



30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IASB Meeting: 12 December 2006, London

Project: Short-term convergence: Borrowing Costs

Subject: Comment letter analysis—Appendix (Agenda Paper 7A)

Introduction

1. This paper discusses the following issues raised by respondents to the Exposure Draft of Proposed Amendments to IAS 23 *Borrowing Costs*:
 - a. The transitional provisions
 - b. Inclusion of an analysis of differences between IAS 23 and SFAS 34 *Capitalization of Interest Cost* in the Basis for Conclusions
 - c. Description of borrowing costs
 - d. Reference to borrowing costs in IAS 11 *Construction Contracts*
 - e. Deletion of disclosure of accounting policy
2. The staff does not intend to discuss these issues at the Board meeting, unless a Board member wishes to.

Staff Recommendations

3. The staff recommends that:
 - a. paragraphs 30B and 31A are redrafted to clarify the transitional provisions (paragraphs 4—10).
 - b. the Basis for Conclusions includes an analysis of the remaining differences between IAS 23 and SFAS 34 (paragraphs 11—12).
 - c. the description of borrowing costs in paragraph 5 of IAS 23 should not be changed (paragraphs 13—15).
 - d. paragraph 18 of IAS 11 retains the reference to IAS 23 (paragraphs 16—18).
 - e. the requirement in paragraph 29(a) of IAS 23 to disclose the accounting policy is deleted, as proposed in the Exposure Draft (paragraphs 19—20).

Staff Analysis

Issue 1: Clarifying the transitional provisions

Wording of paragraph 30B

4. Paragraph 30B of [draft] IAS 23 states “However, an entity may designate any date before the effective date and apply the [draft] amendments to borrowing costs relating to all qualifying assets for which it begins capitalisation on or after that date.”
5. Three respondents find these transitional provisions in paragraph 30B confusing. If an entity designates a date before the effective date, the respondents were unsure whether that entity should apply the amendments to all qualifying assets for which the commencement date for capitalisation is on or after the designated date, or to all borrowing costs incurred on qualifying assets after the designated date.
6. The staff proposes to redraft paragraph 30B to clarify that when an entity designates a date before the effective date, the entity should apply the amendments to all qualifying assets for which the commencement date for capitalisation is on or after the designated date.

Interaction of paragraphs 30B and 31A

7. [Two respondents] find the interaction of paragraphs 30B and 31A¹ confusing. Paragraph 30B appears to permit an entity to apply the amendments from any date before the effective date, whilst the last sentence of paragraph 31A appears to permit an entity to apply the amendments only from the beginning of an accounting period.
8. The staff proposes to redraft the last sentence of paragraph 31A to clarify that an entity can choose any date before the effective date for early application of the amendments. An entity need not apply the amendments from the beginning of an accounting period.

Early adoption

9. [Two respondents] do not think that an entity should be allowed to apply the amendments before the effective date, in the interests of comparability.
10. The Board considered the issue before publishing the Exposure Draft. It concluded that an entity should be allowed to apply the amendments before the effective date because users of the financial statements would receive more useful and comparable information than previously. The staff does not recommend changing the transitional provisions of the Exposure Draft.

Issue 2: Inclusion of an analysis of the differences between IAS 23 and SFAS 34 in the Basis for Conclusions

11. [Two respondents] suggest that the Board should identify in the final Basis the remaining differences between IAS 23 and SFAS 34. In their view, this identification would be useful and would enable preparers and users to better understand the remaining differences and their practical implications.
12. The staff has analysed the differences between IAS 23 and SFAS 34 in Appendix A to the IASB website project summary. The staff recommends that the final Basis includes an updated version of this analysis.

¹ Paragraph 31A of [draft] IAS 23 states “An entity shall apply the [draft] amendments that delete paragraphs 7—9 for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is encouraged. If an entity applies the [draft] amendments for a period beginning before [date to be inserted after exposure], it shall disclose that fact.”

Issue 3: Description of borrowing costs

13. Paragraph 5 of IAS 23 states that:

“Borrowing costs may include:

- (a) interest on bank overdrafts and short-term and long-term borrowings;
- (b) amortisation of discounts or premiums relating to borrowings;
- (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;...”

14. [One respondent] suggests that subparagraphs (a), (b) and (c) of paragraph 5 are replaced with ‘the effective interest rate’ calculated using the effective interest rate method in IAS 39. They argue that this would avoid any misunderstanding about what is included in borrowing costs.

15. The staff does not recommend changing the description of borrowing costs at this time. The staff does not know if there would be unforeseen consequences of making the change. The Board decided not to spend time and resources considering aspects of IAS 23 beyond the choice between capitalisation and immediate recognition as an expense as part of the short-term convergence project.

Issue 4: IAS 11 reference to borrowing costs

16. The Exposure Draft proposes to amend the wording of paragraph 18 of IAS 11 as a consequential amendment as follows:

“18 Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:

- (a) insurance;
- (b) costs of design and technical assistance 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~~ if they meet the requirements of IAS 23 *Borrowing Costs*.”

17. [One respondent] suggests that the reference to IAS 23 in paragraph 18 of IAS 11 should be removed. They note that the reference ‘largely is irrelevant because under the percentage of completion method contract costs usually should be recognised as an expense in the accounting period in which they are incurred, in which case there would not be a qualifying asset to which interest cost capitalisation could be applied. The International Financial Reporting Interpretations Committee (IFRIC) noted in the Basis for Conclusions to IFRIC Draft Interpretation D13 *Service Concession Arrangements—The Financial Asset Model* (BC13) that “borrowing costs cannot be capitalised on a contract after revenue has been recognised in relation to the relevant expenditure”.’
18. The staff does not recommend removing the reference to IAS 23 in paragraph 18 of IAS 11. In the staff’s view, whether or not the contract is a qualifying asset is not important. The reference to IAS 23 in IAS 11 means that borrowing costs that are directly attributable to a construction contract should be identified as part of the total contract costs, used to establish the percentage of completion for which contract revenue and costs are recognised. This is consistent with the Board’s conclusion that borrowing costs are part of the historical cost of an asset that takes a substantial period of time to get ready for use or sale. In addition, the staff assumes that the contract price (used as the basis for contract revenue) would include a mark-up on those borrowing costs. Therefore, it is appropriate to include borrowing costs as part of contract costs.

Issue 5: Deletion of disclosure of accounting policy

19. [One respondent] disagrees with the proposed deletion of paragraph 29(a) of IAS 23: the disclosure of the accounting policy for borrowing costs. They think that entities should continue to provide the disclosure because of the potential application of different accounting policies in different periods (as a result of the transitional provisions).
20. The staff does not recommend changing the Exposure Draft in this respect. The staff’s view is that paragraph 29(a) is not required given the accounting policy disclosures required by paragraph 108 of IAS 1 *Presentation of Financial*

Statements and paragraphs 28 and 29 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.