



**JMC JAYASEKERA  
MANAGEMENT CENTRE**  
"Pioneers in Professional Education"

# AAT Level 03

# Financial Accounting and Reporting

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B.Sc. (Acct.) Hons. Gold Medal Winner, ACA, SAT, ACMA (UK), CGMA (UK), CA Prize Winner for AFR subject in Strategic Level II, CA First in Order of Merit Prize Winner in CAB II Level, CIMA Strategic Level Aggregate Prize Winner, Reading for MBA (PIM-SJP).

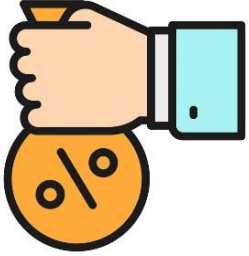
# LKAS 23 – Borrowing Cost

# What is Borrowing Cost?

Interest



# Borrowing Cost Include



Interest Cost



Lease Interest



Foreign Exchange  
Differences on Foreign  
Loans

On  
Borrowings



# Question 01

State whether the following items are borrowing costs or not?

- 1.1 Interest on loan obtained from State bank of China
- 1.2 Interest from fixed deposit made in Sampath Bank
- 1.3 Leasing interest on a lease obtained from LB Finance
- 1.4 Lawyer fee incurred on obtaining the loan
- 1.5 Interest on debentures issued
- 1.6 Foreign exchange gain arose on settling a foreign currency loan.
- 1.7 Foreign exchange loss arose on settling a foreign currency loan.

# What are Qualifying Assets?

Assets take  
Substantial  
Period of Time

To get  
Ready  
for

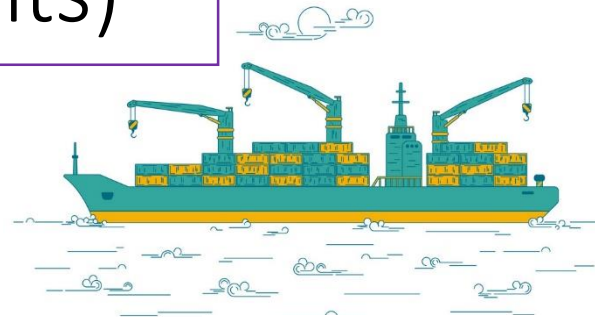
It's  
Intended  
Use or Sale

# Examples for Qualifying Assets

Property Plant and Equipment  
(Buildings, Condominium Properties,  
Highways, Bridges etc.)

Intangible Assets (Software, Patents)

Inventory (Vessels, Aero planes)

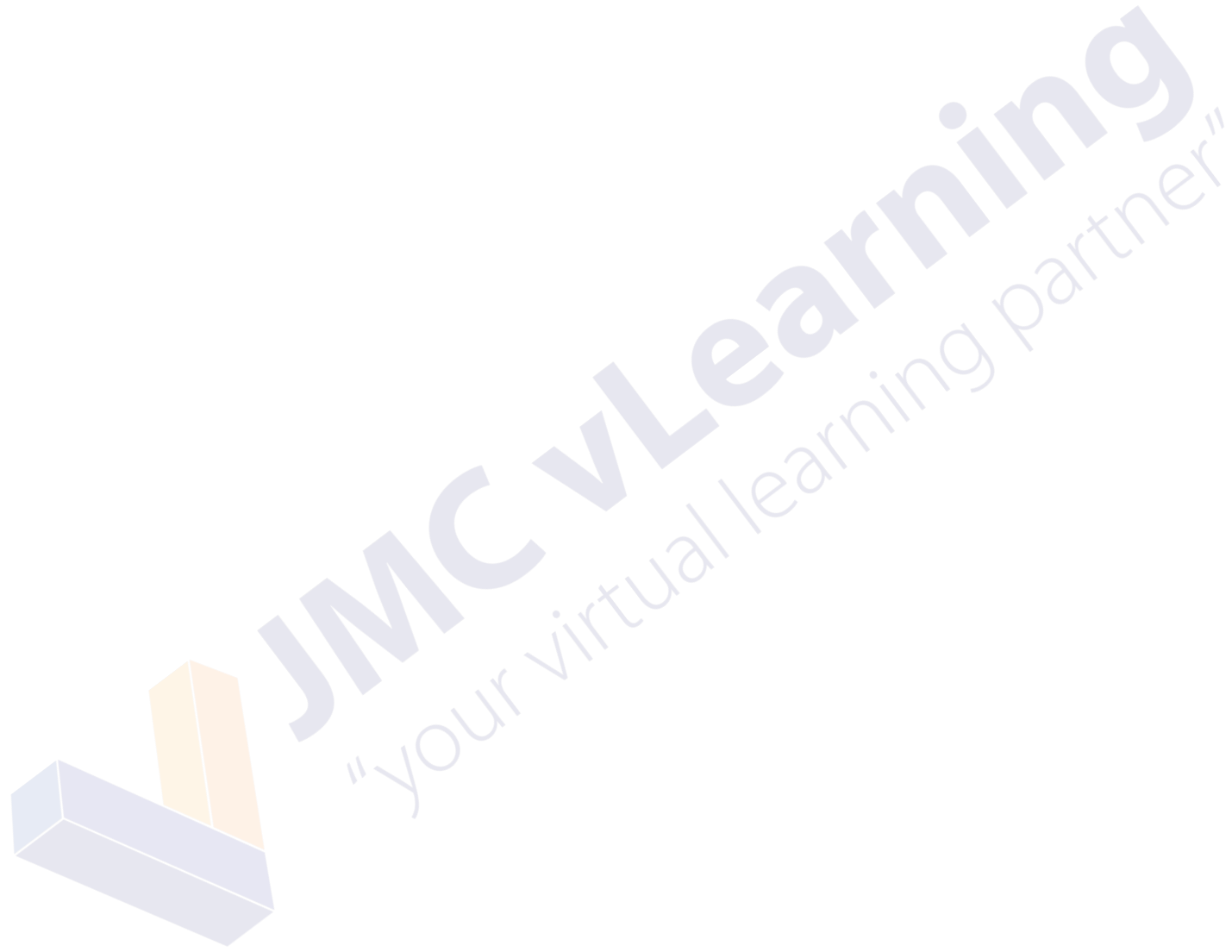


# Question 02

Determine whether following assets are qualifying assets or not

1. Plant purchased on 1/4/X6. Installations were completed on 23/8/X7.
2. Software development project commenced on 1/1/X7, completed on 03/9/X7.
3. Inventory of the company. General manufacturing period is around 1 Month.
4. Engineering items inventory, which takes around 8 months to get ready for the intended use.
5. Building construction project. Expected completion period is 01 year.
6. Acquired bare land, future use has not been determined





