



**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  
6**

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**DATE:** May 27, 2008  
**MEMO TO:** Members of the IPSASB  
**FROM:** John Stanford and Matthew Bohun-Aponte  
**SUBJECT:** Borrowing Costs

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**OBJECTIVE OF THIS SESSION**

To **approve** ED 35, “IPSAS 5, Borrowing Costs (Revised)”

**AGENDA MATERIAL:**

- 6.1 Cut and Paste of Respondents’ Comments to the version internally circulated on May 7<sup>th</sup> 2008.
- 6.2 ED 35, “IPSAS 5, “Borrowing Costs (Revised)””: Mark-Up copy reflecting changes to the version circulated internally on May 7th 2008.

**ACTION REQUIRED**

The IPSASB is asked to:

- **Consider** the key issues raised by internal respondents to the version of the ED circulated on May 7th 2008; and
- **Review** and **approve** draft ED 35.

**BACKGROUND**

At the Toronto meeting in March 2008 the IPSASB directed Staff to make further amendments to the ED , “Proposed Amendments to IPSAS 5, “Borrowing Costs”” to reflect an approach whereby the expensing of borrowing costs would be mandated, except for cash-generating assets where borrowing has been specifically incurred to finance their acquisition, construction or production. In such cases, and only in such cases, entities would be permitted, but not required, to include the costs of the borrowing specifically incurred as part of the cost of a cash-generating qualifying asset.

On May 7th Staff sent out a revised version of the ED. As at May 27th responses had been received from Greg Schollum (001), David Bean (002), Rick Neville (003), Peter Batten (004), Lou Hong and Li Hongxia (005) Stuart Barr (006) and Frans van Schaik (007). Agenda Item 6.2 is a cut and paste summary of the major issues raised by respondents: it does not include minor editorial points. Unedited copies of responses are available from Staff on request. The remainder of this memorandum deals with the major issues raised by respondents and also discusses the format in which the revised ED should be presented to constituents and the name of the ED.

The further draft ED is presented as a marked-up version reflecting changes to the version circulated on May 7<sup>th</sup>. A clean copy is available from Staff on request.

## **FORMAT AND NAME OF DOCUMENT**

The original intention with this project, as for other projects updating IPSASs to evaluate and reflect changes in IFRS since the current IPSAS was approved, was to issue an ED marking-up the changes to the original IPSAS. For example, this approach was applied to the updating of IPSAS 4, “The Effects of Changes in Foreign Exchange Rates” in 2007. However in the case of borrowing costs the changes from both the current IPSAS 5 and the departures from IAS 23, “Borrowing Costs (Revised 2007)” are such that, in substance, the project is now public sector specific.

The large number of changes from the current IPSAS 5 means that it would not be user-friendly to issue a mark-up of changes. Staff therefore proposes that the ED be issued in clean format and that the title should be changed to “ED 35, “IPSAS 5, “Borrowing Costs (Revised 2008)” as the scale of changes goes beyond what would normally be connotated by the term “proposed amendments”. In accordance with this approach the Table of Concordance in the previous version of the ED has been deleted.

### **Action Required**

Members are asked to **confirm** that the ED should be issued in clean format and titled ED 35, “IPSAS 5, “Borrowing Costs (Revised 2008)”

## **BALANCE OF DOCUMENT**

The majority of the material in the body of the revised Standard now deals with the approach to the capitalization of borrowing costs specifically incurred for the financing of cash-generating assets. Most public sector entities will have a small number of cash-generating assets; there is undoubtedly a risk that the volume of material on a permitted, rather than required, approach that will affect a small proportion of assets carried by public sector entities, unbalances the ED. Staff acknowledges this risk, but notes that it is simply a reflection of the complexity of capitalization in comparison with expensing, and that such a structure is inevitable if capitalization is permitted in any form. It is notable that the superseded version of IAS 23, which permitted both expensing and capitalization, devoted three paragraphs to the benchmark treatment (expensing) and eighteen paragraphs to the allowed alternative treatment (capitalization).

Staff does have some reservations whether the limited circumstances in which entities are permitted to capitalize borrowing costs justifies the amount of material in the section “Borrowing Costs Incurred by the Economic Entity.” On balance, Staff thinks that this material, which is drawn, from the current IPSAS, is justified, and has retained the commentary in the current version

### **Action Required**

Members are asked to **confirm** that the current structure and balance of the ED is appropriate.

## OVERALL VIEW OF RESPONDENTS

A number of the respondents raised concerns about the adequacy of the rationale for the adopted approach in the Basis for Conclusions. A number of drafting changes were suggested.

Respondent 001 indicated that the permitted option to capitalize was narrower than he had assumed, but that he was content with the approach, provided that it is acceptable to other Members. Respondent 005 also considered that the circumstances under which capitalization is permitted in the ED are too restrictive. Staff considers that the approach to capitalization, whilst undoubtedly restrictive, does reflect the directions provided in Toronto.

### Action Required

Members are asked to **reaffirm** the approach adopted in Toronto that expensing should be mandated in all cases for borrowing costs, except where borrowing is specifically incurred to finance the acquisition, construction or development of a cash-generating asset.

The following sections analyze respondents' comments in more detail. This part of the memorandum commences with the three issues on which Staff requested a specific view.

## RESTRUCTURING THE OBJECTIVE V CORE PRINCIPLE

The revised IAS 23 replaced the "Objective" section at the start of the body of the Standard with a "Core Principle" section. The ED had followed this approach. There was strong overall support for this change with views that it reflected convergence with IFRSs and better indicated the intent of the paragraph in the section.

Respondent 002 favored retention of the "Objective" paragraph that has been used in the core suite of IPSASs, as more meaningful. He made the point that the use of the term "Core Principle" means that you are "stratifying" principles into core and non-core and that this is less meaningful. Staff thinks that this point is cogent. However, in light of the general comfort with the use of the term "Core Principle". Staff have retained it in the revised version of the ED. Staff also agrees with respondent 001 that this is a general policy issue.

A minor drafting change has been made to clarify that the option to capitalize applicable borrowing costs only applies to cash-generating assets initially measured at cost.

### Action Required

Members are asked **confirm** the retention of the term "Core Principle" and the drafting of Paragraph 1,

## **SCOPE OF FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)**

A number of responses pointed out that the statement in the Background section that the scope of the US Financial Accounting Standards Board (FASB) does not include not-for-profit entities was incorrect. Respondent 002 helpfully noted that FASB Statement 23 does not embrace the private not-for-profit sector and that FASB Statement 62, “Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants—an amendment of FASB Statement No. 34” had been developed to deal with the circumstances of private not-for-profit entities. The wording of this section has been modified to reflect the point that FASB Statement 23 does not cover the private not-for-profit sector or public sector, rather than commenting on FASB’s scope.

### **Action Required**

Members are asked **confirm** the amendments to the background section regarding FASB.

## **COMMENTARY PARAGRAPH 6 ON SCOPE**

Members were asked to provide views on whether this commentary paragraph is necessary. The paragraph provide guidance that an entity does not capitalize borrowing costs related to a cash-generating asset measured at fair value, for example an asset acquired in a non-exchange transaction and inventories that are produced in large quantities on a repetitive basis. There were mixed views. Respondents 002, 004 and 005 favored retention. Respondent 001 favored deletion as he did not find this paragraph clear. Respondent 004 also favored omitting the paragraph.

Staff notes that during the course of this project, Members have debated the question of whether, where a capitalization policy is adopted, assets carried at fair value under the revaluation model in IPSAS 17, “Property, Plant and Equipment” should reflect a component for borrowing costs within the valuation. A number of Members and Technical Advisors did not accept the Staff view that the capitalization of borrowing costs would not apply to assets on the revaluation model for subsequent measurement after initial recognition. These Members and Technical Advisors considered that, where capitalization is adopted as the accounting policy, subsequent carrying amounts should include a component for borrowing costs for assets valued using depreciated replacement cost. It was also accepted that the method of determining such a component is problematic.

