# SSAP 19
# STATEMENT OF STANDARD ACCOUNTING PRACTICE 19
# BORROWING COSTS

*(Issued May 1996)*

*The standards, which have been set in **bold italic type** , should be read in the context of the background material and implementation guidance and in the context of the Foreword to Statements of Standard Accounting Practice and Accounting Guidelines. Statements of Standard Accounting Practice are not intended to apply to immaterial items (see paragraph 8 of the Foreword).*

## Introduction

This Statement prescribes the accounting treatment for borrowing costs. It requires that borrowing costs should be recognised as an expense except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of a qualifying asset.

## Scope

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

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

## Definitions

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

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

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

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 SSAP 14 "Accounting for leases and hire purchase contracts"; 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 stocks that require a substantial period of time to bring them to a saleable condition, manufacturing plants, power generation facilities and investment properties. Stocks that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, and assets that are ready for their intended use or sale when acquired are not qualifying assets. Investments are not normally qualifying assets.

## Recognition

***6. 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 7.***

***7. 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. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Statement.***

8. 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.

## Borrowing costs eligible for capitalisation

9. 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.

10. 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 coordinated 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.

***11. 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 those borrowings.***

12. 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 expenditures on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.

***13. 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 expenditures 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.***

14. In some circumstances, it is appropriate to include all borrowings of the holding company 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

15. When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount should be written down.

## Commencement of capitalisation

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

***a. expenditures for the asset are 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.***

17. Expenditures on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditures are reduced by any progress payments received and grants received in connection with the asset. 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.

18. 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

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

20. 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 or expected 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 stocks to mature or the extended period during which adverse weather conditions delay construction of a bridge, if such weather conditions are common during the construction period in the geographic region involved.

## Cessation of capitalisation

***21. 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.***

22. 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 specification are all that are outstanding, this indicates that substantially all the activities are complete.

***23. 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.***

24. A development comprising several buildings, each of which can be used or sold individually is an example of a qualifying asset for which each part is capable of being usable or saleable while construction continues on other parts of the development. An example of a qualifying asset that needs to be complete 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

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

***a. the accounting policy adopted for borrowing costs;***

***b. the total borrowing costs incurred during the period;***

***c. the amount of borrowing costs capitalised during the period; and***

***d. the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.***

26. In addition, enterprises are encouraged to disclose the amount of borrowing costs capitalised during the period under the following headings:

    a. property, plant and equipment and, where significant, each class of property, plant and equipment;

    b. investment properties;

    c. stocks and work in progress; and

    d. other qualifying assets.

## Effective date

***27. The accounting practices set out in this Statement should be adopted as soon as possible and regarded as standard in respect of financial statements relating to periods beginning on or after 1 April 1996.***

## Transitional arrangements

***28. When the adoption of this Statement constitutes a change in accounting policy, an enterprise is encouraged to adjust its financial statements in accordance with SSAP 2 "Extraordinary items and prior period adjustments". Alternatively, enterprises capitalise only those borrowing costs incurred after the effective date of this Statement which meet the criteria for capitalisation.***

## Note on legal requirements in Hong Kong

29. Paragraph 13(1)(b) of the Tenth Schedule to the Companies Ordinance requires the following to be disclosed in, or by way of a note to, the profit and loss account:

    "the amount of the interest on loans of the following kinds made to the company (whether on the security of debentures or not), namely, bank loans, overdrafts and loans which, not being bank loans or overdrafts,

    i. are repayable otherwise than by instalments and fall due for repayment before the expiration of the period of 5 years beginning with the day next following the expiration of the financial year; or

    ii. are repayable by instalments the last of which falls due for payment before the expiration of that period;

    and the amount of the interest on loans of other kinds so made (whether on the security of debentures or not)".

## Compliance with International Accounting Standards

30. International Accounting Standard IAS 23 (revised 1993) "Borrowing Costs" has a benchmark treatment of recognising all borrowing costs as an expense in the period in which they are incurred. It also permits as an alternative treatment the capitalisation of borrowing costs. The requirements of this statement accord very closely with the content of the alternative treatment permitted under IAS 23. Accordingly, compliance with this Statement ensures compliance in all material respects with the alternative treatment requirements of IAS 23.