



10.0 ACCOUNTING FOR BORROWING COSTS

10.1 Introduction

This chapter covers the following:

- a. Applicable Terms
- b. Applicable Standard
- c. Key IPSAS Provisions
- d. Applicable Accounting Codes
- e. Accounting Documentation
- f. Accounting Procedures
- g. Accounting Treatment
- h. Illustrations

10.2 Applicable Terms

Borrowing Costs are interest and other expenses incurred by an entity in connection with the borrowing of funds. Borrowing costs may include:

- a. Interest on bank facilities or short term and long term borrowings;
- b. Amortization of discounts or premiums relating to borrowing;
- c. Amortization of ancillary costs incurred in connection with the arrangement of borrowing;
- d. Finance charges for finance leases; and
- e. Exchange differences arising from foreign currency borrowings to the extent that they qualify as an adjustment to interest costs.

Generally, **Borrowing Costs** are to be expensed in the period in which they are incurred; however, it is permissible as an alternative treatment, the option of

capitalization of the borrowing costs that are directly attributable to the acquisition, construction, or production of a **qualifying asset**.

The Policy of Government on Borrowing Cost is as provided in the Statement of Accounting Policies (See Appendix ii.40)

Qualifying Asset is an asset that necessarily takes a substantial period of time (usually more than one year) to get ready for its intended use or eventual sale. Examples of qualifying asset for the public sector include office buildings, hospitals, and infrastructure assets such as roads, bridges and power generation facilities.

Generally, inventories that require a substantial period of time to bring them to a saleable condition can be regarded as qualifying assets. However, inventories that are manufactured or produced during the course of regular operations over a short period of time are not qualifying assets.

Borrowing costs relates to the following categories of Borrowing

- a. Domestic Loan/Borrowing;
- b. External Loan / Borrowing

Domestic Loans/Borrowings

Domestic Loans/Borrowings are loans sourced from within the country.

Examples:

- a. Nigerian Treasury Bills (NTBs)
- b. Treasury Certificate
- c. Treasury Bonds
- d. Bank Loans/Overdraft

External Loan / Borrowing

External Loans/Borrowings are loans secured from outside the country and include the following:

- a. Bilateral Loan
- b. Multilateral Loan

All external loans will either be contracted directly by the Federal Government or by State/Local Government through the Federal Government which must guarantee such loans. Therefore, the limit for guarantees is the total amount of foreign debt to be contracted, which is included in the budget approved by the National/State Assembly.

10.3 Applicable Standards

The relevant standard is IPSAS 5-Borrowing Costs

10.4 Key IPSAS Provisions

Recognition:

Generally, borrowing costs should be recognized from the date when the entity:

- a. Incurs borrowing costs;
- b. Incurs expenditure on the qualifying asset; and
- c. Commences activities that are necessary to get the asset ready for its intended use or sale

Criteria for recognition of borrowing costs:

- a. Borrowing costs are recognized as an expense in the period it is incurred whether it is incurred in respect of a qualifying asset or not. This is the preferred method pursuant to the applicable IPSAS.
- b. Alternatively, borrowing cost directly attributable to a qualifying asset are **capitalized** as part of the cost of the assets, when it is probable that they will result in future economic benefits to the entity and the costs can be measured reliably.

When an entity decides to adopt the allowed alternative treatment of capitalization, it is required that the treatment be applied consistently to all borrowing costs that are directly attributable to the qualifying asset.

De-recognition

De-recognition of a financial liability (borrowing costs) is when the obligation is waived, cancelled, discharged or expired.

Measurement

As stated earlier, only borrowing costs incurred that are directly attributable to a qualifying asset can be capitalized to the cost of the asset.

For this purpose, there are two types of borrowings (i.e. specific and general) for which the amount of borrowing costs to be capitalized will differ depending on the type of borrowings.