Given the continuing uncertainty over this issue, coupled with the fact that it is not a central issue under the revised approach in the ED towards capitalization, Staff considers that there is a case to be silent on the issue, which would militate towards the deletion of paragraph 6(a). However, Staff also notes the need to clarify that where assets are acquired through a non-exchange transaction and initially measured at fair value under IPSAS 12, “Inventories” IPSAS 16, “Investment Property”, or IPSAS 17 “Property, Plant and Equipment” borrowing costs should not be capitalized.

Paragraph 10 already states that inventories that are produced over a short period of time, are not qualifying assets, so a prior reference to such inventories in the Scope section seems superfluous. Paragraph 6 (b) has therefore been deleted.

In addition because the term “a cash-generating asset” is not defined in black letter paragraph 8 in the Definition section the commentary paragraph on cash-generating assets has been moved to paragraph 7 in the Scope section.

#### **Action Required**

Members are asked to **confirm** the rewording of paragraph 6 in the Scope section and the repositioning of the commentary paragraph on cash-generating assets to the Scope section.

### **BASIS FOR CONCLUSIONS**

A number of respondents considered that the Basis for Conclusions needed further development. Respondent 006 considered that the Basis for Conclusions neither identifies clearly where IPSAS 5 varies from IAS 23 nor sets out clearly the rationale for doing so. The main detailed points raised were:

- Respondent 001 favored moving the paragraphs BC11-BC13 on “budgeting and borrowing in the public sector” to follow BC5. He considered this one of the key reasons of difference between the public and private sectors;
- Respondents 001, 002 and 004 questioned the argument in the last sentence of previous paragraph BC7 that capitalizing borrowing costs could obscure the levels of debt being incurred by an entity. They argued that the level of debt and recognition and measurement of debt are independent of how related borrowing costs are treated;
- Respondent 004 considered that previous paragraph BC9 does not bring out sufficiently the public-sector-specific nature of the problems in allocating borrowing costs when governments arrange borrowing for their component entities on a centralized basis and reiterated previously submitted drafting proposals;
- Paragraph BC8 dealt with the capitalization of borrowing costs on initial recognition and subsequent revaluation for non-cash generating assets on the fair value model. Respondent 001 favored expanding the paragraph to bring in the concern over the practical difficulties in incorporating borrowing costs into the fair value of non-cash generating assets at subsequent measurement, and concern over the reliability of resultant asset valuations. Conversely Respondent 004 questioned why the argument was raised at all, as the preceding paragraph already rejected capitalizing borrowing costs into the carrying amount of non-cash-generating assets. Consistent with Respondent 001, Respondent 004 found the discussion cryptic. Respondent 004 also considered that the reason why expensing borrowing costs results in greater transparency when the fair value

model is used for non-cash-generating assets was not explained or linked to the discussion; and

- Respondent 002 made a number of small but significant points including the need to emphasize a user perspective and use less assertive and softer language.

Staff has made drafting changes to address these points as follows:

- The last sentence of previous paragraph BC7 that capitalizing borrowing costs could obscure the levels of debt being incurred by an entity has been deleted.
- Staff has retained paragraph BC8 (now paragraph BC10 ) although Respondent 004's point is acknowledged. Staff has some concerns that raising a point of technical difficulty about how to effect aspects of the capitalization of borrowing costs after the principle has been established that capitalization is generally inappropriate in the public sector weakens the argument.
- Paragraph BC 9 on the difficulties and cost of allocating borrowing costs, when governments arrange borrowing for their component entities on a centralized basis, has been redrafted as paragraph BC 11 using much of the material resubmitted by Respondent 004.

**Action Required**

Members are asked to **approve** the redrafted Basis for Conclusions.

**APPROACH WHERE CONTROLLING ENTITY BORROWS  
GENERALLY AND TRANSFERS FUNDS TO CONTROLLED ENTITY**

Respondent 003 questioned the statement in commentary paragraph 22 that capitalizing borrowing costs in the separate financial statements of the controlling entity when the controlling entity borrows funds generally and transfer part of those funds to a controlled entity for the acquisition, construction or development of a cash-generating asset was incorrect. Staff accepts this point- the paragraph should have referred to the possibility that the controlled entity might capitalize such costs. Paragraph 22 has been amended.

**Action Required**

Members are asked to **confirm** the drafting of paragraph 22.

**USE OF TERM SPECIFICALLY INCURRED v DIRECTLY  
ATTRIBUTABLE**

Respondent 005 prefers to use the term “directly attributable” rather than “specifically incurred”. The term “directly attributable” is used in IAS 23. Commentary in paragraphs 10 and 11 of IAS 23 (revised) states that:

“10. 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 expenditure 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.

11. It may be difficult to identify a direct relationship between particular borrowings and a qualifying assets 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 a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other entities in the group. Other complications arise through the use of loans denominated in or linked to foreign currencies, when the group 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 judgement is required.”

Staff consider that the term ”directly attributable” is broader than “specifically incurred” and would potentially include borrowing costs beyond those “specifically incurred”. Staff therefore favors retention of the term “specifically incurred” and considers that it is in accordance with the directions at Toronto.

**Action Required**

Members are asked to **reaffirm** the use of the term “specifically incurred”.

**TRANSITIONAL PROVISIONS**

Respondent 004 highlighted that the explanation in the Summary of Main Changes and the rendition in paragraphs 34-36 were unclear. Respondent 006 also found the transitional provisions convoluted. Staff also noted that the focus of the transitional provision in the version of the ED circulated on May 7th was on the capitalization of borrowing costs relating to cash-generating assets.

In response to these comments and concerns Staff has inserted a revised simplified transitional provision in paragraph 34 based on that in the current IPSAS 5. It encourages, but does not require, an entity, for which application of the revised Standard constitutes a change in accounting policy, to adjust its financial statements in accordance with IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors”. Where an entity does not make such adjustments, it is required to capitalize only those borrowing costs incurred after the effective date of the Standard that meet the criteria for capitalization. All other borrowing costs incurred after the effective date of the Standard are required to be expensed.

**Action Required**

Members are asked to **confirm** the revised transitional provision in paragraph 34.

**BORROWING COSTS  
CUT AND PASTE OF RESPONDENTS COMMENTS TO MAY 7<sup>th</sup>  
CONSULTATION**

**GENERAL**

**Greg Schollum (001)**

The proposed ED as drafted goes a little further than I had anticipated following our discussion in Toronto. I had thought we would be reinstating the option to expense, and retaining the option to capitalise for all assets (cash generating and non cash generating). However, if the ED as drafted reflects the wishes of the Board as a whole, then I'm comfortable to go with that decision.

**David Bean (002)**

No fatal flaws.

**Rick Neville (003)**

Proposed ED reflects decision made in March extremely well.

**Lou Hong/ Li Hongxia (005)**

We believe that, for qualifying cash-generating assets, as long as borrowing costs that are directly attributable to their acquisition, construction or production, these borrowing costs should be capitalized, rather than "may be capitalized". In the draft standard, it only provides certain examples where such borrowing costs can not be capitalized, e.g., the last sentence of paragraph 16. In our opinion, it is not eligible for capitalization because borrowings to further economic and fiscal policies of the government are not those specifically incurred for qualifying cash-generating assets. We are concerned this will result in lack of comparativeness between public sector entities in this regard. Furthermore, the rationale for making such a big difference in this very specific point is not addressed very clearly in the BC.

**Frans Van Schaik (007)**

No comments. Thank you for your effort.

