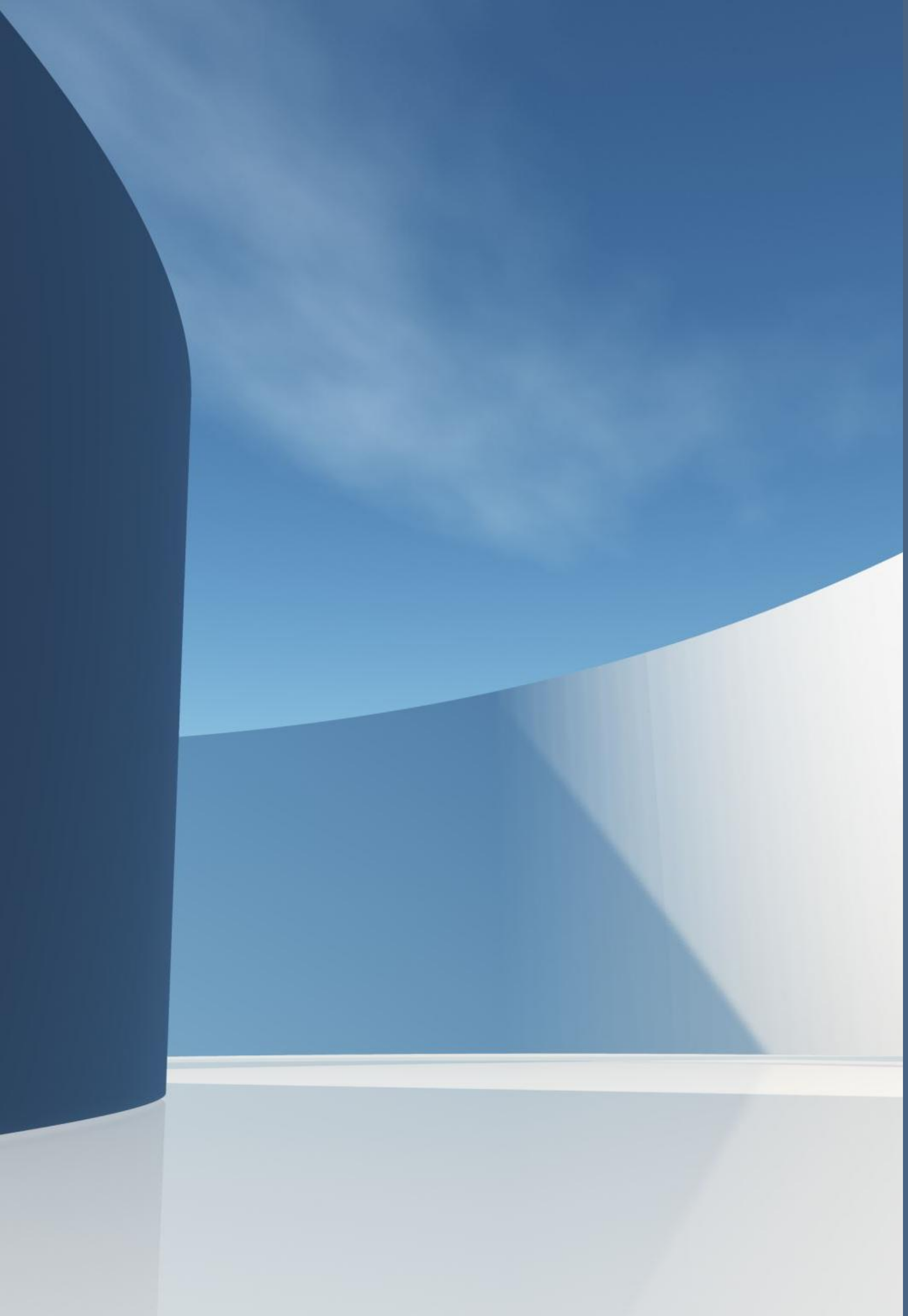

FINANCIAL REPORTING

IAS 23: Borrowing Costs

BORROWING COSTS DEFINED

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

They may include;

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

CORE PRINCIPLE IN THE STANDARD

- **Borrowing costs** that are directly attributable to the acquisition, construction or production of a **qualifying asset** form part of the **cost** of that asset. Any other borrowing costs are recognized as an expense in the statement of profit or loss.

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

Any of the following may be a qualifying asset;

- Manufacturing plants
- Inventories
- Intangible assets
- Investment properties
- Bearer plants.

SCOPE OF THE STANDARD

The standard does not apply to;

- Qualifying assets measured at fair value, such as biological assets accounted for under IAS 41 Agriculture.
- Inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis and that take a substantial period to get ready for sale.

RECOGNITION

- An entity shall capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. (those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made).
- An entity shall recognize other borrowing costs as an expense in the period in which it incurs them.

MEASUREMENT OF BORROWING COSTS

- If an entity borrows funds ***specifically for the purpose of obtaining a qualifying asset***, the amount of borrowing costs eligible for capitalization shall 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.

- If an entity borrows funds ***generally and uses them to obtain a qualifying asset***, the amount of borrowing costs eligible for capitalization shall be determined by ***applying the capitalization rate to the expenditures on the asset***. The capitalization rate is the ***weighted average of the borrowing costs*** applicable to all borrowings of the entity that are outstanding during the period. Borrowing costs applicable to borrowings made specifically for the purpose of obtaining a qualifying asset should be excluded from the computation.

COMMENCEMENT OF CAPITALIZATION

IAS 23 states that capitalization of borrowing costs should commence when all of the following conditions are met:

- Expenditure for the asset is being incurred.
- Borrowing costs are being incurred.
- activities that are necessary to prepare the asset for its intended use or sale are in progress.

ILLUSTRATIONS

Illustration one:

Amazima schools ltd obtained a 7% Ugx. 100 million loan from standard bank on 01 January 2022 to finance the construction of its new administration block with an estimated useful life of 20 years. The school board decided to temporarily invest Ugx. 20 million in 2% treasury bills until 31 March 2022 since not all the funds were needed immediately. Active construction of the block began on 01 February 2022 and was officially completed on 30 November 2022.

Required: Compute the amount of borrowing costs to be capitalized to the cost of the building and consequently show how the building will be accounted for in the financial statements for the year ended 31 December 2022.

Illustration two:

If Amazima schools ltd was to finance the construction of the block from a pool of outstanding loans of the school constituting of a 7% Ugx. 100 million loan stock from Standard Bank, 15% Ugx. 50 million loan from Development Bank and 12% Ugx. 130 million loan from Rural Bank.

Required: Compute the capitalization rate to be used in computing borrowing costs eligible for capitalization.

SUSPENSION OF CAPITALIZATION

An entity shall suspend capitalization of borrowing costs during extended periods in which it suspends active development of a qualifying asset such as due to industrial disputes, staff strikes among others.

However,

An entity does not suspend capitalizing borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

CESSATION OF CAPITALIZATION

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.

Note:

If the construction of the qualifying asset is completed in parts, and each part is capable of being used as construction continues on other parts, the entity shall cease capitalization for that part when it completes substantially all the activities necessary to prepare that part for its intended use or sale.

DISCLOSURES

- amount of borrowing cost capitalized during the period.
- capitalization rate used.

QUESTIONS

May 2024 Qn 2