ACCOUNTING STANDARDS BOARD

STANDARD OF GENERALLY RECOGNISED ACCOUNTING PRACTICE

BORROWING COSTS

(GRAP 5)

Issued by the
Accounting Standards Board

February 2013

Acknowledgement

The Standard of Generally Recognised Accounting Practice (GRAP) on *Borrowing Costs* is based on the International Public Sector Accounting Standard (IPSAS) 5 on *Borrowing Costs* from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board (IPSASB), published by the International Federation of Accountants (IFAC) and is used with the permission of the IFAC.

International Federation of Accountants

529 Fifth Avenue, 6th Floor

New York, New York 10017 USA

Internet: http://www.ifac.org

Contents

Standard of Generally Recognised Accounting Practice

Borrowing Costs

Comparison with the International Public Sector Accounting Standard on *Borrowing Costs* (May 2000)

BORROWING COSTS

This Standard was originally issued by the Accounting Standards Board (the Board) in February 2013. Since then, it has been amended by:

- Improvements to the Standards of GRAP, issued by the Board in March 2020**.**

Introduction

This pronouncement is set out in paragraphs .01 to .40. All paragraphs in this pronouncement have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This pronouncement should be read in the context of its objective, its basis for conclusions and/or the basis for conclusions of its international equivalent, if applicable, the *Preface to the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*[1].

Standards of GRAP and Interpretations of the Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards, published in the Government Gazette.

Directives should be read in conjunction with the applicable Standards of GRAP and Interpretations of the Standards of GRAP.

[1] In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.

Objective

.01 This Standard prescribes the accounting treatment for borrowing costs. This Standard generally requires the immediate expensing of borrowing costs. However, this Standard permits, as an allowed alternative treatment, the capitalisation of borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset.

Scope

.02 An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for borrowing costs.

.03 This Standard does not deal with the actual or imputed cost of net assets. Where a capital charge is applied to individual entities, judgement 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.

Definitions

.04 This Standard uses the following terms 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 Standards of GRAP are used in this Standard with the same meaning as in those other Standards.

Borrowing costs

.05 Borrowing costs may include:

(a) interest expense calculated using the effective interest method as described in the Standard of GRAP on *Financial Instruments*;

(b) finance charges in respect of finance leases and service concession arrangements; and

(c) exchange differences arising from foreign currency borrowings, to the extent that they are regarded as an adjustment to interest costs.

Qualifying assets

.06 Depending on the circumstances, any of the following may be qualifying assets:

(a) office buildings;

(b) hospitals;

(c) infrastructure assets such as roads, bridges and power generation facilities;

(d) intangible assets;

(e) properties that will become self-constructed items of property, plant and equipment once their construction or development is complete;

(f) investment properties measured at cost that are being redeveloped; and

(g) inventories.

Financial assets and inventories that are 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

.07 ***An entity shall recognise all borrowing costs as an expense in the period in which they are incurred.***

.08 Under the benchmark treatment, borrowing costs are recognised as an expense in the period in which they are incurred, regardless of how the borrowings are applied.

Disclosure

.09 ***An entity shall disclose the accounting policy adopted for borrowing costs.***

Borrowing costs — Allowed alternative treatment

Recognition

.10 ***An entity shall recognise borrowing costs as an expense in the period in which they are incurred, except to the extent that they are capitalised in accordance with paragraph 11.***

.11 ***An entity shall recognise borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation shall be determined in accordance with this Standard.***

.12 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 capitalised 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. Other borrowing costs are recognised as an expense in the period in which they are incurred. When an entity applies the Standard of GRAP on *Financial Reporting in Hyperinflationary*

Economies, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period in accordance with paragraph .22 of that Standard.

.13 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 capitalisation

.14 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.

.15 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 transfer, or a contribution from owners. Such transfers may be interest-free, or require that only a portion of the actual interest cost be recovered. Other complications arise through the use of loans denominated in or linked to foreign currencies, when the economic entity operates in highly inflationary economies, and from fluctuations in exchange rates. As a result, 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 judgement is required.

.16 To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period, less any investment income on the temporary investment of those borrowings.

.17 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 expenditure 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 capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.

.18 ***To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditure on that asset. The capitalisation 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 the asset for its intended use or sale are complete. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.***

.19 Only those borrowing costs applicable to the borrowings of the entity may be capitalised. 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 capitalise 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 capitalise any such costs.

