

Borrowing Costs (IAS 23)

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1. Objective and core principle

IAS 23 prescribes how an entity accounts for borrowing costs—mainly whether they are expensed immediately or capitalised as part of an asset.

Objective: To ensure that borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset, rather than distorting profit or loss in the periods before the asset is ready for use or sale.

Core principle (IAS 23.1):

- **Capitalise: Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset** are capitalised as part of the cost of that asset.
- **Expense: All other borrowing costs** are recognised as an expense in profit or loss in the period in which they are incurred.

This principle creates a clear split:

- **Qualifying asset + directly attributable borrowing costs → capitalise**
- **Anything else → expense**

2. Scope of IAS 23

IAS 23 applies to the accounting for borrowing costs in general, but excludes certain items.

2.1 Items within scope

IAS 23 applies to:

- **Borrowing costs** incurred by an entity in connection with:
 - **Loans and overdrafts**
 - **Issued debt instruments** (bonds, debentures)
 - **Finance leases** (interest portion)
 - **Other forms of interest-bearing liabilities**

It covers:

- **Recognition** (capitalise vs expense)
- **Measurement** (how much to capitalise)
- **Timing** (when to start, suspend and stop capitalisation)
- **Disclosure** (what must be disclosed in the financial statements)

2.2 Items outside scope

IAS 23 does **not** apply to:

- **Equity costs:**

- Actual or imputed cost of equity, including preference shares classified as equity.
- **Certain assets measured at fair value:**
 - Assets measured at fair value, where changes in fair value are recognised in profit or loss or other comprehensive income (e.g. some financial instruments).
- **Inventories produced in large quantities on a repetitive basis:**
 - In practice, these usually do **not** qualify as “qualifying assets” because they do not take a substantial period of time to get ready for sale.

3. Key definitions

Understanding the definitions is crucial for exam questions and practical application.

3.1 Borrowing costs

Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.

They include:

- **Interest expense on:**
 - Bank loans
 - Overdrafts
 - Bonds and debentures
 - Finance lease liabilities (interest portion)
- **Amortisation of discounts or premiums** relating to borrowings
- **Amortisation of ancillary costs** incurred in connection with the arrangement of borrowings (e.g. loan arrangement fees)
- **Exchange differences** arising from foreign currency borrowings, to the extent they are regarded as an adjustment to interest costs (judgement required)

They do **not** include:

- **Dividends** on equity instruments
- **Foreign exchange differences** on trade payables (not borrowings)
- **Penalties and fines** not related to borrowing arrangements

3.2 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.

Key points:

- **“Necessarily”**: It is inherent in the nature of the asset that it takes time to be ready.
- **“Substantial period of time”**: Not defined numerically in the standard—requires judgement. Usually interpreted as several months or more.

Common examples of qualifying assets:

- **Property, plant and equipment (PPE) under construction:**
 - Manufacturing plants
 - Office buildings
 - Infrastructure assets
- **Investment property** under development
- **Certain inventories:**
 - Wine maturing over several years
 - Large construction projects (ships, aircraft, cluster homes)
- **Intangible assets:**
 - Development of complex software
 - Large research and development projects (if they meet recognition criteria)

Non-qualifying assets (usually):

- **Short-term inventories** produced in a normal operating cycle
- **Assets ready for use or sale when acquired** (e.g. finished goods, ready-to-use equipment)
- **Financial assets** (e.g. shares or bonds held as investments)

4. Recognition: capitalise vs expense

4.1 When to capitalise borrowing costs

Borrowing costs are capitalised **only** when:

1. **The asset is a qualifying asset**, and
2. **Borrowing costs are directly attributable** to the acquisition, construction or production of that asset.

Directly attributable borrowing costs are those that would have been avoided if the expenditure on the qualifying asset had not been made.

Examples:

- **Specific loan** taken to build a factory:
 - Interest on that loan is directly attributable.
- **General borrowings** used partly to finance a qualifying asset:
 - A portion of the interest is directly attributable, calculated using a capitalisation rate.

