

AASB 123 'Borrowing Costs' Summary

OVERVIEW

- Australian Accounting Standard AASB 123 will replace the existing AAS 34/AASB 1036 'Borrowing Costs'.
- AASB 123 provides a choice of expensing or capitalising certain borrowing costs, where no choice was available under AASB 1036. The Department of Treasury and Finance will not mandate with respect to this choice.
- There are changes to the accounting for exchange rate differences arising from foreign currency borrowings, the calculation of borrowing costs capitalised, and the application of the Standard to extractive industries. In addition, AASB 123 contains less prescriptive guidance and commentary than was included in AASB 1036.
- These changes will only impact a limited number of agencies in the public sector.

INTRODUCTION

AASB 123 will replace Australian Accounting Standards AAS 34/AASB 1036. Its purpose is to prescribe the accounting treatment for borrowing costs. Borrowing costs are defined as interest and other costs incurred by an entity in connection with the borrowing of funds.

AASB 123 permits a choice between two treatments of borrowing costs. The benchmark treatment requires all borrowing costs to be expensed in the period incurred. The treatment prescribed in AASB 1036 (capitalisation of borrowing costs related to qualifying assets¹ and expensing other borrowing costs) is continued in AASB 123 as the alternative to the benchmark treatment.

APPLICATION DATE

The Standard will be applicable from the first reporting period beginning on or after 1 January 2005.

TRANSITIONAL PROVISIONS

All first-time adopters of International Accounting Standards must follow the transitional provisions in AASB 1 'First-time Adoption of Australian Equivalents to International Financial Reporting Standards'.

¹ A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale

Under AASB 1, agencies with a 30 June year-end must produce an opening balance sheet at 1 July 2004 (unpublished) that is compliant with Australian equivalents to IFRSs.

Agencies considering changing their accounting policy on borrowing costs to the 'expense as incurred' basis would have to write off all previously capitalised borrowing costs against the opening balance of retained earnings. This would only apply to assets still measured on the cost basis. Where agencies choose to capitalise borrowing costs as part of a qualifying asset, there will be no retrospective adjustment on transition.

KEY DIFFERENCES FROM THE EXISTING AUSTRALIAN STANDARD

Treatment of borrowing costs

AASB 123 (paragraph Aus1.8) permits a choice between:

- expensing all borrowing costs in the period incurred (the benchmark treatment); or
- expensing borrowing costs except where capitalised as part of a qualifying asset (the allowed alternative treatment and current requirement of AASB 1036).

AASB 1036 (paragraphs 4.1 and 4.2) did not permit a choice and allowed only one treatment for borrowing costs; ie requiring borrowing costs to be recognised as an expense, unless incurred in relation to the acquisition, construction or production of a qualifying asset, in which case capitalisation is required.

Exchange rate differences arising from foreign currency borrowings

- Under AASB 123 borrowing costs include exchange differences arising from foreign currency borrowings **to the extent that they are regarded as an adjustment to interest costs** (paragraph 5(e)).
- Under AASB 1036 (paragraph 11.1.2(e)) borrowing costs included exchange differences arising from foreign currency borrowings **net of the effects of any hedge of the borrowings**.

Therefore:

- to the extent that exchange differences arising from foreign currency borrowings **are not** regarded as an adjustment to interest costs, they would be excluded from the definition of borrowing costs under AASB 123 but included in borrowing costs under AASB 1036, net of the effects of any hedge of the borrowings; and
- to the extent that exchange differences arising from foreign currency borrowings **are** regarded as an adjustment to interest costs, they would be included in borrowing costs under both AASB 123 and AASB 1036. The amount included in borrowing costs under AASB 1036 would be adjusted for the effects of any hedge of

the borrowings. Based on a literal reading of AASB 123, the amount included in borrowing costs would not be adjusted for the effects of any hedge of the borrowings.

Calculation of borrowing costs capitalised

To the extent that funds are borrowed generally:

- AASB 123 (paragraph 17) requires the amount of borrowing costs capitalised to qualifying assets to be determined by applying a capitalisation rate to the **expenditures** on that asset.
- AASB 1036 (paragraph 5.2) required the amount of borrowing costs capitalised to qualifying assets to be determined by applying a capitalisation rate to the **weighted average accumulated expenditures** relating to qualifying assets during the reporting period.

Extractive industries

AASB 1036 (paragraph 1.2) provided that the requirements of AASB 1036 override the requirements of AASB 1022 'Accounting for the Extractive Industries', in relation to the treatment of borrowing costs.

AASB 1036 (paragraph 11.1.13) commented that where exploration and evaluation costs are carried forward under AASB 1022 on the basis that activities have not reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, such costs are not qualifying assets because the probability recognition criteria is not met in respect of these costs. Therefore, any related borrowing costs would be recognised as an expense in the period incurred.

AASB 123 does not address these issues. Therefore, AASB 123 will not override the requirements of AASB 1022.

Additional guidance and disclosure in AASB 1036

AASB 1036 contained additional guidance to that in AASB 123 in relation to the following:

- identifying borrowing costs;
- identifying qualifying assets;
- borrowing costs within an economic entity;
- progress payments and grants received on qualifying assets;
- source and specific application of borrowed funds; and
- specific borrowing exceeding requirements.

Where funds are borrowed specifically for acquiring, constructing or producing a qualifying asset, AASB 1036 required disclosure of the amount of any investment revenue earned on borrowed funds that has been deducted from the borrowing costs incurred in determining the amount of borrowing costs to be capitalised (paragraph 8.1(d)).

IMPACT OF DIFFERENCES

Effect on general reporting in the Public Sector

- Exchange differences arising from foreign currency borrowings that are not regarded as an adjustment to interest costs would be excluded from borrowing costs reported in the financial report. Those that are regarded as an adjustment to interest costs would be included in borrowing costs without adjustment for the effects of (i.e. excluding) any hedge of the borrowings.
- Agencies changing their accounting policy on borrowing costs to the 'expense as incurred' basis would have to write off all previously capitalised borrowing costs against the opening balance of retained earnings. This would only apply to assets still measured on the cost basis. This will only affect a limited number of agencies in the public sector.
- No material effect on disclosure requirements.

FREQUENTLY ASKED QUESTIONS

We are currently capitalising our borrowing costs that relate to qualifying assets. What accounting adjustments do we have to do and what would be the effect on the financial statements?

For agencies that continue to capitalise:

Adoption of this Standard and continued use of capitalising borrowing costs as part of qualifying assets does not constitute a change in accounting policy and no adjustment is necessary.

For agencies that choose to expense all borrowing costs:

Agencies changing the accounting policy on borrowing costs to the expensing method would have to write-off all previously capitalised borrowing costs against the opening balance of retained earnings. This would only apply to assets still measured on the cost basis.

In the 30 June 2006 financial statements, the 2004-05 comparatives would show an adjustment to retained profits and assets (both reduced by the amount of borrowing cost expensed). These adjustments would be reflected both on the 'Reconciliation of Equity' disclosure and on the face of the financial statement. The effect of showing the

borrowing cost as an expense would result in a reduction in the result in the Income Statement.