

# FINANCIAL ACCOUNTING 4

(MFRS16, MFRS108 & MFRS123)

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# **FINANCIAL ACCOUNTING 4**

**(MFRS16,MFRS108 &MFRS123)**

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We hereby declare that this module is our original work. To the best of our knowledge it contains no materials previously written or published by another person. However, if there is any, due acknowledgement and credit are mentioned accordingly in the e-book.



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## **PREFACE**

This e-book is designed to provide source of information and knowledge especially for students who enrolled for Diploma in Accountancy or any students who may require to refer for any topic relevant to them.

This e-book entirely base on the Polytechnic MoHE syllabus for Diploma in Accountancy. As Financial Accounting 4 is a core subject, student need to have comprehensive understanding of this subject with the updated knowledge of Malaysian Accounting Standard Board (MASB) and Malaysian Financial reporting Standards (MFRSs) regulation. This help them to understand concepts and relevance knowledge of financial accounting. This book will cover MFRS 16 Leases, MFRS108 Accounting Policies, Changes in Accounting Estimate and Error.

We would like to take this opportunity to thank all individuals who have given an input for preparation of this e-book.

We welcome any constructive suggestion and comments from lecturers and students. Such feedback is given careful consideration and very helpful for future improvement.

Hyrida Othman  
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## **MFRS16 LEASE**

### **Learning Outcome;**

- **Define leases**
- **Account for right of use assets and lease liabilities in the records of the lessee.**
- **Disclose the presentation lease**

# OVERVIEW



## Objective

The objective is to **ensure that the lessees and lessors provide relevant information in a manner that faithfully represented those transactions.**

Effective for annual period beginning on or after 1 January 2019 (Early application is permitted, provided the new revenue standard, IFRS 15 Revenue from Contracts with Customers has been applied, or is applied at the same date as IFRS 16)

The previous accounting model for leases was criticised for **failing to meet the needs of users of financial statements** because it did not always provide a faithful representation of leasing transactions.

MFRS 16 completes the IASB's project to improve the financial reporting of leases.

# DEFINITION

<b>Lease</b>	A contract or part of contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.
<b>Right-of-use asset</b>	A lease conveys the right to control the use of an identified asset for a period of time in exchange for consideration
<b>Identified asset</b>	An identified asset may be explicitly or implicitly specified in a contract. If a supplier can substitute the asset and has both the practical ability to do so and the supplier would benefit economically from doing so, such right is a substitution right and thus the contract is not or does not contain a lease.
<b>Right to control</b>	Contract must convey a right to control the identified asset, which is conveyed through the entity's right to 1) obtain substantially all of the economic benefits from the asset's use and 2) right to direct the use of the identified asset
<b>Short term leases</b>	Those having a term of 12 months or less, including the effect of extension options. the election for short term leases is by class of asset.
<b>Low value leases</b>	The leases for which the underlying asset of low value(e.g. telephones, office furniture, notebooks). The election for low values leases can be made on a lease-by-lease basis.

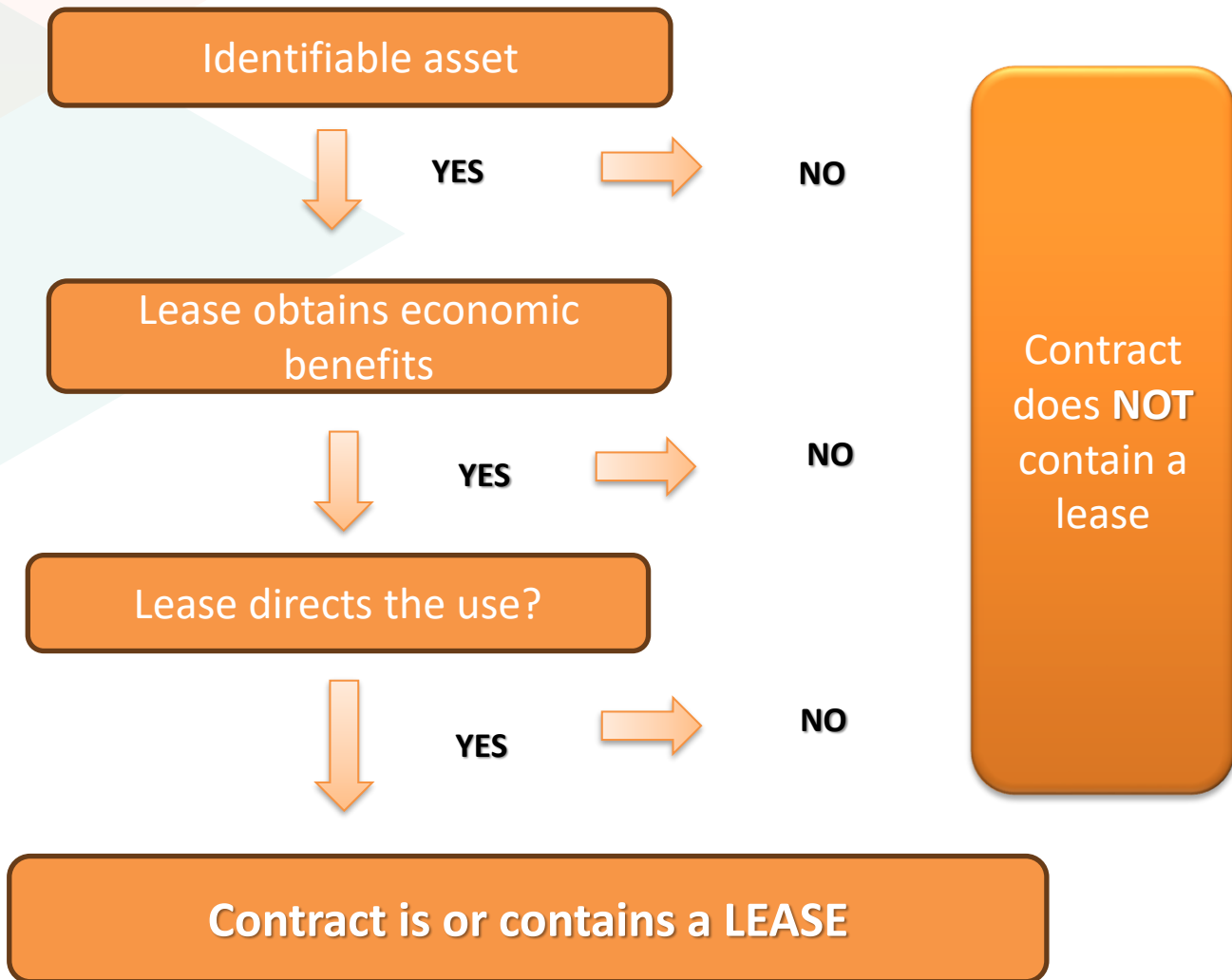
## How to identify a LEASE?

The definition of lease in MFRS 16 gives rise to several considerations in identifying whether a lease exists:-



- Whether there **exists** an **identified asset** with the right to use
  - Whether a **customer has the right** to obtain **substantially all of the economic benefits from the use** of the identified asset throughout the period of use.
  - Whether a customer has the **rights to direct the use** of the identified asset throughout the period of use.
- MFRS16 prescribes that a lease exists when the customer controls the use of the identified asset throughout the period of use. This mean when the customer has the right to:-
    - i. obtain substantially all of the economic benefit from the use of the identified asset through the period of use, and
    - ii. direct the use of the identified asset through that period.

## How to identify a LEASE?



## Test your understanding



The following are five contract to be considered as lease. Identify whether they can be classified as leases.

