IFRS

STAFF PAPER

September 2019

IASB® Meeting

Project	**Comprehensive review of the *IFRS for SMEs*® Standard**
Paper topic	Previous Board decisions—IAS 23 *Borrowing Costs*

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Purpose

1. At this meeting we are asking Board members if the Request for Information that will be issued as part of the 2019 Comprehensive Review of the *IFRS for SMEs* Standard (2019 Review) should seek views on whether and how the requirements of Section 25 *Borrowing Costs* of the *IFRS for SMEs* Standard should be aligned with IAS 23 *Borrowing Costs*.

2. The objective of the Request for Information is to obtain evidence that will assist the Board in deciding whether and how to develop an exposure draft of amendments to the *IFRS for SMEs* Standard.

Summary of the staff recommendation

3. The staff recommend that the Board seek views in the Request for Information on whether and how to align Section 25 with IAS 23, so the Board can obtain evidence about whether:

   (a) to require entities to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset;

(b) to introduce an accounting policy election to either capitalise or expense borrowing costs; or

(c) to maintain the current requirements of Section 25.

Structure of this paper

4. This paper is structured as follows:

   (a) Background (paragraphs 5–10);

   (b) IAS 23 and the 2012 Comprehensive Review of the *IFRS for SMEs* Standard (paragraphs 11–17);

   (c) Staff analysis (paragraphs 18–26);

   (d) Staff recommendation (paragraphs 27–30);

   (e) Question for the Board.

Background

Differences between Section 25 and IAS 23

5. The *IFRS for SMEs* Standard was developed by modifying full IFRS Standards to address the needs of users of SME financial statements and cost-benefit considerations.[1] Consequently, there are differences between the *IFRS for SMEs* Standard and the full IFRS Standards.

6. One of these differences is between Section 25 and IAS 23. Section 25 requires all borrowing costs to be recognised as an expense in profit or loss while IAS 23 requires borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalised as part of the cost of the asset.[2] IAS 23 also requires that other borrowing costs are recognised as expenses in the period in which they are incurred.

[1] *IFRS for SMEs* Standard paragraph BC185.

[2] *IFRS for SMEs* Standard paragraph BC68(d).

7. Paragraph BC120 of the *IFRS for SMEs* Standard explains that, for cost-benefit reasons, the Board decided borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset should be recognised as expenses in the period in which they are incurred.

Reasons for reconsidering this topic

8. In February 2019 the Board tentatively decided to consider, as part of the 2019 Review, some specific issues raised by stakeholders which highlight differences between the *IFRS for SMEs* Standard and full IFRS Standards. The capitalisation of borrowing costs is among those issues raised by stakeholders.[3]

9. Staff have considered aligning the treatment of borrowing costs in Section 25 of the *IFRS for SMEs* Standard with the treatment required by IAS 23 because:

   (a) respondents to the 2012 Comprehensive Review of the *IFRS for SMEs* Standard (2012 Review) and some SMEIG members requested that the Board reconsider allowing borrowing costs to be capitalised instead of being expensed or, alternatively, introducing an accounting policy option for borrowing costs; and

   (b) some respondents to a survey of the Asian-Oceanian Standard-Setters Group (AOSSG) are of the view that borrowing costs should not be recognised in profit or loss in the period in which they are incurred.[4]

10. The staff notes that similar considerations exist for development costs. Staff have not considered aligning the treatment of development costs in the *IFRS for SMEs* Standard with IAS 38 *Intangible Assets* in this paper as this topic will be covered in a separate paper to be brought to the Board in October 2019.

[3] See ***February 2019 Agenda Paper 30***.

[4] AOSSG, *Report of AOSSG Survey on the* IFRS for SMEs *Standard*, 2018.

IAS 23 and the 2012 Comprehensive Review of the *IFRS for SMEs* Standard

11. The Request for Information published as part of the 2012 Review asked the following question about aligning Section 25 with IAS 23:[5]

> Should Section 25 of the *IFRS for SMEs* be changed so that SMEs are required to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, with all other borrowing costs recognised as an expense when incurred?

