INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

IPSAS 5—BORROWING COSTS

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Acknowledgment

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IPSAS 5—BORROWING COSTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 5, *Borrowing Costs* was issued in May 2000.

Since then, IPSAS 5 has been amended by the following IPSASs:

- IPSAS 43, *Leases* (issued January 2022)
- Amendments to IPSAS 5, *Borrowing Costs – Non-Authoritative Guidance* (issued November 2021)
- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- *Improvements to IPSAS 2019* (issued January 2020)
- *Improvements to IPSAS 2018* (issued October 2018)
- *The Applicability of IPSASs* (issued April 2016)
- *Improvements to IPSASs 2015* (issued April 2016)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- IPSAS 32, *Service Concession Arrangements: Grantor* (issued October 2011)

Table of Amended Paragraphs in IPSAS 5

Paragraph Affected	How Affected	Affected By
2	Deleted	The Applicability of IPSASs April 2016
3	Deleted	The Applicability of IPSASs April 2016
6	Amended	Improvements to IPSAS January 2020 IPSAS 32 October 2011 IPSAS 43 January 2022
11	Deleted	The Applicability of IPSASs April 2016
19	Amended	Improvements to IPSASs April 2016
25	Amended	Improvements to IPSAS October 2018
41	Deleted	IPSAS 33 January 2015
41A	New	Improvements to IPSAS October 2018
42A	New	IPSAS 32 October 2011
42B	New	IPSAS 33 January 2015
42C	New	The Applicability of IPSASs April 2016
42D	New	Improvements to IPSAS October 2018
42E	Amended	COVID-19: Deferral of Effective Dates November 2020
42F	New	IPSAS 43 January 2022
43	Amended	IPSAS 33 January 2015
A.1	New	Amendments to IPSAS 5 November 2021
A.2	New	Amendments to IPSAS 5 November 2021
A.3	New	Amendments to IPSAS 5 November 2021
A.4	New	Amendments to IPSAS 5 November 2021
A.5	New	Amendments to IPSAS 5 November 2021

Paragraph Affected	How Affected	Affected By
A.6	New	Amendments to IPSAS 5 November 2021
Heading above paragraph IE1	New	Amendments to IPSAS 5 November 2021
IE1	New	Amendments to IPSAS 5 November 2021
IE2	New	Amendments to IPSAS 5 November 2021
IE3	New	Amendments to IPSAS 5 November 2021
IE4	New	Amendments to IPSAS 5 November 2021
Heading above paragraph IE5	New	Amendments to IPSAS 5 November 2021
IE5	New	Amendments to IPSAS 5 November 2021
IE6	New	Amendments to IPSAS 5 November 2021
IE7	New	Amendments to IPSAS 5 November 2021
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Heading above paragraph IE10	New	Amendments to IPSAS 5 November 2021
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Heading above paragraph IE14	New	Amendments to IPSAS 5 November 2021
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IPSAS 5—BORROWING COSTS

CONTENTS

International Public Sector Accounting Standard 5, *Borrowing Costs*, is set out in the objective and paragraphs 1–43. All the paragraphs have equal authority. IPSAS 5 should be read in the context of its objective, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. 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 capitalization 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. [Deleted]

3. [Deleted]

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:**

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

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

   Terms defined in other IPSASs 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 expense calculated using the effective interest method as described in IPSAS 41, Financial Instruments;

   (b) [Deleted]

   (c) [Deleted]

   (d) Interest in respect of leases liabilities 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 policy and commercial objectives. For example, a government housing department 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.

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. [Deleted]

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 shall 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 shall disclose the accounting policy adopted for borrowing costs.**

Borrowing Costs—Allowed Alternative Treatment

Recognition

17. **Borrowing costs shall 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 shall be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization 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 capitalized 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 recognized 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.**

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 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,

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[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 BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

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 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 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 shall be determined by applying a capitalization rate to the outlays on that asset. The capitalization rate shall be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period. However, an entity shall exclude from this calculation borrowing costs applicable to borrowings made specifically for the purpose of obtaining a qualifying asset until substantially all the activities necessary to prepare that asset for its intended use or sale are complete. The amount of borrowing costs capitalized 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 capitalized. 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 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 IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate. 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 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 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 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 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 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, capitalization 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. **The financial statements shall 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. [Deleted]

41A. *Improvements to IPSAS, 2018*, issued in October 2018, amended paragraph 25. An entity shall apply this amendment to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments.