# Recognition of Borrowing Cost

## Borrowing Cost on

Qualifying Assets

Other Assets

Capitalize

Charge to PnL

Specific Funds

General Pool of Funds

*Capitalize net interest expense*

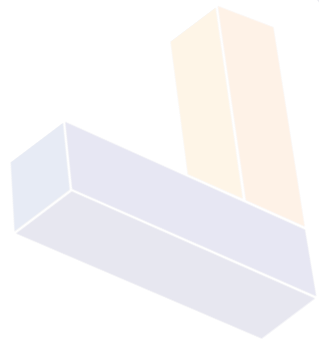
Interest  
Expense

Investment Income  
from Excess funds

*Capitalize gross interest expense.  
Interest Expense calculated using  
weighted average cost of funds  
(Capitalization Rate)*

Specific Fund?

General Pool of Funds?



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# Capitalization Rate Calculation

Total interest cost over  
the period considered

×

100

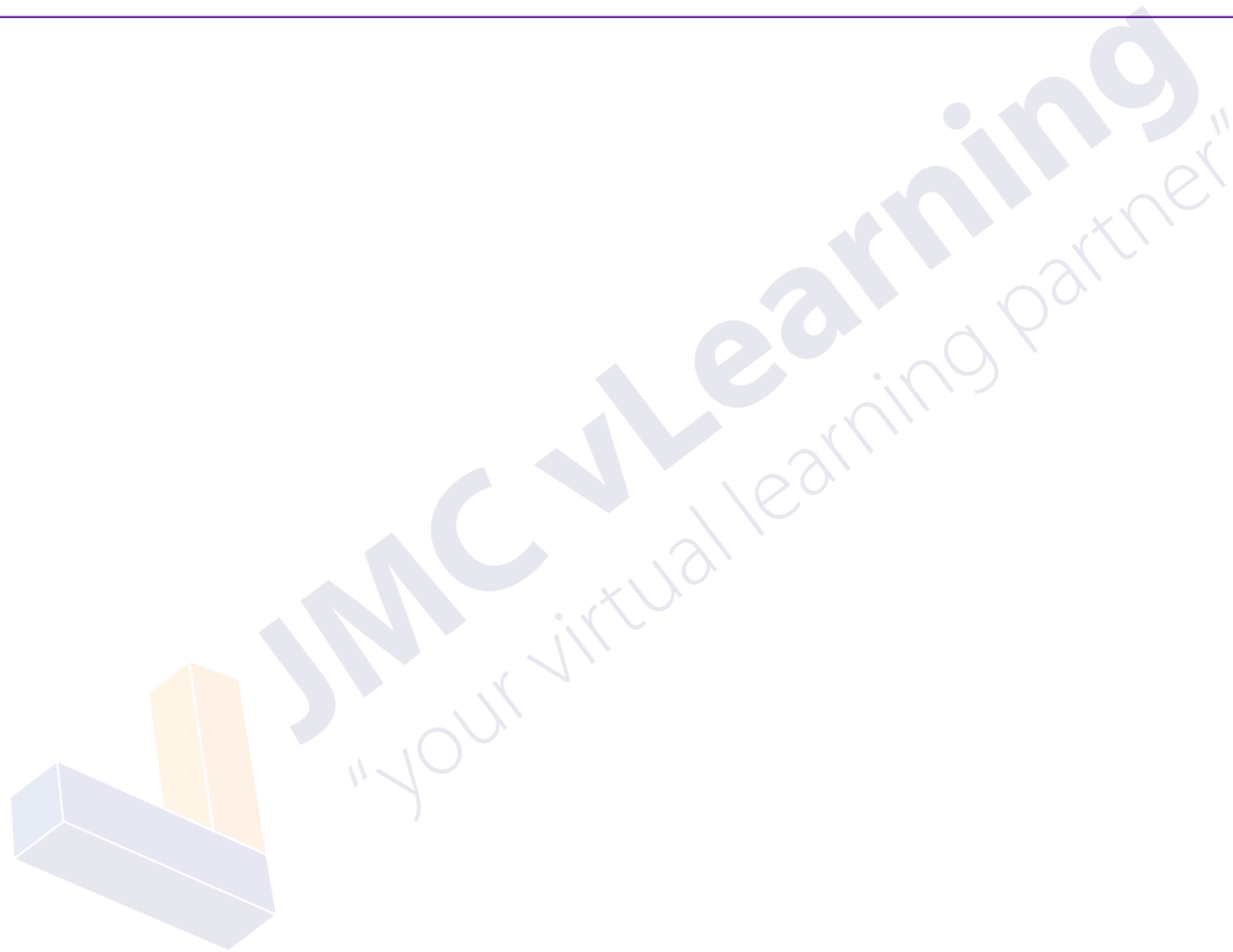
Total borrowings value

# Question 03

Hero PLC has obtained Rs.30Mn 02-year loan from HSBC on constructing a new show room (Project period 12 months) at an interest rate of 10% on 1/1/X8. Another Rs.10Mn three months loan was obtained on 1/1/X8 at the interest rate of 12% to manage the working capital requirements. Working capital cycle is 3 months. Company's Financial year ends on 31 December.

1. Determine whether building and working capital can be classified as Qualifying assets.
2. Calculate the cost of borrowings for the loans separately.
3. Determine the recognition rule based on LKAS 23.

