Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, AASB 123.

Background

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's considerations in reaching the conclusions in this Standard. Individual Board members gave greater weight to some factors than to others.

BC2 Before the mandatory application date of revised AASB 123 *Borrowing Costs* in 2009, the Board conducted a review of the requirement in AASB 123 for not-for-profit entities to 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. As a result of that review, in April 2009 the Board issued AASB 2009-1 *Amendments to Australian Accounting Standards – Borrowing Costs of Not-for-Profit Public Sector Entities*. AASB 2009-1 amended AASB 123 to allow not-for-profit public sector entities to expense borrowing costs as incurred, regardless of how the borrowings are applied.

BC3 The Board intended for the relief granted under AASB 2009-1 to be of an interim nature pending the outcome of:

(a) the work of the New Zealand Financial Reporting Standards Board (FRSB)[1] on the relationship between depreciated replacement cost and borrowing costs, in which the AASB agreed to participate;

(b) the AASB and FRSB work on developing a Process for Modifying, or Introducing Additional Requirements to, IFRSs for PBE/NFP; and

(c) the International Public Sector Accounting Standards Board's (IPSASB's) Borrowing Costs project.

BC4 In March 2011, the AASB decided to reactivate its project on the application of AASB 123 by not-for-profit public sector entities, and evaluate the election for not-for-profit public sector entities to expense immediately all borrowing costs against its *Process for Modifying IFRSs for PBE/NFP ('Process')*.

BC5 In September 2014, the Board discussed the modification for not-for-profit public sector entities to expense borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset against its *Process*. The Board noted that the International Valuation Standards Council issued Technical Information Paper 2 *The Cost Approach for Tangible Assets* in April 2012, which includes discussion of inputs included in a model based on the cost approach, and that the IPSASB's Borrowing Cost project was on hold pending completion of the IPSASB's Conceptual Framework project.

BC6 The Board noted that it would not be appropriate for the accounting for borrowing costs of not-for-profit public sector entities to differ from that of for-profit entities merely because the Board may favour a different treatment conceptually. The Board confirmed that departure from the requirements of IAS 23 *Borrowing Costs* should only be permitted where not-for-profit specific reasons for departure exist.

BC7 The Board decided, on evaluation of IAS 23 against its *Process*, that the modification for not-for-profit public sector entities should be retained in AASB 123. The Board decided to add a Basis for Conclusions to AASB 123 to reflect its conclusions in this regard.

Significant issues

GAAP/GFS convergence

BC8 The Board weighed its policy on GAAP/GFS harmonisation against its policy of transaction neutrality, noting that requiring not-for-profit public sector entities to 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 would create a further difference between Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS). The Board considered the costs of tracking reconciling differences

1 The FRSB has since been succeeded by the New Zealand Accounting Standards Board (NZASB).

over the useful life of the assets, and noted that public sector infrastructure assets may have a longer useful life than most assets held by private sector entities.

Borrowing by not-for-profit public sector entities

BC9 The Board discussed the nature of borrowing in the public sector. The Board observed that borrowing can be related to funding government activities or, in the case of the Commonwealth and depending on the economic circumstances, might have a public policy purpose such as supporting a domestic bond market.

BC10 The Board noted that Australian governments generally use centralised borrowing agencies and the distribution of borrowings to government departments or other agencies could take a different form to the initial debt raising, and that there may be little nexus between centralised borrowings and the individual qualifying assets in a government entity. Similarities in the use of centralised borrowing activities between the Australian government and large private sector entities were considered. The Board also noted that the level of complexity in terms of the number of lines of credit and the number of group entities responsible for acquiring or constructing qualifying assets is likely to be greater than that of the for-profit sector.

BC11 However, the Board also observed that the Standard envisages that entities may borrow centrally and acknowledges that this can create difficulties for determining whether a direct relationship between particular borrowings and a qualifying asset exists, and that the exercise of judgement would be required in such situations.

Measurement of property, plant and equipment by not-for-profit public sector entities

BC12 The Board discussed the prevailing practice in the Australian not-for-profit public sector of revaluing property, plant and equipment subsequent to initial measurement and recognition. The Board noted that the relatively brief time for which government-constructed assets would be qualifying assets that are measured at cost means that any benefit from including capitalising borrowing costs in the initial measurement of an asset would be very limited, as capitalising borrowing costs is consistent with a cost measurement model. This is particularly the case in the context of long-lived assets such as infrastructure assets, on the basis that the relative time for which an asset is likely to be measured at fair value would be significantly longer than the time for which the asset is under construction (and measured at cost).

Balance of costs and benefits

BC13 The Board concluded that it is appropriate to depart from its policy of transaction neutrality for cost-benefit reasons. The Board considered that the costs of requiring not-for-profit public sector entities to capitalise borrowing costs associated with qualifying assets would generally be at least as great as they are for private sector entities, but that any benefits would not be as great due to the prevalence in the public sector of the practice of revaluing property, plant and equipment to fair value.

BC14 The Board observed that the relief in paragraphs Aus8.1 and Aus8.2 does not prevent a not-for-profit public sector entity from adopting an accounting policy of capitalising borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.