A contract between a customer and a freight carrier, which provides the customer with the use of 5 rail cars of a particular type for 3 years.	
--	--

Contract between customer and an airport operator to use a space in the airport to sell its product for a 3-year period.	
--	--

A contract between a customer and a property owner to use Retail Unit A, which is a part of a larger retail space with many retail units, for 5 years.	
--	--

A contact between a customer and a supplier for use of a truck for one week to transport goods from Kuala Lumpur to Kuala Terengganu.	
---	--

Contract between customer and a ship owner for the transportation of cargo from Pelabuhan Klang to Tauranga Port.	
---	--

## Example 1.1



Zharif want to rent some space in the warehouse for storing his goods. He'd like to enter into a 3-year rental contract. The owner of that warehouse offers 2 options to him:

### Option 1

- He will occupy a certain area of XY cubic meters, but the specific place will be determined by the owner of the warehouse, based on actual usage of the warehouse and free storage.

### Option 2

- He will occupy the unit No 41 of XY cubic meters in the sector A of that warehouse. This place is assigned to him and no one can change it during the duration of the contract.

Both contracts look like lease contracts, and indeed, in both cases, Zharif would book the rental payments an expense in profit or loss under the provision of the old MFRS 117.

Under new MFRS 16, he need to assess whether these contracts contain lease as defined in MFRS 16.

The first thing he would look at is whether an underlying asset can be identified.

**Answer;****Option 1:**

The first contract ***does not contain any lease, because no asset can be identified.***

The reason is that the supplier (warehouse owner) can exchange one place for another and he lease only certain capacity. Therefore, he would account for rental payments as for expenses in profit or loss.

**Option 2:**

The second contract ***does contain a lease, because an underlying asset can be identified***– he is leasing the unit No 41 of XY cubic meters in the sector A. Therefore, he need to account for this contract as for the lease and it means recognizing some asset and a liability in his balance sheet.

## Example 1.2



Zekda enters into a contract to lease a warehouse on 1 January 2020 for 3 years. The annual rental payments are RM2,000,000, including the cleaning services, all payable at the end of the year. The rental for similar warehouse without cleaning services is RM1,800,000 per annum and the cost of cleaning services was RM400,000 per annum. Implicit interest rate is 5%. The estimated useful life of the warehouse is 30 years.

Financial year-end is 31 December.

**Question:** How would you account for this contract under MFRS16?

### Answer;

No classification is necessary as one accounting model applies to all leases.

*Follow 3 steps:*

**Step 1 :** Is it a lease under MFRS 16? **Yes**

**Step 2 :** Is there some element other than lease element? **Yes**

Lease element:  $\text{RM}2,000,000 \times (1.8 \text{ m}/2.2 \text{ m}) = \text{RM}1,636,364$

Cleaning element:  $\text{RM}2,000,000 \times (0.4 \text{ m}/2.2 \text{ m}) = \text{RM}363,636$

### 3. How do we recognise these elements?

#### ***At the commencement:***

- i) Recognise right to use a warehouse in the amount equal to the lease liability plus some other items like initial direct costs.
- ii) Calculate lease liability at present value (PV) of lease payments over the lease term.

$$\text{RM1,636,364} \times 2.72325 = \text{RM4,456,228}$$

Accounting entry:

Dr	Right-of-use asset	RM4,456,228	
	Cr	Lease liability	RM4,456,228

#### ***Subsequent measurement***

When a payment is made and/or at the end of reporting period:

- i) Recognise depreciation of the right-of-use asset

$$\text{RM4,456,228} / 3 \text{ years} = \text{RM1,485,409}$$

- ii) Recognise remeasurement of the lease liability to include interest, exclude amount paid and take any lease modifications into account.

$$\text{Interest} = 5\% \times \text{RM4,456,228} = \text{RM222,811}$$

# MEASUREMENT AND RECOGNITION

## ACCOUNTING FOR LEASES BY LESSEE



### Initial (at commencement date)

At the commencement date, a lessee shall measure the **right-of-use asset at cost**. The cost includes:

- a) amount of initial measurement of lease liability.
- b) any lease payment made at or before the commencement, less incentives received.
- c) any *initial direct cost*
- d) an estimate of dismantling and restoration costs.

- A lessee shall measure the lease liability at the present value of the lease payments that are not paid at the date.
- The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined.
- If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

# MEASUREMENT AND RECOGNITION

## ACCOUNTING FOR LEASES BY LESSEE



### Subsequent years

A lessee shall measure the right-of-use at cost:

- a) less any accumulated depreciation and any impairment losses.
- b) adjusted for any remeasurement of the lease liability

After the commencement date, a lessee shall measure the lease liability by:

- a) increasing the carrying amount to reflect interest on lease liability
- b) reducing the carrying amount to reflect the lease paid
- c) remeasuring the carrying amount to reflect any reassessment or lease modifications.

A lessee should recognise finance cost, unless the costs are included in the carrying amount of another asset.

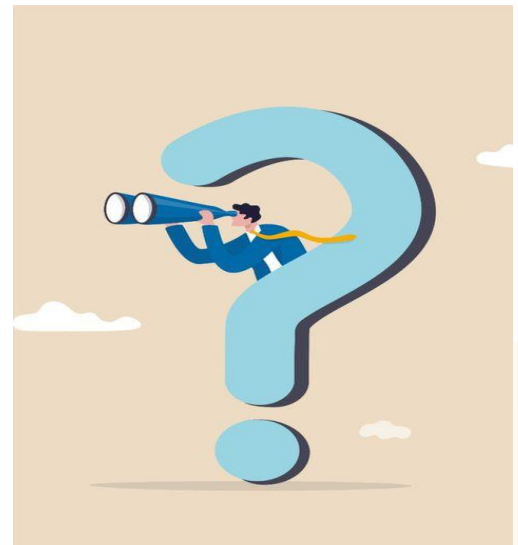
# MEASUREMENT AND RECOGNITION

## DEPRECIATION OF RIGHT-OF-USE (ROU) ASSET

- **MFRS 116** – depreciation method reflects the pattern in which the Right-of-Use (ROU) asset is consumed.
- The method used - straight line method.
- The depreciation should start at the lease commencement date.
- The depreciation period:-

If ownership of the underlying asset is transferred to the lease, or the lessee is reasonably certain to exercise a purchase option, depreciation period is the **end of the estimated useful life of the underlying asset**.

Otherwise, depreciation period is **the earlier of the end of the useful life of the ROU asset or the end of the lease term**.



### Example 1.3



Leona enters into a non-cancellable, non-renewable 5 year lease with Kasih for a machine that will be used in X's manufacturing process. The useful life of the underlying machine is 8 years and ownership remain with Kasih.

You are required to determine the depreciation period.

**Answer;**

*Depreciation period:* 5 years

*Reason:* The contract did not mention the purchase option at the end of the lease term, and the ownership is remaining to the lessor not lessee.

### Example 1.4



Ishak Sdn Bhd enters to a lease non-cancellable lease contract, non-renewable 8 years with Apacc Sdn Bhd for a machine used in production of cookies. The useful life of the machine is 15 years and Ishak Sdn Bhd have the purchase option for the machine at the end of the lease term. The ownership of the asset is transferred to Ishak Sdn Bhd.