Effective Date

42. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after July 1, 2001. Earlier application is encouraged. If an entity applies this Standard for a period beginning before July 1, 2001, it shall disclose that fact.**

42A. **Paragraph 6 was amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 5, 7 and 107C of IPSAS 17, the amendments to paragraphs 2 and 125A of IPSAS 29 and the amendments to paragraphs 6 and 132A of IPSAS 31.**

42B. **Paragraphs 41 and 43 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

42C. **Paragraphs 2, 3 and 11 were deleted by *The Applicability of IPSASs*, issued in April 2016. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2018. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2018, it shall disclose that fact.**

42D. **Paragraph 25 was amended and paragraph 41A added by *Improvements to IPSAS, 2018*, issued in October 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is permitted. If an entity applies these amendments for a period beginning before January 1, 2019, it shall disclose that fact.**

42E. **Paragraph 6 was amended by *Improvements to IPSAS, 2019*, issued in January 2020. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies this amendment for a period beginning before January 1, 2023, it shall disclose that fact and apply IPSAS 41 at the same time.**

42F. **Paragraph 6 was amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.**

43. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* 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 of IPSASs.

Basis for Conclusions

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

Revision of IPSAS 5 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC1. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Revision of IPSAS 5 as a result of *Improvements to IPSAS, 2018*

BC2. The IPSASB reviewed the revisions to IAS 23, *Borrowing Costs*, included in *Annual Improvements to IFRS® Standards 2015–2017 Cycle* issued by the IASB in December 2017, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions. The IPSASB noted that, although IPSAS 5 and IAS 23 have diverged, the accounting for the allowed alternative treatment in IPSAS 5 is consistent with the accounting in IAS 23. The IPSASB agreed, therefore, that there was no public sector specific reason for not adopting the amendments. The IPSASB concurred with the IASB's view that the costs of applying the amendments retrospectively might exceed the potential benefits of doing so. Consequently, an entity applies the amendments only to borrowing costs incurred on or after the date it first applies the amendments.

Revision of IPSAS 5 as a result of *Improvements to IPSAS, 2019*

BC3. The amendments to paragraph 6 update the guidance related to the components of borrowing costs resulting from IPSAS 41, *Financial Instruments* which were inadvertently omitted when IPSAS 41 was issued. The IPSASB agreed to include these minor amendments in *Improvements to IPSAS, 2019*.

Revision of IPSAS 5 as a result of *COVID-19: Deferral of Effective Dates*

BC4. The IPSASB published *Improvements to IPSAS*, *2019* in January 2020, which included amendments to IPSAS 5, *Borrowing Costs*. At the time these amendments were finalized, the Board decided that an entity shall apply them for annual financial statements covering periods beginning on or after January 1, 2022.

BC5. In June 2020, the IPSASB discussed the effect of the COVID-19 pandemic on financial reporting. The Board noted that the pandemic has created significant pressures on the resources public sector entities might otherwise allocate to the implementation of these amendments.

BC6. The Board concluded that deferral during a time of significant disruption would provide much-needed operational relief to public sector entities. Therefore, the Board decided to propose a one-year deferral of the effective date of these amendments.

BC7. The Board did not propose any changes to the amendments other than the deferral of the effective date. Earlier application of the amendments will continue to be permitted.

Revision of IPSAS 5 as a result of the IPSASB's Consultation Paper, *Measurement*, issued in April 2019

BC8. In April 2019, the IPSASB published the Consultation Paper, *Measurement*. The Consultation Paper proposed a comprehensive framework outlining how measurement bases should be determined when applied in the context of IPSAS. One of the objectives of the Consultation Paper was to seek feedback on whether one of the accounting policy choices in IPSAS 5, *Borrowing Costs* should be removed.

BC9. IPSAS 5 permits two accounting policy choices for borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset: capitalization or recognition as an expense.