4.2 When to expense borrowing costs

Borrowing costs are expensed when:

- They are **not directly attributable** to a qualifying asset.
- They relate to **non-qualifying assets**.
- They are incurred **after the asset is ready for its intended use or sale** (capitalisation ceases).

5. Measurement of capitalised borrowing costs

IAS 23 distinguishes between:

- **Specific borrowings** (borrowings obtained specifically for a qualifying asset)
- **General borrowings** (borrowings used for general purposes, including qualifying assets)

5.1 Specific borrowings

When an entity borrows funds specifically for a qualifying asset:

- **Capitalise the actual borrowing costs incurred** on that borrowing during the period, **less** any investment income earned on the temporary investment of those borrowings.

Example 1 — Specific borrowing

Facts:

- On 1 January 20X1, Entity A borrows R10 000 000 at an interest rate of 8% per annum.
- The loan is specifically to finance the construction of a new factory (qualifying asset).
- Construction starts immediately and continues throughout the year.
- During the year, R3 000 000 of the loan is temporarily invested and earns interest income of R150 000.

Calculation:

- **Interest expense on loan:**

$$\text{Interest} = \text{R10 000 000} \times 8\% = \text{R800 000}$$

- **Investment income:**

$$\text{Investment income} = \text{R150 000}$$

- **Capitalised borrowing costs:**

$$\text{Capitalised amount} = \text{R}800\,000 - \text{R}150\,000 = \text{R}650\,000$$

Accounting:

- R650 000 is added to the **cost of the factory**.

5.2 General borrowings

When an entity uses **general borrowings** to finance a qualifying asset:

- Determine a **capitalisation rate** (weighted average interest rate on general borrowings).
- Apply this rate to the **expenditures on the qualifying asset** during the period.
- The amount capitalised **cannot exceed** the total borrowing costs incurred on general borrowings in that period.

Steps:

1. **Calculate weighted average capitalisation rate:**

$$\text{Capitalisation rate} = \frac{\text{Total interest on general borrowings}}{\text{Average general borrowings outstanding}}$$

2. **Determine qualifying asset expenditures** during the period.
3. **Apply capitalisation rate** to those expenditures to get the capitalised borrowing costs.

Example 2 — General borrowings

Facts:

- Entity B has the following general borrowings:
 - Loan 1: R20 000 000 at 6%
 - Loan 2: R10 000 000 at 9%
- Total interest for the year:
 - Loan 1: $\text{R}20\,000\,000 \times 6\% = \text{R}1\,200\,000$
 - Loan 2: $\text{R}10\,000\,000 \times 9\% = \text{R}900\,000$
- Total interest = R2 100 000
- Total general borrowings = R30 000 000
- During the year, Entity B spends R12 000 000 on constructing a qualifying asset (e.g. a new warehouse).

Step 1 — Capitalisation rate:

$$\text{Capitalisation rate} = \frac{\text{R}2\,100\,000}{\text{R}30\,000\,000} = 7\%$$

Step 2 — Capitalised borrowing costs:

$$\text{Capitalised amount} = \text{R}12\,000\,000 \times 7\% = \text{R}840\,000$$

Accounting:

- R840 000 is capitalised as part of the **cost of the warehouse**.
- The remaining interest ($\text{R}2\,100\,000 - \text{R}840\,000 = \text{R}1\,260\,000$) is recognised as an **expense** in profit or loss.

6. Timing: commencement, suspension and cessation of capitalisation

6.1 Commencement of capitalisation

Capitalisation of borrowing costs begins when **all three** of the following conditions are met:

1. **Expenditures for the asset are being incurred.**
2. **Borrowing costs are being incurred.**
3. **Activities necessary to prepare the asset for its intended use or sale are in progress.**

Only when these three conditions are simultaneously satisfied does capitalisation start.

Example 3 — Commencement

- Entity C plans to build a factory.
- It obtains a loan on 1 January 20X1.
- Construction starts on 1 March 20X1.
- Expenditures begin on 1 March 20X1.

Capitalisation starts on 1 March 20X1, because:

- Before 1 March:
 - Borrowing costs are incurred (loan exists).
 - But **no expenditures** and **no construction activities** yet.
- From 1 March:
 - Expenditures incurred.
 - Borrowing costs incurred.
 - Construction activities in progress.

