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IAS 23 Amendments  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
UK

**DRAFT COMMENT LETTER**

Comments should be sent to [Commentletter@efrag.org](mailto:Commentletter@efrag.org) by  
28 September 2006

Dear Sir/Madam

**Re: Exposure Draft of Proposed Amendments to IAS 23 *Borrowing Costs***

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft of Proposed Amendments to IAS 23 *Borrowing Costs*. This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS on the issue.

Firstly we think it worth repeating what we have said before: we support the IFRS/US GAAP convergence project, although we do not believe it appropriate to pursue convergence regardless of the cost. However, having studied the proposals we have two concerns:

- 1 Although the effect of the proposals if implemented will be that companies reporting under IFRS will, like companies reporting in under US GAAP, will be required to capitalise any borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, the amounts that will be capitalised will continue to be different (because the proposals address only one of the differences between IFRS and US GAAP and do not, for example, address the differences that exist as to the composition of the costs and the calculation techniques).
- 2 The objective of an IASB/FASB short-term convergence project is to converge around whichever is considered to be the better of the two sets of requirements. Although that is an appropriate objective for a short-term convergence project, we are not wholly convinced that the existing approach to the capitalisation of actual borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset is preferable to immediate expensing. We would have preferred a more comprehensive review of the strengths and weaknesses of each approach to be undertaken before a conclusion on the matter was reached.

For those reasons, EFRAG questions the wisdom of making the changes proposed at this time. Companies that wish to adopt the US practice of capitalising borrowing costs are already able to do so under existing IFRS, so the proposals are of no benefit to them. Nor of course are the proposed changes of any benefit to companies wishing to continue expensing borrowing costs—indeed, the proposed changes are likely to be viewed more as a burden. Eliminating options in accounting standards helps to simplify the accounting requirements and therefore should in theory make things easier for users; however, the convergence achieved in this case is less than full—and the differences that remain sufficiently important—that we doubt that the proposed change will benefit users to any noticeable extent.

***Question to commentators:***

EFRAG would like to hear commentators' views on whether it would be preferable to insert the paragraphs below in place of the paragraph immediately above ("For those reasons...").

"However, although the IASB's borrowing costs proposals represent a relatively small step towards convergence in this area, it *is* nevertheless a step towards a goal that we support and we accept that not all such steps can be big ones. Furthermore, much importance is attached by many people on both sides of the Atlantic to the elimination of the existing SEC requirement for an IFRS/US GAAP reconciliation; and, although the proposals will achieve less than full convergence, we understand that amount of convergence in this area is likely to be sufficient for the SEC's purposes. Finally, although we think it would have been preferable to carry out the more comprehensive review referred to in paragraph 2 above, we accept that capitalisation is likely to be part of the eventual approach so the proposed change represents a step in the right direction.

For all those reasons on balance we support the proposal in the ED. However, we would hope that the IASB will carry out a more comprehensive piece of work in this area in the near future to address the concerns we have raised in paragraphs 1 and 2 above. We also recommend making it clear in the Basis for Conclusions that a significant factor in proceeding with this proposal is the desire to eliminate the existing reconciliation requirement."

Our detailed answers to the questions are stated in the attached note.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact either Svetlana Pereverzeva or me.

Yours sincerely

Stig Enevoldsen  
**EFRAG, Chairman**

## Question 1

**This Exposure Draft proposes to eliminate the option in IAS 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?**

We recognise that the change proposed by this ED is introduced as part of the convergence with US GAAP and is understood by the IASB to achieve sufficient convergence to result in elimination of the reconciliation requirement in relation to the recognition of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset.

However, we are concerned that the proposals will nevertheless not result in less than full alignment of the accounting. A number of inconsistencies (most significantly composition of the costs under consideration and the calculation techniques) will continue to exist thus resulting in the amounts capitalised under IFRS and US GAAP being different. We therefore question the usefulness of the proposed change. That is particularly so bearing in mind that preparers already have an option of capitalisation and those wishing to achieve the amount of convergence with US GAAP that the proposed amendment achieves can simply follow this option.

The IASB has stated that the objective, when a short-term convergence project is involved, is to converge around whichever is considered to be the better of IFRS and US GAAP. We accept that, if one is adopting a cost-based (or probably even mixed measurement-based) accruals approach, it would seem logical to capitalise expenses directly attributable to the acquisition, construction or production of a capitalised asset. However, EFRAG believes that there are a number of related issues—including the attribution of borrowing costs to assets—that it would be preferable to consider further and address appropriately before reaching a conclusion as to whether the capitalisation approach proposed more appropriately meets the objectives of financial reporting than immediate expensing.

Regardless of convergence, we generally favour elimination of options in accounting standards, not least because it usually results in users benefiting from a simplified accounting framework. However, although these proposals eliminate an option, we do not believe they will benefit users to any noticeable degree because the differences between IFRS and US GAAP mean that, for example, the amounts capitalised will differ.

For these reasons we do not support the proposal.

OR

Notwithstanding these concerns, we support the proposal because:

- 1 although it does not achieve full convergence, it is a step in that direction;
- 2 it appears to enable one of the targets set by the roadmap to be met; and
- 3 although we think further work is needed to ensure that this particular capitalisation approach is preferable to immediate expensing, we accept that capitalisation is likely to be part of the eventual approach so the proposals represent a step in the right direction. We urge the IASB to continue its work in this area in order to more fully address the concerns raised in this letter.

Finally, we note that one argument used in the Basis of Conclusion (BC 10) of the Exposure Draft in favour of the capitalisation of borrowing costs is that it “enhances comparability between assets that are internally developed and those acquired from third parties”. However, all other things being equal the amount capitalised will still not be the same because a profit margin is not usually included in the cost of internally developed assets. This suggests either that the comparability argument is not really appropriate or that the IASB has an elaborated understanding as to what comparability involves when the transactions are different—in which case it would be useful to explain that understanding for wider debate.

## **Question 2**

**This Exposure Draft proposes that entities shall apply the amendments to borrowing costs for which the commencement date is on or after the effective date. However, an entity is permitted to designate any date before the effective date and to apply the [draft] 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?***

While we generally favour retrospective application, in this instance we concur with the Board’s assessment that the cost of retrospective application would outweigh the benefits. We also understand and agree with the Board’s rationale for allowing entities to apply the amendment from any date before the effective date. Therefore, we support the proposed transitional provisions should the Board decide to continue the project which we are opposed to as described above.