BC10. The IPSASB proposed eliminating the option to capitalize borrowing costs in order to:

(a) Address a public sector issue where borrowing is centralized and determined for the economic entity as a whole. Expensing borrowing costs lessens the burden of attributing centralized borrowing costs to specific projects within the public sector;

(b) Enhance comparability between the cost of the acquisition, construction, or production of a qualifying asset between public sector entities; and

(c) Align more closely with the requirements in the Government Finance Statistics Manual (GFSM) 2014.

BC11. In developing its preliminary view, the IPSASB acknowledged the complexity of the issue. This complexity, and opposing views on what should be included in cost, resulted in responses to the preliminary view being split with many respondents supporting the Board's proposal, and equally, many respondents disagreeing. Those that disagreed with the proposal to remove the existing accounting policy choice considered that the reasons given for doing so were insufficient. They argued that:

(a) The difficulties in attributing borrowing costs to specific projects in the public sector were overstated and were an insufficient reason to diverge from private sector accounting treatment. Large conglomerates in the private sector face similar challenges and are able to capitalize borrowing costs;

(b) Borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset are part of the cost of that asset. During the period when an asset is under development, the outlays for the resources used must be financed. Financing has a cost. The cost of the asset should include all costs necessarily incurred to get the asset ready for its intended use or sale, including the cost incurred in financing the outlays as a part of the asset's acquisition, construction, or production cost;

(c) Capitalizing directly attributable borrowing costs enhances accountability and decision making; and

(d) Immediate expensing of borrowing costs would be inconsistent with the requirements in other standards to capitalize transaction costs directly attributable to the acquisition, construction, or production of a qualifying asset.

BC12. Having reviewed the responses, the IPSASB decided to retain the existing accounting policy choice. This approach enables preparers to select the policy that best achieves the measurement objective of the qualifying asset.

BC13. The IPSASB observed the existing accounting policy choice is consistent with the measurement principles in the Conceptual Framework and allows preparers of public sector financial statements to consider the qualitative characteristics of useful information when selecting an approach that most faithfully represents the cost of the asset.

BC14. Further supporting its decision to retain the accounting policy choice, the IPSASB noted the following:

(a) Both capitalizing borrowing costs and expensing borrowing costs have technical merits. In some cases, respondents took opposite views: for example, on whether borrowing costs are an attribute of the cost of an asset;

(b) The goal of the approach when accounting for borrowing costs is to assist financial statement users in obtaining the most appropriate reflection of acquisition, construction, or production costs of a qualifying asset, which may in some cases include borrowing costs;

(c) While at certain levels of government the allocation of borrowing costs is challenging, at other levels, such as at the local government levels, it can be relatively straightforward;

(d) Capitalization of borrowing costs would align with IFRS where that is an economic entity's preferred approach, whereas the expensing of borrowing costs would demonstrate alignment with GFS if that is an economic entity's preferred approach; and

(e) There would need to be a clear benefit to expensing all borrowing costs before the IPSASB would remove the existing accounting policy choice to capitalize borrowing costs. Because there are unavoidable costs in eliminating an accounting policy choice, the IPSASB carefully considered the costs and benefits of any new pronouncement. In this case, the IPSASB had not been informed that preparers who elected to capitalize borrowing costs under IPSAS 5 found doing so unnecessarily burdensome.

BC15. Some respondents to the Consultation Paper identified practical public sector challenges in capitalizing borrowing costs. The IPSASB therefore developed Implementation Guidance and Illustrative Examples to assist entities in determining the extent to which borrowing costs can be capitalized.

Distinction between borrowing costs and transaction costs

BC16. In reaching the conclusion to retain the accounting policy choice, the IPSASB noted that accounting for borrowing costs may not be consistent with accounting for transaction costs. Some respondents proposed that the accounting treatment of borrowing costs and transaction costs should be consistent because they considered either:

(a) Borrowing costs to be a type of transaction costs. Borrowing costs are directly attributable to the borrowing (for example, the issuance of a government financial instrument). Therefore, they meet the criteria of a transaction cost; or

(b) Transaction costs to be a type of borrowing costs. Some respondents proposed this view based on the methodology applied in calculating the effective interest rate of a financial instrument. This is because some transaction costs are added to, or subtracted from, the principal amount of a financial instrument when determining the gross proceeds of a borrowing in order to determine the effective interest rate.

