STAFF PAPER

September 2018

IFRS® Interpretations Committee meeting

Project	**IAS 23 *Borrowing Costs*—Expenditures on a qualifying asset**		
Paper topic	Agenda decision to finalise		
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Introduction

1. At its June 2018 meeting, the IFRS Interpretations Committee (Committee) discussed a submission about the amount of borrowing costs eligible for capitalisation when an entity uses general borrowings to obtain a qualifying asset. In the fact pattern described in the submission:

   (a) an entity constructs a qualifying asset;

   (b) the entity has no borrowings at the start of construction of the qualifying asset. Partway through construction, it borrows funds generally and uses them to finance the construction of the qualifying asset; and

   (c) the entity incurs expenditures on the qualifying asset both before and after it incurs borrowing costs on the general borrowings.

   The submitter asked whether an entity includes expenditures on a qualifying asset incurred before obtaining general borrowings in determining the amount of borrowing costs eligible for capitalisation.

2. The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the amount of borrowing costs

eligible for capitalisation in the fact pattern described in the submission. Consequently, the Committee tentatively decided not to add this matter to its standard-setting agenda. In June 2018, the Committee published a tentative agenda decision (see Agenda Paper 1 of this meeting for a copy of June IFRIC® Update).

3. The purpose of this paper is to:

   (a) analyse the comments on the tentative agenda decision; and

   (b) ask the Committee if it agrees with our recommendation to finalise the agenda decision.

4. There are two appendices to this paper:

   (a) Appendix A—proposed wording of the agenda decision; and

   (b) Appendix B—comment letters.

Comment letter summary

5. We received seven comment letters reproduced in Appendix B to this paper.

6. Six respondents agree with the Committee's decision not to add this matter to its standard-setting agenda for the reasons set out in the tentative agenda decisions. Two of these respondents made suggestions to improve the usefulness of the agenda decision as follows:

   (a) the KASB suggests including an example of how an entity calculates borrowing costs in this situation.

   (b) Deloitte suggests that the Committee explain why an entity does not disregard expenditures incurred on a qualifying asset before the entity obtains general borrowing.

7. One respondent, Pavitra Venkataraman, disagrees with the Committee's conclusion that paragraph 14 of IAS 23 provides an adequate basis for an entity not to disregard any expenditure incurred on a qualifying asset before obtaining the general

borrowings. The respondent suggests amending paragraph 14 of IAS 23 or issuing an Interpretation.

8. Further details about these matters, together with our analysis, is presented below.

Staff analysis

Clarifications to the wording of the agenda decision

Matter raised by respondents

9. As outlined above, some respondents suggested clarifications to the wording of the agenda decision. In particular:

(a) the KASB suggests including an example of how an entity calculates borrowing costs—in particular, it suggests that the Committee include, as part of the agenda decision, the example discussed in Appendix C of Agenda Paper 3A of the Committee's June 2018 meeting.

(b) Deloitte suggests that the Committee explain why an entity does not disregard expenditures incurred on a qualifying asset before the entity obtains general borrowing—in their view, this is because borrowings can be necessary to fund expenditures incurred before, as well as after, those borrowings are drawn down.

(c) we also received a suggestion to more clearly specify that determining when an entity begins capitalising borrowing costs is separate from determining which expenditures to include when applying paragraph 14 of IAS 23.

Staff analysis

10. We think the Committee should not include an example of how an entity calculates borrowing costs in the fact pattern described in the submission. Given the varied nature of qualifying assets and borrowing arrangements, we think any example would have limited applicability. We think the principles and requirements in IAS 23

provide an adequate basis for an entity to determine the amount of borrowing costs eligible for capitalisation—we think including an example would increase the complexity of the agenda decision without providing any significant benefits.

11. We think the Committee should not explain why an entity does not disregard expenditures incurred on a qualifying asset before the entity obtains general borrowings. While we do not disagree with Deloitte's comment that borrowings can be necessary to fund expenditures incurred before, as well as after, those borrowings are drawn down we think specifying this in an agenda decision would go beyond the requirements in IAS 23 and the wording in the Basis for Conclusions to IAS 23.

