
STATUTORY BOARD FINANCIAL REPORTING STANDARD GUIDANCE NOTE 8

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 2020. Earlier application is permitted.

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Statutory Board Financial Reporting Standard Guidance Note 8 *Illustration on Capitalisation of Borrowing Costs* is set out in paragraphs 1-36. 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 8

Illustration on Capitalisation of Borrowing Costs

Objective

1. The objective of this Guidance Note is to provide illustrative examples on the capitalisation of borrowing costs for qualifying assets funded using specific borrowings and general borrowings as set out in SB-FRS 23 *Borrowing Costs* Paragraphs 12 and 14.

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 on 1 February 20x1 and \$25,000 on 1 September 20x1 for the construction of the machinery.
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 asset¹. The building was a qualifying asset funded through a specific loan, whereas the machinery was 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)	$6\% * 7/12 * \$200,000 = \mathbf{\$7,000}$

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)	$C * \$60,000 * 11/12 + C * \$25,000 * 4/12 = 7.31\% * \$60,000 * 11/12 + 7.31\% * \$25,000 * 4/12 = \mathbf{\$4,630}$
Capitalised borrowing costs for the FY (F)	$D + E = \$7,000 + \$4,630 = \mathbf{\$11,630}$
Borrowing costs to be expensed off for the FY (G)	$A + B - F = \$8,000 + \$13,150 - \$11,630 = \mathbf{\$9,520}$

8. For the financial year ended 31 December 20x1, the amount of borrowing costs eligible for capitalisation as costs of:
- Building = \$7,000 (refer to D)
 - Machinery = \$4,630 (refer to E)

The amount of borrowing costs that was recognised as an expense was \$9,520 (refer to G).

Financial Year Ended 31 December 20x2

9. 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.
10. Since the construction of the building had been completed by 31 December 20x1³ and the bank loan of \$200,000 was still outstanding as at 31 December 20x2, this outstanding bank loan should be included in the calculation of capitalisation rate in accordance with SB-FRS 23.
11. The computation of borrowing costs for the financial year ended 31 December 20x2 was 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)	$J * (\$85,000 + \$75,000 + E)^4 = 6.62\% * (\$85,000 + \$75,000 + \$4,630) = \mathbf{\$10,899}$
Capitalised borrowing costs for the FY (M)	$K + L = \mathbf{\$10,899}$
Borrowing costs to be expensed off for the FY (N)	$H + I - M = \$12,000 + \$13,150 - \$10,899 = \mathbf{\$14,251}$

12. For the financial year ended 31 December 20x2, the amount of borrowing costs eligible for capitalisation as costs of:
- Building = Nil (refer to K)
 - Machinery = \$10,899 (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 was recognised as an expense was \$14,251 (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 on 1 February 20x1 and \$25,000 on 1 September 20x1 for the construction of the machinery.
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 asset⁵. The building was a qualifying asset funded through a specific loan, whereas the machinery was funded through general loans.
17. The computation of borrowing costs and the amount of borrowing costs eligible for capitalisation and to be expensed off 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, Statutory C continued the construction of the machinery. Statutory C 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 20x2⁶ and the bank loan of \$200,000 was still outstanding as at 31 December 20x2, this outstanding bank loan should 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 ended 31 December 20x2 was 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)	$8\% * \$130,000 + 5.5\% * \$50,000 = \mathbf{\$13,150}$
Capitalisation rate for general borrowings from 1 Jan 20x2 to 31 Jan 20x2 (Q)	$C = 7.31\%$
Capitalisation rate for general borrowings, <i>starting from 1 Feb 20x2</i> (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)	$6\% * 1/12 * (\$200,000 + D) = 6\% * 1/12 * (\$200,000 + \$7,000) =$ \$1,035
Interest expense to be capitalised as cost of machinery (T)	$[Q * 1/12 * (\$85,000 + \$75,000 + E)] + [R * 11/12 * (\$85,000 + \$75,000 + E)] = [7.31\% * 1/12 * (\$85,000 + \$75,000 + \$4,630)] + [6.62\% * 11/12 * (\$85,000 + \$75,000 + \$4,630)] =$ \$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:
- Building = \$1,035 (refer to S)
 - Machinery = \$10,993 (refer to T)

The amount of borrowing costs that was recognised as an expense was \$13,122 (refer to V).

