

PUBLIC BENEFIT ENTITY INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 5 BORROWING COSTS (PBE IPSAS 5)

Issued September 2014 and incorporates amendments to 31 January 2017 other than consequential amendments resulting from early adoption of PBE IFRS 9 *Financial Instruments*

This Standard was issued on 11 September 2014 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 9 October 2014.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date, which is set out in paragraphs 43.1 to 43.2.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Tier 1 and Tier 2 PBE Standard has been issued as part of a revised full set of PBE Standards that incorporate enhancements for not-for-profit public benefit entities.

This Standard, when applied, supersedes PBE IPSAS 5 *Borrowing Costs* issued in May 2013.

PBE IPSAS 5 BORROWING COSTS

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PBE IPSAS 5 BORROWING COSTS

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Public Benefit Entity International Public Sector Accounting Standard 5 *Borrowing Costs* is set out in the objective and paragraphs 1–44. All the paragraphs have equal authority. PBE IPSAS 5 should be read in the context of its objective, the NZASB’s Basis for Conclusions on PBE IPSAS 5, the *Public Benefit Entities’ Conceptual Framework* and Standard XRB A1 *Application of the Accounting Standards Framework*. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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 capitalisation of borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset.

Scope

1. **This Standard shall be applied in accounting for borrowing costs.**
2. [Not used]
- 2.1 **This Standard applies to Tier 1 and Tier 2 public benefit entities.**
- 2.2 **A Tier 2 entity is not required to comply with the requirements in this Standard denoted with an asterisk (*). Where a Tier 2 entity elects to apply a disclosure concession it shall comply with any RDR paragraphs associated with that concession.**
3. [Not used]
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, judgement 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:**

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

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

Terms defined in other PBE Standards are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

Borrowing Costs

6. Borrowing costs may include:
 - (a) Interest on bank overdrafts and short-term and long-term borrowings;
 - (b) Amortisation of discounts or premiums relating to borrowings;
 - (c) Amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
 - (d) Finance charges in respect of finance leases and service concession arrangements; 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 and commercial objectives. For example, an entity providing housing may be an economic entity that includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis. An economic entity may establish a separate entity such as a trust or trading company, to carry out specific functions.

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.
11. [Not used]

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, schools, 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 shall be recognised as an expense in the period in which they are incurred.**
15. Under the benchmark treatment, borrowing costs are recognised as an expense in the period in which they are incurred, regardless of how the borrowings are applied.

Disclosure

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

Borrowing Costs—Allowed Alternative Treatment**Recognition**

17. **Borrowing costs shall be recognised as an expense in the period in which they are incurred, except to the extent that they are capitalised in accordance with paragraph 18.**
18. **Borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset shall be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation shall 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 capitalised as part of the cost of the asset when (a) it is probable that they will result in future economic benefits or service potential to the entity, and (b) the costs can be measured reliably.¹ Other borrowing costs are recognised as an expense in the period in which they are incurred.
20. **Where an entity adopts the allowed alternative treatment, that treatment shall be applied consistently to all borrowing costs that are directly attributable to the acquisition, construction, or production of all qualifying assets of the entity.**

¹ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC10 of PBE IPSAS 1 *Presentation of Financial Statements* discusses the transitional approach to the explanation of reliability

Borrowing Costs Eligible for Capitalisation

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 coordinated 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 that 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 (a) through the use of loans denominated in or linked to foreign currencies, (b) when the economic entity operates in highly inflationary economies, and (c) 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 capitalisation on that asset shall 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 capitalisation 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 capitalisation shall be determined by applying a capitalisation rate to the outlays 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 capitalised during a period shall 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 capitalised. When a controlling entity borrows funds that are passed on to a controlled entity with no, or only partial, allocation of borrowing costs, the controlled entity may capitalise 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 capitalise any such costs.
27. When a controlling entity transfers funds at partial cost to a controlled entity, the controlled entity may capitalise 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 capitalised to the qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalised 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 capitalisation of borrowing costs. However, if the economic entity met the criteria for capitalisation of borrowing costs, it would be able to capitalise 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 realisable value, the carrying amount is written down or written off in accordance with the requirements of PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets* or PBE IPSAS 26 *Impairment of Cash-Generating-Assets* as appropriate. In certain circumstances, the amount of the writedown or writeoff is written back in accordance with those other standards.

Commencement of Capitalisation

31. **The capitalisation of borrowing costs as part of the cost of a qualifying asset shall 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 capitalised, is normally a reasonable approximation of the outlays to which the capitalisation 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 capitalised 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 capitalisation.

Suspension of Capitalisation

34. **Capitalisation of borrowing costs shall 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 capitalisation. However, capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalisation 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, capitalisation 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 Capitalisation

36. **Capitalisation of borrowing costs shall 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, capitalisation of borrowing costs shall 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 (a) an operating theatre in a hospital when all construction must be complete before the theatre may be used, (b) a

sewage treatment plant where several processes are carried out in sequence at different parts of the plant, and (c) a bridge forming part of a highway.

Disclosure

40. An entity shall disclose:

- (a) The accounting policy adopted for borrowing costs;
- (b) The amount of borrowing costs capitalised during the period; and
- *(c) The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation (when it was necessary to apply a capitalisation rate to funds borrowed generally).

Transitional Provisions

41. [Not used]

Effective Date

42–43. [Not used]

- 43.1 A public benefit entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 April 2015. Earlier application is permitted for not-for-profit public benefit entities as long as the full suite of PBE Standards is applied at the same time.
- 43.2 *2016 Omnibus Amendments to PBE Standards*, issued in January 2017, added a footnote to paragraph 19. An entity shall apply that amendment for annual financial statements covering periods beginning on or after 1 January 2017.

Withdrawal and Replacement of PBE IPSAS 5 (May 2013)

44. This Standard, when applied, supersedes PBE IPSAS 5 *Borrowing Costs* issued in May 2013.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, PBE IPSAS 5.

BC1. The New Zealand Accounting Standards Board (NZASB) has modified IPSAS 5 *Borrowing Costs* for application by Tier 1 and Tier 2 public benefit entities. Where applicable, disclosure concessions have been identified for Tier 2 entities and the language generalised for use by public benefit entities. The NZASB considered that the requirements of IPSAS 5 are generally appropriate for application by public benefit entities.

Comparison with IPSAS 5

PBE IPSAS 5 *Borrowing Costs* is drawn from IPSAS 5 *Borrowing Costs*. There are no significant differences between PBE IPSAS 5 and IPSAS 5.

History of Amendments

PBE IPSAS 5 *Borrowing Costs* was issued in September 2014.

This table lists the pronouncements establishing and substantially amending PBE IPSAS 5. The table is based on amendments issued as at 31 January 2017 other than consequential amendments resulting from early adoption of PBE IFRS 9 *Financial Instruments*.

Pronouncements	Date issued	Early operative date	Effective date (annual financial statements ... on or after ...)
PBE IPSAS 5 <i>Borrowing Costs</i>	Sept 2014	Early application is permitted for not-for-profit public benefit entities	1 April 2015
<i>2016 Omnibus Amendments to PBE Standards</i>	Jan 2017	–	1 Jan 2017

Table of Amended Paragraphs in PBE IPSAS 5		
Paragraph affected	How affected	By ... [date]
Paragraph 19	Amended	<i>2016 Omnibus Amendments to PBE Standards</i> [Jan 2017]
Paragraph 43.2	Added	<i>2016 Omnibus Amendments to PBE Standards</i> [Jan 2017]