IASB documents published to accompany

IAS 23

Borrowing Costs

The text of the unaccompanied standard, IAS 23, is contained in Part A of this edition. Its effective date when issued was 1 January 2009. The text of the Accompanying Guidance on IAS 23 is contained in Part B of this edition. This part presents the following documents:

Basis for Conclusions on IAS 23 *Borrowing Costs*

This Basis for Conclusions accompanies, but is not part of, IAS 23.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 23 *Borrowing Costs* in 2007. Individual Board members gave greater weight to some factors than to others.

BC2 The revisions to IAS 23 result from the Board's Short-term Convergence project. The project is being conducted jointly with the United States standard-setter, the Financial Accounting Standards Board (FASB). The objective of the project is to reduce differences between IFRSs and US generally accepted accounting principles (GAAP) that are capable of resolution in a relatively short time and can be addressed outside major projects. The revisions to IAS 23 are principally concerned with the elimination of one of the two treatments that exist for borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. The application of only one method will enhance comparability. For the reasons set out below, the Board decided to eliminate the option of immediate recognition of such borrowing costs as an expense. It believes this will result in an improvement in financial reporting as well as achieving convergence in principle with US GAAP.

BC3 The Board considered whether to seek convergence on the detailed requirements for the capitalisation of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. However, the Board noted statements by the US Securities and Exchange Commission (SEC) and the European Commission that the IASB and FASB should focus their short-term convergence effort on eliminating major differences of principle between IFRSs and US GAAP. For their purposes, convergence on the detailed aspects of accounting treatments is not necessary. The Board further noted that both IAS 23 and SFAS 34 *Capitalization of Interest Cost* were developed some years ago. Consequently, neither set of specific provisions may be regarded as being of a clearly higher quality than the other. Therefore, the Board concluded that it should not spend time and resources considering aspects of IAS 23 beyond the choice between capitalisation and immediate recognition as an expense. This Basis for Conclusions does not, therefore, discuss aspects of IAS 23 that the Board did not reconsider. Paragraphs BC19–BC26 analyse the differences between IAS 23 and SFAS 34.

Amendments to the scope

Assets measured at fair value

BC4 The exposure draft of proposed amendments to IAS 23 proposed excluding from the scope of IAS 23 assets measured at fair value. Some respondents objected to the proposal, interpreting the scope exclusion as limiting capitalisation of borrowing costs to qualifying assets measured at cost. The Board confirmed its decision not to require capitalisation of borrowing costs relating to assets that are measured at fair value. The measurement of such assets will not be affected by the amount of borrowing costs incurred during their construction or production period. Therefore, requirements on how to account for borrowing costs are unnecessary, as paragraphs B61 and B62 of the Basis for Conclusions on IAS 41 *Agriculture* explain. But the Board noted that the exclusion of assets measured at fair value from the requirements of IAS 23 does not prohibit an entity from presenting items in profit or loss as if borrowing costs had been capitalised on such assets before measuring them at fair value.

Inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis

BC5 The US standard, SFAS 34, requires an entity to recognise as an expense interest costs for inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis because, in the FASB's view, the informational benefit from capitalising interest costs does not justify the cost. The exposure draft did not make an exception for borrowing costs relating to such inventories. The exposure draft, therefore, proposed to require an entity to capitalise borrowing costs relating to inventories that are manufactured in large quantities on a repetitive basis and take a substantial period of time to get ready for sale. Respondents argued that capitalising those borrowing costs would create a significant administrative burden, would not be informative to users and would create a reconciling item between IFRSs and US GAAP.

BC6 The Board decided to exclude from the scope of IAS 23 inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis, even if they take a substantial period of time to get ready for sale. The Board acknowledges the difficulty in both allocating borrowing costs to inventories that are manufactured in large quantities on a repetitive basis and monitoring those borrowing costs until the inventory is sold. It concluded that it should not require an entity to capitalise borrowing costs on such inventories because the costs of capitalisation are likely to exceed the potential benefits.

Elimination of the option of immediate recognition as an expense of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset

BC7 The previous version of IAS 23 permitted two treatments for accounting for borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. They could be capitalised or, alternatively, recognised immediately as an expense. SFAS 34 requires the capitalisation of such borrowing costs.