**Answer;**

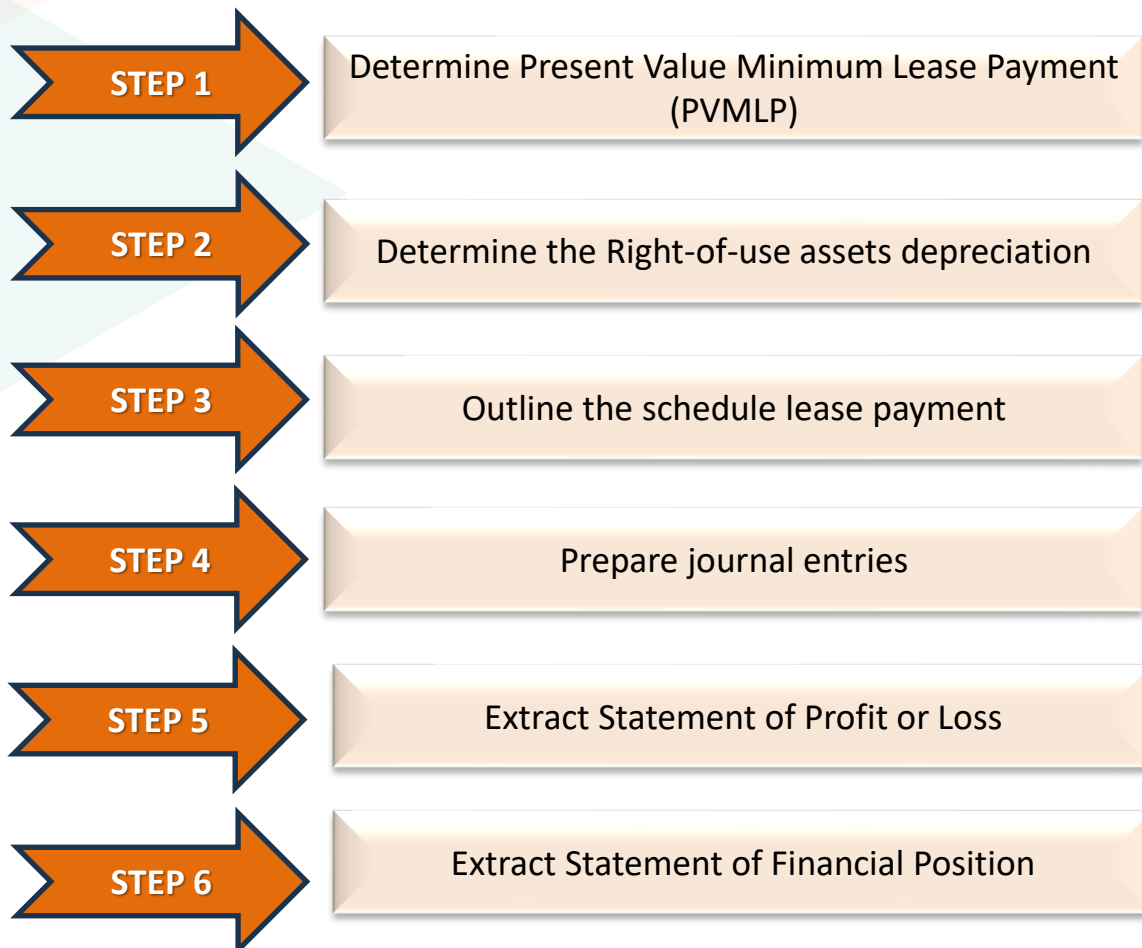
*Depreciation period:* 15 years.

*Reason:* Ishak Sdn Bhd as a lessee has a purchase option at the end of the accounting period.

The ownership of the asset is transferred to Ishak Sdn Bhd at the commencement date.

# MEASUREMENT AND RECOGNITION

## ACCOUNTING TREATMENT



### Payment in Arrears

- Payment is done at the end of the year
- $\text{Bal b/d} + \text{Finance cost (Bal b/d} \times \text{WACC)} - \text{instalment paid} = \text{Bal c/d}$
- $\text{Current liability} = \text{Bal c/d} - \text{Bal c/d of the next period}$
- $\text{Non current liability} = \text{Bal c/d of the next period}$

### Payment in Advance

- Payment is done at the beginning of the year
- $\text{Bal b/d} - \text{instalment paid} + \text{Finance coat } [(\text{Bal b/d} - \text{instalment}) \times \text{WACC}] = \text{Bal c/d}$
- $\text{Current liability} = \text{instalment}$
- $\text{Non current liability} = \text{Bal c/d} - \text{instalment}$

# DISCLOSURE

A lessee shall present in the statement of financial position, or disclose in the notes:

- a) right of use assets separately from other assets
- b) lease liabilities separately from other liabilities

In the statement of profit or loss and other comprehensive income, a lessee shall present separately:-

- a) interest expense (component of finance costs)
- b) depreciation charge



## COMPREHENSIVE EXAMPLE



Jessica Bhd signs an agreement on 1 January 2021 to lease electronic equipment from Granola Bhd. The term of the finance lease is 5 years with no renewal option. The agreement requires Jessica Bhd to make equal annual rental payments of RM50,000 at 31 December 2021. Interest rate of the lease is 7% per annum. The equipment has an estimated economic life of 5 years. The fair value of the equipment at 1 January 2021 is RM100,000. Jessica Bhd uses the straight line depreciation method for all equipment.

**You are required to:**

- a) Calculate the allocation of finance charge in each period by using straight line method.
- b) Prepare the related journal entries at commencement date and for year 2022 in the books of Jessica Bhd.
- c) Prepare extracts of the Statement of Comprehensive Income for the year ended 31 December 2022.
- d) Prepare extracts of the Statement of Financial Position as at 31 December 2022.

Answer;

STEP 1

Determine Present Value Minimum Lease Payment (PVMLP)

PVMLP	=	RM50,000 X 7%,5yrs)
		RM50,000 X 4.1002
		<b>RM205,010</b>

STEP 2

Determine the Right-of-use assets depreciation

Depreciation	=	<u>RM205,010</u>
		5 yrs
		<b>RM41,002</b>

STEP 3

Outline the schedule lease payment

Year	Bal b/f	Interest	Total lease	Lease instalment	Bal c/f
	RM	RM	RM	RM	RM
2021	205,010	14,351	219,361	50,000	169,361
2022	169,361	11,855	181,216	50,000	131,216
2023	131,216	9,185	140,401	50,000	90,401
2024	90,401	6,328	96,729	50,000	46,729
2025	46,729	3,271	50,000	50,000	-

STEP 4

Prepare journal entries

<b>i. Record ROU</b>					
	Dr.	Right of use		RM205,010	
		Cr.	Lease liability		RM205,010
<b>ii. Record depreciation</b>					
	Dr.	Depreciation		RM41,002	
		Cr.	Accumulated depreciation		RM41,002
<b>iii. Record Finance Cost</b>					
	Dr.	Interest expense		RM11,855	
		Cr.	Lease liability		RM11,855
<b>iv. Record Annual payment</b>					
	Dr.	Lease liability		RM50,000	
		Cr.	Bank		RM50,000

## STEP 5

Extract Statement of Profit or Loss

Jessica Bhd	
Statement of Profit and Loss for the year ended 31 December 2022	
	RM
<u>Expenses</u>	
Depreciation	RM41,002
<u>Finance Cost</u>	
Interest expense	RM11,855

## STEP 6

Extract Statement of Financial Position

Jessica Bhd	
Statement of Financial Position as at 31 December 2022	
	RM
<b><u>Non Current Asset</u></b>	
Right of Use (Equipment)	205,010
(-) Acc. Depreciation	(82,004)
	123,006
<b><u>Non Current Liability</u></b>	
Lease liability	90,401
<b><u>Current liability</u></b>	
Lease liability	
(RM131,216-RM90,401)	40,815

# TUTORIAL EXERCISE

## Question 1

Tenunan Sdn Bhd is a manufacturer of 'kain tenun' in Pahang. On 1 January 2022, the company entered into a lease contract for an equipment with Chennai Bhd in India. The lease contract are as follows:-

- the lease term is for 5 years and cannot be cancelled
- Tenunan Sdn Bhd is required to pay RM20,000 annually during the end year
- at the end of the lease term, the equipment acquired has to be return to Chennai Bhd in India.
- an estimated useful life for the equipment is 10 years.
- initial direct cost was RM10,000
- the implicit rate of the lease is 5%.

