would be the same, therefore capitalization is unnecessary. There would be the different bottom line when borrowing costs are capitalized or not for the revalued fixed assets.



**מדינת ישראל**  
משרד האוצר - אגף החשב הכללי  
היחידה לחשבונאות ודיווח

Wednesday, February 13, 2008

Dear Stephenie

First of all I would like to apologize for my late response.

In this phase I will address the changes suggested on IPSAS 5 borrowing costs. In the following weeks, as possible, I will address the latter.

Generally speaking, I agree with the suggested concept that the cost of asset will include all of the expenses spent to bring the asset to a ready state either for use or sale. The attributed costs should include the accumulated borrowing costs and I will like to address two situations:

1. Direct credit used for forming specific assets – in such case there is no dispute on the question of attributing the direct borrowing cost to the asset and I agree that these costs must be attributed to the asset. It is generally easy to identify these costs.
2. General credit used for a specific purpose and a general purpose – these cases are not, theoretically speaking, different from the cases of direct credit. since that in this case the credit was used, also, to establish asset and for standard operation. the principal difference is the entity's ability to appropriately attribute the borrowing cost to the asset, since that in such cases it is required to conduct approximations that may be very complex. One may presume that these cases are exposed to diversions from the required quality characteristics of financial reporting as mentioned in IPSAS 1. The main concern is the exposure to estimates that may divert the financial outcome. Another concern is the overwhelming cost that has to be put in a mechanism that can identify these costs and the incurring imbalance between the cost of extracting this information and advantage of displaying it. For example the government of Israel spends 16% of it's annual budget on interest payment of it's outstanding debt, forming a mechanism that will allow the attribution of such borrowing costs to assets will require a yearly mapping of all projects on a government level and identifying all costs attributed to these projects and applying a mechanism to attribute these borrowing costs.

**Conclusions and recommendations:**

Attributing specific borrowing costs to asset will be carried out as ordered in IPSAS 5 suggestion. never the less attributing non specific borrowing costs to

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רח' קפלן 1 הקריה, ירושלים טל': 02-5317151 פקס: 02-5695359  
1 Kaplan St. Hakirya, Jerusalem Israel Tel: 972-2-5317151

[www.gov.il](http://www.gov.il) : שער הממשלה



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## מדינת ישראל

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assets will expose the financial reporting process, in to one that will be greatly exposed to diversion and will create a great imbalance as to cost vs. benefit.

In IPSAS 5 suggestion the definition of "an able property" is an asset that it's preparation for use or sale requires a significant amount of time, the standard dose not determine what is a significant amount of time. One my presume that the longer the time that is required to form an asset the grater are the borrowing costs formed to the entity. If this is so, I suggest that an entity will determine for its self what is a significant amount of time and on that bases will attribute non specific borrowing costs.

Based on a preliminary examination that the government of Israel has conducted, it will be possible, with reasonable resources that justifies its cost, to determine an able property as one that the amount of time required for it's preparation is three years or more. For these assts only the entity will attribute non specific borrowing costs, Of course that every entity will determine that length of time of its self.

Regards,

Yossi Izkovich, CPA  
Chief Accountant  
Ministry Of Finance, government of Israel  
Tel: ++972-2-5317558  
Fax: ++972-2-5695359

## **Analysis of Member Comments in the context of the “Guidelines for Modifying IASB Documents” (Rules of the Road)**

### **Capitalizing Borrowing Costs**

In order to analyze the issues, it is important to understand the basis for the position set out in IAS 23, Borrowing Costs”.

IAS 23 should be considered in the context of IAS 16, “Property, Plant and Equipment” which requires that property, plant and equipment initially be measured at cost. “Cost” is defined as “the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognized in accordance with the specific requirements of other IFRSs, e.g. IFRS 2, ‘Share-based Payment’.” IAS 16 also specifies that the cost of an item includes capitalized interest in respect of a self-constructed item of property, plant and equipment. IAS 23 provides the requirements for determining which borrowing costs are to be included in the cost of an item of property, plant and equipment. In terms of recognizing an item at its historical cost, the IASB’s view is that if the entity borrows to finance the construction or manufacture of a qualifying asset, then the borrowing costs incurred during the period of time it takes to get the asset ready for use are part of the cost base.

IPSAS 17, “Property, Plant and Equipment” is based on IAS 16, and has the same requirement for initial recognition of assets. However, for assets acquired through non-exchange transactions, cost is measured at the fair value of the asset as at the date of acquisition. Therefore, for such assets, borrowing costs should not be included in the cost base.

IAS 16 and IPSAS 17 require that subsequent to initial recognition an asset shall be measured either at cost less accumulated depreciation and any accumulated impairment loss, or at fair value. Both standards require that where an asset is carried at fair value, revaluations shall be made with sufficient regularity to ensure that the carrying amount is not materially different from the asset’s fair value as at the reporting date.

The position taken in IAS 23 is that where an entity borrows to facilitate the acquisition of a qualifying asset, those borrowing costs shall be included in the cost base for that qualifying asset. The cost to the entity of an asset may be more than the asset’s fair value. The same situation can occur in reporting entities that prepare financial statements in accordance with IPSASs.

### **IASB’s Basis for Conclusions**

In 2007 the IASB eliminated the option of expensing borrowing costs. It did this as part of a short-term convergence project with the FASB’s SFAS 34. The IASB noted the objections of many respondents to its exposure draft including that:

- a) Borrowing costs should not be the subject of a short-term convergence project.

- b) The IASB had not explored in sufficient detail the merits of both accounting options.
- c) The proposal did not result in benefits for users of financial statements because:
  - a. It addressed only one of the differences between IAS 23 and SFAS 34.
  - b. Comparability would not be enhanced because the capital structure of an entity could affect the cost of an asset.
  - c. Credit analysts reverse capitalized borrowing costs when calculating coverage ratios.
- d) The costs of implementing the capitalization model in IAS 23 would be burdensome.
- e) The proposal was not consistent with the IASB's approach on other projects (in particular, the second phase of the Business Combinations project).

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 IASB reasoned that recognizing immediately as an expense borrowing costs relating to qualifying assets does not give a faithful representation of the cost of the asset to the entity.

### **IPSASB Responses to November 2007 Staff Analysis**

As noted in Item 7.0 members were asked to provide their views on the staff analysis of this proposal to remove the expensing option. Seven IPSASB members provided feedback on the issues. The views of these 7 respondents were polarized with 4 opposed to removing the expensing option and 3 in favor of removing the option to be more closely converged with IAS 23.

Appendix 7.2 provides a "cut and paste" of comments by issue while Appendices 7.3.001 – 7.3.007 provide the detailed responses received.

Respondents raised a number of issues to support their positions.

#### *i) Central Borrowing versus Project Financing*

Of the seven respondents, 3 (001, 002, 003) raised the central borrowing issue as a major public sector difference that would warrant a departure. Two respondents (005, 007) who favor deleting the expensing option specifically commented that they did not agree with this argument.

