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April 2007 – Special Edition

Audit

IAS Plus.

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IASB issues revised Standard on borrowing costs

On 29 March 2007 the International Accounting Standards Board (IASB) issued a number of amendments to IAS 23 Borrowing Costs. The amendments eliminate the option available under the previous version of the Standard to recognise all borrowing costs immediately as an expense. To the extent that borrowing costs relate to the acquisition, construction or production of a qualifying asset, the revised Standard requires that they be capitalised as part of the cost of that asset. All other borrowing costs should be expensed as incurred.

The amendments have been made as part of the Board's ongoing convergence project with US generally accepted accounting principles (US GAAP). They eliminate the main difference in the fundamental accounting recognition principle between International Financial Reporting Standards (IFRSs) and US GAAP in this area, although significant measurement differences remain.

The revised Standard is effective for annual periods beginning on or after 1 January 2009, with early application permitted. Retrospective application is not required.

Principal change

For the purposes of this short-term convergence project, the IASB has focussed on eliminating the choice between capitalisation of borrowing costs relating to qualifying assets and the immediate recognition of such costs as an expense.

From the date of implementation of the new Standard, entities are required to include in the cost of qualifying assets (as defined) borrowing costs that are directly attributable to such assets. The benchmark treatment under the previous version of the Standard (expensing all borrowing costs as incurred) has been eliminated.

Note that the definitions of "borrowing costs" (interest and other costs that an entity incurs in connection with the borrowing of funds) and "qualifying asset" (an asset that necessarily takes a substantial period of time to get ready for its intended use or sale) are essentially unchanged from the previous version of IAS 23. Similarly, the detailed criteria for the commencement, suspension and cessation of capitalisation remain the same.

New scope exclusions

Qualifying assets measured at fair value

Qualifying assets measured at fair value (such as biological assets accounted for under IAS 41 Agriculture) are excluded from the scope of the Standard. The measurement of such assets will not be affected by the amount of borrowing costs incurred during their construction/ production. To require entities to move to a policy of capitalisation would force them to change their systems, only to then write off the capitalised borrowing costs when remeasuring the asset to fair value. Note, however, that this exclusion does not prohibit entities following the capitalisation approach in respect of such assets if they choose to do so as a matter of accounting policy (provided that the assets meet the definition of “qualifying”).

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

The second scope exclusion introduced in the revised Standard relates to inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis. Where such inventories take a substantial period to get ready for sale (e.g. maturing whisky), capitalisation of directly attributable borrowing costs is not required. This exception is allowed on the basis that the costs involved in capitalisation (e.g. as a result of difficulties in allocating borrowing costs to inventories and monitoring them until the inventory is sold) would most likely exceed the potential benefits.

Again, this exclusion from the scope of the Standard does not prevent entities that elect to do so following a capitalisation policy in respect of such inventories, provided that the general conditions for capitalisation are met.

Convergence with US GAAP

The IASB’s principal objective in amending IAS 23 is to achieve convergence in principle with US GAAP. By removing the option to expense all borrowing costs, the revisions address the main difference between IAS 23 and the US Statement of Financial Accounting Standards (FAS) 34 Capitalization of Interest Cost.

However, other differences remain – in particular regarding the definition of borrowing costs that are eligible for capitalisation, the definition of qualifying asset, and the detailed calculation of the amount to be capitalised. Therefore, even after the amendments to IAS 23 have been adopted, in many cases the amount capitalised under IFRSs will not be the same as the amount that would be capitalised under US GAAP.

Effective date and transitional provisions

The revised Standard is effective for annual periods beginning on or after 1 January 2009, with early application permitted. If an entity applies the amendments for a period beginning before 1 January 2009, that fact should be disclosed.

The amendments are generally to be applied prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after the effective date of the revised Standard. Therefore, if an entity has previously followed an accounting policy of immediately recognising all borrowing costs as an expense:

- it is not required to retrospectively restate its financial statements for borrowing costs incurred on qualifying assets before the effective date of the Standard;
- nor is it required to apply the capitalisation policy to borrowing costs incurred subsequent to the effective date on projects that had commenced (i.e. that had met IAS 23’s criteria for commencement of capitalisation) before the effective date.

For example, Entity A has 3 ongoing construction projects:

	Project 1	Project 2	Project 3
Date of commencement of capitalisation under IAS 23	01/01/07	01/01/08	01/01/09
Borrowing costs incurred prior to 1 January 2009	CU100	CU50	CU10
Borrowing costs incurred on or after 1 January 2009	Nil	CU50	CU90
Borrowing costs required to be capitalised under IAS 23 (Revised)	Nil	Nil	CU90

However, an entity may choose to designate an earlier date for adoption of the revised Standard – such that the amendments would be applied to all qualifying assets for which the commencement date for capitalisation is on or after that earlier designated date. In the example above, the entity could designate 01/01/07 as the date from which the amendments would be applied – and, in its financial statements in the year in which the amendments are first adopted, could retrospectively capitalise the borrowing costs incurred on Projects 1 and 2 from that date to the commencement of the current reporting period.

First-time adoption

IFRS 1 **First-time Adoption of International Financial Reporting Standards** has been amended to allow first-time adopters to apply the same transitional provisions as existing IFRS users, taking the 'effective date' to be date of transition to IFRSs (where that is later than 1 January 2009). Therefore, borrowing costs related to qualifying assets would be required to be capitalised prospectively from the later of the date of transition to IFRSs and 1 January 2009. First-time adopters would also be permitted to designate an earlier date from which the revised Standard could be applied prospectively.

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