Newsletter

IFRS Alert

Should borrowing costs be capitalised on qualifying expenditures incurred before borrowing costs are incurred?

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pwc

Issue analysis

Should borrowing costs be capitalised on qualifying expenditures incurred before borrowing costs are incurred?

Scenario

- On 1 February 20X1, Entity A began the construction of a qualifying asset.
- At the start of the construction and throughout the financial year ended 31 December 20X1, Entity A had no borrowings.
- On 1 January 20X2, Entity A borrows funds generally.

	Financial year ended 31 December 20X1	**Financial year ended 31 December 20X2**
Expenditure on qualifying assets		
• current year	VND 500 m	VND 800 m
• cumulative to-date	VND 500 m	VND 1,300 m
Borrowings drawndown on 1 January 20X2		VND 2,000 m

Borrowing costs should only be capitalised when incurred, i.e from 1 Jan 20X2. In determining the amount of the borrowing costs eligible for capitalisation in 20X2, Entity A applies the capitalisation rate of 8% to the amount of qualifying expenditures incurred.

Issue

What is the amount of borrowing costs eligible for capitalisation in financial year ended 31 December 20X2?

Issue analysis

Should borrowing costs be capitalised on qualifying expenditures incurred before borrowing costs are incurred?

Analysis and conclusion

1) Commencement of capitalisation of borrowing costs
Applying IAS 23.17, Entity A begins the capitalisation of borrowing costs from the date borrowing costs are incurred, i.e 1 January 20X2.

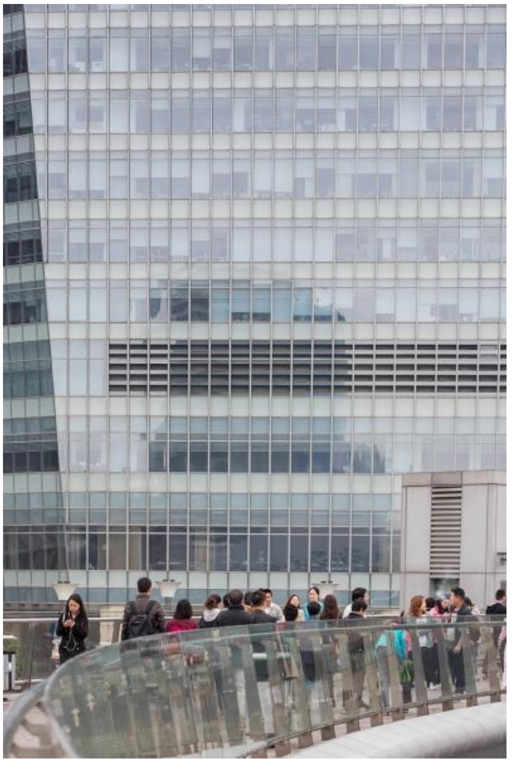
2) Determining the expenditures on the qualifying asset to which the entity applies the capitalisation rate
In accordance with IAS 23.14, Entity A applies the capitalisation rate to the expenditures on that asset. This includes expenditures incurred before the entity obtains the general borrowings.

Illustration:
Assuming Entity A incurred the VND800 m qualifying expenditures evenly throughout 20X2, the amount of borrowing costs eligible for capitalisation in 20X2 is as follows:

Qualifying expenditure		**Weighted average**	**Capitalisation rate**	**Borrowing costs capitalised**
Incurred in 20X1	500 m	500 m	8%/p.a.	40 m (8% x 500 m)
Incurred in 20X2	800 m	650 m (assumed)	8%/p.a.	52 m (8% x 650 m)
Total	1,300 m	1,150 m		92 m (8% x 1,150 m)

Related standards

What standards should be applied/referred to in accounting for borrowing costs?



IAS23.14
To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period.

However, an entity shall exclude from this calculation borrowing costs applicable to borrowings made specifically for the purpose of obtaining a qualifying asset until substantially all the activities necessary to prepare that asset for its intended use or sale are complete. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

IAS 23.17
An entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:

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.

In accordance with IAS 23.14, Entity A applies the capitalisation rate to the expenditures on that asset. This includes expenditures incurred before the entity obtains the general borrowings.

Contact us

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