PROPOSED STATUTORY BOARD FINANCIAL REPORTING STANDARD GUIDANCE NOTE 9

Illustration on Capitalisation of Borrowing Costs

SB-FRS Guidance Note 8 *Illustrations on Capitalisation of Borrowing Costs* applies to Statutory Boards for annual periods beginning on or after 1 January 2019.

Comments to be received by 28 February 2019

This exposure draft on SB-FRS Guidance Note 9 *Illustrations on Capitalisation of Borrowing Costs* is issued by the Accountant-General's Department Technical Directorate for comments only and does not necessarily represent the views of the Directorate. The proposals may be modified in the light of the comments received before being issued as a Statutory Board Financial Reporting Standard (SB-FRS).

Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explaining the problem and providing a suggestion for alternative wording with supporting reasoning.

Comments should be submitted in writing, so as to be received by 28 February 2019 preferably by email to AGD_ASSB_Feedback@agd.gov.sg or addressed to:

Accountant-General's Department
Technical Directorate
100 High Street #06-01
The Treasury
Singapore 179434
Fax: (65) 6332 7678

Contents

Paragraphs

Statutory Board Financial Reporting Standard Guidance Note 9
Illustration on Capitalisation of Borrowing Costs

Statutory Board Financial Reporting Standard Guidance Note 9 *Illustration on Capitalisation of Borrowing Costs* is set out in paragraphs 1-22. All the paragraphs have equal authority. SB-FRS Guidance Notes are issued to standardise the accounting and disclosure requirements of Statutory Boards in specific areas and are to be complied with by Statutory Boards. These Guidance Notes rank behind SB-FRS and INT SB-FRS in terms of importance.

Statutory Board Financial Reporting Standard (SB-FRS) Guidance Note 9

Illustration on Capitalisation of Borrowing Costs

Objective

1. The objective of this Guidance Note is to provide illustrative examples on capitalisation of borrowing costs for qualifying assets funded using specific borrowings and general borrowings under SB-FRS 23 *Borrowing Costs*.

Scope

2. This Guidance Note shall be applied to all general purpose financial statements prepared and presented in accordance with Statutory Board Financial Reporting Standards (SB- FRS).

Illustrative Examples on Capitalisation of Borrowing Costs

Illustrative Example 1 – Usage of Single Capitalisation Rate for a Financial Year

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

Financial Year Ended 31 December 20x1

4. 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 purposes. Statutory Board A used these borrowings to finance general spending and the construction of a new machinery. Statutory Board A used $60,000 for the construction of the machinery on 1 February 20x1 and $25,000 on 1 September 20x1.

5. On 1st May 20x1, Statutory Board A took a bank loan of $200,000 at annual interest rate of 6%. The purpose of the loan was to finance the construction of a building. This was a specific borrowing. The construction of the building commenced on 1st June 20x1 and was completed by 31 December 20x1.

6. According to SB-FRS 23 *Borrowing Costs*, both the building and machinery satisfy the definition of qualifying asset[1]. The building is a qualifying asset funded through a specific loan, whereas the machinery is funded through general loans.

7. The computation of borrowing costs for the financial year ended 31 December 20x1 was as follows:

Item	Computation
Total interest expense incurred on specific borrowings for the financial year (FY) (A)	6% * 8/12 * $200,000 = $8,000
Total interest expense incurred on general borrowings for the FY (B)	8% * $130,000 + 5.5% * $50,000 = $13,150
Capitalisation rate for general borrowings (C)	[8% * $130,000/($130,000+$50,000)] + [5.5% * $50,000/($130,000+$50,000)] = 7.31%
Interest expense to be capitalised as cost of building[2] for the FY (D)	6% * 7/12 * $200,000 = **$7,000**

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

[2] Capitalisation can only start on 1 June 2018, i.e. date of commencement of construction.

Interest expense to be capitalised as cost of machinery for the FY (E)	C * $60,000 * 11/12 + C * $25,000 * 4/12 = 7.31% * $60,000 * 11/12 + 7.31% * $25,000 * 4/12 = **$4,627**
Capitalised borrowing costs for the FY (F)	D + E = $7,000 + $4,627 = **$11,627**
Borrowing costs to be expensed off for the FY (G)	A + B – F = $8,000 + $13,150 – $11,627 = **$9,523**

8. For the financial year ended 31 December 20x1, the amount of borrowing costs eligible for capitalisation as costs of:
   a. Building = $7,000 (refer to D)
   b. Machinery = $4,627 (refer to E)

   The amount of borrowing costs that are recognised as an expense in the Profit or Loss (P/L) is $9,523 (refer to G).

<u>Financial Year Ended 31 December 20x2</u>

9. In the financial year 20x2, ABC continued the construction of the machinery. ABC used an additional $75,000 on 1 January 20x2 for the construction of machinery, which was completed by 31 December 20x2.

10. Since the construction of the building had been completed by 31 December 20x1[3] and the bank loan of $200,000 is still outstanding as at 31 December 20x2, this outstanding bank loan shall be included in the calculation of capitalisation rate in accordance with SB-FRS 23.