Members argued that central borrowing is more common in the public sector than in the for-profit sector and is a reason for departure from the provisions of IAS 23. The members note that typically a treasury department will be responsible for managing a government's debt portfolio, and that the approval of capital projects, such as the acquisition of qualifying assets, would be the responsibility of a different ministry or

department. While approval of projects is not entirely divorced from financing considerations, project financing is not common in this form of government. Members argued that the scale of these borrowings and the diversity of controlled entities acquiring qualifying assets are such that, while it is technically feasible to develop systems to allocate these costs, the cost of developing and maintaining those systems would outweigh the benefits.

Central borrowing is very common particularly for large governments with many controlled entities engaging in the acquisition of qualifying assets and that these borrowings are almost never secured by a charge against the assets of a public sector entity. However, project financing is also present in the public sector, and may be more or less common than central borrowing depending on the jurisdiction. In a number of jurisdictions balanced budget legislation forbids governments or public sector entities from borrowing to finance current expenditures, and the only form of borrowing permitted is for the acquisition of non-current assets, typically assets satisfying the definition of “qualifying asset”. Even in jurisdictions where central borrowing is common, project financing may be undertaken, including where a controlled entity borrows the project funds from the controlling entity, which may or may not have external debt itself.

In the context of central borrowing, in a significant number of jurisdictions governments develop budgets and appropriate resources on the basis of current and capital appropriations, with capital appropriations being allocated for the acquisition of non-current assets. These appropriations focus on the “use of cash” side of the statement of cash flows. On the sources of cash side of the statement of cash flows, the government will either budget for a deficit or a surplus, and often the notion that it can avoid a deficit by not acquiring assets is not entertained seriously. The IPSAS 2, “Cash Flow Statements” does make the distinction between cash flows for and from operating activities and those for and from investing activities, however, for most governments the cash flows for investing activities (such as the acquisition of non-current assets) are not directly related to the cash flows from investing activities (such as the issuing of bonds).

Members noted that central borrowing is also used as a tool for managing fiscal and monetary policy. Some governments that do not need to borrow money for any purpose, nevertheless issue bonds to provide a benchmark security for the bond market.

The IASB considered the issue of central borrowing and concluded that those borrowings that could have been avoided if the qualifying assets were not acquired should be allocated to the qualifying assets in the process of being readied for use during the period should be allocated to those assets. One member noted that the scale of such activities in the public sector is far greater than in the private sector and that this in itself constitutes a public sector reason for varying from IAS 23.

*ii) Revalued Assets – scope*

Four responses (002, 004, 005, 006) provided feedback on the staff suggestion in November that the standard is not applicable to assets that subsequent to acquisition are measured on a revalued basis and therefore it minimizes the effect of borrowing costs. Three of these respondents (002, 004, 006) did not believe that the IASB has scoped out

revalued assets nor did they think it a viable solution for IPSASB to scope these out. One respondent (005) did agree with the proposal to scope these out of the standard.

One member argued that revaluation of assets in the public sector is much more common than in the private sector, and further, that the use of depreciated replacement cost (DRC) is more commonly used as a valuation technique. The member highlighted this a reason for varying from the provisions of IAS 23.

The IASB is aware that there are revaluation issues in respect of property, plant and equipment and investment property. In respect of classes of assets carried at revalued amounts, if a qualifying asset were acquired during the period, and borrowing costs were included in the cost of acquisition, as soon as the asset class is revalued, those borrowing costs are no longer relevant. There is a concern that there may be undue effort and expense incurred to allocate costs when the asset is included in a class of assets that is expected to be revalued at the end of the reporting period.

IAS 23 is prescribing costs to be included in the cost base of an asset on initial recognition, revaluation is a basis for subsequent measurement, and therefore whether or not a class of assets is revalued does not determine the measurement of an asset on initial recognition. The exclusion in IAS 23 would, however, apply to inventories, investment property or property, plant and equipment acquired through a non-exchange transaction, as these are initially measured at fair value.

*iii) IPSAS 5 and IAS 23 Not Fully Converged*

Three respondents (001, 002, 005) commented on the fact that even if this particular issue was converged with IAS 23, IPSAS 5 would still include some departures and therefore would not be fully converged at any rate. Two of these respondents (001, 002) thought this was support for retaining the expensing option while the third respondent (005) thought this reasoning insufficient.

When IPSAS 5 was first developed, certain departures were assessed as appropriate for the public sector at that time. When undertaking the general improvements project and these projects to update existing IPSASs to reflect changes to equivalent IFRSs, the decision of the Board was to focus only on the changes being made and not to revisit previous decisions.

Therefore, in undertaking this update of IPSAS 5, staff have focused only on the new areas of change, consistent with this approach. Staff has specifically not revisited existing departures that did not change when the related IFRS was revised.

If this is the agreed upon process, then the fact that other departures exist should not be used as a rationale to make or not make modifications. Rather, any changes should be made in the context of considering rules of the road and the appropriateness of the specific change for the public sector as opposed to whether or the entire IPSAS is converged or not.

The responses however do raise the point that the IPSASB may want to reconsider its approach to updating IPSASs and consider whether consideration of all of the issues



within the IPSAS should be undertaken. This would significantly slow down the process of IFRS convergence and staff is of the view that this is not the best use of IPSASB's scarce resources.

*iv) Convergence with Statistical Bases of Accounting*

Three members (002, 003, 005) have noted that the statistical bases of accounting require that borrowing costs be recognized as an expense in the period in which they are incurred. Two of these respondents (002, 003) thought this a factor supporting retaining the expensing option. Respondent 005 argued that IFRS convergence takes precedence over convergence with the statistical bases of financial reporting.

The IASB does not consider the statistical bases of reporting when they develop IFRSs. Allowing entities a choice between capitalization and expensing of borrowing costs would permit entities to converge with the statistical bases or with IFRSs, depending on the entity's priorities. Requiring the capitalization of borrowing costs would not permit entities to converge with the statistical bases.

The IPSASB's strategy and workplan over the next 2 years includes four strategic themes, all of equal priority. One of these is IFRS convergence. Another is public sector specific projects, including convergence with the statistical bases where appropriate. It is important to note that while convergence with the statistical bases is a consideration, it is not a strategic theme on its own. It is very specifically included as a factor in the theme related to public sector specific projects and is qualified by "where appropriate". Staff are of the understanding that convergence with the statistical bases may be a factor in developing some standards, it is not an overriding objective or goal on its own. This is distinctly different from IFRS convergence which is a clear strategic objective. Arguably this means that IFRS convergence takes precedence over statistical convergence.

Fundamentally the overriding approach when considering any IFRS convergence project should be the application of the rules of the road in assessing public sector differences.

