



**INTERNATIONAL FEDERATION  
OF ACCOUNTANTS**

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**Agenda Item  
5**

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**DATE:** February 9, 2009  
**MEMO TO:** Members of the IPSASB  
**FROM:** Annette Davis  
**SUBJECT:** Borrowing Costs

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**OBJECTIVE OF THIS SESSION**

- To **note** the responses received on ED 35 “Borrowing Costs”.
- To **review** the Staff analysis of those submissions.
- To **approve** the next steps for this project.

**AGENDA MATERIAL**

- 5.1 Responses to ED 35 “Borrowing Costs”
- 5.2 ED 35 “Borrowing Costs”

**BACKGROUND**

1. In early 2007, the IPSASB initiated 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 that project, the IPSASB reviewed the IASB’s amendments to IAS 23, “Borrowing Costs” issued in March 2007.
2. As a result of the review of IAS 23, the IPSASB issued exposure draft (ED) 35, Borrowing Costs (*Revised 200X*) on September, 3 2008. It proposed amendments to IPSAS 5 “Borrowing Costs” to reflect that, in many circumstances, the capitalization of borrowing costs as part of the cost of an asset is not appropriate for public sector entities. This view, which is a departure from the current IPSAS 5 and IAS 23, is as a result of the IPSASB’s consideration of the issue from a public sector context.
3. The ED also proposes, however, that where entities borrow funds specifically to acquire, construct or produce a qualifying asset, the entity has the option to capitalize those costs as part of the cost of that asset.
4. The comment period ended on January, 7 2009.

## **OVERVIEW**

5. The IPSASB received 23 responses to ED 35. A list of the respondents is set out in Appendix A. The responses vary, Respondents 008 and 013 would prefer that all borrowing costs are expensed, whereas Respondents 014 and 015 would prefer that all directly attributable borrowing costs are required to be capitalised to the appropriate qualifying asset. Some respondents agreed that the inclusion of an option as to whether to capitalise “specifically incurred” borrowing costs is acceptable, but other respondents considered that options in accounting standards “are rarely appropriate” (Respondent 007).
6. This memo is structured as follows.
  - a. Specific matter for comment.
  - b. Development of a Standard based on ED 35.
  - c. Summary of other issues.
  - d. Next steps.

## **SPECIFIC MATTER FOR COMMENT**

7. The IPSASB asked for comments on the following Specific Matter for Comment.

This Exposure Draft proposes that borrowing costs be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with this proposal?

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

8. The following table analyzes the responses received by geographical area and whether the overall response to the proposals in ED 35 is positive or negative. Judgement has been necessary in clarifying responses and drawing out whether the overall view of the respondent is positive or negative. The analysis in this memo should therefore be read in conjunction with the submissions themselves. Appendix D contains a list of respondents.

**Table: Geographical analysis of overall responses to ED 35**

| <b>Region</b> | <b>Supports<br/>ED 35</b> | <b>Does not<br/>support ED 35</b> | <b>Wants<br/>clarification</b> | <b>No clear<br/>view</b> |
|---------------|---------------------------|-----------------------------------|--------------------------------|--------------------------|
| Australasia   | 6                         | 2                                 |                                |                          |
| Europe        | 1                         | 7                                 |                                |                          |
| North America | 2                         | 1                                 |                                | 1                        |
| South Africa  |                           | 1                                 | 1                              |                          |
| Japan         | 1                         |                                   |                                |                          |
| <b>Total</b>  | <b>10</b>                 | <b>11</b>                         | <b>1</b>                       | <b>1</b>                 |

9. Ten respondents (001, 002, 003, 004, 009, 010, 012, 013, 017, 020) supported the proposals in ED 35. Extracts of their comments are set out in Appendix E.
10. Approximately half of the respondents did not agree with the proposals in ED 35, for three main reasons:
  - a. The inclusion of an option to either capitalize or expense specifically incurred borrowing costs on the acquisition, construction or production of a qualifying asset (Respondents 007, 018, 021, 022 and less clearly Respondent 016);
  - b. The limiting of borrowing costs eligible to be capitalized from “directly attributable” in IAS 23 to “specifically incurred” (Respondents 014, 015, 019); and
  - c. The lack of robustness in the justification for the departure from IAS 23 (Respondents 005, 006).

Extracts of their comments are set out in Appendix F.

11. Respondents 008 and 023 did not support any of the proposals in ED 35 and considered that all of the reasons, set out above in paragraph 10, were valid reasons not to support ED 35. Both respondents’ considered that the IPSASB should reconsider this issue and depart from IAS 23 only on the basis of either public sector specific reasons that are consistent with the IPSASB’s “rules of the road” or by forming a conceptual view regarding the costs which should be included in the initial measurement of an asset. Extracts of their comments are set out in Appendix F.
12. Several of the respondents that did not agree with the proposals in ED 35 were national standard setters whereas the respondents which generally supported the proposals tended to be preparers.

#### **DEVELOPING A STANDARD BASED ON ED 35**

13. The above analysis indicates that the main area of disagreement for the majority of those opposing the proposals is the option to either capitalize or expense “specifically incurred” borrowing costs. Removing the option does not alter the core proposal that all other borrowing costs, i.e. general borrowing costs, should be expensed. The removal of the option also removes the internal inconsistency in ED 35 which proposes to prohibit the capitalisation of general borrowing costs, but make the capitalization of specifically incurred borrowing costs optional. Thus, Staff proposes that specifically incurred borrowing costs are required to be capitalised. This proposal would appear to address the concerns of the majority of the respondents who disagreed with the proposals in ED 35.

| ED 35 proposals  | Staff proposal  |
|--|---|
| <ul style="list-style-type: none"> <li>Expense all borrowing costs, except to the extent that they are specifically incurred for the acquisition, construction or production of a qualifying asset.</li> </ul> | <ul style="list-style-type: none"> <li>Same, i.e.:</li> <li>Expense all borrowing costs, except to the extent that they are specifically incurred for the acquisition, construction or production of a qualifying asset.</li> </ul> |
| <ul style="list-style-type: none"> <li>Borrowing costs specifically incurred for the acquisition, construction or production of a qualifying asset may be capitalized.</li> </ul>                              | <ul style="list-style-type: none"> <li>Remove option, i.e.:</li> <li>Borrowing costs specifically incurred for the acquisition, construction or production of a qualifying asset shall be capitalized.</li> </ul>                   |

14. To support the proposed requirement to capitalize specifically incurred borrowing costs, the Basis for Conclusions has been amended, as set out below, marked-up for changes.

BC9. The IPSASB acknowledged, however, that there may be cases where public sector entities borrow specifically to finance the acquisition, construction or production of a qualifying asset, for example, where a municipality issues bonds specifically to finance ~~the construction of a bridge~~~~an identified infrastructure project~~. The IPSASB considered that in such cases capitalizing borrowing costs ~~may be~~~~is~~ appropriate as the borrowing costs are specifically related to that project. The use of the term “specifically incurred” means that there should be no difficulty in identifying relevant costs. Thus, the costs of providing such information to users of the financial statements should not outweigh the benefits obtained, and therefore entities should be permitted to capitalize borrowing costs specifically incurred for the acquisition, construction or production of a qualifying asset. However, because of cost benefit considerations and issues associated with the relevance of the resulting information, the IPSASB concluded that the capitalization of borrowing costs should not be required, but instead should be optional in cases where a public sector entity borrows specifically to finance the acquisition, construction or production of a qualifying asset.

15. Appendix A contains the “standard” paragraphs of ED 35, together with other comments from respondents and marked-up text of Staff proposals for the amendment of those paragraphs.

**Does the Board agree with the Staff’s proposal on the finalization of ED 35?**

## SUMMARY OF OTHER ISSUES

16. Respondents raised several other issues regarding ED 35. Most of these issues have been addressed in Appendix A, with proposed changes to the text of the standard shown in marked up text. However, there were a few issues raised which do not affect the text of the standard, but need to be considered. These issues are considered below.

**Guidance on borrowing costs on subsequent revaluation of the qualifying asset**

17. Respondents 001, 009, 010 and 013 raised an issue regarding the interaction between capitalizing borrowing costs on initial recognition of a qualifying asset and the subsequent revaluation of that asset. These respondents were also concerned about the lack of guidance regarding borrowing costs and asset revaluations. Staff proposes that an additional paragraph be included in the Basis for Conclusions, as follows.

**The effect of borrowing costs on subsequent revaluation of the qualifying asset**

BC3A This Standard is concerned only with the determination of the cost of an asset and its scope specifically excludes assets measured at fair value on initial recognition. Where assets are revalued subsequent to initial recognition, the Standard does not preclude or require the assessment of that value from including the fair value effect of borrowing costs that might be incurred on replacement. The Board understands that, from a valuation perspective, there is little guidance on the inclusion of borrowing costs into asset valuation. They believe that it is for the preparers to decide, in consultation with valuers, whether the inclusion or exclusion of borrowing costs is a better representation of fair value.

18. Respondent 006 raised an issue regarding paragraph BC12, which relates to the revaluation issue. Respondent 006 does not agree with the conclusion in BC12. Paragraph BC12 is set out below.

**Non-Cash-Generating Assets and the Revaluation Model in IPSAS 17**

Under the requirements of IPSAS 17, "Property, Plant and Equipment," many specialized non-cash-generating assets are revalued to fair value on the basis of a cost-based estimate of fair value such as depreciated replacement cost. Current guidance on such revaluation bases does not adequately address the issue of how borrowing costs should be incorporated into the calculation of fair value. In the absence of authoritative guidance on this issue the IPSASB was concerned at the prospect of a range of practices emerging in response to compulsory capitalization of borrowing costs, which would reduce the reliability of the information provided. The IPSASB therefore concluded that it would be inappropriate to require capitalization in respect of qualifying assets that are carried on the revaluation model in IPSAS 17.

19. Staff propose that paragraph BC12 is deleted as the inclusion of BC3A addresses the issue of valuation.

**Consolidation issues**

20. Respondents 001, 012 and 018 raised an issue regarding the inclusion of capitalized borrowing costs on consolidation, where different accounting policies are used within the economic entity. This is particularly relevant where a GBE is included in the consolidated financial statements.
21. Where a GBE capitalizes borrowing costs, those costs will be directly attributable to the associated qualifying asset, using the requirements of IAS 23, whereas a public sector entity capitalizes only those borrowing costs specifically incurred for a qualifying asset, under the requirements of IPSAS 5 (revised). That is,

accounting standards identify the costs to be included in the cost of an asset differently for different sectors. It is well understood that costs of similar assets will differ between entities as a result of operational decisions, such as should we make or buy that asset and management decisions, such as is this asset to be treated as inventory or property. On consolidation, the amounts in the financial statements are not adjusted to reflect that the controlling entity may use those assets differently and so apply a different accounting treatment. The difference in the amount of borrowing costs capitalized is driven by sectoral differences and these differences should not be adjusted on consolidation.

22. To consider that a GBEs treatment of borrowing costs should be adjusted on consolidation into a public sector controlling entity, leads to a much bigger question regarding the removal of all differences in accounting treatment between GBEs and the public sector controlling entity on consolidation. This is a pervasive issue and should not be addressed in only one standard, in this instance borrowing costs.

**The link between “directly attributable” and “specifically incurred” borrowing costs**

23. Respondents 001 and 006 suggested that the distinction between directly attributable borrowing costs and specifically incurred borrowing costs needs to be clarified and the proposed deletion of the first sentence in paragraph 15 should be reinstated to help address this concern. Respondent 013 suggested that preparers would have difficulty in interpreting the meaning of “specifically incurred”, perhaps leading to inconsistent application across entities. Staff considers that to address these concerns, the first sentence of paragraph 15 should be reinstated and adapted to emphasise that the borrowings must be directly linked to obtaining a qualifying asset. The text of this sentence is set out below for reference.

The borrowing costs that are specifically incurred to the acquisition, construction or production of a qualifying asset are those borrowing costs that are directly linked to the qualifying asset and that would have been avoided if the expenditure on the qualifying asset had not been made.

24. Staff also proposes that the text in the Basis for Conclusions is amended, as follows.

**Specifically Incurred Borrowing Costs and Directly Attributable Borrowing Costs**

BC10. Paragraphs BC5–BC7 above set out the reasons for borrowing in the public sector. In summary, borrowing in the public sector is undertaken for reasons of policy relating to:

- (a) the funding of operating deficits;
- (b) the acquisition of assets; or
- (c) borrowing to provide liquidity in a capital market.

BC10A Due to the fact that the level of borrowing is determined for policy reasons, the IPSASB concluded that capitalization of borrowing costs would be limited to specifically incurred borrowing costs that would have been avoided if the acquisition, construction or production of a qualifying asset had not occurred. The IPSASB acknowledges that this is a departure from IAS 23, as that Standard requires the capitalization of directly attributable borrowing costs. Having concluded that the option to capitalize borrowing

~~costs should be limited to such costs related to financing specifically incurred for the acquisition, construction or production of a qualifying asset, the IPSASB considered whether the term “directly attributable” used in IAS 23 achieves this objective. In IAS 23, borrowing costs that are “directly attributable” to the acquisition, construction or production of qualifying assets are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. Effectively, this means any borrowings of the entity are attributed to the acquisition, construction or production of qualifying assets. However, due to the nature of public sector borrowings, the Board concluded that a departure from IAS 23 from directly attributable borrowing costs to specifically incurred borrowing costs is appropriate.~~

~~BC10B. Such Directly attributable borrowings are not limited to funds borrowed specifically for the purpose of acquiring, constructing or producing a particular qualifying asset. Thus “directly attributable” borrowing costs may include costs related to general borrowing, including interest on short-term borrowings such as bank overdrafts, which are not linked to any particular project. The IPSASB therefore concluded that the term “directly attributable” is broader than “specifically incurred” and that its use would not be in accordance with its conclusion that, in the public sector, the option requirement to capitalize borrowing costs should be limited to those costs specifically incurred to finance the acquisition, construction or production of a qualifying asset. An approach of apportioning ~~other otherwise avoidable~~ borrowing costs incurred by the entity is not appropriate due to the mix of reasons for making the borrowings is also likely to be complex for the reasons outlined in paragraph BC8 and is likely to give rise to costs that exceed the related benefits.~~

BC11. The IPSASB noted that some governments operate under fiscal rules that only permit them to borrow for capital purposes. The IPSASB concluded that the existence of such rules on their own is insufficient to create a strong enough link between borrowing and the acquisition, construction or production of specific qualifying assets for the option requirement to capitalize borrowing costs to be exercised. The borrowing needs to be specifically raised for the acquisition, construction or production of a qualifying asset and not part of a general fund.

### **Finance charges arising on service concession arrangements**

25. Respondents 015 and 016 raised an issue regarding the definition of borrowing costs. They were concerned regarding the lack of clarity as to whether the term “borrowing costs” includes finance charges arising from a service concession arrangement. It is unclear from the respondents’ comments whether their concerns relate to public sector entity operators or grantors or both. Staff are unaware of any issues arising for grantors, but can see that there may be issues for operators.
26. The IPSASB does not currently have any guidance on service concession arrangements for either grantors or operators. However, it does have a project which issued, in March 2008, a Consultation Paper “Accounting and Financial Reporting for Service Concession Arrangements”. The Consultation Paper described public-private partnerships (PPPs) as an arrangement between a public sector entity and a private sector entity to deliver a public sector asset (normally infrastructure or a public facility) and/or service. Service Concession Arrangements (SCAs) differ from other types of PPP arrangements in that the risks and benefits associated with constructing, owning and operating the underlying property, along with the control over the property, are shared to a

greater degree by the public sector entity and private sector entity involved in the arrangement.

27. Because the public sector entity is generally the grantor in these arrangements, the project is focused on the accounting and financial reporting issues of the grantor. Only limited consideration is given, in the Consultation Paper, to operators to these arrangements. This is primarily because operators (whether a private sector entity or a government business enterprise) generally would consider IFRIC 12 “Service Concession Arrangements” and SIC 29 “Service Concession Arrangements: Disclosures”, to determine their accounting and financial reporting for service concession arrangements.
28. For a profit-oriented entity or a GBE, paragraph 22 of IFRIC 12 gives guidance on borrowing costs, as set out below.

In accordance with IAS 23, borrowing costs attributable to the arrangement shall be recognized as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service). In this case borrowing costs attributable to the arrangement shall be capitalized during the construction phase of the arrangement in accordance with that Standard.

29. Public sector entities which are not GBEs but are operators may opt to apply IFRIC 12 via the operation of the hierarchy in IPSAS 3 “Accounting Policies, Changes in Accounting Estimates and Errors”.
30. It is expected that an Exposure Draft on accounting and financial reporting for service concession arrangements by grantors will be discussed at the May 2009 IPSASB meeting. Further investigation of the respondents’ comments is necessary to determine whether there is an issue.

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

31. Respondents 006 and 021 suggest that the heading above paragraph 23 be changed as the paragraph deals with impairment generally and lists recoverable service amount, current replacement cost, recoverable amount and net realizable value. However, Respondent 020 gives an explanation of why recoverable service amount does not need to be separately listed. Staff has used this explanation to form the basis of a paragraph to be inserted into the Basis for Conclusions, as set out below.

**Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount**  
BC13A. As defined in the IPSASB “Glossary of Defined Terms”, there is no difference between the definitions of “recoverable amount” and “recoverable service amount” for non-cash-generating assets. Recoverable amount applies to both cash-generating and non-cash-generating assets. Therefore, it is unnecessary to include both terms in paragraph 23.



32. Therefore, Staff has deleted recoverable service amount from paragraph 23. Current replacement cost has also been added to paragraph 23. Staff has also deleted this term so as to align the wording of this paragraph with IAS 23 as there does not appear to be a public sector specific reason for including it.

### **Terminology**

33. Respondent 023 made two suggestions regarding terminology differences:
- a. That it would be helpful for all terminology changes to be discussed in a separate section of the Basis for Conclusions; and
  - b. That the IPSASB consider publishing a list of terminology changes to help readers of the Standards understand why a change has been made and promote consistency in future IPSASs.
34. Regarding 32(a) above, Staff proposes to change the heading of the relevant paragraph from its current “Other Difference–Outlays” to “Terminology–Outlays”.

### **NEXT STEPS**

35. The section on developing a standard based on ED 35 above sets out Staff proposals for the finalization of ED 35. Staff considers that the finalization of ED 35 into a standard is feasible.
36. However, if the Board does not consider that this approach is feasible, Staff considers that there are three options as to how to proceed, as set out below.
- **Option A: Develop a standard based on IAS 23.**  
From the analysis of responses there does not appear to be enough support to be able to finalise a standard requiring the capitalization of directly attributable borrowing costs.
  - **Option B: Develop a revised exposure draft based on the responses received.**  
In light of the mixed responses it will not be possible to develop an IPSAS that reflects a consensus. However, as indicated in paragraph 10, the main concern of a large number of those opposing the ED, is the inclusion of an option permitting entities to either expense or capitalize specifically incurred borrowing costs. Staff has suggested that this concern can be allayed by removing the option to expense specifically incurred borrowing costs.
  - **Option C: Keep the existing IPSAS 5 and issue a statement to advise that this project has been put on hold, pending further work on the conceptual framework project.**

The analysis of responses to ED 35 indicates that there are differing opinions as to whether borrowing costs should be included in the initial measurement of an asset in the public sector. A statement could be issued to inform constituents of the IPSASB's deliberations so far and the decision to put this project on hold, pending further work on the conceptual framework project. See Appendix C for further explanation of this Option.

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| <p><b>Where the Board does not agree to finalize a Standard based on ED 35, which of the above options to they support?</b></p> |
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**APPENDIX A: TEXT OF ED 35 BORROWING COSTS**

| TEXT OF ED 35   | PROPOSED TEXT   | STAFF COMMENTS   |
|---|---|--|
| <b>Core Principle</b>   |   | Respondents 006 and 021 proposed that this heading be changed back to “Objective” to be consistent with other IPSASs and only change to “Core Principle” when all other IPSASs are changed.<br>Staff proposes to leave the heading as it is because standards evolve over time and so have formatting differences. |
| 1. <b>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 qualifying asset that is initially measured at cost. In such cases borrowing costs may form part of the cost of that qualifying asset.</b> | 1. <b>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 qualifying asset that is initially measured at cost. In such cases borrowing costs may form part of the cost of that qualifying asset.</b> | No comments from respondents.  |
| 2. <b>An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for borrowing costs.</b>  | 2. <b>An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for borrowing costs.</b>  | No comments from respondents.  |
| 3. <b>This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).</b>  | 3. <b>This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).</b>  | No comments from respondents.  |
| 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.”   | 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.”   | No comments from respondents.  |
| 5. This Standard does not deal with the actual or imputed cost of net assets/equity. Where jurisdictions apply a capital charge to individual   | 5. This Standard does not deal with the actual or imputed cost of net assets/equity. Where jurisdictions apply a capital charge to individual   | No comments from respondents.  |

| TEXT OF ED 35   | PROPOSED TEXT   | STAFF COMMENTS  |
|---|---|---|
| entities, judgment will need to be exercised to determine whether the charge meets the definition of borrowing costs or whether it is to be treated as an actual or imputed cost of net assets/equity.  | entities, judgment will need to be exercised to determine whether the charge meets the definition of borrowing costs or whether it is to be treated as an actual or imputed cost of net assets/equity.  |   |
| 6. <b>This Standard shall not be applied to borrowing costs specifically incurred for the acquisition, construction or production of a qualifying asset measured at fair value at initial recognition.</b>  | 6. <u>An entity is not required to apply the This Standard <del>shall not be applied</del> to borrowing costs specifically incurred for the acquisition, construction or production of:</u><br><br>(a) a qualifying asset measured at fair value <del>at initial recognition</del> <u>for example a biological asset; or</u><br><br>(b) <u>inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis.</u> | Respondent 006 suggests that: <ul style="list-style-type: none"> <li>this paragraph should be in normal text (ie not bold) to be consistent with IAS 23;</li> <li>that the wording should be the same as the equivalent paragraph in IAS 23.4;</li> <li>that IAS 23.4(b) should be included; and</li> <li>that an example should be given to explain this paragraph in that the scope exclusion “is that of assets acquired as part of a non-exchange transaction”.</li> </ul> Respondent 021 also suggested bullet points 2 and 3.<br><br>Staff has incorporated the first three suggestions. Staff proposes not to make an amendment for the last bullet point because biological assets are measured at fair value on initial recognition. |
| <b>Definitions</b>  |   |   |
| 7. <b>The following terms are used in this Standard with the meanings specified:</b><br><br><b><u>Borrowing costs</u></b> are interest and other expenses incurred by an entity in connection with the borrowing of funds.<br><br>A <b><u>qualifying asset</u></b> is an asset that necessarily | 7. The following terms are used in this Standard with the meanings specified:<br><br><b><u>Borrowing costs</u></b> are interest and other <del>expenses costs that an entity incurs incurred by an entity</del> in connection with the borrowing of funds.  | Respondents 006 and 021 suggest that the qualifying asset definition be amended to include “distribution” to be consistent with IPSAS 12 “Inventories”.<br><br>Staff has incorporated this suggestion.<br><br>Respondent 020 suggests that it would be  |

| TEXT OF ED 35   | PROPOSED TEXT  | STAFF COMMENTS   |
|---|--|--|
| <p>takes a substantial period of time to get ready for its intended use or sale.</p> <p>Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meaning as in those other Standards, and are reproduced in the Glossary of Defined Terms published separately.</p>  | <p>A <u>qualifying asset</u> is an asset that necessarily takes a substantial period of time to get ready for its intended use, <del>or sale</del> <u>or distribution</u>.</p> <p>Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meaning as in those other Standards, and are reproduced in the Glossary of Defined Terms published separately.</p>   | <p>useful to include guidance on “substantial period of time”.</p> <p>The term “substantial period of time” is used in the existing IPSAS 5 without any additional guidance. Therefore, staff has not incorporated this suggestion.</p> <p>Respondent 023 notes that the definition of borrowing costs in the revised IAS 23 is slightly different to that in ED 35.</p> <p>Staff has marked-up the changes to the borrowing costs definition.</p> |
| <b>Borrowing Costs</b>  |  |  |
| <p>8. Borrowing costs may include:</p> <p>(a) Interest on short-term and long-term borrowings;</p> <p>(b) Amortization of discounts or premiums relating to borrowings;</p> <p>(c) Amortization of ancillary costs incurred in connection with the arrangement of borrowings;</p> <p>(d) Finance charges in respect of finance leases recognized in accordance with IPSAS 13, “Leases”; and</p> | <p>8. Borrowing costs may include:</p> <p>(a) <del>Interest on short term and long term borrowings</del> <u>Interest expense using the effective interest method as described in [draft] IPSAS xx “Financial Instruments: Recognition and Measurement”;</u></p> <p>(b) <del>Amortization of discounts or premiums relating to borrowings;</del></p> <p>(c) <del>Amortization of ancillary costs incurred in connection with the arrangement of borrowings;</del></p> <p>(d) Finance charges in respect of finance leases</p> | <p>Respondents 006 and 023 suggest that the wording should be aligned with the latest version of IAS 23.</p> <p>Staff has marked-up the changes.</p>   |
| <b>Qualifying Assets</b>  |  |  |
| <p>9. Depending on the circumstances, examples of qualifying assets include:</p> <p>(a) Hospitals;</p> <p>(b) Office buildings;</p>   | <p>9. Depending on the circumstances, <u>examples of any of the following may be</u> <del>qualifying assets include:</del></p> <p>(a) Hospitals;</p> <p>(b) Office buildings;</p>  | <p>Respondent 006 suggests that an example of an intangible qualifying asset should be added once ED 40 “Intangible Assets” becomes a Standard.</p> <p>Staff does not consider that this is necessary</p>  |