6.2 Suspension of capitalisation

Capitalisation is **suspended** during extended periods in which:

- **Active development is interrupted**, and

- The interruption is **not necessary** for the asset to be ready for its intended use or sale.

During such periods, borrowing costs are **expensed**.

However, capitalisation **continues** during:

- **Normal delays** that are inherent in the process (e.g. drying, curing, administrative approvals that are part of the normal process).

Example 4 — Suspension

- Entity D is constructing a building.
- Construction is halted for 6 months due to a labour strike.
- Borrowing costs continue to be incurred.

During the 6-month strike:

- Capitalisation is **suspended**.
- Borrowing costs are **expensed**.

If, instead, the building requires a 3-month curing period for concrete (normal process):

- Capitalisation **continues** during the curing period.

6.3 Cessation of capitalisation

Capitalisation ceases when:

Substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

At this point:

- Further borrowing costs are **expensed**.
- The asset is now ready for depreciation (if PPE) or use/sale.

If the asset is completed in parts and each part can be used while construction continues on other parts:

- Capitalisation ceases for each part when that part is ready for use.

Example 5 — Cessation

- Entity E builds a shopping centre with multiple phases.
- Phase 1 is completed and opened to the public.
- Phase 2 is still under construction.

For **Phase 1**:

- Capitalisation ceases when Phase 1 is ready for use (opening date).
- Borrowing costs thereafter relating to Phase 1 are expensed.

For **Phase 2**:

- Capitalisation continues until Phase 2 is ready for use.

7. Treatment after capitalisation

Once borrowing costs are capitalised:

- They become part of the **cost of the qualifying asset**.
- The asset is then:
 - **Depreciated** (if PPE or investment property measured at cost), or
 - **Amortised** (if intangible asset), over its **useful life**.

There is **no separate depreciation** of the interest component—everything is included in the asset's carrying amount and depreciated/amortised together.

Example 6 — Subsequent depreciation

Continuing Example 1:

- Factory cost (excluding borrowing costs): R10 000 000
- Capitalised borrowing costs: R650 000
- Total cost of factory: R10 650 000
- Useful life: 20 years
- Residual value: R650 000

Depreciable amount:

$$\text{Depreciable amount} = \text{R10 650 000} - \text{R650 000} = \text{R10 000 000}$$

Annual depreciation (straight-line):

$$\text{Annual depreciation} = \frac{\text{R10 000 000}}{20} = \text{R500 000}$$

The capitalised borrowing costs are embedded in the depreciable amount.

8. Exchange differences and borrowing costs

IAS 23 allows **some** foreign exchange differences on foreign currency borrowings to be treated as an adjustment to interest costs, and therefore capitalised.

Key points:

- Only **exchange differences on foreign currency borrowings** can be considered.
- They are capitalised **to the extent** that they are regarded as an adjustment to interest costs.
- This requires **judgement** and consistent policy.

Example (conceptual):

- Entity F borrows in USD to finance a qualifying asset.
- The functional currency is ZAR.
- Exchange differences arise due to changes in the USD/ZAR rate.
- Some of these differences may be treated as an adjustment to interest and capitalised, if consistent with the entity's policy and IAS 23 guidance.

9. Disclosure requirements

IAS 23 requires entities to disclose:

- **The amount of borrowing costs capitalised** during the period.
- **The capitalisation rate** used to determine the amount of borrowing costs eligible for capitalisation (for general borrowings).
- **The nature of the qualifying assets** for which borrowing costs have been capitalised (usually disclosed in the notes on PPE, investment property and intangible assets).

These disclosures help users of financial statements understand:

- The impact of capitalisation on profit or loss.
- The extent to which asset values include borrowing costs.
- The entity's approach to financing long-term projects.

10. Common exam and practical issues

10.1 Identifying qualifying assets

Key judgement areas:

- Does the asset **necessarily** take a substantial period of time to be ready?
- Is the delay **inherent** in the asset's nature, or just a management choice?

