

**IPSAS 5 – BORROWING COSTS
as adopted by the Maltese Government**

Issued DD/MM/YY

This Standard was issued by the IPSAS Implementation Board pursuant to Part VI, article 38(1) of the Public Finance Management Act No. XXI of 2019

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International Public Sector Accounting Standard 5, *Borrowing Costs*, as adopted by the Maltese Government, is set out in the objective and paragraphs 1–43A. All the paragraphs have equal authority. IPSAS 5¹ should be read in the context of its objective. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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¹ References to IPSAS 5 or any other IPSAS shall be taken as meaning ‘as adopted by the Maltese Government’

Objective

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

Scope

1. **This Standard should be applied in accounting for borrowing costs.**
2. **[Deleted]**
3. **[Deleted]**
4. This Standard does not deal with the actual or imputed cost of net assets/equity. Where jurisdictions apply a capital charge to individual entities, judgment 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/equity.

Definitions

5. **The following terms are used in this Standard with the meanings specified:**

Borrowing costs are interest and other expenses incurred by an entity in connection with the borrowing of funds.

Central Government Entities means Government Ministries and Departments.

Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Terms defined in other IPSAS are used in this Standard with the same meaning as in those other Standards, and are published separately.

Borrowing Costs

6. Borrowing costs may include:
 - (a) Interest on bank overdrafts and short-term and long-term borrowings;
 - (b) Amortization of discounts or premiums relating to borrowings;
 - (c) Amortization of ancillary costs incurred in connection with the arrangement of borrowings;
 - (d) Finance charges in respect of finance leases; and
 - (e) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Economic Entity

7. The term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.
8. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity and group.
9. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide

accommodation on a commercial basis.

Future Economic Benefits or Service Potential

10. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity's objectives but which do not directly generate net cash inflows are often described as embodying service potential. Assets that are used to generate net cash inflows are often described as embodying "future economic benefits." To encompass all the purposes to which assets may be put, this Standard uses the term "future economic benefits or service potential" to describe the essential characteristic of assets.

Government Business Enterprises

11. [Deleted]

Net Assets/Equity

12. Net assets/equity is the term used in this Standard to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.

Qualifying Assets

13. Examples of qualifying assets are office buildings, hospitals, infrastructure assets such as roads, bridges and power generation facilities, and inventories that require a substantial period of time to bring them to a condition ready for use or sale. Other investments, and those assets that are routinely 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

14. **Borrowing costs should be recognized as an expense in the period in which they are incurred.**
15. Under the benchmark treatment, borrowing costs are recognized as an expense in the period in which they are incurred, regardless of how the borrowings are applied.

Disclosure

16. **The financial statements should disclose the accounting policy adopted for borrowing costs.**

Borrowing Costs—Allowed Alternative Treatment

Recognition

17. **Borrowing costs should be recognized as an expense in the period in which they are incurred, except to the extent that they are capitalized in accordance with paragraph 18.**
18. **Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard.**

19. 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 capitalized 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 recognized as an expense in the period in which they are incurred.
20. **Where an entity adopts the allowed alternative treatment, that treatment should 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 Capitalization

21. 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.
22. 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 co-ordinated 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 which have been borrowed centrally may be transferred to other entities within the economic entity as a loan, a grant or a capital injection. Such transfers may be interest-free or require that only a portion of the actual interest cost be recovered. Other complications arise (a) through the use of loans denominated in or linked to foreign currencies, (b) when the economic entity operates in highly inflationary economies, and (c) 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 judgment is required.
23. **To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.**
24. 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 outlays 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 capitalization during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.
25. **[Not used]**
26. Only those borrowing costs applicable to the borrowings of the entity may be capitalized. When a controlling entity borrows funds which are passed on to a controlled entity with no, or only partial, allocation of borrowing costs, the controlled entity may capitalize 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 capitalize any such costs.
27. When a controlling entity transfers funds at partial cost to a controlled entity, the controlled

entity may capitalize 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 capitalized to the qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalized by the controlled entity.

28. 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 capitalization of borrowing costs. However, if the economic entity met the criteria for capitalization of borrowing costs, it would be able to capitalize the borrowing costs to the qualifying asset in its financial statements.
29. [Not used]

Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount

30. When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realizable value, the carrying amount is written down or written off in accordance with the requirements of IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other standards.

Commencement of Capitalization

31. **The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when:**
 - (a) **Outlays for the asset are being incurred;**
 - (b) **Borrowing costs are being incurred; and**
 - (c) **Activities that are necessary to prepare the asset for its intended use or sale are in progress.**
32. Outlays on a qualifying asset include only those outlays 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 capitalized, is normally a reasonable approximation of the outlays to which the capitalization rate is applied in that period.
33. 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 capitalized 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 capitalization.

Suspension of Capitalization

34. **Capitalization of borrowing costs should be suspended during extended periods in which active development is interrupted, and expensed.**

35. Borrowing costs may be incurred during an extended period in which the activities necessary to prepare an asset for its intended use or sale are interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalization. However, capitalization of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalization continues during an extended period needed for inventories to mature or an extended period during which high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.

Cessation of Capitalization

36. **Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.**
37. 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.
38. **When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.**
39. 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 (a) an operating theatre in a hospital when all construction must be complete before the theatre may be used, (b) a sewage treatment plant where several processes are carried out in sequence at different parts of the plant, and (c) a bridge forming part of a highway.

Disclosure

40. **The financial statements should disclose:**
- (a) **The accounting policy adopted for borrowing costs;**
 - (b) **The amount of borrowing costs capitalized during the period; and**
 - (c) [Not used]

Transitional Provisions

41. [Deleted]

Effective Date

- 42-43 [Not used]

- 43A. Central Government entities shall apply this Standard for annual financial statements covering periods beginning or after DD/MM/YY. Earlier application is not permitted.

Appendix 1

Comparison with IPSAS 5

IPSAS 5 Borrowing Costs as adopted by the Maltese Government is drawn from IPSAS 5 Borrowing Costs.

The following are the significant differences between IPSAS 5 Borrowing Costs as adopted by the Maltese Government and IPSAS 5:

Section/s	IPSAS 5 (as adopted)	IPSAS 5
25	Not Used	To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization should be determined by applying a capitalization rate to the outlays on that asset. The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period should not exceed the amount of borrowing costs incurred during that period.
29	Not Used	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.
40(c)	Not Used	The capitalization rate used to determine the amount of borrowing costs eligible for capitalization (when it was necessary to apply a capitalization rate to funds borrowed generally).