**RESTRUCTURING THE OBJECTIVE V CORE PRINCIPLE**

**Greg Schollum (001)**

I'm comfortable either way on this as it makes little difference in my view. It's more of a general policy issue.

**Rick Neville (003)**

I am quite content to leave our IPSASs with an "Objective" paragraph, since it is more meaningful to me in that context, i.e., That is the "objective" of the Standard. Core principles means that you are "stratifying" your principles into core and non-core, which is less meaningful.



**Peter Batten/Jim Paul (Respondent 004)**

I am comfortable with changing "Objective" to "Core Principle" which term perhaps better expresses what this paragraph is typically trying to achieve.

**Lou Hong/ Li Hongxia (005)**

In respect to restructuring "Objective" paragraph as "Core Principle", we agree with the change, i.e., following IASB's new format in IAS 23. In our view, though the IPSASB prescribes a very different standard on borrowing costs from IAS 23, it does not preclude the IPSASB to consistently apply its convergence policy, which is to align IPSASs with IFRSs unless there is a public sector reason for a departure. Apparently, format is not a public specific reason for a departure.

**Stuart Barr (006)**

This paragraph seems consistent with the rest of the document. I think it would be helpful if you shared with us the nature and extent of the mixed views staff have on this matter and we could then comment on those views.

**SCOPE: NEED FOR PARAGRAPH 6**

**Greg Schollum (001)**

I must admit I didn't find paragraph 6 very clear. My preference would be to delete it so we have a set of requirements for non-cash generating assets and a set of requirements for cash generating assets, with no exceptions.

**Rick Neville (003)**

I found the "scope paragraph 6" to be helpful...before I read your specific observation. That being said, I am still in favour of leaving it in. The "theoretical possibility" is remote and judgment would be brought to bear on the issue....if ever it did occur.

**Peter Batten/Jim Paul (004)**

Would be happy to omit scope paragraph 6. On the one hand I could visualise circumstances in which borrowing costs (in the for-profit sector) could have borrowing costs attached if you were in the camp that supported capitalising borrowing costs. On the other hand, if you were capitalising borrowing costs then I don't see why part of the fair value (on a depreciated replacement basis) shouldn't include borrowing costs. However, it is the assumptions that would need to be made to achieve this is one of the reasons that I am so strongly opposed to capitalising borrowing costs in the first place!

**Lou Hong/ Li Hongxia (005)**

In respect to paragraph 6, we believe that it is very necessary to retain the paragraph here. However, in our opinion, its equivalent paragraph in IAS 23 (para 4) exclude those borrowing costs incurred for assets that are measured at fair value as fair value captures all the cost including borrowing costs. Accordingly, it is not necessary to add them in the cost. Under this rationale, we would suggest that paragraph 6 be amended to exclude not only cash-generating qualifying assets measured at fair value by non-exchange transactions, but also those cash-generating qualifying assets measured at fair value by exchange transactions, which are most commonly happened cases in the private sector.

Moreover, to be clear enough, we would prefer the word “may not” in paragraph 6 be changed to “are not required”.

**Stuart Barr (006)**

In my view, this paragraph is useful because it helps clarify the scope of the guidance. I think it would be improved if there was an explanation of the basis for 6(b), which excludes capitalization of borrowing costs for inventories that are produced in large quantities on a repetitive basis. The rationale for this exclusion is not clear to me and I suggest it be clarified.

It is also not clear to me why you have raised the issue in the attached email of an entity receiving a qualifying cash-generating asset partly through a grant and partly through a loan. I don't see this as an issue because a grant as I understand it does not have borrowing costs associated with it and would therefore not fall under the scope of this IPSAS. Are you suggesting the scope paragraph explicitly exclude grants?

**BASIS FOR CONCLUSIONS**

**Greg Schollum (001)**

The Basis for Conclusions contains some good material. However, I suggest that you adjust the Basis for Conclusions as follows:

- (a) move the “budgeting and borrowing in the public sector” paragraphs (BC11 – BC13) to follow BC5. I see this is one of the key reasons of difference between the public and private sectors.
- (b) BC7 – I didn't follow the logic about obscuring the level of debt. Surely the level of debt is unchanged whether or not borrowing costs are capitalised. I suggest that this is reworded or deleted.
- (c) BC8 – I think this should be expanded to bring in the concern over the practical difficulties in incorporating borrowing costs into the fair value of non-cash generating assets for those entities which revalue, and concern over the reliability of resultant asset valuations. (Refer to email sent by Alison Barber (my PA) to Stephanie Fox 20/3/08).

**David Bean (002)**

**BC6:** “Never” is too strong given the option to capitalize. Suggests replacement with “not be”.

**BC7:** The amount of debt incurred will not be obscured. Interest cost will be.

**BC9:** Very few things are cost free. The point is that costs will be significant.

**BC11:** Need for linkage to users.

**BC13:** Assertion that there is no linkage between borrowing and acquisition, production or development of qualifying assets needs to be less assertive. Suggest replacement of “no” with “little”

**Rick Neville (003)**

I found the wording to be very well chosen and explains the rationale for going forward well articulated. I do not have any suggested changes.

**Peter Batten/Jim Paul (004)**

Comments on certain paragraphs as follows:

**BC7:** We do not understand the argument in the last sentence that capitalizing borrowing costs could obscure the levels of debt being incurred. Recognition and measurement of debt are independent of how related borrowing costs are treated.

**BC8:** We are unsure why the argument in the first sentence is raised, since the preceding paragraph already rejects capitalizing borrowing costs into the carrying amount of non-cash-generating assets. In addition, the mention of the IPSASB’s concern in that sentence is cryptic and thus not very helpful.

In relation to the second sentence, we think it should be explained why expensing borrowing costs results in greater transparency when the fair value model is used for non-cash-generating assets.

**BC9:** We think this paragraph does not bring out sufficiently the public-sector-specific nature of the problems with allocating borrowing costs when governments arrange borrowing for their component entities on a centralised basis. We attach as a starting point our wording on this point previously provided on 11 January:

“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.”

**BC10:** We think the argument in the third sentence is unclear about why the “fundamental differences between public and private sector entities” make capitalization inappropriate to mandate for cash-generating qualifying assets but appropriate to permit for those assets to facilitate convergence with the private sector treatment.

**Lou Hong/ Li Hongxia (005)**

See comments under General section above.

**Stuart Barr (006)**

In my view, the Basis for Conclusions does not set out clearly where IPSAS 5 varies from IAS 23 nor does it set out clearly the rationale for doing so. I think it should be revised to list clearly and concisely where variations exist and then provide additional explanatory information as required.

## **SCOPE OF FASB**

**Greg Schollum (001)**

I thought that FASB’s mandate included not for profit entities, but excluded public sector entities.

**David Bean (002)**

Not-for-profits are within the scope of the FASB, but they issued Statement 62 to deal with not-for profits

**Peter Batten/Jim Paul (004)**

The largest paragraph on this page includes an incorrect statement that not-for-profit entities are outside the FASB’s area of responsibility. Therefore, the fact that the amendment to IAS 23 was made to converge with US GAAP for private sector entities has relevance only to the extent that public sector not-for-profit entities have different characteristics and issues from those of private sector not-for-profit entities.

## **COMMENTARY ON ECONOMIC ENTITY (PARAGRAPH 22)**

**Peter Batten/Jim Paul (004)**

In the circumstances described in the last sentence, we disagree with capitalizing borrowing costs in the separate financial statements of the controlling entity, because the qualifying asset is not recognized by the controlling entity.

**Stuart Barr (006)**

Paragraph 22, sentence three, states that “if the controlling entity borrows funds specifically for the construction, acquisition or production of a qualifying cash-generating asset by a controlled entity, those borrowing costs may be capitalized in the separate financial statements of the controlling entity and in the consolidated financial statements of the economic entity of which it is part.”

