MPSAS 5: Borrowing Costs

Sarawak State Government

Agenda

Day 1
- Introduction
- Accounting Principles
- First Time Adoption of MPSAS
- Presentation of Financial Statements

Day 2
- Property, Plant and Equipment
- Intangible Assets

Day 3
- Inventories
- Agriculture
- Investment Properties
- Prepayments
- Impairment of Asset

Day 4
- Financial Instrument

Day 5
- Investments
- Grants, Provisions and Contingencies
- Commitments

Day 6
- Revenue
- Construction Contract
- Employee Benefits
- Borrowing Cost

Day 7
- Public Private Partnership
- Lease Accounting

Day 8
- Policies, Estimates & Errors
- Events After Reporting
- Related Party Disclosures
- General Government Sector
- Trust Accounts and Trust Fund

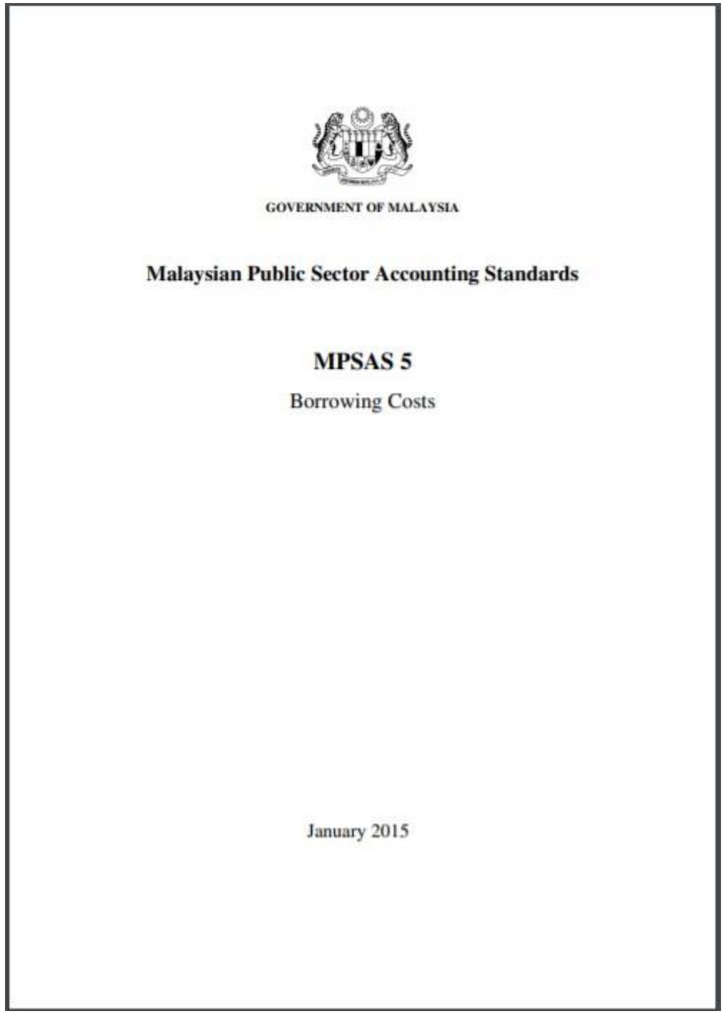
Components & elements of financial statements

	COMPONENTS	MPSAS
1	Statement of Financial Position	MPSAS 1
2	Statement of Financial Performance	MPSAS 1
3	Statement of Changes in Net Assets/Equity	MPSAS 1
4	Cash Flow Statement	MPSAS 2
5	Statement of Budget Performance	MPSAS 24
6	**Notes to the Financial Statements**	Various MPSAS

- Financial statement is to be prepared in accordance with the accounting principles

MPSAS 5

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


GOVERNMENT OF MALAYSIA

Malaysian Public Sector Accounting Standards

MPSAS 5

Borrowing Costs

January 2015

Effective Date: 1 January 2017

Types of borrowing cost

1. Interest on bank overdrafts and short-term and long-term borrowings
2. Amortisation of discounts or premiums relating to borrowings
3. Amortisation of ancillary costs incurred in connection with the arrangement of borrowings
4. Finance charges in respect of finance leases and service concession arrangements
5. Exchange differences arising from foreign currency borrowings, to the extent that they are regarded as an adjustment to interest costs

Recognition

Recap on Accounting Policy

Borrowing Cost - Benchmark Treatment

- Recognised **as expense in the period incurred**, regardless of how the borrowings are applied
- The financial statements shall disclose the accounting policy adopted for borrowing costs

Borrowing Cost - Allowed Alternative Treatment

- **Capitalisation of borrowing costs** that are directly attributable to the acquisition, construction or production of a qualifying asset.
- Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Examples of qualifying assets are office buildings, infrastructure assets such as roads, bridges and power generation facilities

Borrowing Cost - Allowed Alternative Treatment

- If changes in accounting policy >> May apply allowed alternative treatment

- Borrowing cost is recognised as expense in the period incurred, except for borrowing costs directly attributable to the acquisition, construction, or production of a qualifying asset shall be capitalised as part of the cost of that asset

- Borrowing costs are capitalised as part of the cost of the asset when:
  - It is probably that they will result in future economic benefits or service potential to the entity; and
  - The costs can be measured reliably.

