KPMG

COVID-19 | How might capitalisation of borrowing costs be affected?

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What's the issue?

Under IAS 23 *Borrowing Costs*, a company capitalises borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset – i.e. one that necessarily takes a substantial period of time to get ready for its intended use or sale. *[IAS 23.1, 5]*

If a company suspends active development of a qualifying asset for an extended period, then it also suspends capitalisation of the borrowing costs for that asset. *[IAS 23.20]*

The economic turbulence resulting from the COVID-19 coronavirus pandemic might lead to the suspension of projects due to legal restrictions on working or shortages of labour or supplies.

Borrowing costs eligible for capitalisation reflect the interest expense calculated under the effective interest method. Therefore, the renegotiation or modification of borrowing terms may affect the amount of eligible borrowing costs. *[IAS 23.6]*

Getting into more detail

Suspension of projects

The standard does not specify how long an 'extended period' of suspension of active development is. However, a company does not normally suspend capitalisation during a period when it carries out substantial – as opposed to insignificant – technical and administrative work. Similarly, it does not suspend capitalisation when a temporary delay is a necessary part of the development process – e.g. for an external but common event or an interruption that is a typical part of the process. Therefore, a company may need to apply judgement to determine whether it should suspend capitalisation of borrowing costs. *[IAS 23.21, Insights 4.6.160.30]*

Interruptions in construction and development projects due to the COVID-19 outbreak could lead to a suspension in the capitalisation of borrowing costs.

Government actions to fight the COVID-19 outbreak might cause many physical development projects to pause – e.g. because project workers need to stay at home. A company needs to consider both the expected length and the nature of the suspension when evaluating whether an interruption caused by the COVID-19 outbreak will continue for an extended period.

A company continues to capitalise borrowing costs if:

- the interruption is for only a short duration;
- it continues to perform substantial administrative or technical work; or
- it can demonstrate that the interruption is due to a common external event or is a typical part of the process.

Renegotiation of borrowings

Eligible borrowing costs for projects that have not been suspended for an extended period include interest expenses calculated using the effective interest method under IFRS 9 *Financial Instruments*. This includes the actual cost of borrowings taken out for specific qualifying assets and the weighted-average rate on general borrowings used to fund qualifying assets. Therefore, modifications to financial liabilities that are agreed with lenders may lead to adjustments to interest expense that affect the amount of eligible borrowing costs to be capitalised. *[IAS 23.6]*

Actions for management to take now

Reassess whether long-term development projects on which borrowing costs are capitalised are being suspended for an extended period because of the COVID-19 outbreak.

If borrowing costs continue to be capitalised, then consider whether the amounts to be capitalised should change as a result of modifications to the contractual terms of those borrowings.

References to 'Insights' mean our publication **Insights into IFRS**

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