# Answers 03

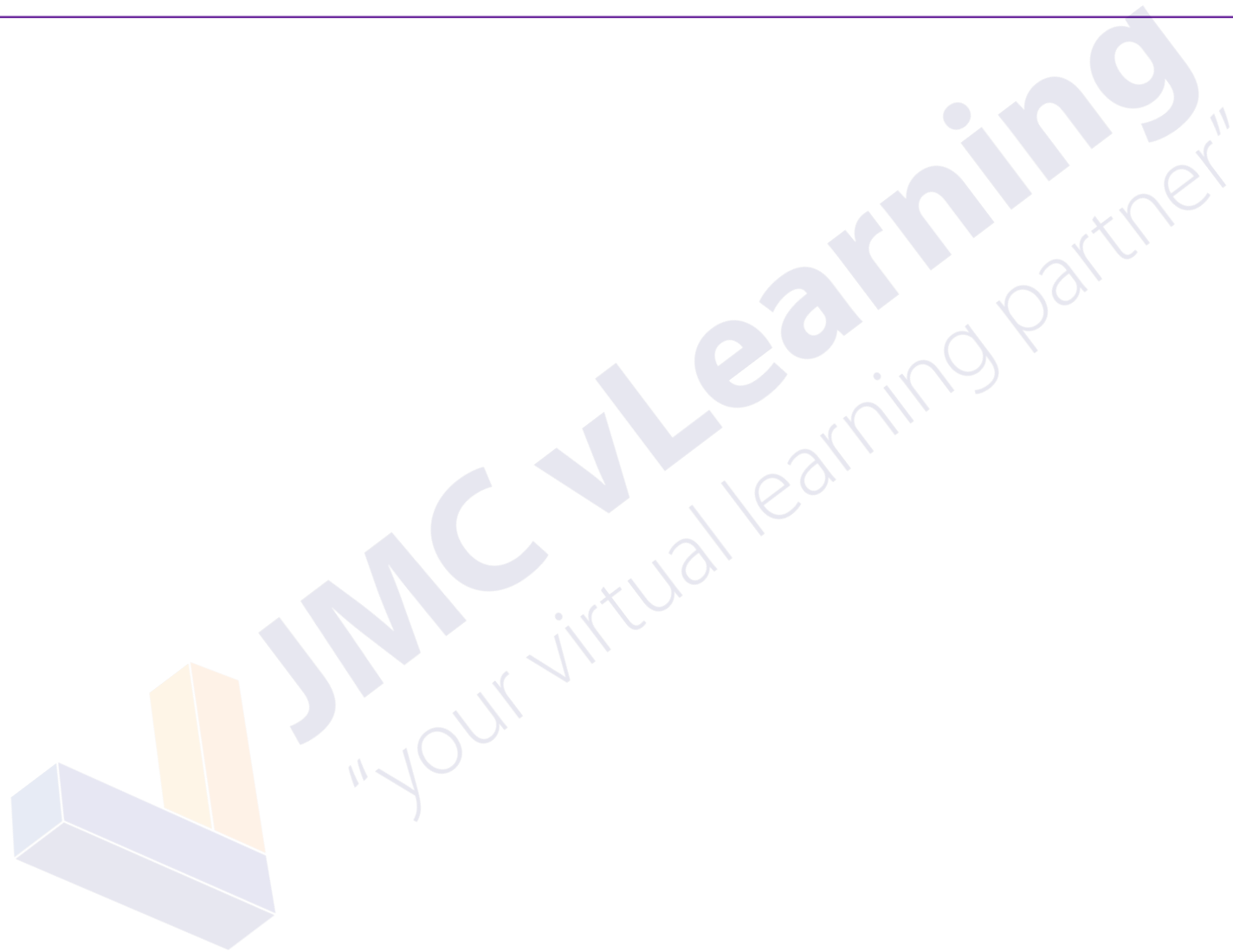


# Question 04

Mega PLC has obtained Rs.10Mn loan from HNB at the interest rate of 10% specifically to fund the Plant development project (01 year) on 1/1/20X8. Out of the total loan value of Rs.10Mn, 50% were invested in a fixed deposit for the first 06 months at an interest rate of 6%. On 30/6/20X8 Fixed deposit got matured and those funds were utilized for the plant development project.

1. Determine whether plant can be classified as a Qualifying asset.
2. Calculate the Cost of borrowings and Investment income.
3. As per LKAS 23, determine the Borrowing cost to be capitalized.

# Answers 04





# Question 05

Mini PLC has following banking facilities available within the company

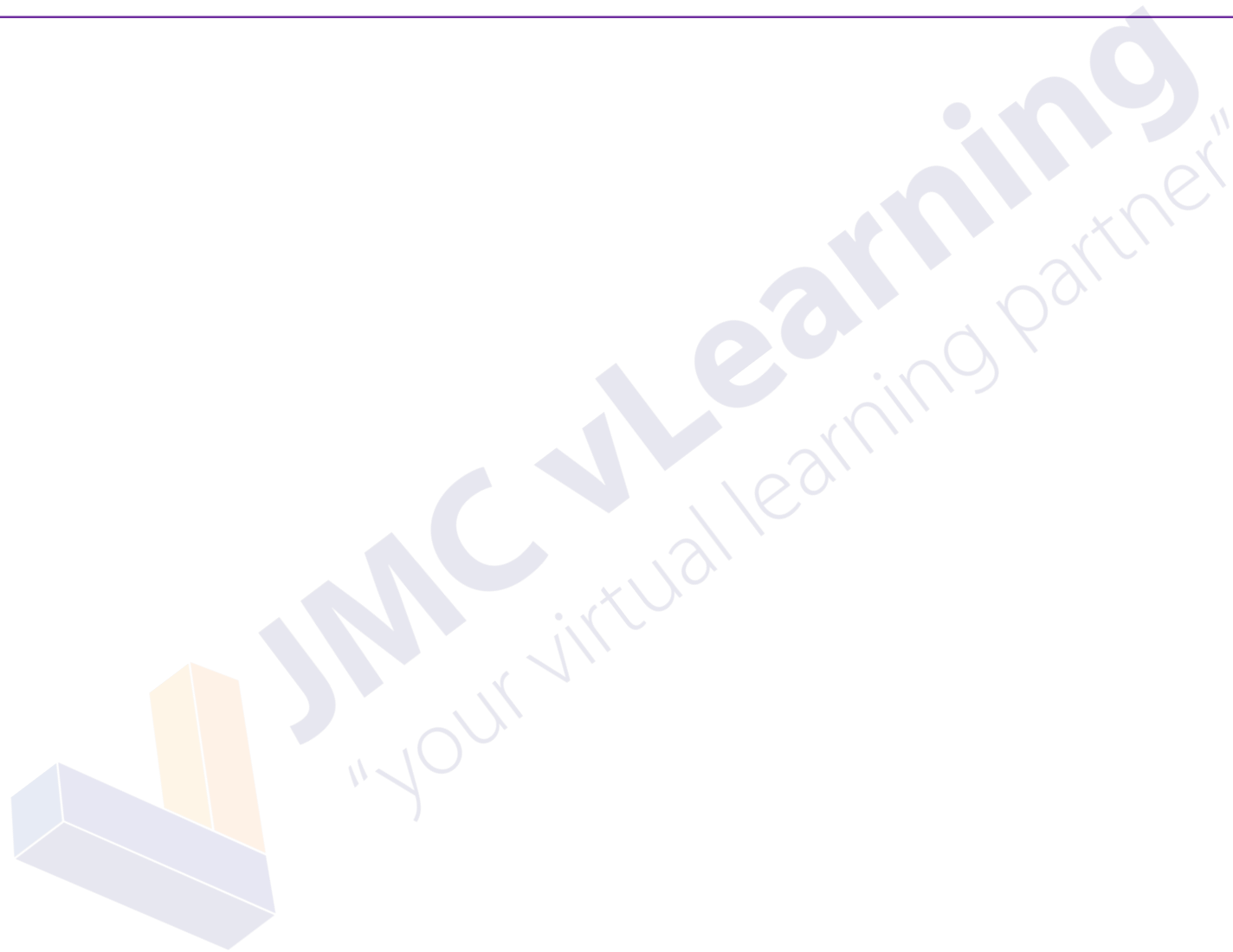
Bank	Facility amount	Interest Rate
Sampath bank	30Mn	10.00%
HSBC	50Mn	10.20%
Standard Chartered	20Mn	10.10%