Illustrative Example 3 – Specific Borrowings with Varying Interest Rates

22. The financial year for Statutory Board D is 31 December.

Financial Year Ended 31 December 20x1

23. On 1st May 20x1, Statutory Board D took a bank loan with variable interest rates of \$200,000. The purpose of the loan was to finance the construction of a building. The construction of the building commenced on 1 June 20x1 and was completed by 31 October 20x2. Statutory Board D did not have any other borrowing, other than this variable bank loan.
24. The interest rate for this variable bank loan was 6% per annum for 20x1, 7% per annum for 20x2 and 8% per annum thereafter until the maturity of the bank loan on 31 December 20x4. The loan was only repaid upon maturity.
25. According to SB-FRS 23, the building satisfies the definition of qualifying asset funded through a specific loan.
26. 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) (W)	$6\% * 8/12 * \$200,000 =$ \$8,000
Interest expense to be capitalised as cost of building ⁸ for the FY (X)	$6\% * 7/12 * \$200,000 =$ \$7,000
Capitalised borrowing costs for the FY	$X =$ \$7,000
Borrowing costs to be expensed off for the FY (Y)	$W - X = \$8,000 - \$7,000 =$ \$1,000

27. For the financial year ended 31 December 20x1, the amount of borrowing costs eligible for capitalisation as costs of building was \$7,000 (refer to X). The amount of borrowing costs that was recognised as an expense was \$1,000 (refer to Y).

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.

⁸ Capitalisation can only start on 1 June 20x1, i.e. date of commencement of construction.

Financial year Ended 31 December 20x2

28. The computation of borrowing costs for the financial year ended 31 December 20x2 was as follows:

Item	Computation
Total interest expense incurred on specific borrowings for the financial year (FY) (Z)	$7\% * \$200,000 = \$ 14,000$
Interest expense to be capitalised as cost of building for the FY (AA) ⁹	$7\% * 10/12 * (\$200,000 + X) = 7\% * 10/12 * (\$200,000 + \$7,000) = \mathbf{\$12,075}$
Capitalised borrowing costs for the FY	AA = \$12,075
Borrowing costs to be expensed off for the FY (BB)	Z - AA = \$14,000 – \$12,075 = \$1,925

29. For the financial year ended 31 December 20x2, the amount of borrowing costs eligible for capitalisation as costs of building was \$12,075 (refer to AA). The amount of borrowing costs that was recognised as an expense was \$1,925 (refer to BB).

Financial Year Ended 31 December 20x3 till Loan Maturity on 31 December 20x4

30. For the financial year ended 31 December 20x3 till the maturity of the loan on 31 December 20x4, the borrowing costs were not capitalised as costs of building as its construction was completed. These borrowing costs were recognised as an expense and they were \$16,000¹⁰ each for financial years ended 31 December 20x3 and 31 December 20x4. The loan was fully repaid on 31 December 20x4.

Illustrative Example 4 – Qualifying Assets Funded Using Borrowings and Own Funds

31. The financial year end of Statutory Board E is 31 December.
32. On 1 January 20x1, Statutory Board E took up a \$130,000 bank loan at 8% per annum and issued bonds of \$50,000 at 5.5% per annum for no specific purposes. In addition to its own operating funds of \$70,000, Statutory Board E used the \$30,000 of the proceeds from these borrowings for the construction of a machinery on 1 September 20x1.
33. According to SB-FRS 23, the machinery satisfied the definition of qualifying asset funded through general loan.
34. 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 FY (CC)	$8\% * \$130,000 + 5.5\% * \$50,000 = \$13,150$
Capitalisation rate for general borrowings (DD)	$[8\% * \$130,000 / (\$130,000 + \$50,000)] + [5.5\% * \$50,000 / (\$130,000 + \$50,000)] = 7.31\%$
Interest expense to be capitalised as cost of machinery for the FY (EE)	$DD * \$30,000 * 4/12 = 7.31\% * \$30,000 * 4/12 = \mathbf{\$731}$

⁹ Capitalisation of borrowing costs as cost of building ceased on 31 October 20x2 because construction of the building was completed on this date.

¹⁰ $8\% * \$200,000 = \$16,000$

Capitalised borrowing costs for the FY	EE = \$731
Borrowing costs to be expensed off for the FY (FF)	CC - EE = \$13,150 – \$731 = \$12,419

35. For the financial year ended 31 December 20x1, the amount of borrowing costs eligible for capitalisation as costs of machinery was \$731 (refer to EE). The amount of borrowing costs that was recognised as an expense was \$12,419 (refer to FF).

Effective Date

36. This Guidance Note is operative for financial statements covering periods beginning on or after 1 January 2020. Earlier application is permitted. If a Statutory Board applies this Guidance Note for an earlier period, it shall disclose that fact.