.20 When a controlling entity transfers funds at partial cost to a controlled entity, the controlled entity may capitalise 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 capitalised to the qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalised by the controlled entity.

.21 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 capitalisation of borrowing costs. However, if the economic entity met the criteria for capitalisation of borrowing costs, it would be able to capitalise the borrowing costs to the qualifying asset in its financial statements.

.22 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.

Assessing the carrying amount of the qualifying asset for write-down or write-off

.23 When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount, recoverable service amount, net realisable value or replacement cost (depending on the nature of the asset), the carrying amount is written down or written off in accordance with the requirements of the Standards of GRAP on *Impairment of Cash-generating Assets, Impairment of Non-cash-generating Assets* and *Inventories*. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those Standards of GRAP.

Commencement of capitalisation

.24 ***An entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when an entity first meets all of the following conditions:***

(a) it incurs expenditures for the asset; and

(b) it incurs borrowing costs.

It undertakes activities that are necessary to prepare the asset for its intended use or sale.

.25 Expenditures on a qualifying asset include only those expenditures 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 capitalised, is normally a reasonable approximation of the outlays to which the capitalisation rate is applied in that period.

.26 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 capitalised 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 capitalisation.

Suspension of capitalisation

.27 ***An entity shall suspend capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset.***

.28 An entity may incur borrowing costs may be incurred during an extended period in which it suspends the activities necessary to prepare an asset for its intended use or sale. Such costs are costs of holding partially completed assets, and do not qualify for capitalisation. An entity does not normally suspend capitalising borrowing costs during a period when it carries out substantial technical and administrative work. An entity also does not suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographical region involved.

Cessation of capitalisation

.29 ***An entity shall suspend capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.***

.30 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.

.31 ***When an entity completes the construction of a qualifying asset in parts, and each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.***

.32 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 an operating theatre in a hospital when all construction must be complete before the theatre may be used; a sewage treatment plant where several processes are carried out in sequence at different parts of the plant; and a bridge forming part of a highway.

Disclosure

.33 ***An entity shall disclose:***

(a) the accounting policy adopted for borrowing costs;

(b) the amount of borrowing costs capitalised during the period;

(c) the cumulative amount of borrowing costs included in the carrying amount of qualifying assets; and

(d) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation (when it was necessary to apply a capitalisation rate to funds borrowed generally).

Transitional provisions

Initial adoption of the Standards of GRAP

.34 ***The transitional provisions to be applied by entities on the initial adoption of this Standard are prescribed in a directive(s). The provisions of this Standard should be read in conjunction with each applicable directive.***

Amendments to Standards of GRAP

.35 ***The amendments to this Standard issued in February 2013, which allow the expensing or capitalising of borrowing costs, shall be applied prospectively, subject to paragraph .39.***

.36 ***Borrowing costs, incurred both before and after the effective date of this amendment and related to qualifying assets for which the commencement date for capitalisation is prior to the effective date of this Standard, shall be recognised in accordance with the entity's previous accounting policies.***

.37 ***Where the adoption of these amendments results in a change in accounting policy, an entity shall disclose this fact in its accounting policies along with sufficient information about the details and dates of the change.***

Effective date

Initial adoption of the Standards of GRAP

.38 ***An entity shall apply this Standard for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.***

Entities already applying Standards of GRAP

.39 ***An entity shall apply the amendments to this Standard issued in February 2013 for annual financial statements covering periods beginning on or after 1 April 2014.***

.39A ***Paragraph .18 was amended by the Improvements to the Standards of GRAP (2020) issued March 2020. These amendments are effective for annual periods beginning on or after 1 April 2023. An entity shall apply these amendments prospectively in accordance with the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors (GRAP 3). Earlier application is permitted. If an entity elects to apply these amendments earlier, it shall disclose this fact.***

Withdrawal of the Standard of GRAP on *Borrowing Costs* (2007)

.40 This Standard supersedes the Standard of GRAP on *Borrowing Costs* issued in 2007.

Basis for conclusions

This basis for conclusions gives the Accounting Standards Board's (the Board's) reasons for accepting or rejecting certain proposals related to the accounting for borrowing costs. This basis for conclusions accompanies, but is not part of, this Standard.

