PSAB Public Sector Accounting Board

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International Public Sector Accounting Standards Board (IPSASB)
277 Wellington Street West
Toronto, ON M5V 3H2 Canada

Re: Response to Exposure Draft 74, IPSAS 5, Borrowing Costs – *Non-Authoritative Guidance*

Thank you for the opportunity to provide input on the proposed non-authoritative guidance to the International Public Sector Standard on borrowing costs.

PSAB staff are overall supportive of the proposals of *Exposure Draft 74, IPSAS 5, Borrowing Costs.* The comments set out in this letter and the appendices represent the views of PSAB staff, not those of the Public Sector Accounting Board (PSAB). While PSAB staff supports the decision to retain both accounting policy options in IPSAS 5, PSAB staff notes minor amendments should be made to IPSAS 5 to align with annual improvements made to IAS 23, Borrowing Costs, and support the proposed non-authoritative guidance.

PSAB staff has included additional minor suggestions to the proposed non-authoritative guidance in the attached Appendix A, where staff believes additional amendment may improve clarity of the proposed guidance.

We hope that you find the comments helpful.

Kind regards,

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APPENDIX A - RESPONSES TO SPECIFIC MATTERS FOR COMMENT

Specific Matter for Comment 1:

Do you agree with the proposed additional implementation guidance and illustrative examples? If not, what changes would you make?

PSAB Staff Response

Overall, PSAB staff agrees with the proposed implementation guidance and illustrative examples. Generally, PSAB staff has only minor suggestions to the proposed guidance that would improve the clarity for readers of the final issued guidance.

However, there is one proposal in the proposed Implementation Guidance that, if retained, should prompt an update to the standard, IPSAS 5. Paragraph A.5 states that:

> *"An 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 bolded part of the sentence was included as an amendment to IAS 23, *Borrowing Costs*, because of the International Accounting Standards Board's Annual Improvements to IFRS Standards 2015-2017 Cycle, to clarify this issue for stakeholders. PSAB staff recommends ensuring a similar amendment be made to paragraph 25 of IPSAS 5, to align with IAS 23 and the proposed non-authoritative guidance in the Exposure Draft.

General Comment

- In reviewing the proposed guidance, PSAB staff noted the use of the term "expenditures" in paragraphs BC6(b), A.2, A.5, IE14, and IE15. While expenditures are referred to in the comparative standard IAS 23, IPSAS 5 exclusively uses the term "outlay" in its existing text. PSAB staff suggests retention and consistent usage of IPSAS terminology such as outlays, where guidance has been modified from International Financial Reporting Standards, to ensure clarity to stakeholders.

Basis for Conclusions

- PSAB staff notes that IPSASB's initial proposal to eliminate the option to capitalize borrowing costs, per paragraph BC5, appears to be driven by objectives to reduce burden in financial statement preparation, enhance comparability, and more closely align with the requirements in the Government Finance Statistics (GFS) Manual 2014. Should more explanation be provided to stakeholders in discussing and linking these concepts to IPSASB's subsequent decision in paragraph BC7 to retain existing guidance? That is, the decision to retain the existing option was based on facilitating 'preparers to select the policy that best achieves the measurement objective of the qualifying asset'. Did the Board conclude that this objective was more critical than further alignment with GFS?

- PSAB staff agrees with the assertion of paragraph BC9b) that the accounting treatment for borrowing costs should be driven by the most appropriate reflection of costs attributable to a qualifying asset. However, PSAB staff is unsure whether this driver for the choice of approach is clear in the text of IPSAS 5. The existing standard does not prescribe or state a preference regarding the capitalization or expensing of borrowing costs. Paragraph BC9b) appears to imply that capitalization of borrowing costs should be applied in all cases where borrowing costs may be applied to a qualifying asset, which is not clear within the standard itself.

- In reviewing paragraphs BC13-14, PSAB staff notes that the IPSASB basis for differentiating the accounting treatment for borrowing costs and transaction costs was driven significantly by the contractual transferability of such costs. PSAB staff disagrees with the argument that because these types of costs are different economic phenomena, as further detailed by BC 13-14, it is appropriate to differentiate their treatment. PSAB staff asserts that for both types of costs, capitalization would be driven by an assessment of both: a) probability of future economic benefit or service potential, and b) reliable measurement of cost or fair value. Both transaction costs (IPSAS 41.57) and borrowing costs (IPSAS 5.18) are capitalized when they are deemed directly attributable to the underlying transaction, and as such PSAB staff does not agree contractual transferability impacts the assessment of capitalization for either of these types of costs.

