



Capitalisation of borrowing cost on land

IAS 23 prescribes when borrowing costs incurred in respect of a qualifying asset must be capitalised to the cost of the asset. An important element of this determination is the timing when the capitalisation of borrowing cost commences or ceases. The IFRIC Interpretation Committee issued an agenda decision that provides some guidance on the timing when capitalisation of borrowing cost in respect of land should cease if a building is being constructed on such land.

IAS 23 *Borrowing Costs* ('IAS 23') deals with the accounting treatment of borrowing costs incurred in connection with the acquisition, construction or production of qualifying assets. The standard defines what constitutes a qualifying asset and sets out which borrowing costs are eligible for capitalisation as part of the cost of the asset. It contains specific principles relating to the commencement and cessation of capitalisation of borrowing cost.

The IFRS Interpretations Committee (the Committee) issued an agenda decision on a question relating to the timing when capitalisation of borrowing cost on land ceases. This article provides a brief overview of the background, analysis and agenda decision.

Background

The building, which is constructed over a period of time, is a qualifying asset in respect of which borrowing costs can be capitalised the property in terms of IAS 23. The development of the building involves the acquisition and development of land and only thereafter the construction of the building. Both the land and building are qualifying assets. The development is funded from general borrowings.

Issue and technical analysis

The question arose when the capitalisation of borrowing cost in respect of the land-component of the property should cease.

The relevant principle in IAS 23 states that capitalisation of borrowing cost ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

One view would be to argue that as soon as the land has been developed and is ready for the construction of the building, all the activities necessary to prepare the land for its intended use (construction of the building) are complete and capitalisation

should cease at this point. Alternatively, capitalisation can continue until all the activities on the construction project as a whole are substantially completed, which would only be the case when the construction of the building has also been completed.

In reaching the decision below, the following principles in IAS 23 and related analysis were relevant:

- ▶ When the construction of a qualifying asset is completed in parts and each part is capable of separate operation, the capitalisation of borrowing cost on a part ceases when substantially all the activities necessary to prepare that part for its intended use.
- ▶ Borrowing costs incurred while land acquired for building purposes is held without any associated development activity cannot be capitalised. If the land can however not be used while the building is constructed, the construction of the building represents such associated development activity.

Position taken

The Committee observed that the decision on when capitalisation of borrowing cost in respect of such land ceases depends on the intended use of the land. Land is not merely held to construct a building; rather, the land and buildings may be owner-occupied (accounted for as property, plant and equipment under IAS 16), held for rental or capital appreciation (accounted for as investment property under IAS 40) or sale (accounted for as inventory under IAS 2). The question when the land has been prepared for its intended use must rather be considered with reference to one of these three purposes. If, in light of the purpose for which the land is held, it is not capable of being used while the building is still under construction, the land and building should be considered together for purposes of assessing whether substantially all the activities to prepare it for intended use have been completed.