Background

BC1. The previous version of this Standard was originally issued by the Board in July 2007. At the time of developing this Standard, there were two international pronouncements available prescribing accounting requirements for borrowing costs:

- the IAS Standard on *Borrowing Costs* (IAS 23) (as revised in March 2007), which requires the capitalisation of borrowing costs which relate to qualifying assets and, the expensing of all other borrowing costs; and
- the International Public Sector Accounting Standard on *Borrowing Costs* (IPSAS 5) (as issued in May 2000) which requires, as the benchmark accounting treatment, the expensing of all borrowing costs and allows, as an alternative, the capitalisation of borrowing costs on qualifying assets.

BC2. In developing the previous version of this Standard, IAS 23 was used instead of IPSAS 5 as it reflected the most up-to-date thinking regarding the treatment of borrowing costs. Since the issue of the previous version of this Standard, a number of developments both internationally and locally have led the Board to reconsider its position on the treatment of borrowing costs.

BC3. During 2008, the IPSASB issued an Exposure Draft which proposed to align IPSAS 5 to the requirements of revised IAS 23. Many respondents to the Exposure Draft did not support capitalising borrowing costs related to qualifying assets because:

(a) it is not always possible to attribute borrowings to particular assets as governments and other public sector entities often borrow centrally to meeting an overall deficit in their funding; and

(b) it is conceptually inappropriate for the cost of assets to differ depending on the way in which they are financed.

BC4. As a result of the possible conceptual issues associated with the capitalisation of borrowing costs, the IPSASB agreed to not make any amendments to IPSAS 5 to align it with IAS 23 and, instead agreed to consider this issue once its Conceptual Framework is complete or sufficiently advanced.

BC5. In 2009, the International Accounting Standards Board (IASB) issued the IFRS for SMEs® Accounting Standard which required the expensing of borrowing costs. The primary reason for this approach was based on cost-benefit considerations.

BC6. In 2010, the Board issued the Discussion Paper on *The Process for the Development of Standards of GRAP* (Discussion Paper 6) requesting inputs on the due process followed by the Board in developing Standards of GRAP and other pronouncements. Respondents to Discussion Paper 6 indicated that reducing complexity should be a factor that the Board considers in developing its Standards and other pronouncements. As a result, the Board amended its due process in the *Preface to the Standards of GRAP* to note that when considering the appropriateness of an international standard, it would consider whether the principles in that Standard could be simplified so as to reduce compliance costs, while still providing quality information.

Amending the accounting treatment of borrowing costs

Expensing of all borrowing costs

BC7. As a result of the issue of the SMEs Standard, the Board was requested by its constituents to consider the appropriateness of the simplifications in this Standard for the public sector. The Board issued the Discussion Paper on *Comparison of the Standards of GRAP to the IFRS for SMEs* (Discussion Paper 5), requesting views on, amongst others, the proposal in the SMEs Standard to expense all borrowing costs. Many respondents supported this proposal noting that the expensing of borrowing costs is simpler and conceptually more appropriate as it does not result in certain assets having a higher cost because they are financed through borrowings. Some respondents also noted that requiring all borrowing costs to be expensed would enhance the comparability of entities' financial statements.

BC8. The Board also considered the nature and purpose for which assets are held in the public sector. As most assets in the public sector are held for their service potential, it considered that the valuation of such assets would not include borrowing costs.

BC9. Based on the comments received on Discussion Paper 5 and the Board's commitment to simplifying principles wherever appropriate, the Board proposed in the Exposure Draft (ED 99) that all borrowing costs should be expensed. The Board also considered that because the benchmark accounting treatment under IPSAS 5 requires borrowing costs to be expensed, this change in approach would bring the Standards of GRAP in closer alignment with the IPSASs.

BC10. Respondents' views to the ED 99 were mixed. A majority of respondents favoured expensing being the only allowed accounting treatment for borrowing costs, while many indicated that entities should be allowed an accounting policy choice to either expense or capitalise borrowing costs.

BC11. Those respondents who supported the expensing of borrowing costs noted that they agreed with the Board's conceptual argument that assets should not cost more just because they were financed through borrowings. Many respondents also supported expensing borrowing costs because of its simplicity both for preparers to apply and for users to understand.

