PROPOSED FINANCIAL REPORTING STANDARD	ED/FRS

Exposure Draft of Proposed

AMENDMENTS TO FRS 23 *BORROWING COSTS*

Comments to be received by 29 August 2006

This exposure draft (ED) contains proposed amendments to FRS 32 *Borrowing Costs*.

This ED should be read in the context of the Preface to Financial Reporting Standards published by the Council on Corporate Disclosure and Governance (CCDG).

This ED is issued by CCDG for comment only and does not necessarily represent the views of CCDG.

Since this ED may be modified as a result of comments received, CCDG would like to hear both from those who agree with the proposals contained in the ED and from those who do not.

Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explain the problem and provide a suggestion for alternative wording with supporting reasoning.

Comments should be submitted in writing, so as to be received by **29 August 2006**, preferably by email to: accounting_stds@acra.gov.sg or addressed to:

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CONTENTS

Introduction

1 This Exposure Draft of Proposed Amendments to FRS 23 *Borrowing Costs* is published as part of the Short-term Convergence project.

2 The objective of the Short-Term Convergence project is to reduce differences between Financial Reporting Standards (FRSs) and US generally accepted accounting principles (US GAAP). The project focuses on differences that can be resolved in a relatively short time and can be addressed outside current and planned major projects. It is one strand of the broader objective of convergence of accounting standards around the world.

3 The proposed amendments to the requirements in FRS 23 for the accounting treatment of borrowing costs result from the consideration of FASB Statement No. 34 *Capitalisation of Interest Cost* (SFAS 34). The proposed amendments eliminate the option in FRS 23 of recognising borrowing costs immediately as an expense, to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. It was concluded that eliminating this option will improve financial reporting and will move closer to the recognition requirements of SFAS 34. The other provisions of FRS 23 are not considered.

Invitation to Comment

CCDG invites comments on the changes to FRS 23 proposed in this Exposure Draft. It would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **29 August 2006**.

Question 1

This Exposure Draft proposes to eliminate the option in FRS 23 of recognising immediately as an expense borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. Do you agree with the proposal? If not, why? What alternative would you propose and why?

Question 2

This Exposure Draft proposes that entities should apply the amendments to borrowing costs for which the commencement date for capitalisation is on or after the effective date. However, an entity would be permitted to designate any date before the effective date and to apply the proposed amendments to borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date. Do you agree with the proposal? If not, why? What alternative would you propose and why?

Proposed Amendments to FRS 23 *Borrowing Costs*

In the Standard, paragraphs 2 and 7–9 and the main heading after paragraph 9 are deleted; the objective and paragraphs 6, 12 and 29 are amended and paragraphs 1, 3, 4, 10, 11, 15, 17, 20, 23, 25 and 27 are changed editorially to improve their style (new text is underlined; deleted text is struck through); and paragraphs 3A, 30A, 30B and 31A are added. Paragraph 5 is included here for reference, but no amendment is proposed.

Objective

This~~e objective of this~~ Standard ~~is to prescribe~~ specifies the accounting treatment for borrowing costs. It ~~This Standard generally~~ requires an entity to capitalise ~~the immediate expensing of~~ borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. ~~However, the Standard permits, as an allowed alternative treatment, the capitalisation of~~ The Standard requires an entity to recognise other borrowing costs as an expense ~~that are directly attributable to the acquisition, construction or production of a qualifying asset~~.

Scope

1 An entity shall apply t~~T~~his Standard ~~shall be applied~~ in accounting for borrowing costs.

2 [Deleted] ~~This Standard supersedes FRS 23 *Capitalisation of Borrowing Costs* approved in 1983.~~

3 The~~is~~ Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.

3A The Standard shall not be applied to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value, for example a biological asset.

Definitions

4 ~~The following terms are used in t~~This Standard uses the following terms with the meanings specified:

***Borrowing costs* are interest and other costs ~~incurred by~~ that an entity incurs in connection with the borrowing of funds.**

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

5 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 recognised in accordance with FRS 17 *Leases*; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

6 Examples of qualifying assets are inventories that require a substantial period of time to bring them to a saleable condition~~,~~ and other assets that take a substantial period of time to get ready for their intended use or sale, such as manufacturing plants, power generation facilities, properties that will become self-constructed investment properties once their construction or development is complete and investment properties measured at cost that are being redeveloped. Other investments, and ~~those~~ inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis 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~~

7 [Deleted] **~~Borrowing costs shall be recognised as an expense in the period in which they are incurred.~~**

8 [Deleted] ~~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~~

9 [Deleted] ~~The financial statements shall disclose the accounting policy adopted for borrowing costs.~~

~~Borrowing costs – allowed alternative treatment~~

Recognition

10 ~~Borrowing costs~~ An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The entity shall recognise other borrowing costs ~~be recognised~~ as an expense in the period in which it incurs them ~~they are incurred, except to the extent that they are capitalised in accordance with paragraph 11~~.

