ACTIVE STANDARD

INTERNATIONAL FINANCIAL REPORTING STANDARDS

# IAS 23

## Borrowing Costs

*Capitalizing borrowing costs on qualifying assets — commencement, suspension and cessation, updated for the 2019 amendment and IFRS 18*

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ROADMAP

# What We Will Cover

### Foundations & Core Principle

The capitalization principle, and what counts as a borrowing cost

### Qualifying Assets

What qualifies for capitalization, and what is excluded

### Capitalization Mechanics

Specific and general borrowings, and the capitalization rate

### Commencement, Suspension & Cessation

The three triggers that start, pause and stop capitalization

### Measurement & Impairment

Capitalize or expense, and the interaction with impairment

### Disclosure Requirements

What every set of financial statements must show

### Worked Illustrations

Four worked examples covering judgment calls and capitalization rate calculations

### Recent Developments

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PART I — FOUNDATIONS

# The Core Principle

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. All other borrowing costs are recognised as an expense.

FOUNDATIONS

# The Core Principle

IAS 23 requires an entity to capitalize borrowing costs directly attributable to a qualifying asset, as part of the cost of that asset.

- 'Directly attributable' means the costs that would have been avoided if the expenditure on the qualifying asset had not been made — a straightforward but strict causation test.
- All OTHER borrowing costs — on funds not used for a qualifying asset — are recognised as an expense in the period in which they are incurred.
- The 2007 revision to IAS 23 eliminated the earlier option to expense ALL borrowing costs immediately — capitalization is now mandatory once the qualifying conditions are met, not a free accounting policy choice.
- The objective is to reflect that a qualifying asset's cost should include the financing cost of getting the asset ready for use — consistent with the historical cost model in IAS 16 and IAS 38.

FOUNDATIONS

# What Counts as a Borrowing Cost?

Borrowing costs are interest and other costs an entity incurs in connection with the borrowing of funds. Three components make up the definition.

### Interest Expense (Effective Interest Method)

Interest expense calculated using the effective interest method under IFRS 9 — the same method used to measure amortised-cost financial liabilities.

### Interest on Lease Liabilities

Interest on lease liabilities recognised under IFRS 16 — a borrowing cost in substance, even though it arises from a lease rather than a loan.

### Exchange Differences on Foreign Currency Borrowings

Exchange differences arising from foreign currency borrowings, to the extent that they are regarded as an adjustment to interest costs.

FOUNDATIONS

# What Is a Qualifying Asset?

A qualifying asset is an asset that necessarily takes a SUBSTANTIAL PERIOD OF TIME to get ready for its intended use or sale.

- Depending on the circumstances, a qualifying asset can be: inventories, manufacturing plants, power generation facilities, intangible assets, investment property, or bearer plants.
- There is no bright-line definition of a 'substantial period' — it is a matter of judgement based on the facts, though many entities use a working benchmark of around 12 months.
- What matters is the TIME needed to get the asset ready, not its size or cost — a large but quickly-completed asset is not a qualifying asset.

FOUNDATIONS

# Scope Exclusions — What Is NOT a Qualifying Asset

Two categories of asset are explicitly excluded from qualifying asset treatment, even if substantial expenditure is involved.

### Assets Measured at Fair Value

Financial assets, and non-financial assets such as biological assets measured at fair value under IAS 41, are not qualifying assets — capitalizing borrowing costs would be redundant, since fair value already reflects all value-relevant information.

### Assets Ready at Acquisition or Produced in Short Periods

Inventories manufactured or otherwise produced in large quantities on a repetitive basis over a short period are not qualifying assets, nor are assets that are ready for their intended use or sale when acquired.

PART II — CAPITALIZATION MECHANICS

# Capitalization Mechanics

How much borrowing cost is eligible for capitalization depends on whether funds were borrowed specifically for the asset, or drawn from a general pool.

# Specific Borrowings

Where an entity borrows funds SPECIFICALLY for the purpose of obtaining a qualifying asset, the calculation is direct.

- ✦ The amount eligible for capitalization is the actual borrowing costs incurred on that specific borrowing during the period.
- ✦ This is REDUCED by any investment income earned on the temporary investment of those borrowed funds, before they are spent on the qualifying asset.
- ✦ The net result — actual borrowing cost minus temporary investment income — is capitalized, even if it differs from what a general capitalization rate would produce.

CAPITALIZATION MECHANICS

# General Borrowings & the Capitalization Rate

Where funds are borrowed generally, and used in part to obtain a qualifying asset, an entity determines the eligible amount by applying a CAPITALIZATION RATE.