*v) Cost/Benefit Arguments*

Five respondents (001, 002, 004, 005, 007) provided feedback on whether the costs of implementing this proposal would outweigh the benefits. Views in this area were mixed. Three of the respondents (001, 002, 004) argued that the cost of applying these IAS changes exceeds the benefits to the public sector though only respondent 002 provided specifics. Respondent 002 was particularly vociferous in this view arguing that additional compliance costs and demands on resources would be high because of the significantly different structures in the public sector and the resulting variations in accounting and management systems which would make tracking borrowing costs complex.

One respondent (005) noted an example where jurisdictions have been applying the capitalization approach even for centrally administered funds and have not had significant issues. Another respondent (007) noted that a preliminary assessment had been done in his national government that indicated that the standards could be applied and the costs justified.

The point has also been made that in some jurisdictions existing processes in place may be able to be enhanced without the incurrence of significant costs or additional burden to meet these reporting requirements. Arguably it is more likely that the public sector will have procedures in place to approve proposed projects for capital expenditure for accountability reasons. Once a project is approved it is usually monitored and borrowing costs could be an additional item to be monitored under an existing process. If similar accountability mechanisms exist in most jurisdictions it may not be as burdensome as thought to implement the proposals.

*vi) Small and Medium Entity Standard*

Two members (001, 002) noted that the IASB's exposure draft of the proposed standard for small and medium entities (SMEs) requires entities to expense borrowing costs. The members questioned which IASB standard the IPSASB is converging with.

The current process for IFRS convergence is very clear that convergence is with existing IASs/IFRSs. IPSAS 5 was developed directly from IAS 23, not the SME proposed standard, and the proposed revisions to IPSAS 5 reflect amendments to IAS 23, not the SME proposed standard.

At its planning meeting in March 2007 the IPSASB considered whether to undertake an SME project and made a decision not to add it to the work plan at that time. The work plan will be reconsidered at this meeting and SMEs will be one of the projects to be discussed. However, at this point this particular project on IPSAS 5 is directly related to IAS 23, not to the SME proposed standard.

Convergence with the SME proposed standard would mean deleting the capitalization option. It is the IPSASB's prerogative to consider that approach but staff are of the view that this would fundamentally change the nature of this updating project. There are a host of considerations that would need to be evaluated in the context on an SME project for the public sector. If this is the IPSASB's desire staff are of the view that this particular project would need to be suspended and the issue considered in the context of a bigger project on SMEs.

*Creation of Perverse Incentives*

One member noted that permitting or requiring entities to capitalize borrowing costs creates perverse incentives because it requires entities to include in an asset's carrying amount costs which would otherwise be recognized as an expense. Thus an entity could improve both its financial position and its financial performance by capitalizing borrowing costs. Entities which would otherwise not borrow, could have a perverse incentive to borrow for specific projects rather than finance them out of existing resources.

Staff would note that this situation also exists in the private sector and thus is not public sector specific. It should be noted however, that large governments with a broad tax base have a much greater capacity to raise debt than most private sector entities, and that the risk of bankruptcy and entity failure is not the same in the public sector as in the private

sector, so private sector entities have a greater incentive to manage their financial position more carefully.

*Reliability and Comparability*

Members noted that the fact that one entity borrows to acquire a qualifying asset and another does not, means that the one that borrows will recognize the asset at a higher amount than the entity that does not. Members argue that this compromises the comparability of financial statements, and the ability of users to rely on those financial statements for an accurate assessment of an entity's financial position and performance.

Staff note that these issues are not specific to the public sector, and that they apply equally in the private sector.

**Analysis -Applying the Rules of the Road**

In undertaking the analysis of this issue staff have started with the guidelines for modifying IASB documents (rules of the road) and have conducted an analysis of the issues raised, as identified above, in that context. The IPSASB was clear that it wanted staff to use the guidelines as a framework for analysis to support departures from IASB documents. Staff has therefore taken the approach of reviewing and analyzing comments received within these guidelines – the “rules of the road”.

***Step One: Are there public sector issues that warrant departure?***

As a reminder, the goal of applying these rules is to assess public sector issues to determine if they warrant a departure in recognition or measurement or in presentation or disclosure.

In determining whether there is a public sector issue that warrants a departure from an IASB document, the following rules would be observed:

1. Where applying the international accounting standards/interpretations would mean the objectives of public sector financial reporting would not be met.
2. Where applying the international accounting standards/interpretations would result in a loss of accountability to stakeholders.
3. Where applying the international accounting standards/interpretations would mean the qualitative characteristics of public sector financial reporting would not be met.
4. Where the cost of applying the international accounting standards/interpretations exceeds the benefit.

So staff have considered the issues members raised by applying the questions:

- 1. Where applying the international accounting standards/interpretations would mean the objectives of public sector financial reporting would not be met.*

As set out in IPSAS 1, the objectives of general purpose financial reporting in the public sector should be to provide information useful for decision making and to demonstrate the accountability of the entity for the resources entrusted to it by:

- a) Providing information about the sources, allocation and uses of financial resources;
- b) Providing information about how the entity financed its activities and met its cash requirements;
- c) Providing information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and commitments;
- d) Providing information about the financial condition of the entity and changes in it; and
- e) Providing aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency and accomplishments. (para 15)

While the scale of central borrowing activities in the public sector may be greater than in the private sector, this is not the test to determine a departure under the rules of the road. Instead, the questions outlined above need to be considered as the filter for determining if there is a public sector difference that warrants a departure. Significance as compared to the private sector is not the filter to be used.

*2. Where applying the international accounting standards/interpretations would result in a loss of accountability to stakeholders.*

While some stakeholders would prefer the IPSASB retain the choice between expensing and capitalizing borrowing costs, other stakeholders clearly favor convergence with the IFRSs. Proponents and opponents of eliminating the expensing option will argue the conceptual benefits of each approach, and consensus may not, ultimately, be achievable. However, there does not appear to be a loss of accountability by converging with the provisions of IAS 23.

*3. Where applying the international accounting standards/interpretations would mean the qualitative characteristics of public sector financial reporting would not be met.*

The qualitative characteristics of financial reporting in the public sector are set out in IPSAS 1, Appendix B, and are:

- Understandability
- Relevance
- Materiality
- Reliability
- Faithful Representation
- Substance over form
- Neutrality
- Prudence
- Completeness
- Comparability

The qualitative characteristics are constrained by:

- Timeliness
- Balance between Benefit and Cost
- Balance between Qualitative Characteristics.

Members have argued that the qualitative characteristics of financial reporting would be jeopardized by the elimination of the expensing option, in particular the relevance, reliability, faithful representation and comparability criteria. Members arguments focus primarily on comparing an asset's carrying amount to its fair value, and thereby arguing that capitalizing borrowing costs has a tendency to inflate the carrying amount of an asset.