# Question 05

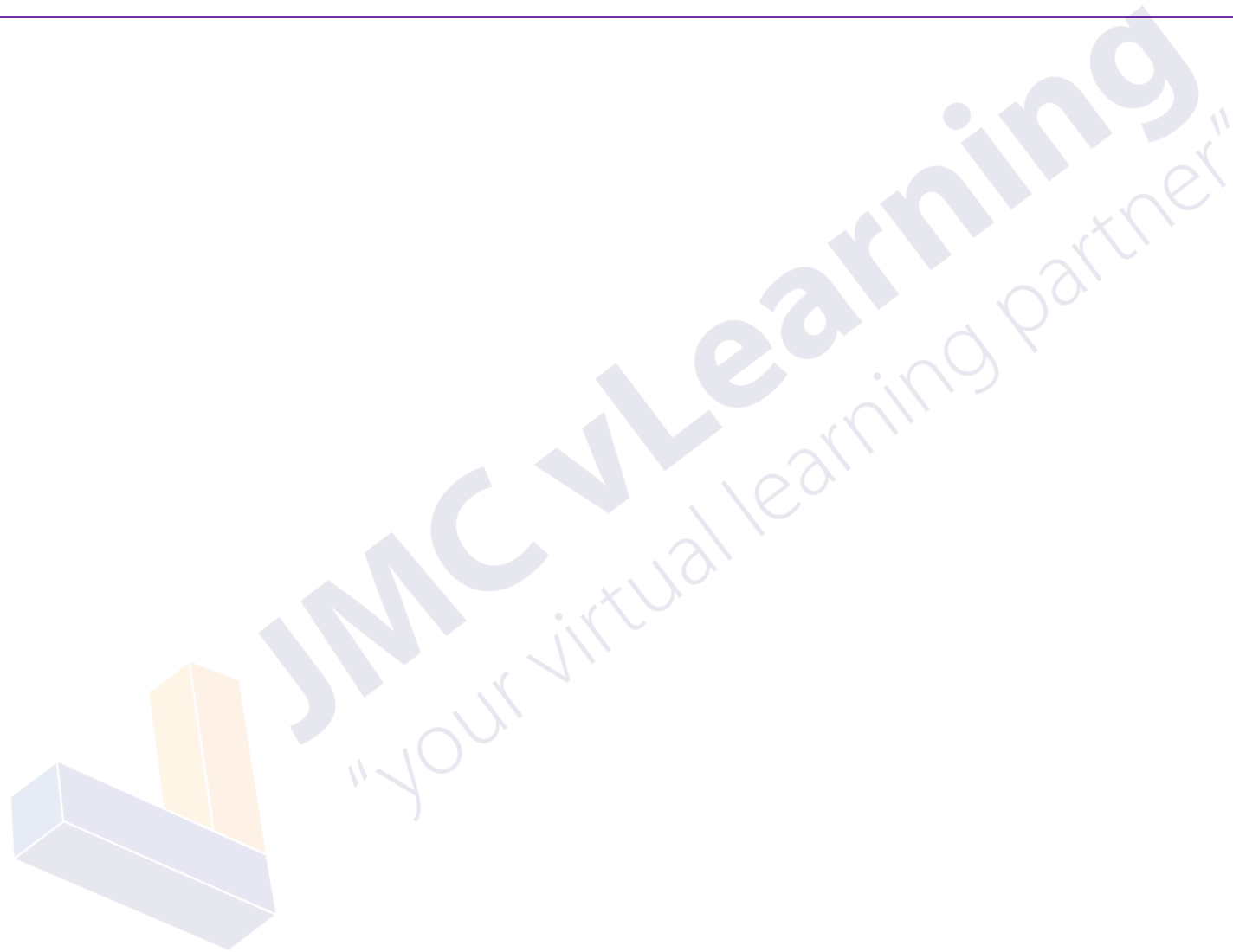
Out of these facilities available Mini used Rs.50Mn to finance the building construction project commenced on 1/1/X7, which was completed on 31/12/20X7. Further during the year ended 31/12/20X7 Mini earned an investment income of Rs.1Mn by investing the excess fund in a fixed deposit.