- ✦ The capitalization rate is the WEIGHTED AVERAGE of the borrowing costs applicable to all borrowings in the general pool during the period — excluding any borrowings made specifically for another qualifying asset.
- ✦ The amount capitalized is this rate applied to the expenditure on the asset that has NOT already been funded by specific borrowings.
- ✦ The amount of borrowing costs capitalized during a period shall not exceed the amount of borrowing costs actually incurred during that period.
- ✦ See Illustration II and Illustration IV for full worked calculations combining specific and general borrowings.

CAPITALIZATION MECHANICS

# The Three Conditions for Commencing Capitalization

Capitalization of borrowing costs commences as the capitalization date, when ALL THREE conditions below are first met together.

### 1 Expenditures for the asset are being incurred

Costs on the qualifying asset itself are actually being incurred — cash payments, transfers of other assets, or assumption of interest-bearing liabilities.

### 2 Borrowing costs are being incurred

The entity is incurring borrowing costs related to funding that expenditure.

### 3 Activities necessary to prepare the asset are in progress

Activities necessary to prepare the asset for its intended use or sale are under way — including technical and administrative work prior to physical construction, such as obtaining permits.

# Suspension of Capitalization

Capitalization of borrowing costs is SUSPENDED during extended periods in which active development of a qualifying asset is interrupted.

- ✦ During a suspension, borrowing costs continue to be incurred, but are no longer eligible for capitalization — they are expensed as incurred for the duration of the interruption.
- ✦ Capitalization is NOT suspended for a period in which substantial technical and administrative work is being carried out, even though physical construction has paused — e.g. while awaiting the outcome of a permit application actively being pursued.
- ✦ Capitalization is also NOT suspended for a temporary delay that is a NECESSARY PART of getting the asset ready — e.g. the time needed for concrete to cure, or for a bridge to settle before further construction, is not a suspension.
- ✦ Capitalization resumes once active development recommences — see Illustration III for a full worked example.

# Cessation of Capitalization

## Complete Cessation

- ✦ Capitalization ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- ✦ An asset is normally ready for its intended use when its physical construction is complete, even though routine administrative work might still continue.
- ✦ Minor modifications, such as decorating a property to a purchaser's or user's specification, do not indicate that activities are still in progress.

## Parts Completed in Stages

- ✦ Where construction of a qualifying asset is completed in PARTS, and each part is capable of being used while construction continues on other parts, capitalization ceases for that completed part when it becomes ready for use.
- ✦ Classic example: a business park comprising several independently usable buildings, or a bridge built in stages, each usable section opened as completed.
- ✦ Where the asset cannot function without ALL its parts complete — e.g. an integrated production plant — capitalization continues on the whole until it is substantially ready as a single unit.

*See Illustration I for a worked example distinguishing "substantially complete" from merely "mostly built".*

PART III — MEASUREMENT & IMPAIRMENT

# Recognition, Measurement & Impairment

When to capitalize versus expense, and how a capitalized borrowing cost interacts with the impairment requirements of IAS 36.

# Recognition — Capitalize or Expense?

Borrowing costs directly attributable to a qualifying asset are capitalized only when BOTH conditions below are met.

- ✦ It is PROBABLE that the borrowing costs will result in future economic benefits to the entity.
- ✦ The borrowing costs can be MEASURED RELIABLY — determined using the effective interest method under IFRS 9.
- ✦ Where these conditions are not met, or the expenditure does not relate to a qualifying asset, borrowing costs are recognised as an expense in the period incurred — this remains the DEFAULT treatment.

# Excess of Carrying Amount Over Recoverable Amount

Capitalizing borrowing costs does not override the impairment requirements elsewhere in IFRS Standards.

- When the carrying amount, or the expected ultimate cost, of a qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other Standards — typically IAS 36 Impairment of Assets.
- In some circumstances, the amount of the write-down or write-back is reversed in accordance with those other Standards.
- This means capitalized borrowing costs can never be used to justify carrying an asset above its recoverable amount — impairment testing applies to the FULL capitalized cost, financing charges included.

PART IV — DISCLOSURE

# Disclosure Requirements

IAS 23's disclosure requirements are deliberately narrow — but essential for understanding how much of an asset's cost is financing rather than construction.

DISCLOSURE

# What the Notes Must Show

1

### Amount of borrowing costs capitalized during the period

The total amount of borrowing costs capitalized during the period, across all qualifying assets.

2

### The capitalization rate used

Where the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to general borrowings, that rate is disclosed.

3

### Accounting policy for borrowing costs

Entities typically disclose their policy for identifying qualifying assets and determining directly attributable borrowing costs, consistent with the general requirement to disclose significant accounting policies.

PART V — APPLICATION

# Worked Illustrations

Four worked examples covering a judgment call on cessation, and full capitalization-rate calculations combining specific and general borrowings.