BC8 The Board proposed in the exposure draft to eliminate the option of immediate recognition as an expense. Many respondents disagreed with the Board's proposal in the exposure draft, arguing that:

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

(b) the Board had not explored in sufficient detail the merits of both accounting options.

(c) the proposal did not result in benefits for users of financial statements because:

(i) it addressed only one of the differences between IAS 23 and SFAS 34.

(ii) comparability would not be enhanced because the capital structure of an entity could affect the cost of an asset.

(iii) credit analysts reverse capitalised borrowing costs when calculating coverage ratios.

(d) the costs of implementing the capitalisation model in IAS 23 would be burdensome.

(e) the proposal was not consistent with the Board's approach on other projects (in particular, the second phase of the Business Combinations project).

BC9 The Board 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. During the period when an asset is under development, the expenditures for the resources used must be financed. Financing has a cost. The cost of the 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 as a part of the asset's acquisition cost. The Board reasoned that recognising immediately as an expense borrowing costs relating to qualifying assets does not give a faithful representation of the cost of the asset.

BC10 The Board confirmed that the objective of the project is not to achieve full convergence on all aspects of accounting for borrowing costs. Rather, it is to reduce differences between IFRSs and US GAAP that are capable of resolution in a relatively short time. The removal of a choice of accounting treatment and convergence in principle with US GAAP will enhance comparability. The Board acknowledges that capitalising borrowing costs does not achieve comparability between assets that are financed with borrowings and those financed with equity. However, it achieves comparability among all non-equity financed assets, which is an improvement.

BC11 A requirement to recognise immediately as an expense borrowing costs relating to qualifying assets would not enhance comparability. Rather, comparability between assets that are internally developed and those acquired from third parties would be impaired. The purchase price of a completed asset purchased from a third party would include financing costs incurred by the third party during the development phase.

BC12 Respondents to the exposure draft argued that requiring the capitalisation of borrowing costs is not consistent with the Board's proposal in the second phase of the Business Combinations project to require an entity to treat as an expense acquisition costs relating to a business combination. The Board disagrees with those respondents. Acquisition costs as defined in the context of a business combination are different from borrowing costs incurred in constructing or producing a qualifying asset. Borrowing costs are part of the cost necessarily incurred to get the asset ready for its intended use or sale. Acquisition costs relating to a business combination are costs incurred for services performed to help with the acquisition, such as due diligence and professional fees. They are not costs of assets acquired in a business combination.

BC13 The Board concluded that the additional benefits in terms of higher comparability, improvements in financial reporting and achieving convergence in principle with US GAAP exceed any additional costs of implementation. Achieving convergence in principle with US GAAP on this topic is a milestone in the Memorandum of Understanding published by the FASB and IASB in February 2006, which is a step towards removal of the requirement imposed on foreign registrants with the SEC to reconcile their financial statements to US GAAP.

BC14 The Board observes that there is an unavoidable cost of complying with any new financial reporting standard. Accordingly, the Board carefully considers the costs and benefits of any new pronouncement. In this case, the Board has not been told that preparers who elected to capitalise borrowing costs under the previous version of IAS 23 found doing so unnecessarily burdensome. In the Board's judgement, any additional costs of capitalising an item of cost of an asset are offset by the advantage of having all entities account for that item in the same way.

Borrowing costs eligible for capitalisation (amendments issued in December 2017)

BC14A When determining the funds that an entity borrows generally, paragraph 14 of IAS 23 required an entity to exclude borrowings made specifically for the purpose of obtaining a qualifying asset. The Board was asked whether an entity includes borrowings made specifically to obtain a qualifying asset in general borrowings when that qualifying asset is ready for its intended use or sale.

BC14B The Board concluded that the reference to 'borrowings made specifically for the purpose of obtaining a qualifying asset' in paragraph 14 should not apply to a borrowing originally made specifically to obtain a qualifying asset if that qualifying asset is now ready for its intended use or sale.