1. Determine whether building can be classified as a Qualifying asset.
2. Calculate the capitalization rate.
3. Explain the accounting treatment for investment income
4. Determine the cost to be capitalized as borrowing cost

# Answers 05



# Answers 05



# Criteria to be satisfied to commence Borrowing Cost capitalization

Expenditure	Borrowing Cost	Activities
Expenditure on asset incurred	Borrowing Cost incurred	Activities necessary to prepare the asset for intended use or sale is in progress

Example – ABC company obtained a bank loan on 1/1/20X1. However, the construction was commenced on 1/3/20X1. The borrowing cost capitalization shall commence on 1/3/20X1.

What happens to the Borrowing Cost capitalization, If the active development of asset is suspended?

Unexpected Unplanned  
Beyond Management  
Control

Suspend BC  
capitalization

Expected, Planned  
Within Management  
Control

Continue BC  
capitalization

# Cessation (end) of Borrowing Cost Capitalization

When all activities are substantially completed

- Even though minor modifications or routine admin work is yet to be completed.
- If it's phased construction (Supermarket), the borrowing cost capitalization can be continued for the phases work in progress.

# Disclosures

Accounting  
policy

Capitalized  
borrowing  
cost

Capitalization  
rate



# Questions 06

Sisil Company is engaged in hydro power projects. On 30/11/20X6 company submitted the planning documents to ministry and obtained the approvals for a new hydro power project in Lakshapana. From 15/12/20X6 company commenced the construction activities.

The construction expenses on clearing the lands were incurred on the same date. Company has borrowed Rs.100Mn from DFCC at the interest rate of 15% on 1/1/20X7 to finance the project.

# Questions 06

50% of the funds received on 1/1/20X7 were invested in a fixed deposit on the same date at a rate of 8%. Fixed deposit got matured and funds were withdrawn on 30/8/20X7.

The construction was temporarily suspended on 01/03/20X7 due to heavy rains. Management was expecting this weather condition and has planned a temporary stoppage for 15 days.

However unexpectedly the raining continued until 01/04/20X7.

On 10/04/20X7 the work was temporarily stopped due to festival season for 15 days.

# Questions 06

Employees initiated a strike demanding a pay hike on 15/5/20X7. The strike lasted for 15 days.

On 15/12/20X7 environmental authority commenced the mandatory checking on power project for them to decide eligibility for the environmental clearing certificate. This activity was there for 15 days, and during that period active development was temporarily halted.

Power station project was ready to be used by 1/6/20X8. However, there were few minor modifications remaining. Those were completed on 15/6/20X8.

# Questions 06

The approval to commence the commercial production was received on 30/6/20X8.

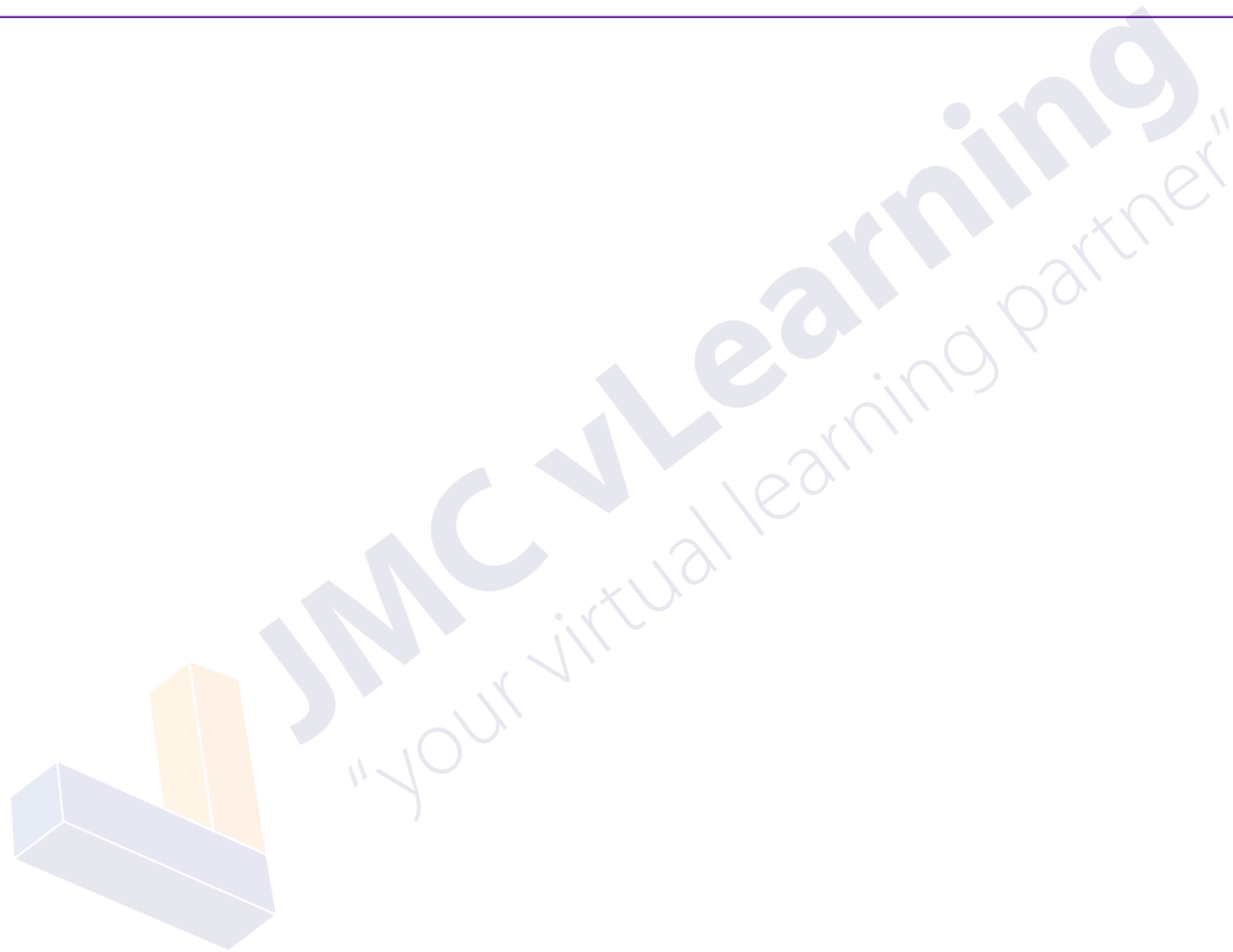
The total project cost incurred excluding the borrowing cost was Rs.100Mn. Company's Financial year ends on 30th June.

