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Proposed amendments to IAS 23

On 25 May 2006, the International Accounting Standards Board (IASB) issued an Exposure Draft (ED) to amend IAS 23 **Borrowing Costs**. The proposed amendments would eliminate the option in IAS 23 of recognising all borrowing costs immediately as an expense. To the extent that borrowing costs relate to the acquisition, construction or production of a qualifying asset measured on a cost basis, the revised standard would require that they be capitalised as part of the cost of that asset. All other borrowing costs would be expensed as incurred.

The proposals are part of the IASB's ongoing project to eliminate differences between International Financial Reporting Standards (IFRSs) and US Generally Accepted Accounting Principles (US GAAP). Although the ED addresses the main difference between US GAAP and IAS 23, some differences would remain (see below).

No effective date has been specified for the proposals – but it is unlikely to be before 1 June 2007. Retrospective application would not be required. The IASB has requested comments on the ED on or before 29 September 2006.

Ken Wild, Deloitte's global IFRS leader, says:

"The impact of these changes is likely to vary significantly between jurisdictions. In some regions, for example in many regimes in Asia, capitalisation of borrowing costs for qualifying assets is common practice. In others, and I am particularly thinking of Europe here, it has been more unusual. Our recent experience of transition to IFRSs in Europe in 2005 is that entities were more likely to stick with their existing practice of expensing all interest when incurred. Therefore, a new requirement to switch to capitalisation will be quite a change.

On the wider question of convergence with US GAAP, I continue to be concerned at the approach that is being adopted. This ED is a prime example of a proposal to converge with US GAAP without any real debate as to whether that will result in better accounting. In addition, the fact that the ED does not address all of the differences between IFRSs and US GAAP in this area means that it would not result in convergence in any case."

Principal changes

For the purposes of the current ED, the IASB has focussed on eliminating the choice between capitalisation of borrowing costs relating to qualifying assets and their immediate recognition as an expense. No substantive changes are proposed to the definitions of borrowing costs or qualifying assets, nor to the detailed criteria for the commencement, suspension or cessation of capitalisation.

The Board is taking the opportunity to propose one amendment to the scope of IAS 23 – to specifically exclude biological assets and other assets measured at fair value such as investment properties that are being redeveloped. The capitalisation of borrowing costs is limited to qualifying assets measured on a cost basis.

Convergence with US GAAP

The IASB's principal objective in proposing these amendments is to achieve a measure of convergence with US GAAP. The ED addresses the main difference between IAS 23 and the US Statement of Financial Accounting Standards (SFAS) 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 a qualifying asset, and the detailed calculation of the amount to be capitalised. Therefore, in many cases, the amount capitalised under IFRSs may not be the same as the amount that would be capitalised under US GAAP.

Effective date and transitional provisions

No effective date has been specified for the proposals.

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

- it would not be required to retrospectively restate its financial statements for borrowing costs incurred on qualifying assets before the effective date of the Standard;
- nor would it be 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.

However, an entity may choose to designate an earlier date for adoption of the amendments – 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.

First-time adoption

IFRS 1 **First-time Adoption of International Financial Reporting Standards** would be amended to allow first-time adopters to apply the same transitional provisions as existing IFRS users. Therefore, borrowing costs related to qualifying assets would be required to be capitalised prospectively from the later of the effective date of the amended standard and the date of transition to IFRSs. First-time adopters would also be permitted to designate an earlier date from which the revised standard could be applied prospectively.

Comment deadline

The comment deadline for the proposals is 29 September 2006.

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