LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD

MASB Standard 27

Borrowing Costs

Any correspondence regarding this Standard should be addressed to:

The Chairman
Malaysian Accounting Standards Board
Suites 5.01 – 5.03, 5th Floor
No. 338, Jalan Tuanku Abdul Rahman
50100 Kuala Lumpur

Tel : 03-27159199
Fax : 03-27159212

E-mail address : masb@po.jaring.my
Website address : http://www.masb.org.my/

Borrowing Costs

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The standards, which have been set in bold type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the Foreword to MASB Standards. MASB Standards are not intended to apply to immaterial items.

Objective

The objective of this Standard is to prescribe the accounting treatment for borrowing costs. This Standard generally requires the immediate expensing of borrowing costs. However, the Standard permits, as an allowed alternative treatment, the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

Scope

1. **This Standard should be applied in accounting for borrowing costs.**

2. This Standard does not deal with the actual or imputed cost of equity, including preference share capital not classified as a liability.

Definitions

3. **The following terms are used in this Standard with the meanings specified:**

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

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

4. Borrowing costs may include:

   (a) interest on bank overdrafts and short-term and long-term borrowings;

   (b) amortisation of discounts or premiums relating to borrowings;

   (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

(d) finance charges in respect of finance leases recognised in accordance with MASB 10, Leases; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

5. Examples of qualifying assets are inventories that require a substantial period of time to bring them to a saleable condition, manufacturing plants, power generation facilities and investment properties. Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Borrowing Costs - Benchmark Treatment

Recognition

6. **Borrowing costs should be recognised as an expense in the period in which they are incurred.**

7. Under the benchmark treatment borrowing costs are recognised as an expense in the period in which they are incurred regardless of how the borrowings are applied.

Disclosure

8. **The financial statements should disclose the accounting policy adopted for borrowing costs.**

Borrowing Costs - Allowed Alternative Treatment

Recognition

9. **Borrowing costs should be recognised as an expense in the period in which they are incurred, except to the extent that they are capitalised in accordance with paragraph 10.**

10. **Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. This treatment should be applied consistently to all borrowing costs that are directly attributable to the acquisition, construction or production of all qualifying assets of the enterprise. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard.**

11. Under the allowed alternative treatment, borrowing costs that are directly attributable to the acquisition, construction or production of an asset are included in the cost of that asset. Such borrowing costs are capitalised as part of the cost of the asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

12. Where an enterprise has chosen a policy of capitalising borrowing costs when all the conditions laid down in paragraph 10 are met, for purposes of comparability, that treatment should be applied consistently to all qualifying assets of the enterprise. The enterprise should continue to capitalise such borrowing costs even if the carrying amount of the asset exceeds its recoverable amount. However, under such circumstances, the carrying amount of the qualifying asset is to be written down or written off in accordance with the requirements of paragraph 19 of this Standard.

Borrowing Costs Eligible for Capitalisation

13. The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. When an enterprise borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.

14. It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an enterprise is co-ordinated centrally. Difficulties also arise when a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other enterprises in the group. Other complications arise through the use of loans denominated in or linked to foreign currencies, when the group operates in highly inflationary economies, and from fluctuations in exchange rates. As a result, the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgement is required.

15. To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of that borrowing.

16. The financing arrangements for a qualifying asset may result in an enterprise obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditure on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. Temporary investments are highly liquid investments that are readily convertible to known amount of cash and which are subject to insignificant risks of changes in value. In determining the amount of borrowing costs eligible for capitalisation during a period, any income earned on such investments is deducted from the borrowing costs incurred.

17. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

18. In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.

Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount

19. When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other MASB Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other MASB Standards.

Commencement of Capitalisation

20. The capitalisation of borrowing costs as part of the costs of a qualifying asset should commence when:

(a) expenditure for the asset is being incurred;

(b) borrowing costs are being incurred; and

(c) activities that are necessary to prepare the asset for its intended use or sale are in progress.

21. Expenditure on a qualifying asset includes only expenditure that has resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditure is reduced by any progress payments received and grants received in connection with the asset in accordance with generally accepted accounting principles. The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditure to which the capitalisation rate is applied in that period.

22. The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They 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. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

Suspension of Capitalisation

23. Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.

24. Borrowing costs may be incurred during an extended period in which the activities necessary to prepare an asset for its intended use or sale are interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalisation. However, capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalisation of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period needed for inventories to mature or the extended period during which high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.

Cessation of Capitalisation

25. Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

26. 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. If minor modifications, such as the decoration of a property to the purchaser's or user's specifications, are all that are outstanding, this indicates that substantially all the activities are complete.

27. When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.

28. A business park comprising several buildings, each of which can be used individually is an example of a qualifying asset for which each part is capable of being usable while construction continues on other parts. An example of a qualifying asset that needs to be completed before any part can be used is an industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

Disclosure

29. **The financial statements should disclose:**

    (a) **the accounting policy adopted for borrowing costs;**

    (b) **the amount of borrowing costs capitalised during the period; and**

    (c) **the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.**

Transitional Provisions

30. In light of the comments received during the exposure period, the MASB has decided to provide a transitional period for enterprises to comply with this Standard. The transitional period provided takes cognizance that certain types of industries may have practical difficulties in complying immediately with the Standard. The transitional provisions are set out below.

31. **An enterprise that capitalises borrowing costs attributable to the acquisition, construction or production of a qualifying asset and continues to capitalise the borrowing costs even after all the activities necessary to prepare a qualifying asset for its intended use or sale are substantially complete, is allowed a transitional period to ensure full compliance with the allowed alternative treatment provisions of this Standard. This Standard requires such enterprises to fully comply with paragraphs 9-29 of this Standard for annual financial periods commencing on or after 1 July 2003. Where an enterprise avails itself of this transitional provision in the preparation of its financial statements, it should comply with paragraph 29 and also disclose, by way of a note to its financial statements, the financial impact of the departure (i.e. capitalising instead if expensing off) on the enterprise's net profit or loss, assets, liabilities, and equity for each period presented.**

32. **For annual financial periods commencing on or after 1 July 2003, an enterprise which has adopted the allowed alternative treatment of capitalising borrowing costs and availed itself of the transitional provision above, should comply with the recognition requirements of paragraphs 9 to 28. The change should be applied retrospectively in accordance with MASB 3, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.**

33. **Irrespective of the transitional provision above, the effect of adopting this Standard on its effective date should be recognised retrospectively in accordance with MASB 3, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.**

Effective Date

34. **This MASB Standard becomes operative for annual financial statements covering periods beginning on or after 1 July 2002.**

Appendix 1

Compliance with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity in all material respects with International Accounting Standard IAS 23 (revised), Borrowing Costs.