Tips:

- Long-term construction projects → usually qualifying.
- Short-term inventories → usually not qualifying.
- Intangible assets → consider development phase and time required.

10.2 Specific vs general borrowings

Specific borrowings:

- Direct link to qualifying asset.
- Capitalise **actual interest** less investment income.

General borrowings:

- No direct link.
- Use **capitalisation rate** (weighted average interest rate).
- Apply to **expenditures** on qualifying asset.

10.3 Timing traps

- Capitalisation **does not start** just because a loan is obtained.
- All three conditions (expenditures, borrowing costs, activities) must be present.
- Capitalisation **must be suspended** during abnormal interruptions.
- Capitalisation **must cease** when the asset is substantially ready for use or sale.

10.4 Over-capitalisation

- The amount capitalised **cannot exceed** total borrowing costs incurred in the period.
- If calculated capitalised amount > total borrowing costs, cap it at total borrowing costs.

11. Integrated example — full scenario

Let's put everything together in a more comprehensive example.

Example 7 — Integrated scenario

Facts:

- Entity G starts constructing a new production plant (qualifying asset) on 1 April 20X1.
- Estimated construction period: 18 months.
- On 1 January 20X1, Entity G obtains:
 - **Specific loan:** R15 000 000 at 7% per annum, specifically for the plant.
 - **General borrowings:** R20 000 000 at 9% per annum (existing).
- Expenditures on the plant during 20X1:
 - April: R4 000 000
 - July: R5 000 000
 - October: R3 000 000
- During May and June, construction is halted for 2 months due to an abnormal flood (not part of normal process).
- The entity temporarily invests unused specific loan funds and earns R200 000 investment income in 20X1.

Step 1 — Commencement of capitalisation

- Borrowing costs on specific loan start on 1 January 20X1.
- Expenditures and construction activities start on 1 April 20X1.
- Capitalisation starts on **1 April 20X1** (all three conditions met).

Step 2 — Suspension

- Construction halted in May and June due to abnormal flood.
- Capitalisation is **suspended** during May and June.
- Borrowing costs in those months are **expensed**.

Step 3 — Specific borrowing calculation

- Interest on specific loan for the year:

$$\text{Interest} = \text{R}15\,000\,000 \times 7\% = \text{R}1\,050\,000$$

- Investment income: R200 000
- Borrowing costs eligible for capitalisation (specific loan):

$$\text{Eligible specific borrowing costs} = \text{R}1\,050\,000 - \text{R}200\,000 = \text{R}850\,000$$

However, we must **exclude** the portion relating to the suspension period (May and June). For simplicity, assume interest accrues evenly:

- Monthly interest on specific loan:

$$\text{Monthly interest} = \frac{\text{R}1\,050\,000}{12} = \text{R}87\,500$$

- Interest for May and June (2 months):

$$\text{Suspension interest} = 2 \times \text{R}87\,500 = \text{R}175\,000$$

Assume investment income of R200 000 relates to periods outside suspension (to keep the example simple).

- Capitalisable specific borrowing costs:

$$\text{Capitalisable specific} = \text{R}850\,000 - \text{R}175\,000 = \text{R}675\,000$$

Step 4 — General borrowings

- Interest on general borrowings:

$$\text{Interest (general)} = \text{R}20\,000\,000 \times 9\% = \text{R}1\,800\,000$$

- Capitalisation rate:

$$\text{Capitalisation rate} = \frac{\text{R1 800 000}}{\text{R20 000 000}} = 9\%$$

- Expenditures on plant (only months with active construction):
 - April: R4 000 000 (active)
 - May–June: construction halted → **no capitalisation**
 - July: R5 000 000 (active)
 - October: R3 000 000 (active)

For simplicity, assume average expenditures for the year on which general borrowings are applied is R12 000 000 (sum of active months).

- Capitalisable general borrowing costs:

$$\text{Capitalisable general} = \text{R12 000 000} \times 9\% = \text{R1 080 000}$$

Step 5 — Total capitalised borrowing costs

- Total capitalised:

$$\text{Total capitalised} = \text{R675 000} + \text{R1 080 000} = \text{R1 755 000}$$

- Check: total capitalised must not exceed total borrowing costs:
 - Total borrowing costs:
 - Specific: R1 050 000
 - General: R1 800 000
 - Total: R2 850 000

R1 755 000 < R2 850 000 → OK.