I understand this to mean that under these circumstances the controlling entity capitalizes the borrowing costs on its financial statements while the controlled entity records the qualifying cash-generating asset. It is not clear to me why it makes sense under these circumstances for the controlling entity to capitalize borrowing costs on its financial statements while the controlled entity records the qualifying cash-generating asset. Nor is it clear how these capitalized borrowing costs would ever flow to the income statement on the books of the controlling entity.

## **TRANSITIONAL PROVISIONS**

### **Peter Batten/Jim Paul (004)**

The explanation (in the Summary of Main Changes) and the rendition (in paragraphs 34-36) of the changed transitional provisions are wordy and their focus is unclear. Please review and redraft. If we understand correctly the change proposed, we suggest saying more directly that the transitional provisions in the revised IPSAS do not permit retrospective application of a change in accounting policy to commence capitalizing borrowing costs into the carrying amount of a cash-generating qualifying asset.

### **Stuart Barr (006)**

I encourage you to take another look at transitional provisions paragraphs 35 and 36 with a view to clarifying the wording as it is unclear to me what these paragraphs mean.

## **SHOULD CAPITALIZATION BE MANDATED?**

### **Lou Hong/ Li Hongxia (005)**

We believe that, for qualifying cash-generating assets, as long as borrowing costs that are directly attributable to their acquisition, construction or production, these borrowing costs should be capitalized, rather than “may be capitalized”. In the draft standard, it only provides certain examples where such borrowing costs can not be capitalized, e.g. the last sentence of paragraph 16. In our opinion, it is not eligible for capitalization because borrowings to further economic and fiscal policies of the government are not those specifically incurred for qualifying cash-generating assets. We are concerned this will result in lack of comparativeness between public sector entities in this regard. Furthermore, the rationale for making such a big difference in this very specific point is not addressed very clearly in the BC.

## **USE OF “SPECIFICALLY INCURRED” v “DIRECTLY ATTRIBUTABLE”**

### **Lou Hong/ Li Hongxia (005)**

For the recognition principle in paragraph 12 and elsewhere in the Standard, we are wondering whether we can change “borrowing costs that are specifically incurred for the acquisition, construction or production of a qualifying asset as part of the cost of the that cost” to “borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of the that cost”, the latter is the

wording in IAS 23. We understand that, from paragraph 15, the intention and meaning of two descriptions are the same. In this case, we need to adopt a consistent convergence policy.

## **USE OF “SHOULD” AND “SHALL”**

### **David Bean (002)**

In Summary of Changes questions use of “should” rather than “shall”.

Exposure Draft ~~XX~~35

~~MM-YYYY~~ July 2008

Comments are requested by ~~MM-DD~~,

*Proposed International Public Sector Accounting  
Standard*

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~~Amendments to~~ IPSAS 5,  
“Borrowing Costs”  
(Revised 2008)”



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, ~~Amendments to IPSAS 5, "Borrowing Costs (Revised 2008)"~~, for publication in ~~MM, June YYYY2008~~. 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, YYYYNovember 30, 2008~~. 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~~ a revised International Public Sector Accounting Standard is drawn in part 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.

**E-mail: [publications@iasb.org](mailto:publications@iasb.org).**

**Internet: <http://www.iasb.org>.**

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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 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.

In reviewing the changes made by the IASB to IAS 23, the IPSASB noted that the IASB's project was focused on converging IAS 23 with the USA's Financial Accounting Standards Board's (FASB's) Statement 34, "Capitalization of Interest Cost" and that not for profit entities and public sector entities are outside the scope of that Statement. The revised IAS 23 requires entities to capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. The previous benchmark treatment of recognizing an expense in relation to borrowing costs in the period in which they are incurred has been withdrawn. In considering the applicability of the principles established in IAS 23 to the public sector, the IPSASB was cognizant that qualifying assets in the public sector, apart from those ~~of~~ GBEs, would not ordinarily be ~~anticipated or intended~~ operated in order to generate positive cash inflows, and that public sector entities frequently borrow for public policy purposes, including ~~to maintain the maintenance~~ a of a benchmark bond rate, to sustain deficit financing and to further the government's monetary policy. At a national government level, and often at lower levels of government, borrowings ~~are often~~ are not attributable to a particular asset acquisition or capital project. For these reasons, the IPSASB has decided that borrowing costs in the public sector ~~should be~~ are to be recognized

immediately as an expense, except in certain specific circumstances. The IPSASB continues, however, to maintain its strategy of converging IPSASs with IFRSs where appropriate. ~~Therefore, it permits, but does not require, entities that incur borrowing costs specifically to acquire~~ acquire, construct or produce a cash-generating qualifying asset to capitalize those borrowing costs ~~in the same way that an entity applying IFRSs would. In all other circumstances entities shall recognize an expense for borrowing costs in the period in which they are incurred.~~

Until the proposed ~~IPSAS~~ revised 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 are identified in marked up type. In addition, compared to the former IPSAS 5, the proposed amended IPSAS 5 includes additional sections: "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~~November 30 2008. 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:

This Exposure Draft proposes that borrowing costs be recognized immediately as an expense except in the specific circumstances established in paragraph 12.

Do you agree with this proposal? Please provide your reasons.

~~Please provide your rationale for agreeing or disagreeing with this proposal.~~

## 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 a “core principle” section

### Scope

- ~~To include in paragraph 6 a scope exclusion. An entity may not capitalize 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 this scope exclusion.~~

### Definitions

- In paragraph ~~7~~6:
  - 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.
- In paragraph ~~9~~9:
  - To amend the examples of qualifying assets.
  - 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 the previous IPSAS 5 have now been replaced with the words “financial assets” and “inventories” respectively.

### Recognition

- To require the immediate recognition as an expense of borrowing costs, except ~~that~~ where the borrowing costs are specifically incurred for the ~~the~~ acquisition, construction or production of a cash-generating qualifying asset. In such circumstances an entity has the option to capitalize those borrowing costs.

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 13 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 23 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.~~

### **Transitional Provisions**

- ~~•To require in paragraph 34 an entity to apply this standard to borrowing costs relating to cash-generating 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 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 a provision.~~

**PROPOSED ~~AMENDED-REVISED~~ TEXT**  
**IPSAS 5—BORROWING COSTS**  
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International Public Sector Accounting Standard 5, “Borrowing Costs” (Revised 2008) (IPSAS 5) is set out in paragraphs 1–~~38~~37 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.

## Introduction

IN1. International Public Sector Accounting Standard (IPSAS) 5, “Borrowing Costs,” replaces IPSAS 5, “Borrowing Costs” (issued May 2000), and ~~should-is to 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. The IASB amended IAS 23 as part of its convergence program with the United States’ Financial Accounting Standards Board (FASB). The revised IAS 23 converges with FASB Statement 34, “Capitalization of Interest Cost.”
- IN3. The revision to IPSAS 5 ~~does not reflect reflects the changes made by the IASB to IAS 23 in accordance with the IPSASB’s convergence strategy except that~~ the IAS 23 requirement to capitalize borrowing costs ~~that are directly attributable to the acquisition, construction or production of a qualifying asset is not applied to public sector entities.~~ The revised IPSAS 5 does, however, ~~permit entities provide~~ the option of capitalizing those borrowing costs incurred specifically for the acquisition, construction or production of a cash-generating qualifying asset ~~that is initially measured at cost~~. This reflects the IPSASB’s ongoing commitment to the convergence, where appropriate, of public and private sector financial reporting standards.

