

STAFF PAPER

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IFRS® Interpretations Committee Meeting

Project	Analysis of feedback on proposed amendments to IAS 23: Borrowing costs on completed qualifying assets		
Paper topic	Deliberation of comments received		
CONTACT(S)	Kan Hara	khara@ifrs.org	+44 (0)20 7246 6968
	Jawaid Dossani	jdossani@ifrs.org	+44 (0)20 7332 2742

This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (the Committee). Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards—only the Committee or the International Accounting Standards Board (the Board) can make such a determination. Decisions made by the Committee are reported in IFRIC® *Update*. The approval of a final Interpretation by the Board is reported in IASB® *Update*.

Introduction

1. This paper analyses the feedback on the proposed amendments to IAS 23 *Borrowing Costs*. The International Accounting Standards Board (the Board) proposes to amend IAS 23 to clarify that when a qualifying asset is ready for its intended use or sale, an entity treats any outstanding borrowing made specifically to obtain that qualifying asset as part of the funds that it has borrowed generally.
2. The proposed amendments to IAS 23 were included in the [Exposure Draft Annual Improvements to IFRS Standards 2015-2017 Cycle](#) (the Exposure Draft). The comment period for the Exposure Draft ended in April 2017, and the Board received comments from 51 respondents. The comment letters can be accessed [here](#).

Structure

3. We have analysed what we consider to be the main matters for redeliberation in the main body of this paper, and analysed other matters raised in Appendix A to the paper.

4. The paper is structured as follows:
 - (a) summary of staff recommendations and next steps;
 - (b) summary of the proposed amendments and feedback;
 - (c) staff analysis; and
 - (d) staff recommendation.
5. Appendix A to this paper analyses other matters raised.

Summary of staff recommendations and next steps

6. We recommend that the Board finalise the proposed amendments to IAS 23 subject to drafting changes. In finalising the amendments, we recommend that the Board clarify:
 - (a) the rationale for the amendments in the Basis for Conclusions (see paragraphs 15-25 of this paper); and
 - (b) that an entity includes funds borrowed specifically to obtain an asset other than a qualifying asset as part of general borrowings (see paragraphs 26-32 of this paper).
7. Subject to the IFRS Interpretations Committee's (the Committee) discussions at this meeting, we will present the Committee's recommendations to the Board at a future Board meeting.

Summary of the proposed amendments and feedback

The proposed amendments to IAS 23

8. The Board received a request to clarify whether an entity includes borrowings made specifically to obtain a qualifying asset in general borrowings when the qualifying asset is ready for its intended use or sale.
9. Paragraph 14 of IAS 23 states:

...The capitalisation rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that

are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

10. The Board proposed to amend paragraph 14 of IAS 23 to clarify that any specific borrowing that remains outstanding after the related asset is ready for its intended use or sale becomes part of the funds that an entity borrows generally. In other words, an entity should not interpret the reference in paragraph 14 to excluding ‘borrowings made specifically for the purpose of obtaining a qualifying asset’ to apply to borrowings originally made specifically to obtain a qualifying asset that is now ready for its intended use or sale.

The proposed transition requirements

11. The Exposure Draft proposed that an entity apply the amendments to IAS 23 prospectively to borrowing costs incurred on or after the effective date, with earlier application permitted.

Summary of feedback

12. A large number of respondents agreed with the proposed amendments and a few respondents disagreed. Some of the respondents who agreed with the proposed amendments expressed concerns about particular aspects of the proposals.
13. Those who agreed said that the proposed amendments would:
- (a) be consistent with, and improve the clarity of, the existing requirements in IAS 23; and
 - (b) help reduce diversity in practice.
14. The main matters identified by some respondents are:
- (a) consistency with, and clarification of, the existing principle in IAS 23 (Issue I—see paragraphs 15–25 of this paper); and
 - (b) borrowings made specifically to obtain an asset other than a qualifying asset (Issue II—see paragraphs 26–32 of this paper).

Staff analysis and recommendation

Issue I—Consistency with, and clarification of, the existing principle in IAS 23

Overview of feedback

15. Paragraph 8 of IAS 23 states:

An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset...

16. Paragraph 10 of IAS 23 states:

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

17. One respondent said that the proposed amendments do not address the problem comprehensively—in its view, they would introduce an additional rule without clarifying the core principle of IAS 23.

