

# HKFRS News

Shedding light on the HKICPA's activities\*

April 2007

## In this newsletter...

- 1 Amendments to IAS/  
HKAS 23 *Borrowing  
Costs*
- 2 *Contacts*



HKFRS has converged with IFRS effective from 1 January 2005. Contents contained in this newsletter are relevant to both HKFRS preparers and IFRS preparers.

## Amendments to IAS/HKAS 23 *Borrowing Costs*

The International Accounting Standards Board (IASB) published amendments to IAS 23 *Borrowing Costs* last month. This article discusses the key features of IAS 23R, its implications for financial reporting and action that management should take. HKAS 23R is expected to be published by the Hong Kong Institute of Certified Public Accountants (HKICPA) in due course.

The current version of IAS 23 provides management with a policy choice. Management can opt to capitalise borrowing costs relating to qualifying assets or expense the borrowing costs. IAS 23R removes this option and requires management to capitalise borrowing costs attributable to qualifying assets. Qualifying assets are assets that take a substantial time to get ready for their intended use or sale. An example of this is self-constructed assets such as buildings, machinery and internally developed software (intangible assets).

### Key implications

- Management no longer has the option to expense borrowing costs on qualifying assets. The impact of this change depends on the current policy for borrowing costs. Companies already capitalising borrowing costs will not have much difficulty applying the change. They need, however, to be aware of a change that was made to the scope of IAS 23.
- IAS 23R only applies to qualifying assets measured at cost. Qualifying assets measured at fair value are outside the scope. This may have an impact on companies with investment properties, or companies with biological assets.
- Inventories that are routinely manufactured, or otherwise produced in large quantities on a repetitive basis, are outside the scope of IAS 23R. Inventories like whisky and wine will no longer be eligible for capitalisation under IAS 23R.
- Companies that expense borrowing costs under their current accounting policy must identify their qualifying assets. Examples of these are production companies who often construct their own assets for use in the production process and telecom companies who often construct their own network. However, qualifying assets can also appear in less obvious industries, for example, a retail company might build or redevelop its own stores. Other examples of qualifying assets are product development costs and implementation of new IT systems.

The capitalisation of borrowing costs on qualifying assets sometimes lead to practical questions, such as what are the qualifying assets? Over which period must management capitalise the borrowing costs? What general borrowings must be included in the determination of the capitalisation rate? This will be more complicated in group situations when different subsidiaries have qualifying assets and different borrowings (specific and general) at different rates. The standard recognises the difficulty and states that management must exercise judgment.

## Remaining differences from US GAAP

The changes to the standard were made as part of the short-term convergence project between IASB and US Financial Accounting Standards Board (FASB). Although the most significant difference will be removed, IAS 23R does not eliminate all the differences between US GAAP and IFRS. The remaining differences are in the definitions of borrowing costs and qualifying assets. For example, US GAAP does not allow exchange differences to be included; they are included in IAS 23R. Investments accounted for by the equity method may be qualifying assets under US GAAP; they are not qualifying assets under IAS 23R.

## Action to take now

While IAS 23R is not mandatory until 2009 calendar years, management should start to consider:

- **Early adoption** – some companies will choose to adopt the new guidance early to align their IFRS and US GAAP reporting or may want to designate a particular date from when it will apply IAS 23R.
- **Identification of qualifying assets** – companies must identify the assets for which it must start capitalising borrowing costs.
- **Determination of the appropriate borrowing cost** – companies must determine which specific borrowings and general borrowings are to be included in the calculation of the borrowing costs to be capitalised. They will also need to determine the capitalisation rate in the case of general borrowings.
- **Systems and controls** – the determination and computation of borrowing costs to be capitalised requires updates to information systems and controls.

## Summary of IAS 23R requirements

- A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
- Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. These may include interest on borrowings; amortisation of discounts or premiums on borrowings; amortisation of ancillary costs; finance charges in respect of finance leases; and exchange differences arising from foreign currency borrowings to the extent that they are regarded as adjustment to interest costs.
- An entity must determine which borrowings are to be allocated to the qualifying asset. In the case of specific borrowings, the borrowing costs of these specific borrowings less any investment income are capitalised as part of the cost of the qualifying asset.
- In the case of general borrowings, an entity must calculate a capitalisation rate based on the weighted average of the borrowing costs applicable other than the borrowings made specifically for the purpose of obtaining the qualifying asset.
- Commencement of capitalisation is the date when an entity incurs expenditures for the qualifying asset, incurs borrowing costs and undertakes activities that are necessary to prepare the assets for their intended use or sale. In case of suspension of activities during extended periods, an entity suspends capitalisation. An entity stops capitalisation of borrowing costs when substantially all the activities necessary are complete.

IAS 23R is applicable for periods beginning on or after 1 January 2009. Early adoption is encouraged, but this should be disclosed. However, an entity may designate any date before the effective date and apply the Standard to borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date.

## Contacts

For further help, please contact:

**Hong Kong**  
22/F Prince's Building  
Central, Hong Kong  
Tel: (852) 2289 8888

**Beijing**  
26/F Office Tower A  
Beijing Fortune Plaza  
7 Dongsanhuan Zhong Road  
Chaoyang District  
Beijing 100020, PRC  
Tel: (86) (10) 6533 8888

**Shanghai**  
11/F PricewaterhouseCoopers Center  
202 Hu Bin Road  
Shanghai 200021, PRC  
Tel: (86) (21) 6123 8888

**Chongqing**  
Room 1905  
19/F Metropolitan Tower  
68 Zou Rong Road  
Chongqing 400010, PRC  
Tel: (86) (23) 6393 7888

**Dalian**  
8/F Senmao Building  
147 Zhongshan Road  
Xigang District  
Dalian 116011, PRC  
Tel: (86) (411) 8379 1888

**Guangzhou**  
25/F Center Plaza  
161 Lin He Xi Road  
Guangzhou 510620, PRC  
Tel: (86) (20) 3819 2000

**Macau**  
28/F Unit C  
Bank of China Building  
Avenida Doutor Mario Soares  
Macau  
Tel: (853) 7995 111

**Qingdao**  
4601 Qingdao International Finance Center  
59 Hong Kong Zhong Road  
Qingdao 266071, PRC  
Tel: (86) (532) 8089 1888

**Shenzhen**  
38/F Shun Hing Square  
Di Wang Commercial Centre  
5002 Shennan Road East  
Shenzhen 518008, PRC  
Tel: (86) (755) 8261 8888

**Suzhou**  
3/F International Building  
2 Su Hua Road  
Suzhou Industrial Park  
Suzhou 215021, PRC  
Tel: (86) (512) 6288 6860

**Tianjin**  
17/F The Exchange Tower One  
189 Nanjing Road, Heping District  
Tianjin 300051, PRC  
Tel: (86) (22) 2330 6789

**Xi'an**  
Room 728  
Zhongda International Mansion  
30 Nan Da Street  
Xi'an 710002, PRC  
Tel: (86) (29) 8720 3336

<http://www.pwchk.com>  
<http://www.pwc.com/ifrs>