BC17. The IPSASB considered these views, but decided that borrowing costs and transaction costs are different economic phenomena. The IPSASB concluded it is appropriate for the accounting principles to differ for each type of “cost” depending on the facts and circumstances.

BC18. In reaching this view, the IPSASB noted that borrowing costs comprise interest and other expenses incurred by an entity in connection with borrowing funds. Borrowing costs are often contractually linked to the underlying borrowing. Should the borrowing be transferred, the borrowing costs would either be transferred to the new counterparty or separated contractually.

BC19. Transaction costs are incremental costs directly attributable to the transaction. However, transaction costs are independent of the contractual terms of the debt instrument. Should the debt instrument be transferred, the entity transferring the instrument is generally not compensated for the transaction costs because they are not transferred to the counterparty assuming the instrument.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 5.

A.1 Period of Borrowing Cost Capitalization

When applying the allowed alternative treatment, as described in paragraphs 17–18, when can an entity begin to include borrowing costs in the cost of the qualifying asset?

Where outlays and borrowings have been incurred specifically to fund a qualifying asset's acquisition, construction, or production, the costs of those borrowings should be capitalized when the activities necessary to prepare the asset for its intended use or sale begin. The activities necessary to get the asset ready for use encompass more than the asset's physical acquisition, construction, or production. The activities include technical and administrative work prior to the commencement of physical acquisition, construction, or production, but exclude holding the asset when no development that changes the asset's condition is being undertaken.

The activities (i.e., technical and administrative work) undertaken prior to commencement of the physical acquisition, construction, or production of a qualifying asset should contribute to the actual development or construction of that asset.

A.2 Limit on Capitalization

When applying the allowed alternative treatment, as described in paragraphs 17–18, to specific borrowings, are borrowing costs included in the cost of the qualifying asset in that period limited to the borrowing costs incurred in that period?

Yes. If a borrowing can be specifically associated with outlays on acquisition, construction, or production of a qualifying asset, the amount of borrowing costs capitalized during that period is limited to the borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

A.3 Asset Funded through Transfers

In many jurisdictions, the acquisition, construction, or production of a qualifying asset is funded through a transfer from another public sector entity. Does the entity acquiring, constructing, or producing the qualifying asset consider the transferor's underlying source of the funds, i.e., whether the funds are generated by tax revenues, general cash holdings or borrowings, when it determines the amount that can be included in the cost of the qualifying asset when applying the allowed alternative treatment, as described in paragraphs 17–18?

No. When the acquisition, construction, or production of a qualifying asset is fully funded through a transfer, there will be no directly attributable borrowing costs to capitalize. The entity may include in the cost of the qualifying asset only those borrowing costs which it has incurred.

A.4 Asset Funded through a Centralized Lending Program – Interest Rates

A centralized lending agency may fund its activities by borrowings through several separate loan instruments. Each instrument may have a different interest rate. An entity may borrow funds from the centralized lending agency and use these funds for the acquisition, construction, or production of a qualifying asset. If the entity is using the allowed alternative treatment, as described in paragraphs 17–18, does the entity apply the weighted average interest rate incurred by the centralized lending agency when including borrowing costs in the cost of the qualifying asset?

No. The weighted average interest rate incurred by the centralized lending agency is not relevant in the preparation of the financial statements of the entity acquiring, constructing, or producing the qualifying asset. The entity can include in the cost of the qualifying asset only those borrowing costs which it itself has incurred.

The entity must consider all facts and circumstances when determining the borrowing costs incurred in its arrangement with the centralized lending agency. In some cases, the interest rate stated in the terms of the arrangement may not reflect the true borrowing costs associated with the funds received. When the entity identifies concessionary terms, the entity should apply the requirements in IPSAS 41, *Financial Instruments*, paragraphs AG118–AG127[1] and capitalize borrowing costs based on a market related interest rate that the entity would have incurred on a similar loan (see IPSAS 41, IE153-IE172 for examples illustrating how to determine the interest rate in a concessionary loan). Interest expense calculated using the effective interest rate method is eligible for inclusion in the cost of the qualifying asset in accordance with this Standard.