The aim of the IASB in revising IAS 23, is to determine the one of the elements of the cost of an asset. The cost of an asset to an entity is to an extent subject to the particular circumstances of the entity, so different entities will invariably pay different costs to acquire identical assets. Variables include not only the financing arrangements of the entity, but delivery and installation costs, regulatory fees and taxes. The IASB has determined that borrowing costs are included in the cost of a qualifying asset and that these meet their qualitative characteristics of financial reporting, which are identical to the IPSASB's.

*4. Where the cost of applying the international accounting standards/interpretations exceeds the benefit.*

Members argued that the cost of calculating the borrowing costs to be capitalized would exceed the benefits of providing that information to users. One member (002) provided specific information that indicated that the cost would outweigh the benefits. Two members (005 and 007) provided information that indicated the contrary.

The cost of providing information cannot be discounted but members have provided conflicting views on this issue. The IASB received similar arguments and concluded that the increased benefits in terms of higher comparability, improvements in financial reporting and achieving convergence with US GAAP exceed any additional costs of implementation. The IPSASB has not previously considered convergence with the GAAP of a particular nation to be a goal, however, convergence with IFRS is one of the IPSASB's strategic objectives.

*Alternatives Available*

Given the analysis in the rules of the road and considering the divergent views of members, there seem to be a number of alternatives available for the IPSASB to consider:

1. Proceed with the Exposure Draft as proposed in November 2007 (i.e. remove the option to expense borrowing costs) and include a more detailed specific matter for comment noting the differing views on whether capitalization of borrowing costs should be mandated.

2. Issue an ED that illustrates both options (permitting expensing and mandating capitalization), explains the pros and cons of each in the introductory material, and asks respondents for their view.
3. Issue an exposure draft that permits expensing of borrowing costs as an allowed alternative, with guidance indicating when expensing is appropriate. This would allow the other amendments to IPSAS 5 that are necessary to converge with IAS 23 to be made while retaining the current accounting options. This would presume a decision that there is a public sector reason for departure and therefore documentation of this rationale would be required in the basis for conclusions.

*Staff Recommendation*

Staff are of the view that option 1 is more consistent with the historic cost principles underpinning IAS 16 and IAS 23, as well as the current IPSAS 5, IPSAS 16 and IPSAS 17 and that the project should proceed as per option 1.

Staff have attached a draft ED at item 7.4 that can be adapted should any of options 1 – 3 be selected.

***Step Two: Are the departures so significant that a public sector specific project should be initiated?***

The goal of applying these rules is to determine if the public sector issues that warrant a departure from the related IASB document are so significant that a public sector specific project should be initiated. In considering this step the nature of the public sector issue identified and its significance would be considered. It is necessary to assess the issue and the adequacy with which it has been dealt with in the IASB document.

Staff are of the view that the IPSASB should be able to resolve the issues related to borrowing costs without initiating a public sector specific project. While there are mixed views on the issue of deleting the expensing option for borrowing costs, the alternatives to the IASB position can be readily addressed in the existing IPSAS, particularly considering that the most viable alternative is the existing IPSASB position. Therefore a new public sector specific project is deemed unnecessary.

***Step Three: Modify IASB Documents***

The goal of applying these rules is to set parameters on the modifications that would be made to an IASB documents to address public sector differences.

IPSASB staff have developed a draft exposure draft based on the current IAS 23, at attachment 7.2. All changes proposed were developed in the context of the guidelines for modifying IASB documents as set out in step 3.

***Step Four: Issue IPSAS converged (to varying degrees) with IASB Documents***

The goal of applying these rules is to identify changes in style and terminology that are applied to all IPSASs.

Since this is a project to update an existing IPSAS, much of this step has already been undertaken when IPSAS 5 was first developed. Additional changes have been made in line with the guidelines in step 4 and the basis for conclusions modified appropriately. Any additional required aspects of this step will be undertaken after the IPSASB considers responses to any exposure draft it issues as it finalizes the standard.

## **Cut and Paste of Member Comments**

### **Central Borrowing**

#### **001 – Neville**

I do NOT agree with the staff's proposal 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. I have reviewed the staff rationale for removing this option and I am not convinced that this rationale still addresses my concerns 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.

#### **002 – Batten**

The first concern addressed is the allocation of central borrowing costs when the funds are distributed to subsidiaries in various ways. As indicated by staff and discussed above IPSAS 5 diverges from IAS 23 (paragraphs 17 to 21 and 26 to 29) to effectively exempt subsidiaries from most of the impact of an economic entity policy of capitalizing borrowing costs on qualifying assets. What does not seem to be addressed is the application of this policy on the economic entity, for example a whole of Government. To the extent that the economic entity has incurred borrowing costs it will have to apply them to the applicable qualifying assets, with consequent depreciation impacts over many years. To be in compliance the economic entity will be required to maintain a large and very complex set of records and consolidation adjustments. These adjustments will in turn require audit verification. This is a substantial consumption of resources with very little benefit and over time will be prone to errors. In short, a nightmare. Possibly the best solution (other than retaining the expensing option) is to limit the application of paragraph 49 of IPSAS 6 in a way that the intentions of the amendments originally made to IPSAS 5 also are effective on the consolidated economic entity.

The second concern raised in the presentation seems to be where borrowing costs are not directly attributable. IAS 23 (and IPSAS 5 to the extent not exempted by paragraphs 17 to 21 and 26 to 29) addresses this by requiring the use of a weighted average interest rate where borrowings are not directly attributable. This provides an answer, but it is the application of this answer to all expenditures on qualifying assets, especially at the economic entity level, that is the problem. This is because of the large number of qualifying assets in numerous locations and subsidiaries, often in circumstances where the resources to effectively apply accrual accounting are limited.



**003 – Bergmann**

Central borrowing: We are of the view that central borrowing has a different notion in the public sector. While private sector enterprises centralize the financing function mainly to offer the investors/lenders a strategic package, the public sector does so mainly to save cost and perhaps improve compliance. From the investor's perspective it's usually not an investment into strategic activities, but a risk free lending to a prime borrower. Thus, both from the preparer's and the user's perspective, the situation is different from private sector. Perhaps, at least from the preparer's perspective, it's more similar to the SME situation, in which also IAS retains the expensing option.

In our view, also the consequences for consolidated and separate financial statements would be critical in the public sector. There is strong resistance against consolidation in the public sector. By increasing the complexity in this area, we would certainly jeopardize our goal of whole of government reporting. We think the compliance with IAS 23 is not worth putting this more fundamental goal at risk.

**005 – van Schaik**

**Difficulties in capitalizing borrowing costs where borrowing is administered centrally**

In general we agree with staff's analysis and the conclusion that central borrowing administration does not lead to a different treatment from IAS 23. We would like to make the following observations:

- In respect of the phrase 'directly attributable' we do not think that pooling of borrowing costs is a sufficient reason to conclude that there is no direct link between the borrowing costs and the incurring of the outlays. Our interpretation of paragraph
- In the Netherlands most municipalities have been using the capitalization approach for many years in combination with generally borrowed and centrally administered funds, even though they are not obliged to. This doesn't seem to be onerous, nor does it have difficult audit implications.