# Illustration I — When Does Capitalization Stop?

## FACT PATTERN

Woolworth is constructing a stadium. As at 31 October 2025, construction of the stadium is complete to a large extent — the ticket booking office and the stadium doors are the only remaining items to be finished. Woolworth's auditor insists that capitalization of borrowing costs should stop at 31 October 2025. Required: as the entity's accountant, give your opinion on this issue.

## SOLUTION

The stadium cannot be used for its intended purpose — hosting ticketed events — until the ticket booking office and the doors are complete. Spectators cannot be admitted, and tickets cannot be sold, without these elements.

The test for cessation is whether SUBSTANTIALLY ALL the activities necessary to prepare the asset for its intended use are complete — not merely whether construction looks largely finished.

Because the stadium is not yet capable of being used for its intended purpose, it is NOT substantially ready. Capitalization of borrowing costs should therefore CONTINUE beyond 31 October 2025, until the ticket booking office and doors are completed.

The auditor's position would only be correct if the remaining work were a genuinely minor modification unrelated to the asset's core functionality — which is not the case here.

# Illustration II — Specific & General Borrowings

## FACT PATTERN

Z Ltd has a building under construction for the year ended 31 December 2025, financed with $8,000,000 of debt, of which $6,000,000 is a construction loan borrowed specifically for the building. The remaining $2,000,000 of building expenditure is financed from Z Ltd's general borrowing pool. The debt structure, outstanding throughout 2025, is: Construction loan @ 11% — $6,000,000; Long-term debenture @ 9% — $9,000,000; Long-term subordinated debenture @ 10% — $3,000,000 (debentures issued at the same time). Required: (a) interest payable for the year, (b) capitalized interest, (c) interest expense in profit or loss.

## SOLUTION (a) — INTEREST PAYABLE DURING THE YEAR

| Borrowing | Principal ($) | Rate | Interest ($) |
|---|---|---|---|
| Construction loan | 6,000,000 | 11% | 660,000 |
| Long-term debenture | 9,000,000 | 9% | 810,000 |
| Subordinated debenture | 3,000,000 | 10% | 300,000 |
| **Total interest payable** | — | — | **1,770,000** |

# Illustration II — Specific & General Borrowings (continued)

## SOLUTION (b) — CAPITALIZATION RATE ON THE GENERAL POOL

Weighted average rate on the general pool (debenture + subordinated debenture) = ($810,000 + $300,000) ÷ ($9,000,000 + $3,000,000) = $1,110,000 ÷ $12,000,000 = 9.25%.

| Component | Basis | Capitalized ($) |
|---|---|---|
| Specific construction loan | $6,000,000 × 11% | 660,000 |
| General pool (remaining expenditure) | $2,000,000 × 9.25% | 185,000 |
| **Total capitalized interest** | — | **845,000** |

## SOLUTION (c) — INTEREST EXPENSE IN PROFIT OR LOSS

Total interest payable $1,770,000 – capitalized interest $845,000 = $925,000 recognised as an interest expense in profit or loss for the year.

# Illustration III — Suspension of Capitalization

## FACT PATTERN

An entity begins constructing a qualifying warehouse in February 2025, financed by a specific construction loan carrying interest of $8,000 per month. Construction proceeds normally until 1 June 2025, when a labour dispute halts all site activity for three months, with no technical or administrative work continuing during this period. Site activity resumes on 1 September 2025, and the warehouse is completed on 31 December 2025. Required: determine the total borrowing cost capitalized for the year.

## SOLUTION

Borrowing costs are capitalized only while all three commencement conditions continue to be met — expenditure, borrowing costs, and active preparation activity. During the three-month labour dispute (June–August 2025), no technical or administrative work is being carried out, so capitalization is SUSPENDED for this period.

Capitalization applies for February–May 2025 (4 months) and September–December 2025 (4 months) = 8 months of the 11-month construction period.

Capitalized borrowing cost = 8 months × $8,000 = $64,000.

The interest incurred during the 3-month suspension (3 × $8,000 = $24,000) is recognised as an expense in profit or loss, not capitalized — even though the loan remained outstanding and interest continued to accrue throughout the labour dispute.