Step 6 — Accounting summary

- R1 755 000 capitalised as part of the **cost of the plant**.
- Remaining borrowing costs:

$$\text{Remaining} = \text{R2 850 000} - \text{R1 755 000} = \text{R1 095 000}$$

- R1 095 000 recognised as **finance cost** in profit or loss.

12. Summary and exam memory hooks

To keep IAS 23 clear in your mind:

- **Core rule:** Directly attributable borrowing costs + qualifying asset → capitalise. Everything else → expense.
- **Qualifying asset:** Takes a **substantial period** to be ready for use or sale.

- **Specific borrowings:** Capitalise **actual interest** less **investment income**.
- **General borrowings:** Use **capitalisation rate** (weighted average interest) × **expenditures**.
- **Timing:** Start when **expenditures + borrowing costs + activities** all present. Suspend for **abnormal interruptions**. Stop when asset is **substantially ready**.
- **Disclosure:** Amount capitalised, capitalisation rate, nature of qualifying assets.

13. 20 Multiple-Choice Questions

1. What is the core principle of IAS 23?

- A. All borrowing costs must be expensed
- B. Borrowing costs must always be capitalised
- C. Borrowing costs directly attributable to a qualifying asset must be capitalised
- D. Borrowing costs may be capitalised only if management chooses

➤ **Answer: C**

2. Which of the following is *not* a borrowing cost under IAS 23?

- A. Interest on bank loans
- B. Amortisation of loan arrangement fees
- C. Exchange differences on foreign currency borrowings (adjustment to interest)
- D. Dividends on ordinary shares

➤ **Answer: D**

3. A qualifying asset is one that:

- A. Is expensive
- B. Takes a substantial period of time to get ready for use or sale
- C. Is financed through borrowings
- D. Is held for investment purposes

➤ **Answer: B**

4. Which of the following is an example of a qualifying asset?

- A. Finished goods inventory
- B. A building under construction
- C. A motor vehicle purchased ready for use
- D. A financial asset

➤ **Answer: B**

5. When does capitalisation of borrowing costs begin?

- A. When borrowings are obtained
- B. When expenditures, borrowing costs, and activities to prepare the asset are all occurring together
- C. When the asset is completed
- D. When the entity decides to capitalise

➤ **Answer: B**

6. Capitalisation must be suspended when:

- A. Construction is halted due to abnormal delays
- B. Borrowings are repaid
- C. The entity earns investment income
- D. The asset is almost complete

➤ **Answer: A**

7. Capitalisation ceases when:

- A. Borrowings are fully repaid
- B. The asset is substantially ready for its intended use or sale
- C. The entity sells the asset
- D. The entity stops incurring borrowing costs

➤ **Answer: B**

8. For specific borrowings, the amount capitalised is:

- A. Actual interest incurred
- B. Actual interest incurred minus investment income
- C. Weighted average interest rate × expenditures
- D. Total borrowings × interest rate

➤ **Answer: B**

9. For general borrowings, the capitalisation rate is:

- A. The highest interest rate
- B. The lowest interest rate
- C. The weighted average interest rate
- D. The prime lending rate

➤ **Answer: C**

10. Borrowing costs must be expensed when:

- A. They relate to non-qualifying assets
- B. They relate to qualifying assets
- C. Borrowings are long-term
- D. Borrowings are foreign currency denominated

➤ **Answer: A**

11. Which of the following is *not* a condition for commencement of capitalisation?

- A. Borrowing costs are being incurred
- B. Expenditures for the asset are being incurred
- C. The entity has obtained a loan
- D. Activities to prepare the asset are in progress

➤ **Answer: C**

12. Exchange differences may be capitalised only when:

- A. They arise on any foreign currency transaction
- B. They are regarded as an adjustment to interest costs
- C. They relate to trade payables
- D. They increase profit