BC12. Those respondents who favoured allowing an accounting policy choice argued that the borrowing costs incurred on qualifying assets are directly related to the cost of the asset. They argue that because these costs would otherwise not have been incurred, borrowing costs are similar to other transaction costs and should form part of the initial cost of the asset. These respondents also indicated that capitalising borrowing costs provided valuable information to users about future funding decisions relating to the replacement of an asset.

BC13. As respondents' views were polarised, the Board considered other factors in deciding whether entities should be allowed to capitalise borrowing costs. In particular, it considered the following:

(a) The equivalent IPSAS allows entities a choice of expensing or capitalising borrowing costs. Therefore allowing an accounting policy choice would align this Standard more closely with the IPSAS.

(b) The Board is currently undertaking research into the appropriate accounting framework for Government Business Enterprises (GBEs). GBEs currently apply IFRS® Accounting Standards or Statements of GAAP which require the capitalisation of borrowing costs. If the Board were to require the expensing of borrowing costs in the Standards of GRAP, this may be a significant difference in accounting if GBEs are to apply Standards of GRAP in future.

(c) Current practice amongst entities seems to be diverse. Permitting entities to make an accounting policy choice, would allow the Board additional time to undertake a post-implementation of this Standard to assess what practice or policy is most prevalent in the sector. This could in future lead to the elimination of one of the alternatives.

BC14. Based on the factors noted above, the Board considered, on balance, that entities should be allowed an accounting policy choice of either expensing or capitalising borrowing costs. The Board did however note that additional disclosures would be needed about the cumulative borrowing costs to ensure that users are able to make adjustments to the amounts reported in the financial statements to achieve comparability.

Disclosures

BC15. When the Board debated allowing entities a choice of accounting policy for the treatment of borrowing costs, it was mindful that comparability across entities may be impacted. As a result, the Board agreed that if an entity chooses to capitalise borrowing costs, it must disclose the cumulative borrowing costs capitalised to qualifying assets. This would enable users to adjust the amounts reported in the financial statements, making them comparable with entities that expense borrowing costs. The Board agreed that for such information to be relevant, the amount disclosed should represent the remaining carrying amount of the borrowing costs included in the various qualifying assets.

Transitional provisions

BC16. The Board considered whether entities should be required to apply the amendments to this Standard retrospectively or prospectively. The Board agreed that applying the requirements retrospectively would be onerous. It also agreed that, in order to be consistent with its decision to simplify the requirements of the Standards of GRAP wherever appropriate and to reduce the costs of compliance, the Board agreed that applying the amendments prospectively may be more appropriate.

BC17. In considering the effect of prospective application of the amendments, the Board considered the requirements in GRAP 3. "Prospective application" means applying the new accounting policy to transactions, other events and conditions occurring after the date which the policy is changed. The effect of applying the amendments to this Standard prospectively is that, if any assets met the criteria to be classified as "qualifying assets" prior to the effective date of the amendments, the accounting policy for such assets remains unchanged. This means that no adjustments should be made to any borrowing costs incurred on assets where their construction is completed prior to the effective date of the amendments. Similarly, if a qualifying asset is in the process of being constructed prior to the effective date of the amendments, an entity should continue to capitalise borrowing costs until the activities necessary to prepare the qualifying asset for its intended use or sale are complete. In these circumstances, an entity continues to apply its existing accounting policy, based on the previous version of this Standard issued in July 2007, regarding the capitalisation of borrowing costs to such assets.

Comparison with the International Public Sector Accounting Standard on *Borrowing Costs* (May 2000)

This Standard is drawn primarily from IPSAS 5. The main differences between IPSAS 5 and this Standard are as follows:

- The scope of this Standard is different to that of IPSAS 5 in that GBEs are defined differently.
- This Standard has incorporated certain changes made by the revised version of IAS 23 issued in March 2007 as part of the IASB's joint short-term convergence project with the Financial Accounting Standards Board, but excludes those amendments that require the capitalisation of borrowing costs.
- This Standard requires disclosure of the carrying amount of the cumulative borrowing costs included in the cost of assets.
- This Standard uses different terminology, in certain instances, from IPSAS 5. The most significant examples are the use of the terms "net assets" and "expenditures" in this Standard. The equivalent terms in IPSAS 5 are "net assets/equity" and "outlays" respectively.
- This Standard does not contain transitional provisions as they have been incorporated in directives dealing with transitional provisions for all Standards of GRAP.