
IAS 23 Borrowing costs
Scope
Interest incurred on a loan take to acquire or construct a qualifying asset
Qualifying asset
Take time
to get ready for intended use
1. PPE
2. IA under develop
3. Made to order inventory
Borrowing costs
Borrowing costs includes interest using the effective interest rate
premium
discount
transaction costs
Exchange difference arising from foreign borrowings
regarded as
Adjustment to
Interest costs
Capitalisation rate
Specific Borrowings
Specific interest rate
of borrowings
General Borrowings
Weighted Average
Temporary income
Total Interest
Total Loan Amount
When
Commencement of Capitalisation
Borrowing costs incurred
expenses incurred
activities started
Cessation of Capitalisation
asset is
ready for use
Temporary suspension
Expenses
write off
Reasons
Matching concept The cost is to generate future economic benefits
The cost of buying a PPE & constructing a PPE should be the same
Spencer Cheah
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IAS 23: BORROWING COSTS

SCOPE

The objective of IAS 23 is to prescribe the accounting treatment for borrowing costs. Borrowing costs include interest on bank overdrafts and borrowings, amortisation of discounts or premiums on borrowings, finance charges on finance leases and exchange differences on foreign currency borrowings where they are regarded as an adjustment to interest costs.

IAS 23 Borrowing costs refers to all interest incurred on loan taken to acquire or construct a **qualifying asset.** A qualifying asset is an asset that will take substantial time to get ready for its intended use.

Example:
Which of the below asset can be treated as a qualifying asset under IAS 23 *Borrowing Costs*.

☐ Development costs that do not meet the criteria of IAS 38
☐ Construction of investment properties
☐ The entity took a loan to construct an equipment for sale to a customer. The construction will take approximately 8 months.

BORROWING COSTS

Borrowing costs refers to the interest incurred on the loan. However, there may be other costs incurred such as discount on issue, premium on redemption, issue costs or even exchange differences arising from foreign borrowings. All these costs are used to determine the effective interest rate for capitalization.

Example:
ABC issued $10 million 3% bond on 1 January 2019 for $8.5 million. The bond will mature in 3 years-time where it will be redeemed at $11 million. The entity incurs an issue cost of $0.5 million. During the year there was a penalty of $0.2 million for late payment of interest.

Which of the following can be capitalized as part of IAS 23 Borrowing Costs?
☐ 3% coupon rate
☐ $1.5 million discount on issue
☐ $1 million premium on redemption
☐ $0.5 million issue costs
☐ $0.2 million penalty

CAPITALISATION RATE

Borrowing cost may include:

- interest expense calculated by the effective interest method under IFRS 9,
- If the entity has a specific borrowing, the interest rate capitalised is the interest rate incurred. However if it involved general borrowing, the entity will have to use the **WEIGHTED AVERAGE INTEREST RATE.**

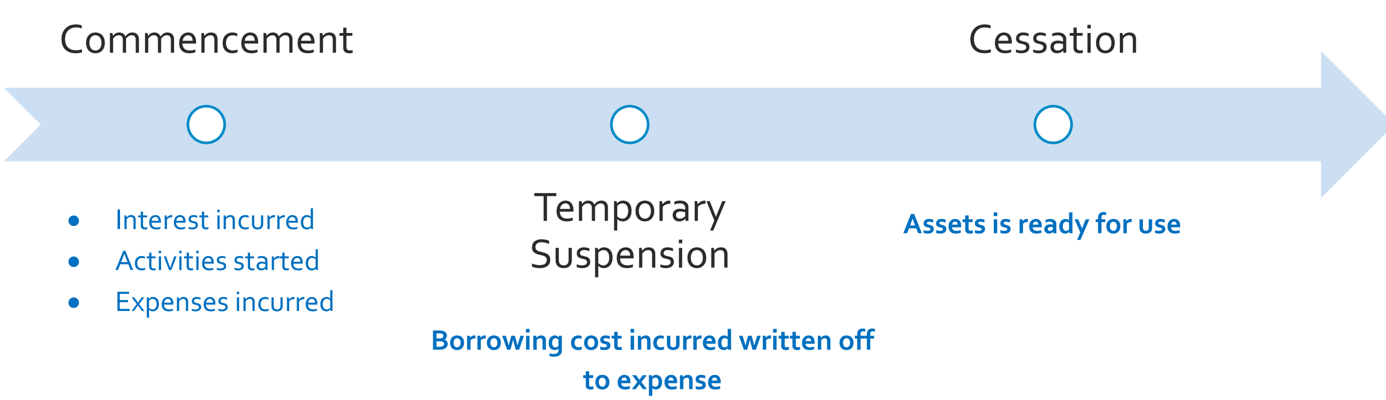
$$\textbf{W/A interest rate} = \frac{\textbf{Total Interest}}{\textbf{Total Loan Amount}}$$

COMMENCEMENT & CESSATION OF CAPITALISATION

An entity will commence capitalisation only when all the following three conditions are met;

- The borrowing costs incurred
- The activities to get the asset ready for use has started
- The expenses are incurred

In the event, there is any temporary suspension any borrowing costs incurred during the period will be written-off as expense. Capitalisation of borrowing cost will cease when the asset is ready for use.



Example:

On 1 January 2017, ABC took a $500 million loan to finance the construction of a property which is expected to take two years to complete. The construction of the property started on 1 April 2017.

The loan drawn-down was as follows:

1 January 2017	$200 million
1 April 2017	$300 million

Construction of the property was halted for a month in July due to a mistake by the architect. Meanwhile a temporary income of $500,000 was earned in September 2017.

Assuming that the borrowing cost is 10%, determine the borrowing cost capitalized and also written off for the year ended 31 December 2017.

Solution:

PYQ: Mar/June 2016

Emcee, a public limited company, is a sports organisation which owns several football and basketball teams. It has a financial year end of 31 May 2016. Emcee needs a new stadium to host sporting events which will be included as part of Emcee's property, plant and equipment. Emcee therefore commenced construction on a new stadium on 1 February 2016, and this continued until its completion which was after the year end of 31 May 2016. The direct costs were $20 million in February 2016 and then $50 million in each month until the year end. Emcee has not taken out any specific borrowings to finance the construction of the stadium, but it has incurred finance costs on its general borrowings during the period, which could have been avoided if the stadium had not been constructed. Emcee has calculated that the weighted average cost of borrowings for the period 1 February–31 May 2016 on an annualised basis amounted to 9% per annum. Emcee needs advice on how to treat the borrowing costs in its financial statements for the year ending 31 May 2016.

Required:
Discuss how the above events would be shown in the financial statements of Emcee under International Financial Reporting Standards.

(6 marks)

Solution:

Borrowing costs
IAS 23 allows a borrowing cost to be capitalized if the interest incurred is on a loan taken to acquire or construct a qualifying asset. The construction of a stadium is a qualifying asset thus the interest can be capitalized.

Commencement & cessation of capitalization
Emcee can only start capitalization once the borrowing cost incurred and the expenses and activities to get the asset ready for use started.

Thus, it will start capitalization on 1 February 2016 and once the stadium is ready for use, Emcee will stop capitalization.

Weighted Average cost of borrowings
If an entity has general borrowing, weighted average cost of borrowings would be used. Thus, Emcee will use its weighted average cost of 9%.