| TEXT OF ED 35  | PROPOSED TEXT  | STAFF COMMENTS  |
|--|--|---|
| <p>(c) Infrastructure assets such as roads and bridges;</p> <p>(d) Power generation facilities;</p> <p>(e) Intangible assets; and</p> <p>(f) Investment properties.</p> <p>Inventories that are produced over a short period of time and financial assets are not qualifying assets. Assets that are ready for their intended use, sale or distribution when acquired are not qualifying assets.</p> | <p>(c) Infrastructure assets such as roads and bridges;</p> <p>(d) Power generation facilities;</p> <p>(e) Intangible assets; and</p> <p>(f) Investment properties.</p> <p><u>Financial assets, and inventories that are manufactured, or otherwise produced, over a short period of time, and financial assets</u> are not qualifying assets. Assets that are ready for their intended use, sale or distribution when acquired are not qualifying assets.</p> | <p>as there is no equivalent example in IAS 23.</p> <p>Respondent 020 suggests that it would be useful to describe what is meant by “depending on the circumstances”.</p> <p>Staff does not consider that this is necessary as IAS 23 does not give guidance on this term and there appears to be no public sector reason for including further guidance.</p> <p>Staff has aligned the wording to the latest version of IAS 23 by marking-up the changes.</p> |
| <b>Recognition</b>   |  |   |
| <p>10. 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 11.</p>  | <p>10. An entity shall recognize borrowing costs as an expense in the period in which it incurs them, except to the extent that <u>they are borrowing costs which are specifically incurred for the acquisition, construction or production of a qualifying asset shall be capitalized</u>—in accordance with paragraph 11.</p>  | <p>No comments from respondents.</p> <p>Staff has marked-up text relating to the removal of the option.</p>   |
| <p>11. Borrowing costs that are specifically incurred for the acquisition, construction or production of a 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.</p>  | <p>11. <u>Borrowing costs that are specifically incurred for the acquisition, construction or production of a qualifying asset may be capitalized as part of the cost of that asset.</u> The amount of borrowing costs eligible for capitalization shall be determined in accordance with this Standard.</p>   | <p>Respondent 023 suggests combining this paragraph with paragraph 14.</p> <p>Staff considers this unnecessary as its proposal is to remove the option.</p> <p>Staff has marked-up text relating to the removal of the option.</p>  |
| <p>12. Borrowing costs that are specifically incurred for the acquisition, construction or production of a 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</p>   | <p>12. <u>Borrowing costs that are specifically incurred for the acquisition, construction or production of a qualifying asset may be included in the cost of that asset.</u> <u>Specifically incurred</u> Such borrowing costs may be capitalized as part of the cost of the asset when it is probable that they will result in future</p>  | <p>Respondent 020 suggests that the first sentence should be deleted as it repeats paragraph 11 and, as a consequence, the second sentence should be amended.</p> <p>Staff has marked-up the changes.</p>   |

| TEXT OF ED 35   | PROPOSED TEXT  | STAFF COMMENTS   |
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| service potential to the entity and the costs can be measured reliably. Other borrowing costs are recognized as an expense in the period in which they are incurred.  | economic benefits or service potential to the entity and the costs can be measured reliably. Other borrowing costs are recognized as an expense in the period in which they are incurred.  |  |
| 13. When an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity recognizes 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. | 13. When an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, <u>these borrowing costs are not specifically incurred borrowing costs and therefore,</u> the entity recognizes an expense <del>for the borrowing costs</del> in the period in which they are incurred.<br><u>13A</u> 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. | Respondent 006 suggests clarifying the wording of this paragraph.<br>Staff has marked-up the changes.<br>Respondents 020 and 023 suggest splitting the paragraph into 2 paragraphs as it deals with 2 different subjects.<br>Staff has incorporated this suggestion.                                       |
| 14. <b>Where an entity adopts the treatment in paragraph 11, that treatment shall be applied consistently to all borrowing costs that are specifically incurred for the acquisition, construction or production of all qualifying assets of the entity.</b>   | 14. <del>Where an entity adopts the treatment in paragraph 11, that treatment shall be applied consistently to all borrowing costs that are specifically incurred for the acquisition, construction or production of all qualifying assets of the entity.</del>  | See comments for paragraph 11.<br>Deleted as unnecessary with no option.   |
| <b>Borrowing Costs Eligible for Capitalization</b>  |  |  |
| 15. 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. Funds sourced from general borrowings of the entity are not specifically incurred and costs related to such borrowings are not eligible for capitalization.  | 15. <u>The borrowing costs that are specifically incurred to the acquisition, construction or production of a qualifying asset are those borrowing costs that are directly linked to the qualifying asset and that would have been avoided if the expenditure on the qualifying asset had not been made.</u> When an entity borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that <del>directly-specifically</del> relate to that qualifying asset can be readily identified.  | Respondents 001 and 006 suggest that the proposed deletion of the first sentence of this paragraph be reinstated.<br>Staff has reinstated this paragraph in an amended form. See paragraph 23 of the memo.<br>Respondents 001, 006 and 021 suggest that “directly” should be replaced with “specifically”. |

| TEXT OF ED 35  | PROPOSED TEXT   | STAFF COMMENTS   |
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|  | Funds sourced from general borrowings of the entity are not specifically incurred and costs related to such borrowings are not eligible for capitalization.   | Staff has marked-up changes.   |
| 16. Funds that have been borrowed centrally may be transferred to other entities within the economic entity as a loan, a grant or a capital injection. Some loans may be interest-free or require that only a portion of the actual interest cost be recovered and grants or capital injections do not normally incur interest. Public sector entities may coordinate borrowing to further the economic and fiscal policies of the government. In both cases, borrowing costs in respect of such borrowings do not qualify for capitalization. | 16. <del>Funds that have been borrowed centrally may be transferred to other entities within the economic entity as a loan, a grant or a capital injection. Some loans may be interest-free or require that only a portion of the actual interest cost be recovered and grants or capital injections do not normally incur interest. Public sector entities may coordinate borrowing to further the economic and fiscal policies of the government. In both cases, borrowing costs in respect of such borrowings do not qualify for capitalization.</del> | Respondents 001 and 006 suggest that this paragraph should be clarified. Respondent 006 also suggests that borrowing costs and the capitalization thereof, is not applicable to grants or capital injections as these are not borrowings and should therefore be deleted.<br><br>Staff agrees with Respondent 006 and has deleted the relevant sentences. Staff has also deleted the last part of the paragraph as it is dealt with in paragraphs 19-22. |
| 17. <b>To the extent that an entity borrows funds specifically for the purpose of acquiring, constructing or producing a 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.</b>   | 17. <b>To the extent that an entity borrows funds specifically for the purpose of <u>acquiring, constructing or producing obtaining</u> a 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.</b>   | Respondent 006 suggests that this paragraph should be moved up to be the first in this section.<br><br>Staff is reluctant to reorder paragraphs which are taken from IAS 23.<br><br>Respondent 023 suggests that the wording should be aligned with the latest version of IAS 23.<br><br>Staff has marked-up the changes.  |
| 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  |   | No comments from respondents.  |



| TEXT OF ED 35   | PROPOSED TEXT  | STAFF COMMENTS   |
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| such funds is deducted from the borrowing costs incurred.   |  |  |
| <b>Borrowing Costs Incurred by the Economic Entity</b>  | <del>Borrowing Costs Incurred by the Economic Entity</del>   | Staff proposes to move this section to the Illustrative Examples section of the Standard as each of the paragraphs explains which entities within an economic entity will have specifically incurred borrowing costs. The comments from Respondents regarding these paragraphs have been taken into account in the text of the Illustrative Examples section.<br>See Appendix B. |
| 19. If a controlling entity borrows funds which are then loaned to a controlled entity, the controlled entity may capitalize only those borrowing costs which it itself incurs specifically in relation to the acquisition, construction or production of a qualifying asset. Such costs will normally be documented in the loan agreement with the controlling entity. Where a controlled entity receives an interest-free capital contribution or capital grant, it will not incur any borrowing costs and consequently will not capitalize any such costs. | 19. <del>If a controlling entity borrows funds which are then loaned to a controlled entity, the controlled entity may capitalize only those borrowing costs which it itself incurs specifically in relation to the acquisition, construction or production of a qualifying asset. Such costs will normally be documented in the loan agreement with the controlling entity. Where a controlled entity receives an interest-free capital contribution or capital grant, it will not incur any borrowing costs and consequently will not capitalize any such costs.</del> | Respondents 006 and 020 suggest deleting the last sentence as it is not relevant to borrowing 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 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   | 20. <del>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 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</del>   | Respondent 006 suggests changing the word “can” to “may”.  |

| TEXT OF ED 35  | PROPOSED TEXT   | STAFF COMMENTS  |
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| <p>acquisition, construction or production of a 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 capitalized by the controlled entity.</p>  | <p><del>acquisition, construction or production of a 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 capitalized by the controlled entity.</del></p>  |   |
| <p>21. When a controlling entity has transferred funds at no cost to a controlled entity, neither the controlling entity nor the controlled entity would meet the criteria for capitalization of borrowing costs 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.</p>   | <p><del>21. When a controlling entity has transferred funds at no cost to a controlled entity, neither the controlling entity nor the controlled entity would meet the criteria for capitalization of borrowing costs 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.</del></p>   |   |
| <p>22. When a controlling entity borrows funds generally, and lends part of those funds to a controlled entity specifically for the acquisition, construction or production of a 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. If the controlling entity borrows funds specifically for the acquisition, construction or production of a qualifying asset by a controlled entity, those borrowing costs, if transferred to the controlled entity, may be capitalized in the separate financial statements of the controlled entity and in the consolidated financial statements of the economic entity.</p> | <p><del>22. When a controlling entity borrows funds generally, and lends part of those funds to a controlled entity specifically for the acquisition, construction or production of a 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. If the controlling entity borrows funds specifically for the acquisition, construction or production of a qualifying asset by a controlled entity, those borrowing costs, if transferred to the controlled entity, may be capitalized in the separate financial statements of the controlled entity and in the consolidated financial statements of the economic entity.</del></p> | <p>Respondent 001 suggests that the term "own financial statements" should be used instead of "separate financial statements" as the later term has its own definition which does not fit with the meaning of this paragraph.</p> |

| TEXT OF ED 35   | PROPOSED TEXT  | STAFF COMMENTS  |
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| <p><b>Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount</b></p>   | <p><b>Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount</b></p>  | <p>Respondents 006 and 021 suggest amending this heading to encompass “impairment” as recoverable service amount, current replacement cost, recoverable amount and net realizable value are covered in the paragraph below.</p> <p>Staff proposes to leave the heading as it is. See paragraphs 31-32 in the memo above for the explanation.</p>  |
| <p>23. When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable service amount or its current replacement cost, or its recoverable amount or net realizable value, the carrying amount is written down or written off in accordance with the requirements of IPSAS 12, “Inventories”, IPSAS 21, “Impairment of Non-Cash-Generating Assets” or IPSAS 26, “Impairment of Cash-Generating Assets.” In certain circumstances, the amount of the write-down or write-off, in relation to an impairment of assets, is written back in accordance with IPSAS 21 or IPSAS 26.</p> | <p>23. When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its <del>recoverable service amount or its current replacement cost, or its</del> recoverable amount or net realizable value, the carrying amount is written down or written off in accordance with the requirements of <del>IPSAS 12, “Inventories”, IPSAS 21, “Impairment of Non-Cash-Generating Assets” or IPSAS 26, “Impairment of Cash-Generating Assets.”</del><u>other Standards</u>. In certain circumstances, the amount of the write-down or write-off, <del>in relation to an impairment of assets,</del> is written back in accordance with <del>IPSAS 21 or IPSAS 26</del><u>those other Standards</u>.</p> | <p>Respondent 020 is unclear as to why “the carrying amount” and “the expected ultimate cost” are included at the beginning of the sentence.</p> <p>These terms are used in the previous version of IPSAS 5 and therefore Staff has not made any changes.</p> <p>Staff notes that specific standards have been listed rather than using the generic term “Standards”.</p> <p>Staff proposes to uses “Standards” as this will align the wording with IAS 23.</p> |

| TEXT OF ED 35  | PROPOSED TEXT  | STAFF COMMENTS   |
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| <b>Commencement of Capitalization</b>  | <b>Commencement of Capitalization</b>  |  |
| <p>24. An entity may begin capitalizing borrowing costs as part of the cost of a qualifying asset, in accordance with paragraph 11, on the commencement date. The commencement date for capitalization is the date when the entity first meets all of the following conditions:</p> <p>(a) It incurs outlays for the assets;</p> <p>(b) It incurs borrowing costs specifically incurred for the acquisition, construction or production of the qualifying asset; and</p> <p>(c) It undertakes activities that are necessary to prepare the asset for its intended use, sale or distribution.</p> | <p>24. An entity <del>may</del><u>shall</u> begin capitalizing borrowing costs as part of the cost of a qualifying asset, in accordance with paragraph 11, on the commencement date. The commencement date for capitalization is the date when the entity first meets all of the following conditions:</p> <p>(a) It incurs outlays for the assets;</p> <p>(b) It incurs borrowing costs specifically <del>incurred</del> for the acquisition, construction or production of the qualifying asset; and</p> <p>(c) It undertakes activities that are necessary to prepare the asset for its intended use, sale or distribution.</p> | <p>Respondents 006 and 021 suggest removing the second “incurred” from (b).</p> <p>Staff has marked-up the changes.</p> <p>Staff has marked-up text relating to the removal of the option.</p> |
| <p>25. Outlays on a qualifying asset include only those outlays that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities.</p>   | <p>25. Outlays on a qualifying asset include only those outlays that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities.</p>   | <p>No comments from respondents.</p>   |

| TEXT OF ED 35   | PROPOSED TEXT  | STAFF COMMENTS  |
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| 26. The activities necessary to prepare the asset for its intended use, 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 may be 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. | 26. The activities necessary to prepare the asset for its intended use, 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 <u>prior to the commencement of the physical construction</u> . 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 <del>may be</del> <u>are</u> 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. | Respondent 023 suggests that the wording should be aligned with the latest version of IAS 23.<br><br>Staff has marked-up the changes and removed the option.  |
| <b>Suspension of Capitalization</b>   | <b>Suspension of Capitalization</b>  |   |
| 27. <b>An entity shall suspend capitalization of borrowing costs during extended periods in which it suspends active development of a qualifying asset.</b>   | 27. <b>An entity shall suspend capitalization of borrowing costs during extended periods in which it suspends active development of a qualifying asset.</b>  | Respondent 020 suggests that it would be useful to include guidance on “an extended period”.<br><br>This term is used in the current version of IPSAS 5 and so Staff has not made any changes.<br><br>Respondent 006 suggests that “active development” be changed to “construction or production” to be consistent with the rest of the Standard.<br><br>This term is also used in the current version of IPSAS 5 and so Staff has not made any changes. |
| 28. An entity may incur borrowing costs during an extended period in which it suspends the activities   | 28. An entity may incur borrowing costs during an extended period in which it suspends the activities  | Respondent 001 suggests that “specifically for the construction or production of the  |

| TEXT OF ED 35   | PROPOSED TEXT   | STAFF COMMENTS   |
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| <p>necessary to prepare an asset for its intended use, 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, sale or distribution. For example, capitalization continues during the extended period that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.</p> | <p>necessary to prepare an asset for its intended use, 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, sale or distribution. For example, capitalization continues during the extended period that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.</p> | <p>qualifying asset” be added to the end of the third sentence.</p> <p>This wording is similar to that used in the current version of IPSAS 5 and so Staff has not made any changes.</p> |
| <b>Cessation of Capitalization</b>  | <b>Cessation of Capitalization</b>  |  |
| <p>29. <b>An entity shall cease capitalizing borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use, sale or distribution are complete.</b></p>   | <p>29. <b>An entity shall cease capitalizing borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use, sale or distribution are complete.</b></p>   | <p>No comments from respondents.</p>   |
| <p>30. An asset is normally ready for its intended use, 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 are outstanding, this indicates that substantially all the activities are complete.</p>  | <p>30. An asset is normally ready for its intended use, 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 are outstanding, this indicates that substantially all the activities are complete.</p>  | <p>No comments from respondents.</p>   |

| TEXT OF ED 35  | PROPOSED TEXT  | STAFF COMMENTS  |
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| 31. When an entity completes the construction of a 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, sale or distribution.   | 31. When an entity completes the construction of a 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, sale or distribution.   | <p>Respondent 001 suggests that this sentence be modified as follows.</p> <p><b>“...the entity shall cease capitalizing borrowing costs <u>directly attributable to a given part</u> when it completes substantially all the activities...”</b></p> <p>Respondent 020 suggests that the same part of this sentence be modified <b>“...for that part of the qualifying asset ...”</b></p> <p>This wording is similar to that used in the current version of IPSAS 5 and so Staff has not made any changes.</p> |
| 32. An office development comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being used while construction continues on other parts. Examples of qualifying assets that need to be complete before any part can be used include an operating room in a 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. | 32. An office development comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being used while construction continues on other parts. Examples of qualifying assets that need to be complete before any part can be used include an operating room in a 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. | No comments from respondents.   |
| <b>Disclosure</b>  |  |   |
| 33. An entity shall disclose:  | 33. An entity shall disclose:  | Respondent 020 suggests:  |
| <p>(a) The accounting policy adopted for borrowing costs incurred specifically for the acquisition, construction or production of qualifying assets; and</p> <p>(b) The amount of borrowing costs capitalized during the period, if any.</p>   | <p>(a) The accounting policy adopted for borrowing costs incurred specifically for the acquisition, construction or production of qualifying assets; and</p> <p>(b) The amount of borrowing costs capitalized during the period, if any.</p>   | <ul style="list-style-type: none"> <li>adding a disclosure for the year to date capitalized amount before amortization for ease of comparison; and</li> <li>given the content of paragraphs 19-22 on the economic entity, should reference be made to IPSAS 20</li> </ul>   |

| TEXT OF ED 35  | PROPOSED TEXT  | STAFF COMMENTS   |
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|  |  | <p>“Related Party Disclosures”.</p> <p>Staff do not propose to add the disclosure as IPSAS 1.106 requires material revenue and expenses to be disclosed separately.</p> <p>Staff do not propose to amend the paragraph to refer to IPSAS 20.</p> |
| <b>Transitional Provisions</b>   |  |  |
| <p>34. When application of this Standard constitutes a change in accounting policy, an entity shall apply the Standard to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after the effective date.</p>  | <p>34. When application of this Standard constitutes a change in accounting policy, an entity shall apply the Standard to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after the effective date.</p>  | <p>No comments from respondents.</p>   |
| <p>35. However, an entity may designate any date before the effective date and apply the Standard to borrowing costs relating to all qualifying assets for which the commencement date is on or after that date.</p>   | <p>35. However, an entity may designate any date before the effective date and apply the Standard to borrowing costs relating to all qualifying assets for which the commencement date is on or after that date.</p>   | <p>No comments from respondents.</p>   |
| <b>Effective Date</b>  |  |  |
| <p>36. This IPSAS becomes effective for annual financial statements covering periods beginning on or after Month XX, 20XX. Earlier application is encouraged. If an entity applies the Standard from a date before Month XX, 20XX it shall disclose that fact.</p> | <p>36. This IPSAS becomes effective for annual financial statements covering periods beginning on or after Month XX, 20XX. Earlier application is encouraged. If an entity applies the Standard from a date before Month XX, 20XX it shall disclose that fact.</p> | <p>No comments from respondents.</p>   |



| TEXT OF ED 35  | PROPOSED TEXT  | STAFF COMMENTS                |
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| 37. 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. | 37. 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. | No comments from respondents. |
| <b>Withdrawal of IPSAS 5 (issued 2000)</b>   |  |                               |
| 38. This standard supersedes IPSAS 5, "Borrowing Costs" issued in 2000.  | 38. This standard supersedes IPSAS 5, "Borrowing Costs" issued in 2000.  | No comments from respondents. |

## APPENDIX B: ILLUSTRATIVE EXAMPLES

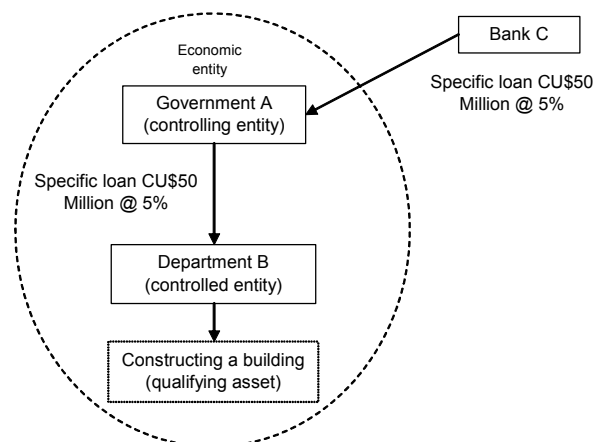
In the Illustrative Examples section of IPSAS 5, the following examples are inserted, as follows. The text has been marked-up to show changes from the paragraphs in ED 35 on which they are based.

*These examples accompany, but are not part of IPSAS 5 (revised).*

### Borrowing Costs Incurred by the Economic Entity

#### Example 1

- 19.1 If a controlling entity borrows funds specifically for obtaining a qualifying asset and the funds which are then loaned to a controlled entity, the controlled entity may capitalize only those borrowing costs which it itself incurs specifically in relation to the acquisition, construction or production of a qualifying asset. Such costs will normally be documented in the loan agreement with the controlling entity. ~~Where a controlled entity receives an interest-free capital contribution or capital grant, it will not incur any borrowing costs and consequently will not capitalize any such costs.~~

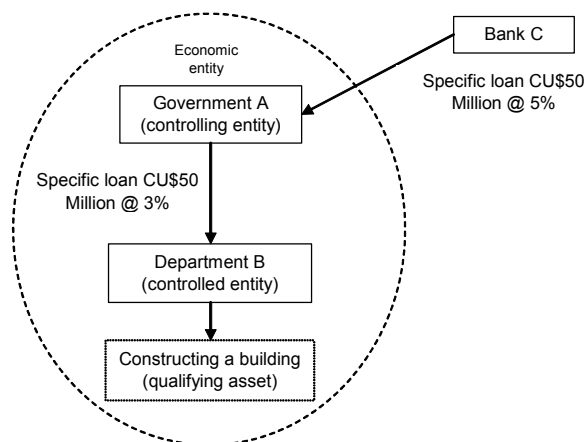


|  | Economic Entity                            | Controlling Entity | Controlled Entity                          |
|--|--|--------------------|--|
| Capitalization of specifically incurred borrowing costs? | Yes – interest capitalized at 5% per annum | No                 | Yes – interest capitalized at 5% per annum |

#### Example 2

202. When a controlling entity transfers funds which have been arranged specifically for the purpose of obtaining a qualifying asset, 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 qualifying asset. These borrowing costs are not necessarily identical to the borrowing costs incurred by the controlling entity. In the financial statements of

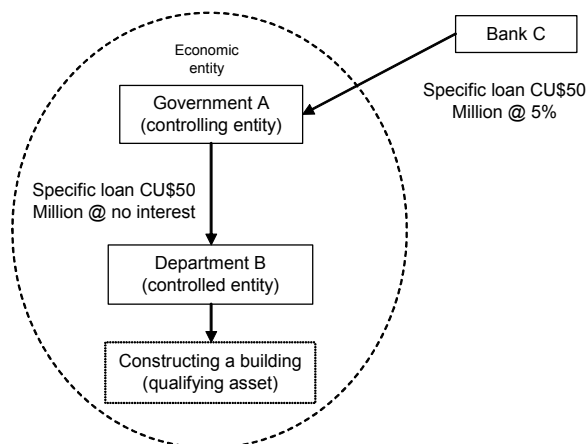
the economic entity, the full amount of borrowing costs specifically incurred for the acquisition, construction or production of a qualifying asset can be capitalized as part of the cost of that qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalized by the controlled entity.



|   | Economic Entity                            | Controlling Entity | Controlled Entity                          |
|---|--|--------------------|--|
| <b>Capitalization of specifically incurred borrowing costs?</b> | Yes – interest capitalized at 5% per annum | No                 | Yes – interest capitalized at 3% per annum |

### Example 3

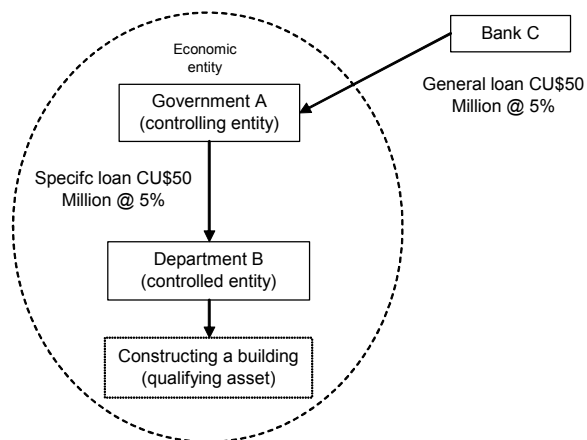
213. When a controlling entity has transferred funds which have been arranged specifically for the purpose of obtaining a qualifying asset, at no cost to a controlled entity, neither the controlling entity nor the controlled entity would meet the criteria for capitalization of borrowing costs in their separate-own financial statements. However, if the economic entity met-meets the criteria for the capitalization of borrowing costs, it would be able to capitalize the borrowing costs to the qualifying asset and thus, the borrowing costs are capitalized in its-the consolidated financial statements of the economic entity.



|  | Economic Entity                            | Controlling Entity | Controlled Entity        |
|--|--|--------------------|--------------------------|
| Capitalization of specifically incurred borrowing costs? | Yes – interest capitalized at 5% per annum | No                 | No – no interest charged |

#### Example 4

22-4 When a controlling entity borrows funds generally, and lends part of those funds to a controlled entity specifically for the acquisition, construction or production of a qualifying asset, the borrowing costs of the controlling entity are not eligible for capitalization either by that controlling entity in its separate-own financial statements or by the economic entity in its consolidated financial statements. The borrowing costs of the controlled entity has received funds specifically for obtaining a qualifying asset and therefore, the borrowing costs are capitalized may, however, be eligible for capitalization in the controlled entity's separate-own financial statements. If the controlling entity borrows funds specifically for the acquisition, construction or production of a qualifying asset by a controlled entity, those borrowing costs, if transferred to the controlled entity, may be capitalized in the separate financial statements of the controlled entity and in the consolidated financial statements of the economic entity.



|   | <b>Economic Entity</b> | <b>Controlling Entity</b> | <b>Controlled Entity</b> |
|---|------------------------|---------------------------|--------------------------|
| <b>Capitalization of specifically incurred borrowing costs?</b> | No                     | No                        | No                       |

## APPENDIX C: EXPLANATION OF OPTION C

- **Option C: Keep the existing IPSAS 5 and issue a statement to advise that this project has been put on hold, pending further work on the conceptual framework project.**

The analysis of responses to ED 35 indicates that there are differing opinions as to whether borrowing costs should be included in the initial measurement of an asset in the public sector. A statement could be issued to inform constituents of the IPSASB's deliberations so far and the decision to put this project on hold, pending further work on the conceptual framework project.

1. The statement proposed in Option C could contain the following information:
  - a. that the analysis of responses to ED 35 indicates that there are differing opinions as to whether borrowing costs should be included in the initial measurement of an asset in the public sector;
  - b. that a number of respondents considered that the costs of capitalization of specifically incurred borrowing costs for a qualifying asset outweigh the benefits of providing this information to users of the financial statements;
  - c. that those respondents who supported capitalization of borrowing costs held differing views as to whether they should be specifically incurred borrowing costs or directly attributable borrowing costs;
  - d. that this project is one small part of the IPSASB's IFRS convergence strategic objective;
  - e. that borrowing costs are relatively small (or immaterial) compared to the total amounts shown in the financial statements (see paragraph 2 below for further details);
  - f. that this issue should be revisited once the IPSASB's conceptual framework project is further advanced.
2. Using information from the governmental financial statements posted on the IPSASB's Intranet site last year, for the Government of New Zealand (using NZ IFRSs) and the Victorian State Government of Australia (using Australian IFRSs), the following statistics were calculated:

|   |             |
|---|-------------|
| Interest expenses compared to<br>Total expenses   | 2.7% - 4.3% |
| Additions to property, plant and equipment<br>for the year compared to<br>Total property, plant and equipment | 5.1% - 6.0% |

3. If either of these entities adopted a policy of capitalising eligible (either “directly attributable” or “specifically incurred”) borrowing costs to a qualifying asset, the amount would only be a small portion of the total interest expenses incurred for the year. Therefore, immaterial to the financial statements as a whole.

