

IPSAS 5—BORROWING COSTS

Acknowledgment

This International Public Sector Accounting Standard is drawn primarily from International Accounting Standard (IAS) 23, “Borrowing Costs” published by the International Accounting Standards Committee (IASC). The International Accounting Standards Board (IASB) and the International Accounting Standards Committee Foundation (IASCF) were established in 2001 to replace IASC. The International Accounting Standards (IASs) issued by IASC remain in force until they are amended or withdrawn by IASB. Extracts from IAS 23 are reproduced in this publication of the Public Sector Committee of the International Federation of Accountants with the permission of IASB.

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CONTENTS

	Paragraph
Objective	
Scope.....	1–4
Definitions	5–13
Borrowing Costs.....	6
Economic Entity	7-9
Future Economic Benefits or Service Potential	10
Government Business Enterprises	11
Net Assets/Equity	12
Qualifying Assets	13
Borrowing Costs — Benchmark Treatment.....	14–16
Recognition	14–15
Disclosure.....	16
Borrowing Costs — Allowed Alternative Treatment	17–40
Recognition	17–39
Borrowing Costs Eligible for Capitalization	21–29
Excess of the Carrying Amount of the Qualifying Asset Over Recoverable Amount	30
Commencement of Capitalization	31–33
Suspension of Capitalization	34–35
Cessation of Capitalization.....	36–39
Disclosure	40
Transitional Provisions	41
Effective Date	42–43
Comparison with IAS 23	

The standards, which have been set in bold, should be read in the context of the commentary paragraphs in this Standard which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.

Objective

This Standard prescribes the accounting treatment for borrowing costs. This Standard generally requires the immediate expensing of borrowing costs. However, the Standard permits, as an allowed alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

Scope

1. **This Standard should be applied in accounting for borrowing costs.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**
3. Government Business Enterprises (GBEs) are required to comply with International Accounting Standards (IASs) issued by the International Accounting Standards Committee. The Public Sector Committee’s Guideline No. 1, “Financial Reporting by Government Business Enterprises” notes that IASs are relevant to all business enterprises, regardless of whether they are in the private or public sector. Accordingly, Guideline No. 1 recommends that GBEs should present financial statements that conform, in all material respects, to IASs.
4. This Standard does not deal with the actual or imputed cost of net assets/equity. Where jurisdictions apply a capital charge to individual entities, judgment will need to be exercised to determine whether the charge meets the definition of borrowing costs or whether it should be treated as an actual or imputed cost of net assets/equity.

Definitions

5. **The following terms are used in this Standard with the meanings specified:**

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements.

Accrual basis means a basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions

and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.

Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

Borrowing costs are interest and other expenses incurred by an entity in connection with the borrowing of funds.

Cash comprises cash on hand and demand deposits.

Contributions from owners means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:

- (a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or
- (b) Can be sold, exchanged, transferred or redeemed.

Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

Controlled entity is an entity that is under the control of another entity (known as the controlling entity).

Controlling entity is an entity that has one or more controlled entities.

Distributions to owners means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

Economic entity means a group of entities comprising a controlling entity and one or more controlled entities.

Exchange difference is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

Exchange rate is the ratio for exchange of two currencies.

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.

Foreign currency is a currency other than the reporting currency of an entity.

Government Business Enterprise means an entity that has all the following characteristics:

- (a) Is an entity with the power to contract in its own name;
- (b) Has been assigned the financial and operational authority to carry on a business;
- (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
- (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
- (e) Is controlled by a public sector entity.

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

Net assets/equity is the residual interest in the assets of the entity after deducting all its liabilities.

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

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

Borrowing Costs

6. Borrowing costs may include:
 - (a) Interest on bank overdrafts and short-term and long-term borrowings;
 - (b) Amortization of discounts or premiums relating to borrowings;

- (c) Amortization of ancillary costs incurred in connection with the arrangement of borrowings;
- (d) Finance charges in respect of finance leases; and
- (e) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Economic Entity

- 7. The term “economic entity” is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.
- 8. Other terms sometimes used to refer to an economic entity include “administrative entity,” “financial entity,” “consolidated entity” and “group.”
- 9. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.

Future Economic Benefits or Service Potential

- 10. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity’s objectives but which do not directly generate net cash inflows are often described as embodying “service potential.” Assets that are used to generate net cash inflows are often described as embodying “future economic benefits.” To encompass all the purposes to which assets may be put, this Standard uses the term “future economic benefits or service potential” to describe the essential characteristic of assets.

Government Business Enterprises

- 11. Government Business Enterprises (GBEs) include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. IPSAS 6, “Consolidated Financial Statements and Accounting for Controlled Entities” provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.

Net Assets/Equity

12. “Net assets/equity” is the term used in this Standard to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.

Qualifying Assets

13. Examples of qualifying assets are office buildings, hospitals, infrastructure assets such as roads, bridges and power generation facilities, and inventories that require a substantial period of time to bring them to a condition ready for use or sale. Other investments, and those assets that are routinely produced over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Borrowing Costs—Benchmark Treatment**Recognition**

14. **Borrowing costs should be recognized as an expense in the period in which they are incurred.**
15. Under the benchmark treatment, borrowing costs are recognized as an expense in the period in which they are incurred, regardless of how the borrowings are applied.

Disclosure

16. **The financial statements should disclose the accounting policy adopted for borrowing costs.**

Borrowing Costs—Allowed Alternative Treatment**Recognition**

17. **Borrowing costs should be recognized as an expense in the period in which they are incurred, except to the extent that they are capitalized in accordance with paragraph 18.**
18. **Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard.**
19. Under the allowed alternative treatment, borrowing costs that are directly attributable to the acquisition, construction or production of an asset are included in the cost of that asset. Such borrowing costs are capitalized as part of the cost of the asset when it is probable that they will result in future

economic benefits or service potential to the entity and the costs can be measured reliably. Other borrowing costs are recognized as an expense in the period in which they are incurred.

