**NSTITUTE OF FINANCE MANAGEMENT**

**ADVANCED FINANCIAL REPORTING I**

**BACC3 AND BAIT 3 AND BAS 3 (2022/2023)**

**IAS 23 BORROWING COSTS**

**REVIEW QUESTIONS**

**Question 1**

On 1 January 2015, Sainsco began to construct a supermarket which had an estimated useful life of 40 years. It purchased a leasehold interest in the site for Tshs 25 million. The construction of the building cost Tshs 9 million and the fixtures and fittings cost Tshs 6 million. The construction of the supermarket was completed on 30 September 2015 and it was brought into use on 1 January 2016. Sainsco borrowed Tshs 40 million on 1 January 2015 in order to finance this project. The loan carried interest at 10% pa. It was repaid on 30 June

20X6.

**Required**

1. Calculate the borrowing costs to be capitalized
2. Calculate the total amount to be included at cost in property, plant and equipment in respect of the development at 31 December 20X5.

**Question 2**

An entity borrowed Tshs 1 million at 7.5% in order to finance the construction of a new building which would take 12 months to complete. As stage payments were to be made in respect of the construction costs, surplus funds were invested and during the 12 month period interest income of Tshs 35,000 was earned.

Required

**Calculate borrowing costs that should be capitalized?**

**Question 3**

A socially responsible multinational corporation (MNC) decided to construct a tunnel that will link two sides of the village that were separated by a natural disaster years ago. Realizing its role as a good corporate citizen, the MNC has been in this village for a couple of years exploring oil and gas in the nearby offshore area. The tunnel would take two years to build and the total capital outlay needed for the construction would be not less than Tshs 20 million. To allow itself a margin of safety, the MNC borrowed Tshs 22 million from three sources and used the extra Tshs 2 million for its working capital purposes. Financing was arranged in this way:

* Bank term loans: Tshs 5 million at 7% per annum
* Institutional borrowings: Tshs 7 million at 8% per annum
* Corporate bonds: Tshs 10 million at 9% per annum

In the first phase of the construction of the tunnel, there were idle funds of Tshs 10 million, which the MNC invested for a period of six months. Income from this investment was Tshs 500,000.

**Required**

What borrowing costs should be capitalized?

**Question 4**

1. Apex is a publicly listed supermarket chain. During the current year it started the building of a new store. The directors are aware that in accordance with IAS 23 *Borrowing costs* certain borrowing costs have to be capitalised.

**Required: Explain the circumstances when, and the amount at which, borrowing costs should be capitalised in accordance with IAS 23**

1. Details relating to construction of Apex’s new store: Apex issued a Tshs 10 million unsecured loan with a coupon (nominal) interest rate of 6% on 1 April 2014. 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 defi nition of a qualifying asset in IAS 23. Construction of the store commenced on 1 May 2014 and it was completed and ready for use on 28 February 2015, but did not open for trading until 1 April 2015. During the year trading at Apex’s other stores was below expectations so Apex suspended the construction of the new store for a two-month period during July and August 2014. The proceeds of the loan were temporarily invested for the month of April 2014 and earned interest of Tshs 40,000.

**Required: Calculate the net borrowing cost that should be capitalised as part of the cost of the new store and the finance cost that should be reported in the income statement for the year ended 31 March 2015**

**Question 5**

1. Highlife Company is a company that builds holiday resorts. On 1 July 2014, Highlife Company borrowed Tshs 12 million at annual interest rate of 10% to finance the purchase of land and development of a resort for its own business. The asset was built in order to accommodate holidays starting from 1st May 2015. Highlife began the construction of the new resort on 1 August 2014. Construction ceased completely for half a month to accommodate the Christmas and New Year Holidays. The resort was completed on March 2015. Investment income of Tshs 100,000 was earned from temporary investment borrowings drawn down but not yet applied to finance construction work.
2. Highlife has also constructed a new head office. The new head office has been financed from the pool of existing borrowings. The cost of the new office block was 20million. Construction was started on 1 July 2014 and was scheduled to be completed by 31 March 2015. In fact, the building was completed on 30 June 2015 as the Company encountered geographical complications with the building’s foundations. It also suffered dispute with workers over pay and work conditions which resulted in a strike. This strike caused a halt to construction for 2 months until it was resolved.

