LKAS 23

Borrowing Costs

1. Borrowing Costs

Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.

Borrowing Cost Includes:

- ✓ Interest expense calculated using the effective interest method as described in SLFRS 9;
- ✓ Interest in respect of lease liabilities recognised in accordance with SLFRS 16 *Leases*; and
- ✓ Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

The Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability

2. Qualifying Asset

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

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

- Inventories
- Manufacturing plants
- Power generation facilities
- Intangible assets
- Investment properties
- Bearer plants

3. Recognition

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the **cost of that asset.**

Criteria:

- When it is probable that they will result in future economic benefits to the entity and
- The costs can be measured reliably.

4. Borrowing costs eligible for capitalization

Entity borrows funds specifically

Entity borrows funds generally

Entity borrows funds specifically

	Rs
The actual borrowing costs incurred on that borrowing during the period	100.00
Less: Any investment income on the temporary investment of those borrowings	(3.00)
The amount of borrowing costs eligible for capitalization	**97.00**

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Entity borrows funds generally

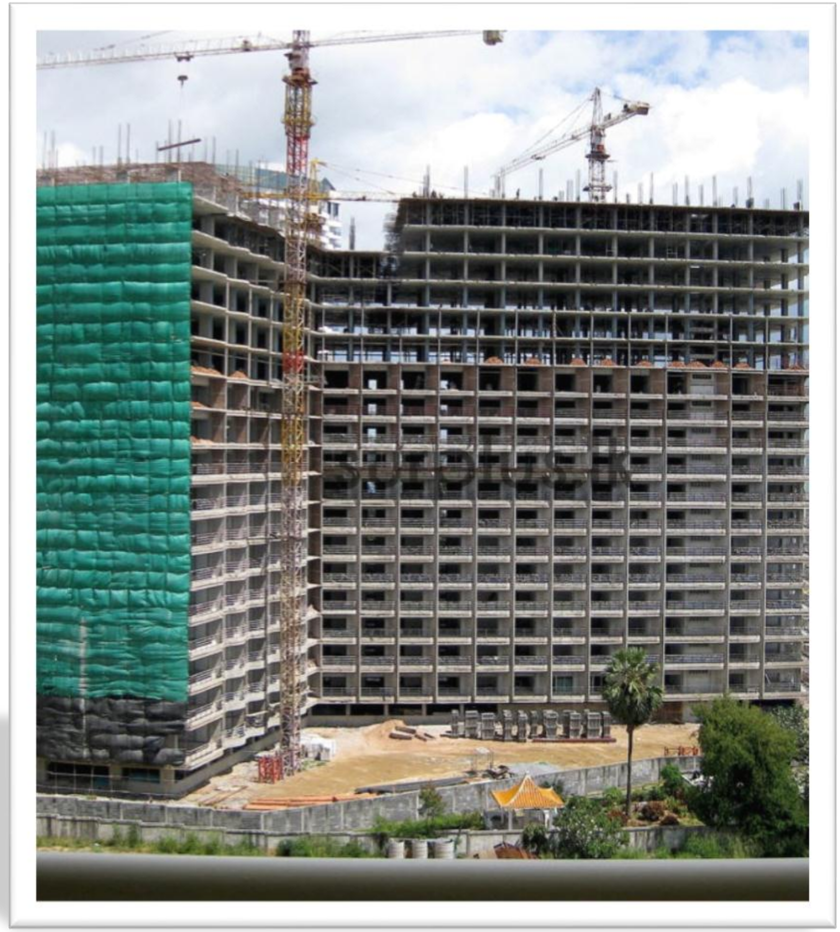
Capitalisation Rate → weighted average of the borrowing cost

5. Excess of the carrying amount of the qualifying asset over recoverable amount

Carrying Value > Recoverable Value ➡ Impairment

6. Commencement Of Capitalisation

a) It incurs expenditures for the asset;
b) It incurs borrowing costs; and
c) It undertakes activities that are necessary to prepare the asset for its intended use or sale.



7. Suspension Of Capitalisation

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

8. Cessation Of Capitalisation

- An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- 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 are outstanding, this indicates that substantially all the activities are complete.
- 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.

9. Disclosure

- The amount of borrowing costs capitalised during the period
- The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Question 01

Carriageways Co had the following bank loan outstanding during the whole of 2018 which from the company's general borrowings for the year:

	Rs.
9% loan repayable 2019	15 mn
11% loan repayable 2020	24 mn

Carriageways Co began construction of a qualifying asset on 1st April 2018 and withdraw funds of Rs. 10 mn on that date to fund construction.

On 1 August 2018 an additional Rs. 8 mn was withdrawn for the same purpose.

Calculate the borrowing costs which can be capitalized in respect of this project for the year ended 31st December 2018.

Question 02

Leclerc Co has borrowed Rs. 2.4 mn to finance the building of a building. Construction is expected to take two years. The loan was drawn on 1 January 2018 and work began on 1 March 2018. Rs. 1 million of the loan was not utilized until 1 July 2018 . So Leclerc was able to invest it until needed.

Leclerc Co is paying 8% on the loan and can invest surplus funds at 6%.

Calculate the borrowing cost to be capitalized for the year ended 31 December 2018 in respect of this project.

Question 03

Appex issued a Rs. 10 million unsecured loan with a coupon nominal interest rate of 6% on 01 April 2018. The loan is redeemable at a premium which means the loan has an effective finance cost of 7.5% per annum. The loan was specifically issued to finance the building of the new store which meets the definition of LKAS 23.

Construction of the store commenced on 01 May 2018 and it was completed and ready for use on 28 February 2019, but did not open for trading until 01 April 2019.

During the year trading at Appex's other stores was below expectations Appex suspended the construction of the new store for a two month period during July and August 2018. The proceeds of the loan were temporarily invested for the month of April 2018 and earned interest of $ 40,000.

Required:

Prepare a schedule showing the net borrowing cost that should be capitalized as part of the cost of the new store and the finance cost that should be reported in profit and loss for the year ended 31 March 2019.