1. Determine whether this power project meets the definition of Qualifying asset.
2. Determine the commencement date of borrowing cost capitalization.
3. Explain the accounting treatment for Investment income.

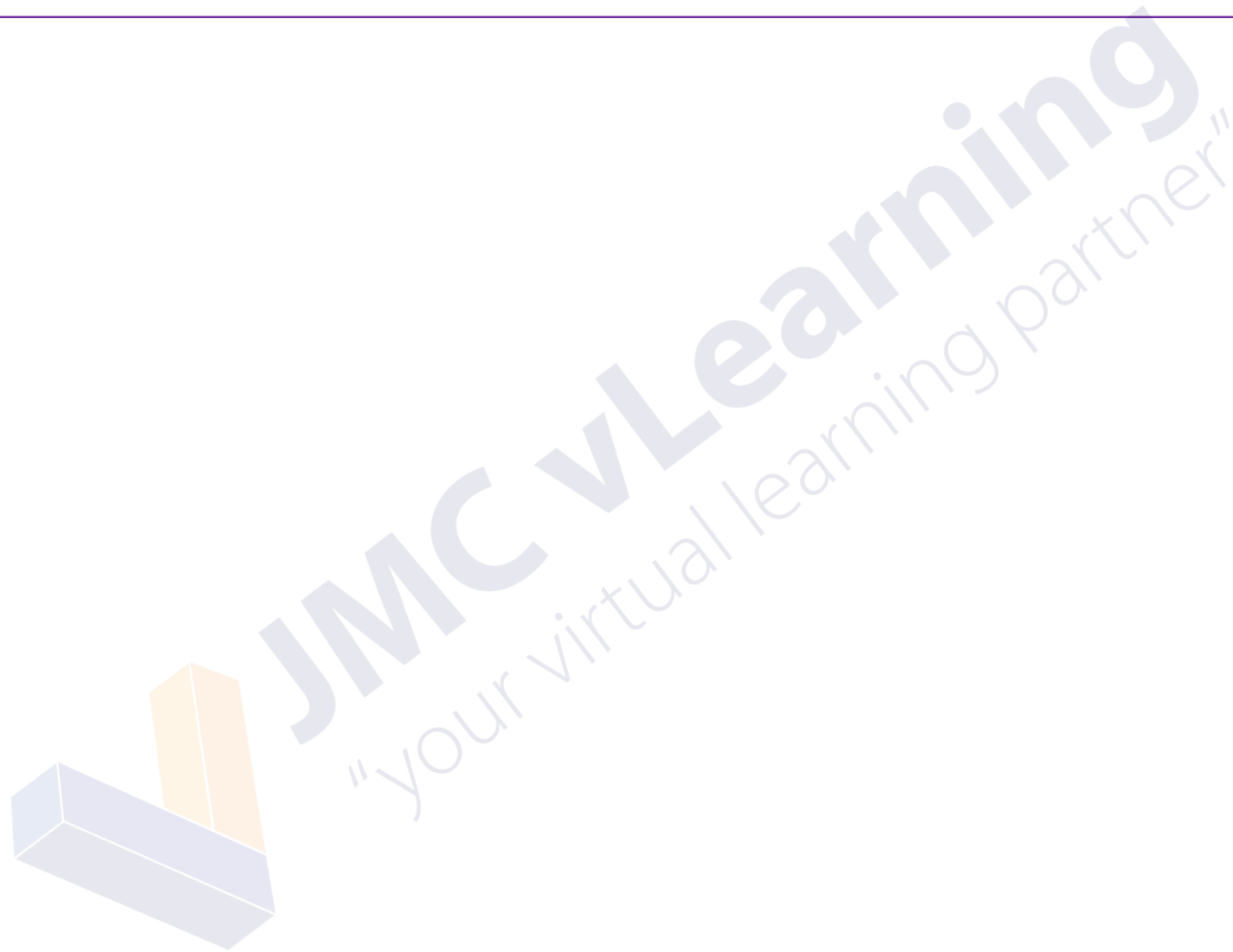
# Questions 06

4. When shall borrowing cost capitalization cease, as per LKAS 23?
5. Determine the cessation date for borrowing cost capitalization
6. As per LKAS 23, what is the accounting treatment on borrowing cost for temporary suspension of active developments?
7. Calculate the borrowing cost to be capitalized over the project period
8. What is the total cost of the power project?