**APPENDIX D: LIST OF RESPONDENTS**

|     | <b>Organization</b>   | <b>Country</b>  | <b>Region</b> |
|-----|---|-----------------|---------------|
| 001 | The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) | Australia       | Australasia   |
| 002 | Joint Accounting Bodies   | Australia       | Australasia   |
| 003 | Auckland City Council   | New Zealand     | Australasia   |
| 004 | The Japanese Institute of Certified Public Accountants                        | Japan           | Japan         |
| 005 | Audit Scotland  | UK              | Europe        |
| 006 | Accounting Standards Board  | South Africa    | South Africa  |
| 007 | Accounting Standards Board  | UK              | Europe        |
| 008 | Australian Accounting Standards Board   | Australia       | Australasia   |
| 009 | Office of the Auditor-General   | New Zealand     | Australasia   |
| 010 | Manukau City Council  | New Zealand     | Australasia   |
| 011 | Dr Joseph Maresca   | USA             | North America |
| 012 | Government of Canada  | Canada          | North America |
| 013 | The Treasury  | New Zealand     | Australasia   |
| 014 | Dutch Local Government Accounting Standards Board                             | The Netherlands | Europe        |
| 015 | Province of British Columbia  | Canada          | North America |
| 016 | Institute of Chartered Accountants of Scotland                                | UK              | Europe        |
| 017 | Swedish National Financial Management Authority                               | Sweden          | Europe        |
| 018 | Chartered Institute of Public Finance and Accountancy (CIPFA)                 | UK              | Europe        |
| 019 | Norwegian Institute of Public Accountants                                     | Norway          | Europe        |
| 020 | Canadian Institute of Chartered Accountants                                   | Canada          | North America |
| 021 | Patrick Kabuya  | South Africa    | South Africa  |
| 022 | FEE   | EU              | Europe        |
| 023 | FRSB  | New Zealand     | Australasia   |



**APPENDIX E: TEXT EXTRACTS FROM RESPONDENTS WHICH  
SUPPORT ED 35**

Set out below are respondents' comments regarding their reasoning for supporting the IPSASB's proposals in ED 35.

**R001 The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)**

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

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

HoTARAC concurs with the views expressed in paragraphs BC5 to BC8 of ED 35 concerning the problems associated with attributing borrowing costs to assets in the public sector. In the Australian public sector, while the Government usually raises taxes and borrows funds on a central basis, it will distribute these funds to departments and other subsidiary entities in a variety of ways, including appropriations, grants, loans and equity contributions. Consequently, the funding position of each subsidiary entity, reflected in its individual financial reports, will vary depending on a mixture of historic and current practice.

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

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

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

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

**(b) *Consistency with Government Finance Statistics***

HoTARAC concurs with the views expressed in BC13 concerning convergence with statistical bases of reporting.

In Australia, the public sector prepares financial reports under the GFS framework as well as under GAAP. Recently, the GFS and GAAP frameworks have been harmonised through the issuance by the Australian Accounting Standards Board of AASB 1049 *Whole-of-Government and General Government Sector Financial Reporting*. The Australian Accounting Standards Board has also commenced a Project to harmonise GAAP-GFS presentational requirements for entities within the General Government Sector. Under GFS, borrowing costs are expensed, an approach which HoTARAC believes is the best conceptual treatment as it most accurately reflects the minimal or non-existent linkages discussed in (a) above between centralised borrowings and assets.

HoTARAC is strongly committed to convergence with GFS. From a public sector perspective, the proposals in ED35 would allow an entity to adopt a treatment for borrowing costs that is consistent with GFS.

#### **R002 Joint Accounting Bodies**

Although we support the removal of options to improve the comparability of financial reporting between entities, we do not think the pursuit of a comparability objective more important than the provision of relevant information. We believe the (proposed) Standard strikes the appropriate balance. We also note the fungible nature of cash makes it difficult to distinguish what funds are borrowed for what purpose. The principle adopted by the IPSASB is to immediately expense borrowing costs (except in certain specific circumstances). We believe this principle is best able to accommodate the fungibility of cash.

#### **R003 Auckland City Council**

##### **General Comments**

We support in general the proposal of the IPSASB that public sector entities should not be required to capitalise all directly attributable borrowing costs as required by IAS 23, but rather should have the option to either recognise borrowing costs as an expense during the period in which they are incurred or capitalise borrowing costs that are related to funds specifically borrowed to acquire, construct or produce a qualifying asset to the cost of that asset with all other borrowing costs expensed as incurred.

#### **R004 The Japanese Institute of Certified Public Accountants**

We agree with this proposal. Our reasoning is as follows.

- (1) Whether borrowing costs be basically recognized immediately as an expense.

Under the revised IAS 23, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalized to form part of the cost of that asset. In IAS 23, borrowing costs that are “directly attributable” to the acquisition, construction or production of qualifying assets are those borrowing costs that would have been avoided had the expenditure on the qualifying asset not been made. Such borrowings are not limited to funds borrowed specifically for the purpose of acquiring, constructing or producing a particular qualifying asset.

Borrowing in the public sector may be for investing or operating activities, and not only for financing activities. Therefore, borrowing costs in the public sector are not always restricted to costs that would have been avoided had the expenditure on the qualifying asset not been made.

In conclusion, we think it rational that borrowing costs be basically recognized immediately as an expense, and not capitalized.

#### **R009 Office of the Auditor-General**

Our reasons for strongly agreeing that there should be an option for public sector entities to expense borrowing costs include:

- We are unclear about whether capitalization of any borrowing costs is likely to result in information that is meaningful to users of the financial statements of public sector entities.
- We find it difficult to rationalize why the manner of funding a qualifying asset should drive the value at which it is initially recorded. It makes no sense to us that just because an entity has more debt its assets should be recorded at a higher value. For example, why should an

asset that is 100% debt funded be initially recorded at a higher value than an asset with no debt funding?

- We believe it is often debatable whether there is a linkage between borrowings by particular public sector entities and the acquisition, construction or production of qualifying assets by those entities, as explained in the Board's Basis for Conclusions.
- We do not accept the argument that compulsory capitalization will result in increased comparability. That argument does not make sense because the amount capitalized in each case is entity specific based on a range of factors including the level of debt of the entity. If comparability is a key driver, the Board should consider mandating the expensing of borrowing costs.
- We are unclear about the effect of initial capitalization of borrowing costs on subsequent revaluation of qualifying assets using depreciated replacement cost (DRC). We are not aware of any valuation guidance about how to incorporate borrowing costs in a DRC valuation, therefore we are concerned about the range of valuation practices that could emerge and the resulting adverse impact on the reliability of the information provided as explained in the Board's Basis for Conclusions.
- We have serious reservations about whether the benefits of capitalization of borrowing costs outweigh the costs of doing so.

#### **R010 Manukau City Council**

The council agrees with the proposal that public sector entities should not be required to capitalize borrowing costs specifically incurred on qualifying assets. The council considers that the capitalisation of borrowing costs as part of the cost of an asset is not appropriate for public sector entities.

Our main concerns with mandatory capitalisation are as follows:

##### Difficulties in attributing costs to Assets

For public sector entities, borrowings are not always attributable to particular asset acquisitions as construction can often occur over numerous projects at the same time. It is often difficult to distinguish what funds are borrowed for what purpose and therefore attributing the borrowing costs to specific assets would be arbitrary. There would also be administrative difficulties in analysing interest costs on projects that extend over a substantial period.

#### **R012 Government of Canada**

The council agrees with the proposal that public sector entities should not be required to capitalize borrowing costs specifically incurred on qualifying assets. The council considers that the capitalisation of borrowing costs as part of the cost of an asset is not appropriate for public sector entities. Our main concerns with mandatory capitalisation are as follows:

##### Difficulties in attributing costs to Assets

For public sector entities, borrowings are not always attributable to particular asset acquisitions as construction can often occur over numerous projects at the same time. It is often difficult to distinguish what funds are borrowed for what purpose and therefore attributing the borrowing costs to specific assets would be arbitrary. There would also be administrative difficulties in analysing interest costs on projects that extend over a substantial period.

#### **R013 The Treasury**

The New Zealand Treasury fully supports the IPSASB proposal to amend IAS 23.

The New Zealand Treasury view is that the IAS 23 approach, which is based on the view that borrowing costs are "directly attributable" to a qualifying asset if they would have been avoided had the expenditure on the qualifying asset not been made, should not be adopted in an IPSAS because of differences between the sectors.

The IASB presumably considers borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made can be reliably determined by profit-oriented entities. While they acknowledge in the standard that this can be “difficult and the exercise of judgment is required” such an assessment may be possible as:

- profit-oriented entities are unlikely to use debt financing to fund operating expenses because of solvency requirements, more easily allowing the attribution of borrowing to assets;
- material expenditure on the construction or development of material qualifying assets is likely to have specific finance arrangements, or where that is not the case, the financing cost is still likely to be an element in decisions to construct or develop qualifying assets; and
- profit oriented entities typically report on a historic cost approach (making the issue a one-off event) or, when the asset is subsequently revalued, remeasure to a fair value basis, using observable market based evidence where capitalised borrowing costs is not an issue.

In the public sector, entities with the power to tax are not constrained by solvency requirements but rather by the intertemporal budget constraint. For such entities borrowing represents a future tax requirement. If the capital expenditure on qualifying assets had not been made, it is possible to determine the tax that would have been avoided. However the borrowing, (and the borrowing cost) that would have been avoided depends on the fiscal stance of the taxing entity. There is not a direct attribution of borrowing costs to qualifying assets, when expenditure on a qualifying asset is financed by tax which may be from previous taxes (conservative, saving), current taxes (balanced, neither saving nor borrowing) or future taxes (liberal, borrowing) and where the fiscal stance is subject to change.

In the public sector, entities without the power to tax that develop or construct non-cash generating assets are constrained by the funding policies of their parent body. These funding policies may include debt or equity financing or any combination thereof, and may or may not include a form of capital charge. Again, this adds an extra step in the attribution process, muddying the connection between borrowing costs and capital expenditure on the asset. In the private sector such subsidiaries tend not to have to prepare general purpose financial reports and so the cost is not as high as in the public sector where general purpose financial reports are more commonly required.

In the public sector, capital budget decisions do not factor in a market based financing cost but rather make use of a public sector discount rate. There is a rich literature, and much debate, on the use of public sector discount rates. Such a tool is necessary when making trade-off decisions, within a constrained budget, on the comparative value of investments in such areas health and educational facilities, resource and energy projects, transport infrastructure, housing, national parks, defence, the prison system etc. To substitute a capitalised borrowing cost component in accountability documentation for the discount component used in decision-making documentation renders that accountability documentation less relevant and less understandable.

#### **R017 Swedish National Financial Management Authority**

We agree with the reasoning behind the conclusions made by the IPSASB. To that we would like to add that from the standpoint of valuation of acquired assets it should be an advantage to have the same fundamental principles independently of, among other things, the methods of financing. Capital costs are in that perspective however, in most cases, not external transactions. As the IPSASB argues such calculations are complex and resource intensive as is the case with many calculations involved in accrual accounting. But in contrast to most other calculations, the calculations of capital costs for assets exceed related benefits.

In the public sector context we also are of the opinion that such benefits are less obvious. Distribution of capital costs can influence efficiency in the production. That kind of incentives are not less if the costs incurred are accounted for as expenses rather than being capitalized. There is no risk incurred with accounting for a negative capital as a consequence of such expenses if the

assets are financed with loans. In contrary to a company that situation is possible to handle without the need for a process of bankruptcy.

Another noticeable difference between many entities in the public sector compared to entities in the private sector is that the former often are able to borrow without mortgages or other pledges. It is in that context most cost efficient to borrow in batches not linked to the financing of specific assets.

#### **R020 Canadian Institute of Chartered Accountants**

Thank you for the opportunity to comment on Exposure Draft 35 (ED 35). In general, Public Sector Accounting Board (PSAB) staff support the proposal that entities should be permitted, but not required, to capitalize borrowing costs specifically incurred on qualifying assets. This option is comparable to PSAB's standard on accounting for borrowing costs of tangible capital assets.

Given the nature and operations in the public sector, PSAB staff agree that it would be inappropriate to require capitalization of borrowing costs in the public sector. Public sector entities often borrow for general purposes, not specifically for the acquisition or construction of an asset. Allocating borrowing costs to the acquisition or construction of a particular asset could be subjective or arbitrary.

PSAB staff support giving public sector entities the option to capitalize borrowing costs as this may result in a more relevant cost basis for certain qualifying assets which are generally not developed internally in some type of public sector entities. For example, in certain jurisdictions, hospitals may be built by public private partnerships. In these circumstances, borrowing or financing costs are normally included in the purchase price of qualifying assets acquired from third parties or in the contract costs of qualifying assets constructed through public private partnerships. Capitalizing borrowing costs of qualifying assets that are developed internally in these types of entities would produce a more comparable cost of these assets. We suggest that IPSASB consider including this discussion in the "Recognition" section of ED 35 for public sector entities to consider in determining their accounting policy on borrowing costs.

Our standard allows capitalization of borrowing costs that can be directly attributable to obtaining tangible capital assets. IPSASB's proposal of allowing capitalization of borrowing costs only if they are "specifically incurred" to obtaining a qualifying asset is easy to apply and objective. However, public sector entities would be able to choose which assets to capitalize borrowing costs by structuring the financing accordingly. Consequently, the form (as opposed to the economic substance) of financing may drive the accounting.

**APPENDIX F: TEXT EXTRACTS FROM RESPONDENTS WHICH DO NOT SUPPORT ED 35**

Set out below are respondents' comments regarding their disagreement with the proposal to permit, but not require, entities to capitalize borrowing costs which are specifically incurred on qualifying assets.

**R007 Accounting Standards Board (UK)**

We do not agree with the proposal to permit, but not require, capitalisation where borrowing costs are specifically incurred on qualifying assets. We believe options in accounting standards impair comparability and are therefore rarely appropriate. In our view, the standard should require borrowing costs that are specifically incurred for the acquisition, construction or production of a qualifying asset to be capitalised as there should be no difficulty in identifying the relevant costs.

**R016 Institute of Chartered Accountants of Scotland**

We agree that government borrowings are often not attributable to a particular asset or capital project. Therefore, we agree that it is reasonable for the proposed standard to require a public sector entity to recognize borrowing costs as an expense in the period they are incurred unless they are specifically incurred for the acquisition, construction or production of a qualifying asset. However, we question whether it is reasonable to give public sector entities, adopting IPSASs, the option of either capitalizing borrowing costs which are directly attributable to qualifying assets or expensing them. Requiring the capitalization of borrowing costs which are directly attributable to a qualifying assets would lead to consistent practice and aid the comparability of financial statements prepared by public sector entities.

The most recent version of IAS 23 requires that "borrowing costs that are directly attributable ..... are capitalized as part of the cost of the qualifying asset". Therefore, if the objective of the IPSAS 'General Improvements Project' is to converge with IFRSs to the extent appropriate for the public sector then we would expect a clear justification for this difference to be explained in the Exposure Draft.

**R018 Chartered Institute of Public Finance and Accountancy (CIPFA)**

We are content that the Exposure Draft provides a public sector rationale for departure from IAS 23, based on a different assessment of the costs and benefits of producing reliable and relevant information. While we consider that capitalizing borrowing costs would provide a more faithful representation of the cost of the asset, we agree that paragraphs BC5 to BC8 of the Basis for Conclusions set out reasons why there is often no meaningful way to attribute borrowing costs to specific qualifying assets.

However, we are not persuaded that paragraph BC9 provides sufficiently developed justification for the proposal to permit, but not require, capitalization of borrowing costs which are specifically incurred on qualifying assets. In CIPFA's view it would be better if the standard could be redrafted so that capitalization was either required or prohibited in these cases.

**R021 Patrick Kabuya**

I am of the view that it should be a requirement for borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets to be capitalized as part of the cost of such an asset. Such a requirement would be in line with the key underlying accounting principle

that requires an entity to capitalize any costs directly incurred to bring an asset to the location and condition for it to be capable of operating in the manner intended by management.

Such an instance would arise when the entity obtains specific funding for the acquisition, construction or development of a qualifying asset as it is able to allocate the funding and related costs to a specific project.

The option to expense borrowing cost should still be allowed. As an example, such an option should be applied on borrowing costs incurred where an entity generally borrows funds for qualifying assets.

If the principle in the comment above is accepted, a review should be done on the entire proposed standard to ensure consistent explanation of the principle: including basis of conclusion. Simply, specific funding cost should be capitalized while general funding costs should be expensed.

#### **R022 FEE**

(7) An alternative approach to that taken in the Exposure Draft would be to rearticulate the IPSAS to make it clear that:

- In general, direct attribution will not be possible, and in line with IAS 23 ‘other borrowing costs’ should be expensed; but
- Where attribution is possible, capitalisation should be required.

(8) We find it more difficult to understand how the reasoning provided by the Board supports the proposal to permit, but not require, capitalisation where borrowing costs are specifically incurred on qualifying assets. Allowing preparers to choose the accounting treatment for these costs seems counter to the spirit of the amendments to IAS 23, and in particular the ED proposal:

- Does not promote comparability, as the ED does not provide a reason why one public sector preparer might choose to capitalise specific borrowing, while another might expense it
- Might result in borrowing arrangements being structured to engineer a particular accounting treatment.

However, our main concern is that the ED does not seem to provide any particular public sector reason for ‘optionality’. In FEE’s view it would be helpful if the public sector rationale for the proposal to permit, but not require capitalisation where borrowing costs were fully explained.

Set out below are respondents’ comments where they do not believe that ED 35 needs to depart from the provisions of IAS 23.

#### **R014 Dutch Local Government Accounting Standards Board**

In the Netherlands most municipalities are using the capitalization approach for very many years in combination with generally borrowed and centrally administered funds, even though they are not obliged to. This is not considered onerous, nor does it have any audit implications.

In our Local Government Accounting Standards we do not confine the capitalization of borrowing costs to those costs that are specifically incurred or directly attributable. In fact, our standards allow capitalizing imputed interest costs even if the asset is financed with net assets/equity.

In our opinion conceptually the capitalization option is the better treatment of borrowing costs.

**We therefore do not agree with the ED, which limits the capitalization of borrowing costs to those costs that are specifically incurred. We propose to allow capitalization of all borrowing costs, which are directly attributable to the asset.**

**R015 Province of British Columbia**

In reviewing the exposure draft, we are concerned about the limitation of the application of the proposed standard to borrowing costs that are specifically incurred for the acquisition, construction or production of a qualifying asset as it would likely lead to inconsistent accounting policies in governments with respect to capitalization of assets because capital assets purchased from general borrowing would not have the applicable borrowing costs capitalized.

We are concerned that IPSASB is becoming too rules based rather than principles based. In the current case, the exposure draft is assuming that government is not in a position to accurately allocate the cost of large or jumbo borrowings when it is more efficient or economical to issue them. We follow a policy of borrowing at the most effective cost available and where applicable, to on-lend the funds to a Crown corporation to directly fund a construction project. In some cases, the entire borrowing is on-lent and would, in that case, meet the IPSASB requirement that the borrowing is directly related to the asset acquisition. In other cases, it is more efficient to bundle several borrowing needs that may result in on-lending to several Crown corporations and may also include general funding. The Treasury Branch is tasked with raising funds at the most efficient cost to government. We can, and do, project our cash needs over reasonable future periods, including known construction contract draw-downs. We establish or identify minimum cash balances needed and enter the market to maintain those cash balances at appropriate levels; we time our access to the market to take advantage of the price of funds. We feel we know where the money is being used. It is our responsibility to put in place accounting practices and internal control procedures to allow us to clearly identify how borrowings are utilized. These practices and procedures are reflected in our Public Accounts which are subject to the opinion of the Auditor General. The problem with IPSAS 5 would occur on consolidation because the on-lending is reversed and IPSAS 5, by applying a rules based approach, would preclude the allocation when, in principle, IPSAS 5 says that interest during construction may be capitalized. Accounting rules should not oblige governments to undertake a series of inefficient small borrowings to meet the rule, accounting practice should not drive government policy. The exposure draft seems to be saying that IPSASB does not believe that governments have in place the accounting practices and internal control procedures to be able to clearly identify the allocation of the cost of borrowing and therefore, the IPSAS will preclude any allocation. We do not agree with the proposal.

**R019 Norwegian Institute of Public Accountants**

The central borrowing model is not a feature only in the public sector. Paragraphs 21-25 and 29 of existing IPSAS 5 discuss the determination of the amount of borrowing costs to be capitalized as well as the difficulties related to central borrowing cases. Paragraph 29 specifically discusses the determination of a capitalization rate at the economic entity level and the controlled entity level.

In accordance with the principle of IPSAS 5/IAS 23, borrowing costs are eligible for capitalization only in the case where they are directly attributable to the acquisition, constructions or production of a qualifying asset. This means capitalization is not implemented where the incurring of borrowing costs is not related to the incurring of the outlays/expenditures on a qualifying asset and capitalization only applies to the situation where a direct link between the borrowing costs and the incurring of the outlays/expenditures on a qualifying asset exists.

In revising IAS 23 many respondents argued that the costs of implementing the capitalization model would be burdensome. The IASB noted however that “there is an unavoidable cost of complying with any new financial reporting standard” and “it has not been told that preparers who elected to capitalize borrowing costs under the previous version of IAS 23 found doing so unnecessarily burdensome”. The IASB concluded that the additional benefits in terms of higher



comparability, improvements in financial reporting and achieving convergence with US GAAP exceed additional costs of implementation.

Central borrowing procedures may be more common in the public sector than in the private sector, but the additional compliance costs for public sector entities would not be different from those for private sector entities. The benefits from the removal of the expensing option from IPSAS 5 in terms of higher comparability and achieving convergence with IFRS justify the additional compliance costs.

The capitalization of borrowing costs would, for both the public sector and the private sector, enhance comparability between assets internally developed and those acquired from third parties, because the purchase price of a completed asset would include financing costs incurred by the third party during the development phase.

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

Set out below are respondents' comments where they do not believe that the basis for conclusions justifies the proposals in ED 35.

#### **R005 Audit Scotland**

We may have been more convinced of the merits of a public sector standard departing from IAS 23 if IPSASB were to base their conclusions more heavily on the alignment with statistical reporting but even here we would observe that an adjustment between financial and statistical bases will be required to be made in any event for those private sector entities following IAS 23.

In conclusion therefore Audit Scotland considers that IPSASB needs to reconsider the basis for its conclusions to reflect the different range of circumstances surrounding borrowing by public sector entities and, if it wishes to confirm its current proposals, to more robustly justify a departure from IAS 23 in the circumstances of entities such as those in UK local government.

#### **R006 Accounting Standards Board (South Africa)**

Under the current pronouncements relating to borrowing costs, most South African entities expense borrowing costs as a result of cost-benefit considerations. Therefore, some respondents support the proposed option to either expense or capitalize borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets.

However, the general accounting principle with regards to the capitalization of costs as part of an asset, requires an entity to capitalize any costs *directly attributable* to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. As a standard setter, we are of the view that this principle also applies to borrowing costs. Thus, borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets should be capitalized as part of the cost of such assets, as the borrowing costs were incurred to bring these assets to the location and condition necessary for it to be capable of operating in the manner intended by management. When entities obtain specific funding for the acquisition, development or construction of a qualifying asset it would be possible to allocate the funding, and the borrowing costs incurred thereon, to the specific acquired, developed or constructed asset.

We therefore propose that the general accounting principle should be applied to the capitalization of borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets. The IPSAS should clarify how borrowing costs *specifically incurred* relates and links to costs *directly attributable* with regards to a specific asset. This clarification could be

provided as an explanatory paragraph to paragraphs .10 and .11. Capitalizing borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets will also enhance comparability between entities.

We consider the cost-benefit consideration in BC 9 not an adequate reason for allowing the option to expense borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets. The conclusion should be further clarified and motivated.

Set out below are respondents' comments where they do not support the proposals in ED 35 because they do not agree with (a) the inclusion of an option to either capitalize or expense specifically incurred borrowing costs for obtaining a qualifying asset, (b) the limiting of borrowing costs eligible to be capitalized from "directly attributable" to "specifically incurred", and (c) the lack of robustness in the justification for the departure from IAS 23.

**R008 Australian Accounting Standards Board**

In general, the AASB is in favour of the IPSASB revising IPSAS 5 *Borrowing Costs* in light of the recent revision of IAS 23 *Borrowing Costs* and modifying it to reflect not-for-profit public sector circumstances. However, the AASB particularly does not support the IPSASB departing from IAS 23 by introducing an optional treatment for borrowing costs 'specifically incurred' to finance the acquisition, construction, or production of a qualifying asset. The AASB encourages the IPSASB to reconsider the proposed types of departures from IAS 23, and depart only on the basis of either:

- public sector specific reasons that are consistent with the IPSASB's guidelines for modifying IFRSs; or
- more fundamentally, a conceptual view.

**R023 New Zealand FRSB**

However the FRSB:

- does not agree with the proposal articulated in the Exposure Draft;
- does not consider that continuing to permit alternative treatments in relation to borrowing costs incurred by public sector entities is appropriate;
- believes that it is inappropriate to propose a new category of "specifically incurred" borrowing costs;
- believes that the proposal to prohibit the capitalisation of general borrowing costs but make the capitalisation of specific borrowing costs optional is internally inconsistent.

The FRSB acknowledges that reasonable arguments can be advanced for either capitalisation or expensing of borrowing costs. The FRSB considers that normally a standard setter's position on the treatment of borrowing costs should reflect the standard setter's views on the more fundamental issue of which costs should be included in the initial measurement of an asset. We note that the IASB did not undertake a fundamental review of the arguments for and against capitalisation in making the most recent amendments to IAS 23.

The FRSB is of the view that the IPSASB should reconsider this issue and form a view following its "rules of the road" as to whether there is justification for a different view of whether borrowing costs should be included in the initial measurement of an asset in the public sector. If, following more detailed consideration of this issue, the IPSASB considers that capitalisation of borrowing costs is consistent with its views on asset measurement for the public sector, then the FRSB considers that it would be appropriate for the IPSASB to adopt the requirements of IAS 23. Alternatively, if the IPSASB believes that expensing borrowing costs is more consistent with its

views on asset measurement, then the FRSB considers that IPSAS 5 should be amended to mandate expensing. However, a view different to IAS 23 would imply that assets in the public sector have a fundamentally different measurement objective to assets in the private sector.