12. We agree with the suggestion that the agenda decision should more clearly specify that determining when the entity begins capitalising borrowing costs is separate from determining which expenditures to include when applying paragraph 14 of IAS 23 and suggest some editorial amendments to the wording of the tentative agenda decision in this respect. Appendix A to this paper, which sets out the draft wording for the final agenda decision, includes these editorial suggestions.

Does paragraph 14 of IAS 23 provide an adequate basis for the Committee's conclusion

Matter raised by respondents

13. As outlined above, one respondent, Pavitra Venkataraman, disagrees with the Committee's conclusion that paragraph 14 of IAS 23 provides an adequate basis for an entity not to disregard any expenditure incurred on a qualifying asset before obtaining the general borrowings. The respondent says that the wording in paragraph 14 of IAS 23 is consistent with the Committee's conclusion that an entity does not disregard expenditures incurred before obtaining general borrowings. However, the respondent says the context in which the above paragraph has been framed could lead to a question of whether entities include only those expenditures incurred after obtaining general borrowings.

Staff analysis

14. We agree with the respondent that the wording in paragraph 14 of IAS 23 is consistent with the Committee's conclusion in June 2018 that an entity does not disregard expenditures incurred on a qualifying asset before obtaining general borrowings. The respondent has not provided any new information that was not previously considered by the Committee in reaching this conclusion. The respondent has also not provided a basis for its statement that '…the context in which the above paragraph [paragraph 14 of IAS 23] has been framed, it leads to a question whether entities should include only those expenditures incurred after borrowing'. Accordingly, we recommend no change to the wording of the agenda decision in this respect.

Staff recommendation

15. On the basis of our analysis, we recommend confirming the tentative agenda decision as published in IFRIC Update in June 2018 with some editorial amendments. Appendix A to this paper sets out the proposed wording of the final agenda decision.

Question for the Committee
Does the Committee agree with our recommendation to finalise the agenda decision set out in Appendix A to this paper?

Appendix A—Proposed wording of the agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined and deleted text is struck through)

Expenditures on a qualifying asset (IAS 23 *Borrowing Costs*)

The Committee received a request about the amount of borrowing costs eligible for capitalisation when an entity uses general borrowings to obtain a qualifying asset.

In the fact pattern described in the request:

(a) an entity constructs a qualifying asset;

(b) the entity has no borrowings at the start of the construction of the qualifying asset. Partway through construction, it borrows funds generally and uses them to finance the construction of the qualifying asset; and

(c) the entity incurs expenditures on the qualifying asset both before and after it incurs borrowing costs on the general borrowings.

The request asked whether an entity includes expenditures on a qualifying asset incurred before obtaining general borrowings in determining the amount of borrowing costs eligible for capitalisation.

The Committee observed that an entity applies paragraph 17 of IAS 23 in determining the commencement date for capitalising borrowing costs. The paragraph requires an entity to begin capitalising borrowing costs when it meets all the following conditions:

(a) it incurs expenditures for the asset;

(b) it incurs borrowing costs; and

(c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Applying paragraph 17 of IAS 23 to the fact pattern described in the request, the entity would not begin capitalising borrowing costs until it incurs borrowing costs.

Once the entity incurs borrowing costs and therefore satisfies all three conditions in paragraph 17 of IAS 23, it then applies paragraph 14 of IAS 23 to determine ~~The Committee also observed that in determining~~ the expenditures on a qualifying asset to which ~~an entity~~ it applies the capitalisation rate. ~~(paragraph 14 of IAS 23),~~ The Committee observed that in doing so the entity does not disregard expenditures on the qualifying asset incurred before it ~~the entity~~ obtains the general borrowings.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the amount of borrowing costs eligible for capitalisation in the fact pattern described in the request. Consequently, the Committee ~~[~~decided~~]~~ not to add this matter to its standard-setting agenda

Appendix B—Comment letters

Deloitte.