Based on the information above:

- a) Describe **TWO (2)** criteria to recognise the right to use the equipment according to MFRS 16 for Tenunan Sdn Bhd .
- b) Report all accounting treatments related in 2022 based on MFRS16 with the relevant calculations:
  - amount of right of use equipment
  - amount of depreciation right of use equipment
  - lease payment table for 5 years
  - journal entries
- c) Prepare extracted statement of Profit and Loss and extracted Statement of Financial Position as at 31 December 2022.

A decorative graphic for 'Question 2' featuring a yellow and black starburst shape with a dotted pattern, containing the text 'Question 2' in a blue font.

## Question 2

- a) Give **THREE (3)** criteria to determine whether a contract contains a lease.
- b) On 1 January 2022, Ultimate Sdn Bhd signed a non-cancellable agreement to lease an equipment for five (5) years with Biduanda Sdn Bhd. Annual lease payments of RM30,000 are made at the end of each lease year starting 31 December 2022. The implicit rate which known by both parties is 10%. The straight line method was used to depreciate the asset and the useful life of the assets is 8 years. At the end of the lease term, the equipment acquired must be returned to Ultimate Sdn Bhd.

### Required

- i. Using PVIFA table, report the amount of right-of-use asset.
  - ii. Outline the table of lease payment that would be suitable for Biduanda Sdn Bhd (round up your answer to the nearest RM).
- c) From the above situation (b), you are required to prepare:
- i. Journal entries for the year 2022.
  - ii. Extracted Statement of Profit or Loss for the year ended 31 December 2022.
  - iii. Extracted Statement of Financial Position as at 31 December 2022.

Question 3

Noreen Bhd makes some cookies in Taman Orked. Noreen Bhd need a machine for mass production. They leased a machine from Fareha Bhd on 1<sup>st</sup> January 2022. The lease contract were as follows:-

- i. The lease term was for 7 years and cannot be cancelled.
- ii. Noreen Bhd is to make annual payments for RM90,000 for 5 years and the balance remaining years for RM80,000 each year at the end of the year.
- iii. At the end of the lease, the machine is required to be returned to Fareha Bhd.
- iv. The machine has fair value of RM1,000,000 and an estimated useful life for 10 years
- v. The implicit interest rate of the lease is 10%

**You are required to:**

- a) Identify the lessor and lessee based on situation above.
- b) Show related accounting treatments (2022) for the machine in Noreen Bhd records:
  - at the commencement date
  - subsequent year
- c) Illustrate the financial statements (extract) on 31<sup>st</sup> December 2022 for Noreen Bhd books.

**Question 4**

Hoorey Sdn Bhd makes plastic toys in Port Dickson. Its financial year ends 31 December. On 1<sup>st</sup> January 2021, the company entered into a lease contract with Elijah Sdn Bhd to lease 5 machines for 5 years in order to increase production. Hoorey Sdn Bhd is required to pay Elijah Sdn Bhd rental of RM100,000 per annum at the end of the year. The fair value of the 5 machines is RM800,000. It is estimated that the machines have a useful life of 10 years. It is also stated in the contract that Elijah Sdn Bhd, is responsible for maintaining the machine during the lease period.

The implicit interest rate is 5% per annum.

**You are required to:**

- a) Identify the lessor and lessee
- b) Show all related accounting treatments on commencement date and 31<sup>st</sup> December 2022.
- c) Prepare an extract of the statement of profit or loss and statement of financial position for 2022.


**Question 5**

Suca Sucre makes up its account to 31 December each year. It enters into a lease contract to lease an equipment with the following terms:

<b>Inception of lease</b>	<b>1 January 2022</b>
<b>Term</b>	Five years; RM3,000 paid at commencement of lease, followed by four payments of RM3,000 payable at the start of each subsequent year
<b>Fair value</b>	RM12,000
<b>Useful life</b>	8 years
<b>Interest rate implicit in the lease</b>	12%

**You are required to:-**

- a) show all related accounting treatments at commencement date and subsequent year.
- b) show the extract of Suca Sucre's Statement Profit or Loss and Statement of Financial Position as at 31 December 2022.

Question 6

On 1 January 2021, Ayash Bhd entered into an agreement to lease a plant from a manufacturer over a 4 year's lease term. The Plant has a total estimated useful life of 10 years. The lease does not transfer ownership of the plant to Ayash Bhd by the end of the lease term and there is no purchase option available. The lease requires four annual payments of RM100,000 each, commencing on 1 January 2021. The rate of interest implicit for the lease is 10% and the present value of lease payments is RM316,990. **Ayash Bhd** incurred initial direct costs of RM20,000 and after four years it will have to dismantle the plant at an estimated (discounted) cost of RM15,000. The finance manager of Ayash Bhd has identified this lease as an operating lease under MFRS 16 and has changes all amounts paid in respect of the lease to the profit or loss.

***You are required:***

- a) Explain **TWO (2)** circumstances under MFRS16 to identify the right to use the plant for Ayash Bhd.
- b) Show the transactions to record the right of use (ROU) asset and the journal entries upon the initial recognition of the lease.
- c) Prepare the extract Statement of Comprehensive Income for the year ended 31<sup>st</sup> December 2022 and extract Statement of Financial Position as at 31<sup>st</sup> December 2022.



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## **MFRS108 ACCOUNTING POLICIE, CHANGES IN ACCOUNTING ESTIMATES AND ERROR**

**Learning Outcome;**

- **Define Accounting Policies**
- **Discuss the selection of Accounting Policies.**
- **Define Changes in Accounting Estimates and Error**
- **Discuss Changes in Accounting Estimates and Error**
- **Describe the accounting treatment**
- **Discuss the disclosure required**

# OVERVIEW



## Objective

The objective of **MFRS 108** is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors. The standard is intended to **enhance the relevance and reliability of an entity's financial statements and the comparability of those financial statements over time and with the financial statements of other entities**. Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in MFRS 101 Presentation of Financial statements.

# DEFINITION

<p><b>Accounting policies</b></p>	<p>Specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements</p>
<p><b>A change in accounting estimates</b></p>	<p>An adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities.</p> <p>Changes in accounting estimates result from new information or new development and, accordingly, are not corrections of errors.</p>
<p><b>Material omission or misstatement</b></p>	<p>Material omission or misstatement of items are material if they could individually or collectively, influence the economic decisions that users make on the basis of the financial statements.</p> <p>Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances.</p> <p>The size or nature of the item, or a combination of both, could be the determining factor.</p>

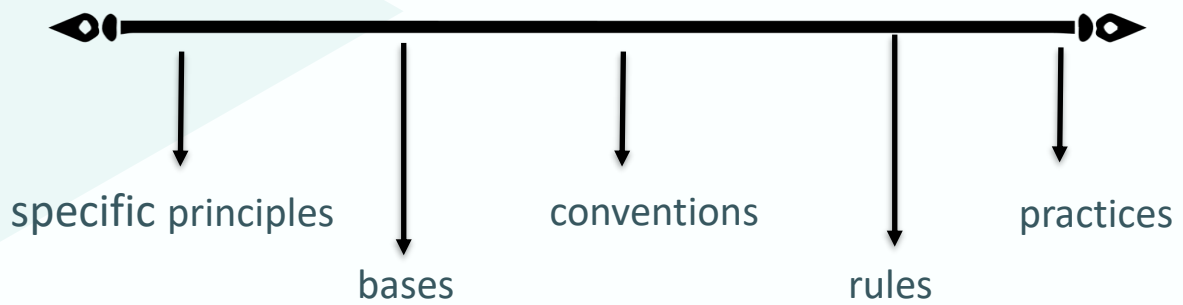
# DEFINITION

<p><b>Prior period error</b></p>	<p>Omission from, and misstatements in the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:-</p> <ul style="list-style-type: none"> <li>(a) was available when financial statements for those periods were authorised for issue</li> <li>(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.</li> </ul>
<p><b>Retrospective application</b></p>	<p>Applying new accounting policy to transactions, other events and conditions as if that policy had always been applied.</p>
<p><b>Prospective application</b></p>	<p>Change in accounting policy and of recognising the effect of a change in accounting estimate, respectively.</p>

# ACCOUNTING POLICIES

## What is accounting policies?

according to MFRS 108, accounting policies are



applied by entity in preparing and presenting



**FINANCIAL STATEMENT**

How to select which accounting policies to apply?