Implementation Guidance

- PSAB staff notes that paragraph A.1 draws from paragraph 31 of IPSAS 5. However, the usage within the proposed application guidance appears to implicitly include a presumption that outlays for the asset are being incurred in a period. As the proposed non-authoritative guidance does appear to draw directly from paragraphs 31 and 33 of IPSAS 5, referencing these paragraphs and ensuring the inclusion and assessment of all three criteria of paragraph 31 may assist stakeholders in understanding the proposed guidance.

  PSAB staff notes that the paragraph should be amended to "…borrowings should be capitalized when the activities ~~necessary to get the asset ready for use~~ necessary to prepare the asset for its intended use or sale begin," to align with the guidance of IPSAS 5.31.

- PSAB staff agrees with the implementation guidance provided in paragraph A.2. However, PSAB staff is unsure if there exists a limit on the amount of investment income deducted from temporary investments on the capitalization of borrowing costs. Consider a situation where the criteria of IPSAS 5.31 have been satisfied, but the investment income on excess borrowings exceeds the amount of borrowing eligible for capitalization. Might this result in a conceptual negative interest rate and thereby reduce the carrying value of the qualifying asset, or is there a limit on the reduction of borrowing costs?

- In reviewing paragraph A.3, PSAB staff agrees with the proposed guidance where procurement of a qualifying asset is fully funded through a transfer. Conversely, PSAB staff believes the standard and proposed non-authoritative guidance lack clarity regarding the appropriate treatment for qualifying assets that are funded through a combination of transfers or concessionary grants, and interest-bearing borrowings. For example:

  - Would the full amount of qualifying borrowing costs, with consideration for limits on capitalization, apply?
  - Does the provision of specifically applied concessionary funding source, such as a non-interest-bearing transfer, impact the proportion of borrowing costs that may be applied in a period?

- As noted above, paragraph A.5 states that an “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**.” This appears to be drawn from either paragraph 25 or 38 of IPSAS 5. However, in reviewing paragraph 38 of IPSAS 5, PSAB staff notes that the context for this guidance appears to be restricted to component parts of a specific qualifying asset, rather than to the general exclusion of borrowings made specifically to any other qualifying asset. Conversely, paragraph 25 does not contain guidance to include, in the weighted average calculation, borrowings specifically to other qualifying assets that are ready for their intended use.

  PSAB staff notes that the above bolded sentence was included as an amendment to IAS 23, Borrowing Costs, because of the International Accounting Standards Board’s Annual Improvements to IFRS Standards 2015-2017 Cycle, to clarify this issue for stakeholders. PSAB staff recommends ensuring a similar amendment be made to paragraph 25 of IPSAS 5, to align with IAS 23 and the proposed non-authoritative guidance of the Exposure Draft.

  Further, PSAB staff suggests an additional or revised example, considering both general and specific project funding streams, to illustrate this concept to stakeholders. Illustrating the inclusion of excess borrowing for specific qualifying assets that are ready for use in general borrowings would also be of benefit to stakeholders in interpreting and applying the standard’s guidance.

Illustrative Examples

- As previously noted, PSAB staff supports the inclusion of a robust example of weighted average borrowing rate calculation that considers multiple specific project borrowings, general borrowings, and inclusion of excess specific project borrowings for ready for use qualifying assets for inclusion in general borrowing. PSAB staff believes a comprehensive example would be of value to stakeholders and reflective of the breadth of complex funding arrangements that exist within the public sector.

- In reviewing paragraph IE13-15, PSAB staff notes the implication that there is precedence in the draw-down of funding sources, whereby expenditures of CU200 million are applied wholly against the loan of CU250 million, rather than considering that a proportion of expenditure may also be allocated from the Federal grant provided of CU500 million. PSAB staff is unsure whether the standard is clear that interest-bearing borrowings would be considered exclusively in the determination of capitalized borrowing costs, rather than factoring in the concessionary element of the Federal grant in determining amounts eligible for capitalization.