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20 August 2018

Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom
E14 4HD

Dear Ms Lloyd

Tentative agenda decision - IAS 23 *Borrowing Costs*: Expenditures on a qualifying asset

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the June IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for clarification on the amount of borrowing costs eligible for capitalisation when an entity uses general borrowings to obtain a qualifying asset.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision, although we believe that the value of the tentative agenda decision could be enhanced by elaborating on the statement that "the entity does not disregard expenditures on the qualifying asset incurred before the entity obtains the general borrowings" to clarify that this is because borrowings can be necessary to fund expenditures incurred before, as well as after, those borrowings are drawn down.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

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21 August 2018

Chair of the IFRS Interpretations Committee
7 Westferry Circus, Canary Wharf, London E14 4HD
United Kingdom

Dear Ms Lloyd:

The Korea Accounting Standards Boards (KASB) sends its comments on the two tentative agenda decisions on IAS 23 issued in June.

Please do not hesitate to contact us if you have any questions regarding our comments. You may direct your inquiries either to me (ehkim@kasb.or.kr) or to Jungah Yang, (yja518@kasb.or.kr), Director of KASB.

Best regards,

Eui-Hyung Kim
Chair, Korea Accounting Standards Board

Cc: Sungsoo Kwon, Vice-Chair, Korea Accounting Standards Board
Se-hwan Park, Senior Director, Korea Accounting Standards Board
Hyun-Duck Choi, Director, Korea Accounting Standards Board

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We are pleased to comment on the tentative agenda decisions on IAS 23 issued in June.

Tentative Agenda Decision—Borrowing Costs on Land (IAS 23)

We agree with the Tentative Agenda Decision—Borrowing Costs on Land (IAS 23).

According to the tentative agenda decision, borrowing costs incurred in respect of land expenditures during the construction of the building seem to be capitalised as the cost of the land. However, many entities have capitalised such borrowing costs as part of the cost of the building. Thus, we have a concern that diversity in practice would be induced unless the agenda decision clearly addresses this issue.

Tentative Agenda Decision—Expenditures on a Qualifying Asset (IAS 23)

We agree with the Tentative Agenda Decision—Expenditures on a Qualifying Asset (IAS 23).

We believe that it would help stakeholders better understand paragraphs 17 and 14 of IAS 23 if the Committee adds Appendix C (Calculation of borrowing costs eligible for capitalisation) of the agenda paper to this agenda decision.

BR PETROBRAS

Rio de Janeiro, August 21, 2018
CONTRIB 037/2018

Mr Hans Hoogervorst
International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

Subject: Expenditures on a Qualifying Asset and Borrowing Costs on Land

Reference: Tentative agenda decision

Dear Mr Hoogervorst,

Petróleo Brasileiro S.A. - Petrobras welcomes the opportunity to comment on the topics: Expenditures on a qualifying asset and Borrowing costs on land. We believe this is an important opportunity for all parties interested in the future of IFRS and we hope to contribute to the progress of the Board's activities.

We agree with the IFRS IC conclusions reported in these tentative agenda decisions that the principles and requirements in IFRS Standards provide adequate basis for an entity to determine the amount of borrowing costs eligible for capitalisation and when to cease capitalising borrowing costs on land expenditures in the fact pattern described in the submission.

We hope that our comments help the IASB in making the decisions necessary to develop and maintain principles-based standards of high quality. If you have any questions in relation to the content of this letter please do not hesitate to contact us (contrib@petrobras.com.br).
Respectfully,

/s/Rodrigo Araujo Alves

Rodrigo Araujo Alves

Chief Accounting and Tax Officer

MASB MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

21 August 2018

Ms. Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Ms. Lloyd

IFRS Interpretations Committee Tentative Agenda Decisions

The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comments on the following Tentative Agenda Decisions published in IFRIC Update June 2018:

(1) Tentative Agenda Decision - Borrowing Costs on Land (IAS 23 *Borrowing Costs*).

(2) Tentative Agenda Decision - Expenditures on Qualifying Asset (IAS 23 *Borrowing Costs*).

(3) Tentative Agenda Decision - Determination of the exchange rate when there is a long-term lack of exchangeability (IAS 21 *The Effects of Changes in Foreign Exchange Rates*).