**007 – Izkovich**

Generally speaking, I agree with the suggested concept that the cost of asset will include all of the expenses spent to bring the asset to a ready state either for use or sale. The attributed costs should include the accumulated borrowing costs and I will like to address two situations:

1. Direct credit used for forming specific assets – in such case there is no dispute on the question of attributing the direct borrowing cost to the asset and I agree that these costs must be attributed to the asset. It is generally easy to identify these costs.
2. General credit used for a specific purpose and a general purpose – these cases are not, theoretically speaking, different from the cases of direct credit. since that in this case the credit was used, also, to establish asset and for standard operation . the principal difference is the entity's ability to appropriately attribute the borrowing cost to the asset, since that in such cases it is required to conduct approximations that may be very complex. One may presume that these cases are exposed to diversions from the required quality characteristics of financial

reporting as mentioned in IPSAS 1. The main concern is the exposure to estimates that may divert the financial outcome. Another concern is the overwhelming cost that has to be put in a mechanism that can identify these costs and the incurring imbalance between the cost of extracting this information and advantage of displaying it. For example the government of Israel spends 16% of its annual budget on interest payment of its outstanding debt, forming a mechanism that will allow the attribution of such borrowing costs to assets will require a yearly mapping of all projects on a government level and identifying all costs attributed to these projects and applying a mechanism to attribute these borrowing costs.

**Conclusions and recommendations:**

Attributing specific borrowing costs to asset will be carried out as ordered in IPSAS 5 suggestion. never the less attributing non specific borrowing costs to assets will expose the financial reporting process, in to one that will be greatly exposed to diversion and will create a great imbalance as to cost vs. benefit.

In IPSAS 5 suggestion the definition of "qualifying asset" is an asset that it's preparation for use or sale requires a significant amount of time, the standard does not determine what is a significant amount of time. One may presume that the longer the time that is required to form an asset the greater are the borrowing costs formed to the entity. If this is so, I suggest that an entity will determine for itself what is a significant amount of time and on that basis will attribute non-specific borrowing costs.

## **Revalued Assets**

### **002 – Batten**

I disagree with the analysis presented that this standard is not applicable to assets that subsequent to acquisition are measured on a revalued basis, and therefore it minimizes the effect of borrowing costs. My understanding is that the staff of the Australian ASB queried the application with relevant IASB staff who confirmed that, during the construction stage, assets under IAS 16 are on a cost basis and therefore borrowing costs apply. This coincides with my interpretation of the impacts of IAS 16 and IAS 23, which I believe is supported by IAS 23 BC4 as quoted. Consequently the compliance pain remains during the construction stage, and afterwards at least until the asset is subsequently revalued, which could be several years.

As a separate matter, I think that there are also concerns about the measurement of revalued assets. For many government assets this is measured on a depreciated replacement cost basis. If the government's policy is to capitalize borrowing costs on construction, to what extent should borrowing costs be included in the measurement of depreciated replacement cost? I'm not sure that the scope exclusion proposed to be transferred from IAS 23 overcomes this issue, but I would be interested to hear from members with more expertise in this area.

Finally, as discussed above I have concerns about the conceptual arguments and do not think that they are fully addressed in the basis of conclusions. They don't seem to have

been overwhelming when the IASB drafted the SME standard. It's noteworthy that the expensing option was headed "Benchmark Treatment" in previous versions of IAS 23.

#### **004 – Schollum**

In my view, two qualitative characteristics (reliability and comparability) will be compromised by the compulsory capitalisation of borrowing costs.

Reliability will be compromised as compulsory capitalisation of borrowing costs will also mean compulsory inclusion of borrowing costs into revaluations of these assets. 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.

The problem is that there is currently no guidance as to how the borrowing cost component should be incorporated into assessments of fair value of most public sector assets. As most public sector assets that are revalued are done so on the basis of Depreciated Replacement Cost (DRC), appropriate guidance needs to be developed which is consistent with the notion of DRC, i.e. reflecting the remaining service potential embodied in the asset.

I am aware that DRC is sometimes used by profit oriented entities (e.g. GBEs and private sector entities) to revalue assets, but such valuations are carried out in the context of a cash flow based valuation cap. On the other hand, DRC valuations for public sector entities other than GBEs do not have a cross check to a cash flow based valuation figure, as the assets are non cash generating. This increases the risk that DRC may no longer represent a good proxy for fair value.

There is therefore 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.

Also, comparability will be compromised because of the numerous capital structures (i.e. debt/equity ratios) which exist among public sector entities around the world. The only way to enhance comparability would be to require expensing rather than prohibit it.

...

#### **Why the scope of IPSAS 5 is not the same as IAS 23**

IAS 23 currently scopes out qualifying assets measured at fair value (e.g. biological assets) and IPSASB staff have, after 'informally' checking with IASB staff, concluded that this means any asset carried at fair value is scoped out of IAS 23.

Institute staff in New Zealand and AASB staff in Australia have separately concluded that the scope exclusion in IAS 23 relates only to those assets that were initially recognised at fair value as opposed to assets such as property, plant and equipment which

are initially recognised at cost and subsequently revalued. Entities with assets initially recognised at cost would typically capitalise borrowing costs as part of accumulating the cost of those assets prior to any revaluation.

I suspect that if IPSASB staff more ‘formally’ check with IASB staff, it will become clear that the IASB had no intention of scoping out all revalued assets from IAS 23. (If this remains the IPSASB staff view, I suggest more formally checking with the IASB prior to the Toronto meeting).

Therefore, I don’t believe that we can simply scope all revalued assets out of IPSAS 5 unless the IPSASB clearly acknowledges that that is a departure from the IASB position or unless the IASB formally acknowledges all revalued assets are scoped out of IAS 23.

Then the question has to be asked, if we are consciously departing from the IASB position, why would we not just retain the expensing option?

**005 – van Schaik**

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

We agree with staff’s proposal to exclude from the scope qualifying assets carried measured at fair value.

**006 – Sekikawa**

I do not think that scope exclusion of asset measured under the revaluation model would be a good solution. Current IPSAS 17 (and current IAS 16) have an existing unresolved issue how to apply DRC approach, i.e. whether a DRC notion include normal assumed borrowing cost or not. (My preliminary view is that DRC does include assumed borrowing cost, but I have not a firm idea how to calculate it) Preferable approach is treating the issue directly. Since this is also an issue in IAS 16, I propose to seek their view on the matter.

I doubt appropriateness of IASB’s staff informal views that the scope exclusion of IAS 23 applies to the asset revalued under IAS 16. BC 4 of IAS 23 imply that IASB scoped out such asset because the bottom line would be the same, therefore capitalization is unnecessary. There would be the different bottom line when borrowing costs are capitalized or not for the revalued fixed assets.