1. refer to relevant standard
2. management judgement

An entity must select and apply its accounting policies **consistently** for similar transactions, other events and conditions, unless a MFRS specifically requires or permits categorisation of items for which different policies may be appropriate.



# MEASUREMENT AND RECOGNITION



# DISCLOSURE

The following information is disclosed when there is a change in accounting policy resulting from the initial application of a standard or an interpretation which has a material effect on the current period or any period presented, or when it might have an effect on the future periods:

- a. A title of the standard or interpretation.
- b. When applicable, that the change in accounting policy is made in accordance with its transitional provisions.
- c. The nature of the change in accounting policy
- d. When applicable, a description of the transitional provisions.
- e. When applicable, the transitional provisions that might have an extent practicable on the future period.
- f. For the current period and each prior period presented, to the extent practicable, the amount of the adjustment:-
  - i. For each financial statements line item affected
  - ii. If MFRS 133 *Earning Per Share* applies to the entity, for basic and diluted earnings per share.
- g. The amount of the adjustment relating to periods before those presented, to the extent practicable.
- h. If retrospective application is impracticable for a particular period or for the periods presented, the circumstances that led to the existence of that condition and a description on how and from when the exchange in accounting policy is applied.

**Example 2.1**



The Board of director of Ramona Bhd decided to change an accounting policy for the company in 2022. On 1st January 2022, retained profit for the company was RM2,000,000. The cumulative effect of the change in accounting policy is decrease of RM350,000 in retained profit at 1<sup>st</sup> January 2022, the beginning of the current reporting period.

You are required to *identify* and *explain* the element in the above scenario according to MFRS108.

**Answer;**

**Standard (MFRS108)**

**Changes in Accounting Policy**

Basis of measurement of the elements of financial statements represent accounting policies.

Any changes in the basis of measurement therefore constitute a change in accounting policy.

**Treatment**

**i. Retrospective application**

ii. Adjustment to the opening balance of retained profit.

**Adjustment**

	RM
Retained profit 1 <sup>st</sup> January 2022	2,000,000
Prior year adjustment	(350,000)
<b>Restated retained profit 1<sup>st</sup> January 2022</b>	<b>1,650,000</b>

# ACCOUNTING ESTIMATES

## What is accounting estimates?

The amendment (2019) MFRS 108 defines according to MFRS 108, amendment (2019) accounting estimates as



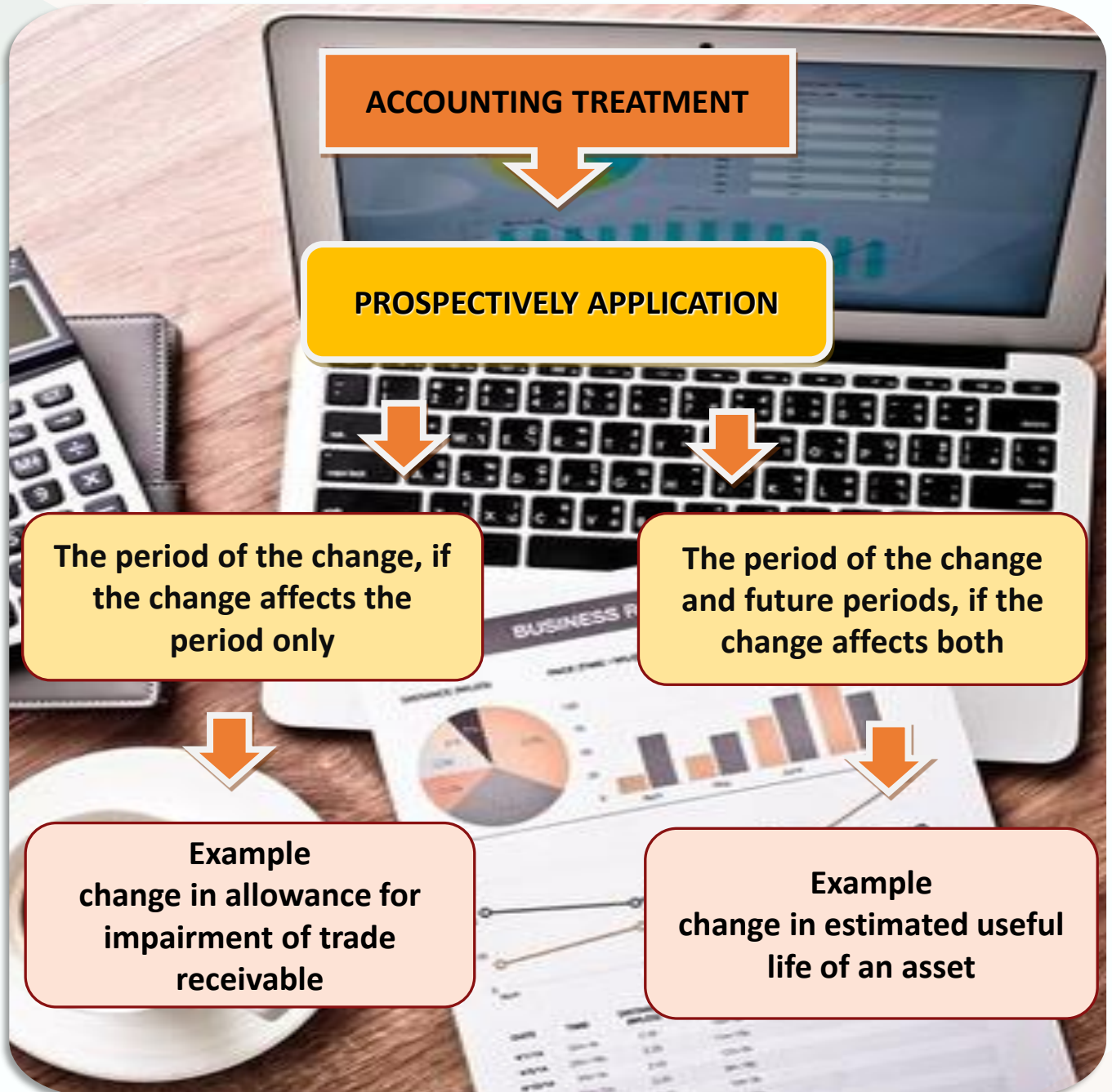
“judgements or assumptions used in applying an accounting policy when, because of estimation uncertainty, an item in financial statements cannot be measured with precision”.

Examples of accounting estimates include:

- a) a loss allowance for expected credit loss
- b) the net realizable value of an item of inventory
- c) the fair value of an asset or liability
- d) the depreciation expense for an item of property, plant and equipment
- e) a provision for warranty obligations



# MEASUREMENT AND RECOGNITION



To the extent that a change in an accounting estimate gives rise to change in assets and liabilities, or relates to an item of equity, it shall be recognized by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

# DISCLOSURE

When an entity has a change in accounting estimates, the following disclosures are required:

- a. The nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, or
- b. If it is impractical to quantify the effect in the future periods, this fact should be disclosed.