WORKED ILLUSTRATIONS

# Illustration IV — Weighted Average Capitalization Rate

## FACT PATTERN

An entity has no specific borrowings for its new distribution centre, so the $3,000,000 of qualifying expenditure incurred evenly through 2025 is funded entirely from general borrowings: a $5,000,000 loan outstanding all year at 8%, and a new $4,000,000 loan drawn on 1 July 2025 at 6%, outstanding for the remaining six months. Average qualifying expenditure for the year is $1,500,000. Required: the capitalization rate and the borrowing cost capitalized.

| Step | Calculation | Result |
|---|---|---|
| Weighted average borrowing cost | ($5,000,000 × 8%) + ($4,000,000 × 6% × 6/12) | $520,000 |
| Weighted average borrowings outstanding | ($5,000,000 × 12 + $4,000,000 × 6) ÷ 12 | $7,000,000 |
| Capitalization rate | $520,000 ÷ $7,000,000 | 7.43% |
| **Borrowing cost capitalized** | **7.43% × $1,500,000 average qualifying expenditure** | **≈ $111,450** |

*The $111,450 capitalized amount is well within the $520,000 of borrowing costs actually incurred during the year, so the capitalization cap under IAS 23 is not a binding constraint in this case.*

PART VI — RECENT DEVELOPMENTS

# Amendments & IFRS 18 Impact

The 2019 amendment on specific borrowings after an asset is ready, and how IFRS 18 reshapes the presentation of borrowing costs.

# The 2019 Amendment — Specific Borrowings After the Asset Is Ready

Annual Improvements to IFRS Standards 2015–2017 Cycle amended IAS 23, effective for annual periods beginning on or after 1 January 2019.

- The amendment clarifies that if a specific borrowing remains OUTSTANDING after the related qualifying asset is ready for its intended use or sale, that borrowing becomes part of the entity's GENERAL borrowings when calculating the capitalization rate for other qualifying assets.
- Before the amendment, practice was inconsistent on whether a specific borrowing, once its related asset was complete, should be folded into the general pool or excluded entirely from further capitalization calculations.
- This matters in practice for groups with multiple qualifying assets under construction at once, financed by a mix of specific and general borrowings at different stages of completion.
- The amendment applies prospectively to borrowing costs incurred on or after the beginning of the annual period in which the entity first applies it.

# Impact of IFRS 18 on Presentation of Borrowing Costs

IFRS 18 Presentation and Disclosure in Financial Statements replaces IAS 1 and is effective for annual periods beginning on or after 1 January 2027 (early application permitted).

### Expensed Borrowing Costs — Financing

Borrowing costs that are NOT capitalized, and are instead expensed as incurred, are classified in the FINANCING category of the statement of profit or loss under IFRS 18's defined structure.

### Capitalized Costs — Embedded in the Asset

Borrowing costs capitalized into a qualifying asset's cost leave the income statement entirely, re-emerging later as part of depreciation or cost of sales, in whichever category that expense sits.

### What Does NOT Change

IFRS 18 does not alter the capitalization test, the capitalization rate calculation, or the commencement/suspension/cessation rules under IAS 23 — the impact is confined to where expensed borrowing costs are presented.

SUMMARY

# Key Takeaways

### Capitalize only when required

Directly attributable borrowing costs on qualifying assets are capitalized; everything else is expensed as incurred.

### Time, not cost, defines a qualifying asset

It's the substantial period needed to get ready for use or sale that matters, not the size of the asset.

### Specific and general borrowings are calculated differently

Specific borrowings capitalize actual cost net of temporary investment income; general borrowings use a weighted average capitalization rate.

### Three triggers control the capitalization window

Expenditure, borrowing costs and active preparation activity must all be present to commence — and capitalization pauses or stops when they're not.

### Impairment still applies

A capitalized borrowing cost never shields a qualifying asset from being written down to its recoverable amount.

### The 2019 amendment closed a capitalization-rate gap

A specific borrowing left outstanding after its asset is ready now joins the general pool for other assets' capitalization rates.

ABOUT THE AUTHOR

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B D Chatterjee is a Chartered Accountant and financial thought leader with over 35 years of global experience spanning corporate finance, accounting standards, financial reporting, business valuation and financial due diligence. As a seasoned CFO, he has led finance functions across major corporations and now heads Digital CFO Solutions, a platform delivering institutional-grade IFRS, US GAAP and valuation workbooks alongside fractional CFO services.

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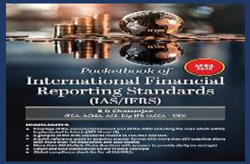


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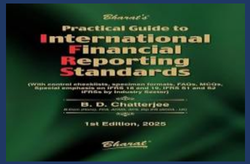


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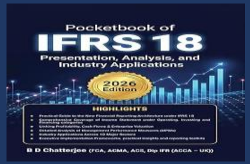


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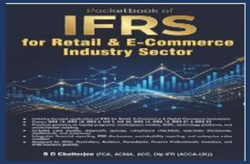


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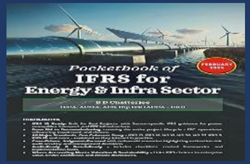


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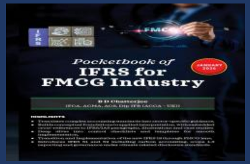


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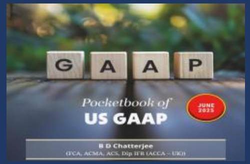


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