**Cost/Benefit**

**001 – Neville**

My last point deals with the principles we adopted for our " Rules of the Road " on convergence. One of those principles included cost benefit as a reason for considering departure. If we were to accept the IAS standard, I would expect the cost to implement this proposal to exceed the benefit in reporting for the public sector.

**002 – Batten**

Fourthly, in developing our *Rules of the Road* we included cost benefit as a reason for considering departure. I believe that borrowing costs are clearly a circumstance where the cost of applying the IAS changes exceeds the benefit to a public sector reporter.

...

The third concern, which is where with my experience both in the private sector and government I would refute staff's opinion, is that additional compliance costs for the public sector would not be significantly different, presumably because of the similarity between a government undertaking central borrowing and a company group doing the same. While on the face of it the situations are very similar, the difference in organization and structure between say a listed profit seeking company and a government has a very different outcome. The listed company is only likely to have a few subsidiaries that undertake the construction of qualifying assets. All subsidiary entities will have boards that largely are made up either of board members of the parent entity or of management staff. The entire economic entity will act in a disciplined way and in particular will follow group policies and use common systems that, inter alia, produce regular financial and management reports both for individual entities and the entire group. In such a group, funding of subsidiaries will probably be made in the most tax effective way, but it will also be relatively simple to keep track on different bases for different reporting purposes. Moreover, the qualifying assets concerned will have depreciable lives that rarely exceed two or three decades. Those private sector economic entities affected by this standard generally will have the resources to handle the problem and can probably minimize the cost and impact.

By contrast, governments may have scores of subsidiary entities, with many of them constructing qualifying assets with depreciable lives of many decades. Although there will be a need to follow the general policies of government, many of these entities will have been set up deliberately with local, largely independent management boards. They are likely to have independent accounting resources and systems. And of course there is independence, competition and often inconsistency of reporting between departments and portfolio entities reflecting independence and equality between ministers under the Westminster system. Accounting and management systems in many jurisdictions reflect local and departmental reporting requirements, with occasional population of a summarized chart of accounts for whole of government reporting. Funding to departments is by means of parliamentary appropriation from a central fund without concern whether the fund holds monies from taxes or borrowed funds. The departments in turn either spend the appropriations or pass them on as grants. They may also allow subsidiary entities to borrow, usually from a central agency. Any system of accounts and records to track directly and indirectly attributable borrowing costs, their application to qualifying assets, and the subsequent depreciation impacts would be complex, resource demanding and costly.

To partially overcome this problem the existing IPSAS 5 revisions to paragraphs 17 to 21 and addition of paragraphs 26 to 28 simplify the application of this standard to subsidiary entities, although in a way that results in inconsistency with IAS 23. However a problem remains when preparing a consolidated financial report at the whole of government

(WoG) level. If you just consolidate the individual entities as they stand (which I think is the best approach, but probably needs clarification of the application of paragraph 49 of IPSASB 6) then borrowing costs at the WoG level will not have been applied to qualifying assets with consequential interest expense and depreciation impacts. Consequently unless paragraph 49 of IPSAS 6 does not apply, you will not be in compliance with the proposed IPSAS 5 with potential serious consequences including audit qualification. As an alternative you may set up a vast structure of notional lending, capitalization and depreciation accounts and supporting records as previously discussed so that on consolidation into the WoG position the results and position of qualifying assets that are in subsidiary entities following IPSAS 5 can be adjusted to reflect the borrowing costs at the WoG level. Apart from being very demanding of scarce accounting resources, very likely to go wrong over the decades it would have to operate, and confusing for any reader who wondered why two hospitals were at one figure in their local entity accounts but another in the WoG accounts, this second alternative seems to be completely contrary to the intention underlying the original changes to paragraphs 17 to 21 and 26 to 28 in IPSAS 5!

#### **004 – Schollum**

There is no doubt in my mind that significant additional costs will be incurred in the public sector environment with no increase in the benefit, during:

- the initial interest capitalisation process, particularly for whole of Government reporting where centralised borrowing is the norm and the borrowing is not ascribed at a lower level of reporting entity;
- incorporation into DRC valuations of a component for capitalised interest (i.e. additional costs incurred by valuers, preparers and auditors).

When faced with the current options to either expense or capitalise, very few public sector entities currently capitalise borrowing costs. This is no co-incidence in my view.

#### **005 – van Schaik**

In the Netherlands most municipalities have been using the capitalization approach for many years in combination with generally borrowed and centrally administered funds, even though they are not obliged to. This doesn't seem to be onerous, nor does it have difficult audit implications.

#### **007 – Izkovich**

Based on a preliminary examination that the government of Israel has conducted, it will be possible, with reasonable resources that justifies its cost, to determine a qualifying asset as one that the amount of time required for its preparation is three years or more. For these assets only the entity will attribute non-specific borrowing costs, Of course that every entity will determine that length of time of its self.

## **Statistical Bases**

### **002 – Batten**

Staff acknowledge this as a concern, but consider it inappropriate to rely on it as a reason for departure from IFRS. I don't see why, given that convergence with GFS is also a strategy of IPSASB. I disagree with staff's conclusion. Our strategy of convergence with IFRS is to obtain cost and efficiency benefits for both the board and our users, not to converge whatever the circumstances. Continuation of the existing choice easily enables GFS convergence which would be beneficial to a number of jurisdictions.

Staff also considers that the impact of the difference is minimized because their analysis is that assets at fair value are excluded. This is a weak argument, both because a small difference is still a difference and because I am not sure that the non application to revalued assets is as presented. See below

### **003 – Bergmann**

Convergence with statistical basis: We think that GFS is one of the most obvious public sector specific reasons to depart from IAS/IFRS. The staff proposal scoping out assets at fair value makes things even more cumbersome, as GFS does not measure at fair value in any particular case. Thus the staff proposal would greatly increase complexity as it creates yet another category of assets and liabilities which needs different treatment.

### **005 – van Schaik**

We agree with staff's analysis that there is no convergence issue here. Market value is the measurement basis under statistical accounting and application of IPSAS 5 (as well as IAS 23) is not required for qualifying assets measured at fair value. Furthermore, in our opinion convergence with IFRS takes precedence over convergence with statistical bases of financial reporting.

## **Other Departures in Standard**

### **001 – Neville**

Even if we made the change as suggested by the staff's proposal, the proposed IPSAS 5 would not be converged with the IASB equivalent. Paragraphs 17 to 21 in the proposed IPSAS 5 are different from the intent of IAS 23. In the proposed IPSAS 5, the revisions appear to restrict the application of the capitalization approach in a group situation, such as a government with many controlled entities, which is not the case in the IAS equivalent.

