IAS 23
Borrowing costs

1. Objective

The objective of IAS 23 is to prescribe the treatment and recognition of borrowing costs. However, entities are not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value, for example a biological asset within the scope of IAS 41 - Agriculture or inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis.

2. Scope

Borrowing costs are interest and other costs incurred by a company in connection with the borrowing of funds.

Borrowing costs may include:

- **Interest expenses calculated** by applying the effective interest method as described in IFRS 9;
- **Exchange differences** arising from borrowings in foreign currency to the extent that are regarded as an adjustment to interest costs;
- **Finance charges** in respect of finance leases (in accordance with IAS 16).

The Standard requires a company to capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. These costs will be included as part of the cost of the asset. A qualifying asset is defined as an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

3. Accounting impact

3.1 If the borrowed funds are specifically allocated to the qualifying asset

In this case, the costs eligible for capitalization correspond to the costs that are specifically incurred during the reporting period, less any investment income obtained through the temporary investment of the borrowed funds.

3.2 If the borrowed funds are not specifically allocated to the qualifying asset

The amount **of borrowing costs eligible for capitalization** should be determined by applying a capitalization rate to the expenditure on the qualifying asset.
This capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the company that are outstanding during the period.
The total amount of the borrowing costs capitalized during a reporting period must never exceed the total amount of borrowing costs incurred during this same period.

Example 1: To finance the investment of a building, company X takes out a loan of 600,000 on 1 February N, released in two installments:

- the 1st installment, amounting to 200,000 and contracted at an annual rate of 4%, was released by the bank on 1 March N;
- the 2nd installment of 400,000, contracted at an annual rate of 4.5% was made available on 1 September N.

Construction of the building was completed on 30 September N. During the interim period while this fixed asset was being produced, company X was able to invest the amount of 150,000 between 1 May N and 31 July N, at a rate of 2%.
The requirement is to calculate the amount of interest to be allocated to the building's cost price 1 December N and capitalized.

The amount of interest paid was equal to:

- installment 1: 200,000 × 4% × 7/12 = 4,667 for the interest incurred between 1 March and 30 September N
- installment 2: 400,000 × 4.5% × 1/12 = 1,500 for the interest incurred between 1 and 30 September N

The amount of interest received for the funds invested was equal to:

150,000 × 2% × 3/12 = 750 for the period between 1 May and 31 July N.
The net cost of the loan eligible for capitalization is therefore: 4,667 + 1,500 – 750 = 5,417.

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Example 2: Company Y took out a loan under the same conditions, but the loan is not specifically allocated to an investment of 500,000. The 600,000 in financing is also used to benefit the company's cash flow to the extent of 100,000 and thus is not available to be invested.
The interest rate to be applied to the investment expenditures must be computed, and used to calculate the amount to be capitalized as part of the cost price of the asset.

This interest rate equals:
[(200,000 × 4% × 10/12) + (400,000 × 4.5 % × 4/12)]/[(200,000 × 10/12) + (400,000 × 4/12)] = 4.22%.

This is the rate used to determine the amount of interest eligible for capitalization, here: [(200,000 × 7/12) + (300,000 × 1/12)] × 4.22% = 5,978.

3.3 Commencement of capitalization

Capitalization of borrowing costs as part of the cost of a qualifying asset must begin when all three of these conditions are met:

- expenditures for the asset have been incurred;
- borrowing costs have been incurred;
- activities necessary to prepare the asset for its intended use or sale begin.

Capitalization of borrowing costs will cease 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, the entity shall cease capitalising borrowing costs in the same way for each part.

Capitalization of borrowing costs must be suspended if the active development of a qualifying asset is interrupted over an extended period (unless the causes for the suspended activity are outside the company's control, such as delays caused by the authorities, weather-related disturbances, etc.).

4. Disclosure

The notes to the accounts must disclose:

- the amount of borrowing costs capitalized during the period;
- the capitalization rate used to determine the amount of borrowing costs eligible for capitalization.