IAS 23-

BORROWING COSTS

Presentation by:

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Session Outlook

Objectives

Definitions

Scope

Accounting Treatment

Practical Approach

Borrowing Costs

NSE Listed Companies

Equity – 75%

Debt – 25%

Session Outlook

	2006	2007	2008	2009	2010	2011	2012	**AVERAGE**
BOC	25%	25%	29%	23%	25%	27%	27%	**26%**
EABL	25%	33%	33%	34%	38%	46%	84%	**42%**
EVERADY	52%	63%	56%	60%	66%	75%	67%	**63%**
MUMIAS	35%	38%	39%	39%	39%	39%	38%	**38%**
UNGA	39%	38%	38%	43%	43%	34%	38%	**39%**
AVERAGE	35%	39%	39%	40%	42%	44%	51%	**42%**

Objectives

- To prescribe the accounting treatment for borrowing costs.

Objectives…

Lending rates

- Sacco – 12%
- Bank – 14%

Definitions

Borrowing Cost

This may include;

Interest, finance charges, exchange differences arising from foreign currency borrowings

Qualifying Asset

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

This may include;

- Property, plant and equipment
- Investments property during the construction period
- Intangible asset during the development period
- Made-to-order inventories

Scope

This standard does not apply to the following;

- Actual or imputed cost of equity, including preferred capital not classified as a liability
- Qualifying asset measured at fair value, for example, biological assets measured in accordance with IAS 41- Agriculture
- Inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis and that take substantial period to get ready for sale eg the maturing whisky.

Accounting Treatment

Recognition & Measurement

Borrowing cost that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset and therefore should be capitalized.

Other borrowing costs are recognised as expenses.

Accounting Treatment…

Recognition & Measurement…

Borrowing costs eligible for capitalization

Specific borrowings:

To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalization as the <u>actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.</u>

Accounting Treatment…

Recognition & Measurement…

General borrowings:

To the extent that an entity borrows funds generally and uses it for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the expenditures on that asset.

The capitalization rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Accounting Treatment…

Recognition & Measurement…

Commencement

Capitalization of borrowing costs commences when the entity meets all the following conditions:

- It incurs expenditures for the asset; and
- It incurs borrowing costs; and
- It undertakes activities that are necessary to prepare the asset for its intended use or sale.

Accounting Treatment…

Recognition & Measurement…

Suspension

An entity shall suspend capitalization of borrowing costs during extended periods in which it suspends active development of a qualifying asset.

Accounting Treatment…

Recognition & Measurement…

Cessation

An entity shall cease capitalization of borrowing costs when substantially, all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

When an entity completes the construction of a qualifying asset in parts and each part is capable of being used while construction continues in other parts, the entity shall cease capitalizing borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.

Accounting Treatment...

Disclosure Requirements

- Amount of borrowing cost capitalized in the period
- Capitalization rate used.

Application

Qualifying Assets

Faiba Telecommunication Company has acquired a 4G license. The license could be sold or licensed to a third party.

However, management intends to use it to operate a wireless network. Development of the network starts when the license is acquired.

Question:
Should borrowing costs on the acquisition of the 4G license be capitalized until the network is ready for its intended use?

Application…

Qualifying Assets…

Answer

Yes.

The license has been exclusively acquired to operate the wireless network. The fact that the license can be used or licensed to a third party is irrelevant.

The acquisition of the license is the first step in a wider investment project (developing the network). It is part of the network investment, which meets the definition of a qualifying asset under IAS 23.

Application…

Qualifying Assets…
Illustration II

Cyton Construction Company has incurred expenses for the acquisition of a permit allowing the construction of a building. It has also acquired equipment that will be used for the construction of various buildings.

Question:

Can borrowing costs on the acquisition of the permit and the equipment be capitalized until the construction of the building is complete?

Application…

Qualifying Assets…
Illustration II

Solution:
Yes for the permit, which is specific to one building. It is the first step in a wider investment project. It is part of the construction cost of the building, which meets the definition of a qualifying asset.

No for the equipment, which will be used for other construction projects. It is ready for its 'intended use' at the acquisition date. It does not meet the definition of a qualifying asset.

Application…

Jeni Holdings has the following sources of borrowing;

7 year old loan – Kes 8 million, Interest Kes 1 million
25 year old loan – Kes 12million, Interest Kes 1 Million
Bank overdraft- Kes 4 million, Interest Kes 0.6 million

a. Calculate the capitalization rate if all of the borrowings are used to finance the production of qualified assets but non of the borrowings relate to a specific qualifying asset

b. If the 7 year loan is an amount which can be specifically identified with a qualified asset, the rate which should be used on the other assest.

Application…

Solution

a. (1m+1m+0.6m)/(8m+12m+0.6m) = 10.833%

b. (1m+0.6m)/ (12m+4m) = 10%

The End

Thank you !