➤ **Answer: B**

13. Which of the following assets would *not* normally qualify under IAS 23?

- A. A ship under construction
- B. Wine maturing over several years
- C. Inventories produced in large quantities on a repetitive basis
- D. A hydroelectric plant under construction

➤ **Answer: C**

14. Capitalisation cannot exceed:

- A. Total expenditures on the asset
- B. Total borrowing costs incurred in the period
- C. Total cost of the asset
- D. Total interest on specific borrowings

➤ **Answer: B**

15. Investment income earned on temporarily invested specific borrowings is:

- A. Added to the cost of the asset
- B. Deducted from borrowing costs capitalised
- C. Ignored
- D. Treated as revenue only when the asset is complete

➤ **Answer: B**

16. Which of the following is a directly attributable borrowing cost?

- A. Interest on a loan used to build a factory
- B. Interest on overdrafts used for general working capital
- C. Dividends on preference shares classified as equity
- D. Penalties for late tax payments

➤ **Answer: A**

17. Borrowing costs incurred during normal delays (e.g. curing periods) are:

- A. Expensed
- B. Capitalised
- C. Deferred until completion
- D. Ignored

➤ **Answer: B**

18. When a qualifying asset is completed in parts, capitalisation:

- A. Continues until all parts are complete
- B. Ceases for each part when that part is ready for use
- C. Must be suspended until the entire project is complete
- D. Is prohibited

➤ **Answer: B**

19. Which of the following is included in the cost of a qualifying asset?

- A. Capitalised borrowing costs
- B. Future interest costs
- C. Dividends on equity instruments
- D. Unrealised foreign exchange gains

➤ **Answer: A**

20. After capitalisation, borrowing costs included in the asset's cost are:

- A. Expensed immediately
- B. Depreciated or amortised as part of the asset
- C. Shown separately in the statement of financial position
- D. Revalued annually

➤ **Answer: B**

14. Comprehensive Question Bank (with Solutions)

SECTION A — THEORY QUESTIONS (Short-form)

1. Define “borrowing costs” according to IAS 23.

Solution: Borrowing costs are interest and other costs incurred by an entity in connection with the borrowing of funds. They include interest expense, amortisation of discounts/premiums, amortisation of loan fees, and certain exchange differences on foreign currency borrowings treated as interest adjustments.

2. What is a qualifying asset?

Solution: A qualifying asset is one that **necessarily takes a substantial period of time** to get ready for its intended use or sale. Examples: buildings under construction, large manufacturing plants, ships, aircraft, wine maturing over years, and certain intangible assets under development.

3. State the core principle of IAS 23.

Solution: Borrowing costs **directly attributable** to the acquisition, construction, or production of a qualifying asset must be **capitalised** as part of the cost of that asset. All other borrowing costs are **expensed**.

4. List three examples of borrowing costs that must be capitalised when directly attributable.

Solution:

- Interest on specific borrowings
- Amortisation of loan arrangement fees
- Exchange differences on foreign currency borrowings treated as interest adjustments

5. When does capitalisation of borrowing costs begin?

Solution: When **all three** conditions below are met:

1. Expenditures for the asset are being incurred
2. Borrowing costs are being incurred
3. Activities necessary to prepare the asset for use or sale are in progress

6. When must capitalisation be suspended?

Solution: During **extended periods of abnormal interruption** in construction or development (e.g., strikes, floods, non-normal delays).

7. When does capitalisation cease?

Solution: When **substantially all activities** necessary to prepare the asset for its intended use or sale are complete.

8. What is investment income in the context of IAS 23?

Solution: Income earned from temporarily investing unused specific borrowings. It must be **deducted** from capitalised borrowing costs.

9. What is the capitalisation rate?

Solution: The **weighted average interest rate** on general borrowings used to determine the amount of borrowing costs eligible for capitalisation.

10. Why can capitalised borrowing costs never exceed total borrowing costs incurred?

Solution: IAS 23 prohibits capitalising more than the actual borrowing costs incurred, ensuring the asset is not overstated.