12. Based on the feedback received the Board decided not to align Section 25 with IAS 23, and made the following observations:[6]

> …permitting accounting policy options to capitalise development and borrowing costs that meet the criteria for capitalisation in IAS 23, in addition to the current approach, would result in more accounting policy options than full IFRS. The IASB noted that it continues to support its rationale for requiring the recognition of all borrowing costs as expenses, for cost-benefit reasons as set out in paragraphs BC113–BC114 and BC120, and for not providing the additional, more complex, accounting policy options for SMEs as set out in paragraphs BC208–BC209. The IASB noted that an SME should disclose additional information about its borrowing costs if it is considered relevant to users of its financial statements.

Feedback from the 2012 Review

13. Few respondents to the 2012 Request for Information and the 2013 Exposure Draft *Proposed Amendments to the* IFRS for SMEs *Standard* supported entities

[5] 2012 *Request for Information—Comprehensive Review of the* IFRS for SMEs *Standard*.

[6] *IFRS for SMEs* Standard paragraph BC214.

[6] *IFRS for SMEs* Standard paragraph BC214.

being required to capitalise borrowing costs as required by IAS 23.[7] However, many respondents supported an accounting policy option to permit an entity to capitalise its borrowing costs (see paragraphs 16–17).

14. Many respondents indicated that the *IFRS for SMEs* Standard should not be changed because:[8]

    (a) the requirements of IAS 23 are complex and require preparers to make significant judgements;

    (b) it is unclear why the Board is reconsidering its decision to simplify the approach in the *IFRS for SMEs* Standard, which was based on cost-benefit considerations;

    (c) SMEs may not have sufficient expertise or systems in place to appropriately apply the requirements, which means the financial information they could provide would likely be of poor quality;

    (d) requiring SMEs to capitalise certain borrowing costs would increase costs without adding significant benefits to users of their financial statements;

    (e) SMEs can disclose additional information in the notes to the financial statements about borrowing costs recognised as expenses if they believe such information would be useful; and

    (f) requiring or permitting SMEs to capitalise borrowing costs would increase complexity in other areas (for example, deferred taxation).

15. Some respondents were of the view that the Board should revise the requirements of the *IFRS for SMEs* Standard to align the treatment of borrowing costs with the treatment required by IAS 23 because:[9]

    (a) borrowing costs are significant costs for some SMEs, for example, start-up entities. Requiring costs to be recognised as expenses can have a significant effect on profits and net assets, potentially reducing

[7] *IFRS for SMEs* Standard paragraph BC213.

[8] See ***April 2013 Agenda Paper 8D***.

[9] See ***April 2013 Agenda Paper 8D***.

entities' access to loan financing and discouraging further investment needed to grow the business; and

(b) including a requirement to recognise borrowing costs as expenses would cause entities applying the *IFRS for SMEs* Standard to appear less profitable than entities applying full IFRS Standards.

16. Most respondents to the 2012 Request for Information suggested an alternative approach—an accounting policy option, instead of a requirement, for SMEs to capitalise borrowing costs that meet the criteria for capitalisation.[10]

17. These respondents explained that an accounting policy option would still allow SMEs to recognise borrowing costs as expenses in profit or loss (the current requirements of Section 25). They also noted the following benefits associated with an accounting policy option:

(a) an accounting policy option would not add significant complexity to the *IFRS for SMEs* Standard, as SMEs can make an accounting policy choice to use the simpler option;

(b) although an accounting policy option would reduce comparability among SMEs it would, however, improve comparability with entities applying full IFRS Standards;

(c) such an accounting policy option would provide flexibility and make it easier for jurisdictions to adopt the *IFRS for SMEs* Standard; and

(d) SMEs that have expertise in capitalising borrowing costs should be allowed to do so and should not be prohibited from providing users of financial statements with more relevant information where appropriate.

Staff analysis

18. The Board took care, both in developing the *IFRS for SMEs* Standard and during the 2012 Review, to maintain the simplicity of the Standard without reducing the information provided in financial statements prepared applying the Standard. The

[10] See ***April 2013 Agenda Paper 8D***.

Board sought to ensure that such financial statements continued to reflect the financial position, financial performance and cash flows of an entity, and remained useful for making economic decisions. The Board achieved this by eliminating the most complex options and instead requiring simpler accounting for some transactions, including borrowing costs.