20. **Where an entity adopts the allowed alternative treatment, that treatment should be applied consistently to all borrowing costs that are directly attributable to the acquisition, construction or production of all qualifying assets of the entity.**

Borrowing Costs Eligible for Capitalization

21. 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 outlays on the qualifying asset had not been made. When an entity borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.
22. It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an entity is co-ordinated centrally. Difficulties also arise when an economic entity uses a range of debt instruments to borrow funds at varying rates of interest, and transfers those funds on various bases to other entities in the economic entity. Funds which have been borrowed centrally may be transferred to other entities within the economic entity as a loan, a grant or a capital injection. Such transfers may be interest-free or require that only a portion of the actual interest cost be recovered. Other complications arise through the use of loans denominated in or linked to foreign currencies, when the economic entity operates in highly inflationary economies, and from fluctuations in exchange rates. As a result, 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 judgment is required.
23. **To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.**
24. The financing arrangements for a qualifying asset may result in an entity obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for outlays on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their outlay on the qualifying asset. In determining the amount of borrowing costs

eligible for capitalization during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.

25. **To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization should be determined by applying a capitalization rate to the outlays on that asset. The capitalization rate should 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 capitalized during a period should not exceed the amount of borrowing costs incurred during that period.**
26. Only those borrowing costs applicable to the borrowings of the entity may be capitalized. When a controlling entity borrows funds which are passed on to a controlled entity with no, or only partial, allocation of borrowing costs, the controlled entity may capitalize only those borrowing costs which it itself has incurred. Where a controlled entity receives an interest-free capital contribution or capital grant, it will not incur any borrowing costs and consequently will not capitalize any such costs.
27. When a controlling entity transfers funds at partial cost to a controlled entity, the controlled entity may capitalize that portion of borrowing costs which it itself has incurred. In the financial statements of the economic entity, the full amount of borrowing costs can be capitalized to the qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalized by the controlled entity.
28. When a controlling entity has transferred funds at no cost to a controlled entity, neither the controlling entity nor the controlled entity would meet the criteria for capitalization of borrowing costs. However, if the economic entity met the criteria for capitalization of borrowing costs, it would be able to capitalize the borrowing costs to the qualifying asset in its financial statements.
29. In some circumstances, it is appropriate to include all borrowings of the controlling entity and its controlled entities when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each controlled entity to use a weighted average of the borrowing costs applicable to its own borrowings.

Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount

30. When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realizable value, the carrying amount is written down or written off in accordance with the requirements of other international and/or national accounting standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other standards.

Commencement of Capitalization

31. **The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when:**
- (a) **Outlays for the asset are being incurred;**
 - (b) **Borrowing costs are being incurred; and**
 - (c) **Activities that are necessary to prepare the asset for its intended use or sale are in progress.**
32. Outlays on a qualifying asset include only those outlays that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. The average carrying amount of the asset during a period, including borrowing costs previously capitalized, is normally a reasonable approximation of the outlays to which the capitalization rate is applied in that period.
33. The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, borrowing costs incurred while land is under development are capitalized during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalization.

Suspension of Capitalization

34. **Capitalization of borrowing costs should be suspended during extended periods in which active development is interrupted, and expensed.**
35. Borrowing costs may be incurred during an extended period in which the activities necessary to prepare an asset for its intended use or sale are interrupted. Such costs are costs of holding partially completed assets and

do not qualify for capitalization. However, capitalization of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalization continues during an extended period needed for inventories to mature or an extended period during which high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.

Cessation of Capitalization

36. **Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.**
37. An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that is outstanding, this indicates that substantially all the activities are complete.
38. **When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.**
39. An office development comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being used while construction continues on other parts. Examples of qualifying assets that need to be complete before any part can be used include an operating theatre in a hospital when all construction must be complete before the theatre may be used; a sewage treatment plant where several processes are carried out in sequence at different parts of the plant; and a bridge forming part of a highway.

Disclosure

40. **The financial statements should disclose:**
 - (a) **The accounting policy adopted for borrowing costs;**
 - (b) **The amount of borrowing costs capitalized during the period; and**
 - (c) **The capitalization rate used to determine the amount of borrowing costs eligible for capitalization (when it was**

necessary to apply a capitalization rate to funds borrowed generally).

Transitional Provisions

41. **When the adoption of this Standard constitutes a change in accounting policy, an entity is encouraged to adjust its financial statements in accordance with IPSAS 3, “Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies.” Alternatively, entities following the allowed alternative treatment should capitalize only those borrowing costs incurred after the effective date of this Standard which meet the criteria for capitalization.**

Effective Date

42. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after July 1, 2001. Earlier application is encouraged.**
43. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity’s annual financial statements covering periods beginning on or after the date of adoption.

Comparison with IAS 23

International Public Sector Accounting Standard (IPSAS) 5, “Borrowing Costs” is drawn primarily from International Accounting Standard (IAS) 23, “Borrowing Costs.” The main differences between IPSAS 5 and IAS 23 are as follows:

- Commentary additional to that in IAS 23 has been included in IPSAS 5 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 5 uses different terminology, in certain instances, from IAS 23. The most significant examples are the use of the terms “entity,” “revenue,” “statement of financial performance,” “statement of financial position” and “net assets/equity” in IPSAS 5. The equivalent terms in IAS 23 are “enterprise,” “income,” “income statement,” “balance sheet” and “equity.”
- IPSAS 5 contains a different set of definitions of technical terms from IAS 23 (paragraph 5).