18. The respondent suggested that the Board clarify the meaning of ‘directly attributable’, in particular whether borrowing costs incurred are directly attributable to a qualifying asset only if:

- (i) the entity could *theoretically* have repaid the borrowings if it had not incurred the qualifying expenditure (View I); or
- (ii) the entity *actually uses* the borrowings to fund the acquisition, construction or production of a qualifying asset (View II).

19. In addition, some respondents said that the Board has not provided a clear rationale for the proposed amendments. They say that including a borrowing made to finance a qualifying asset as general borrowings is appropriate only in some situations—for example, (a) when the purpose of the borrowing has changed, (b) the qualifying asset has been disposed of, or (c) only to the extent that the entity has not used funds from a specific borrowing.

Staff analysis

20. Paragraph 14 of IAS 23 contains requirements that an entity applies when determining the amount of borrowing costs eligible for capitalisation when it borrows funds generally and uses them to obtain a qualifying asset. Paragraph 14 of IAS 23 requires an entity to use 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 purposes of obtaining a qualifying asset’.
21. Paragraph BC24 of IAS 23 states (emphasis added):
- 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.
22. We think borrowing costs incurred are directly attributable to a qualifying asset if the entity could have repaid the borrowing if the entity had not incurred the expenditure on the qualifying asset (ie view I in paragraph 18 of this paper). This is because, in the situation described in paragraph 14 of IAS 23, an entity is required to use all outstanding borrowings in determining the capitalisation rate—regardless of whether the entity actually uses that borrowing to finance the construction of the qualifying asset. The Board specifically rejected the notion that an entity uses judgement in selecting the borrowings it considers appropriate to meet the objective of capitalising directly attributable borrowing costs (ie View II in paragraph 18 of this paper).
23. As explained in [Agenda Paper 9](#) of the Committee’s May 2015 meeting, we think paragraph 14 of IAS 23 requires an entity to exclude specific borrowings to avoid taking account of those specific borrowing costs twice. To the extent an entity capitalises some borrowing costs specifically to a qualifying asset, it would be inappropriate for the entity to include the related borrowings as part of general borrowings.

24. For this reason, we disagree with respondents who say it is appropriate to include specific borrowings as part of general borrowings only in particular situations—see paragraph 19 above. In our view, the proposed narrow-scope amendments are consistent with the requirements in IAS 23. We think that no substantive change is needed in this respect. Nonetheless, we will clarify the rationale when drafting the Basis for Conclusions to the amendments.

Recommendation

25. We recommend no substantive change to the proposed amendments in this respect. Nevertheless, we recommend that the Board further clarify the rationale for the amendment when drafting the Basis for Conclusions.

Issue II—Borrowings made specifically to obtain an asset other than a qualifying asset

Overview of feedback

26. Some respondents said that the proposed amendments do not address the treatment of borrowing costs on borrowings made specifically to obtain an asset other than a qualifying asset—the respondents said the Committee and the Board discussed, but did not conclude on, this matter in 2009.

Staff analysis

27. Both the Board and Committee previously discussed whether an entity includes as part of general borrowings, funds borrowed specifically to obtain an asset other than a qualifying asset.
28. The Board concluded that the requirements in IAS 23 provide an adequate basis for an entity to determine whether to include such borrowings as part of general borrowings. The IASB Update from July 2009 states:

IAS 23 requires an entity to determine a rate on its general borrowings for purposes of capitalising borrowing costs on qualifying assets. The issue was whether debt incurred specifically to acquire a non-qualifying asset could be excluded from general borrowings. The Board noted that IAS 23 excludes only debt used to acquire qualifying assets from the

determination of the capitalisation rate. The Board decided not to include this issue in the annual improvements project.

29. The agenda decision from the Committee, published in November 2009, is reproduced below:

The IFRIC received a request for guidance on what borrowings comprise "general borrowings" for purposes of capitalisation of borrowing costs in accordance with IAS 23. IAS 23 paragraph 14 states that "To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset". The request asked for guidance on the treatment of general borrowings used to purchase a specific asset other than a qualifying asset as defined in the standard.

The IFRIC noted that because paragraph 14 of IAS 23 refers only to qualifying assets, some conclude that borrowings related to specific assets other than qualifying assets cannot be excluded from determining the capitalisation rate for general borrowings. Others note the general principle in paragraph 10 that the borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. The IFRIC noted that paragraph 11 of IAS 23 states 'the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgement is required.'

