

## Should capital expenditure incurred on projects funded using general borrowings, which remain outstanding after qualifying asset has completed construction, be included in capitalisation rate?

According to SB-FRS 23 paragraph 18, when estimating the expenditures to which the capitalisation rate is applied in a period, the *borrowing costs previously capitalised* as part of the qualifying asset should be included in the average carrying amount of the asset during that period.

This means that the capital expenditures applied to the capitalisation rate should be *cumulative* in nature (i.e. included in capitalisation rate even after qualifying asset has completed construction). This is applicable only for *projects funded using general borrowings*, as capital expenditure incurred using specific borrowings would have been capitalised as part of the “specific asset” upon completion (i.e. no more capital expenditure will be incurred in relation to the completed qualifying asset funded using specific borrowings, even if the specific borrowings remain outstanding after asset completion).

The above is illustrated in the following illustrative example:

### **Illustrative Example on Capitalisation of Outstanding General Borrowing Costs**

The financial year end of Statutory Board A is 31 December.

#### **Financial Year Ended 31 December 20X1**

On 1 January 20X1, Statutory Board A took up a \$130,000 bank loan at 8% per annum and issued debentures of \$50,000 at 5.5% per annum for no specific purpose. Statutory Board A used these borrowings to finance general spending and the construction of a new machinery. Statutory Board A used \$60,000 on 1 February 20X1 and \$25,000 on 1 September 20X1 for the construction of the machinery.

On 1 May 20X1, Statutory Board A took up another bank loan of \$200,000 at annual interest rate of 6% for no specific purpose. Statutory Board A used these borrowings to finance general spending and the construction of a new building. The construction of the building commenced on 1 June 20X1 and was completed by 31 December 20X1. Statutory Board A used \$100,000 for the construction of the building.

According to SB-FRS 23, **both the building and machinery satisfy the definition of qualifying asset**. Both the building and the machinery were funded through general loans.

The computation of borrowing costs for the financial year ended 31 December 20X1 was as follows:

Item	Computation
Total interest expense incurred on general borrowings for the financial year (FY) (A)	$(6\% * 8/12 * \$200,000) + (8\% * \$130,000 + 5.5\% * \$50,000) = \mathbf{\$21,150}$
<b>Capitalisation rate for general borrowings (B)</b>	$[8\% * \$130,000 / (\$130,000 + \$50,000 + \$200,000)] + [5.5\% * \$50,000 / (\$130,000 + \$50,000 + \$200,000)] + [6\% * \$200,000 / (\$130,000 + \$50,000 + \$200,000)] = \mathbf{6.62\%}$
Interest expense to be capitalised as cost of machinery for the FY (C)	$B * \$60,000 * 11/12 + B * \$25,000 * 4/12 = 6.62\% * \$60,000 * 11/12 + 6.62\% * 25,000 * 4/12 = \mathbf{\$4,192}$
Interest expense to be capitalised as cost of building for the FY (D)	$B * \$100,000 * 7/12 = \mathbf{\$3,861}$
Capitalised borrowing costs for the FY (E)	$C + D = \$4,192 + \$3,861 = \mathbf{\$8,052}$
Borrowing costs to be expensed off for the FY (F)	$A - E = \$21,150 - \$8,052 = \mathbf{\$13,098}$

For the financial year ended 31 December 20X1, the amount of borrowing costs eligible for capitalisation as costs of:

Machinery = \$4,192 (refer to C)

Building = \$3,861 (refer to D)

The amount of borrowing costs that was recognised as an expense was \$13,098 (refer to F).

### **Financial Year Ended 31 December 20X2**

In the financial year 20X2, Statutory Board A continued the construction of the machinery. Statutory Board A used an additional \$75,000 on 1 January 20X2 for the construction of machinery, which was completed by 31 December 20X2.

The computation of borrowing costs for the financial year ended 31 December 20X2 was as follows:

Item	Computation
Total interest expense incurred on general borrowings for the FY (G)	$(6\% * 8/12 * \$200,000) + (8\% * \$130,000 + 5.5\% * \$50,000) = \mathbf{\$21,150}$
<b>Capitalisation rate for general borrowings (H)</b>	$[6\% * \$200,000 / (\$200,000 + \$130,000 + \$50,000)] + [8\% * \$130,000 / (\$200,000 + \$130,000 + \$50,000)] + [5.5\% * \$50,000 / (\$200,000 + \$130,000 + \$50,000)] = \mathbf{6.62\%}$
Interest expense to be capitalised as cost of machinery for the FY (I)	$H * (\$85,000 + \$75,000 + C) = 6.62\% * (\$85,000 + \$75,000 + \$4,192) = \mathbf{\$10,870}$
Interest expense to be capitalised as cost of building for the FY (J)	Nil as the construction of the building had been completed in the previous financial year.
Capitalised borrowing costs for the FY (K)	$I + J = \mathbf{\$10,870}$

Borrowing costs to be expensed off for the FY (L)	G – K = \$21,150 - \$10,870 = <b>\$10,280</b>
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For the financial year ended 31 December 20X2, the amount of borrowing costs eligible for capitalisation as costs of:

Building = Nil (refer to J)

Machinery = \$10,870 (refer to I)

The amount of borrowing costs that was recognised as an expense was \$10,280 (refer to L).

**As can be seen from the above computation (see (H)), the computation of capitalisation rate for the FY should include *all outstanding general borrowings* as at end of the FY, including the outstanding general borrowings which relate to the qualifying asset which has already been completed in the previous FY.**