The FRSB is extremely interested in the outcome of IPSASB's deliberations on this issue. The implementation of NZ IAS 23 Borrowing Costs (revised 2007) has been deferred for public benefit entities<sup>1</sup>, pending further consideration of issues raised by public benefit entities regarding mandatory capitalisation. One of the reasons for deferring application of the revised standard to public benefit entities was a desire to wait until IPSASB had completed its deliberations on ED 35.

## Department of Treasury and Finance

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Ms Stephanie Fox  
Technical Director  
The International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street  
4th Floor  
TORONTO ONTARIO  
CANADA M5V 3H2

Dear Ms Fox

### COMMENTS ON EXPOSURE DRAFT 35 - IPSAS 5 *BORROWING COSTS*

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board on Exposure Draft 35 IPSAS 5 *Borrowing Costs*.

HoTARAC strongly supports the proposals in ED 35. The attachment to this letter, Attachment A, provides a more detailed response, including HoTARAC's rationale to support its views.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on 612 6215 3551.

Yours sincerely

D W Challen

**CHAIR**

**HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE**

/ December 2008

Encl

Contact: David Tadd  
Phone: 03 6233 2515  
Our Ref: D/ 14423

Attachment A

**COMMENTS ON EXPOSURE DRAFT 35  
IPSAS 5 “BORROWING COSTS” (REVISED 200X)**

**1. Specific matter for comment**

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

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

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

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

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

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

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

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

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

## **(b) Consistency with Government Finance Statistics**

HoTARAC concurs with the views expressed in BC13 concerning convergence with statistical bases of reporting.

In Australia, the public sector prepares financial reports under the GFS framework as well as under GAAP. Recently, the GFS and GAAP frameworks have been harmonised through the issuance by the Australian Accounting Standards Board of AASB 1049 *Whole-of-Government and General Government Sector Financial Reporting*. The Australian Accounting Standards Board has also commenced a Project to harmonise GAAP-GFS presentational requirements for entities within the General Government Sector. Under GFS, borrowing costs are expensed, an approach which HoTARAC believes is the best conceptual treatment as it most accurately reflects the minimal or non-existent linkages discussed in (a) above between centralised borrowings and assets.

HoTARAC is strongly committed to convergence with GFS. From a public sector perspective, the proposals in ED35 would allow an entity to adopt a treatment for borrowing costs that is consistent with GFS.

## **2. Other comments**

### **(a) Distinction between “specifically incurred” and “directly attributable”**

HOTARAC believes that the distinction between “specifically incurred” (as used in ED 35) and “directly attributable” (as used in IAS 23) may require additional clarification. For example, paragraph 15 of the ED, in explaining “specifically incurred”, uses the term “directly”, which may be confusing. Further, ED 35 does not include some of the relevant IAS 23 guidance, for example, reference to costs that could be “avoided if the expenditure on the qualifying asset had not been made”. An alternative approach that may resolve some of these issues is for the ED to use the term “directly attributable” and to clarify that, in the public sector context, “general borrowings” are not regarded as “directly attributable”.

### **(b) Fair value scope exclusion**

HoTARAC believes that additional guidance should be included in the ED regarding the fair value scope exclusion. This could clarify, for example, how this exclusion operates where a jurisdiction adopts the revaluation model for property, plant and equipment after initial recognition. HoTARAC believes that it should be made clear in the ED that, even though a jurisdiction may adopt the revaluation model for property, plant and equipment after initial recognition, the borrowing cost standard nevertheless applies where initial recognition is at cost.

In addition, HoTARAC believes the ED should contain guidance about the treatment of borrowing costs on subsequent revaluation of an asset, where the depreciated replacement cost approach to revaluation is adopted. For example, the New Zealand Accounting Standards Board has included an additional paragraph New Zealand 33.14 in NZ IAS 16 *Property, Plant and Equipment* clarifying that borrowing costs should be included as a component of depreciated replacement cost (assuming the initial borrowing costs are eligible for capitalisation). HoTARAC believes that this guidance is required given that ED 35 proposes capitalisation as an option.

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

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

**(d) Whole-of-government inconsistencies**

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

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

**3. Editorial Comments**

*Paragraph 16*

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

*Paragraph 17*

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

*Paragraph 22*

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

*Paragraph 28*

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

*Paragraph 31*

To clarify the presumed intent of the sentence, it is recommended that it be amended to read “ ... the entity shall cease capitalising borrowing costs directly attributable to a given part when it completes substantially all the activities ...”.

*Amendments to Guidance in Other IPSASs*

Two references to financial years at the very end of Example 2 need to be amended from “20-1” to “20X1” for consistency with the rest of the example.



2 December 2008

Ms Stephenie Fox  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street, 4<sup>th</sup> Floor  
Toronto, Ontario M5V 3H2  
CANADA

Via [EDComments@ifac.org](mailto:EDComments@ifac.org)

Dear Stephenie

**Comments on Exposure Draft 35 IPSAS 5 “Borrowing Costs” (Revised 200X)**

Thank you for the opportunity to comment on the IPSASB Exposure Draft 35 IPSAS 5 “Borrowing Costs” (Revised 200X). CPA Australia, The Institute of Chartered Accountants and the National Institute of Accountants (the joint accounting bodies) have considered the above exposure draft (ED) and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government, academia throughout Australia and internationally.

The Joint Accounting Bodies agree with the proposal to retain the option of either capitalising or immediately expensing borrowing costs, when those costs are specifically incurred in relation to financing the acquisition, construction or production of a qualifying asset. Further, we support the proposal to require the immediate expensing of borrowing costs, when the borrowing costs are not specifically incurred in relation to financing the acquisition, construction or production of a qualifying asset.

The Joint Accounting Bodies reason that any decision to retain or remove the options available within the International Public Sector Accounting Standards Board’s (IPSASB) standards should be made only after a comprehensive evaluation of the relevance of the information to the decisions-making needs of users. Since users of public sector accounts are likely to have different needs from users of accounts of those entities participating in the capital markets, we encourage further research in this area.

**Representatives of the Australian Accounting Profession**



[cpaaustralia.com.au](http://cpaaustralia.com.au)



[charteredaccountants.com.au](http://charteredaccountants.com.au)



[nia.org.au](http://nia.org.au)


Although we support the removal of options to improve the comparability of financial reporting between entities, we do not think the pursuit of a comparability objective more important than the provision of relevant information. We believe the (proposed) Standard strikes the appropriate balance. We also note the fungible nature of cash makes it difficult to distinguish what funds are borrowed for what purpose. The principle adopted by the IPSASB is to immediately expense borrowing costs (except in certain specific circumstances). We believe this principle is best able to accommodate the fungibility of cash.

If you have any questions regarding this submission, please do not hesitate to contact Mark Shying (CPA Australia) at [mark.shying@cpaaustralia.com.au](mailto:mark.shying@cpaaustralia.com.au), Kerry Hicks (the Institute) at [kerry.hicks@charteredaccountants.com.au](mailto:kerry.hicks@charteredaccountants.com.au), or Tom Ravlic (NIA) at [tom.ravlic@nia.org.au](mailto:tom.ravlic@nia.org.au).

Yours sincerely



**Geoff Rankin**  
Chief Executive Officer  
CPA Australia Ltd



**Graham Meyer**  
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**Roger Cotton**  
Chief Executive Officer  
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Copy: Bruce Porter : Acting Chairman - Australian Accounting Standards Board

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And

Technical Director  
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277 Wellington Street, 4<sup>th</sup> floor  
Toronto, Ontario M5V 3H2  
Canada

5 December 2008

Dear Sir/Madam

### **IPSAS ED 35 *Borrowing Costs***

I am pleased to present Auckland City's (the Council's) submission on the exposure draft titled IPSAS ED 35 *Borrowing Costs* (ED 35) issued by the International Public Sector Standards Board ("IPSASB"). The Financial Reporting Standards Boards also issued ED 35 for comment in New Zealand.

### **General Comments**

We support in general the proposal of the IPSASB that public sector entities should not be required to capitalise all directly attributable borrowing costs as required by IAS 23R, but rather should have the option to either recognise borrowing costs as an expense during the period in which they are incurred or capitalise borrowing costs that are related to funds specifically borrowed to acquire, construct or produce a qualifying asset to the cost of that asset with all other borrowing costs expensed as incurred.

We disagree however with the proposal of ED 35 limiting borrowing costs allowed to be capitalised by public sector entities to those that are "specifically incurred" in relation to funding of the acquisition, construction or production of a qualifying asset. We believe that this is an unnecessary departure from IAS 23R that requires capitalisation of borrowing costs that are "directly attributable"<sup>1</sup> to the acquisition, construction or production of a qualifying asset. We address these comments in more detail below.

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<sup>1</sup> "Directly attributable" is defined in para 11 of IAS 23 as borrowing costs that would have been avoided if there had been no expenditure on the asset. Directly attributable borrowing costs under IAS 23 include borrowing costs incurred both on specific borrowings as well as those incurred on general borrowings.





In this letter we made reference to the following documents:

- IPSAS ED 35 *Borrowing Costs* (ED 35)
- NZ IAS 16 *New Zealand Equivalent to Property, Plant and Equipment* (NZ IAS 16)
- IAS 23 *Borrowing Costs* revised in 1993 (IAS 23 (1993))
- IAS 23 (Revised in 2007) *Borrowing Costs* (IAS 23R)
- New Zealand Local Government Act 2002 (LGA 2002)

### **Specific Matter for Comment**

We have addressed the specific areas you have requested comment on below.

**This Exposure Draft proposes that borrowing costs be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs. Do you agree with this proposal? Please provide your rationale for agreeing or disagreeing with this proposal.**

### **General comments**

Currently, the Council applies the alternative approach under NZ IAS 23 (1993) to capitalise borrowing costs that are directly attributable to qualifying assets<sup>2</sup>. Qualifying assets of the Council typically include new or improved public assets (such as buildings and bridges) with long lives.

The accounting policies of the Council are very specific and permit borrowing to fund capital expenditure of new and improved public assets only under specific circumstances. Borrowing is permitted provided that:

- depreciation of the asset is fully funded from current rates or other council revenues, and
- sufficient rate surpluses are forecasted to allow 60% of the debt to be repaid over 30 years on a straight line basis.

Borrowing is generally not permitted to fund renewal or replacement of infrastructure assets as those are typically funded by rates. In addition, borrowing is generally not permitted to fund operating expenditure.

The Council decided to adopt the alternative approach under NZ IAS 23 (1993) as it ensures that the cost of the investment in new assets, including the cost of debt funding during acquisition, construction or production is spread over the useful lives of these assets.

In our view it is appropriate for the Council to capitalise borrowing costs of qualifying assets as part of the costs of those assets as by doing so the Council ensures that each generation of ratepayers contributes a fair share towards the cost of the assets they use, including the costs of funding the acquisition, construction or production of those assets. Intergenerational equity is a key principle underlying the sustainable debt policy of the Council.

The LGA 2002 also incorporates the concept of intergenerational equity. This concept implies that it is appropriate to spread the cost of the asset over its useful life. In our view interest costs incurred in relation to funding the acquisition, construction or production of assets used by ratepayers is a cost of providing those assets.

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<sup>2</sup> Based on materiality, the Council limits capitalisation to qualifying assets that have a total cost to construct of more than \$2 million and take at least 12 months to complete. The Council regularly reviews this threshold.



We acknowledge that for some public sector entities, such as smaller local councils, the costs of tracking and capitalising borrowing costs might outweigh the benefits. Therefore we support the proposal of the IPSASB that public sector entities should not be required to capitalise all directly attributable borrowing costs as required by IAS 23R. However, we support the proposal to give public sector entities the option to either recognise borrowing costs as an expense during the period in which they are incurred or capitalise borrowing costs.

***Directly attributable vs specifically incurred borrowing costs***

As discussed above the Council adopted the alternative approach under IAS 23 (1993) and therefore is currently capitalising borrowing costs that are "directly attributable" to financing the acquisition, construction or production of a qualifying asset.

ED 35 proposes to give the option to public sector entities to either capitalise or expense borrowing costs that are "specifically incurred" in relation to financing the acquisition, construction or production of a qualifying asset. It does not, however, permit or require the capitalisation of borrowing costs in relation to other borrowings that are "directly attributable" to financing the acquisition, construction or production of a qualifying asset.

Therefore if the requirements of ED 35 are approved in New Zealand, the Council would need to revise its policy and would only be able to capitalise borrowing costs on funds that have been specifically borrowed to fund capital expenditure.

Currently the Council's borrowings include both general and specific funding of capital expenditure. The Council operates a central treasury function that uses a range of debt instruments and lends funds to group companies. In case of specific projects, such as the renovation of the Auckland Marina, the Council would typically borrow funds specifically to finance the project, but as the cost of capital expenditure might change, the relating debt may also be adjusted. In other cases, the Council might use general borrowing to fund capital projects. As discussed above, borrowing is generally not used to fund renewals, replacement or operating expenditure. To the extent the funds are used for the purpose of obtaining qualifying assets, the amount of borrowing costs eligible for capitalisation is determined by applying a capitalisation rate to the expenditures on those assets.

The Introduction to ED 35 states that the ED *"permits entities that incur borrowing costs specifically to acquire, construct or produce a qualifying asset to capitalize those borrowing costs in the same way that an entity applying IFRSs would."*

We don't believe, however, that the proposed approach of ED 35 is consistent with that of IAS 23R which requires capitalisation of borrowing costs that are "directly attributable" to financing the acquisition, construction or production of a qualifying asset. Economically, and from the Council's point of view, there is no difference whether the funds are borrowed specifically to finance the capital expenditure of a qualifying asset or whether general funds are borrowed that are then used to fund that expenditure. However, if the proposals of the IPSASB to allow capitalisation of borrowing costs relating to specific borrowing only are approved in New Zealand, we expect that the administrative burden of the Council to comply would increase. For example the Council would be required to set up new accounting codes and prepare and keep more documentation, such as bank documents, internal agreements to ensure reliable documentation of borrowing costs relating to specific borrowing.



The Basis of Conclusions (BC) attached to ED 35 discusses the IPSASB's reasons for departing from the provisions of IAS 23R. BC 5 states that *"..The aggregate level of borrowings is often set in the context of political or economic factors such as decisions on the appropriate levels of taxation. ... Therefore, in the public sector it is often difficult to distinguish financing from external borrowing and other sources of finance and there is often no meaningful way to attribute borrowing costs to qualifying assets."*

These assumptions made by the IPSASB may not be applicable to all public sector entities. In our experience, it is not difficult to differentiate between external borrowing and other resources of funding such as operational revenue of the Council. In fact, the Council's sustainable debt policy has specific requirements that set out circumstances under which the Council is permitted to use external debt to fund various types of expenditure.

BC 6 continues: *"Governments and other public sector entities may borrow for public policy purposes, for example they may issue debt securities to provide liquidity in the capital markets."*

In New Zealand, providing liquidity to capital markets is not the responsibility of local governments or other public sector entities. Rather, it is the responsibility of the central bank that influences the money supply in an economy directly as part of its monetary policies.

The IPSASB concluded, based on the arguments set out in the Basis of Conclusions to the ED, that capitalising "directly attributable" borrowing costs is *"unlikely to provide relevant and reliable information or enhance accountability. It is also likely that the cost to do so would exceed the related benefits, if any"* [BC 7].

*"Any accounting system to track directly attributable borrowing costs and their application to qualifying assets is likely to be complex and resource intensive. The IPSASB is of the view that in these cases, the costs incurred in capitalizing borrowing costs would be likely to exceed the related benefits, if any"* [BC 8].

The Council has implemented a robust Revenue and Financing Policy that allows the "tracking" of funds attributable to the financing of the acquisition, construction or production of qualifying assets. The funding policy and the related rating policies are signed off by the Council as well as by the auditors of the Council and the Council's system is sufficiently robust that a clear linkage can be drawn between directly attributable borrowing costs and the assets that the borrowing costs helped to fund.

In our experience the process of "tracking" directly attributable borrowing costs is not particularly resource intensive and the benefits for the ratepayers (i.e. smoothing the impact of capital intensive projects on rates) is considered to outweigh the costs.

Therefore we disagree with the proposed departure from IAS 23 and we believe that the proposals should allow capitalisation of directly attributable borrowing costs and not limit eligibility for capitalisation to borrowing costs related to funds borrowed specifically to acquire, construct or produce qualifying assets.



### **Impact on valuations**

When we considered our accounting policy in relation to borrowing costs, we also considered the accounting and practical implications of capitalisation of borrowing costs on asset valuations.

The Council holds property, plant and equipment (PP&E) accounted for under NZ IAS 16<sup>3</sup> both at cost and revalued amounts. The Council and its valuer considered the impact of capitalising borrowing costs to the valuation of assets carried at revalued amounts. These considerations are summarised below.

The valuation of the Council's non-specialised assets is based on market evidence. The valuation of specialised assets and that of assets which operate in a monopoly context is based on depreciated replacement cost (DRC) if fair value is not able to be reliably determined using market-based evidence in accordance with paragraph 33 of NZ IAS 16. Specialised assets include the City's roading and drainage, specialised buildings, plant and equipment.

Additional paragraphs were added to the New Zealand version of IAS 16 for public benefit entities in relation to assets valued based on DRC. For instance, NZ IAS 16 para NZ33.14 states that (if an entity adopts the allowed alternative treatment in IAS 23 Borrowing Costs) *"borrowing costs that would be embodied in the fair value of the asset is included as a component of depreciated replacement cost. The inclusion of such an amount as a component of DRC is consistent with the principle underlying the inclusion in the initial cost of an asset of borrowing costs eligible for capitalisation as permitted by IAS 23."*

Therefore, in New Zealand, if a public service entity adopts the allowed alternative treatment in NZ IAS 23 *Borrowing Costs*, an amount equal to the amount of borrowing costs that would be embodied in the fair value of the asset is included as a component of depreciated replacement cost. The inclusion of such an amount as a component of DRC is consistent with the principle underlying the inclusion in the initial cost of an asset of borrowing costs eligible for capitalisation as permitted by NZ IAS 23.

In practice, the Council's valuers' valuation software, models the capital expenditure profile and allows for capitalised interest as a function of interest rate (using the relevant Government Stock rates) and the lead times assigned for each component (line item in the fixed asset register).

The valuer has incorporated capitalised interest in its valuations for public and private sector entities for the past 10 years or more and does not see this as an issue. The lead times adopted are available (just as lives adopted for accounting depreciation are provided in annual reports) based on times to design and build typical assets of each type.

In addition, the accounting policy of the Council enables the valuers to determine which specialised assets are 'qualifying assets' that should have capitalised interest included in their DRC valuation.

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<sup>3</sup> In adopting IAS 16 for application as New Zealand Equivalent to IAS 16 (NZ IAS 16) changes have been made to the standard for application of the standard by public benefit entities. Public benefit entities applying the paragraphs that were added to the New Zealand version of IAS 16 will not comply with IAS 16.

*Public benefit entities* are defined by para NZ 6.1 of NZ IAS 16 as reporting entities whose primary objective is to provide goods and services for community or social benefit and where any equity has been provided with the view to supporting that primary objective rather than for a financial return to equity holders.

The above would only need to be considered for assets valued based on DRC. The valuation of assets valued using market evidence (e.g. land and office buildings) is based on sales evidence, capitalised rentals of comparable properties or discounted cash flows, and therefore no interest is taken into account when valuing these assets.

In our experience an accounting policy to capitalise directly attributable borrowing costs to the initial costs of qualifying assets and the subsequent inclusion of borrowing costs in DRC valuations can be implemented and applied in a robust and reliable manner and the benefits outweigh the costs of implementation.

***Borrowing costs incurred by the Economic Entity***

Similar to the above, we believe that the proposals should allow capitalisation of directly attributable borrowing costs incurred by the economic entity and not limit eligibility for capitalisation to borrowing costs related to funds borrowed specifically to acquire, construct or produce qualifying assets.

**Concluding comments**

Please contact the undersigned should you wish to discuss the content of this letter.

Yours faithfully

A handwritten signature in black ink, appearing to be 'Ravi Ganeshalingam', written over a horizontal line.

Ravi Ganeshalingam  
Corporate finance manager





**The Japanese Institute of  
Certified Public Accountants**

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**December 12, 2009**

**Technical Director**

**International Public Sector Accounting Standards Board**

**International Federation of Accountants**

**277 Wellington 4th Floor**

**Toronto, Ontario, M5V 3H2 CANADA**

**Comments on the Proposed International Public Sector Accounting Standard,  
IPSAS 5 “Borrowing Costs” (Revised 200X)**

Dear Sir:

The Japanese Institute of Certified Public Accountants (JICPA) is pleased to comment on the Proposed International Public Sector Accounting Standard, IPSAS 5 “Borrowing Costs” (Revised 200X)” (the “ED”), as follows:

**On “Specific Matter for Comment”**

This Exposure Draft proposes that borrowing costs be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with this proposal?

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

We agree with this proposal. Our reasoning is as follows.

(1) Whether borrowing costs be basically recognized immediately as an expense.

Under the revised IAS 23, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalized to form part

of the cost of that asset. In IAS 23, borrowing costs that are “directly attributable” to the acquisition, construction or production of qualifying assets are those borrowing costs that would have been avoided had the expenditure on the qualifying asset not been made. Such borrowings are not limited to funds borrowed specifically for the purpose of acquiring, constructing or producing a particular qualifying asset.

Borrowing in the public sector may be for investing or operating activities, and not only for financing activities. Therefore, borrowing costs in the public sector are not always restricted to costs that would have been avoided had the expenditure on the qualifying asset not been made.

In conclusion, we think it rational that borrowing costs be basically recognized immediately as an expense, and not capitalized.

(2) Whether an entity is permitted, but not required, to capitalize borrowing costs that are specifically incurred on qualifying assets.

Borrowing in the public sector for financing activities may be allocated to deficits in the present fiscal year or to public investment on the acquisition, construction or production of a qualifying asset.

It may be rational that borrowing costs to allocate public investment on the acquisition, construction or production of a qualifying asset be capitalized when incurred, and the depreciation charge be recognized for future generations of citizens who use this asset.

In conclusion, we think it rational that an entity is permitted, but not required, to capitalize borrowing costs that are specifically incurred on qualifying assets.

Yours sincerely,

Yasuo Kameoka  
Takao Kashitani  
Executive Board Member  
Chair of the Public Sector Committee  
The Japanese Institute of Certified Public Accountants



## **IPSASB**

### **Exposure Draft 35: Borrowing Costs**

#### **Comments by Audit Scotland**

## Comments by Audit Scotland

### Introduction

Audit Scotland is the public sector audit agency undertaking the external audit of the majority of public sector entities in Scotland covering both national and local government. We also contribute to the development of accounting frameworks and practices for the public sector across the UK. We welcome the opportunity to comment on the Exposure Draft.

### Overall comments

Audit Scotland notes the proposals in the Exposure Draft but does not believe that the basis for conclusions justifies the proposals in the circumstances of local government in the UK.

Local government in the UK borrows generally but, in broad terms, only for capital purposes and is not allowed to borrow to run revenue deficits. In principle therefore we can see no significant difference between the circumstances of local government in the UK and the circumstances of a private sector group with a central Treasury management function, which are specifically provided for in IAS 23.

We may have been more convinced of the merits of a public sector standard departing from IAS 23 if IPSASB were to base their conclusions more heavily on the alignment with statistical reporting but even here we would observe that an adjustment between financial and statistical bases will be required to be made in any event for those private sector entities following IAS 23.

In conclusion therefore Audit Scotland considers that IPSASB needs to reconsider the basis for its conclusions to reflect the different range of circumstances surrounding borrowing by public sector entities and, if it wishes to confirm its current proposals, to more robustly justify a departure from IAS 23 in the circumstances of entities such as those in UK local government.

We hope that you find our comments helpful and should you require any further information please contact Russell A J Frith, Director of Audit Strategy, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH, e-mail [rfrith@audit-scotland.gov.uk](mailto:rfrith@audit-scotland.gov.uk).

17 December 2008



The Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West, 4<sup>th</sup> Floor  
Toronto, Ontario  
Canada  
M5V 3H 2  
Per e-mail: [EDComments@ifac.org](mailto:EDComments@ifac.org)

15 December 2008

Dear Stephanie,

**IPSAS 5 BORROWING COSTS (ED 35)**

In response to your request for comment on Exposure Draft 35 IPSAS 5 *Borrowing Costs*, issued by the International Public Sector Accounting Standards Board (IPSASB), we enclose our comment letter.

We would like to thank you for the opportunity to provide comment on this exposure draft. In addition to our response to the specific question, we have also included comment on other aspects in the exposure draft.

Please do not hesitate to contact me should you wish to discuss or require any clarification on our comment provided.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Erna Swart'.

**Erna Swart**  
**Chief Executive Officer**

Board Members: Mr R Cottrell (Chairperson), Mr V Jack, Dr L Konar, Mr T Makwetu,  
Mr I Mamoojee, Mr F Nomvalo, Mr I Sehoole, Mr V Smith  
Chief Executive Officer: Ms E Swart



## SPECIFIC MATTER FOR COMMENT

*The Exposure Draft proposes that borrowing costs be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with the proposal?*

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

Under the current pronouncements relating to borrowing costs, most South African entities expense borrowing costs as a result of cost-benefit considerations. Therefore, some respondents support the proposed option to either expense or capitalise borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets.

However, the general accounting principle with regards to the capitalisation of costs as part of an asset, requires an entity to capitalise any costs *directly attributable* to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. As a standard setter, we are of the view that this principle also applies to borrowing costs. Thus, borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets should be capitalised as part of the cost of such assets, as the borrowing costs were incurred to bring these assets to the location and condition necessary for it to be capable of operating in the manner intended by management. When entities obtain specific funding for the acquisition, development or construction of a qualifying asset it would be possible to allocate the funding, and the borrowing costs incurred thereon, to the specific acquired, developed or constructed asset.

We therefore propose that the general accounting principle should be applied to the capitalisation of borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets. The IPSAS should clarify how borrowing costs *specifically incurred* relates and links to costs *directly attributable* with regards to a specific asset. This clarification could be provided as an explanatory paragraph to paragraphs .10 and .11. Capitalising borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets will also enhance comparability between entities.

We consider the cost-benefit consideration in BC 9 not an adequate reason for allowing the option to expense borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets. The conclusion should be further clarified and motivated.

## OTHER MATTERS

### Summary of main changes

1. This section proposes to replace the previous “objective” section with a “core principle”. To ensure consistency with other IPSASs, we propose that the section should not be replaced until the proposal is incorporated in all the other IPSASs.

### Scope exclusion

2. Paragraph .06 scopes out borrowing costs specifically incurred for the acquisition, construction or production of a qualifying asset measured at fair value at initial recognition.

We support the scope exclusion but propose the inclusion of an example to illustrate and clarify this scope exclusion. This could be done either as an explanatory paragraph to paragraph .06, or alternatively, be explained as part of paragraph IN5. An example that explains the scope exclusion is that of assets acquired as part of a non-exchange transaction. Biological assets are another example that could be included once the IPSAS dealing with biological assets has been finalised.