BC14C The Board observed that paragraph 8 requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Paragraph 10 states that borrowing costs are directly attributable to a qualifying asset if those borrowing costs would have been avoided had the expenditure on the qualifying asset not been made. In other words, an entity could have repaid that borrowing if the expenditure on the qualifying asset had not been made. Accordingly, paragraph 14 requires an entity to use all outstanding borrowings in determining the capitalisation rate, except those made specifically to obtain a qualifying asset not yet ready for its intended use or sale.

BC14D The Board concluded that if a specific borrowing remains outstanding after the related qualifying asset is ready for its intended use or sale, it becomes part of the funds an entity borrows generally. Accordingly, the Board amended paragraph 14 to clarify this requirement.

BC14E Some respondents to the exposure draft of the proposed amendments to IAS 23 asked the Board to clarify that an entity includes funds borrowed specifically to obtain an asset other than a qualifying asset as part of general borrowings. The amendments to paragraph 14 referring to 'all' borrowings clarify the requirements in this respect.

Effective date and transition

BC15 Development of a qualifying asset may take a long time. Additionally, some assets currently in use may have undergone and completed their production or construction process many years ago. If the entity has been following the accounting policy of immediately recognising borrowing costs as an expense, the costs of gathering the information required to capitalise them retrospectively and to adjust the carrying amount of the asset may exceed the potential benefits. Hence, the Board decided to require prospective application, which was supported by respondents to the exposure draft.

BC16 The Board noted that the revisions would result in information that is more comparable between entities. On that basis, if an entity wished to apply the revised Standard from any date before the effective date, users of the entity's financial statements would receive more useful and comparable information than previously.

BC17 Therefore, an entity is permitted to apply the revised Standard from any designated date before the effective date. However, if an entity applies the Standard from such an earlier date, it should apply the Standard to all qualifying assets for which the commencement date for capitalisation is on or after that designated date.

BC18 The Board recognises that the Standard may require an entity that reconciles its IFRS financial statements to US GAAP to maintain two sets of capitalisation information—one set that complies with the requirements of IAS 23 and one that complies with the requirements of SFAS 34. The Board wishes to avoid imposing on such entities the need to maintain two sets of capitalisation information. Therefore, before the effective date, the Board will consider what actions it might take to avoid this outcome.

Borrowing costs eligible for capitalisation (amendments issued in December 2017)

BC18A Developing a qualifying asset may take a long time. Moreover, the development of some assets currently in use may have been completed many years ago. The costs of gathering the information required to capitalise borrowing costs retrospectively may therefore be significant. In addition, the nature of each development generally varies and therefore retrospective application might not provide useful trend information to users of financial statements. The Board concluded that the costs of applying the amendments retrospectively might exceed the potential benefits of doing so. Consequently, an entity applies the amendments only to borrowing costs incurred on or after the date it first applies the amendments.

Differences between IAS 23 and SFAS 34

BC19 The following paragraphs summarise the main differences between IAS 23 and SFAS 34.

Definition of borrowing costs

BC20 IAS 23 uses the term ‘borrowing costs’ whereas SFAS 34 uses the term ‘interest costs’. ‘Borrowing costs’ reflects the broader definition in IAS 23, which encompasses interest and other costs, such as~~:~~

(a) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs~~;~~. [1] ~~and~~

~~(b) amortisation of ancillary costs incurred in connection with the arrangement of borrowings.~~

1 In 2007 the Board was advised that some of the components of borrowing costs in paragraph 6 are broadly equivalent to the components of interest expense calculated using the effective interest method in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. Consequently, the Board amended paragraph 6 to refer to the relevant guidance in IAS 39 when describing the components of borrowing costs. Subsequently, IFRS 9 *Financial Instruments* replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39.

BC21 EITF Issue No. 99–9 concludes that derivative gains and losses (arising from the effective portion of a derivative instrument that qualifies as a fair value hedge) are part of the capitalised interest cost. IAS 23 does not address such derivative gains and losses.

Definition of a qualifying asset

BC22 The main differences are as follows:

(a) IAS 23 defines a qualifying asset as one that takes a substantial period of time to get ready for its intended use or sale. The SFAS 34 definition does not include the term *substantial*.

(b) IAS 23 excludes from its scope qualifying assets that are measured at fair value. SFAS 34 does not address assets measured at fair value.