The IFRIC noted that the standard itself acknowledges that judgement will be required in its application. In addition, the

IFRIC concluded that any guidance it could provide would be in the nature of application guidance rather than an interpretation. The IFRIC also noted that the Board will consider whether to add this issue to the annual improvements project. At its meeting in July, the Board noted that IAS 23 excludes only debt used to acquire qualifying assets from the determination of the capitalisation rate. The Board decided not to include this issue in the annual improvements project.

Therefore, the IFRIC decided not to add the issue to its agenda.

30. As outlined in paragraphs 14 and BC24 of IAS 23, an entity includes all borrowings other than those made specifically to obtain a qualifying asset. Based on the Board's conclusion in 2009, we think it is clear that general borrowings includes funds borrowed specifically to obtain an asset other than a qualifying asset—this conclusion is also consistent with the rationale for the proposed amendment to IAS 23.
31. In addition, when discussing the proposed amendments to IAS 23, the Committee, at its July 2015 meeting, asked the staff to make clear that 'all borrowings, other than those for which borrowing costs are capitalised in accordance with paragraph 12 of IAS 23, should be included in the general borrowings pool'¹.

Staff recommendation

32. The amendments reinforce the previous conclusions of the Board—that general borrowings includes funds borrowed specifically to obtain an asset other than a qualifying asset. We think it would be helpful to explicitly include those previous conclusions on this matter in IAS 23. Consequently, we recommend that the Board clarify in the final amendments that an entity includes funds borrowed specifically to obtain an asset other than a qualifying asset as part of general borrowings.

¹ IFRIC Update from July 2015 which can be accessed [here](#).

Question 1 for the Committee

Does the Committee agree with the staff recommendation to finalise the proposed amendments, and in doing so, to clarify:

- (a) the rationale for the amendments in the Basis for Conclusions; and
- (b) that an entity includes funds borrowed specifically to obtain an asset other than a qualifying asset as part of general borrowings.

Analysis of other matters

33. Appendix A to this paper summarises other matters raised by respondents together with our related recommendations. Respondents also made some editorial suggestions, which we will consider when drafting the final amendments.

Question 2 for the Committee

Does the Committee agree with the staff recommendations on the other matters outlined in Appendix A?

Appendix A
Analysis of other matters

Other matters	Staff analysis and recommendation
<i>I—Potential inconsistency with paragraph 15 of IAS 23</i>	
<p>One respondent said that the proposed amendments are not consistent with the requirements in paragraph 15 of IAS 23². Paragraph BC24 of IAS 23 says an entity uses all outstanding borrowings (other than those made specifically to obtain a qualifying asset) in determining the capitalisation rate while paragraph 15 allows an entity to exercise judgement in determining which borrowings to include.</p>	<p>Paragraph 15 of IAS 23 requires an entity to apply judgement to assess whether it is appropriate to include <i>all</i> borrowings of the parent and its subsidiary or whether it is appropriate for a subsidiary to use its own borrowings—ie whether an entity applies a group-wide capitalisation rate or a capitalisation rate for each subsidiary.</p> <p>Having determined whether it is appropriate to apply a group-wide capitalisation rate or a separate rate for a subsidiary, we think an entity then applies paragraph 14 of IAS 23 to determine the actual capitalisation rate—this paragraph requires the use of <i>all</i> borrowings of the group or of that subsidiary (other than those made specifically to obtain a qualifying asset).</p> <p>Accordingly, we think that there is no inconsistency between paragraph 15 and the proposed amendments to IAS 23.</p> <p>We recommend no change in this respect.</p>

² Paragraph 15 of IAS 23 states: ‘In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.’

II—Requests for clarifications beyond the scope of the amendments

Some respondents asked the Board to clarify particular aspects of IAS 23 that are beyond the scope of the narrow-scope amendments. In particular:

- a. Some respondents said in some situations, loan agreements prohibit an entity from using a specific borrowing to finance other activities. These respondents asked for clarity as to whether it is appropriate to include as part of general borrowings a borrowing with such restrictions.
- b. One respondent suggested clarifying whether an entity includes specific borrowings for which it has suspended interest capitalisation as part of its general borrowings.
- c. One respondent asked the Board to reconsider the definition of a qualifying asset—in particular when an entity satisfies a performance obligation within a contract with a customer over time.
- d. Paragraph 14 of IAS 23 states that the amount of borrowing costs an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period. One respondent suggested clarifying whether this sentence refers to total borrowing costs capitalised (ie both specific borrowing costs and general borrowing costs) or to general borrowings costs only. The respondent also suggested clarifying whether the borrowings an entity includes in determining this limit should exclude any

Addressing these other aspects of IAS 23 goes beyond the scope of this narrow-scope amendment. The proposed amendments to IAS 23 would not change, nor add complexity to, an entity's assessment of these matters.