## Changes from Previous Requirements

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

### Scope

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

- ~~(a) A cash-generating 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-IN5.~~ The Standard:

- Modifies the definition of ~~b~~Borrowing ~~c~~Costs and ~~a~~ 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”;
- Clarifies that financial assets, and inventories that are produced over a short period of time, are not qualifying assets.

## Recognition

~~IN7-IN6.~~ The Standard requires immediate recognition of borrowing costs as an expense, except where borrowing costs are specifically incurred for the acquisition, construction or production of a cash-generating qualifying asset ~~that is initially measured at cost~~. In such cases an entity has the option to capitalize those borrowing costs ~~or to recognize them immediately as an expense~~. The Standard previously permitted ~~the either the~~ expensing or capitalizing as part of the cost of the asset, of borrowing costs directly attributable to the acquisition, construction or production of any qualifying asset.



~~IN8.IN7.~~ 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.

### **Transitional Provisions**

~~IN9.~~ The Standard requires an entity to apply this Standard to borrowing costs relating to cash-generating 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.

~~IN10.~~ 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 cash-generating qualifying assets for which the commencement date for capitalization is on or after that date.

## Core Principle

1. Borrowing costs are to be recognized as an expense in the period in which they are incurred, except where borrowing costs ~~are specifically incurred for the acquisition, construction or production of a cash-generating qualifying asset~~ that is initially measured at cost. In such cases borrowing costs may form part of the cost of that cash-generating asset.

## Scope

2. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for borrowing costs.
3. This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).
4. The “Preface to International Public Sector Accounting Standards” issued by the IPSASB explains that GBEs apply IFRSs which are issued by the IASB. GBEs are defined in IPSAS 1, “Presentation of Financial Statements”.
5. ~~This~~ 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~~ is to be treated as an actual or imputed cost of net assets/equity.
6. An entity ~~may~~ shall not capitalize borrowing costs directly attributable to the acquisition, construction or production of a ~~÷~~
  - (a) ~~A cash-generating qualifying asset acquired in a non-exchange transaction and measured at fair value at initial recognition, for example an asset acquired through a non-exchange transaction and initially measured at fair value underin accordance with~~ IPSAS 12, “Inventories” IPSAS 16, “Investment Property”, ~~–or~~ IPSAS 17 “Property, Plant and Equipment”; ~~or~~
  - (b) ~~Inventories that are produced in large quantities on a repetitive basis.~~
7. ~~Cash-generating assets are assets held with the primary objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit oriented entity. Holding an asset to generate a commercial return indicates that an entity intends to generate positive cash inflows from the asset (or from the cash-generating unit of which the asset is a part) and earn a commercial return that reflects the risk involved in holding the asset. An asset may be held with the primary objective of generating commercial return even though it does not meet that objective during a particular reporting period. Conversely, an asset may be a non-cash-generating asset even though it may be breaking even or generating a commercial return during a particular reporting period. Further guidance on the distinction between cash-generating and non-cash-generating assets is found in IPSAS 21, “Impairment of Non-Cash-Generating Assets” and IPSAS 26, “Impairment of Cash-Generating Assets”.~~

## Definitions

- ~~78~~6. This Standard uses the following terms with the meanings specified:

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

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Terms defined in other IPSASs 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

89. 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.

### Cash Generating Assets

9. ~~Cash generating assets are assets held with the primary objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit oriented entity. Holding an asset to generate a commercial return indicates that an entity intends to generate positive cash inflows from the asset (or from the cash generating unit of which the asset is a part) and earn a commercial return that reflects the risk involved in holding the asset. An asset may be held with the primary objective of generating commercial return even though it does not meet that objective during a particular reporting period. Conversely, an asset may be a non-cash generating asset even though it may be breaking even or generating a commercial return during a particular reporting period. Further guidance on the distinction between cash generating and non-cash generating assets is found in IPSAS 21, "Impairment of Non-Cash Generating Assets" and IPSAS 26, "Impairment of Cash Generating Assets".~~

### Qualifying Assets

10. Depending on the circumstances, any of the following may be qualifying assets:

- (a) Inventories;
- (b) Office buildings;
- (c) Hospitals;
- (d) Infrastructure assets such as toll roads, toll bridges;
- (e) Power generation facilities;
- (f) Intangible assets; and
- ~~(g)~~ Investment properties.

Financial assets, and inventories that are produced over a short period of time, are not qualifying assets. Assets that are ready for their intended use ~~or~~ sale or distribution when acquired are not qualifying assets.

### Recognition

- 11. An entity shall recognize borrowing costs as an expense in the period in which it incurs them, except to the extent that they are capitalized in accordance with paragraph 12.
- 12. Borrowing costs that are specifically incurred for the acquisition, construction or production of a cash-generating qualifying asset may be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization shall be determined in accordance with this Standard.

13. When an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall recognize an expense for the borrowing costs in the period in which they are incurred. 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.

### **Borrowing Costs Eligible for Capitalization**

14. Borrowing costs that are specifically incurred for the acquisition, construction or production of a cash-generating qualifying asset may be included in the cost of that asset. Such borrowing costs may be 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.
15. The borrowing costs that are ~~directly attributable to~~ specifically incurred for the acquisition, construction or production of a cash-generating qualifying asset are those borrowing costs that were incurred specifically to finance the acquisition of that asset. 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.
16. ~~An economic entity may use a range of debt instruments to borrow funds at varying rates of interest. 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. Complications may 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.~~ Public sector entities may coordinate such borrowing to further the economic and fiscal policies of the government. Such general borrowings do not qualify for capitalization.
17. **To the extent that an entity borrows funds specifically for the purpose of obtaining a cash-generating qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.**
18. 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.

### **Borrowing Costs Incurred by the Economic Entity**

19. If a controlling entity borrows funds which are then loaned to a controlled entity with no, or only partial ~~allocation~~ non-charging of the controlling entity's borrowing costs, the controlled entity may capitalize only those borrowing costs which it itself ~~has incurred~~ pays for specifically in relation to ~~for~~ the acquisition, construction or production of a cash-generating qualifying asset, which will normally be documented in the loan agreement with the controlling entity. Where a controlled entity receives an interest-free loan or capital grant, it will not incur any borrowing costs and consequently will not capitalize any such costs.
20. 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 specifically for the acquisition, construction or production of a cash-generating qualifying asset. These borrowing costs are not necessarily identical to the borrowing costs incurred by the controlling entity. In the financial statements of the economic entity, the full amount of borrowing costs specifically incurred for the acquisition, construction or production of a cash-generating qualifying asset can be capitalized as part of the cost of that qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs of the controlling entity also capitalized by the controlled entity.

21. When a controlling entity has transferred funds at no cost to a controlled entity, neither the controlling entity nor the controlled entity meet the criteria for capitalization of borrowing costs in their separate financial statements. 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.
22. When a controlling entity borrows funds generally, and lends part of those funds specifically to a controlled entity for the acquisition, construction or production of a cash-generating qualifying asset, the borrowing costs of the controlling entity are not eligible for capitalization either by that controlling entity in its separate financial statements or by the economic entity in its consolidated financial statements. The borrowing costs of the controlled entity may, however, be eligible for capitalization in the controlled entity's separate financial statements. Similarly, if the controlling entity borrows ~~specifically~~ funds specifically for the construction, acquisition or production of a qualifying cash-generating asset by a controlled entity, those borrowing costs may be capitalized in the separate financial statements of the controlled ~~entity~~ entity and in the consolidated financial statements of the economic entity of which it is part.

### **Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount**

23. When the carrying amount or the expected ultimate cost of the cash-generating qualifying asset exceeds its recoverable amount or net realizable value, the carrying amount is written down or written off in accordance with the requirements IPSAS 26, "Impairment of Cash-Generating Assets". In certain circumstances, the amount of the write-down or write-off is written back in accordance with IPSAS 26.

