

BORROWING COST (IAS 23/IPSAS 5)

These are cost associated with borrowing e.g. interests and floatation cost that an entity incurs in connection with borrowing. Borrowing cost is directly attributable to the acquisition, construction or production of a qualifying asset. **They should be capitalized. Other borrowing costs are recognized as an expense eg legal expense.**

Examples of borrowing costs.

- a) Interest on loan/borrowing.
- b) Floatation cost eg legal costs.
- c) Principle amount.
- d) Amortization of discount or premium relating to borrowing.
- e) Exchange difference in-case of foreign currency transaction.

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

Example of qualifying asset.

- Inventory that are manufactured or produced over a long period of time.
- Manufacturing plant.
- Power generation facilities.
- Intangible assets.
- Investment properties

Accounting treatment and recognition of borrowing costs.

- ❖ 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.
- ❖ An entity shall recognize other borrowing cost as an expense in the period in which it incurs them.

Borrowing cost eligible to be capitalized

- Interest cost will only be capitalized as part of qualifying asset during the period of active construction during the year.
- Interest cost incurred before commencement and during inactive period should be charged to profit and loss.
- Interest income earned from temporary investment of surplus funds should be deducted from the borrowing cost eligible for capitalization.
- Interest earned during the preconstruction and inactive period should be excluded from determination of borrowing cost to be capitalized.
- When a qualifying asset is financed by more than one debt, the interest cap rate will be determined as follows :

$$\text{CAP RATE} = \frac{\text{Aggregate interest cost}}{\text{Aggregate amount borrowed}}.$$

How accounting treatment under IPSAS 5 differs from IAS 23.

IPAS 5 requires borrowing costs to be expensed immediately in the period in which they are incurred regardless of how the borrowing is applied. This is the benchmark treatment.

Under IAS 23 the revised version requires that all borrowing costs that are eligible for capitalization should be capitalized and included as part of qualifying asset.

Dec 2022 Q 3 b

Net interest to be capitalised	shooo
Interest expense during active period $10\% \times 240000 \times \frac{8}{12}$	1600
Less: Interest income during construction period $6\% \times 10000 \times \frac{3}{12}$	(150)
Borrowing cost to be Capitalised	1450

OR

Interest expense for the year $10\% \times 240000$	2400
less: pre-construction interest cost $10\% \times 240000 \times \frac{2}{12}$	(400)
= Suspense period interest exp (to PSL) $10\% \times 240000 \times \frac{2}{12}$	(400)
Interest expense eligible for Capitalisation	1600
less: interest earned on temporary investment	
Interest income earned $6\% \times 10000 \times \frac{5}{12}$	250
less: interest exp during pre-construction $6\% \times 10000 \times \frac{2}{12}$	(100)
Net interest cost to be Capitalised	1450

SEP 2021 Q 4 a

$$\text{Cap rate} = \frac{\text{Aggregate interest expense}}{\text{Aggregate debt outstanding}} \times 100\%$$

$$= \frac{10\% \times 300,000 + 12\% \times 200,000 \times 100\%}{300,000 + 20,000} = 10.8\%$$

(i) Determination of borrowing cost eligible to be Capitalised

<u>power plant</u>	<u>storage facility</u>
$10.8\% \times 100,000 = 10800$	Interest to 31 Dec 2020
Interest from 1 July 2020	$6\% \times 60,000 \times \frac{9}{12} = 2700$
$10.8\% \times 75000 \times \frac{6}{12} = 4050$	
	<u>14850</u>

(ii) Value of the Asset

	<u>power plant</u>	<u>storage facility</u>
	shooo	shooo
Cost of Construction	175000	60000
Borrowing cost	14850	2700
	<u>189850</u>	<u>62700</u>

Dec 2012 Q5 c.

(i) solution:

	Project A	Project B
Interest expense	$9\% \times 10m$	$9\% \times 20m$
Interest income	$7\% \times 5m \times \frac{1}{2}$	$7\% \times 10m \times \frac{1}{2}$
Borrowing cost to capitalise	<u>725,000</u>	<u>1450,000</u>

(ii) Value of Asset

	Project A	Project B
Amount invested	10,000,000	20,000,000
Borrowing cost	<u>725,000</u>	<u>1450,000</u>
	<u>10,725,000</u>	<u>21,450,000</u>

Sep 2015 Q4 b:

	Mining Equipment	power plant
Interest expense	$8\% \times 60,000 \times \frac{6}{12} = 2400$	$15.6\% \times 40,000$
		$15.6\% \times 30,000 \times \frac{5}{12}$
		<u>1950</u>
		<u>8190</u>

$$\text{Cap rate} = \frac{\text{Aggregate interest exp}}{\text{Aggregate Amount borrowed}} = \frac{10.8\% \times 120,000 + 24\% \times 80,000}{120,000 + 80,000} \times 100\% = 15.6\%$$

(iii) Value of the Asset

Mining Equipment power plant

	Mining Equipment	power plant
Cost invested	60,000	70,000
Borrowing cost	<u>2400</u>	<u>8190</u>
	<u>62400</u>	<u>78190</u>