3. IAS 23.04(b) further scopes out inventories that are manufactured or otherwise produced, in large quantities on a repetitive basis. The proposed IPSAS does not include a similar scope exclusion, nor does the comparison with IAS 23 and/or the Basis for Conclusions to the proposed IPSAS explain the reason for the deviation.

We are of the view that such a scope exclusion is equally applicable to the public sector, for example the department of health can produce a vaccine in large quantities on a repetitive basis. We therefore propose the inclusion of a similar scope exclusion in the proposed IPSAS.

4. We further propose that the wording in paragraph .06 should be aligned with the wording in IAS 23.04, as the wording in the equivalent IAS is much more simplified. We also propose that paragraph .06 should be a grey letter paragraph and not a bold text paragraph.

### Definitions (paragraph .07)

5. As the definition of inventory in IPSAS 12 acknowledges that inventories are assets that can be consumed or distributed in the rendering of services, we propose that the definition of a qualifying asset should also be expanded to incorporate this requirement. The definition of qualifying asset should therefore be amended as follows:

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

This deviation from the definition in IAS 23 should be highlighted in the comparison with IAS 23.

### Borrowing costs (paragraph .08)

6. The proposed IPSAS does not incorporate the latest amendments to IAS 23 that resulted from the IASB's *Improvements to IFRSs* issued in May 2008. The following amendments to paragraph .08 (a) to (c) should be incorporated:

.08(a) interest expense calculated using the effective interest rate method as described in the relevant international and national accounting

standard dealing with financial instruments) ~~Interest on short term and long term borrowings;~~

.08(b) ~~[deleted] Amortization of discounts or premiums relating to borrowings;~~

.08(c) ~~[deleted] Amortization of ancillary costs incurred in connection with the arrangement of borrowings;~~

### **Qualifying assets (paragraph .09)**

7. The list of qualifying asset examples included in paragraph .09(a) to (d) are all examples of property, plant and equipment. We therefore propose that examples of qualifying intangible assets should also be included as part of this list once the IPSAS on intangible assets has been finalised.

### **Recognition**

8. We propose that the word “they” in the second last sentence of paragraph .13 should be clarified. Although similar to IAS 23, in reading the sentence, it might be interpreted that “they” refer to “borrowing costs” as opposed to “the asset”. Borrowing costs will never increase the future economic benefits or service potential of an asset.

### **Borrowing costs eligible for capitalisation**

9. Even though the sequence in IAS 23 is similar to that proposed in the IPSAS, we recommend the inclusion of paragraph .17 before paragraphs .15 and .16 as paragraph .17 contains the basic principle in this section and paragraphs .15 and .16 are further explanations thereof.
10. Reference is made to “directly relate” in the first sentence of paragraph .15. As “directly attributable” has been amended to “specifically incurred” throughout the proposed IPSAS, the word “directly” should be amended to “specifically”.
11. We do not understand the reason for the deletion of the first sentence in paragraph .15 as it is not explained in the Basis for Conclusions. We propose that this sentence should be retained as it further clarifies the principles dealt with in this section.
12. Paragraph .16 explains that funds that have been borrowed centrally may be transferred to other entities within the economic entity as a loan, *a grant or a capital injection*. The paragraph further explains that some loans may be interest-free or require that only a portion of the actual interest cost be recovered and *grants or capital injections* do not normally incur interest.  
  
Borrowing costs, and the capitalisation thereof, is not applicable to grants or capital injections as this is not forms of borrowings, and should therefore be deleted. This amendment should also be applied to paragraph .19.
13. We also recommend that the phrase “in both cases” in the last sentence of paragraph .16 should be amended to “in these cases”.

### **Borrowing costs incurred by the economic entity**

14. We propose that the word “can” in the last sentence of paragraph .20 should be amended to “may”:  
  
“.....the full amount of borrowing costs specifically incurred for the acquisition, construction or production of a qualifying asset ~~can~~ may be capitalized as part of the cost of that qualifying asset...”.



### **Excess of the carrying amount of the qualifying asset over recoverable amount**

15. The heading to this section only deals with recoverable amount. Reference is however made in the section to recoverable amount, current replacement cost, recoverable service amount and net realisable value. We therefore propose that the heading should be amended to “Impairment of qualifying assets”.
16. The last sentence makes reference to “the write-down or write-off in relation to impairment of assets is written back”. We propose that more appropriate wording should be used to explain the reversal of any impairment that is aligned with the wording in IPSAS 12, 21 and 26.
17. In addition, we propose that the phrase “those other standards” should be retained or alternatively, that IPSAS 12 be added as a reference in this paragraph.

### **Commencement of capitalization**

18. We propose that paragraph .24(b) should be amended as follows:  
“It incurs borrowing costs specifically ~~incurred~~ for the acquisition, construction.....”.

### **Suspension of capitalization**

19. The proposed IPSAS makes reference to “acquisition, construction and development” throughout the Standard. Even though the wording is similar to that of IAS 23, we propose that the term “active development” in paragraph .27 should be amended to “construction or production” to be consistent with the wording used throughout the proposed IPSAS.

### **Amendments to guidance on other IPSASs**

20. We propose that the word “comparable” in paragraph 2.1 should be retained.
21. The year-end dates in the second part of the “extracts from the notes” should be amended to 20X1.

### **Illustrative examples**

22. We propose that the amounts used in the example should be rounded to the nearest thousand for simplification of the example.

### **Basis for Conclusions**

23. BC 12 concludes that the IPSASB deems it inappropriate to require capitalisation in respect of qualifying assets that are carried on the revaluation model in IPSAS 17.

We do not understand this conclusion, as no amendment related to this conclusive paragraph was incorporated in the proposed IPSAS. Furthermore, we do not agree with the conclusion in BC 12. Any changes in the fair value of a qualifying asset on valuation date will be reflected in the revaluation reserve, or will be reflected in the statement of financial performance if a revaluation reserve does not exist. If borrowing costs were included as part of the cost of the qualifying asset, and that asset is subsequently measured by applying the revaluation model, any adjustments resulting from the revaluation will be reflected in the revaluation reserve or in the statement of financial performance. It is therefore appropriate to require the capitalisation of borrowing costs to qualifying assets carried on the revaluation model in IPSAS 17.

### **Comparison with IAS 23**

24. The comparison with IAS 23 should also highlight the difference between the proposed IPSAS and IAS 23 with regards to the treatment of borrowing costs incurred on funds borrowed generally. The proposed IPSAS requires the expenditure of borrowing costs incurred on funds that were borrowed generally whereas IAS 23 requires the capitalisation of such borrowings costs based on the application of a calculated capitalisation rate.

The comparison currently only highlights the difference in the treatment of borrowing costs incurred on funds borrowed specifically.

25. In addition, we recommend that the inclusion of the explanatory guidance in paragraph .22 on the treatment of borrowing costs incurred for funds specifically and generally borrowed by the controlling entity which are then lend to the controlled entity, should also be highlighted as part of the comparison with IAS 23.

## Accounting Standards Board

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[www.frc.org.uk/asb](http://www.frc.org.uk/asb)



Stephenie Fox  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street, 4<sup>th</sup> Floor  
Toronto, Ontario, M5V 3H2  
CANADA

19 December 2008

Dear Stephenie

### Exposure Draft 35: IPSAS 5 'Borrowing Costs'

The UK Accounting Standards Board (ASB) welcomes the opportunity to comment on the International Public Sector Accounting Standards Board's (IPSASB) proposals for amending IPSAS 5 'Borrowing Costs'.

The proposals in ED 35 differ markedly from those in IAS 23 in that the latter generally requires capitalisation of borrowing costs where they are material, whereas ED 35 proposes prohibiting this (except in the case of borrowing costs that are 'specifically incurred' which we address below). Although we support IPSASB's strategic objective to converge IPSASs with IFRS, except where there are strong public sector reasons for departure, we agree with the proposals in ED 35.

In particular, we agree that in the public sector there is often no meaningful way to attribute borrowing costs to qualifying assets because borrowings are frequently used to finance current spending and because public sector entities may borrow for public policy purposes and to provide liquidity to the capital markets. Because we believe that IPSAS should only depart from IFRS where there are strong public sector reasons, we consider it important that the proposed standard sets out its arguments as clearly and persuasively as possible.

We do not agree with the proposal to permit, but not require, capitalisation where borrowing costs are specifically incurred on qualifying assets. We believe options in accounting standards impair comparability and are therefore rarely appropriate. In our view, the standard should require borrowing costs that are specifically incurred for the acquisition, construction or production of a qualifying asset to be capitalised as there should be no difficulty in identifying the relevant costs.

The standard is concerned only with the determination of the cost of an asset and its scope specifically excludes assets measured at fair value on initial recognition. We support this scope. We would, however, suggest that the standard makes clear that, where assets are revalued on a replacement cost basis, it does not preclude the assessment of that value from including the borrowing costs that might be incurred on replacement.

If you would like any further information on the comments made in this letter, then please contact me or Alan O'Connor on 020 7492 2421 or [a.oconnor@frc-asb.org.uk](mailto:a.oconnor@frc-asb.org.uk).

Yours sincerely



**Ian Mackintosh**

Chair, Accounting Standards Board

DDI: 020 7492 2440

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Australian Government  
Australian Accounting  
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19 December 2008

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### **Proposed Amendments to IPSAS 5 *Borrowing Costs***

The Australian Accounting Standards Board (AASB) is pleased to submit its comments on the Exposure Draft ED 35 IPSAS 5 *Borrowing Costs*. In formulating these comments, the AASB has sought and considered the views of Australian constituents. These responses are published on the AASB's website:

<http://www.aasb.gov.au/Work-In-Progress/Pending.aspx>.

In general, the AASB is in favour of the IPSASB revising IPSAS 5 *Borrowing Costs* in light of the recent revision of IAS 23 *Borrowing Costs* and modifying it to reflect not-for-profit public sector circumstances. However, the AASB particularly does not support the IPSASB departing from IAS 23 by introducing an optional treatment for borrowing costs 'specifically incurred' to finance the acquisition, construction, or production of a qualifying asset. The AASB encourages the IPSASB to reconsider the proposed types of departures from IAS 23, and depart only on the basis of either:

- public sector specific reasons that are consistent with the IPSASB's guidelines for modifying IFRSs; or
- more fundamentally, a conceptual view.

### ***Guidelines for modifying IFRSs***

The IPSASB initiated a continuous improvements project to update existing IPSASs to converge with the latest related IFRSs, to the extent appropriate for the public sector, and has developed guidelines to be used in that process. In the context of those guidelines, the AASB is concerned that the IPSASB has not identified sufficient public sector specific reasons for departing from IAS 23.

The AASB notes that reasons given for departing from IAS 23 in ED 35 about the difficulty in the public sector of associating borrowings with particular qualifying assets are also issues in the private for-profit sector.

Although issues arise for governments that borrow centrally, similar issues also arise in many large businesses. For example, a private sector parent entity may raise funds through debt and equity sources for a group of companies and then allocate funding to a particular subsidiary for the construction of a qualifying asset. In such a situation, it would be difficult for the entity to distinguish the proportion of debt financing because financing is provided from a pool of funds.

ED 35 also argues that the large number of controlled entities in the public sector means that tracking borrowing costs can be complex and resource intensive due to the individual accounting systems used by those controlled entities. The AASB notes that this is also a challenge faced by private sector entities that may have hundreds of subsidiaries.

The AASB is not convinced with the arguments put forward to modify IAS 23. In particular, the AASB does not think that the IPSASB has adequately established a basis for introducing the notions of ‘specifically incurred’ and ‘general borrowings’ and the consequential different accounting treatments. Consistent with the IPSASB guidelines for modifying IFRSs, the IPSASB should use the IAS 23 notion of ‘directly attributable’ borrowing costs in IPSAS 5 and thereby keep IAS 23 broadly intact.

### *Conceptual view*

Although the AASB has been unable to identify public sector facts and circumstances to justify a departure from IAS 23, from a conceptual view, the AASB does not support treating borrowing costs differently from other financing costs. The AASB considers that there are sound conceptual arguments for immediately expensing all borrowing costs – that is, treating them as costs of the period in which they are incurred.

From the viewpoint of consistency, one conceptual response to the issue of accounting for borrowing costs would be to require all financing costs to be capitalised to qualifying assets. That is, if the cost of finance associated with the acquisition, construction, or production of a qualifying asset should be included in its recognised cost, conceptually this should be done regardless of the form that finance takes. There seems little justification for only including the cost of finance to the extent of debt financing, but not including the cost of finance to the extent of equity financing.

Since many entities use both debt and equity finance for their business activities, it seems inconsistent and conceptually unconvincing that the entity should trace the source of funding to determine the amount to be capitalised to a particular qualifying asset. Also, the fungible nature of cash means that pooled debt and equity funds can be difficult to apportion.

The AASB does not agree that qualifying assets should have different acquisition costs (and therefore carrying amounts) based on the financing adopted by the entity or simply based on difficulties associated with the apportionment of pooled funds. If capitalisation of only borrowing costs is allowed, the financing structure of an entity could affect the acquisition cost of an asset as well as its carrying amount. If an entity is debt-free, it could have a qualifying asset with a lower carrying amount compared to a debt-financed entity.

Further, the AASB notes that IPSAS 17 *Property, Plant and Equipment* (and IAS 16 *Property, Plant and Equipment*) explains the elements of cost in the context of property, plant and equipment and provides examples of directly attributable costs. IPSAS 17 seems to focus on the costs of “bringing the asset to the location and condition necessary for it to be capable

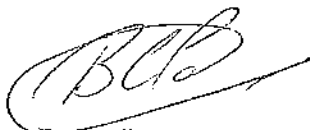
of operating in the manner intended by management” (see IPSAS 17.30 (b)). Borrowing costs are not specifically included as a directly attributable cost and the examples of directly attributable costs do not refer to borrowing costs. Consistent with the notion of cost underpinning IPSAS 17 and the characteristic it is attempting to measure, the AASB does not believe that borrowing costs are relevant to the location, condition or operating capability of assets.

Although there are some conceptual arguments for capitalising all financing costs (including borrowing costs and notional costs of equity financing) to qualifying assets, the AASB believes that the weight of conceptual argument supports the view that borrowing costs are period costs and should be recognised immediately as an expense. This is because borrowing costs represent an element of the cost of financing the entity’s collective activities for a period and represent the cost of the return due to the lender for the funds held by the entity for a certain period.

In summary, the AASB considers that ED 35 does not adequately justify the proposed modifications to IAS 23 based on the IPSASB’s guidelines for modifying IFRSs, but that the IPSASB could potentially depart from IAS 23 based on conceptual grounds.

If you have any queries regarding this submission, please contact Latif Oylan (loylan@aasb.gov.au) or me.

Yours sincerely



Bruce Porter  
Acting Chairman





22 December 2008

File Ref: ER02-0008

Stephenie Fox  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street, 4<sup>th</sup> floor  
Toronto  
Ontario M5V 3H2  
Canada

Kevin Brady

Dear Stephenie

### **EXPOSURE DRAFT 35: IPSAS 5 BORROWING COSTS (REVISED 200X)**

We are pleased to comment on the International Public Sector Accounting Standards Board's (the Board's) Exposure Draft that proposes revisions to IPSAS 5 *Borrowing Costs*.

We are strongly of the view that public sector entities should have an option to expense borrowing costs. Therefore, we agree with the Board's proposed exposure draft in this respect. Also, we agree that public sector entities should be permitted to capitalise borrowing costs, although we would caution against capitalisation particularly where qualifying assets are likely to be subject to regular revaluation. However, we do not understand the rationale for changing the wording of borrowing costs that are to be capitalised from "directly attributable" borrowing costs to "specifically incurred" borrowing costs. We elaborate on our views below.

#### **Option to expense borrowing costs**

Our reasons for strongly agreeing that there should be an option for public sector entities to expense borrowing costs include:

- We are unclear about whether capitalisation of any borrowing costs is likely to result in information that is meaningful to users of the financial statements of public sector entities.
- We find it difficult to rationalise why the manner of funding a qualifying asset should drive the value at which it is initially recorded. It makes no sense to us that just because an entity has more debt, its assets should be recorded at a higher value. For example, why should an asset that is 100% debt funded be initially recorded at a higher value than an asset with no debt funding?



- We believe it is often debateable whether there is a linkage between borrowings by particular public sector entities and the acquisition, construction or production of qualifying assets by those entities, as explained in the Board's Basis for Conclusions.
- We do not accept the argument that compulsory capitalisation will result in increased comparability. That argument does not make sense because the amount capitalised in each case is entity specific based on a range of factors, including the level of debt of the entity. If comparability is a key driver, the Board should consider mandating the expensing of borrowing costs.
- We are unclear about the effect of initial capitalisation of borrowing costs on subsequent revaluation of qualifying assets using depreciated replacement cost (DRC). We are not aware of any valuation guidance about how to incorporate borrowing costs in a DRC valuation, therefore we are concerned about the range of valuation practices that could emerge and the resulting adverse impact on the reliability of the information provided, as explained in the Board's Basis for Conclusions.
- We have serious reservations about whether the benefits of capitalisation of borrowing costs outweigh the costs of doing so.

### **Capitalisation of borrowing costs permitted**

Our reason for agreeing that capitalisation of borrowing costs should be permitted is on the basis that some public sector entities may be able to rationalise capitalisation to meet the information needs of users of their financial statements. However, we foresee problems trying to rationalise capitalisation of borrowing costs in a jurisdiction such as New Zealand, where most public sector entities revalue qualifying assets using DRC. (Note our comment above about DRC valuations.)

It is interesting to note the New Zealand experience with borrowing costs in the public sector. In New Zealand, International Financial Reporting Standards are used as the basis for financial reporting standards for the public sector. When the International Accounting Standards Board issued IAS 23 (July 2007) the New Zealand standard setter made no changes to the New Zealand equivalent to IAS 23 (NZ IAS 23) for the public sector. The decision was controversial at the time. The submissions received from those operating in the public sector on the exposure of the proposed NZ IAS 23 did not support mandatory capitalisation of borrowing costs for the public sector.

Recently the standard setter accepted that requiring public sector entities to capitalise borrowing costs to qualifying assets was likely to create unnecessary problems for those entities when NZ IAS 23 (July 2007) becomes mandatory. As a result, the standard setter has reinstated the option for the public sector to expense borrowing costs, at least until such time as the problems have been addressed.

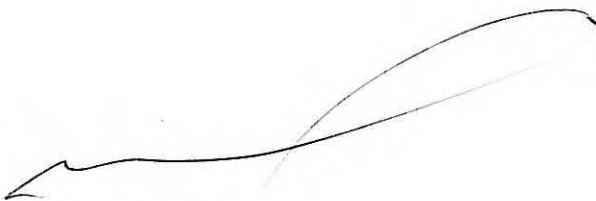
### **Specifically incurred versus directly attributable borrowing costs**

We agree that it is appropriate to limit the circumstances for capitalisation of borrowing costs. However, we do not understand the rationale for replacing the words “directly attributable” from IAS 23 with “specifically incurred”. We note the discussion in the Basis for Conclusions, paragraphs BC5 to BC7 and BC10 and BC11, but we still do not understand the distinction that the Board was trying to draw.

In our view, “directly attributable” borrowing costs when put in the context of the discussion in paragraphs BC5 to BC7, is likely to give the same result as “specifically incurred” borrowing costs (that is, general borrowings will be excluded). Therefore, we would prefer to see the words “directly attributable” retained in IPSAS 5 and the relevant discussion from paragraphs BC5 to BC7 incorporated into IPSAS 5 to provide context.

If you have any questions or would like clarification about any of our comments, please contact Todd Beardsworth on 0064 4 917 1590 or email him at [todd.beardsworth@oag.govt.nz](mailto:todd.beardsworth@oag.govt.nz).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Kevin Brady', with a long, sweeping horizontal stroke followed by a curved flourish.

Kevin Brady

copy to            Director – Accounting Standards  
                      New Zealand Institute of Chartered Accountants  
                      P O Box 11 342  
                      Wellington  
                      New Zealand



*Te Kaunihera o*  
**MANUKAU**  
*City Council*

*From the Directorate of:*  
**FINANCE**

Technical Director  
International Public Sector Accounting Standards Board  
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CANADA

Via e-mail to [EdComments@ifac.org](mailto:EdComments@ifac.org)

Dear Sir/Madam

## **Exposure Draft of Proposed amendments to IPSAS 5 “Borrowing Costs”**

### **1 Introduction**

The Manukau City Council is submitting this letter in response to the request of the International Public Sector Accounting Standards Board for comment on the Exposure Draft, ED 35. The council is a territorial local authority which provides a range of services based around land use, urban and community planning and development. The council also provides local infrastructure and facilities. The purpose of the council is to enable democratic local decision-making to promote the social, economic, environmental and cultural well-being of Manukau City which is the third largest city in New Zealand.

### **2 Specific matter for comment**

This Exposure Draft proposes that borrowing costs be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs.

### **3 The council's response**

The council agrees with the proposal that public sector entities should not be required to capitalize borrowing costs specifically incurred on qualifying assets. The council considers that the capitalisation of borrowing costs as part of the cost of an asset is not appropriate for public sector entities.

Our main concerns with mandatory capitalisation are as follows:

#### Difficulties in attributing costs to Assets

For public sector entities, borrowings are not always attributable to particular asset acquisitions as construction can often occur over numerous projects at the same time. It is often difficult to distinguish what funds are borrowed for what purpose and therefore attributing the borrowing costs to specific assets would be arbitrary. There would also be administrative difficulties in analysing interest costs on projects that extend over a substantial period.



*Te Kaunihera o*  
**MANUKAU**  
*City Council*

Lack of guidance of impact on asset revaluations.

Public sector assets are valued using depreciated replacement cost and there is currently no guidance regarding the incorporation of borrowing costs into an asset valuation prepared on a depreciated replacement costs basis.

Depreciated replacement cost is based on an estimate of the current gross replacement cost of the assets, less allowances for physical deterioration, obsolescence and optimisation. To include borrowing costs in depreciated replacement cost measures would be an arbitrary exercise.

Further, these assets are re-valued on a regular basis (the council re-values every three years) and the impact of the capitalization of borrowing costs would be lost upon revaluation.

**4 Conclusion**

Manukau City Council agrees with the proposal that public sector entities should not be required to capitalize borrowing costs specifically incurred on qualifying assets as it could potentially create significant additional work and cost for councils and other public benefit entities that have significant assets which can take substantial periods to construct, particularly where those assets are revalued.

Yours faithfully

Ross Chimside  
**GROUP MANAGER FINANCIAL CONTROL**



Technical Director of the IPSAS Board  
277 Wellington St. 4th floor  
Toronto, ONTARIO

Regarding: IPSAS 5 on Borrowing Costs DUE 1-7- 09  
From : Dr. Joseph S. Maresca CPA, CISA

Colleagues,  
Thank you for the opportunity to critique this IPSAS # 5.  
The commentary is listed below:

(1) There are practical implementation problems with regard to funding for government controlled entities by means of appropriation through a central fund. The challenge is to disaggregate the central fund utilizing a rational method or means like a special fund.

Accounting for governmental units emphasizes legal form over the economic substance of the transaction in contradistinction to for-profit entities which emphasize the economic substance over legal form. The impact of the legislative process and custodianship over scarce resources are the main drivers in governmental accounting.

A fund is an independent fiscal and accounting entity composed of money or resources which are separated for the purpose of carrying out specific activities or attaining certain objectives enshrined in the regulatory or legislative process of the host country.  
A governmental unit will have within its own jurisdiction a specific mission or statutory guidelines with designated assets, liabilities and fund equities.

A series of special funds may help to target the monies authorized by statute. i.e. Special Revenue Funds account for specific revenue sources or finance designated activities required by statute.

Debt service funds account for paying interest and principal on long term debt other than revenue bonds. Capital Project funds are mapped to the acquisition of capital facilities.

Enterprise Funds account for the financing of public services where the involved costs are absorbed in the form of user fees or charges for such services. i.e. bridges and tolls

(2) Page 11 calls for immediate expensing of borrowing costs except for incurrences for qualified assets. Financial reporting during hyperinflation recognizes as an expense a part of borrowing costs to compensate for inflation. Consistency would call for application of the same principle to periods

of deflation in the world economy. The VIX index would provide a dis-passionate metric for measuring volatility fairly and in synchronization with predictable market patterns. Moving averages document the evolution and ultimate direction of the patterns in the market. An intermarket profile may be required to interpret the global data and trends.

Monetary units are inherently subject to measureable fluctuations. Money has a utility as a medium of exchange and a real value determinable by the amount of goods and services exchanged. The real value is known as the purchasing power of a dollar. Due to inflation or deflation, the amount of goods and services exchangeable by a dollar or any other currency will vary. For instance, the purchasing power of the dollar changes from one time period to another.

Historical amounts may be adjusted for changes in the general price level to convert currency with a different purchasing power into amounts whose purchasing power is the same or comparable. Since today's currency may not be comparable to prior years, adjustments are necessary to make inter-period comparisons according to a uniform metric. Adjusting historical costs for price-level changes provides a good metric for determining real losses on assets which yield ready cash while providing for real gains for carrying debt during a period of inflation. The case for carrying debt during deflation is murkier because the debt may be refinanced at a lower rate. In addition, the collateral is worth less due to a deflation in the value of the assets which serve as collateral for the loan in the instant case.

(3) Page 18 calls for capitalizing borrowing costs when future economic benefits are probable and by extension estimable. This treatment appears to be correct theoretically.

When a controlled entity acquires an interest-free capital contribution, there may be no borrowing costs and by extension- no capitalization of costs.

(4) When a controlled entity transfers funds, it may capitalize a portion of its incurred borrowing costs. This action would be fair and estimable. When the controlling entity transfers funds at no cost to the controlled entity- neither meets the criteria for capitalizing costs.

(5) An intra-governmental service fund may be established to sell goods and services to a governmental unit but not the general public. This type of fund ensures uniformity and certain economies of scale in the procurement of goods and services for the government unit- taken as a whole.

by Dr. Joseph S. Maresca CPA, CISA



Treasury Board of Canada  
Secrétariat

Secrétariat du Conseil du Trésor  
du Canada

Ottawa, Canada  
K1A 0R5

January 6, 2009

Ms. Stephenie Fox  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street, 4th Floor  
Toronto, Ontario, M5V 3H2  
Email: [EDComments@ifac.org](mailto:EDComments@ifac.org)

Dear Ms. Fox:

**Subject: ED 35 – IPSAS 5 “Borrowing Costs”**

Thank you for the opportunity to comment on the Exposure Draft 35 – **IPSAS 5 “Borrowing Costs” (Revised 200X)** that was issued in September 2008.

