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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

CL-25-1 | Corporate Financial Reporting

Corporate Level (2025 – Curriculum)

- LKAS 23 – Borrowing Costs

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LKAS 23 – Borrowing Costs

Core Principle

Borrowing costs that are **directly attributable** to the acquisition, construction or production of a qualifying asset form **part of the cost** of that asset. **Other** borrowing costs are recognised as an **expense**.

Scope (Important)

An entity shall apply this Standard in accounting for borrowing costs. The standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.

Not required to apply the Standard:
• a qualifying asset measured at fair value, for example a biological asset within the scope of LKAS 41 Agriculture • inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis

Definitions

Borrowing costs	Interest and other costs that an entity incurs in connection with the borrowing of funds.
Qualifying asset	Asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Borrowing Cost Includes

- Interest expense calculated using the effective interest method as described in SLFRS 9
- Interest in respect of lease liabilities recognized in accordance with SLFRS 16 Leases
- Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Qualifying Asset might include

- Inventories *(Ex- Air crafts)*
- Power generation facilities
- Investment properties
- Manufacturing plants
- Intangible assets *(Ex – Software)*
- Bearer plants

Below are not Qualifying Assets

1. **Financial assets**, and
2. Inventories that are manufactured, or otherwise produced, over a **short period of time.**
3. Assets that are **ready for their intended use or sale when acquired** are not qualifying assets.

Question 01 – Qualifying Assets

State which assets can be considered as qualifying assets.

Asset	Description	Yes/No
Manufacturing Plant	It will take 02 years to complete the construction.	
Power Generation Facility	It will take 04 years to complete the construction.	
Office Building	It is expected to upgrade (taking 1.5 years) and rent out to a 3rd party	
Orange Juice	The production process will take five hours	
Wine	It will take 10 years to mature	
Inventory of a wholesaler	These goods will be sold without changing their original condition	
Building	It is available for use at the time of acquisition	

Recognition

Borrowing Costs

Directly attributable to the acquisition, construction or production of a qualifying asset	Other borrowing costs
Capitalize → Recognize as a part of the cost of the asset	Recognize as an **expense** in the period in which it incurs

- Directly attributable borrowing costs are capitalized as part of the cost of the asset when:
  - it is probable that they will result in future economic benefits to the entity and
  - the costs can be measured reliably.
- When an entity applies LKAS 29 Financial Reporting in Hyperinflationary Economies, it recognizes as an expense the part of borrowing costs that compensates for inflation during the same period.

Borrowing costs eligible for capitalization

Type of borrowing	Specific Borrowings	General Borrowings
Borrowing costs eligible for capitalizations	Actual borrowing costs incurred on that borrowing during the Period less any investment income on the temporary investment of those borrowings	Calculated by applying a capitalizations rate to the expenditures on that asset (Capitalization rate * Expenditure incurred on that asset)

- An entity shall **exclude** from this calculation borrowing costs applicable to borrowings made specifically *(specific borrowings)* for the purpose of obtaining qualifying asset.
- The amount of borrowing costs that an entity capitalizes during a period shall not exceed the amount of borrowing costs it incurred during that period.

Calculation of capitalization rate

- The capitalization rate shall be the **weighted average of the borrowing costs** applicable to all borrowings of the entity that are **outstanding during the period**.

Question 02 – Specific Borrowings

Apex issued a Rs. 10 million unsecured loan with a coupon (nominal) interest rate of 6% on 1 April 2018. The loan is redeemable at a premium which means the loan has an effective finance cost of 7.5% per annum. The loan was specifically issued to finance the building of the new store which meets the definition of a qualifying asset in LKAS 23.

Construction of the store commenced on 1 May 2018, and it was completed and ready for use on 28 February 2019 but did not open for trading until 1 April 2019. The proceeds of the loan were temporarily invested for the month of April 2018 and earned interest of Rs. 40,000.

Required:

Prepare a schedule showing the net borrowing cost that should be capitalized as part of the cost of the new store and the finance cost that should be reported in profit or loss for the year ended 31 March 2019.

Question 03 – Capitalization rate

An entity has two outstanding items of debt during the year ended 31 December 2025.

- Rs. 80m bank loan with an interest rate of 7% (Obtained on 01.07.2025)
- Rs. 100m loan notes with an interest rate of 9%

Neither has been obtained for a specific purpose.

Required:

Calculate the capitalization rate to be applied to expenditure on qualifying assets funded using these general borrowings.

Commencement, suspension and cessation of capitalization

Commencement	Suspension	Cessation
Shall **begin** to capitalize on the **commencement date**. Commencement date is the **first date** that meet all following conditions. 1. it incurs expenditures for the asset 2. it incurs borrowing costs 3. it undertakes activities that are necessary to prepare the asset for its intended use or sale	An entity shall **suspend capitalization** of borrowing costs during extended periods in which it suspends active development of a qualifying asset. Have to consider the impact to the development period of the qualifying asset ***(Materiality of the event)***	Shall **cease capitalizing** borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. When the construction of a qualifying asset is completed in parts where each part is capable of being used while construction continues 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.

Commencement date criteria in detail

1. **It incurs expenditures for the asset**
   a. Include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities.

b. Expenditures are reduced by any progress payments received and grants received in connection with the asset.
c. The average carrying amount of the asset during a period, including borrowing costs previously capitalized, is normally a reasonable approximation of the expenditures to which the capitalization rate is applied in that period.

2. **It undertakes activities that are necessary to prepare the asset for its intended use or sale**
   a. Those are not limited to the physical construction of the asset.
   b. Can **include** technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits prior to the commencement of the physical construction.
   c. However, it **excludes** holding of an asset when no production or development that changes the asset's condition is taking place.
   d. Ex:

Borrowing costs incurred while land is under development	**Capitalized**
Borrowing costs incurred while land acquired for building purposes is held without any Associated development activity	**Cannot be capitalized.**

Question 04 - Commencement

Based on the information below, identify from which date the entity should commence capitalization.

1. On 01.01.2025 the plan of the building was passed.
2. On 25.02.2025 the company borrowed Rs.10 Mn to construct a building.
3. On 01.03.2025 construction was started, and an initial amount was paid to the contractor.

Temporary suspension in detail

- When an entity suspends activities in an extended period costs incurred in hat extended periods are costs of holding partially completed assets and do not qualify for capitalization.

- However, an entity does not normally suspend capitalizing borrowing costs during a period when it carries out substantial technical and administrative work.

- Further, an entity also does not suspend capitalizing borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.
    - Example - capitalization continues during the extended period that high water levels delay construction of a bridge, if such high-water levels are common during the construction period in the geographical region involved.

Question 05 – Suspension

In each below incident identify whether to suspend the capitalization or not with reasons in line with LKAS 23.

1. Workers go on strike
2. A delay due to a damage by fire
3. Factory closed down during a holiday season
4. The production process is slow

Cessation of capitalization in detail

- An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue.
    - For example, minor modifications, such as the decoration of a property to the purchaser's or user's specification, are the only outstanding activities, this indicates that substantially all the activities are complete.

Disclosures

An entity shall disclose:
1. The amount of borrowing costs capitalized during the period; and
2. The capitalization rate used to determine the amount of borrowing costs eligible for capitalization

Please note that the disclosure requirements are continuously changing and updating. Therefore, referring to the standard is important for disclosures.