SECTION B — CALCULATION QUESTIONS (With Full Workings)

11. Specific Borrowing Calculation

Question: Entity A borrows **R12,000,000** at **10%** specifically to construct a qualifying asset. During the year, **R4,000,000** is temporarily invested, earning **R120,000** interest. Construction runs for the full year.

Required: Calculate the borrowing costs to be capitalised.

Solution: Interest incurred:

$$12,000,000 \times 10\% = R1,200,000$$

Less: investment income

R120,000

Capitalised borrowing costs:

$$R1,200,000 - R120,000 = R1,080,000$$

12. General Borrowings Calculation

Question: Entity B has the following borrowings:

- Loan 1: R20,000,000 at 6%
- Loan 2: R10,000,000 at 9%

Expenditures on a qualifying asset during the year: **R15,000,000**.

Required: Calculate the capitalisation rate and borrowing costs to be capitalised.

Solution: Interest:

Loan 1: $20\text{m} \times 6\% = R1,200,000$

Loan 2: $10\text{m} \times 9\% = R900,000$

Total interest = **R2,100,000**

Capitalisation rate:

$$\frac{2,100,000}{30,000,000} = 7\%$$

Capitalised borrowing costs:

$$15,000,000 \times 7\% = R1,050,000$$

13. Commencement Timing

Question:

- Loan obtained: 1 Jan
- Construction begins: 1 April
- Expenditures begin: 1 April

Required: When does capitalisation begin?

Solution: Capitalisation begins on **1 April**, when all three conditions are met.

14. Suspension Calculation

Question:

Interest for the year on specific borrowings = R900,000 Construction halted for 3 months due to abnormal delays.

Required: Calculate the interest to be expensed.

Solution: Monthly interest:

$$900,000/12 = R75,000$$

Suspension period:

$$75,000 \times 3 = R225,000$$

Interest expensed: **R225,000** (Remaining interest capitalised: R675,000)

15. Cessation Scenario

Question: A cluster homes complex has two phases. Phase 1 is completed and occupants have moved in. Phase 2 continues to be constructed.

Required: How is capitalisation treated?

Solution: Capitalisation **ceases for Phase 1** when it is ready for use. Capitalisation **continues for Phase 2** until it is ready for use.

16. Weighted Expenditure Calculation

Question: Expenditures on a qualifying asset:

- Jan: R3,000,000
- Apr: R5,000,000
- Sep: R2,000,000

General borrowing rate: 8%

Required: Calculate weighted average expenditures.

Solution: Weights based on months outstanding:

- Jan expenditure outstanding 12 months: $3m \times 12 = 36m$
- Apr expenditure outstanding 9 months: $5m \times 9 = 45m$
- Sep expenditure outstanding 4 months: $2m \times 4 = 8m$

Total weighted:

$$36 + 45 + 8 = 89\text{m}$$

Weighted average expenditure:

$$89\text{m}/12 = \text{R}7,416,667$$

Capitalised borrowing costs:

$$7,416,667 \times 8\% = \text{R}593,333$$

17. Exchange Difference Adjustment

Question: Foreign currency loan interest = R500,000. Exchange loss treated as interest adjustment = R80,000

Required: Calculate capitalisable borrowing costs.

Solution:

$$500,000 + 80,000 = \text{R}580,000$$

18. Maximum Capitalisation Rule

Question: Calculated capitalisable borrowing costs = R2,500,000. Actual total borrowing costs incurred = R2,200,000

Required: How much may be capitalised?

Solution: Capitalisation is limited to **R2,200,000**.

19. Specific vs General Borrowings Mix

Question: Specific borrowing interest (net): R600,000. General borrowing interest: R1,400,000. Capitalisation rate applied to expenditures = R900,000

Required: Calculate total capitalised borrowing costs.

Solution: Total capitalised:

$$600,000 + 900,000 = \text{R}1,500,000$$

Check limit: Total borrowing costs = 600,000 + 1,400,000 = R2,000,000 → OK.

20. Depreciation Impact

Question:

- Asset cost excluding borrowing costs = R10,000,000
- Capitalised borrowing costs = R800,000
- Useful life = 20 years
- Residual value = R0

Required: Calculate annual depreciation (straight-line method).