## Example 2.2



On 1st January 2019, Clique Berhad bought a machine for RM250,000 by cash. The machine is expected to have useful life of 8 years with no scrap value.

However, in January 2022, due to frequent usage, which exceeded the recommended guideline, the company decided to change the estimated useful life from 8 years to 6 years.

You are required to *identify* and *explain* the element in the above scenario according to MFRS108.

**Answer;**

**Standard  
(MFRS108)**

Changes in Accounting Estimates

Change in estimated useful life merely reflects a shift in the management's expectation of the pattern of periodic consumption of machine and therefore represents a revision on accounting estimate.

**Treatment**

- i. **Prospective application**
- ii. Applying a new accounting estimates to transactions or event occurring after then date the estimated is changed.
- iii. Recognising the effect of the change in the current and future periods affected by the change.

**Adjustment**

Year	Cost RM	Depreciation RM	Acc. Depreciation RM	Carrying Amount RM
2019	250,000	31,250	31,250	218,750
2020	250,000	31,250	62,500	187,500
2021	250,000	31,250	93,750	156,250
2022	250,000	156,250/3years =52,083	145,833	104,167

**Journal entry at the end of 31<sup>st</sup> December 2022**

Dr	Depreciation	RM52,083
	Cr Accumulated depreciation	RM52,083

# ERROR

## What is error?

according to MFRS 108, prior period errors



omission from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

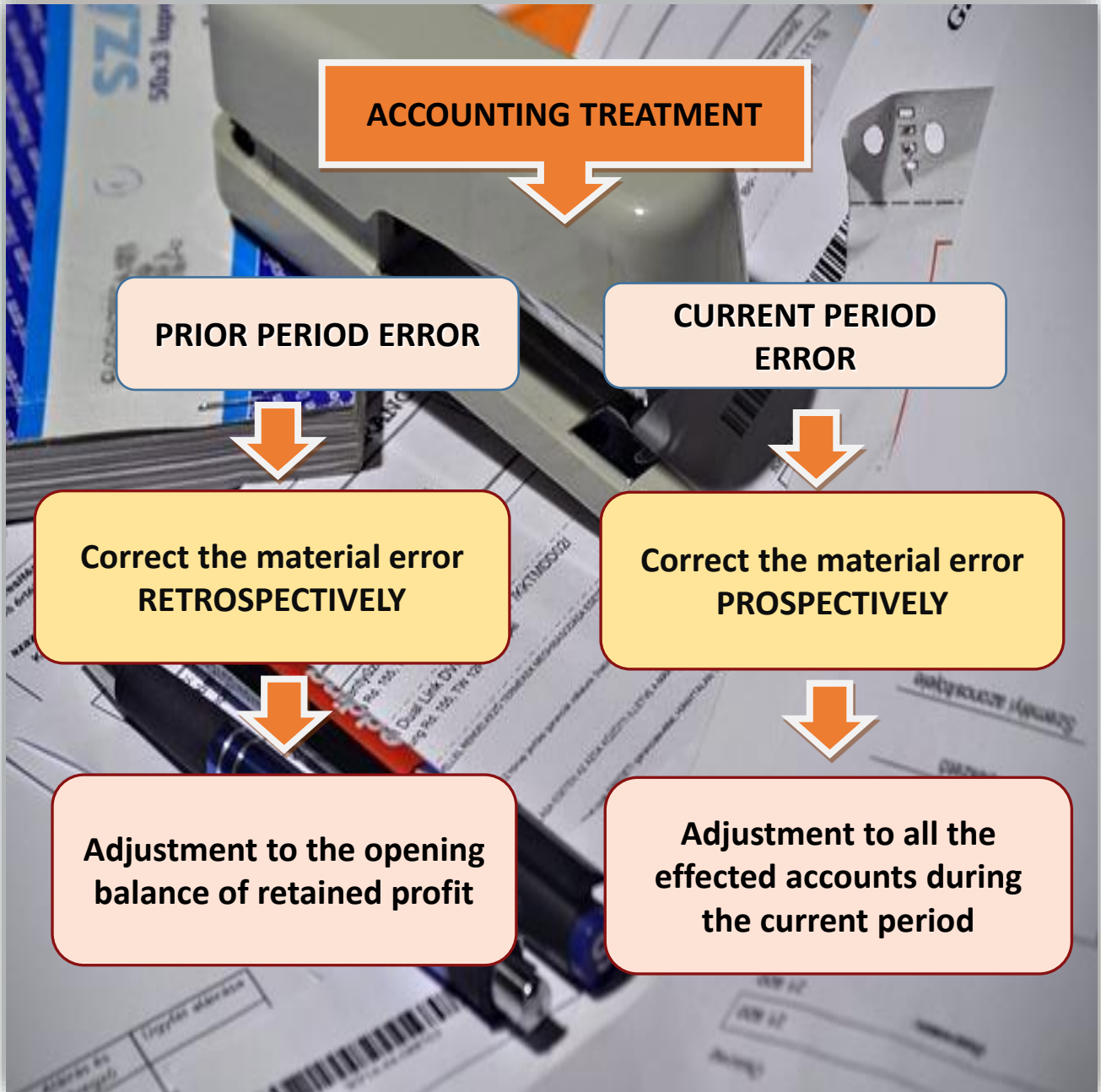
- a) was available when financial statements for those periods were authorized for issue; and
- b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

## Examples of error include:

- a) The effect of mathematical mistakes
- b) Mistakes in applying accounting policies
- c) Oversight or misinterpretation of facts
- d) fraud



# MEASUREMENT AND RECOGNITION



# DISCLOSURE

The following disclosures are required:

- a. The nature of the prior period error
- b. For each period presented, to the extent practicable, the amount of the correction:
- c. The amount of the correction at the beginning of the earliest prior period presented.
- d. If retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error is corrected.

Financial statements of a subsequent periods need not make the above disclosures.



### Example 2.3



Madam Mulan, the accountant of Sari Etiqa Bhd is currently reviewing some accounting task done by Aiman, one of the trainees in the accounting department.

While scrutinizing some of the transactions for the year ended 31st December 2022, he found the following information:-

Payment made to Telegu Bhd on 1st November 2022 totalling RM250,000 was wrongly recorded as payment to Temenggong Bhd.

**Answer;**

**Standard (MFRS108)**

It is a current year error.

This is because the payment to Telegu Bhd was wrongly recorded in Temenggong Bhd account in current year.

**Treatment**

- i. Prospective application**
- ii. Adjustment to all the affected accounts during the current period.

**Journal entry**

Dr. Telegu Bhd	RM250,000		
	Cr. Temenggong Bhd		RM250,000



## COMPREHENSIVE EXAMPLE

Purple Bhd involved in the manufacturing of computer chips. For the year ended 31 December 2022, the company encountered several situations which required your attention.

- i. In January 2022, Purple Bhd discovered that some of the inventories sold in 2021 were included in the inventories for the year ended 31 December 2021. as a result, the inventories on that date were overstated by RM250,000.
- ii. Purple Bhd acquired a machine costing RM10,000 on 1 January 2020 and depreciated the machine on a straight-line basis over 10 years. In 2022, due to heavy usage, the remaining useful life of the machine was revised to 6 years.
- iii. Purple Bhd acquired a plant in 2019. Due to proper maintenance of the plant, no depreciation has been provided. The annual depreciation charge per annum should be RM250,000.
- iv. Purple Bhd changed its method of valuing inventory from the First-in-First-out (FIFO) method to the weighted average method.