The Government of Canada bases its accounting policies on the Accounting Standards issued by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA). Our government is therefore not required to follow the International Public Sector Accounting Standards (IPSAS). Nonetheless, IPSAS are an important secondary source of generally accepted accounting principles (GAAP) in Canadian GAAP literature, so we have a vested interest in this proposal.

PSAB’s standards allow the capitalization of interest costs directly attributable to the acquisition, construction or development of a tangible capital asset when it is the government’s policy to capitalize such costs. The Government of Canada’s accounting policy is to expense all borrowing costs. Unlike the private sector, governments may operate in significant deficit positions. In this context, the cost of financing public debt is considered to be a very significant indicator of public finances and of the government’s financial condition.

For these reasons, we consider that there are government specific circumstances that justify departing from IAS 23 “Borrowing Costs” and we are in general agreement with the proposal outlined in the Exposure Draft that expensing borrowing costs would be the general principle for governments. We also support the exception suggested in the Exposure Draft that governments should have an option to capitalize such borrowing costs when incurred specifically for the acquisition, construction or development of capital assets.

**Canada**

- 2 -

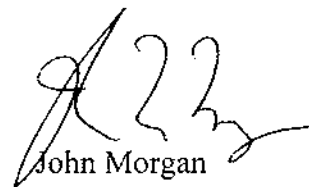
In cases where the exception has been applied, the Exposure Draft would require disclosure of the amount of interest capitalized during the year. However, given the importance of the total interest as a financial indicator as discussed earlier, we would suggest that also presenting the total amount of interest incurred, including both expensed and capitalized during the year, would enhance the understandability and usefulness of the information provided in financial statements.

We should note that in Canada, Public Sector GAAP require a modified equity basis rather than a full consolidation approach for Government Business Enterprises (GBEs), which means that GBEs' accounting policies are not conformed to the controlling government's standards when consolidating. Under this approach, when a government borrows funds and lends part of those funds to a controlled GBE for which the borrowing costs are eligible for capitalization, the consolidated results of the controlling government would depart from those envisaged at paragraph 22 of the exposure draft as they would exclude the portion of interest capitalized by the GBE.

In addition, we note that IPSAS 5 does not apply to GBEs as they are required to follow IFRSs. The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants currently is re-assessing earlier guidance given with respect to the potential adoption of IFRS in 2011 by government controlled entities such as GBEs and Government Business-Type Organisations (GBTOs). Until we know what the outcome of the PSAB re-assessment will be, we cannot yet fully assess the impact that the proposed international approach could have when compared to Canadian standards.

Thank you again for providing the opportunity to comment on this Exposure Draft. If you have any questions related to these comments, please do not hesitate to contact either Ms. Louise Breton at [Louise.Breton@tbs-sct.gc.ca](mailto:Louise.Breton@tbs-sct.gc.ca) (613-957-9675), or Mr. Bill Matthews at [Bill.Matthews@tbs-sct.gc.ca](mailto:Bill.Matthews@tbs-sct.gc.ca) (613-952-0931).

Yours sincerely,



John Morgan  
Assistant Comptroller General  
Financial Management and Analysis  
Sector

c.c.: Rod Monette, Comptroller General of Canada  
Bill Matthews, Executive Director, Government Accounting, Policy & Reporting  
Louise Breton, Director Accounting Policy Research





**THE TREASURY**

Kaitohutohu Kaupapa Rawa

AC-2-1-23

23 December 2008

Ms Stephenie Fox  
Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street, 4th Floor  
Toronto, Ontario M5V 3H2  
CANADA

Dear Ms Fox

#### **COMMENTS ON EXPOSURE DRAFT 35 BORROWING COSTS**

Thank you for the opportunity to comment on the IPSASB Exposure Draft 35 "Borrowing Costs" (Revised 200X).

The New Zealand Treasury in preparing for the implementation from 1 July 2009 of NZ IAS 23, which is a standard containing no amendments from IAS 23, has encountered such difficulties that we have both argued ourselves and supported representations from our Audit Office to New Zealand standard setters to amend the NZ requirements.

In response the FRSB and ASRB have agreed to defer implementation of the NZ IAS 23 for public benefit entities pending further consideration, including consideration of the outcome of IPSASB deliberations.

This issue, and the IPSASB deliberations on it, is therefore of critical importance in New Zealand.

#### **Should IAS 23 be amended?**

The New Zealand Treasury fully supports the IPSASB proposal to amend IAS 23.

The New Zealand Treasury view is that the IAS 23 approach, which is based on the view that borrowing costs are "directly attributable" to a qualifying asset if they would have been avoided had the expenditure on the qualifying asset not been made, should not be adopted in an IPSAS because of differences between the sectors.

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The IASB presumably considers borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made can be reliably determined by profit-oriented entities. While they acknowledge in the standard that this can be “difficult and the exercise of judgment is required” such an assessment may be possible as:

- profit-oriented entities are unlikely to use debt financing to fund operating expenses because of solvency requirements, more easily allowing the attribution of borrowing to assets;
- material expenditure on the construction or development of material qualifying assets is likely to have specific finance arrangements, or where that is not the case, the financing cost is still likely to be an element in decisions to construct or develop qualifying assets; and
- profit oriented entities typically report on a historic cost approach (making the issue a one-off event) or, when the asset is subsequently revalued, remeasure to a fair value basis, using observable market based evidence where capitalised borrowing costs is not an issue.

In the public sector, entities with the power to tax are not constrained by solvency requirements but rather by the intertemporal budget constraint. For such entities borrowing represents a future tax requirement. If the capital expenditure on qualifying assets had not been made, it is possible to determine the tax that would have been avoided. However the borrowing, (and the borrowing cost) that would have been avoided depends on the fiscal stance of the taxing entity. There is not a direct attribution of borrowing costs to qualifying assets, when expenditure on a qualifying asset is financed by tax which may be from previous taxes (conservative, saving), current taxes (balanced, neither saving nor borrowing) or future taxes (liberal, borrowing) and where the fiscal stance is subject to change.

In the public sector, entities without the power to tax that develop or construct non-cash generating assets are constrained by the funding policies of their parent body. These funding policies may include debt or equity financing or any combination thereof, and may or may not include a form of capital charge. Again, this adds an extra step in the attribution process, muddying the connection between borrowing costs and capital expenditure on the asset. In the private sector such subsidiaries tend not to have to prepare general purpose financial reports and so the cost is not as high as in the public sector where general purpose financial reports are more commonly required.

In the public sector, capital budget decisions do not factor in a market based financing cost but rather make use of a public sector discount rate. There is a rich literature, and much debate, on the use of public sector discount rates. Such a tool is necessary when making trade-off decisions, within a constrained budget, on the comparative value of investments in such areas health and educational facilities, resource and energy projects, transport infrastructure, housing, national parks, defence, the prison system etc. To substitute a capitalised borrowing cost component in accountability documentation for the discount component used in decision-making documentation renders that accountability documentation less relevant and less understandable.

In the public sector, it is more common than in the private sector to revalue large “qualifying assets” to depreciated replacement cost. The assets are commonly large because this represents a significant portion of a nation’s infrastructure. The assets are revalued because current information is generally considered more relevant. Depreciated replacement cost is commonly used because the assets are ‘specialised’ and this also accounts for why they are more prevalent in the public sector. In such cases there are significant difficulties in determining a capitalised borrowing cost component of replacement cost as assumptions are necessary for such matters as:

- Whether to use entity-specific borrowing or an assessment based on similar other entity borrowing as a base;
- If entity specific, how existing debt and/or future debt plans should be ascribed to the calculation;
- If not entity specific, whether it possible to establish a meaningful or useful industry norm, and to account for expected changes in the norm over time
- What constitutes an industry when the public sector entity is the only owner of the type of assets under question;
- Whether net debt or gross debt should be applied as a base for the calculation; and
- What time period should be assumed for the capitalisation period of large network infrastructure assets.

These judgments, which are difficult and which will have a major impact on the amounts reported not only for the asset’s carrying value, but also for subsequent depreciation charges, are not commonly required in the private sector where valuations are more likely to be an exit-based rather than an entry-based concept, and where the concept of a qualifying period will not be taken into account.

The New Zealand Treasury has heard arguments that the above features are not necessarily unique to the public sector, that even if there is a significant amount of judgement required, a relatively wide range of results reported, and likely additional costs not so commonly incurred in the private sector, these are not by themselves sufficient justification for amendment. We disagree. We contend that the differences described above are more than sufficient to justify an amendment to the standard. We also note that IAS 23 itself had three dissenting opinions on the basis of cost-benefit for the private sector alone!.

The New Zealand Treasury also notes that it has not heard any arguments justifying applying the IAS 23 approach in terms of improved accountability or decision-making by users. We consider that because information on an entity’s total finance costs are less readily accessible under the standard, because of the arbitrary nature of the assumptions, because the impact of following the standard leads to depreciation on DRC valuations (borrowing cost inclusive) being reported as an expense **before** any replacement the borrowing occurs, because the requirements are likely to lead to

different valuations for the same asset by subsidiaries and the parent, accountability or decision-making are in fact impaired if the IAS 23 approach is taken.

**Should a more tightly defined “direct attribution” be permitted to be capitalised?**

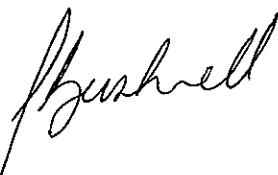
The New Zealand Treasury understands the arguments that costs that are directly attributable to the construction or development of an asset should be included in the costs of that asset.

However, the New Zealand Treasury view is that the use of a more tightly specified “direct attribution” that would be permitted to be capitalised suffers from difficulties in definition. We consider that it will always be likely to be possible to organise an entity’s financing activity so that it fits with its definition. Our concern is not so much that this will lead to manipulation, but rather that different entities will measure an asset differently depending on their methodology for financing themselves, leading to a loss of comparability.

We also consider that some of the arguments we have outlined above (as regards difficulties with depreciated replacement cost valuations and lack of benefit in terms of accountability and decision-making) also apply to a more tightly defined definition of directly attributable such as “specifically incurred”.

The New Zealand Treasury’s preference therefore is to require all borrowing costs to be expensed. Because preparers can still adopt this approach under the IPSASB’s proposal, the New Zealand Treasury finds the proposed IPSAS acceptable. A better and cleaner option however would be a requirement to expense all borrowing expenses.

Yours sincerely



Peter Bushnell  
Deputy Secretary to the Treasury

cc: Patricia McBride  
Director – Accounting Standards  
NZ Institute of Chartered Accountants  
PO Box 13 142  
WELLINGTON



Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West

Toronto, Ontario, Canada M5V 3H2

By email to: [edcomments@ifac.org](mailto:edcomments@ifac.org)

6 January 2009

Dear Stephenie Fox

**Exposure Draft, ED 35, "Borrowing Costs (Revised 200X),"**

The Dutch Local Government Accounting Standards Board (Commissie BVV) is pleased to present its comment on this exposure draft.

*The IPSASB would particularly value comments on the following:*

*This Exposure Draft proposes that borrowing costs be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with this proposal?*

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

In the Netherlands most municipalities are using the capitalization approach for very many years in combination with generally borrowed and centrally administered funds, even though they are not obliged to. This is not considered onerous, nor does it have any audit implications.

In our Local Government Accounting Standards we do not confine the capitalization of borrowing costs to those costs that are specifically incurred or directly attributable. In fact, our standards allow capitalizing imputed interest costs even if the asset is financed with net assets/equity.

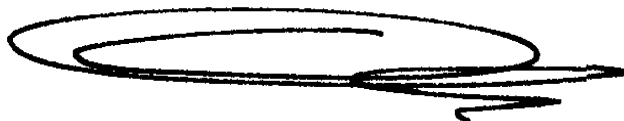
In our opinion conceptually the capitalization option is the better treatment of borrowing costs.

**We therefore do not agree with the ED, which limits the capitalization of borrowing costs to those costs that are specifically incurred. We propose to allow capitalization of all borrowing costs, which are directly attributable to the asset.**

We hope this comment is a helpful contribution to the development of the revised standard.

Sincerely

**Dutch Local Government Accounting Standards Board (Commissie BVV)**



Willem G.J. Wijntjes  
Chairman



January 6, 2009

CLIFF #: 182952

Via e-mail: [EDComments@ifac.org](mailto:EDComments@ifac.org)

Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street, 4<sup>th</sup> Floor  
Toronto, Ontario M5V 3H2

Dear Sir or Madam:

**RE: IPSASB Exposure Draft 35 – IPSAS 5 “Borrowing Costs”**

Thank you for the opportunity to comment on the IPSASB Exposure Draft 35 – IPSAS 5 “Borrowing Costs”.

The Summary Financial Statements of the Province of British Columbia are prepared in accordance with Canadian Public Sector Accounting Board (PSAB) standards. Since the exposure draft relates to IPSASB standards, the Province of BC is not directly impacted by the proposed revisions at this time; however, because PSAB may be influenced by IPSASB, any changes to IPSAS 5 may impact PSAB guidance in the future.

Although this was not specifically raised in this exposure draft, the Province of BC believes financial instruments should be recorded at the lower of cost or market. We do not support the use of fair value measurement in the Statement of Financial Position unless the change in fair value represents a permanent impairment as it creates artificial volatility in our Summary Financial Statements. We believe it could mislead our readers for funding availability or deficit, and compromise the credibility and reliability of our statements.

.../2



- 2 -

In reviewing the exposure draft, we are concerned about the limitation of the application of the proposed standard to borrowing costs that are specifically incurred for the acquisition, construction or production of a qualifying asset as it would likely lead to inconsistent accounting policies in governments with respect to capitalization of assets because capital assets purchased from general borrowing would not have the applicable borrowing costs capitalized.

We are concerned that IPSASB is becoming too rules based rather than principles based. In the current case, the exposure draft is assuming that government is not in a position to accurately allocate the cost of large or jumbo borrowings when it is more efficient or economical to issue them. We follow a policy of borrowing at the most effective cost available and where applicable, to on-lend the funds to a Crown corporation to directly fund a construction project. In some cases, the entire borrowing is on-lent and would, in that case, meet the IPSASB requirement that the borrowing is directly related to the asset acquisition. In other cases, it is more efficient to bundle several borrowing needs that may result in on-lending to several Crown corporations and may also include general funding. The Treasury Branch is tasked with raising funds at the most efficient cost to government. We can, and do, project our cash needs over reasonable future periods, including known construction contract draw-downs. We establish or identify minimum cash balances needed and enter the market to maintain those cash balances at appropriate levels; we time our access to the market to take advantage of the price of funds. We feel we know where the money is being used. It is our responsibility to put in place accounting practices and internal control procedures to allow us to clearly identify how borrowings are utilized. These practices and procedures are reflected in our Public Accounts which are subject to the opinion of the Auditor General. The problem with IPSAS 5 would occur on consolidation because the on-lending is reversed and IPSAS 5, by applying a rules based approach, would preclude the allocation when, in principle, IPSAS 5 says that interest during construction may be capitalized. Accounting rules should not oblige governments to undertake a series of inefficient small borrowings to meet the rule, accounting practice should not drive government policy. The exposure draft seems to be saying that IPSASB does not believe that governments have in place the accounting practices and internal control procedures to be able to clearly identify the allocation of the cost of borrowing and therefore, the IPSAS will preclude any allocation. We do not agree with the proposal.

Additionally, the proposed standard in section 6 states that it shall not be applied to borrowing costs specifically incurred for the acquisition, construction, or production of a qualifying asset measured at fair value at initial recognition. As a result, borrowing costs would not be attributable to those assets recognized at fair value under IPSASB's recently issued consultation paper titled "Accounting and Financial Reporting for Service Concession Arrangements." We have commented on that paper that where the Public Private Partnership (P3) costs are the result of a competitive bidding procedure, the cost of construction established in the P3 contract is a market based value and is equal to fair value. We allocate the total financing cost of the P3 between interest



- 3 -

during construction and operating costs, and capitalize the interest during construction. This total asset cost would not be less than replacement cost under the same procurement procedure. The adoption of the consultation paper proposals into IPSASs could result in significant inconsistencies in accounting treatment between assets acquired by a government under a service concession agreement and assets acquired directly by a government. This is because borrowing costs incurred under a service concession agreement could not be capitalized (the proposed section 6 would prevent capitalization of specifically incurred borrowing costs under a service concession agreement when the asset is initially recognized at fair value) whereas, a government could capitalize borrowing costs for those assets it directly acquires, constructs or produces (the proposed section 11 allows the capitalization of borrowing costs specifically incurred on qualifying assets).

We believe that upfront borrowing costs, including discounts and other pricing adjustments, should be amortized over the term of the borrowing, whether or not funds have been borrowed to acquire qualifying assets. This would ensure that the entire borrowing costs are recognized during the period in which the benefits from the borrowing are received.

In response to the question set out in the “Specific Matter for Comment” section:

***“This Exposure Draft proposes that borrowing costs be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with this proposal?”***

The Province of BC disagrees with this proposal. We believe that borrowing costs, other than interest, for operating or capital purposes should be amortized either over the term of the debt holding or the amortization of the related asset, and in no circumstances should they be expensed immediately. Additionally, interest during construction of an asset should be included in the cost of the asset. Borrowing costs represent a benefit that should be amortized over the term of the borrowing.

We also believe that borrowing costs should be capitalized as part of the cost of the asset, regardless of whether the funds borrowed were specifically incurred or borrowed on a portfolio basis with a portion being used for capital purposes. The substance of how the funds were borrowed should not matter, but that it is reflective of the transaction incurred to acquire or construct that asset.

Borrowing costs should also be included in the costs of ready-made tangible capital assets in those cases where we make a down payment on a contract because it more accurately reflects the total cost of the assets and the benefits derived from these costs. An example might be where a government buys a fleet of buses for a \$100 million and makes a deposit on the signing of the contract of \$20 million for the buses which will be delivered over twelve months.

- 4 -

Thank you again for the opportunity to comment on the IPSASB Exposure Draft 35 – IPSAS 5 “Borrowing Costs”. Should you have any comments or questions concerning this response, please contact me at (250) 387-6692 or by e-mail: [Cheryl.Wenzezenki-Yolland@gov.bc.ca](mailto:Cheryl.Wenzezenki-Yolland@gov.bc.ca), or Carl Fischer, Executive Director, Financial Reporting and Advisory Services Branch, at (250) 356-9272 or by e-mail: [Carl.Fischer@gov.bc.ca](mailto:Carl.Fischer@gov.bc.ca).

Sincerely,



*for* Cheryl Wenezenki-Yolland, CMA, FCMA  
Comptroller General

cc: Carl Fischer, Executive Director  
Financial Reporting and Advisory Services  
Office of the Comptroller General

~~Chris Trumpy, Deputy Minister~~  
Ministry of Finance

~~Nick Paul, Deputy Secretary to the Treasury Board~~  
Ministry of Finance

~~Auditor General of British Columbia~~

~~Rick Neville~~ Ron Salole  
Canadian Member of IPSASB



CS/PSC-SUB/mb

Ms Stephenie Fox  
Technical Director  
International Public Sector Accounting Standards Board  
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277 Wellington Street, 4<sup>th</sup> Floor  
TORONTO  
Ontario M5V 3H2 CANADA

By email: [EDComments@ifac.org](mailto:EDComments@ifac.org)

7 January 2009

Dear Stephenie

### **EXPOSURE DRAFT 35 “BORROWING COSTS (REVISED 200X)”**

The Public Sector Committee of the Institute of Chartered Accountants of Scotland (ICAS) welcomes the opportunity to comment on the International Public Sector Accounting Standards Board’s Exposure Draft 35 on “Borrowing Costs (Revised 200X)”. The Public Sector Committee is a broad based committee of ICAS members with representation from across the public services.

The Institute’s Charter requires it to act primarily in the public interest, and our submissions are therefore intended to place the general public interest first. Our Charter also requires us to represent our members’ views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

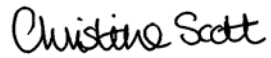
Our overall comments are set out below, with our detailed comments set out in the Appendix.

### **Overall Comments**

We support IPSASB’s strategic objective to converge International Public Sector Accounting Standards (IPSASs) with international accounting standards, departing only where there are strong public sector reasons for doing so. However, we believe it is important that the reasoning for departures is set out clearly as part of the consultation documentation and we are not clear from the Exposure Draft why public sector entities are to be given the option of either capitalising borrowing costs which are directly attributable to qualifying assets or expensing them, when IAS 23 “Borrowing Costs” now mandates the capitalisation of borrowing costs in the same circumstances.

Please do not hesitate to contact me if you have any queries about this submission.

Yours sincerely



CHRISTINE SCOTT  
Assistant Director, Charities and Public Sector

## Appendix

### ***Specific matter for comment***

*The IPSASB would particularly value comments on the following:*

*The Exposure Draft proposes that borrowing costs be recognised immediately as an expense except where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalise such costs. Do you agree with the proposal?*

*Please provide your rationale for agreeing or disagreeing with the proposal.*

### ***Response***

We agree that government borrowings are often not attributable to a particular asset or capital project. Therefore, we agree that it is reasonable for the proposed standard to require a public sector entity to recognise borrowing costs as an expense in the period they are incurred unless they are specifically incurred for the acquisition, construction or production of a qualifying asset. However, we question whether it is reasonable to give public sector entities, adopting IPSASs, the option of either capitalising borrowing costs which are directly attributable to qualifying assets or expensing them. Requiring the capitalisation of borrowing costs which are directly attributable to a qualifying assets would lead to consistent practice and aid the comparability of financial statements prepared by public sector entities.

The most recent version of IAS 23 requires that “borrowing costs that are directly attributable ..... are capitalised as part of the cost of the qualifying asset”. Therefore, if the objective of the IPSAS ‘General Improvements Project’ is to converge with IFRSs to the extent appropriate for the public sector then we would expect a clear justification for this difference to be explained in the Exposure Draft.

### **Other comments**

#### ***The definition of ‘borrowing costs’ and ‘borrowing of funds’***

‘Borrowing costs’ are defined within the proposed standard as “interest and other expenses incurred by an entity in connection with the borrowing of funds”. Finance charges in respect of finance leases are included within this definition. However, it is not clear whether the definition extends to finance charges in respect of service concession arrangements for the provision of infrastructure and other assets, i.e. PPP and PFI type arrangements. If this standard was to be implemented within the UK local government sector, changes to legislation would probably be required to permit finance charges in relation to PPP and PFI arrangements to be treated as ‘borrowing costs’. Therefore, it is important that the proposed standard provides a definition for ‘borrowing of funds’ in addition to the definition of ‘borrowing costs’.

We are defining ‘infrastructure’ in the context of this response in broad terms, meaning hospitals, offices etc as well as assets such as roads and bridges which are more commonly defined as infrastructure.

***The definition of ‘acquisition’***

Another matter which requires to be addressed by the proposed IPSAS is criteria for assessing when a public sector entity should be considered to have ‘acquired’ a ‘qualifying asset’ which is being constructed by a third party either as part of a service concession arrangement or through a conventional procurement. The transfer of legal title from a contractor to a public sector entity may not necessarily reflect the point at which the risks and rewards of ownership lie with the public sector entity.



EKONOMISTYRNINGSVÄRKET

Date  
January 7, 2009  
Reference number  
4/9-817/2008  
Our reference  
Claes-Göran Gustavsson

Your date  
  
Your reference number

Technical Director  
International Public Sector Accounting Standards  
Board  
International Federation of Accountants  
277 Wellington Street, 4th Floor  
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## Comments on ED 35 IPSAS 5 “Borrowing Costs” (Revised 200X)

The Swedish National Financial Management Authority (ESV) appreciates the opportunity to comment on the ED 31 Employee Benefits.

ESV is the government agency responsible for financial management and development of GAAP in the Swedish central government. Full accrual accounting was introduced in 1993 and we hope that our experience will be a contribution in your work with various accounting issues.

### Overall Opinion

Our overall opinion is that we agree with the proposal that borrowing costs are to be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets and that in such cases an entity is permitted, but not required, to capitalize those costs.

### Rationale for agreeing with the proposal

We agree with the reasoning behind the conclusions made by the IPSASB. To that we would like to add that from the standpoint of valuation of acquired assets it should be an advantage to have the same fundamental principles independently of, among other things, the methods of financing. Capital costs are in that perspective however, in most cases, not external transactions. As the IPSASB argues such calculations are complex and resource intensive as is the case with many calculations involved in accrual accounting. But in contrast to most other calculations, the calculations of capital costs for assets exceed related benefits.

In the public sector context we also are of the opinion that such benefits are less obvious. Distribution of capital costs can influence efficiency in the production. That kind of incentives are not less if the costs incurred are accounted for as expenses rather than being capitalized. There is no risk incurred with accounting for a negative capital as a consequence of such expenses if the assets are financed with loans. In contrary to a company that situation is possible to handle without the need for a process of bankruptcy.



Another noticeable difference between many entities in the public sector compared to entities in the private sector is that the former often are able to borrow without mortgages or other pledges. It is in that context most cost efficient to borrow in batches not linked to the financing of specific assets.

These comments have been prepared by Claes-Göran Gustavsson and Curt Johansson.

Yours sincerely,

Pia Heyman

Head of Department,  
Department of Accounting and Internal Audit

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Our ref: AASP\Responses\090109 SC0105

Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
Toronto, Ontario, Canada M5V 3H2

By email to: [edcomments@ifac.org](mailto:edcomments@ifac.org)

9 January 2009

Dear Stephenie Fox

**Exposure Draft, ED 35, "Borrowing Costs (Revised 200X)"**

CIPFA is pleased to present its comments on this exposure draft, which has been reviewed by CIPFA's Accounting and Auditing Standards Panel. We firmly support IPSASB's strategic objective to converge IPSASs with IFRS, and adopting alternative approaches only where there are clear public sector reasons for departure.

**Key points from IAS 23**

ED 35 takes forward matters raised in the International Accounting Standards Board's March 2007 revision of IAS 23, which increases convergence between IFRS and US GAAP, and also helps eliminate options. The revised standard generally requires capitalisation of borrowing costs on qualifying assets which are accounted for on a historical cost basis. The IASB Basis for Conclusions explains that recognising immediately as an expense borrowing costs relating to qualifying assets does not give a faithful representation of the cost of the asset. We agree with these IASB reasoning, and consider that it applies equally to public sector assets.

**Comment on ED 35**

We are content that the Exposure Draft provides a public sector rationale for departure from IAS 23, based on a different assessment of the costs and benefits of producing reliable and relevant information. While we consider that capitalising borrowing costs would provide a more faithful representation of the cost of the asset, we agree that paragraphs BC5 to BC8 of the Basis for Conclusions set out reasons why there is often no meaningful way to attribute borrowing costs to specific qualifying assets.

However, we are not persuaded that paragraph BC9 provides sufficiently developed justification for the proposal to permit, but not require, capitalisation of borrowing costs which are specifically incurred on qualifying assets. In CIPFA's view it would be better if the standard could be redrafted so that capitalisation was either required or prohibited in these cases.

These points and some other matters are set out in more detail in an attached annex.

I hope these comments are a helpful contribution to the development of the revised standard.