We agree with the Interpretations Committee's reasons set out in the respective Tentative Agenda Decision for not adding these items onto its agenda.

If you need further clarification, please contact the undersigned by email at beeleng@masb.org.my or at +603 2273 3100.

Thank you.

Yours sincerely,

TAN BEE LENG
Executive Director

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Deutsches Rechnungslegungs Standards Committee e.V.
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Sue Lloyd
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Berlin, 31 July 2018

Dear Sue,

IFRS IC's decisions in its June 2018 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the decisions taken by the IFRS Interpretations Committee (IFRS IC) and published in the June 2018 IFRIC Update.

We agree with the final agenda decision as regards IAS 7 and the two tentative agenda decisions in respect of IAS 23.

However, we do not fully concur with the tentative agenda decision on the IAS 21 issue, for the following reasons:

- Whilst agreeing with the IFRS IC's observations as regards the current requirements on how to assess the exchange rate to be used, we note that the IFRS IC did not answer the main question, being "*whether, in those circumstances, an entity is required to use an official exchange rate in applying IAS 21*". Hence, the IFRS IC's conclusion does not add clarity as to whether official rates should be used if restrictions apply.
- Further, the IFRS IC notes that IAS 21 does "*not … include explicit requirements on the exchange rate [to be used] when the (official) spot exchange rate is not observable*", which in Venezuela's case seems a misplaced statement given that these rates are clearly *observable*. The "real issue" as we understand it is whether or not these rates are also

applicable in situations where either official rates are limited to transactions that meet certain criteria that are not met for the specific transaction under consideration or other restrictions apply (e.g. limited liquidity). We also note that the issue is deeply intertwined with hyperinflation, at least in Venezuela's case.

- This said, we are unclear what the research suggested in the IFRIC Update would focus on. We have doubts that this issue could be resolved through narrow-scope standard-setting – as it evidences a more general lack of appropriate requirements on currency translation in situations where there is hyperinflation.

If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow
President

MAZARS

Mrs Sue Lloyd

IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Paris, August 28, 2018

Tentative Agenda Decisions – IFRIC Update June 2018

Dear Sue,

MAZARS is pleased to comment on the various IFRS Interpretations Committee tentative agenda decisions published in the June 2018 IFRIC Update.

We have gathered all our comments as appendices to this letter, which can be read separately and are meant to be self-explanatory.

Should you have any questions regarding our comments on the various tentative agenda decisions, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin **Edouard Fossat**

Financial Reporting Technical Support

MAZARS

Appendix 2

Expenditures on a qualifying asset (IAS 23 Borrowing Costs)—Agenda Paper 3A

We agree with the tentative IFRS IC decision not to add this matter to its standard-setting agenda.

I, Pavitra Venkatraman, am a student of Accountancy and an independent accounting researcher. I welcome the opportunity to offer my views on Committee's tentative decisionmade in its meeting held in June 2018 with regards to Expenditures on a Qualifying Asset(Agenda Paper 3A IAS 23 - Borrowing Costs)

I agree with the Committee's view that Para 17 of IAS 23 provides a clear principle direction that an entity should not begin capitalizing any borrowing costs until it has incurred any borrowing costs. Hence I concur with the Committee's decision not to add this matter to its standard setting agenda.

However, I beg to disagree with the Committee's view that Para 14 of IAS 23 provides a clear direction for entities, to not disregard any expenditure it has incurred on the qualifying asset before it obtains the general borrowings.

Para 14 of IAS 23-

"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 amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period."

On reading the above, the standard directs entities to determine all general borrowings it has done for the purpose of obtaining a qualifying asset and apply the capitalisation rate on all the expenditure incurred on all the qualifying asset. Though, one can assume that the term "*expenditure on that asset*" directs entities to include all expenditure incurred, whether before or after borrowing, considering the context in which the above paragraph has been framed, it leads to a question whether entities should include only those expenditure incurred after borrowing.

Hence, for the sake of clarity, I would request that Para 14 of IAS 23 is amended or an interpretation is issued in this regard to clarify that all expenditure incurred, irrespective of its timing can be included in qualifying expenditure.

Regards
Pavitra Venkatraman