### **Commencement of Capitalization**

24. **An entity may begin capitalizing borrowing costs as part of the cost of a cash-generating qualifying asset in accordance with paragraph 12 on the commencement date. The commencement date for capitalization is the date when the entity first meets all of the following conditions:**
- (a) **It incurs outlays for the asset;**
  - (b) **It incurs borrowing costs specifically related to the acquisition of the ~~cash-generating~~ qualifying asset; and**
  - (c) **It undertakes activities that are necessary to prepare the asset for its intended use or sale.**
25. Outlays on a cash-generating qualifying asset include only those outlays that have resulted in payments of cash, transfers of other assets or the assumption of interest bearing liabilities.
26. The activities necessary to prepare the cash-generating qualifying asset for its intended use, ~~or~~ sale or distribution 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**

27. **An entity shall suspend capitalization of borrowing costs during extended periods in which it suspends active development of a cash-generating qualifying asset.**
28. An entity may incur borrowing costs during an extended period in which it suspends the activities necessary to prepare an asset for its intended use, ~~or~~ sale or distribution. Such costs are costs of

holding partially completed assets and do not qualify for capitalization. However, an entity does not normally suspend capitalizing borrowing costs during a period when it carries out substantial technical and administrative work. An entity also does not suspend capitalizing borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use, ~~or~~ sale or distribution. For example, capitalization continues during the extended period that high water levels delay construction of a toll bridge, if such high water levels are common during the construction period in the geographical region involved.

### Cessation of Capitalization

29. **An entity shall cease capitalizing borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.**
30. An asset is normally ready for its intended use, ~~or~~ sale or distribution 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~~ are outstanding, this indicates that substantially all the activities are complete.
31. **When an entity completes the construction of a cash-generating qualifying asset in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalizing borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or ~~sale~~ sale.**
32. An office development, to be rented out at market rents, comprising several buildings, each of which can be used individually, is an example of a cash-generating 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 room in a ~~for~~ for-profit hospital when all construction must be complete before the room 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

33. **An entity shall disclose:**
  - (a) The accounting policy adopted for borrowing costs incurred specifically for the acquisition, construction or production of cash-generating qualifying assets; and
  - (b) The amount of borrowing costs capitalized during the period, if any.

### Transitional Provisions

34. **When application of this Standard constitutes a change in accounting policy, an entity ~~shall~~ is encouraged to adjust its financial statements in accordance with IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors". Alternatively, entities shall capitalize only those borrowing costs incurred after the effective date of the Standard that meet the criteria for capitalization. All other borrowing costs incurred after the effective date of the Standard shall be expensed. ~~apply the Standard to borrowing costs relating to cash-generating qualifying assets for which the commencement date for capitalization is on or after the effective date.~~**
- ~~35. However, an entity may designate any date before the effective date and apply the Standard to borrowing costs relating to cash-generating qualifying assets for which the commencement date for capitalization is on or after that date.~~
- ~~36. An entity is permitted to apply the revised Standard from any date before the effective date, if, for example, it is judged that earlier application would provide users of the entity's financial statements with more relevant and useful information. If an entity applies the Standard from such an earlier date, it should apply the Standard to all cash-generating qualifying assets for which the~~

~~commencement date for capitalization is on or after that designated date.~~

### **Effective Date**

- ~~3735.~~ An entity shall apply the Standard for annual periods beginning on or after MM DD, YYYY. Earlier application is encouraged. If an entity applies the Standard from a date before MM DD, YYYY it shall disclose that fact.
- ~~3836.~~ 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)**

- ~~3937.~~ This ~~standard~~Standard supersedes IPSAS 5, "Borrowing Costs" issued in 2000.

## 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 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 capitalized in accordance with ~~the allowed alternative treatment in~~ IPSAS 5, "Borrowing Costs."

A2. 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" capitalized by the contractor in accordance with IPSAS 5, "Borrowing Costs."

A3. In IPSAS 17, "Property, Plant and Equipment," paragraph 37 is amended to read ~~as follows~~ 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 recognized as interest over the period of credit unless such interest is recognized in the carrying amount of the item in accordance with the allowed alternative treatment capitalized in accordance with IPSAS 5.



## **Illustrative Examples**

### **Expensing of Borrowing Costs**

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~~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 B'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. It is intended and anticipated that the rail line will generate a substantial commercial return for the government. ~~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. Government B may not capitalize any of its borrowing costs.

### **Capitalization of Borrowing Costs**

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 20X8 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. The transit system is intended to generate a commercial return. ~~and it is anticipated that it will do so.~~

#### *Analysis*

The bond issue is issued specifically to finance the construction of a cash-generating qualifying asset. Government A may elect to recognize the borrowing costs incurred to ready the subway line for use as part of the cost of the asset and capitalize them.

## **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 IPSASB's IFRS Convergence Program is an important element in IPSASB's work program. The IPSASB's strategy is to converge the accrual basis IPSASs with IFRSs issued by the 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 (US). The Short term Convergence project is aimed at reducing differences between IFRSs and the US Generally Accepted Accounting Principles 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 of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as an expense.~~

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.~~

BC5. ~~IPSAS 5 varies significantly from IAS 23 in respect of the treatment of borrowing costs. The IPSASB decided that it was inappropriate for public sector entities to capitalize borrowing costs except in limited cases. Even in those cases, capitalization should not be mandatory. In the limited cases where capitalization of borrowing cost is permitted, the principles established in IAS 23 are followed. This Basis for Conclusions explains the public sector specific reasons for these departures.~~

## **Non-Cash Generating Assets**

~~The majority of qualifying assets acquired, constructed or produced by public sector entities are non-cash generating assets as defined in IPSAS 21, "Impairment of Non-Cash Generating Assets". These assets are not intended to generate positive cash inflows during the course of their useful lives. The IPSASB considers that increasing the carrying amount of these assets to include borrowing costs attributable to their acquisition would be misleading to users of public sector general purpose financial statements. In the private sector a project is evaluated on the basis of its anticipated return on investment including its ability to service any borrowings made to acquire the assets of the project, therefore many would argue that capitalization of borrowing costs is appropriate. In the public sector however, projects to develop non-cash generating assets are not initiated on the basis of the assets' ability to generate positive cash inflows. The financing decisions of the entity should, therefore be distinguished from particular asset acquisition decisions. **The IPSASB is of the view that the carrying cost of non-cash generating assets should never include any capitalized borrowing costs.**~~

~~BC6. The IPSASB is not convinced that capitalizing borrowing costs related to non-cash generating qualifying assets, or capitalizing generic borrowings, would satisfy the qualitative characteristics of general purpose financial statements in the public sector. In particular, the IPSASB believes that that capitalizing most borrowing costs in the public sector would not increase the relevance or accountability aspects of financial statements.~~

~~BC7. For public sector entities using the fair value model for non-cash generating assets, the IPSASB had a concern about capitalizing borrowing costs on initial recognition and how this would be reflected on subsequent revaluation. They concluded that expensing borrowing costs is a more appropriate treatment for the public sector and results in greater transparency when the fair value model for non-cash generating assets is used.~~

~~BC9. The IPSASB is also of the opinion that capitalization will introduce unnecessary complexity into the financial management systems of most public sector entities. The necessity to track borrowing costs over many years and attribute such borrowing costs to qualifying assets will necessarily add complexity to the financial management system, which will not be cost free. The IPSASB is not convinced that the additional cost involved in capitalization of borrowing costs will be justified by yielding additional benefits to users of financial statements.~~