11 ~~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.~~ An entity shall determine ~~T~~the amount of borrowing costs eligible for capitalisation ~~shall be determined~~ in accordance with this Standard.

12 ~~Under the allowed alternative treatment, b~~Borrowing costs that are directly attributable to the acquisition, construction or production of a~~an~~ qualifying asset are included in the cost of that asset. Such borrowing costs are capitalised as part of the cost of the asset when it is probable that they will result in future economic benefits to the entity and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the

period in which they are incurred. When an entity applies FRS 29 *Financial Reporting in Hyperinflationary Economies*, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period in accordance with paragraph 21 of that Standard.

Paragraphs 13, 14, 16, 18 and 19 are unchanged.

Borrowing costs eligible for capitalisation

15 **To the extent that an entity borrows 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~~ it shall determine~~d~~ the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.**

17 **To the extent that an entity borrows funds ~~are borrowed~~ generally and uses~~d~~ them for the purpose of obtaining a qualifying asset, ~~the amount of borrowing costs eligible for capitalisation shall be~~ it shall determine~~d~~ the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures 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 that an entity capitalise~~d~~s during a period shall not exceed the amount of borrowing costs it incurred during that period.**

Commencement of capitalisation

20 **An entity shall begin capitalising ~~The capitalisation of~~ borrowing costs as part of the cost of a qualifying asset ~~shall commence~~ when the entity:**

(a) incurs expenditures for the asset ~~are being incurred~~;

(b) incurs borrowing costs ~~are being incurred~~; and

(c) undertakes activities that are necessary to prepare the asset for its intended use or sale ~~are in progress~~.

Paragraphs 21 and 22 are unchanged.

Suspension of capitalisation

23 **An entity shall suspend ~~C~~capitalisation of borrowing costs ~~shall be suspended~~ during extended periods in which it suspends active development ~~is interrupted~~.**

Paragraph 24 is unchanged.

Cessation of capitalisation

Paragraphs 26 and 28 are unchanged.

25 **An entity shall cease ~~C~~capitalis<u>ing</u>~~ation of~~ borrowing costs ~~shall cease~~ when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.**

27 **When <u>an entity completes</u> 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~~ <u>the entity</u> shall cease <u>capitalising borrowing costs</u> when <u>it completes</u> substantially all the activities necessary to prepare that part for its intended use or sale ~~are completed~~.**

Disclosure

29 **<u>An entity shall disclose</u> ~~The financial statements shall disclose~~:**

(a) <u>[deleted]</u> **~~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.**

Paragraphs 30 and 31 are unchanged.

Transitional provisions

30A **When application of the [draft] amendments that delete paragraphs 7–9 constitutes a change in accounting policy, an entity shall apply the amendments to borrowing costs relating to qualifying assets for which it begins capitalisation on or after the effective date.**

30B **However, an entity may designate any date before the effective date and apply the [draft] amendments to borrowing costs relating to all qualifying assets for which it begins capitalisation on or after that date.**

Effective date

31A **An entity shall apply the [draft] amendments that delete paragraphs 7–9 for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is encouraged. If an entity applies the [draft] amendments for a period beginning before [date to be inserted after exposure], it shall disclose that fact.**

Appendix
Amendments to other pronouncements

The amendments in this [draft] appendix shall be applied for annual periods commencing on or after [date to be inserted after exposure]. If an entity applies the proposed amendments to FRS 23 for an earlier annual period, these amendments shall be applied for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

A1 FRS 101 *First-time Adoption of Financial Reporting Standards* is amended as described below.

Paragraphs 9, 12 and 13 are amended and after paragraph 25G a heading and paragraph 25H are inserted, as follows:

9 The transitional provisions in other FRSs apply to changes in accounting policies made by an entity that already uses FRSs; they do not apply to a *first-time adopter's* transition to FRSs, except as specified in paragraphs 25D, 25H, 34A and 34B.

12 This FRS establishes two categories of exceptions to the principle that an entity's opening FRS balance sheet shall comply with each FRS:

(a) paragraphs 13–25~~G~~H grant exemptions from some requirements of other FRSs.

(b) paragraphs 26–34B prohibit retrospective application of some aspects of other FRSs.

13 An entity may elect to use one or more of the following exemptions:

(a) …

(k) leases (paragraph 25F); ~~and~~

(l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G)~~.~~; and

(m) borrowing costs (paragraph 25H).

An entity shall not apply these exemptions by analogy to other items.

