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By Lee Wee Hoong

The application of Malaysian Financial Reporting Standards (MFRS) 15 *Revenue from Contracts with Customers* (MFRS 15) had been dominating the heart of every accountant in 2018, especially for those who are in the real estate sector. What's more, the first time adoption of MFRS by real estate developer was rather interesting where the balance sheet sees new term, and profit or loss sees changes on timing with revenue recognition.

Nevertheless, while we settled with the big issues in relation to the revenue recognition side of MFRS 15, new issues have crept out in relation to the cost side. One of this is MFRS 123 *Borrowing Costs* (MFRS 123).

Throughout 2018, the International Financial Reporting Standards (IFRS) Interpretations Committee (the Committee) in London received a number of submissions in relation to the application of IAS 23 *Borrowing Costs* (MFRS 123 equivalent) (IAS 23) relating to real estate sector.

One of the most notable submission is the capitalisation of borrowing costs for over time transfer of constructed goods as follow:

IAS 23 – OVER TIME TRANSFER OF CONSTRUCTED GOODS
(Agenda Paper 3) (Nov 2018)

ISSUES:

In a specific fact pattern, the entity, a real estate developer, constructs a residential multi-unit real estate development (building) and sells the individual units in the building to customers. The entity signs contracts with customers for the sale of units in the building before construction begins, and continue to market the remaining unsold units in the building throughout the construction period. The entity intends to enter into contracts with customers for the unsold units as soon as it finds a suitable customer.

The entity recognises revenue over time for the sale of individual units in the development in applying paragraph 35(c) of IFRS 15. Consideration promised by the customer is in the form of cash or another financial asset.

The entity borrows funds specifically to the construction of the building.

Does an entity capitalise borrowing costs in relation as part of the cost of the units when an entity recognises revenue over the time for the sale of individual units in the development?

AGENDA DECISION:

The Committee subsequently finalised the Tentative Agenda Decision in March 2019 meeting where Borrowing Costs will not be capitalised when the borrowing relate to the construction of multi-unit real estate development for which revenue is recognised over time.

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(continued)

RATIONALE FOR THE AGENDA DECISION:

Based on the fact pattern, the unit under construction does not fall under the definition of Qualifying Asset in accordance with IAS 23 paragraph 5, i.e.

> “an asset that necessarily takes a substantial period of time to get ready for its intended use or sale”.

The Staff of the Committee also analysed that for unsold units, these units are ready for their intended sale in their current condition, and hence, would not necessarily takes a substantial period of time to get it ready for its intended use or sale.

HOW DOES THE COMMITTEE'S DECISION IMPACT US IN MALAYSIA?

The Malaysian Accounting Standards Board (MASB) on 20 March 2019 made an announcement on the International Financial Reporting Interpretations Committee (IFRIC) Agenda Decision above. For consistency with IFRS, the MASB has decided that an entity will apply the above change in accounting policy as a result of the Agenda Decision above on IAS 23 to financial statements of annual periods beginning on or after 1 July 2020.

Considering the above, non-private real estate developers in Malaysia that have similar circumstances as the fact pattern in the Agenda Decision, will have to cease capitalisation of borrowing costs once a project is ready for sale. As the Agenda Decision is to apply retrospectively, any borrowing costs which have been previously capitalised subsequent to launch will need to be unwind, and that includes the borrowing costs previously capitalised and residing in unsold units which are presently held as inventories.

However, for first time adopter of MFRS' framework, an entity may elect the optional exemption available in MFRS 1 *First Time Adoption of Malaysian Financial Reporting Standards* (MFRS 1) in relation to borrowing costs in paragraph D23. By applying D23, an entity may elect to apply the requirements of MFRS 123, including the Tentative Agenda decision above from the date of transition, hence will not require to restate the borrowing costs that was previously capitalised under the previous Generally Accepted Accounting Principles (GAAP). The accounting for change in accounting policy will be effected on or after the date of transition.

CONCLUDING THOUGHTS

The mandatory date for the change in accounting policy above is for financial statements of annual periods beginning on or after 1 July 2020. This is on the basis that an entity is allowed sufficient time to implement changes in accounting policies that arise from an agenda decision published by the Committee. An entity needs to consider agenda decisions and implement any necessary policy changes before the due date.

Perhaps this is the time to discuss with us how the change will affect your organisation.

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HEAD OFFICE

TANG SENG CHOON
HEAD OF AUDIT & ASSURANCE
sengchoontang@bdo.my

REJEESH BALASUBRAMANIAM
PARTNER, AUDIT & ASSURANCE
rejeesh@bdo.my

PENANG OFFICE

KOAY THEAM HOCK
PARTNER, AUDIT & ASSURANCE
koayth@bdo.my

JOHOR BAHRU OFFICE

JOHNNY SIA
PARTNER, AUDIT & ASSURANCE
johnnysia@bdo.my

Level 8
BDO @ Menara CenTARa
360 Jalan Tuanku Abdul Rahman
50100 Kuala Lumpur, Malaysia
T: +603 2616 2888
F: +603 2616 2970
E: bdo@bdo.my

www.bdo.my

BDO Malaysia
@bdomalaysia1
BDO Malaysia
@bdo_malaysia