Project	**Annual Improvements – 2009–2011 cycle**
Topic	**IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Clarification of borrowing costs exemption**

Introduction

1. This paper discusses a perceived lack of guidance in paragraph D23 of IFRS 1 *First-time Adoption of International Financial Reporting Standards* with respect to the accounting at the date of transition for borrowing costs capitalised in accordance with previous GAAP for completed and under construction projects at that date.

Purpose of this paper

2. The purpose of this paper is to ask the Board to consider an amendment to the exemption for borrowing costs in IFRS 1 that would clarify the accounting for borrowing costs at the date of transition and from this date onwards.

3. This paper:

   (a) provides background information and explains the issue;

   (b) makes a staff recommendation for

      (i) a proposed amendment to IFRS 1 as presented in Appendix A,

(ii) an assessment of the proposed amendment against the criteria for inclusion in the *Annual Improvements* process;

(c) asks the Board whether they agree with the IFRS Interpretations Committee's (the Committee) recommendation.

Background information and issue raised

4. The transition provisions for borrowing costs for existing as well as first-time preparers are set out in paragraphs 27 and 28 of IAS 23 *Borrowing costs*. They provide a relief on transition: prospective application to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after the effective date, when applying IAS 23 is a change in accounting policy.

5. The staff notes that these transition provisions are silent on the application to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is before the transition date.

6. Given the lack of guidance, constituents are split in their views as to whether the carrying amount of capitalised borrowing costs under previous GAAP should be:

   (a) View 1: eliminated at the transition date,

   (b) View 2: retained ("grandfathered") at the transition date.

7. Furthermore, for qualifying assets under construction at the date of transition and for which the commencement date for capitalisation is before the transition date, constituents hold different views as to the accounting for subsequent costs to be capitalised:

   (a) View A: subsequent capitalised costs should follow the requirements of IAS 23,

   (b) View B: subsequent capitalised costs should remain accounted for in accordance with previous GAAP, even if inconsistent with IAS 23.

8. At the IFRS Interpretation Committee meeting in May 2010, the Committee agreed with the staff proposal to recommend the Board add this issue to the 2009–2011 *Annual Improvements* cycle[1].

Staff analysis

Capitalised borrowing costs at the date of transition

9. The staff believes that the intent in item (a) of the definition of 'prospective application' in paragraph 5 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is to describe that no adjustment is made from the application of a new accounting policy at the date of change, hence no effect is to be recognised in the financial statements. In other words, amounts determined in accordance with previous GAAP should be carried over to the statement of financial position at the date of transition rather than eliminated.

10. In addition, the staff believes that when the change in policy is from one method of capitalisation to another rather than from expensing borrowing costs to capitalising them, transition provisions should still be the same.

11. The staff therefore supports view 2 presented in paragraph 6 above.

Subsequent borrowing costs for qualifying assets under construction at the date of transition

12. The staff believes that view B (see paragraph 7 above) would have the effect of carrying over accounting principles post transition that are inconsistent with IAS 23 for qualifying assets under construction at the date of transition. The financial statements would show borrowing costs recorded and measured using different bases; comparability and consistency would be impaired.

[1] The Committee recommended the Board amend the exemption for borrowing costs in IFRS 1. The proposed amendment would require an entity to apply the requirements in IAS 23 *Borrowing Costs* to borrowing costs incurred on qualifying assets as from the date of transition to IFRSs. The amendment will not require an entity to restate the borrowing costs component of assets determined in accordance with previous GAAP at the date of transition. However, an entity may choose to apply IAS 23 from an earlier date.

13. The staff notes that IFRS 1 only provides guidance for the accounting at the date of transition. Subsequent events and transactions should be accounted for in accordance with the relevant effective IFRSs.

14. Therefore, the staff considers view A as the appropriate answer.

Staff recommendation

Proposed amendment

15. The staff believes that additional guidance should be given in IFRS 1 for qualifying assets for which the commencement date of capitalisation is before the transition date whether they are under construction or completed at the date of transition.

16. The proposed amendment wording is included in Appendix A.

Consequential amendments

17. The staff is of the opinion that no consequential amendment to IAS 23 is needed on the grounds that the effective date has now passed. In other words, the proposed amendment is only relevant for first-time adopters.

Annual Improvements *criteria assessment*

18. The staff believes the proposed clarification of the transition requirements in paragraph D23 of IFRS 1 does not propose to introduce a new accounting principle. In addition, the proposed change enhances the quality of financial information. Consequently, the staff is of the opinion that the proposed change is a necessary but non-urgent amendment to IFRSs. Therefore the staff is of the opinion that it meets the criteria for inclusion in the *Annual Improvements* cycle for 2009-2011.

Questions to the Board

19. The Committee discussed this issue and agreed to recommend that the Board should include this issue in the *Annual Improvements* 2009-2011 cycle.

Question 1 – Committee recommendation on the need for the amendment
Does the Board agree with the Committee recommendation to amend IFRS 1 as proposed in paragraph 15?

Question 2 – Staff assessment of the proposed amendment against the criteria for inclusion in the *Annual Improvements* process
Does the Board agree with the inclusion of the proposed amendment to IFRS 1 in the *Annual Improvements* cycle for 2009-2011?

Question 3 – Wording for the proposed amendment
Does the Board agree with the wording for the proposed amendment as set out in Appendix A?

Appendix A - Drafting for proposed amendment

A1. This appendix includes drafting of the proposed amendment. It is based on the text included in the most recently issued standards (including the *Improvements to IFRSs* published in May 2010). New text is underlined and deleted text is struck through.

Proposed amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph 39F is added. In Appendix D, paragraph D23 is amended.

Effective date

39F *Improvements to IFRSs* issued in [date] amended paragraph D23. An entity shall apply this amendment for annual periods beginning on or after 1 January 2012. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

Appendix D

Exemptions from other IFRSs

Borrowing costs

D23 A first-time adopter may apply the transitional provisions set out in paragraphs 27 and 28 of IAS 23, as revised in 2007. In those paragraphs references to the effective date shall be interpreted as 1 January 2009 or the date of transition to IFRSs, whichever is later. An entity applies the requirements in IAS 23 from the date the entity chooses to apply IAS 23, as permitted by paragraph 28 of IAS 23, to borrowing costs incurred from that date rather than from the commencement date, including to qualifying assets under construction at that date. If the entity chooses to apply IAS 23 from the date of transition to IFRSs, it is not required to restate the borrowing costs component of assets at the date of transition in its opening IFRS statement of financial position.

Basis for Conclusions on proposed amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Borrowing costs relating to qualifying assets for which the commencement date for capitalisation is before transition date

BC1 Concerns were raised by first-time adopters on the transition provisions for borrowing costs relating to qualifying assets for which the commencement date for capitalisation is before the date of transition. Before this proposed amendment, constituents found it unclear whether balances in accordance with previous GAAPs should be retained or eliminated in the opening statement of financial position. Constituents also questioned the accounting, subsequent to transition date, for capitalised borrowing costs relating to such qualifying assets when these qualifying assets are under construction at the date of transition. Therefore, the Board proposes to clarify that such balances should be carried over in the opening statement of financial position. Such balances should not be eliminated as this would entail an impact on retained earnings inconsistent with the effects of a prospective application. In addition, the Board proposes to clarify that incurred borrowing costs after the date of transition that relate to qualifying assets under construction at the date of transition should be accounted for in accordance with IAS 23.