Borrowing costs

25H A first-time adopter may apply the transitional provisions set out in paragraphs 30A and 30B of FRS 23 *Borrowing Costs*. In those paragraphs any reference to the effective date shall be interpreted as [date to be inserted after exposure] or the date of transition to FRSs, whichever is later.

In the Implementation Guidance, paragraphs IG23 and IG24 are amended as follows. Paragraph IG25 is deleted.

IG23 On first adopting FRSs, an entity ~~adopts a policy of~~ begins capitalising borrowing costs (FRS 23) ~~allowed alternative treatment) or not capitalising them (FRS 23 benchmark treatment). The entity applies that policy consistently in its opening~~

~~FRS balance sheet and in all periods presented in its first FRS financial statements~~. In accordance with paragraph 25H of the FRS, an entity:

(a) capitalises borrowing costs relating to qualifying assets for which it begins capitalisation on or after [date to be inserted after exposure] or the date of transition to FRSs (whichever is later);

(b) may elect to designate any date before [date to be inserted after exposure] or the date of transition to FRSs (whichever is later) and to capitalise borrowing costs relating to all qualifying assets for which it begins capitalisation on or after that date.

However, if the entity established a deemed cost for an asset, the entity does not capitalise borrowing costs incurred before the date of the measurement that established the deemed cost.

IG24 ~~Under the allowed alternative treatment,~~ FRS 23 requires disclosure of interest capitalised during the period. Neither FRS 23 nor the FRS requires disclosure of the cumulative amount capitalised.

IG25 [Deleted] ~~FRS 23 contains transitional provisions that encourage retrospective application, but permit an entity that adopts the allowed alternative treatment to capitalise (prospectively) only those borrowing costs incurred after the effective date of FRS 23 that meet the criteria for capitalisation. However, if a first-time adopter adopts the FRS 23 allowed alternative treatment, the FRS requires retrospective application of that treatment, even for periods before the effective date of FRS 23 (paragraph 9 of the FRS).~~

A2 In FRS 1 *Presentation of Financial Statements* paragraph 110 is amended as follows:

110 In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in the reported financial performance and financial position. Disclosure of particular accounting policies is especially useful to users when those policies are selected from alternatives allowed in Standards and Interpretations. An example is disclosure of whether a venturer recognises its interest in a jointly controlled entity using proportionate consolidation or the equity method (see FRS 31 *Interests in Joint Ventures*). Some Standards specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow. For example, FRS 16 requires disclosure of the measurement bases used for classes of property, plant and equipment. ~~FRS 23 *Borrowing Costs* requires disclosure of whether borrowing costs are recognised immediately as an expense or capitalised as part of the cost of qualifying assets.~~

A3 In FRS 7 *Cash Flow Statements* paragraph 32 is amended as follows:

32 The total amount of interest paid during a period is disclosed in the cash flow statement whether it has been recognised as an expense in the income statement or capitalised in accordance with ~~the allowed alternative treatment in~~ FRS 23 *Borrowing Costs*.

A4 In FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, Example 2 of Implementation Guidance is deleted.

A5 In FRS 11 *Construction Contracts*, paragraph 18 is amended as follows:

18 Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:

(a) insurance;

(b) costs of design and technical assistance that are not directly related to a specific contract; and

(c) construction overheads.

Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll. Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs ~~when the contractor adopts the allowed alternative treatment in~~ if they meet the requirements of FRS 23 *Borrowing Costs*.

A6 In FRS 16 *Property, Plant and Equipment*, paragraph 23 is amended as follows:

23 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is recognised in the carrying amount of the item in accordance with ~~the allowed alternative treatment in~~ FRS 23.

A7 In FRS 38 *Intangible Assets*, paragraph 32 is amended as follows:

32 If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with ~~the capitalisation treatment permitted in~~ FRS 23 *Borrowing Costs*.

A8 INT FRS 101 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* is amended as described below.

Paragraph 8 is amended as follows:

8 The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. ~~The allowed alternative treatment of c~~Capitalisation under FRS 23 is not permitted.

In the Basis for Conclusions, the second sentence of paragraph BC26 is footnoted as follows:

BC26 The issue whether the unwinding of the discount is a borrowing cost for the purposes of FRS 23 *Borrowing Costs* was considered. This question arises because if the unwinding of the discount rate were deemed a borrowing cost for the purposes of FRS 23, in certain circumstances this amount might be capitalised under the allowed alternative treatment of capitalisation.* ...

* In [date to be inserted after exposure], FRS 23 was amended to require the previously allowed alternative treatment of capitalisation. Capitalisation of borrowing costs for a qualifying asset becomes the only accounting treatment. That amendment does not affect the reasoning set out in this paragraph.