**Required:**

- a) State whether each of the above situation is a change in accounting policy, change in accounting estimates or error for Purple Bhd in accordance with MFRS 108 Accounting Policies, Changes in Accounting Estimates and Errors.
- b) For situations (i), (ii) and (iii) above, prepare the relevant journal entries for the year ended 31 December 2022.

**Answer;**

**i.**

a.	MFRS 108	Prior Year Error
	Fact	Some inventories sold in 2021 were included in the inventories for the year ended 31 December 2021.
	Treatment	<ul style="list-style-type: none"> <li>i. Correct the material error retrospectively.</li> <li>ii. Adjustment to the opening balance of retained profit.</li> </ul>
b.	Journal Entry	Dr. Retained profit      RM250,000 Cr. Inventories              RM250,000

**ii.**

a.	MFRS 108	Changes in Accounting Estimates
	Fact	The remaining useful life of machine was revised from 10 years to 6 years,
	Treatment	<ul style="list-style-type: none"> <li>i. <b>Prospectively</b> application</li> <li>ii. Applying a new accounting estimate to transactions or event occurring after the date the estimates is changed</li> <li>iii. Recognizing the effect of the change in the current and future periods affected by the change.</li> </ul>
b.	Journal Entry	Dr. Depreciation      RM2,000 Cr. Accumulated depreciation      RM2,000  <i>Working:-</i>  1 <sup>st</sup> January 2020  Depreciation = RM10,000 / 10 years = RM1,000  In 2022  Carrying value = RM10,000 – RM2,000 = RM8,000  New depreciation = RM8,000 / 4years = <u>RM2,000</u>

iii.

<b>a.</b>	<b>MFRS 108</b>	<b>Prior Year Error</b>
	Fact	No depreciation has been provided since 2019.
	Treatment	<ul style="list-style-type: none"> <li>i. Correct the material error <b>retrospectively</b>.</li> <li>ii. Adjustment to the opening balance of retained profit.</li> </ul>
<b>b.</b>	Journal Entry	Dr. Retained profit      RM750,000 Dr. Depreciation        RM250,000 Cr. Accumulated depreciation      RM1,000,000

iv.

<b>a.</b>	<b>MFRS 108</b>	<b>Changes in Accounting Policy</b>
	Fact	Changed method in valuing inventory from FIFO to weighted average method.
	Treatment	<ul style="list-style-type: none"> <li>i. Apply the change retrospectively.</li> <li>ii. Apply new accounting policy as if that policy had always been applied.</li> </ul>

## TUTORIAL EXERCISE

### Question 1

Discuss the accounting treatment and disclosure for each of the following independent events and transactions. Assume that the tax rate is 25% where applicable. The year end is 31 December.

- i. During the course of finalizing the accounts for 2022, the accountant discovered that goods sold in 2021 of RM50,000 were included in the closing inventory of 2021. The opening inventory of 2022 included this inventory.
- ii. On 1 January 2020, a plant costing RM450,000 was purchased and it was estimated that the economic life was ten years. In 2022, it was determined that the economic life was ten years. In 2022, it was determined that the remaining economic life was five years.
- iii. The company acquired a large asset for RM12 million. Effective year 2022, the accounting standard requires the cost of the asset to be allocated to its various components and depreciated accordingly. The company has lost the record and is unable to assign the costs to the various components.
- iv. The entity has not depreciated its hotel building as it maintains it very well. The hotel building was constructed at a cost of RM150 million in 2020 and its scrap value was estimated at RM100 million.
- v. An entity acquired a property for RM50 million in 2016. The asset is depreciated at 5% on cost. The entity had adopted the cost model. In year 2022 the entity wants to adopt the revaluation model.

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## Question 2

Irkaz Sdn Bhd is involved in supplying music instrument business. The retained earning account in the books of Irkaz Sdn Bhd showed an opening balance of RM650,000 as at 1st April 2021. During the year ended 1st March 2022, situations below were identified:

- i. On 10th February 2021, it was identified that the acquisition of furniture worth RM20,000 on 1<sup>st</sup> April 2019 was mistakenly treated as maintenance expenses. It is company's policy to depreciate furniture at 10% on cost.
- ii. Irkaz Sdn Bhd acquired motor vehicles costing RM100,000 on 1<sup>st</sup> April 2018 and depreciate over 10 years. Due to heavy usage of musical instrument delivery, management has decided to change estimation useful life from 10 years to 8 years on 1<sup>st</sup> April 2021.

As an account's clerk in Irkaz Sdn Bhd you are **required** to:-

- a) provide necessary journal entries to rectify the situation
- b) propose restatement of changes in equity for the year ended 31<sup>st</sup> March 2022

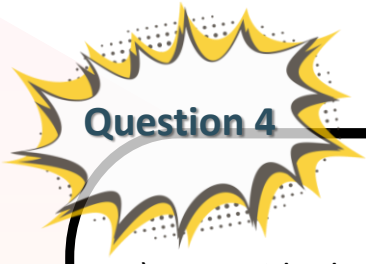
**Question 3**

As at 1 January 2022, the retained earnings balance in the books of Mechamato Sdn Bhd was RM1,500,000. During the financial year ended 31 December 2022, the internal auditor of Mechamato Sdn Bhd had identified the following situations:-

- i. In January 2022, Mechamato Sdn Bhd discovered that some of the inventories sold in 2021 were included in the inventories for the year ended 31st December 2021. As result, the inventories on that date were overstated by RM350,000.
- ii. Mechamato Sdn Bhd acquired a machine costing RM50,000 on 1st January 2020 and depreciated the machine based on straight line method over 8 years. In 2022, due to heavy usage of the machine, the remaining useful life was revised to 4 years.
- iii. Payment to trade payable amounted RM50,000 in April 2021, was wrongly recorded as repair and maintenance.

**You are required to:-**

- a) prepare appropriate journal entries for all the above situations.
- b) estimate the restated opening balance of the retained earnings.



**Question 4**

- a) Provide the explanation on:-
  - i. Retrospective application
  - ii. Prospective application
- b) State whether each of the following statements regarding a change in accounting policies, a change in accounting estimates and errors is **TRUE** or **FALSE**.

No	Particular	True/False
i.	The management has decided to use the straight line method to depreciate their non-current asset. The decision decided is an example of changes in accounting estimates.	
ii.	An entity decided to extend the useful life of its non-current asset from 5 years to 8 years. The decision is an example of changes in accounting estimates.	
iii.	Under or over cast last year inventory, posting bad debts expenses to an asset account and accounting transaction not recorded are examples of current year error.	
iv.	Written off bad debts, inventory obsolescence and provision of warranties are classified as changes in accounting estimates.	
v.	The management had decided to use the weighted average method to replace the previous methods (FIFO). The decision is an example of changes in accounting policy.	

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### Question 5

The following are independent transaction relating to changes in accounting policies, changes in accounting estimates and errors. Financial year ended for all transaction is 30 June 2022.

- i. A machinery costing RM60,000 and residual value of RM3,000 was acquires on 1<sup>st</sup> July 2018 and depreciated on a straight line basis over 15 years. As at 1<sup>st</sup> July 2021, the remaining useful life of the machinery was revised to 10 years with no residual value.
- ii. A sum of RM500,000 collected from trade receivables was misappropriated by one of the account clerks in May 2021. This was discovered in June 2022 and no adjustment has been made to rectify the losses due to fraud.
- iii. Payment to trade payable amounted to RM150,000 in April 2021, was wrongly recorded as repair and maintenance.