**Pool of existing borrowings Amount Annual interest rate %**

Bank overdraft 10,000,000 12

Bank loan 20,000,000 9

Debenture 30,000,000 6

**Required**

1. Explain the circumstances in which borrowings costs should be capitalized, including explanation of how to deals with periods where no construction is taking place
2. Calculate the amounts to be capitalized to increase the carrying amount of the resort and the head office.
3. Outline the effect of capitalizing borrowing costs attributable to qualifying assets, as opposed to recognizing them in the profit or loss as incurred, on the information provided to users of financial statements.

**Question 6**

At a directors' board meeting of Fast Ltd on 1 January 2015, the directors committed themselves to building a new factory building and the work began on 1 February 2015. The work was suspended in June and July because of the unavailability of raw materials. On 1 November 2015, the new factory building was completed and on 1 December 2015 production began in the new factory building.

The cost of the new office building was Tshs2.5 million, which was financed from existing borrowings. The borrowings and interest rates for the year ended 31 December 2015 were as follows:

* Bank loan Tshs1.5 million 6% p.a
* Debenture Tshs2.5 million 8% p.a

It is the accounting policy of Fast Ltd to capitalise borrowing costs and the accountant at Fast Ltd has capitalised borrowing costs of Tshs0.2 million, being Tshs2.5 million at 8%.

**Required:**

Draft a reply to your finance director which by presenting the revised calculations in accordance with International Financial Reporting Standards.

**Question 7**

1. IAS 23 ‘Borrowing Costs’ had a benchmark treatment that required borrowing costs to be recognised as an expense in the period in which they are incurred. During March 2015, the IASB issued amendments to IAS 23. These amendments eliminate the option available under the existing standard to recognize borrowing costs as an expense. Under the revised standard, to the extent that borrowing costs relate to the acquisition, construction or production of a “qualifying asset,” they should be capitalized as part of the cost of the asset.

**Required:**

**Discuss the arguments in favour of, and those against, the capitalisation of borrowing costs as part of the cost of an asset.**

1. On 1 April 2015, Webster commenced the construction of a large development consisting of several separate retail premises. It has a policy of capitalising borrowing costs where this is permissible under IAS 23. At 31 March 2016 the amount of expenditure on the development totalled Tshs 12 million. These expenditures can be taken to have been incurred evenly throughout the year. The development is being financed from funds generally borrowed for the construction of similar development projects. Webster’s cost of capital on these funds can be calculated from the following:

Tshs 2 million overdraft at 15% per annum

Tshs 3 million 5 year secured 8% loan note

Tshs 5 million 5 year unsecured 10 % loan note

Construction of the development was halted twice during the accounting period to 31 March 2016. The first occasion, for a two-week period, was due to the discovery of ancient artefacts unearthed during excavation work. The second, an extended period of two months, was due to an industrial relations dispute.

**Required:**

**Calculate the amount of finance costs that Webster should capitalised for the period to 31 March 2016**

**Question 8**

XYZ a publicly listed company had two loans in existence in the year it commenced construction of a qualifying asset.

**The details of the loans are:**

|  |  |  |
| --- | --- | --- |
|  | 1st January 2013 | 31st December 2013 |
|  | Tshs'million | Tshs'million |
| 12% bank loan repayable in 2016 | 500 | 500 |
| 9% bank loan repayable in 2017 | 750 | 750 |

The two loan notes were originally generally obtained but partly applied to the construction of a qualifying asset. Construction works began on 1st April 2013 with expenditure of Tshs 180 million and Tshs 70 million drawn down for the construction on 1st April 2013 and 1st November 2013 respectively, from existing loans. Construction works were completed on 31st December 2013.

**Required:**

Explain and quantify how the borrowing costs on the loans and the qualifying asset ought to be accounted for by XYZ for the year ended 31st December 2013 in accordance with IAS 23 ‘Borrowing costs’.