19. The accounting for borrowing costs in the *IFRS for SMEs* Standard is simpler than that in full IFRS Standards as Section 25 requires all borrowing costs to be recognised as expenses in profit or loss.

20. Nevertheless, staff have considered whether applying the principles in IAS 23 would give rise to information that more faithfully represents borrowing costs of an entity applying the *IFRS for SMEs* Standard and their impact on the cost of a qualifying asset, than that obtained by applying the current requirements of Section 25.

21. The staff acknowledge that introducing the IAS 23 requirements for capitalising borrowing costs may add complexity to the *IFRS for SMEs* Standard should SMEs be required to capitalise borrowing costs, or an accounting policy option be introduced.

22. One added complexity would be that SMEs would need to exercise judgement in determining which assets are qualifying assets, deducting investment income from general borrowings against borrowing costs incurred and estimating the amount of borrowing costs eligible for capitalisation for assets financed by a combination of specific and general borrowings.

23. Furthermore, if entities are required to capitalise borrowing costs, Section 17 *Property, Plant and Equipment* of the *IFRS for SMEs* Standard would have to be amended. This is because Section 17.11(e) currently prohibits borrowing costs from being capitalised to the cost of property, plant and equipment.

24. In response to the concern in paragraph 23, Thailand[11] explained that SMEs generally borrow funds for specific qualifying assets and the calculation of

[11] Thailand does not use the *IFRS for SMEs* Standard.

borrowing costs eligible for capitalisation is generally straightforward and relatively less complex compared to other estimation and measurement requirements contained in the *IFRS for SMEs* Standard.[12]

Accounting policy option

25. In considering respondents' views on introducing an accounting policy option into the *IFRS for SMEs* Standard, staff also considered the complexity an accounting policy option could introduce.

26. During the 2012 Review, the Board noted the following regarding an accounting policy option being introduced in Section 25:

    (a) users of SME financial statements that need to understand the accounting policies used and make comparisons between SMEs have said they prefer SMEs to have no, or only limited, accounting policy options. Furthermore, while SMEs could still choose to apply the simpler option, adding complex options to the *IFRS for SMEs* Standard would add complexity throughout the Standard.[13]

    (b) the staff's outreach to providers of finance, who are considered to be the primary external user group of SME financial statements, confirmed the importance of restricting accounting policy options for SMEs. These providers of finance noted that they generally add the information from audited financial statements of SMEs directly into their models when making lending decisions. Consequently, it is important to these parties that SMEs should provide comparable information to which they do not need to make adjustments.[14]

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[12] AOSSG, *Report of AOSSG Survey on the* IFRS for SMEs *Standard*, 2018.

[13] *IFRS for SMEs* Standard paragraph BC208.

[14] *IFRS for SMEs* Standard paragraph BC209.

Staff recommendation

27. The staff acknowledges that the Board would need to balance several considerations in deciding whether to introduce an accounting policy option to capitalise borrowing costs—the need to provide information that is relevant to users of financial statements, the cost-benefit implications and the principle of simplicity.

28. The staff also acknowledges the views expressed by respondents during the 2012 Review and those of AOSSG members, including on the costs and benefits each option may introduce to the *IFRS for SMEs* Standard.

29. The staff note that there are mixed views on the capitalisation of borrowing costs by entities applying the *IFRS for SMEs* Standard (see paragraphs 18-26). Consequently, the staff are unable to obtain a clear view on whether:

    (a) to require that entities applying the *IFRS for SMEs* Standard should capitalise borrowing costs;

    (b) to introduce an accounting policy option; or

    (c) to leave the requirements of the *IFRS for SMEs* Standard unchanged.

30. Consequently, the staff recommend that the Board seek views on those matters in the Request for Information.

Question for the Board

Question
Does the Board agree with the staff recommendation to seek views in the Request for Information on aligning Section 25 of the *IFRS for SMEs* Standard with IAS 23, so that evidence can be obtained about whether the Board should: a. require entities to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset; b. introduce an accounting policy election to either capitalise or expense borrowing costs; or c. maintain the current requirements of the *IFRS for SMEs* Standard?