

ED: Proposed Amendments to IAS 23

This Comment Letter was sent by BDO Global Coordination B.V. on behalf of BDO International, to International Accounting Standards Board on 29 September, 2006:

Dear Sir,

**Exposure Draft of proposed amendments to IAS 23 *Borrowing costs***

Thank you for the opportunity to comment on the above Exposure Draft (ED). We do not agree with the proposal and prefer at this juncture to leave IAS 23 unchanged.

The two main reasons advanced in the ED for the change are:

- Convergence with SFAS 34 – although it is acknowledged that some differences would remain
- That under the Framework and other standards cost should include all costs directly attributable to bringing an asset to the location and condition necessary for it to be ready for its intended use.

Although we are supportive both of the removal of accounting choices in standards and the efforts being made by the IASB and world national standard setters to converge accounting standards, we do not support the proposals in the ED because:

- We do not agree that capitalisation of borrowing costs always results in better accounting. Indeed, we feel that in certain circumstances the expensing of borrowing costs is superior accounting.
- Mandating capitalisation of interest cost on the basis that they are 'directly attributable' seems at odds with the proposals in the IFRS 3 ED that directly attributable acquisition costs be expensed.

Our comments on the specific questions posed in the invitation to comment are set out below.

**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 do not agree with the proposal and prefer at this juncture to leave IAS 23 unchanged.

Whilst convergence is a laudable goal, it must also be borne in mind that there will be significant additional costs for those entities forced to adopt a policy of capitalisation. For example new systems need to be developed and maintained for the purposes of determining the correct amount of borrowing costs to capitalise and to provide the associated disclosures.

Given that the vast majority of entities currently preparing or intending to prepare their financial statements in accordance with IFRS do not have to do a reconciliation to US GAAP, we feel that there needs to be tangible benefits associated with a policy of capitalisation beyond the convergence issue. At the very least it needs to be demonstrated that capitalisation is technically more superior and will result in a more relevant picture of an entity's financial performance and position. Unfortunately, we do not feel that the Basis of Conclusions adequately demonstrates that this will be the case. Indeed BC 3 notes that neither IAS 23 or SFAS 34 can be "regarded as being of a clearly higher quality than the other".

Consider the accounting of an entity under 2 different scenarios:

- Scenario A: The entity acquires a qualifying asset through the use of existing surplus funds; and
- Scenario B: The same entity borrows money to acquire a qualifying asset, notwithstanding that it has sufficient existing surplus funds

Under Scenario A the entity does not incur borrowing costs because it uses surplus funds. However, there is an opportunity cost of doing so that will be reflected in the income statement: namely a reduction in interest receivable that would have been earned on existing, available funds, or returns that would have been made had the funds been invested elsewhere.

Under Scenario B, however, the entity's profits would be higher than Scenario A because it would continue to earn investment income from the pre-existing funds, while the borrowing costs incurred would be capitalised. These will only be recognised in the income statement at some point in the future, and potentially spread over many years. Although the standard requires that the amount of borrowing costs eligible for capitalisation is reduced by investment income on the temporary investment of those borrowings (paragraph 15), this does not include investment income on pre-existing funds where the entity chooses to borrow.

As a result the entity will, in the short term at least, show higher profits under Scenario B. This seems counterintuitive given that the borrowing costs incurred would almost certainly be more than the interest income forgone from not spending the existing surplus funds.

It does not seem sensible to require an accounting treatment that potentially gives a favourable accounting result to an entity that borrows money (whether it needs to or not) compared to an entity that does not borrow. Notwithstanding the Board's observation in BC10 that it enhances comparability where assets are internally developed rather than acquired from third parties, we envisage situations where the policy reduces comparability between entities,

We also note that the proposed treatment conflicts with other proposals issued by the Board. For example, it is proposed that all incidental costs incurred on a business combination should be expensed. It is not immediately apparent to us why such costs are less deserving of capitalisation than borrowing costs incurred on acquiring a qualifying asset.

## Question 2

**This Exposure Draft proposes that entities should apply the amendments to borrowing costs for which the commencement date for capitalisation is on or after the effective date. However, an entity would be permitted to designate any date before the effective date and to apply the proposed 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?**

As noted above we do not agree with the proposals to require the capitalisation of borrowing costs on qualifying assets. However, if the Board proceeds with those proposals, we would support the transitional rules as drafted in the ED.

We would be pleased to discuss our comments and observations with you further if this would be helpful. Please contact Helen Thomson at +32 2 778 01 30.

Yours faithfully,

BDO Global Coordination B.V.

---