### **002 – Batten**

Firstly, even if we ignored the disadvantages of abandoning the benchmark expensing option and made the currently proposed changes to the standard, we would still not have an IPSAS standard that was converged with the IASB equivalent. This is because paragraphs 17 to 21 plus additional paragraphs 26, 27 and 28 in IPSAS 5 are different from IAS 23 in ways that result in significant differences in the application of the standard, in that subsidiary entities can ignore indirect borrowing costs that are incurred elsewhere in the economic entity. These existing revisions appear to restrict and simplify

the application of the capitalization approach in a group situation, such as a government with many controlled entities. These existing IPSAS 5 differences were presumably introduced to reduce the impact of the capitalization approach, and thus make application of this standard more cost effective.

Regrettably, these changes do not appear to benefit any whole of government entity trying to prepare consolidated financial statements which potentially is still required to make a huge range of consolidation adjustments. Nevertheless these revised/additional IPSAS 5 paragraphs remain and would still result in a non-converged standard. A new reader of the proposed amended standard might also be confused because these paragraphs refer to capitalization in a permissive rather than mandatory way. This is not an argument for currently revising paragraphs 17-21 and removing paragraphs 26 to 28. I do not believe that this should be done without full consideration by the Board, in the same way as the Board retained the exemption of fair valued assets from impairment in the absence of a full review of the standard for assets at fair value.

#### **005 – van Schaik**

Some might argue that even if the expensing option is removed from the standard we would still not have an IPSAS that is converged with the IAS 23. The commentary in paragraphs 17 through 19 of IPSAS 5 (agenda item 9.3 Beijing meeting) is different from IAS 23. In our view this additional commentary is justified by public sector specific reasons. We do not think that this is a sufficient reason to retain the expensing option in IPSAS 5. By removing the expensing option IPSAS 5 is again converged with IAS 23 as it was before the IASB revised IAS 23 in 2007.

### **SMEs**

#### **001 – Neville**

It is my understanding that there are two IASB standards that deal with this issue, one for large enterprises and one for small and medium enterprises. Again, it is my understanding that the IASB standard for small and medium size enterprises allows a choice between expensing or capitalizing interest costs. If so, then we have a dilemma. I would venture to guess that a large number of our constituents fall under the small to medium size enterprises umbrella, as well. Therefore, how would we deal with those constituents if we were to remove the expense option from the proposed IPSAS?

#### **002 – Batten**

Secondly, with which IASB standard are we converging? The proposed IASB standard for small and medium enterprises (SME) takes the expensing approach to interest costs. This was apparently decided on a cost benefit approach, but shows that the IASB is not totally wedded to the capitalization of interest costs. I would suggest that many of our constituents, with the possible exception of some national and a few major state or provincial governments are no better resourced with accountants than the typical enterprise that the IASB was considering when it drafted its SME standard. I therefore consider that it would be equally appropriate for IPSASB to converge to the SME standard and remove the capitalization option.



**Exposure Draft XX**

MM YYYY

Comments are requested by MM DD, XXXX

*Proposed International Public Sector Accounting  
Standard*

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# 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  
Toronto, Ontario M5V 3H2 CANADA

Email responses should be sent to: [EDComments@ifac.org](mailto:EDComments@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).

The approved text of the IFRSs is that published by the IASB in the English language, and copies may be obtained directly from IASB Publications Department, 30 Cannon Street, London EC4M 6XH, United Kingdom.

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

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## **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)<sup>1</sup> – 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.

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<sup>1</sup> 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:

- 4.—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. This proposal occasioned considerable debate within the IPSASB. Some members were of the view that the way in which central borrowing is used as a tool of fiscal and monetary policy is so different to the manner in which centralized borrowing is used in the private sector, that the cost of such borrowings should not be allocated to the cost of acquisition of qualifying assets. Other members disagreed and were of the view that IPSAS 5 should be converged as much as possible with IAS 23. Some members were also of the view that the option to expense all borrowing costs in the period in which they are incurred should be retained to facilitate convergence of IPSASs with statistical bases of accounting, which require the recognition of expenses in relation to borrowing costs. Whilst the IPSASB did not, ultimately, reach a consensus on this issue, it felt that it was important to canvas the views of constituents to determine the most appropriate principles to include within the IPSASs. The IPSASB will make a final decision on whether to require capitalization, or retain the option to recognize an expense, after it considers the responses to this exposure draft.

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 acquired through a non-exchange transaction and measured initially at fair value under IPSASs 12, 16 or 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**  
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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 acquired through a non-exchange transaction and initially measured at fair value under IPSAS 12, 16 or 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.

IN7. The Standard makes the previous allowed alternative option of capitalizing borrowing costs attributable to the acquisition, construction or production of a qualifying asset the benchmark treatment. The previous benchmark treatment of expensing borrowing costs is now an allowed alternative treatment.

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.

Alternative paragraph IN7. To be used if IPSASB decide to retain expensing as an option for the ED.

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.

IN 11 would not be required if the IPSASB decide to retain the expensing option.

### **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 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. ~~The~~is 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 acquired through a non-exchange transaction and initially measured at fair value under IPSAS 12, 16 or 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. Staff are of the view that the IAS 23 only excludes from its scope assets that are initially measured at fair value. IAS 23 does not address the subsequent measurement of assets.

## 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) ~~o~~Office buildings;
  - (c) ~~h~~Hospitals;
  - (d) ~~i~~Infrastructure assets such as roads, bridges



- (e) ~~And~~ 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 themthey 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 StandardOther 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—Allowed Alternative Treatment

### Recognition

- 11A. Borrowing costs should be recognized as an expense in the period in which they are incurred.

Text that would be included if the IPSASB elect to retain the expensing option for the ED.

11B. Under the allowed alternative treatment, borrowing costs are recognized as an expense in the period in which they are incurred, regardless of how the borrowings are applied.

This text may be included if the IPSASB decides to retain the expensing option for the exposure draft.

### **Disclosure**

11C. The financial statements should disclose the accounting policy adopted for borrowing costs.

### **Use of the Allowed Alternative Treatment**

11D. Use of the allowed alternative treatment may be appropriate where a public sector entity, including a national government, uses borrowing primarily as an instrument of monetary or fiscal policy, for example, to maintain a benchmark bond within the debt securities market. Use of the allowed alternative treatment will generally be appropriate where there is no discernible relationship between borrowings and outlays on non-current assets, or where the reporting entity has a stated accounting policy of converging financial reporting with statistical bases of reporting.

11E. Use of the allowed alternative treatment will be inappropriate where there is a clear relationship between borrowing and the acquisition of a qualifying asset. For example, if borrowings are secured by a charge on the qualifying asset, or the entity is required by law or binding agreement to borrow only to acquire non-current assets, use of the allowed alternative treatment would be inappropriate. In jurisdictions where, for example, a public sector entity requires approval from constituents to issue bonds to construct specific non-current assets, then the use of benchmark treatment is clearly indicated.