Solution: Total cost:

$$10,000,000 + 800,000 = R10,800,000$$

Annual depreciation:

$$10,800,000/20 = R540,000$$

SECTION C — LONG-FORM SCENARIO QUESTIONS (With Full Solutions)

21. Integrated Scenario

Question: Entity X begins construction of a factory on 1 March. Borrowings:

- Specific loan: R10,000,000 at 7%
- General borrowings: R15,000,000 at 9%

Expenditures:

- March: R3,000,000
- June: R4,000,000
- October: R2,000,000

Construction halted July–August due to abnormal delays. Investment income on specific borrowings: R100,000.

Required: Calculate total borrowing costs capitalised.

Solution:

Step 1 — Specific Borrowings

Interest:

$$10,000,000 \times 7\% = R700,000$$

Less investment income:

$$700,000 - 100,000 = R600,000$$

Suspension period: 2 months. Monthly interest:

$$700,000/12 = R58,333$$

Suspension interest:

$$58,333 \times 2 = R116,666$$

Capitalisable specific interest:

$$600,000 - 116,666 = R483,334$$

Step 2 — General Borrowings

Interest:

$$15,000,000 \times 9\% = R1,350,000$$

Capitalisation rate:

$$1,350,000/15,000,000 = 9\%$$

Weighted expenditures:

- March (10 months): $3m \times 10 = 30m$
- June (7 months): $4m \times 7 = 28m$
- October (3 months): $2m \times 3 = 6m$

Total weighted:

$$30 + 28 + 6 = 64m$$

Weighted average expenditure:

$$64m/12 = R5,333,333$$

Capitalisable general interest:

$$5,333,333 \times 9\% = R480,000$$

Step 3 — Total Capitalised

$$483,334 + 480,000 = R963,334$$

22. Qualifying Asset Identification

Question: Which of the following qualify?

1. A warehouse built over 18 months
2. Inventories produced monthly
3. A software development project taking 2 years
4. A vehicle purchased ready for use

Solution: Qualifying assets: **1** and **3**

23. Abnormal vs Normal Delays

Question: Concrete curing period of 2 months occurs. Should capitalisation continue?

Solution: Yes — curing is a **normal** part of the construction process.

24. Foreign Exchange Scenario

Question:

- Loan interest = R300,000
- Exchange loss on loan = R50,000
- Exchange gain on trade payable = R20,000

Required: Calculate capitalisable borrowing costs.

Solution: Only foreign exchange differences on borrowings count:

$$300,000 + 50,000 = R350,000$$

25. Multi-Phase Completion

Question: A power plant has three units. Unit 1 is completed and operational. Units 2 and 3 continue to be constructed.

Required: How is capitalisation treated?

Solution: Capitalisation **ceases for Unit 1** when ready for use. Capitalisation **continues for Units 2 and 3**.

SECTION D — EXTENDED EXAM-STYLE QUESTIONS

26. Essay Question

Question: Explain the difference between specific and general borrowings and how borrowing costs are calculated under each category.

Solution: Specific borrowings are loans obtained specifically for a qualifying asset. Capitalise **actual interest incurred**, less **investment income**. General borrowings are used for general purposes. Capitalise using a **weighted average interest rate** applied to **weighted average expenditures**.

27. Conceptual Question

Question: Why does IAS 23 require capitalisation of borrowing costs for qualifying assets?

Solution: To ensure the cost of the asset reflects all costs necessary to bring it to working condition. Expensing interest would distort profit and understate asset value.

28. Disclosure Requirements

Question: List the disclosures required under IAS 23.

Solution:

- Amount of borrowing costs capitalised
- Capitalisation rate used
- Nature of qualifying assets

29. Policy Application

Question: An entity chooses to expense all borrowing costs. Is this allowed?

Solution: No. IAS 23 **requires** capitalisation when borrowing costs are directly attributable to a qualifying asset.

30. Practical Judgment

Question: An asset takes 4 months to construct. Does it qualify?

Solution: Judgement required. Many entities consider “substantial period” to be several months. If 4 months is not substantial in the entity’s context, it may not qualify.