- Where an entity adopts the allowed alternative treatment, that treatment shall be **applied consistently to all borrowing costs** that are directly attributable to the acquisition, construction or production of all qualifying assets of the entity.

Borrowing Cost - Allowed Alternative Treatment (cont'd)

Borrowing costs eligible for capitalisation

- To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset - **actual borrowing costs incurred** on that borrowing during the period, less any investment income on the temporary investment of those borrowings.

- 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 shall be determined by applying a capitalisation rate to the outlays on that asset.

- The capitalisation rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Amount of borrowing cost ≤ Borrowing cost incurred during the period

Borrowing Cost - Allowed Alternative Treatment (cont'd)

Commencement of capitalisation

The capitalisation of borrowing costs as part of the cost of a qualifying asset shall commence when:

- Outlays for the asset are being incurred;
- Borrowing costs are being incurred; and
- Activities that are necessary to prepare the asset for its intended use or sale are in progress.

Suspended during extended periods in which active development is interrupted, and expensed

Cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete

Borrowing Cost - Allowed Alternative Treatment (cont’d)

Cessation of capitalisation

Telco Entity A is in the process of rolling out its 3G network. Entity A plans to commence the offering of 3G services once it has achieved 60% population coverage. Throughout the rollout period, which lasts for 18 months, entity A completes the rollout of cell sites, testing the sites and the leased lines and microwave links between the sites and the core network. Testing the network sites continues up to the point that entity A achieves 60% population coverage. Certain final tests on all sites are completed just in advance of the commercial launch and are vital to confirming the network's operational readiness.

Over which period does entity A capitalise borrowing costs?

Cease capitalisation upon 60% population coverage as intended by management

Disclosure requirements

The financial statements shall 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 (when it was necessary to apply a capitalisation rate to funds borrowing generally).

Recognition of borrowing cost – Benchmark treatment -Illustrative example (Scenario 1)

The State has obtained a 5 years borrowing of RM1,000,000 from the Federal Government for the development of a low-cost residential area. The interest rate of the borrowing is 5% per annum. The loan is due for settlement at the end of the 5 years borrowing period.

1) To record the borrowings upon obtaining the fund

DR/CR	Account description	Amount (RM)
DR	Cash	1,000,000
CR	Borrowings	1,000,000

Recognition of borrowing cost – Benchmark treatment -Illustrative example (Scenario 1) (cont'd)

2) To record the interest expense in Year 1

The State would have to record an interest expense from the borrowings (RM1,000,000 x 5% = RM50,000).

DR/CR	Account description	Amount (RM)
DR	Interest expense	50,000
CR	Borrowings	50,000

Similar journal entry to recognise the borrowing costs in the subsequent years up to Year 5.

3) To record the settlement of borrowings at the end of Year 5

At the end of Year 5, the State settle the borrowings including principal balance and interest expense for Year 5 (RM1,000,000 + RM50,000 = RM1,050,000)

DR/CR	Account description	Amount (RM)
DR	Borrowings	1,050,000
CR	Cash	1,050,000

Recognition of borrowing cost – Allowed alternative treatment - Illustrative example (Scenario 2)

The State has obtained a 5 years borrowing of RM2,000,000 from the Federal Government for the construction of a building. The fund borrowed was specifically for the purpose of funding the construction of the building.

The interest rate of the borrowing is 5% per annum. The loan is due for settlement at the end of the 5 years borrowing period.

1) To record the borrowings upon obtaining the fund

DR/CR	Account description	Amount (RM)
DR	Cash	2,000,000
CR	Borrowings	2,000,000

Recognition of borrowing cost – Allowed alternative treatment – Illustrative example (Scenario 2) (cont'd)

2) To record the interest expense in Year 1

The physical construction of the building commenced upon obtaining the borrowings. At the end of Year 1, the State will capitalise from the borrowing costs (RM2,000,000 x 5% = RM100,000).

DR/CR	Account description	Amount (RM)
DR	Property, plant and equipment – building	100,000
CR	Borrowings	100,000

Similar journal entry to recognise the borrowing costs in the subsequent years up to Year 3.

Recognition of borrowing cost – Allowed alternative treatment – Illustrative example (Scenario 2) (cont'd)

3) To record the interest expense in Year 4

The construction of the building was completed and ready for use at the end of Year 3. The capitalisation of borrowing costs should cease when the building is ready for intended use.

At the end of Year 4, the State would have to record an interest expense from the borrowings (RM2,000,000 x 5% = RM100,000).

DR/CR	Account description	Amount (RM)
DR	Interest expense	100,000
CR	Borrowings	100,000

Recognition of borrowing cost – Allowed alternative treatment – Illustrative example (Scenario 2) (cont'd)

4) To record the settlement of borrowings at the end of Year 5

At the end of Year 5, the State settle the borrowings including principal balance and interest expense for Year 5 (RM2,000,000 + RM100,000 = RM2,100,000)

DR/CR	Account description	Amount (RM)
DR	Borrowings	2,100,000
CR	Cash	2,100,000