Specific Borrowing

When an entity specifically borrows funds for the purpose of obtaining a particular qualifying asset, the borrowing costs that are directly related to that qualifying asset can be readily identified. Therefore, when funds are borrowed specifically for the purpose of obtaining a qualifying asset, the borrowing costs that are eligible for capitalization should be the actual borrowing costs incurred on such borrowing during the period, less any income earned on the temporary investment of those borrowings.

General Borrowing

When the financing activity of an enterprise is coordinated centrally or a range of debt instruments are used to borrow funds at varying rates of interest, such borrowings cannot be readily identifiable with a specific qualifying asset. As a result, the exercise of judgment is required to determine the amount of borrowing costs that are directly attributable to the acquisition, construction, or production of that qualifying asset. To the extent that funds are borrowed generally and are used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization should be determined by applying a capitalization rate to the expenditure on that asset.

The capitalization rate in such cases 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. However, the borrowing costs capitalized during a period should not exceed the actual borrowing costs incurred during that period.

Initial Measurement

Commencement of Capitalization

The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied:

- a. Expenditure for the acquisition, construction, or production of a qualifying asset is 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.

Subsequent Measurement

Suspension of Capitalization

The capitalization of borrowing costs should be suspended during extended periods in which active development is interrupted. This will depend on the facts of each situation.

However, capitalization of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out.

Cessation of Capitalization

Capitalization of borrowing costs should cease 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 or sale when its physical construction or production is complete even though routine administrative work might still continue.

Disclosure

An entity shall disclose in the notes to the accounts the following:

- a. The amount of borrowing costs capitalized during the period;
- b. The effective capitalization rate used to determine the amount of borrowing costs eligible for capitalization (when it was necessary to apply a capitalization rate to funds borrowed generally); and
- c. The accounting policy adopted for borrowing costs.

10.5 Accounting Documents

- a. MoU/Loan Agreement
- b. Cash book
- c. Receipt Voucher
- d. Journal Voucher
- e. Subsidiary Ledger
- f. General Ledger
- g. Loan Amortization Schedule
- h. Other relevant documents

10.6 Accounting Procedures

- a. Authorization
- b. Ascertain the amount borrowed and applicable interest and related charges from the Loan amortization schedule
- c. Recognize borrowing costs in the Books of Accounts
- d. Post appropriately to the relevant Cash books/ledgers

10.7 Accounting Treatment

S/No	Detail	Remarks
i	For Specific Loans:	
1	Dr Qualifying Assets Cr Loan Cr Other Creditors	On recognition
	Dr Loan Dr Other Creditors Cr Bank/Cash	On payment
ii	General Loans -Portion Attributable to qualifying Assets	
2	DR Qualifying assets CR Loan CR Other Creditors	On recognition
	Dr Loan Dr Other Creditors Cr Bank/Cash	When payment is finally made

10.8 Illustrations

Recognition of Borrowing Cost as an Expense

On 2nd January, 20X3, a Public Health Institution XYX accepted a bank facility to implement an approved staff minimum wage. The terms of the facility include: Principal amount ₦1,000,000, Interest rate 10%, tenure 24 months, administrative and other processing cost amounted to ₦120,000

Accounting Entries as at 31st December 20X3

S/No	Details	Dr (₦)	Cr (₦)	Remark
	Borrowing Cost			
	Interest Charges	78,615		To recognize borrowing cost for the year ended 20x3.
	Admin. & Others	120,000		
	Bank		198,615	

Borrowing Cost Capitalised

On 2nd January, 20X3, a Public Health Institution XYX accepted a bank facility to construct a female ward. The terms of the facility include: Principal amount ₦1,000,000, Interest rate 10%, tenure 24 months, administrative and other processing cost amounted to ₦120,000

Accounting Entries as at 31st December 20X3

S/No	Details	Code	Dr (₦)	Cr (₦)	Remark
	PPE (Building)		198,615		To recognize borrowing cost for the year ended 20x3.
	Bank			198,615	