If the centralized lending agency and the entity to which it lends funds are part of the same economic entity, in the financial statements of the consolidated entity, the borrowing costs incurred by the centralized lending agency can be capitalized to the qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalized by the controlled entity.

A.5 Asset Funded through an Entity's Own General Borrowing – Borrowings are not Specific to Qualifying Asset

When an entity acquiring, constructing, or producing a qualifying asset manages its own borrowing program, but borrowings are not specific to the qualifying asset, how does the entity determine the borrowing costs directly attributable to the qualifying asset? This may occur when an entity uses cash on hand to fund the cost of a qualifying asset. This cash on hand is funded from general borrowings, tax revenue and other fees and transfers.

The amount of borrowing costs eligible for inclusion in the cost of the qualifying asset is determined using the weighted average of the borrowing costs applicable to all borrowings of the entity outstanding during the period. The weighted average of borrowing costs is then applied to the outlays on the qualifying asset incurred during the period in determining the amount eligible for capitalization.

The entity shall exclude from the weighted average calculation, those borrowings that are made specifically for the purpose of obtaining another qualifying asset until substantially all the activities necessary to prepare that asset for its intended use are complete. The amount of borrowing costs capitalized during a period shall not exceed the amount of borrowing costs incurred during that period.

A.6 Asset Funded through General Borrowings – Range of Debt Instruments

Does an entity apply a weighted average of borrowing costs when multiple debt instruments are used to fund the cost of a qualifying asset?

Yes. An entity may not be able to fund the cost of a qualifying asset with a single debt instrument. When multiple debt instruments are used, the cost of borrowing is determined by calculating the weighted average of the borrowing costs applicable to all the debt instruments outstanding during the period, excluding borrowings that are made specifically for the purpose of obtaining another qualifying asset (until substantially all the activities necessary to prepare that asset for its intended use are complete).

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[1] Where an entity has not yet adopted IPSAS 41, the requirements in IPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraphs AG84-AG90 are applied. Similar to the IPSAS 41 requirements, an entity should capitalize borrowing costs based on a market related interest rate that the constructing entity would have incurred on a similar loan.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 5.

Qualifying Asset Constructed Over a Period of Time

IE1. On March 31, 20X1, Municipality XYZ begins construction of a tunnel to accommodate transit between two commercial hubs. The construction period is 5 years and the project is budgeted to cost CU100 million (CU20 million is paid to the construction company on the date the construction begins and on March 31 of each subsequent year during the construction period). Municipality XYZ issues a 25-year CU100 million bond on March 31, 20X1 that yields a fixed coupon of 5 per cent per annum. This bond was issued specifically to finance the construction of this project. The Municipality has a December 31 year end and earns a rate of interest of 3 percent on the temporary investment of any excess borrowings.

IE2. On December 31, 20X1, the Municipality has accrued borrowing costs of CU3.75 million (CU100 million x 5 percent x 9/12 months).

IE3. In determining the borrowing costs that can be included in the cost of the tunnel, the Municipality is limited to capitalizing the borrowing costs incurred during the period less any investment income on the temporary investment of those borrowings.

IE4. At December 31, 20X1, Municipality XYZ recognizes its tunnel asset as a work in progress. The amount capitalized is CU21.95 million (CU20 million + [CU100 million x 5 percent x 9/12 months] – [CU80 million x 3 percent x 9/12 months]). This represents the funds transferred to the construction company and the borrowing costs incurred during the period less the investment income earned on the CU80 million invested.

Centralized Borrowing Program – Eligible Borrowing Costs

IE5. The Department of Infrastructure begins construction of a new road network on June 15, 20X1. The project costs are budgeted to be CU500 million. All financing required by the Department of Infrastructure, and all other government departments, is secured centrally by the Department of Finance.

IE6. The Department of Finance estimates its cash flow needs on an annual basis in order to determine the most appropriate source of funding to meet its internal lending needs. These sources include tax revenue, fee revenue, bonds issuances and loans.

