

**Statement of  
Financial Accounting Standards  
No. 3**

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Translated by

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**Statements of Financial Accounting Standards No.3**

**Borrowing Cost**

**I Introduction**

- (1) The objective of this Statement is to establish the accounting standards for interest costs. The interest costs stated above refer to interest and other costs incurred by an enterprise in connection with the borrowing of funds, which usually include:
  - (a) interest on short-term and long-term borrowings and bank overdrafts;
  - (b) amortization of discounts or premiums relating to borrowings;
  - (c) amortization of ancillary costs incurred in connection with the arrangement of borrowings;
  - (d) accrued interest expense of lease liability under capital leases;
  - (e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as interest costs.

**II Explanation**

- (2) The cost of an asset should include all necessary and reasonable expenditures incurred to bring the asset to the condition and/or location necessary for its intended use (or for its salable condition). If a period of time is required to carry out the necessary acquisition or

construction and to bring the asset to its necessary condition and location, then all the interest costs incurred as a result of such expenditure is a part of the costs of acquiring the asset. Therefore, such interest costs should be capitalized as part of acquiring costs for the asset and amortized over the service life of the asset, rather than expensed as interest costs in the period they incurred. The objectives of capitalizing interest costs are two-folds:

- (a) to permit the acquisition costs of the asset to fully reflect the total investment in the asset; and
- (b) to permit all related acquisition costs of the asset, which benefit future periods, to be amortized over the economic useful life in order to meet the requirements of the matching principle.

### III Accounting standards

#### Qualifying assets

- (3) Assets that qualify for capitalization of interest costs include:
  - (a) assets that are acquired or constructed by the business, or by others for the business' own use; and
  - (b) assets intended for sale or lease that are constructed or otherwise produced as a discrete project (e. g., ship, real estate development or building construction by construction business).

However, the interest incurred on expenditure for the following types of assets shall not be capitalized:

- (a) inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time;
- (b) assets that are in use or ready for their intended use in the

operating activities of the business; and

- (c) assets that are not being used in the operating activities of the business and that are not undergoing the activities necessary to get them ready for use.
- (4) If land is not undergoing development and construction activities to get it ready for its intended use, then the interest incurred for acquiring such land cost cannot be capitalized. If land is aggressively undergoing development or construction activities, then the interest costs incurred on the land and development costs, while those activities are in progress, should be capitalized and treated as a part of the cost of the improvement. If land is developed for sale, then the capitalized interest cost should be treated as a part of the acquisition cost of the developed land.

#### Capitalization period

- (5) The amount of interest cost to be capitalized for qualifying assets is limited to the interest cost incurred during the acquisition or construction periods that theoretically could have been avoided if expenditures for the assets had not been made.
- (6) During each accounting period, the amount of interest to be capitalized for each qualifying asset shall be determined by applying an interest rate(s) to the average amount of accumulated expenditure for the asset during the period. The capitalization interest rates used in an accounting period shall be the interest rates applicable to borrowings outstanding during the period.

If the asset is constructed or acquired for sale and advance deposits are received, or government grants are acquired, the average advance receipts and government grants during the period shall be deducted from the average amount of accumulated expenditure.

If a business obtains borrowed funds for the purpose of acquisition or construction of a qualifying asset, then the rate on that borrowing is the capitalization rate to be applied. If the average accumulated

expenditure for the asset exceeds the amount of specific new borrowings associated with the asset, then the capitalization rate to be applied to such excess shall be a weighted average of the rates applicable to other borrowings of the business. However, if the difference between capitalization rates derived from a different measurement and the weighted average rate is not material, then this other measurement can be used to compute the capitalization rate.

- (7) The total amount of interest cost capitalized in an accounting period shall not exceed the total amount of interest cost recognized by the business during that period. However, the interest income derived from temporary investment of the unused specific borrowings for a qualifying asset or from compensated balance of general borrowings shall be offset against the borrowing costs. Expenditures on a qualifying asset include only those expenditures that have resulted in payment of cash, transfers of non-cash assets, or the assumption of interest-bearing liabilities.

#### **Capitalization period**

- (8) The capitalization period shall commence when all the following three conditions are present:
- (a) expenditures for the asset are being incurred;
  - (b) activities that are necessary to bring the asset to the condition and location for its intended use are in progress; and
  - (c) interest costs are being incurred.

The “necessary activities” stated above in the second condition not only encompass physical construction but also include all the steps required to prepare the asset for its intended use. For example, they include administrative and technical work prior to the commencement of physical construction, such as the activities associated with development of a plan, obtaining permits from government authorities during the pre-construction stage.

Interest capitalization shall continue as long as these three conditions are present. If the business substantially suspends all activities related to the acquisition or construction of the asset, interest capitalization shall cease until activities are resumed. However, if evidence shows that such suspension or delay is due to temporary and uncontrollable conditions and will be immediately resumed in the foreseeable future, or such temporary delay is a necessary part of the construction process, capitalization of interest costs shall not be ceased. Nevertheless, the time period for such temporary suspension or delay of activities shall not exceed three months.

- (9) The capitalization of interest costs shall cease when the qualifying asset is substantially complete and ready for its intended use or sale. When qualifying assets are completed in parts and each part is capable of being used independently while work continues on other parts (e.g. condominiums), capitalization of interest costs shall cease on each part when it is substantially complete and ready for its intended use.

Some assets must be completed in their entirety before any part of the asset can be used (e.g. construction of manufacturing facilities). For such assets, interest capitalization shall continue until the entire asset is substantially complete and ready for its intended use.

Some assets cannot be used effectively until a separate related facility has been completed (e.g. oil drilling equipment cannot be effectively used until completion of the pipeline). In such a situation, capitalization of interest costs shall continue until the related facility is also substantially complete and ready for its intended use.

#### **When the book value of the qualifying asset is higher than its fair value**

- (10) When the book value of a qualifying asset is higher than its fair value, the capitalization of interest costs shall continue and the loss from the excess of book value over fair value shall be recognized.

**Accounting for capitalized interest costs**

- (11) Since the capitalized interest cost is an integral part of the total cost of a qualifying asset, it should be treated as part of the asset acquisition cost.

**Disclosures**

- (12) The following information shall be presented in the financial statements or disclosed in the related footnotes:
- (a) the total amount of interest costs before interest capitalization;
  - (b) the amount of interest costs capitalized during the period; and
  - (c) the capitalization rate used to determine the amount of interest costs eligible for capitalization.

Items (b) and (c) above shall be disclosed separately in accordance with the classifications of qualifying assets.

**Accounting treatment in the transition period**

- (13) Starting from January 1, 1983, the procedures for recognizing accounting changes resulting from the adoption of this Statement are:
- (a) No retroactive adjustment is required despite the existence of non-capitalized interest cost for qualifying asset(s), or capitalized interest cost for non-qualifying asset(s) prior to January 1, 1983. Interest costs incurred on or after January 1, 1983 shall be capitalized in accordance with requirements in the first revision of this Statement.
  - (b) Effective January 1, 1983, the capitalization of interest costs for non-qualifying assets should cease, however, no adjustment is required for the interest costs already capitalized.

**IV Notes**

- (14) This Statement was issued on December 31, 1982. The first revision was made on March 21, 1985 and the second revision was on January 11, 2001. The revised provisions in this second revision shall be effective for financial statements with fiscal years ending on or after December 31, 2001. Early adoption of this Statement is encouraged. No retroactive adjustment is required when adopting the provisions of the second revision of this Statement.

The provisions of this Statement need not be applied to immaterial items.
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