#### ~~BC8. Cash-Generating Assets~~

~~BC9. The IPSASB supports the previous benchmark treatment in the superseded IAS 23, and consistent with its approach to non-cash generating assets, considers that financial statements should distinguish between the cost of an asset, and any financing decisions related to the acquisition, construction or production of an asset. The IPSASB however, retains its strategy of converging IPSASs with IFRSs where the provisions of the IFRSs are relevant for the public sector. The IPSASB has concluded that in respect of cash generating qualifying assets it should allow entities to apply the same financial reporting treatment that would be applied by a private sector entity, but recognizing the fundamental differences between public and private sector entities, does not require that treatment. The IPSASB is of the view that only those borrowing costs that are specifically incurred for the acquisition, construction or production of a cash generating qualifying asset should be eligible for capitalization, other borrowing costs in the public sector are too removed from the acquisition of cash generating qualifying assets for any allocation to be anything other than arbitrary. The IPSASB has, however, concluded that cash generating assets acquired through non-exchange transactions, which are initially recognized at their fair value as at the date of acquisition in accordance with IPSAS 12, "Inventories"; IPSAS 16, "Investment Property"; IPSAS 17, "Property, Plant and Equipment" and IPSAS 23, "Revenue from Non-Exchange Transactions (Taxes and Transfers)", should be excluded from the scope of the IPSAS.~~

#### ~~Budgeting and Borrowing in the Public Sector~~

~~BC10. A feature unique to the public sector is that governments frequently budget for deficits, sometimes for extended periods, and finance those deficits by borrowing. This type of borrowing is unrelated to the acquisition, construction or production of qualifying assets and there is often no meaningful way to allocate such borrowing costs to qualifying assets. Often outlays on qualifying assets are a relatively minor part of the government's annual outlays, the bulk of which are consumed by expenses, such as the payment of social benefits to individuals and households. This can be distinguished from the for-profit sector where entities will normally budget for a loss only in unusual circumstances, and certainly not for an indefinite period.~~

~~BC11. Governments and other public sector entities are often market makers in the bond market, whereby their securities form the benchmark security for the bond market, and form the basis for pricing other securities. Some~~

~~governments that report surpluses in their statements of financial performance, net assets in their statements of financial position, and net inflows of cash from operations nevertheless issue debt into the market to create a market for debt securities. Such actions are often public policy debt issuings, and may be made irrespective of the government's need or lack thereof for the funds raised by the debt issue. Private sector entities do not normally issue debt for public policy purposes.~~

~~BC12. The reasons for public sector borrowing outlined in the preceding paragraphs mean that there is no linkage between these types of borrowing and the acquisition, construction or production of qualifying assets. While it is feasible to allocate these borrowings to qualifying assets, the IPSASB is of the view that doing so would not improve the quality of information provided by the general purpose financial statements of public sector entities.~~

### ~~Convergence with Statistical Bases of Reporting~~

~~BC14. The IPSASB includes as one of its key strategic themes the convergence where appropriate of IPSASs and statistical bases of reporting. Under statistical bases of reporting borrowing costs are recognized as an expense in the period in which they are incurred. The IPSASB is of the view that the approach to borrowing costs established in IPSAS 5 furthers this strategic theme in an appropriate manner, whilst still permitting entities to converge their reporting in relation to their cash generating assets with the IFRSs.~~

### ~~Other Changes~~

#### ~~Outlay(s)~~

~~BC13. 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~~

~~BC14. 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". The IPSASB has not included this requirement because the IPSAS does not permit the capitalization of interest related to assets acquired through non-exchange transactions.~~

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 Pronouncements” (as part of the ~~standard~~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 amended:

### **Example 2—Change in Accounting Policy with Retrospective Application**

- 2.1. During 20X2, the entity changed its accounting policy for the treatment of borrowing costs that are directly attributable to the acquisition of a hydro-electric power station which is under construction. In previous periods, the entity had capitalized such costs. The entity has now decided to expense, rather than capitalize them. Management judges that the new policy is preferable because it results in a more transparent treatment of finance costs, ~~and is consistent with local industry practice, making the entity’s financial statements more comparable transparent.~~
- 2.2. The entity capitalized borrowing costs incurred of CU2,600 during 20X1 and CU5,200 in periods prior to 20X1. All borrowing costs incurred in previous years with respect to the acquisition of the power station were capitalized.
- 2.3. The accounting records for 20X2 show surplus before interest of CU30,000; and interest expense of CU3,000 (which relates only to 20X2).
- 2.4. The entity has not recognized any depreciation on the power station because it is not yet in use.
- 2.5. In 20X1, the entity reported:

	CU
Surplus before interest	18,000
Interest expense	—
Surplus	<u>18,000</u>

- 2.6. 20X1 opening accumulated surpluses was CU20,000 and closing accumulated surpluses was CU38,000.
- 2.7. The entity had CU10,000 of contributed capital throughout, and no other components of net assets/equity except for accumulated surplus.

### **Public Sector Entity – Statement of Financial Performance**

	20X2	(restated) 20X1
	CU	CU
Surplus before interest	30,000	18,000
Interest expense	(3,000)	(2,600)
Surplus	<u>27,000</u>	<u>15,400</u>

### **Public Sector Entity – Statement of Changes in Net Assets/Equity**

	(restated)	
	Contributed capital	Accumulated Surplus
		Total

	Contributed capital CU	(restated) Accumulated Surplus CU	Total CU
Balance at 31 December 20X0 as previously reported	10,000	20,000	30,000
Change in accounting policy with respect to the capitalization of interest (Note 1)	-	(5,200)	(5,200)
Balance at 31 December 20X0 as restated	10,000	14,800	24,800
Surplus for the year ended 31 December 20X1 (restated)	-	15,400	15,400
Balance at 31 December 20X1	10,000	30,200	40,200
Surplus for the year ended 31 December 20X2	-	27,000	27,000
Closing at 31 December 20X2	10,000	57,200	67,200

**Extracts from the Notes**

- During 20X2, the entity changed its accounting policy for the treatment of borrowing costs related to a hydro-electric power station. Previously, the entity capitalized such costs. They are now written off as expenses as incurred. Management judges that this policy provides reliable and more relevant information because it results in a more transparent treatment of finance costs ~~and is consistent with local industry practice, making the entity's financial statements more comparable.~~ This change in accounting policy has been accounted for retrospectively and the comparative statements for 20X1 have been restated. The effect of the change on 20X1 is tabulated below. Opening accumulated surpluses for 20X1 have been reduced by CU5,200 which is the amount of the adjustment relating to periods prior to 20X1.

<i>Effect on 20-1</i>	CU
(Increase) in interest expense	(2,600)
(Decrease) in surplus	(2,600)
<i>Effect on periods prior to 20-1</i>	
(Decrease) in surplus	(5,200)
(Decrease) in assets in the course of construction and in accumulated surplus	(7,800)

### **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.~~

### **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 the provisions of the related International Accounting Standard.*

### **Background**

- BC1. The IPSASB’s IFRS Convergence Program is an important element in IPSASB’s work program. The IPSASB’s strategy is to converge the accrual basis IPSASs with IFRSs issued by the 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 1993 version. 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 (US). The Short-Term Convergence project is aimed at reducing differences between IFRSs and the US Generally Accepted Accounting Principles 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 benchmark treatment of immediate recognition as an expense of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. Therefore under the revised IAS 23 borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that 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.
- BC5. IPSAS 5 varies significantly from IAS 23 in respect of the treatment of borrowing costs. The IPSASB decided that it was inappropriate for public sector entities to capitalize borrowing costs except in limited cases. Even in those cases, capitalization should not be mandatory. In the limited cases where capitalization of borrowing cost is permitted, the principles established in IAS 23 are followed. This Basis for Conclusions explains the public sector specific reasons for these departures from the revised IAS 23. These are:
- Budgeting and Borrowing in the Public Sector;
  - Purpose of Holding Non-Cash-Generating Assets in Public Sector;
  - Non-Cash-Generating Assets and Fair Value Measurements;
  - Allocation of Borrowing Costs When Borrowing is on a Centralised Basis;
  - Convergence with Statistical Bases of Reporting;