Yours sincerely

Steven Cain  
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## ANNEX

### Specific Matters 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 where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with this proposal?  
Please provide your rationale for agreeing or disagreeing with this proposal.*

The March 2007 revision of IAS 23 requires the capitalisation of borrowing costs on qualifying assets.

The proposals in ED 35 differ markedly from those in IAS 23, in that they:

- a) generally require borrowing costs to be recognised immediately, but
- b) optionally allow capitalisation or immediate recognition of borrowing costs which are specifically incurred on qualifying assets.

Public sector reasons for departure from IAS 23 are set out in the Exposure Draft's Basis for Conclusions at paragraphs BC4 to BC13.

CIPFA is content that the Basis for Conclusions provides a public sector rationale for the proposed divergence noted at (a) above, explaining that for a number of reasons there is often no meaningful way to attribute borrowing costs to specific qualifying assets.

However, CIPFA is concerned that neither the main text nor the Basis for Conclusions provide a sufficiently clear and persuasive basis for the treatment noted at (b) above. Paragraph BC9 explains that there are arguments both for and against capitalising borrowing costs which are specifically incurred on qualifying assets. While we would not disagree with this, it is not clear that the discussion at BC9 supports an IPSAS approach which allows preparers to choose the accounting treatment for these costs. This 'optionality' might also be seen as running counter to the IASB intention to eliminate options.

We therefore find it difficult to support the proposal to permit, but not require, capitalisation of borrowing costs which are specifically incurred on qualifying assets. In CIPFA's view it would be better if the standard could be redrafted to either require or prohibit capitalisation on a systematic basis. Alternatively, if the Board considers that there are overwhelming reasons why the ED proposal should be preserved, it would be helpful if this could be more fully and persuasively explained.

### Other Comments

Paragraph 22 of the proposed standard discusses reporting by controlled and controlling entities. In particular it discusses the situation where assets are purchased using funding which is 'general' funding from the perspective of the controlling entity, but which is 'specifically incurred' borrowing from the perspective of the controlled entity. Paragraph 22 directs that these borrowing costs should not be capitalised in the financial statements of the controlling entity, but may be capitalised in the financial statements of the controlled entity.

While this treatment is consistent with the other text in the ED, the Board may wish to consider the issues which may arise for consolidated financial statements where a 'mixed' approach to capitalisation is permitted. The adjusting amounts will often not be material from the perspective of the controlling entity, but there might be problems in some cases.

Stephenie Fox  
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E-mail: [edcomments@ifac.org](mailto:edcomments@ifac.org)

19. January 2009

Dear Stephenie,

### **IPSASB ED 35 Borrowing Costs**

Den norske Revisorforening (the Norwegian Institute of Public Accountants) is pleased to provide you with our comments on ED 35 Borrowing Costs.

#### **General Comment**

We strongly support the strategic objective to converge IPSASs with IFRS, except where there are strong public sector reasons for a departure. It is important that drafted standards set out such reasoning clearly and persuasively. We are sorry to say that in our opinion, this ED does not meet those criteria.

#### ***Specific Matters for Comment***

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

The central borrowing model is not a feature only in the public sector. Paragraphs 21-25 and 29 of existing IPSAS 5 discuss the determination of the amount of borrowing costs to be capitalized as well as the difficulties related to central borrowing cases. Paragraph 29 specifically discusses the determination of a capitalization rate at the economic entity level and the controlled entity level.

In accordance with the principle of IPSAS 5/IAS 23, borrowing costs are eligible for capitalization only in the case where they are directly attributable to the acquisition, constructions or production of a qualifying asset. This means capitalization is not implemented where the incurring of borrowing costs is not related to the incurring of the outlays/expenditures on a qualifying asset and capitalization only applies to the situation where a direct link between the borrowing costs and the incurring of the outlays/expenditures on a qualifying asset exists.

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

Central borrowing procedures may be more common in the public sector than in the private sector, but the additional compliance costs for public sector entities would not be different from those for private sector entities. The benefits from the removal of the expensing option from IPSAS 5 in terms of higher comparability and achieving convergence with IFRS justify the additional compliance costs.

The capitalization of borrowing costs would, for both the public sector and the private sector, enhance comparability between assets internally developed and those acquired from third parties, because the purchase price of a completed asset would include financing costs incurred by the third party during the development phase.

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

#### ***How to include borrowing costs in Depreciated Replacement Cost (DRC) valuation***

DRC is at the bottom of the fair value-hierarchy in both IAS 16 and the equivalent IPSAS 17. The potential inclusion of borrowing costs in DRC valuation is an issue as a consequence of removal of the expensing option and is not a public sector specific issue.

IAS 23 includes the scope exclusion for “a qualifying asset measured at fair value, for example a biological asset”. This scope exclusion in IAS 23 applies to the assets in IAS 16 when they are measured at fair value but does not apply when they are measured at cost. This would mean the scope exclusion in IAS 23 applies to assets carried on revaluation model. We do not think there is any public sector specific reason for departure from the scope exclusion in IAS 23.

Both IPSAS 17 and IAS 16 specify that an item of property, plant and equipment should be measured at its cost on initial recognition and subsequently be measured on either the cost model or the revaluation model. It may be that revaluation occurs more commonly in parts of public sector, or in some jurisdictions, than in private sector. But this does not mean public sector entities would incur higher compliance costs than private sector entities when capitalizing borrowing costs.

If the expensing option is removed from IPSAS 5, the additional benefits in terms of higher comparability for assets measured at cost across public/private sector entities and achieving convergence with IFRS justify the additional compliance costs of capitalizing borrowing costs in the original costs of qualifying assets.

#### ***Conceptual Arguments***

Regarding the comparability argument, the IASB acknowledged that capitalizing borrowing costs does not achieve comparability between assets financed by borrowings and those



financed by equity. IASB concluded that capitalization achieves comparability among all non-equity financed assets.

The IASB concluded that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are part of the cost of that asset. The cost of an asset should include all costs necessarily incurred to get the asset ready for its intended use or sale, including the cost incurred in financing the expenditures for acquisition, construction or production of a qualifying asset. The IASB responded that immediate expensing of borrowing costs does not give a faithful representation of the cost of the asset.

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

### **Conclusion**

The public sector reasons you have raised, are not adequate to warrant a departure from IAS 23 by retaining the expensing option in IPSAS 5.

We hope these comments are a helpful contribution to the development of the revised standard. For further information on this letter, please contact Mr. Harald Brandsås.

Best regards,  
Den norske Revisorforening



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January 8, 2009

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**Re: Comments on Exposure Draft 35 – Revised IPSAS 5 “Borrowing Costs”**

Thank you for the opportunity to comment on Exposure Draft 35 (ED 35). In general, Public Sector Accounting Board (PSAB) staff support the proposal that entities should be permitted, but not required, to capitalize borrowing costs specifically incurred on qualifying assets. This option is comparable to PSAB’s standard on accounting for borrowing costs of tangible capital assets.

Given the nature and operations in the public sector, PSAB staff agree that it would be inappropriate to require capitalization of borrowing costs in the public sector. Public sector entities often borrow for general purposes, not specifically for the acquisition or construction of an asset. Allocating borrowing costs to the acquisition or construction of a particular asset could be subjective or arbitrary.

PSAB staff support giving public sector entities the option to capitalize borrowing costs as this may result in a more relevant cost basis for certain qualifying assets which are generally not developed internally in some type of public sector entities. For example, in certain jurisdictions, hospitals may be built by public private partnerships. In these circumstances, borrowing or financing costs are normally included in the purchase price of qualifying assets acquired from third parties or in the contract costs of qualifying assets constructed through public private partnerships. Capitalizing borrowing costs of qualifying assets that are developed internally in these types of entities would produce a more comparable cost of these assets. We suggest that IPSASB consider including this discussion in the “Recognition” section of ED 35 for public sector entities to consider in determining their accounting policy on borrowing costs.

Our standard allows capitalization of borrowing costs that can be directly attributable to obtaining tangible capital assets. IPSASB’s proposal of allowing capitalization of borrowing costs only if they are “specifically incurred” to obtaining a qualifying asset is easy to apply and objective. However, public sector entities would be able to choose which assets to capitalize borrowing costs by structuring the financing accordingly. Consequently, the form (as opposed to the economic substance) of financing may drive the accounting.



In addition to our comments above on the specific matter requested by IPSASB and our suggested improvements and clarifications on specific paragraphs in the appendix to this letter, we would like to offer our observations on the following issues:

1. A qualifying asset is defined as an asset that takes a substantial period of time to get ready for its intended use or sale in ED 35. It appears that “a substantial period of time” is an essential element in this definition. It is therefore important that public sector entities understand what “a substantial period of time” means. PSAB staff suggest that IPSASB provide more guidance on what is considered “a substantial period of time” to ensure proper interpretation and consistent application of this standard.
2. Intangible assets are included as an example of qualifying assets in ED 35. However, intangible asset is not currently defined in IPSAS’s Glossary of Defined Terms. IPSASB has not yet issued any Consultation Paper or ED on Intangible Assets. It may be premature for public sector entities to capitalize borrowing costs incurred for obtaining intangible assets when it is unclear whether the intangible assets should be recognized in the financial statements. PSAB staff suggest that IPSASB consider removing intangible assets from the examples of qualifying assets until an IPSAS on Intangible Assets is issued.
3. Whenever an accounting option is allowed, it is almost unavoidable that there will be a comparability issue when users compare financial statements of entities adopting different accounting policies. The disclosure requirements proposed in paragraph 33 of ED 35 will, to a certain extent, mitigate this problem. However, a user who is interested in comparing financial information of public sector entities will still need to gather all the necessary historical information to form a meaningful comparison of entities that adopted different accounting policy on borrowing costs. PSAB staff suggest that IPSASB consider requiring disclosure of year-to-date capitalized amount before amortization to make comparison easier.
4. A number of paragraphs (primarily paragraphs 16, and 19 to 22) in ED 35 address the principles and application of the proposed recognition criteria for borrowing costs in situations where more than one entity in the economic entity is involved in the borrowing and acquisition/construction of the qualifying assets. Given the number of scenarios discussed in the paragraphs, and the number and level of entities involved (for example, controlling entity, controlled entity, economic entity), it is quite complex and not easy to follow. PSAB staff suggest that IPSASB consider including a decision tree or flow chart to summarize how each entity involved in the different scenarios should account for the borrowing costs. This decision tree or flow chart will enhance understanding of the proposed standard and serve as a quick reference for public sector entities when applying the proposed standard in different situations.



Page 3

We hope that you find our comments and observations in this letter and the appendix useful. Please note that these comments are views of PSAB staff and not those of the Public Sector Accounting Board.

Yours truly,

Tim Beauchamp  
Director  
Public Sector Accounting



## **Appendix: Comments on Specific Paragraphs**

### **Paragraph 9**

#### **“Depending on the circumstances”**

A qualifying phrase “depending on the circumstances” is included at the beginning of this paragraph before the list of examples of qualifying assets. There is no description or discussion of the circumstances that would affect the assets listed not meeting the definition of qualifying assets. It is suggested that such circumstances be described and guidance be provided to help public sector entities understand the application of the definition of qualifying assets in different circumstances.

#### **Inventories**

Based on the definition of qualifying assets, assets including “*inventories that are produced over a short period of time ... are not qualifying assets.*” Consequently, the existing ED 35 wording appears redundant. For greater certainty, it is suggested that the existing IPSAS 5 wording regarding inventories be kept and be included as item (g) to the list of qualifying assets. Suggested wording:

*“(g) Inventories that require a substantial period of time to bring them to a condition ready for use, sale or distribution.*

~~*“Inventories that are produced over a short period of time and Financial assets are not qualifying assets.”*~~

### **Paragraph 12**

The first sentence appears redundant as it repeats the first sentence of paragraph 11. It is suggested that the first sentence and the first word “Such” at the beginning of the second sentence in paragraph 12 be removed.

### **Paragraphs 13**

The first and second sentences of this paragraph address two different issues, the first one about borrowing for general purposes and the second one about entities operating in a hyperinflationary environment. These two issues are not related. It is suggested that these two sentences be separated into two paragraphs to ensure that each issue gets their individual attention.

### **Paragraph 14**

This paragraph addresses a general principle of consistent application of a chosen accounting option to all qualifying assets of an entity. It is suggested that this paragraph be moved up to follow



immediately after paragraph 12, before paragraphs that discuss specific issues such as hyperinflationary economies, central or joint borrowings.

Paragraph 14 refers to a “treatment” on capitalization of borrowing costs of qualifying assets. It is suggested that the term “treatment” be removed and replaced as:

*“Where an entity **capitalizes borrowing costs in accordance with** paragraph 11, that **accounting policy** shall be applied consistently to all borrowing costs that are specifically incurred for the acquisition, construction or production of all qualifying assets of the entity.”*

## Paragraph 16

### Second sentence

This sentence appears fragmented. It is suggested that it be replaced with:

*“No borrowing costs will be incurred by the other entities if the funds are provided to them through interest free loan, grant or capital injection. Some loans may be provided with concessionary terms, in those cases, the other entity may capitalize only borrowing costs that it itself incurs specifically for the qualifying asset.”*

### Third sentence

A number of clarifications about IPSASB’s intentions are required in this sentence for greater certainty and to avoid misinterpretation.

- It is not clear what the relationship among the “public sector entities” referred to in this sentence is. As the second part of the sentence refers to furthering the policies of the government, it appears that they are within the same economic entity.
- It is not clear what “coordinate borrowing” means.

### Last sentence

A number of clarifications about IPSASB’s intentions are required in this sentence for greater certainty and to avoid misinterpretation.

- It is not clear what “both cases” refers to (for example, does it refer to the first and last sentences of this paragraph, or to borrowings that further both the economic and fiscal policies)?
- It is not clear which entities are not allowed to capitalize borrowing costs in each of the “both cases”?



## **Paragraphs 19 to 22 - Borrowing Costs Incurred by the Economic Entity**

It appears that various recognition principles and discussion of their applications are intermingled in these paragraphs. This makes the paragraphs hard to follow and the concepts unnecessarily complex. It is suggested that the general principles be grouped together and described first, then followed by discussion of application of the principles in different specific scenarios. Discussion of scenarios should cover recognition of borrowing costs by all the entities involved in their own financial statements.

The last sentence in paragraph 19 appears redundant as it seems to repeat the second sentence of paragraph 16. It is suggested that this sentence be removed.

### **Paragraph 23**

This paragraph addresses asset impairment during the capitalization period. As borrowing cost is not the only cost of a qualifying asset that is eligible for capitalization during the construction and production period, it is unclear why it needs to be specifically addressed here in ED 35. Is there any IPSAS that addresses asset impairment during capitalization period? If yes, perhaps this paragraph should refer to that standard.

#### First sentence

It is unclear why both “the carrying amount” and “the expected ultimate cost” of a qualifying asset are included at the beginning of this sentence. Depending on the stage of the construction and production of the qualifying asset, these two amounts/costs can be quite different. Is it the intention that an entity makes two impairment assessments, one with “the carrying amount” and another with “the expected ultimate cost”? It is also unclear which specific value (among those listed or all values listed) a public sector entity should assess against the carrying amount or the expected ultimate cost.

As defined in the IPSAS Glossary, there is no difference between the definitions of “recoverable amount” and “recoverable service amount” for non-cash generating assets. Since “recoverable service amount” only applies to non-cash generating assets and “recoverable amount” applies to both cash and non-cash generating assets, it is suggested that the term “recoverable amount” (as opposed to using both terms “recoverable service amount” and “recoverable amount”) be used in this paragraph to avoid unnecessary complication and confusion.

#### Last sentence

IPSAS 12, similar to IPSAS 21 and IPSAS 26, also allows reversal of an asset written down in a prior period, is there any reason why IPSAS 12 is not mentioned in this sentence?





### Paragraph 27

Suspension of development activities over “extended periods” appears to be an important consideration for suspension of capitalization. It is suggested that a definition or guidance be provided for “an extended period”.

### Paragraph 31

For greater certainty, it is suggested that words in bold be added to ensure no misinterpretation

*“When an entity completes the construction of a 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 **for that part of the qualifying asset** when it completes substantially all the activities necessary to prepare that part for its intended use, sale or distribution.”*

### Paragraph 33

Paragraphs 19 to 22 address many scenarios where related parties are involved. IPSASB may want to consider making reference to related party disclosure requirements in IPSAS 20.

8 January 2009

The Technical Director  
International Public Sector Accounting Standards Board  
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Per e-mail: [EDComments@ifac.org](mailto:EDComments@ifac.org)

Dear Stephenie,

### **SUBMISSION ON ED 35 ON *BORROWING COSTS***

In response to your request for comments on the Exposure Draft 35 *Borrowing Costs*, please find below my personal comments for your consideration.

### **SPECIFIC MATTERS FOR COMMENTS**

#### **Question 1**

*The Exposure Draft proposes that borrowing costs be recognized immediately as an expense except where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with the proposal?*

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

I am of the view that it should be a requirement for borrowing costs specifically incurred for the acquisition, construction or development of qualifying assets to be capitalised as part of the cost of such an asset. Such a requirement would be in line with the key underlying accounting principle that requires an entity to capitalise any costs directly incurred to bring an asset to the location and condition for it to be capable of operating in the manner intended by management.

Such an instance would arise when the entity obtains specific funding for the acquisition, construction or development of a qualifying asset as it is able to allocate the funding and related costs to a specific project.

The option to expense borrowing cost should still be allowed. As an example, such an option should be applied on borrowing costs incurred where an entity generally borrows funds for qualifying assets.

If the principle in the comment above is accepted, a review should be done on the entire proposed standard to ensure consistent explanation of the principle: including basis of conclusion. Simply, specific funding cost should be capitalised while general funding costs should be expensed.

## **OTHER COMMENTS**

### **Paragraph 1 - Core principle vs objective**

The other IPSAS refer to the term ‘*objective*’ not ‘*core principles*’: the new term used in the exposure draft. I am not aware of the IPSASB decision to change the terminology from ‘objective’.

To ensure consistency, I propose retention of the term *objective* until the decision is made to change the term in all standards and a process to effect the change is implemented.

### **Paragraph 6 - Scope**

While I support the scope exclusion, I propose inclusion of an example to illustrate instances where the scope exclusion would arise. The equivalent International Accounting Standard (IAS) 23 – *Borrowing Cost* provides an example of a biological asset.

In addition, IAS 23 scopes out inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis. We are of the view that the exclusion should also be included in the ED.

## **Paragraph 7 - Definitions**

The definition of qualifying assets should also include the term ‘distribution’ to align it with the definition of inventories in IPSAS 12. The definition should hence be

*“A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use, ~~or~~ or distribution”.*

## **Paragraph 15 – Borrowing costs eligible for capitalisation**

Based on our comment under specific matters for comments above, I propose reinstatement of the deleted explanation on borrowing cost that are directly attributable to qualifying assets. However, the terminology should be changed from ‘directly’ to ‘specifically’.

## **Paragraph 23**

I propose the change of the heading of the section as it deals with other aspects besides recoverable amount i.e. it refers to current replacement cost, recoverable service amount and net realizable value. Probably use the term impairment.

## **Paragraph 24 (b)**

Review the sentence to delete the reported word ‘incur’. We suggest:

*“It incurs borrowing costs specifically ~~incurred~~ for the acquisition, construction or production of qualifying assets”.*

Please do not hesitate to contact me should you wish to discuss any of my comments.

Yours sincerely

Patrick Kabuya



19 January 2009

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IPSASB  
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E-mail: [edcomments@ifac.org](mailto:edcomments@ifac.org)

Ref.: PSC/HvD/SS/SR

Dear Ms Fox,

**Re: FEE Comments on IPSASB Exposure Draft, ED 35, “Borrowing Costs”  
(Revised 200X)**

- (1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the IPSASB Exposure Draft, ED 35, “*Borrowing Costs (Revised 200X)*”, (the “ED”).

**General Comment**

- (2) We support IPSASB’s strategic objective to converge IPSASs with IFRS, except where there are strong public sector reasons for departure. We also consider it important that proposed standards set out such reasoning as clearly and persuasively as possible.



### Specific Matters 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 where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with this proposal?*

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

- (3) We note that in the IASB's basis for conclusions for the March 2007 revision of IAS 23, the IASB explains that the revision helps achieve convergence between IFRS and US GAAP, and also helps eliminate options in order to enhance comparability.
- (4) The proposals in ED 35 differ from those in IAS 23, in that ED 35 requires the recognition of an expense as the default method, whereas IAS 23 requires the capitalisation of all borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset.
- (5) Although we agree that borrowing requirements in the public sector are generally determined for the sector or for a reporting entity as a whole, and that there is often no meaningful way to attribute borrowing costs to specific qualifying assets, it should be observed that the central borrowing model is not a feature exclusively in the public sector.
- (6) However, we wish to observe that in accordance with the principle of IPSAS5/IAS 23, borrowing costs are eligible for capitalization only in the case where they are directly attributable to the acquisition, constructions or production of a qualifying asset. This means capitalization is not implemented where the incurring of borrowing costs is not related to the incurring of the outlays/expenditures on a qualifying asset and capitalization only applies to the situation where a direct link between the borrowing costs and the incurring of the outlays/expenditures on a qualifying asset exists. Although in the light of the attribution issues, we can see that the default accounting treatment for public sector qualifying assets would be different, even if IAS 23 is applied without amendment.



(7) An alternative approach to that taken in the Exposure Draft would be to rearticulate the IPSAS to make it clear that:

- In general, direct attribution will not be possible, and in line with IAS 23 'other borrowing costs' should be expensed; but
- Where attribution is possible, capitalisation should be required.

(8) We find it more difficult to understand how the reasoning provided by the Board supports the proposal to permit, but not require, capitalisation where borrowing costs are specifically incurred on qualifying assets. Allowing preparers to choose the accounting treatment for these costs seems counter to the spirit of the amendments to IAS 23, and in particular the ED proposal:

- Does not promote comparability, as the ED does not provide a reason why one public sector preparer might choose to capitalise specific borrowing, while another might expense it
- Might result in borrowing arrangements being structured to engineer a particular accounting treatment.

However, our main concern is that the ED does not seem to provide any particular public sector reason for 'optionality'. In FEE's view it would be helpful if the public sector rationale for the proposal to permit, but not require capitalisation where borrowing costs were fully explained.

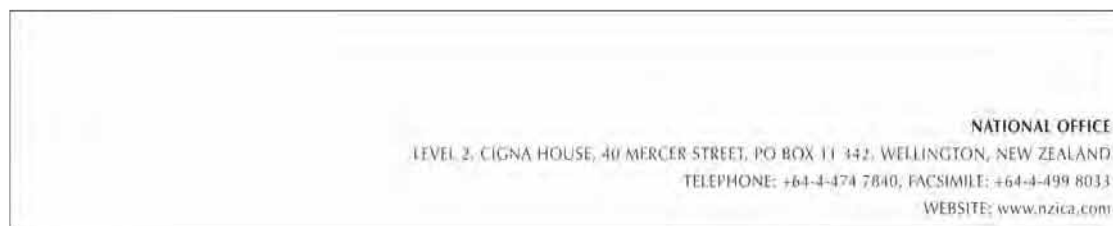
We hope these comments are a helpful contribution to the development of the revised standard. For further information on this letter, please contact Ms Saskia Slomp from the FEE Secretariat.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Hans van Damme', is written over a horizontal line.

Hans van Damme  
President





30 January 2009

Ms Stephenie Fox  
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Dear Stephenie

**ED35 IPSAS 5 Borrowing Costs (Revised 200X)**

The Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants is pleased to submit its comments on ED35 *IPSAS 5 Borrowing Costs (Revised 200X)*. We apologise for the delay in sending this submission.

The FRSB supports the IPSASB's efforts to converge its standards with the latest related IFRSs, to the extent appropriate for the public sector. The FRSB supports the IPSASB use of the "rules of the road" to determine whether or not it is appropriate to converge fully with IFRSs.

However the FRSB:

- does not agree with the proposal articulated in the Exposure Draft;
- does not consider that continuing to permit alternative treatments in relation to borrowing costs incurred by public sector entities is appropriate;
- believes that it is inappropriate to propose a new category of "specifically incurred" borrowing costs
- believes that the proposal to prohibit the capitalisation of general borrowing costs but make the capitalisation of specific borrowing costs optional is internally inconsistent.

The FRSB acknowledges that reasonable arguments can be advanced for either capitalisation or expensing of borrowing costs. The FRSB considers that normally a standard setter's position on the treatment of borrowing costs should reflect the standard setter's views on the more fundamental issue of which costs should be included in the initial measurement of an asset. We note that the IASB did not undertake a fundamental review of the arguments for and against capitalisation in making the most recent amendments to IAS 23.

The FRSB is of the view that the IPSASB should reconsider this issue and form a view following its "rules of the road" as to whether there is justification for a different view of whether borrowing costs should be included in the initial measurement of an asset in the public sector. If, following more detailed consideration of this issue, the IPSASB considers that capitalisation of borrowing costs is consistent with its views on asset measurement for the public sector, then the FRSB considers that it would be appropriate for the IPSASB to adopt the

requirements of IAS 23. Alternatively, if the IPSASB believes that expensing borrowing costs is more consistent with its views on asset measurement, then the FRSB considers that IPSAS 5 should be amended to mandate expensing. However, a view different to IAS 23 would imply that assets in the public sector have a fundamentally different measurement objective to assets in the private sector.

The FRSB is extremely interested in the outcome of IPSASB's deliberations on this issue. The implementation of NZ IAS 23 *Borrowing Costs* (revised 2007) has been deferred for public benefit entities<sup>1</sup>, pending further consideration of issues raised by public benefit entities regarding mandatory capitalisation. One of the reasons for deferring application of the revised standard to public benefit entities was a desire to wait until IPSASB had completed its deliberations on ED 35.

The Appendix to this letter contains our comments on other issues noted in the Exposure Draft for your consideration, should you not support our recommendation above.

If you have any queries or require clarification of any matters in this submission, please contact Patricia McBride (patricia.mcbride@nzica.com) in the first instance, or me.

Yours sincerely



Joanna Perry  
**Chairman – Financial Reporting Standards Board**  
Email: joannaperry@xtra.co.nz

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<sup>1</sup> Public Benefit Entities are defined in New Zealand equivalents to IFRSs as “reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.” The term encompasses a number of public sector entities and not-for-profit entities.

## Appendix 1: ED35 Other Matters for Comment

### *Clarity of Standard*

1. We suggest that paragraph 13 be split into two paragraphs. The second sentence, which refers to IPSAS 10 “Reporting in Hyperinflationary Economies” is relevant only to entities that capitalise borrowing costs.
2. Notwithstanding the FRSB’s view regarding alternative treatments within standards, the wording of the first sentence of paragraph 11 could be amended to make it clear that the proposed Standard permits a choice of two alternative treatments of specifically incurred borrowing costs. At the same time, the text of paragraph 14 could be incorporated, for example:

“An entity shall choose either to expense or capitalise borrowing costs that are specifically incurred for the acquisition, construction or production of a qualifying asset and shall apply that treatment consistently to all borrowing costs that are specifically incurred for the acquisition, construction or production of a qualifying asset.”