IE7. The Department of Infrastructure negotiates a 10-year loan from the Department of Finance. The Department of Finance requires the Department of Infrastructure to pay borrowing costs of 3 percent per annum. This is consistent with the market rate of interest the Department of Infrastructure would incur if the arrangement was negotiated at arm's length.

IE8. When the Department of Infrastructure secures financing from the Department of Finance, the Department of Infrastructure is aware borrowings comprise various sources, but has no visibility of how the Department of Finance sources the funds, nor of the weighted average borrowing costs the Department of Finance incurs.

IE9. In determining the borrowing costs eligible for inclusion in the cost of the road network, the Department of Infrastructure includes only those borrowing costs which it itself has incurred. Because the loan is at market terms, the Department of Infrastructure concludes there are no concessionary elements and determines borrowing costs eligible for inclusion in the cost of the road network are based on the interest rate of 3 percent stated in the contract.

General Borrowing – Weighted Average Cost of Borrowing

IE10. State Government T has begun construction of a new airport. The cost of this airport is budgeted to be CU500 million. State Government T manages its own borrowings; however, it does not borrow for specific projects. In determining its borrowing needs, State Government T budgets its cash shortfall over a given period and ensures borrowings will cover its liquidity needs.

IE11. Over the construction period, State Government T held three instruments that were open for the entire construction period:

- State Bonds – CU1 billion, yielding an annual rate of 5 percent;
- Loan with Financial Institution A – CU300 million, with an annual interest rate of 7 percent; and
- Loan with Financial Institution B – CU600 million, with an annual interest rate of 9 percent.

IE12. In determining the amount of borrowing costs eligible for inclusion in the cost of the airport, State Government T calculates the weighted average of the borrowing costs applicable to all borrowings of the entity outstanding during the period.

	A	B	C	D = B x C
	Principal	**Interest Rate**	**Proportion of Debt**	**Weighted Average**
State Bonds	CU1,000 million	5 percent	1,000 / 1,900	2.63
Loan A	CU300 million	7 percent	300 / 1,900	1.11
Loan B	CU600 million	9 percent	600 / 1,900	2.84
Weighted Average Interest Rate				**6.58 percent**

IE13. State Government T calculates the weighted average of the borrowing costs applicable to all borrowings of the entity outstanding during the period to be 6.58 percent.

Specific Borrowing – Borrowing for Part of Qualifying Asset's Amount

IE14. State Government C began construction of a new road network on January 1, 20X1. The cost of this road network is budgeted to be CU750 million. State Government C funds this project with amounts received on January 1, 20X1 from two sources:

- Federal grant in the amount of CU500 million; and
- Loan from a financial institution of CU250 million, with an annual interest rate of 5 percent.

In order to receive the federal grant, State Government C was required to show it was able to secure financing. It is State Government C's policy to allocate borrowed funds to the construction of the qualifying asset first. State Government C earns a rate of interest of 3 percent on the temporary investment of any excess borrowings.

IE15. As at December 31, 20X1, State Government C has incurred outlays of CU200 million as part of the construction of the asset. These outlays were transferred in one lump sum payment to the construction company at the commencement of construction on January 1, 20X1. In addition to the outlays of CU200 million, State Government C capitalizes CU11 million ([CU250 million x 5 percent] – [CU50 million x 3 percent]) in borrowing costs, against the qualifying asset.

IE16. Because State Government C borrowed CU250 million for the purposes of obtaining the road network, but has only incurred outlays related to that qualifying asset in the amount of CU200 million, State Government C was able to earn interest revenue on the excess funds borrowed. State Government C capitalized borrowing costs incurred during the period of CU12.5 million less the investment income of CU1.5 million on the temporary investment of those borrowings.

Comparison with IAS 23

IPSAS 5, *Borrowing Costs* is drawn primarily from IAS 23, *Borrowing Costs* (1993). The main differences between IPSAS 5 and IAS 23 are as follows:

- IPSAS 5 uses different terminology, in certain instances, from IAS 23. The most significant examples are the use of the terms "revenue," "statement of financial performance," and "net assets/equity" in IPSAS 5. The equivalent terms in IAS 23 are "income," "income statement," and "equity."
- IPSAS 5 contains a different set of definitions of technical terms from IAS 23 (paragraph 5).