### **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 determined 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 capitalized~~ during a 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 disclose:

- ~~(a) The accounting policy adopted for borrowing costs;~~
- ~~(b)~~ (a) The amount of borrowing costs capitalized during the period; and
- ~~(c)~~ (b) 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).

Sub-paragraph (a) will be reinstated if the IPSASB decides to retain the expensing option for the ED.

## **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.

If the IPSASB decides to retain the expensing option for the ED, paragraph A1 would not be required, Paragraphs A2 – A4 would be modified to refer to the benchmark treatment in IPSAS 5.

## **Illustrative Examples**

### **Benchmark Treatment**

Municipal Government A is subject to a constitutional restriction requiring it to balance its budget. Under the law, Government A may only issue debt to develop public infrastructure, and in such cases it requires the approval of voters in a ballot initiative.

In 20X8, Government A decides to build a new subway line for its transit system. The estimated cost of the subway line is CU2,000,000,000. It will finance this by a bond issue. In November 2008 during the legislative elections, Government A includes a question asking the voters for approval to issue bonds to finance the building of the subway line. It receives approval from the majority of voters.

#### *Analysis*

The bond issue is clearly related to the construction of a qualifying asset. Government A should use the benchmark treatment and capitalize those borrowing costs incurred to ready the subway line for use.

### **Allowed Alternative Treatment**

National Government B has a range of responsibilities including providing infrastructure, education and healthcare for the citizens of its country, it is also responsible for regulating the financial markets and developing appropriate monetary and fiscal policies. There are no laws or binding arrangements that restrict its ability to borrow or lend funds. Government B has net assets of CU500,000,000,000 and in the previous reporting period recognized a net surplus of CU20,000,000,000, this was the seventh consecutive year in which it recognized a net surplus.

Government B takes the view that a liquid debt securities market is a necessary component of its monetary policy, consequently it has a policy of maintaining CU100,000,000,000 in sovereign debt securities on issue to ensure that there is a benchmark bond available for the national securities market. The proceeds of these debt securities are invested in Government A's sovereign wealth fund, which currently has a balance of CU150,000,000,000. This fund invests in a wide range of equity and debt securities, commodities and property, both in country B and internationally.

In 20X0 Government B decides to build a high speed rail line between two major cities. The estimated cost of the rail line is CU2,000,000,000. Government B will finance the construction of the rail line from its accumulated surpluses.

#### *Analysis*

The CU100,000,000,000 in bonds that Government B has in the debt securities market are issued for monetary policy purposes and are unrelated to the decision to construct a rail line. The rail line is to be financed from its accumulated surpluses. In these circumstances adopting the allowed alternative treatment may be appropriate.

## **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](http://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.

### *Allowed Alternative Treatment*

- BC5A. The IPSASB is of the view that in the public sector borrowings are used as a tool of fiscal and monetary policy and not solely as a financing tool. The IPSASB has also identified that convergence of financial reporting with reporting under the statistical bases of accounting is an important feature of the public sector in a number of jurisdictions. In recognition of these factors, the IPSASB has decided to retain the option to expense borrowing costs as an allowed alternative treatment. The IPSASB has, however, identified those circumstances where it may be appropriate to use the allowed alternative treatment, and those circumstances where it is inappropriate to use the allowed alternative treatment.
- BC5B. The IPSASB considers that it may be appropriate to use the allowed alternative treatment where a public sector issues debt instruments primarily as a fiscal or monetary policy tool, for example to maintain a benchmark bond in the debt securities market. The IPSASB also considers

These paragraphs would be included if the IPSASB elects to retain the expensing option for the ED.



it appropriate to use the allowed alternative treatment where the entity has a stated policy of converging financial reporting with the statistical bases of reporting.

- BC5C. The IPSASB considers it inappropriate to use the allowed alternative treatment where there is a clear connection between the borrowing and the acquisition of a qualifying asset. In these circumstances, the borrowing would have been avoided if the entity had not decided to acquire the asset, therefore, in accordance with the principles of historic cost accounting, the borrowing costs are part of the cost base of the acquired asset.

*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.

If the IPSASB decides to retain the expensing option for the ED, this amendment is still required because in Example 2 the borrowings are clearly related to the construction of the hydroelectric dam, and capitalizing would be appropriate.

**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.

| <b>Superseded<br/>IPSAS 5<br/>paragraphs</b> | <b>Current<br/>IPSAS 5<br/>paragraph</b> | <b>Superseded<br/>IPSAS 5<br/>paragraphs</b> | <b>Current<br/>IPSAS 5<br/>paragraph</b> | <b>Superseded<br/>IPSAS 5<br/>paragraphs</b> | <b>Current<br/>IPSAS 5<br/>paragraph</b> |
|----------------------------------------------|------------------------------------------|----------------------------------------------|------------------------------------------|----------------------------------------------|------------------------------------------|
| Objective                                    | 1                                        | 17                                           | 10                                       | 34                                           | 25                                       |
| 1                                            | 2                                        | 18                                           | None                                     | 35                                           | 26                                       |
| 2                                            | 3                                        | 19                                           | 11                                       | 36                                           | 27                                       |
| 3                                            | 4                                        | 20                                           | None                                     | 37                                           | 28                                       |
| 4                                            | 5                                        | 21                                           | 12                                       | 38                                           | 29                                       |
| 5                                            | 7                                        | 22                                           | 13                                       | 39                                           | 30                                       |
| 6                                            | 8                                        | 23                                           | 14                                       | 40                                           | 31                                       |
| 7                                            | None                                     | 24                                           | 15                                       | 41                                           | 32                                       |
| 8                                            | None                                     | 25                                           | 16                                       | 42                                           | 34                                       |
| 9                                            | None                                     | 26                                           | 17                                       | 43                                           | 35                                       |
| 10                                           | None                                     | 27                                           | 18                                       | None                                         | 6                                        |
| 11                                           | None                                     | 28                                           | 19                                       | <u>None</u>                                  | <u>11D</u>                               |
| 12                                           | None                                     | 29                                           | 20                                       | <u>None</u>                                  | <u>11E</u>                               |
| 13                                           | 9                                        | 30                                           | 21                                       | None                                         | 33                                       |
| 14                                           | <del>None</del> <u>11A</u>               | 31                                           | 22                                       | None                                         | 36                                       |
| 15                                           | <del>None</del> <u>11B</u>               | 32                                           | 23                                       |                                              |                                          |
| 16                                           | <del>None</del> <u>11C</u>               | 33                                           | 24                                       |                                              |                                          |

### 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 includes an allowed alternative treatment of expensing borrowing costs. IPSAS 5 states that in circumstances where borrowing is unrelated to the acquisition of qualifying assets, or where the entity has a policy of converging with the statistical bases of accounting, expensing of borrowing costs may be appropriate.
- IPSAS 5 contains a different set of definitions of technical terms from IAS 23 (paragraph 5).

The final dot point will be required if the IPSASB decides to retain the expensing option for the ED.