### *Terminology*

3. The FRSB notes that it is the IPSASB’s policy to make certain terminology changes to better reflect the public sector scope of the documents. Paragraph 16 of the Basis for Conclusions states that the term “outlay/s” is used instead of “expenditures” as the term expenditure has a narrower meaning in the public sector context. The FRSB believe that it would be helpful for all terminology changes to be discussed in a separate section of the Basis for Conclusions.
4. The FRSB also notes that the definition of borrowing costs uses slightly different words than those used in IAS 23, with the use of the words “other expenses” instead of “other costs”. The FRSB is unsure as to why this change has been made. If it is a change in terminology to address the public sector context, then this should be stated. The FRSB considers that apart from deliberate changes in terminology there should be no changes to the IAS 23 wording.
5. The FRSB asks the IPSASB to consider publishing a list of terminology changes as this would help readers of the Standards understand why a change has been made and promote consistency in future IPSASs.

### *Editorials*

6. The FRSB notes that in a couple of places, the wording of the exposure draft has not been aligned with that of IAS 23. Examples include:
  - paragraph 8 does not include the 2008 IASB amendments to IAS 23. If IPSASB has deliberately chosen to use the earlier version of IAS 23 the deletion of the words “bank overdrafts” in paragraph 8(a) does not align with the earlier version of IAS 23;
  - the end of the second sentence in paragraph 26 is missing the following words “... prior to the commencement of the physical construction.”

*Proposed International Public Sector Accounting  
Standard*

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**IPSAS 5 “Borrowing  
Costs” (Revised 200X)**



**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, ED 35, “Borrowing Costs (Revised 200X),” for publication in September, 2008. 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 **January 7, 2009**. All comments will be considered a matter of public record. Comments should be addressed to:

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>.

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### **ACKNOWLEDGMENT**

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

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## **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.

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 in GBEs, would not ordinarily be anticipated or intended to generate positive cash inflows, and that public sector entities frequently borrow for public policy purposes, including to maintain 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 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 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 entities that incur borrowing costs specifically to acquire, construct or produce a 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 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," "Amendments to Guidance on Other IPSASs," "Illustrative Examples," "Basis for Conclusions," 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 January 7, 2009. 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 where borrowing costs are specifically incurred on qualifying assets. In such cases an entity is permitted, but not required to capitalize such costs (see paragraph 11). Do you agree with this proposal?

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

## SUMMARY OF MAIN CHANGES TO IPSAS 5

### BORROWING COSTS

The main changes proposed are:

#### **Core Principle**

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

#### **Scope**

To include in paragraph 6 a scope exclusion. The Standard does not apply to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value at initial recognition. Previously, IPSAS 5 did not have this scope exclusion.

#### **Definitions**

To remove the following unnecessary definitions from paragraph 7: accrual basis, assets, cash, contributions from owners, distributions to owners, economic entity, expenses, government business enterprise, liabilities, net assets/equity and revenue. Accordingly, the guidance on these definitions (paragraphs 7–12 in existing IPSAS 5) has also been deleted.

#### **Recognition**

To require the immediate recognition as an expense of borrowing costs, except that where the borrowing costs are specifically incurred for the acquisition, construction or production of a qualifying asset 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.

#### **Transitional Provisions**

To include a transitional provision that, when application of this Standard constitutes a change in accounting policy, an entity shall apply the Standard to borrowing costs

relating to qualifying assets for which the commencement date for capitalization is on or after the effective date.

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 TEXT**  
**IPSAS 5—BORROWING COSTS**  
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International Public Sector Accounting Standard 5, “Borrowing Costs” (IPSAS 5) is set out in paragraphs 1–38 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 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 IPSAS differs significantly from the key requirement of the revised IAS 23, which is to capitalize borrowing costs directly attributable to the acquisition, construction or production of qualifying assets. The IPSAS requires the immediate expensing of borrowing costs, except for borrowing costs specifically incurred on qualifying assets, which may be expensed or capitalized. In such cases, the Standard gives entities the option of capitalizing those borrowing costs.

### **Changes from Previous Requirements**

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

#### **Scope**

- IN5. The Standard does not apply to borrowing costs directly attributable to the acquisition, construction or production of an asset measured at fair value at initial recognition.

#### **Definitions**

- IN6. The Standard omits 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.”

#### **Recognition**

- IN7. 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 qualifying asset. In such cases an entity has the option to capitalize those borrowing costs. The Standard



previously permitted 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. 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 includes a transitional provision that, when application of this Standard constitutes a change in accounting policy, an entity shall apply the Standard to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after the effective date.
- 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 qualifying assets for which the commencement date for capitalization is on or after that date.

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

## **ObjectiveCore Principle**

1. ~~This Standard prescribes the accounting treatment for borrowing costs. This Standard generally requires the immediate expensing of borrowing costs. However, the Standard permits, as an allowed alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.~~**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 qualifying asset that is initially measured at cost. In such cases borrowing costs may form part of the cost of that qualifying asset.**

## **Scope**

- ~~1.2.~~ **This Standard should be applied in accounting for borrowing costs. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for borrowing costs.**
- ~~2.3.~~ **This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).**
- ~~3.4.~~ 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.
- ~~4.6.~~ **This Standard shall not be applied to borrowing costs specifically incurred for the acquisition, construction or production of a qualifying asset measured at fair value at initial recognition.**

## **Definitions**

- ~~5.7.~~ **The following terms are used in this Standard with the meanings specified:**

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

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

**Borrowing costs** are interest and other expenses incurred by an entity in connection with the borrowing of funds.

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

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

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

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

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

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

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

- ~~(a) — Is an entity with the power to contract in its own name;~~
- ~~(b) — Has been assigned the financial and operational authority to carry on a business;~~

- ~~(c) — Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;~~
- ~~(d) — Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and~~
- ~~(e) — Is controlled by a public sector entity.~~

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

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

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

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

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

## Borrowing Costs

~~6.8.~~ Borrowing costs may include:

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

## Economic Entity

- ~~7. — The term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.~~

- ~~8. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity and group.~~
- ~~9. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.~~

### **Future Economic Benefits or Service Potential**

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

### **Government Business Enterprises**

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

### **Net Assets/Equity**

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

### **Qualifying Assets**

- ~~9. Examples of qualifying assets are office buildings, hospitals, infrastructure assets such as roads, bridges and power generation facilities, and inventories that require a substantial period of time to bring them to a condition ready for use or sale. Other investments, and those assets that are routinely produced over a short period of time, are not qualifying assets.~~

~~Assets that are ready for their intended use or sale when acquired also are not qualifying assets. Depending on the circumstances, examples of qualifying assets include:~~

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

~~13. Inventories that are produced over a short period of time and financial assets are not qualifying assets. Assets that are ready for their intended use, sale or distribution when acquired are not qualifying assets.~~

### **Borrowing Costs—Benchmark Treatment**

#### **Recognition**

- ~~14. Borrowing costs should be recognized as an expense in the period in which they are incurred.~~
- ~~15. Under the benchmark treatment, borrowing costs are recognized as an expense in the period in which they are incurred, regardless of how the borrowings are applied.~~

#### **Disclosure**

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

### **Borrowing Costs—Allowed Alternative Treatment**

#### **Recognition**

- ~~17.10. An entity shall~~ **Borrowing costs should be recognized** ~~borrowing costs~~ as an expense in the period in which ~~it they are incurred~~ **incurs them**, except to the extent that they are capitalized in accordance with paragraph 11~~18~~.
- ~~18.11. Borrowing costs that are~~ **directly attributable to** ~~specifically incurred~~ **for** the acquisition, construction or production of a qualifying asset **should** ~~may~~ be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization **should** ~~shall~~ be determined in accordance with this Standard.
- ~~19.12. Under the allowed alternative treatment, borrowing~~ **Borrowing** costs that are ~~directly attributable to~~ **specifically incurred for** the acquisition, construction

or production of ~~an a qualifying~~ asset ~~are may be~~ included in the cost of that asset. Such borrowing costs ~~are 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. Other borrowing costs are recognized as an expense in the period in which they are incurred.

13. When an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity recognizes 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.

20-14. Where an entity adopts the ~~allowed alternative~~ treatment in paragraph 11, that treatment ~~should shall~~ be applied consistently to all borrowing costs that are ~~directly attributable to~~ specifically incurred for the acquisition, construction or production of all qualifying assets of the entity.

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

21-15. ~~The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the outlays on the qualifying asset had not been made.~~ When an entity borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified. Funds sourced from general borrowings of the entity are not specifically incurred and costs related to such borrowings are not eligible for capitalization.

22-16. ~~It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an entity is co-ordinated centrally. Difficulties also arise when an economic entity uses a range of debt instruments to borrow funds at varying rates of interest, and transfers those funds on various bases to other entities in the economic entity. Funds which that 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 Some loans may be interest-free or require that only a portion of the actual interest cost be recovered and grants or capital injections do not normally incur interest. Other complications arise through the use of loans denominated in or linked to foreign currencies, when the economic entity operates in highly inflationary economies, and from fluctuations in exchange rates. As a result, the determination of the amount of borrowing~~

~~costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgment is required. Public sector entities may coordinate borrowing to further the economic and fiscal policies of the government. In both cases, borrowing costs in respect of such borrowings do not qualify for capitalization.~~

~~23.17.~~ **To the extent that an entity borrows funds ~~are borrowed~~ specifically for the purpose of obtaining-acquiring, constructing or producing a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalization ~~on that asset should be determined~~ as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.**

~~24.18.~~ 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.

~~25.~~ **~~To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization should be determined by applying a capitalization rate to the outlays on that asset. The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period should not exceed the amount of borrowing costs incurred during that period.~~**

#### Borrowing Costs Incurred by the Economic Entity

~~26.19.~~ ~~Only those borrowing costs applicable to the borrowings of the entity may be capitalized. When a controlling entity borrows funds which are passed on to a controlled entity with no, or only partial, allocation of borrowing costs, the controlled entity may capitalize only those borrowing costs which it itself has incurred. If a controlling entity borrows funds which are then loaned to a controlled entity, the controlled entity may capitalize only those borrowing costs which it itself incurs specifically in relation to the acquisition, construction or production of a qualifying asset. Such costs will normally be documented in the loan agreement with the controlling entity.~~ Where a controlled entity receives an interest-free capital contribution or capital grant, it will not incur any borrowing costs and consequently will not capitalize any such costs.



- ~~27-20.~~ 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 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 qualifying asset can be capitalized ~~to~~ as part of the cost of that the qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalized by the controlled entity.
- ~~28-21.~~ When a controlling entity has transferred funds at no cost to a controlled entity, neither the controlling entity nor the controlled entity would meet the criteria for capitalization of borrowing costs 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.
- ~~29-22.~~ In some circumstances, it is appropriate to include all borrowings of the controlling entity and its controlled entities when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each controlled entity to use a weighted average of the borrowing costs applicable to its own borrowings. When a controlling entity borrows funds generally, and lends part of those funds to a controlled entity specifically for the acquisition, construction or production of a 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. If the controlling entity borrows funds specifically for the acquisition, construction or production of a qualifying asset by a controlled entity, those borrowing costs, if transferred to the controlled entity, may be capitalized in the separate financial statements of the controlled entity and in the consolidated financial statements of the economic entity.

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

- ~~30-23.~~ When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable service amount or its current replacement cost, or its recoverable amount or net realizable value, the carrying amount is written down or written off in accordance with the requirements of ~~other international and/or national accounting standards~~ IPSAS 12, "Inventories", IPSAS 21, "Impairment of Non-Cash-Generating Assets" or IPSAS 26, "Impairment of Cash-Generating Assets." In certain circumstances, the

amount of the write-down or write-off, in relation to an impairment of assets, is written back in accordance with ~~those other standards~~ IPSAS 21 or IPSAS 26.

### Commencement of Capitalization

~~31.24. The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when~~ An entity may begin capitalizing borrowing costs as part of the cost of a qualifying asset, in accordance with paragraph 11, on the commencement date. The commencement date for capitalization is the date when the entity first meets all of the following conditions:

- (a) ~~Outlays for the asset are being incurred~~ It incurs outlays for the assets;
- (b) ~~Borrowing costs are being incurred~~ It incurs borrowing costs specifically related to incurred for the acquisition, construction or production of the qualifying asset; and
- (c) It undertakes Activities activities ~~that are necessary to prepare the asset for its intended use, or sale are in progress or~~ distribution.

~~32.25. Outlays on a qualifying asset include only those outlays that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. The average carrying amount of the asset during a period, including borrowing costs previously capitalized, is normally a reasonable approximation of the outlays to which the capitalization rate is applied in that period.~~

~~33.26. The activities necessary to prepare the 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 may be~~ capitalized during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalization.

### Suspension of Capitalization

~~34.27. An entity shall suspend Capitalization capitalization of borrowing costs should be suspended during extended periods in which it suspends active development is interrupted, and expensed of a qualifying asset.~~

~~35-28.~~ ~~An entity may incur Borrowing-borrowing costs may be incurred during an extended period in which the-it suspends the activities necessary to prepare an asset for its intended use, or-sale or distribution-are interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalization. However, an entity does not normally suspend capitalizing-ation of borrowing costs is not normally suspended during a period when it carries out substantial technical and administrative work-is being-carried-out. An entity also does not suspend Capitalization capitalizing-ation of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use, or-sale or distribution. For example, capitalization continues during an-the extended period needed for inventories to mature-or an-extended-period during which-that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.~~

### Cessation of Capitalization

~~36-29.~~ ~~An entity shall cease Capitalization-capitalizing of borrowing costs should-cess-when substantially all the activities necessary to prepare the qualifying asset for its intended use, or-sale or distribution are complete.~~

~~37-30.~~ 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.

~~38-31.~~ When an entity completes the construction of a qualifying asset ~~is completed~~ in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalization-capitalizing of borrowing costs should-cess-when it completes substantially all the activities necessary to prepare that part for its intended use, or-sale or distribution-are-completed.

~~39-32.~~ An office development comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being used while construction continues on other parts. Examples of qualifying assets that need to be complete before any part can be used include an operating theatre-room in a hospital when all construction must be complete before the theatre-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

~~40-33.~~ ~~The financial statements should~~An entity shall disclose:

- (a) The accounting policy adopted for borrowing costs incurred specifically for the acquisition, construction or production of qualifying assets; and
- (b) The amount of borrowing costs capitalized during the period, if any; and
- ~~(c) The capitalization rate used to determine the amount of borrowing costs eligible for capitalization (when it was necessary to apply a capitalization rate to funds borrowed generally).~~

## Transitional Provisions

~~41-34.~~ When the adoption application of this Standard constitutes a change in accounting policy, an entity shall apply the Standard to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after the effective date. ~~is encouraged to adjust its financial statements in accordance with IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors." Alternatively, entities following the allowed alternative treatment should capitalize only those borrowing costs incurred after the effective date of this Standard which meet the criteria for capitalization.~~

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

## Effective Date

~~42-36.~~ This IPSAS becomes effective for annual financial statements covering periods beginning on or after ~~July 1, 2004~~Month XX, 20XX. Earlier application is encouraged. If an entity applies the Standard from a date before Month XX, 20XX it shall disclose that fact.

~~43-37.~~ 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)

38. This 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.”~~

A3. In IPSAS 17, “Property, Plant and Equipment,” paragraph 37 is amended to read as follows:

37. The cost of an item of property, plant and equipment is the cash price equivalent or, for an item referred to in paragraph 27, its fair value at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as interest over the period of credit unless such

interest is ~~recognized in the carrying amount of the item~~capitalized in accordance with ~~the allowed alternative treatment in~~ IPSAS 5.

## 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~~specifically incurred for 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 that makes~~ 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**

|                         | (restated) |         |
|-------------------------|------------|---------|
|                         | 20X2       | 20X1    |
|                         | CU         | CU      |
| Surplus before interest | 30,000     | 18,000  |
| Interest expense        | (3,000)    | (2,600) |
| Surplus                 | 27,000     | 15,400  |

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

|   | (restated)          |                     |         |
|---|---------------------|---------------------|---------|
|   | Contributed capital | Accumulated Surplus | Total   |
|   | CU                  | CU                  | CU      |
| Balance at December 31 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 December 31 20X0 as restated   | 10,000              | 14,800              | 24,800  |
| Surplus for the year ended December 31 20X1 (restated)                              | -                   | 15,400              | 15,400  |
| Balance at December 31 20X1   | 10,000              | 30,200              | 40,200  |
| Surplus for the year ended December 31 20X2   | -                   | 27,000              | 27,000  |
| Closing at December 31 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.



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

## **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. The government 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 surplus of CU20,000,000,000. This was the seventh consecutive year in which it recognized a surplus.

Government B takes the view that a liquid debt securities market is a necessary component of its monetary policy, consequently it has a policy of maintaining CU100,000,000,000 in sovereign debt securities on issue to ensure that there is a benchmark bond available for the national securities market. The proceeds of these debt securities are invested in Government 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. 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.

*Analysis*

The bond issue is issued specifically to finance the construction of a 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, ED 35, “Borrowing Costs (Revised 200X).” 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 accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities. Accrual basis IPSASs that are converged with IFRSs retain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure.
- BC2. 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 of IAS 23 resulted from the Short-Term Convergence Project it is conducting jointly with the Financial Accounting Standards Board (FASB) in the United States (US). The Short-Term Convergence Project is aimed at reducing those differences between IFRSs and US Generally Accepted Accounting Principles for non-governmental entities 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) was to eliminate the benchmark treatment of immediate expense recognition 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 are capitalized to form part of the cost of that asset.
- BC3. The IPSASB completed a General Improvements Project in 2006. In early 2007, the IPSASB initiated 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.
- BC4. ED 35 differs significantly from the key requirement of the revised IAS 23, which is to capitalize borrowing costs directly attributable to the acquisition, construction or production of qualifying assets. The IPSASB decided that it was inappropriate to require public sector entities to capitalize borrowing costs. ED 35 therefore retains the option of either capitalizing or immediately expensing borrowing costs, when those costs are specifically incurred in relation to financing the acquisition, construction or production of a qualifying asset. However, unlike the existing IPSAS 5 and the revised IAS 23, this proposed IPSAS does not permit or require borrowing costs to

be capitalized in relation to other borrowings that are directly attributable to financing the acquisition, construction or production of a qualifying asset. When borrowing costs are not specifically incurred in relation to financing the acquisition, construction or production of a qualifying asset, ED 35 would require immediate expensing of those borrowing costs. This Basis for Conclusions explains the public sector specific reasons for these departures from the revised IAS 23. These are in relation to:

- Borrowing in the Public Sector;
- Specifically Incurred Borrowing Costs and Directly Attributable Borrowing Costs;
- Non-Cash-Generating Assets and the Revaluation Model in IPSAS 17; and
- Convergence with Statistical Bases of Reporting.

### **Borrowing in the Public Sector**

- BC5. Borrowing in the public sector is often centralized and borrowing requirements are determined for the economic entity as a whole. Borrowing may be for investing, financing or operating activities. The aggregate level of borrowing will be set in the context of political and economic factors, such as decisions on the appropriate levels of taxation. The funding allocated to specific programs and entities may be derived from a variety of sources, and consequently the resources transferred are often indistinguishable in character. A feature of fiscal management in the public sector is that governments sometimes budget for deficits, occasionally for extended periods of time, and those deficits are financed by borrowing. In many jurisdictions 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 in which entities would normally budget for a loss only in unusual circumstances, and certainly not for an indefinite period. Therefore, in the public sector it is often difficult to distinguish financing from external borrowing and other sources of finance and there is often no meaningful way to attribute borrowing costs to qualifying assets.
- BC6. Governments and other public sector entities may borrow for public policy purposes, for example they may issue debt securities to provide liquidity in the capital markets. Often these securities form the benchmark security for the bond market and a common basis for pricing other securities.
- BC7. The reasons for public sector borrowing outlined in the preceding paragraphs mean that there is little linkage between these types of borrowing and the acquisition, construction or production of qualifying

assets. For example, a government that has a policy of maintaining CU100 billion in bonds in the market, while not actually needing the cash, will find that, if it were required to capitalize borrowing costs, it would capitalize interest for any qualifying assets acquired, constructed or produced in any years in which bonds are outstanding. While it may be feasible to allocate these borrowings to qualifying assets, the IPSASB is of the view that doing so is unlikely to provide relevant and reliable information or enhance accountability. It is also likely that the cost to do so would exceed the related benefits, if any.

- BC8. In the public sector controlling entities may have a large number of controlled entities. Many of these controlled entities are responsible for acquiring, constructing or producing qualifying assets. Although there will be a general policy framework, many controlled entities are likely to have their own financial management systems, reflecting their own reporting needs. Funding for such controlled entities may be by means of appropriation from a central fund without regard to whether such appropriations are financed from taxes, borrowings or other sources. Any accounting system to track directly attributable borrowing costs and their application to qualifying assets is likely to be complex and resource intensive. The IPSASB is of the view that in these cases, the costs incurred in capitalizing borrowing costs would be likely to exceed the related benefits, if any.
- BC9. The IPSASB acknowledged, however, that there may be cases where public sector entities borrow specifically to finance the acquisition, construction or production of a qualifying asset, for example, where a municipality issues bonds specifically to finance an identified infrastructure project. The IPSASB considered that in such cases capitalizing borrowing costs may be appropriate and therefore entities should be permitted to capitalize borrowing costs specifically incurred for the acquisition, construction or production of a qualifying asset. However, because of cost-benefit considerations and issues associated with the relevance of the resulting information, the IPSASB concluded that the capitalization of borrowing costs should not be required, but instead should be optional in cases where a public sector entity borrows specifically to finance the acquisition, construction or production of a qualifying asset.

### **Specifically Incurred Borrowing Costs and Directly Attributable Borrowing Costs**

- BC10. Having concluded that the option to capitalize borrowing costs should be limited to such costs related to financing specifically incurred for the acquisition, construction or production of a qualifying asset, the IPSASB considered whether the term “directly attributable” used in IAS 23 achieves this objective. In IAS 23, borrowing costs that are “directly attributable” to the acquisition, construction or production of qualifying assets are those

borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. Effectively, this means any borrowings of the entity are attributed to the acquisition, construction or production of qualifying assets. Such borrowings are not limited to funds borrowed specifically for the purpose of acquiring, constructing or producing a particular qualifying asset. Thus “directly attributable” borrowing costs may include costs related to general borrowing, including interest on short-term borrowings such as bank overdrafts, which are not linked to any particular project. The IPSASB therefore concluded that the term “directly attributable” is broader than “specifically incurred” and that its use would not be in accordance with its conclusion that, in the public sector, the option to capitalize borrowing costs should be limited to those costs specifically incurred to finance the acquisition, construction or production of a qualifying asset. An approach of apportioning otherwise avoidable borrowing costs is also likely to be complex for the reasons outlined in paragraph BC8 and is likely to give rise to costs that exceed the related benefits.

- BC11. The IPSASB noted that some governments operate under fiscal rules that only permit them to borrow for capital purposes. The IPSASB concluded that the existence of such rules on their own is insufficient to create a strong enough link between borrowing and the acquisition, construction or production of specific qualifying assets for the option to capitalize borrowing costs to be exercised.

### **Non-Cash-Generating Assets and the Revaluation Model in IPSAS 17**

- BC12. Under the requirements of IPSAS 17, “Property, Plant and Equipment,” many specialized non-cash-generating assets are revalued to fair value on the basis of a cost-based estimate of fair value such as depreciated replacement cost. Current guidance on such revaluation bases does not adequately address the issue of how borrowing costs should be incorporated into the calculation of fair value. In the absence of authoritative guidance on this issue the IPSASB was concerned at the prospect of a range of practices emerging in response to compulsory capitalization of borrowing costs, which would reduce the reliability of the information provided. The IPSASB therefore concluded that it would be inappropriate to require capitalization in respect of qualifying assets that are carried on the revaluation model in IPSAS 17.

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

- BC13. 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 concluded that the approach to borrowing costs adopted in ED 35 furthers this strategic theme in an appropriate manner.

**Overall Conclusion: Approach to Borrowing Costs, Qualitative Characteristics of Financial Reporting and Balance between Benefit and Cost**

- BC14. For the above reasons the IPSASB concluded that requiring public sector entities to capitalize borrowing costs as part of the cost of qualifying assets would not satisfy the qualitative characteristics of general purpose financial reporting. In particular, the IPSASB believes that capitalizing borrowing costs generally would diminish the reliability of information reported in the financial statements of public sector entities while achieving, at best, a modest increase in the relevance of the information reported. Similarly, for these reasons, such a requirement generally would not enhance the accountability of public sector entities. The IPSASB also believes that, in many cases, the cost of capitalizing borrowing costs would likely exceed any benefits obtained.
- BC15. The IPSASB also concluded that, in view of the reasons for public sector borrowing (see paragraphs BC5–BC7), permitting public sector entities to capitalize borrowing costs that are directly attributable, but not specifically incurred, in relation to financing the acquisition, construction or production of a qualifying asset would not increase the relevance and reliability of information reported in their financial statements and would not enhance their accountability.

**Other Difference—Outlays**

- BC16. 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. Therefore, both the existing IPSAS 5 and ED 35 use the term “outlay(s)” instead of the equivalent term “expenditure(s)” used in IAS 23.



### Table of Concordance

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

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

| <b>Superseded<br/>IPSAS 5<br/>paragraphs</b> | <b>Current<br/>IPSAS 5<br/>paragraph</b> |
|--|--|
| 16   | None                                     |
| 17   | 10                                       |
| 18   | 11                                       |
| 19   | 12                                       |
| 20   | 14                                       |
| 21   | 15                                       |
| 22   | 16                                       |
| 23   | 17                                       |
| 24   | 18                                       |
| 25   | None                                     |
| 26   | 19                                       |
| 27   | 20                                       |
| 28   | 21                                       |
| 29   | 22                                       |
| 30   | 23                                       |
| 31   | 24                                       |

| <b>Superseded<br/>IPSAS 5<br/>paragraphs</b> | <b>Current<br/>IPSAS 5<br/>paragraph</b> |
|--|--|
| 32   | 25                                       |
| 33   | 26                                       |
| 34   | 27                                       |
| 35   | 28                                       |
| 36   | 29                                       |
| 37   | 30                                       |
| 38   | 31                                       |
| 39   | 32                                       |
| 40   | 33                                       |
| 41   | 34                                       |
| 42   | 36                                       |
| 43   | 37                                       |
| None   | 6  |
| None   | 13                                       |
| None   | 35                                       |
| None   | 38                                       |

### **Comparison with IAS 23**

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

- IPSAS 5 (Revised) 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 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.
- IPSAS 5 (Revised) 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 (Revised) uses the term “outlay(s)” to replace the equivalent term “expenditure(s).”



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