<p>borrowings the entity may have excluded when applying the requirements in paragraph 15 of IAS 23.</p> <p>e. One respondent asked for clarity as to how an entity applies the requirements in paragraph 15 of IAS 23. The respondent said some think the paragraph permits an entity to apply only a group-wide rate or separate rates for each subsidiary, while others think an entity applies judgement in each situation depending on the way a group is financed.</p> <p>f. Two respondents suggested clarifying the definition of borrowings. For example, one respondent asked whether a bank includes liabilities, such as customer accounts, trading positions and securities sale and repurchase agreements in determining ‘borrowings’.</p>	
<p>III—Transition requirements</p>	
<p><i>III-1 Meaning of ‘for an earlier period’</i></p>	
<p>A few respondents suggested the Board clarify whether the reference to applying the amendments ‘for an earlier period’ in the proposed transition requirements in paragraph 29D of IAS 23 is intended to permit early application from the beginning of any interim period or whether an entity can early apply the amendments only from the beginning of an annual reporting period.</p> <p>In addition, some respondents suggested amending proposed paragraph 28A of IAS 23 to clarify that an entity applies the amendments to borrowings costs incurred on or after ‘the date it first applies the amendment’ rather than referring to a particular date as proposed in the Exposure Draft. This is because referring to a particular date would,</p>	<p>We will amend proposed paragraph 28A of IAS 23 to allow entities to apply the amendments to an earlier period.</p> <p>We think amending paragraph 28A of IAS 23 will also clarify that an entity can apply the amendments only from the beginning of an annual reporting period. This is because an entity would apply the amendments only to ‘borrowing costs incurred on or after the beginning of the <i>first annual reporting period</i> beginning on or after the date it first applies the amendment’.</p>

<p>in effect, prevent an entity from applying the amendments in an earlier period.</p>	
<p><i>III-2 Request to consider exemption for first-time adopters</i></p>	
<p>One respondent said the transition requirements for first-time adopters should be the same as those for entities that already apply IFRS Standards, especially for relatively minor amendments to IFRS Standards such as annual improvements.</p>	<p>The Committee and the Board considered whether to provide transition requirements for first-time adopters when developing the proposed amendments to IAS 23.</p> <p>Paragraph D23 of IFRS 1 <i>First-time Adoption of International Financial Reporting Standards</i> already permits a first-time adopter to apply the requirements in IAS 23 from the date of transition or from an earlier date. We think the Board should not include any additional requirements for first-time adopters.</p> <p>We recommend no change in this respect.</p>
<p><i>III-3 Permit retrospective application</i></p>	
<p>One respondent suggested entities be allowed to apply the amendments retrospectively because:</p> <p>(a) mandatory prospective application could impair the comparability of financial information; and</p> <p>(b) it is necessary to retain consistency with the transitional requirements in paragraphs 27 and 28 of IAS 23.</p>	<p>The amendments clarify the requirements of paragraph 14 of IAS 23. We think the Board should not provide an option for entities to apply the amendments retrospectively. For the reasons outlined in paragraph BC3 of the Exposure Draft, we think few, if any, entities would make use of this option. Accordingly, we see no reason to complicate the requirements by including an option that we expect most entities not to adopt.</p> <p>In addition, we note that paragraphs 27 and 28 of IAS 23 are no longer applicable for entities that already apply IFRS Standards.</p> <p>We recommend no change in this respect.</p>

III-4 Prospective application for entities that already apply the treatment proposed in the Exposure Draft

One respondent said it would be inappropriate to require entities already applying IAS 23 in line with the proposed amendments to apply the amendments prospectively.

If an entity already applies the proposed accounting treatment, the application of the amendments, whether on a prospective or a retrospective basis, would not affect the entity.

We recommend no change in this respect.

IV—Request for application guidance and/or examples

A few respondents suggested the Board provide application guidance and/or examples to clarify the application of the proposed amendments.

The amendments are narrow in scope and clarifying in nature. We see little benefit in developing examples—the application of the amendments will very much depend on the specific facts and circumstances.

We recommend no change in this respect.