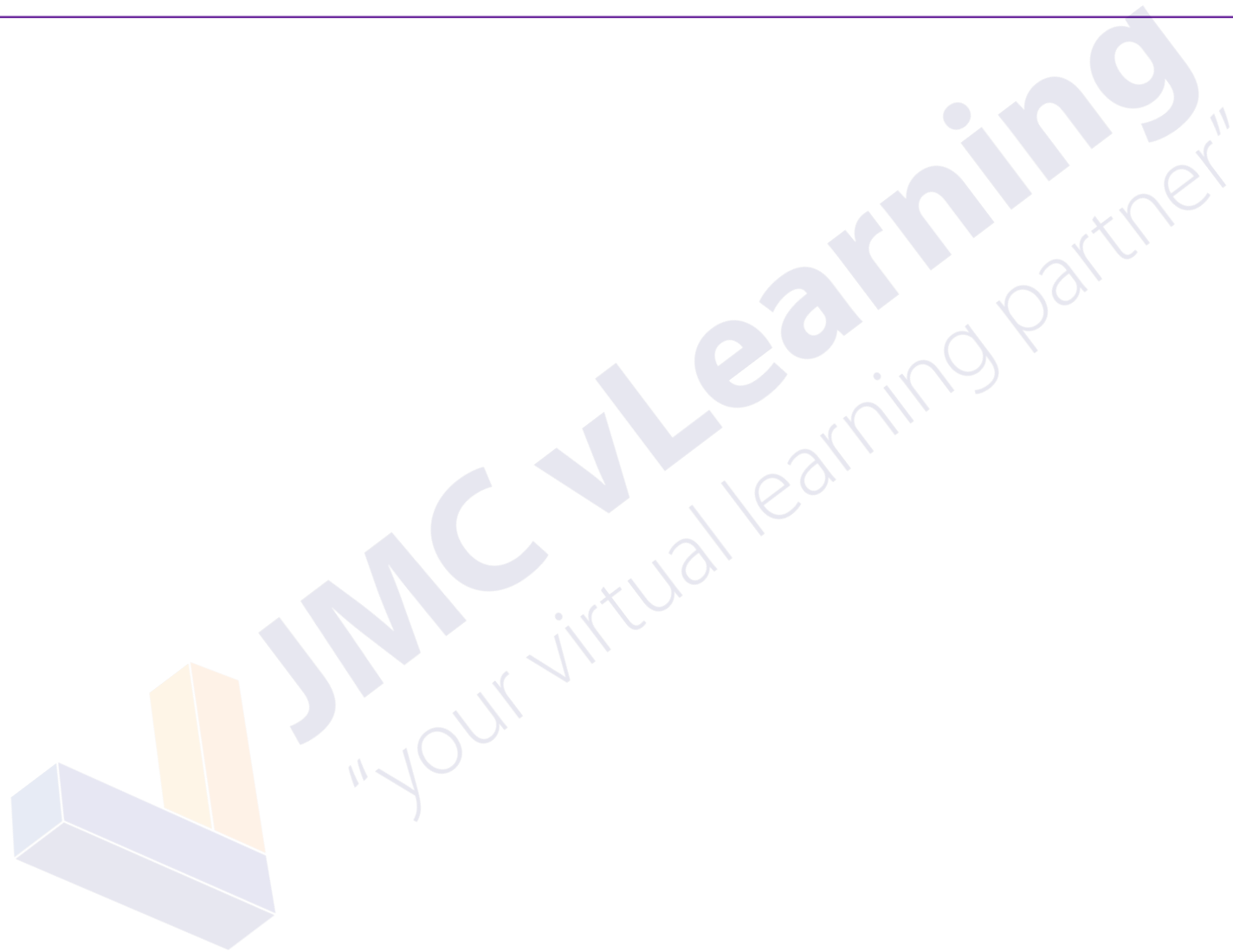
# Answer 06



# Answer 06



# Answer 06





# Question 07

Dimo Company initiated a showroom construction project. The project was funded from the pool of funds available in the company. The pool of funds available include followings

Bank	Facility Amount	Interest Rate
Commercial Bank	40 Mn	10%
Bank of Ceylon	20 Mn	9%
Hatton National Bank	15 Mn	12%
HSBC	25 Mn	15%

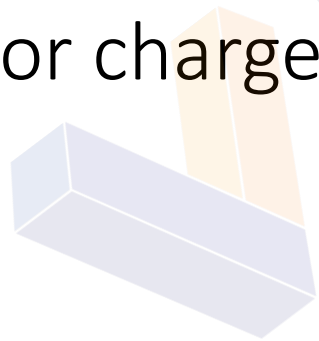
# Question 07

The project value was Rs.50Mn and the construction was commenced on 1/4/X7.

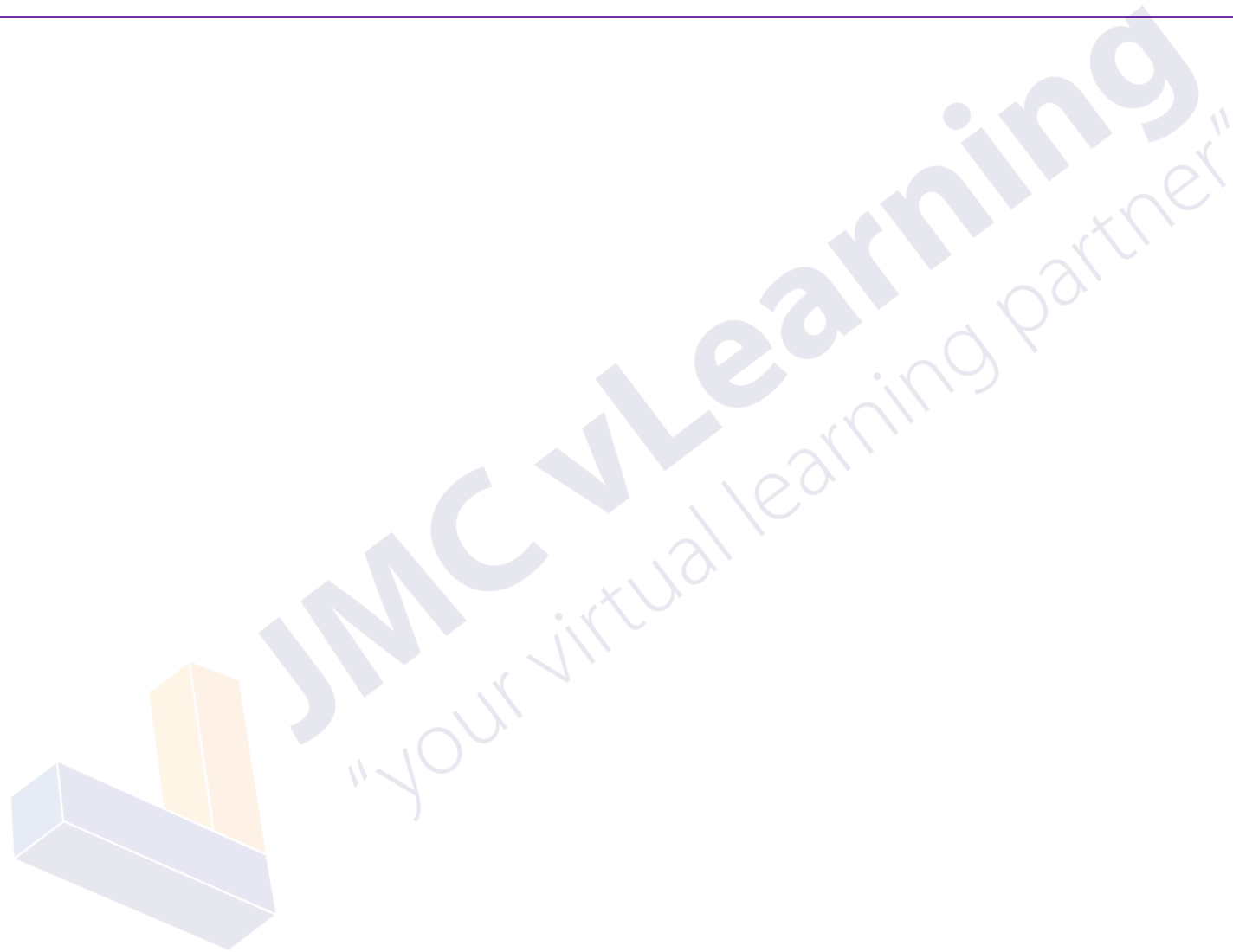
The investment income earned from investing excess cash in pool of funds were Rs.1Mn. The active construction was suspended on 15/5/20X7 due to unexpected delay in material supply for 15 days. Showroom was ready to be used by 31/12/20X7, however management commenced using the showroom from 1/2/20X8. Company's Financial year ends on 31 March.