### **Budgeting and Borrowing in the Public Sector**

- BC6. A feature unique to the public sector is that governments frequently budget for deficits, sometimes for extended periods, and finance those deficits by borrowing. This type of borrowing is unrelated to the acquisition, construction or production of qualifying assets and there is often no meaningful way to allocate such borrowing costs to qualifying assets. Often outlays on qualifying assets are a relatively minor part of the government's annual outlays, the bulk of which are consumed by expenses, such as the payment of social benefits to individuals and households. This can be distinguished from the for-profit sector where entities will normally budget for a loss only in unusual circumstances, and certainly not for an indefinite period.
- BC7. Governments and other public sector entities are often market makers in the bond market, whereby their securities form the benchmark security for the bond market, and form the basis for pricing other securities. Some governments that report surpluses in their statements of financial performance, net assets in their statements of financial position, and net inflows of cash from operations nevertheless issue debt into the market to create a market for debt securities. Such actions are often public policy debt issuings, and may be made irrespective of the government's need for the funds raised by the debt issue. Private sector entities do not normally issue debt for public policy purposes.
- BC8. The reasons for public sector borrowing outlined in the preceding paragraph mean that there is little linkage between these types of borrowing and the acquisition, construction or production of qualifying assets. While it may be feasible to allocate these borrowings to qualifying assets, the IPSASB is of the view that doing so may not be cost-effective. The necessity of tracking borrowing costs over many years and attributing such borrowing costs to qualifying assets will necessarily add complexity to the financial management system. The IPSASB is not convinced that such additional complexity and resultant costs will be justified by yielding additional benefits to users of financial statements.

### **Purpose of Holding Non-Cash Generating Assets in Public Sector**

- BC9. The IPSASB also considered the nature of most of the assets operated by public sector entities. The majority of qualifying assets acquired, constructed or produced by public sector entities are non-cash generating assets as defined in IPSAS 21, "Impairment of Non-Cash Generating Assets". These assets are not intended to generate positive cash inflows during the course of their useful lives. The IPSASB considers that incorporating borrowing costs attributable to their acquisition, production or development in the carrying amount of these assets would be misleading to users of public sector general purpose financial statements. This is because in the private sector a project is evaluated on the basis of its anticipated return on investment, including the ability of an asset to generate sufficient cash-flows to service the cost of borrowings made for its acquisition, construction or production. Therefore many argue that the capitalization of borrowing costs is appropriate- such a view is reflected in the revised IAS 23. In the public sector, however, projects to develop non-cash generating assets are not initiated on the basis of the assets' ability to generate positive cash inflows. In the public sector the financing decisions of the entity should, therefore be distinguished from particular asset acquisition decisions.

### **Non-Cash Generating Assets and Fair Value Measurements**

- BC10. For public sector entities adopting the revaluation model for non-cash generating property, plant and equipment, the IPSASB noted that there are significant practical difficulties in incorporating borrowing costs in the carrying values for measurement subsequent to initial recognition and have concerns over the reliability of resultant asset valuations. For these reasons the IPSASB concluded that expensing borrowing costs is a more appropriate treatment for the public sector and results in greater transparency when the revaluation model for non-cash generating property, plant and equipment is adopted..



### **Allocation of Borrowing Costs**

BC11. In the public sector controlling entities may have a large number of controlled entities. Many of these controlled entities may be responsible for acquiring or constructing qualifying assets with long depreciable lives. Although there will be a need to follow the general policies of government, there are likely to be diverse governance arrangements and many controlled entities are likely to have their own financial management systems, reflecting local reporting needs. Funding to such controlled entities may be by means of appropriation from a central fund without regard to whether such appropriations are financed from taxes or borrowings. Any system of accounts and records to track directly attributable borrowing costs, their application to qualifying assets, and the subsequent depreciation impacts would be complex, resource demanding and costly. The IPSASB does not think that such costs would be commensurate with the benefits to users of accounting requirements mandating the capitalizing of borrowing costs.

### **Convergence with Statistical Bases of Reporting**

BC12. The IPSASB has a key strategic theme to converge IPSASs with statistical bases of reporting where appropriate. Under statistical bases of reporting borrowing costs are recognized as an expense in the period in which they are incurred. The IPSASB is of the view that the approach to borrowing costs established in IPSAS 5 furthers this strategic theme in an appropriate manner, whilst still permitting entities to converge their reporting in relation to their cash-generating assets with FRS (see below paragraph BC14).

### **Overall Conclusion: Approach to Borrowing Costs and Qualitative Characteristics of Financial Reporting**

BC13 For the above reason the IPSASB concluded that a general requirements to capitalize directly attributable borrowing costs as part of the cost of qualifying assets would not satisfy the qualitative characteristics of general purpose financial statements in the public sector. In particular, the IPSASB believes that that capitalizing most borrowing costs in the public sector would not increase the relevance of aspects of the financial statements and would not enhance accountability.

### **Cash-Generating Assets**

BC14 As noted above a key aspect of the IPSASB's strategy is the convergence of IPSASs with IFRSs where the provisions of the IFRSs are relevant for the public sector. The IPSASB has concluded that for cash-generating qualifying assets, entities should be permitted to apply an approach that enhances comparisons with private sector entities holding similar assets and applying IAS 23, provided that conditions related to the nature of the borrowing are satisfied. It is for public sector entities to evaluate whether the benefits of adopting such a treatment are commensurate with the costs. The IPSASB is of the view that only those borrowing costs that are specifically incurred for the acquisition, construction or production of a cash-generating qualifying asset should be eligible for capitalization. Other borrowing costs in the public sector are too remote from the acquisition of cash-generating qualifying assets and any allocation risks being arbitrary. The IPSASB has also concluded that cash-generating assets acquired through non-exchange transactions, which are initially recognized at their fair value as at the date of acquisition in accordance with IPSAS 12, "Inventories"; IPSAS 16, "Investment Property"; IPSAS 17, "Property, Plant and Equipment" should be excluded from the scope of the IPSAS.

## **Other Changes**

### **Outlay(s)**

BC11. 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. It was therefore decided to use the term “outlay(s)” in IPSAS 5 to replace the equivalent term “expenditure(s)” in IAS 23.

### **Applicable Outlays**

BC12. 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”. The IPSASB has not included this requirement because the IPSAS does not permit the capitalization of interest related to assets acquired through non-exchange transactions.

### 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:

- IPSAS 5 requires the recognition of an expense in relation to borrowing costs in the period in which they are incurred, except that borrowing costs specifically incurred for the acquisition, construction or production of a cash—generating qualifying asset may be capitalized. IAS 23 requires the capitalization of all borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset.
- ~~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 “net assets/equity,” “economic entity,” “controlling entity” and “controlled entity” in IPSAS 5. The equivalent terms in IAS 23 are “equity,” “group,” “parent” and “subsidiary.”
- IPSAS 5 uses the term “outlay(s)” to replace the equivalent term “expenditure(s)” in IAS 23.
- IAS 23 requires expenditures to be reduced by the amount of progress payments received and government grants received in connection with the asset. IPSAS 5 does not contain a similar provision because it does not permit the capitalization of borrowing costs in relation to assets acquired by means of a non-exchange transaction.
- IPSAS 5 has different transitional provisions to IPSAS 23. The transitional provisions in IPSAS 5, encourage, but do not require, an entity to adjust its financial statements in accordance with IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” when application of IPSAS 5 constitutes a change in accounting policy.

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