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Status: Final**Effective date:**Periods beginning on or after 1st January
2009**Accounting impact:**Mandatory capitalisation of qualifying
borrowing costs

International Financial Reporting Bulletin

IAS 23 *Borrowing Costs*

Background

The current version of IAS 23 permits two approaches to borrowing costs. The benchmark treatment is to charge them as an expense in the period in which they are incurred, with an allowed alternative treatment being to add borrowing costs to the carrying value of qualifying assets. The latest revision to IAS 23 *requires* interest to be capitalised in certain circumstances.

Requirements

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are required to be added to the cost of that asset. Borrowing costs are capitalised using either the actual interest rate charged on funds borrowed specifically to construct an asset, or the weighted average cost of general borrowings. Borrowing costs are capitalised while the asset is being prepared for use.

Other borrowing costs are recognised as an expense.

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.

Eligible borrowing costs

Borrowing costs include interest, the amortisation of related discounts and premiums, and ancillary costs incurred in connection with the arrangement of overdrafts and borrowings.

If funds are borrowed specifically to acquire an asset, then the borrowing costs capitalised are the actual costs incurred on the borrowings, net of any investment income derived from temporarily investing surplus funds.

If funds used to acquire an asset come from general borrowings, then a capitalisation rate is applied to the expenditure. The capitalisation rate is the weighted average borrowing cost for the period. Specific funds borrowed to acquire another qualifying asset are excluded from the calculation of the weighted average capitalisation rate.

The total borrowing costs capitalised in a period must not exceed the total borrowing costs incurred during that period.

Commencement of capitalisation and the average carrying amount

Capitalisation commences when an entity first meets all of the following conditions:

- it incurs expenditure on a qualifying asset;
- it incurs borrowing costs; and
- it undertakes activities necessary to prepare the asset for its intended use or sale.

The average carrying amount on which the capitalisation rate is applied includes previously capitalised borrowing costs, but it is reduced by any payments and grants received.

Activities necessary to prepare the asset for its intended use or sale include technical and administrative work prior to commencement of physical construction. However, interest incurred while assets are held without being developed does not qualify for capitalisation. For example, borrowing costs incurred while land is under development are capitalised as the development work is undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any development work being carried out are expensed, as they do not qualify for capitalisation.

Suspension of capitalisation Capitalisation of borrowing costs is suspended during extended periods in which active development is suspended. However, capitalisation is not normally suspended if technical or administrative work is being undertaken, or if a temporary delay is a necessary part of getting an asset ready for its intended use.

Cessation of capitalisation Capitalisation of borrowing costs ceases when substantially all the activities necessary to prepare the asset for its intended use or sale are complete. This will be the case for instance, where minor modifications are required, such as decorating a property to the purchaser's specification, or where only routine administrative work is required for completion.

If an asset is completed in stages, and each stage is capable of independent use or sale, then capitalisation of borrowing costs ceases as each stage is completed. An example of this is developing a business park, where each unit can be used or sold independently.

Disclosure The following items are required to be disclosed:

- the amount of borrowing costs capitalised during the period; and
- the capitalisation rate used.

Effective date and transitional provisions

The revised IAS 23 is mandatory for annual periods beginning on or after 1st January 2009. Early application is permitted.

If an entity previously had an accounting policy of expensing borrowing costs, meaning that the adoption of the revised IAS 23 requires a change of accounting policy, the change of accounting policy is not applied retrospectively. The

requirement to capitalise borrowing costs applies to qualifying assets acquired *after* the date of adoption of the revised standard. There is no requirement to restate existing assets (although an earlier date from which borrowing costs are capitalised can be designated if an entity wishes to do so).

Disclosures before adoption

IAS 8 requires entities to disclose information about new standards and interpretations that are in issue, but that are not yet mandatory and which they have not yet adopted, including known or reasonably estimable information about the effect of adoption.

Suggested wording for this disclosure is:

IAS 23 (Revised) *Borrowing Costs* was issued in March 2007 and is effective for periods beginning on or after 1 January 2009. IAS 23 requires entities to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets. If IAS 23 (Revised) had been adopted in this period, then finance costs would have been reduced by approximately £300,000 and property, plant and equipment increased by the same amount.

Action required

Entities should ensure that they are able to record capital expenditure, borrowing costs and construction activities in sufficient detail to enable them to comply with the revised IAS 23 when it is adopted.