# Question 07

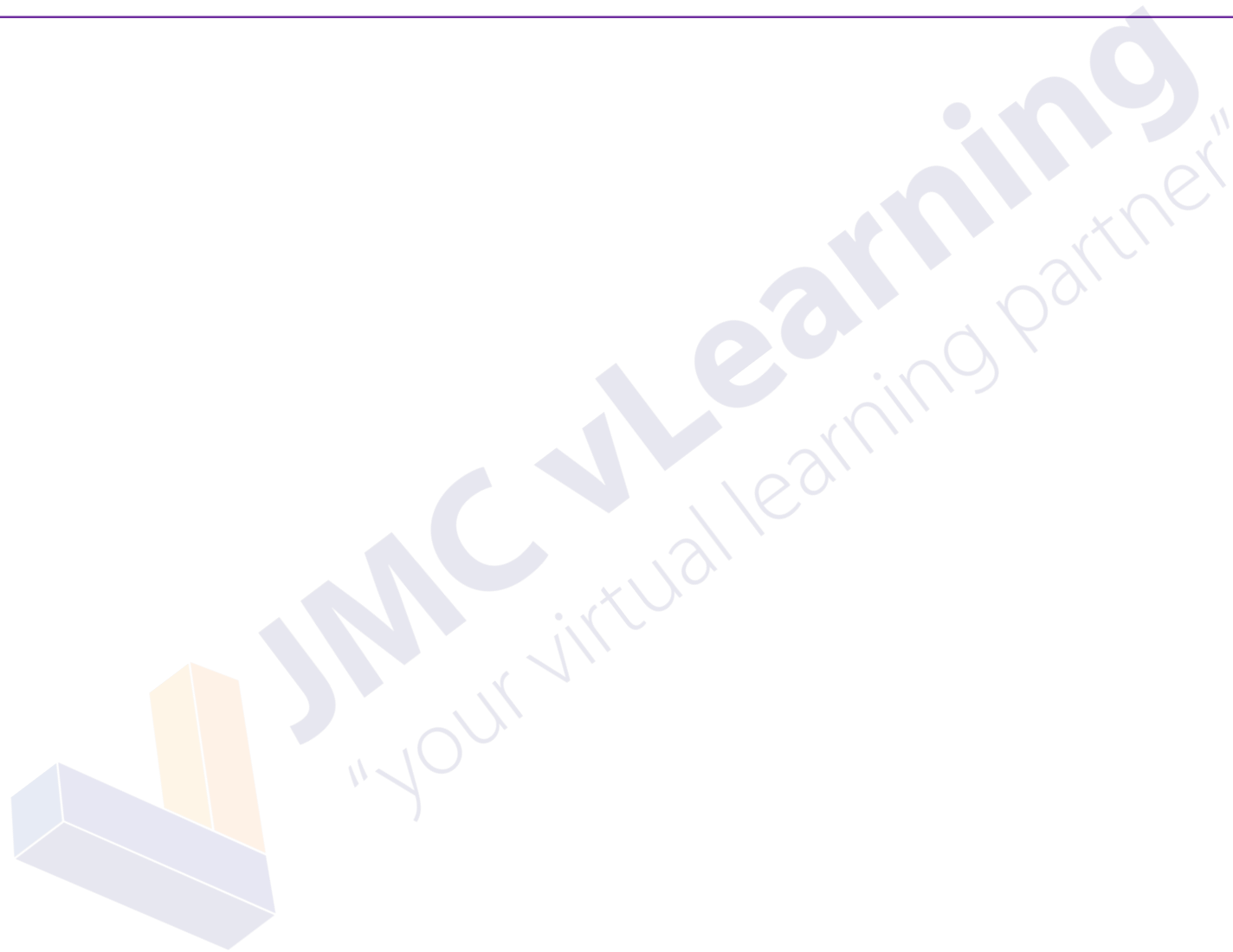
1. Determine whether this showroom project meets the definition of a Qualifying asset.
2. Compute the capitalization rate.
3. Explain the accounting treatment for Investment income.
4. Determine the cessation date for borrowing cost capitalization
5. Calculate the borrowing cost and determine the whether to capitalize or charge to Profit or loss.



# Answers 07



# Answers 07



# 2021 January Question No. 03

XYZ Ltd. has started construction of a new factory building on 01st June 2019 and it will be completed on 30th September 2021. An amount of Rs.30 million was utilized during the year ended 31st March 2020 for the construction of this new building. The loan obtained from PQR Bank was fully utilized for this construction. The balance amount spent on construction was used from the debenture issue and the loan obtained from ABC Bank.

You have given the following additional information relating to loans and debenture issue:

# 2021 January Question No. 03

	Date obtained	Interest p.a.	Amount
PQR Bank	2019.4.1	14%	15 Million
ABC Bank	2019.4.1	12%	10 Million
Debentures (Rs.100 per debenture)	2019.4.1	16%	10 Million

# 2021 January Question No. 03

Though the interest was paid on loans obtained from PQR Bank and ABC Bank, no capital repayments were made during the year ended 31st March 2020.

**You are required to:**

Calculate the borrowing cost to be capitalized on the building for the year ended 31st March 2020 as per LKAS 23 - Borrowing Cost. (05 marks)



# Answers



# Answers