11. The computation of borrowing costs for the financial year end 31 December 20x2 is as follows:

Item	Computation
Total interest expense incurred on specific borrowings for the FY (H)	6% * $200,000 = $12,000
Total interest expense incurred on general borrowings for the FY (I)	8% * $130,000 + 5.5% * $50,000 = $13,150
Capitalisation rate for general borrowings (J)	[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)] = 6.62%
Interest expense to be capitalised as cost of building (K)	Nil as the construction of the building had been completed in the previous financial year.
Interest expense to be capitalised as cost of machinery (L)	J * (85,000+$75,000+E)[4] = 6.62% * ($85,000+$75,000+$4,627) = **$10,898**
Capitalised borrowing costs for the FY (M)	K + L = **$10,898**
Borrowing costs to be expensed off for the FY (N)	H + I – M = $12,000 + $13,150 – $10,898 = **$14,252**

12. For the financial year ended 31 December 20x2, the amount of borrowing costs eligible for capitalisation as costs of:
   a. Building = Nil (refer to K)
   b. Machinery = $10,898 (refer to L)

[3] It was assumed that substantially all the activities necessary to prepare the building for its intended use or sale have been completed.

[4] SB-FRS 23, paragraph 18 sets out that "*The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalisation rate is applied in that period.*" If the carrying amount fluctuates significantly over the year and/or the amount is material, calculating capitalised borrowing costs using actual balances (including capitalised borrowing costs to date) on a month-to-month basis may be more appropriate.

The amount of borrowing costs that are recognised as an expense in the P/L is $14,252 (refer to N).

Illustrative Example 2 – Usage of Multiple Capitalisation Rates for a Financial Year

13. The financial year end of Statutory Board C is 31 December.

Financial Year Ended 31 December 20x1

14. On 1 January 20x1, Statutory Board C 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 purposes. Statutory Board C used these borrowings to finance general spending and the construction of a new machinery. Statutory Board C used $60,000 for the construction of the machinery on 1 February 20x1 and $25,000 on 1 September 20x1.

15. On 1st May 20x1, Statutory Board C took a bank loan of $200,000 at annual interest rate of 6%. The purpose of the loan was to finance the construction of a building. This was a specific borrowing. The construction of the building commenced on 1st June 20x1 and was completed by 31 January 20x2.

16. According to SB-FRS 23 *Borrowing Costs*, both the building and machinery satisfy the definition of qualifying asset[5]. The building is a qualifying asset funded through a specific loan, whereas the machinery is funded through general loans.

17. The computation of borrowing costs and the amount of borrowing costs eligible for capitalisation and to be expensed off in the P/L for the financial year ended 31 December 20x1 are the same as that presented in Paragraphs 7 and 8 respectively of this Guidance Note.

Financial Year Ended 31 December 20x2

18. In the financial year 20x2, ABC continued the construction of the machinery. ABC used an additional $75,000 on 1 January 20x2 for the construction of machinery, which was completed by 31 December 20x2.

19. Since the construction of the building had been completed by 31 January 20x2[6] and the bank loan of $200,000 is still outstanding as at 31 December 20x2, this outstanding bank loan shall be included in the calculation of capitalisation rate in accordance with SB-FRS 23, starting from the date that the construction of the building was completed (i.e. 1 February 20x2).

20. The computation of borrowing costs for the financial year end 31 December 20x2 is as follows:

Item	Computation
Total interest expense incurred on specific borrowings for the FY (O)	6% * $200,000 = $12,000
Total interest expense incurred on general borrowings for the FY (P)	8% * $130,000 + 5.5% * $50,000 = **$13,150**
Capitalisation rate for general borrowings from 1 Jan 20x2 to 31 Jan 20x2 (Q)	C = 7.31%
Capitalisation rate for general borrowings, *starting from 1 Feb 20x2* (R)	[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)] = 6.62%

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

[6] It was assumed that substantially all the activities necessary to prepare the building for its intended use or sale have been completed.

Interest expense to be capitalised as cost of building (S)	6% * 1/12 * ($200,000+$7,000) = **$1,035**
Interest expense to be capitalised as cost of machinery (T)	[Q * 1/12 * ($85,000+$75,000+E)[7]] + [R * 11/12 * ($85,000+$75,000+E)] = [7.31% * 1/12 * ($85,000+$75,000+$4,627)] + [6.62% * 11/12 * ($85,000+$75,000+$4,627)] = **$10,993**
Capitalised borrowing costs for the FY (U)	S + T = $1,035 + $10,993 = **$12,028**
Borrowing costs to be expensed off for the FY (V)	O + P – U = $12,000 + $13,150 – $12,028 = **$13,122**

21. For the financial year ended 31 December 20x2, the amount of borrowing costs eligible for capitalisation as costs of:
    c. Building = $1,035 (refer to S)
    d. Machinery = $10,993 (refer to T)

    The amount of borrowing costs that are recognised as an expense in the P/L is $13,122 (refer to V).

Effective Date

22. This Guidance Note is operative for financial statements covering periods beginning on or after 1 January 2019.

[7] SB-FRS 23, paragraph 18 sets out that "*The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalisation rate is applied in that period.*" If the carrying amount fluctuates significantly over the year and/or the amount is material, calculating capitalised borrowing costs using actual balances (including capitalised borrowing costs to date) on a month-to-month basis may be more appropriate.