(c) SFAS 34 includes as qualifying assets investments in investees accounted for using the equity method, in some circumstances.[2] Such investments are not qualifying assets according to IAS 23.

(d) SFAS 34 does not permit the capitalisation of interest costs on assets acquired with gifts or grants that are restricted by the donor or grantor in some situations. IAS 23 does not address such assets.

Measurement

BC23 When an entity borrows funds specifically for the purpose of obtaining a qualifying asset:

(a) IAS 23 requires an entity to capitalise the actual borrowing costs incurred on that borrowing. SFAS 34 states that an entity may use the rate of that borrowing.

(b) IAS 23 requires an entity to deduct any income earned on the temporary investment of actual borrowings from the amount of borrowing costs to be capitalised. SFAS 34 does not generally permit this deduction, unless particular tax-exempt borrowings are involved.

BC24 SFAS 34 requires an entity to use judgement in determining the capitalisation rate to apply to the expenditures on the asset—an entity selects the borrowings that it considers appropriate to meet the objective of capitalising the interest costs incurred that otherwise could have been avoided. When an entity borrows funds generally and uses them to obtain a qualifying asset, IAS 23 permits some flexibility in determining the capitalisation rate, but requires an entity to use all outstanding borrowings other than those made specifically to obtain a qualifying asset.

2 While the investee has activities in progress necessary to commence its planned principal operations provided that the investee's activities include the use of funds to acquire qualifying assets for its operations.

Disclosure requirements

BC25 IAS 23 requires disclosure of the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation. SFAS 34 does not require this disclosure.

BC26 SFAS 34 requires disclosure of the total amount of interest cost incurred during the period, including the amount capitalised and the amount recognised as an expense. IAS 23 requires disclosure only of the amount of borrowing costs capitalised during the period. IAS 1 *Presentation of Financial Statements* requires the disclosure of finance costs for the period.

BC27 [Deleted]

Appendix
Amendments to Basis for Conclusions on other pronouncements

This appendix contains amendments to the Basis for Conclusions on other pronouncements that are necessary in order to ensure consistency with the revised IAS 23.

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The amendments contained in this appendix when IAS 23 was issued in 2007 have been incorporated into the text of the Basis for Conclusions on IFRS 1 and IFRICs 1 and 12.

Dissenting opinions

Dissent of Anthony T Cope, Philippe Danjou and Robert P Garnett

DO1 The Board's decision to require the capitalisation of borrowing costs relating to qualifying assets will cause a significant change in accounting for the many preparers that currently apply the benchmark treatment of recognising borrowing costs as an expense. Messrs Cope, Danjou and Garnett believe that such a change will require the establishment of cumbersome measurement processes and monitoring of capitalised costs over a long period. This is likely to involve considerable accounting work and incremental auditing costs.

DO2 Users of financial statements responding to the exposure draft did not support the change because they saw no informational benefit in a model that capitalises costs, other than the capitalisation of the actual economic cost of capital of the investment. In addition, Messrs Cope, Danjou and Garnett believe that a standard requiring the capitalisation of borrowing costs should discuss more extensively which assets qualify for the purpose of capitalising which borrowing costs.

DO3 As a consequence, Messrs Cope, Danjou and Garnett dissent because, in their view, the costs of this particular change will far outweigh the benefits to users.

DO4 In addition, this requirement to capitalise borrowing costs will achieve only limited convergence with US GAAP—differences will remain that could lead to materially different capitalised amounts. Furthermore, entities that are required to reconcile net income and shareholders' equity to US GAAP already have the option to capitalise borrowing costs and, thus, may recognise amounts that are more comparable to, albeit still potentially materially different from, those recognised in accordance with US GAAP.

DO5 The Memorandum of Understanding published by the FASB and the IASB states that trying to eliminate differences between standards that are both in need of significant improvement is not the best use of resources. Messrs Cope, Danjou and Garnett support the convergence work programme, but only if it results in higher quality standards and improved financial reporting. They are of the opinion that IAS 23 and SFAS 34 are both in need of significant improvement and should not have been addressed as part of short-term convergence.