**Required:**

- a) Determine whether it is a change in accounting policy, a change in accounting estimates or error for each of the situation above.
- b) For each situation, explain whether application should be done retrospectively or prospectively
- c) Prepare necessary journal entries to rectify the situation above. Show the relevant calculations.

A decorative graphic for 'Question 6' featuring a yellow and white starburst shape with a dotted pattern, containing the text 'Question 6' in a blue font.

### Question 6

As at 1<sup>st</sup> July 2021, the retained profit balance in the books of Harley Bhd was RM4,500,000. During the financial year ended 30 June 2022, the internal auditor of Harley Bhd has identified the following situations:-

- i. The company acquired and recorded a machine on 1<sup>st</sup> January 2022 at a cost of RM300,000. However, the transportation cost of RM1,000 was treated as revenue expenditure. The useful life of the machine is 10 years and its scrap value is RM50,000. The depreciation charge of RM12,500 was already recorded for that year.
- ii. It was discovered that the company had overcharged a credit customer with a sales amount of RM50,000 on 1<sup>st</sup> January 2021.
- iii. The company purchased a plant costing RM450,000 on 1<sup>st</sup> July 2018 and depreciated the plant on straight line basis over 10 years. Starting 1<sup>st</sup> July 2021, due to heavy usage, the estimated useful life of the machine was revised to 6 years.

#### Required:-

With the reference to MFRS 108

- a) Determine whether it is a change in accounting policy, a change in accounting estimates or error for each of the situation above.
- b) For each situation, explain whether application should be done retrospectively or prospectively
- c) Prepare necessary journal entries to rectify the situation above. Show the relevant calculations.



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## **MFRS123 BORROWING COST**

### **Learning Outcome;**

- **Define Borrowing Cost and Qualifying Asset**
- **Discuss the recognition of Borrowing Cost.**
- **Determine the disclosure required for Borrowing Cost.**

# OVERVIEW



## Core principle

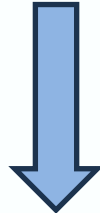
Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense.

An entity shall apply this Standard in accounting for borrowing costs.

The standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.

# BORROWING COST

## What is Borrowing Cost?



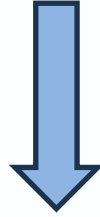
According to **MFRS 123**, borrowing cost are the interest and other costs that an entity incurs in connection with borrowing of funds.

Borrowing costs may include:

- a) interest expense calculated using effective interest methods as described in MFRS 9 *Financial Instruments*;
- b) interest expense calculated using effective interest methods as described in MFRS 9, interest in respect of lease liabilities recognized in accordance with MFRS 16 *Leases*;
- c) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.



## What is Qualifying Asset?



A **Qualifying Asset** is an asset that necessarily takes a substantial period of time to get ready for its intended use for sale.

Any of the following may be qualifying assets:

- a) inventories
- b) manufacturing plants
- c) power generation facilities
- d) intangible assets
- e) investment property
- f) bearer plants

Financial assets, and inventories that are manufactured, or otherwise produced, over a short period of time, are **NOT** qualifying assets.

Assets that are ready for their intended use or sale when acquired are **NOT** qualifying assets.



# MEASUREMENT AND RECOGNITION

## ACCOUNTING TREATMENT



An entity shall **capitalise** borrowing costs that directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

An entity shall recognise other borrowing cost as an expenses in the period in which it incurs them.

Borrowing cost that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset. Such borrowing costs are **capitalised** as part of the cost of the asset when it is probable that they will result in future economic benefits to the entity and the costs can be measured reliably.

# MEASUREMENT AND RECOGNITION

## ELIGIBLE OF BORROWING COST

### SPECIFIC BORROWING (MFRS 123.12)

- 100% for the qualifying asset
- To extent that an entity **funds specifically** for the purpose of obtaining a qualifying asset, the entity shall **determine the amount of borrowing cost eligible for capitalisation** as the actual borrowing costs incurred on that borrowing during the period **less any investment income on the temporary investment of these borrowings.**
- Borrow loan to specific asset

### GENERAL BORROWING (MFRS 123.14)

- General purpose
- To extent that an entity **borrow funds generally** and uses them for the **purposes of obtaining a qualifying asset**, the entity shall determine the amount of borrowing costs eligible for capitalisation **by applying a capitalisation rate** to the expenditures on that asset.



## COMMENCEMENT, SUSPENSION AND CESSATION OF CAPITALIZATION BORROWING COST

### When to start?

On the commencement date for capitalisation is the date when the entity first meets **ALL** the following conditions: -

- ✓ It incurs expenditure for the asset
- ✓ It incurs borrowing costs; and
- ✓ It undertakes activities that are necessary to prepare the asset for its intended use or sale

### When to suspend?

An entity shall suspend capitalisation of borrowing costs during extended period in which it suspends active development of a qualifying asset.

### When to stop?

An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are **complete**.

When an entity completes the construction of qualifying asset in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it substantially all the activity necessary to prepare that part for its intended use or sale.



## CALCULATION OF BORROWING COST

### SPECIFIC BORROWING

	RM
Actual borrowing costs incurred (Outstanding borrowing x interest rate x X/12)	XXX
(-) Temporary investment income (Amount invested x interest rate x X/12)	<u>(XXX)</u>
Amount to be capitalized	<u>XXX</u>

### GENERAL BORROWING

	RM
(Expenditure on QA x capitalization rate x X/12)	XXX
(Expenditure on QA x capitalization rate x X/12)	<u>XXX</u>
Amount to be capitalized	<u>XXX</u>

Capitalization rate =  $\frac{\text{Total borrowing costs incurred}}{\text{Weighted borrowings outstanding during const.}}$  X100

Weighted borrowings outstanding during const.

### Example 3.1



#### Specific Borrowings

1<sup>st</sup> November 2022, Wira Saujana Bhd borrowed RM500,000 at 5.5% for building warehouse. On the 31<sup>st</sup> of December 2022, the balance from the borrowing was RM400,000 in fixed deposit at 2.5% per annum.

- Calculate the interest charged for borrowing loan
- Calculate the interest income for the fixed deposit
- Identify the borrowing cost that will be capitalised.

#### Answer;

a. Interest expenses charged	$RM500,000 \times 0.055 \times 2/12 = RM 4,583$
b. Interest income for fixed deposit	$RM400,000 \times 0.025 \times 2/12 = RM1,667$
c. Capitalised borrowing cost	$RM4,583 - RM1,667 = RM2,916$

With income		Without income	
Dr. Warehouse	RM2,916	Dr. Warehouse	RM4,583
Dr. Interest expense	RM1,667	Cr. Bank	RM4,583
Cr. Bank	RM 4,583		
RM2,916 will be capitalised and RM1,667 will be as an expense in profit and loss statement		RM4,583 will be capitalised	

### Example 3.2



#### General Borrowings

1<sup>st</sup> November 2022, Wira Saujana Bhd borrowed a Loan A RM500,000 at 7% and Loan B RM200,000 at 6%. Some of the money used to **purchase material for construction of warehouse, RM60,000**. Calculate the capitalisation rate.

- Calculate the interest charged for borrowing loan A and B
- Calculate the interest income that can be capitalised
- Calculate the interest that can be charged as expenses

#### Answer

#### Capitalization rate

Borrowing item	Principal RM	Interest rate (a) RM	Weighted average (b)	(a) * (b)
Loan A	500,000	7%	5/7	5%
Loan B	200,000	6%	2/7	1.7%
<b>Total</b>	<b>700,000</b>			<b>6.7%</b>

## Answer

## Interest charged for Loan A and B

Borrowing item	Principal RM	Interest rate (a)	Total interest (2 months)
Loan A	500,000	7%	5,833
Loan B	200,000	6%	2,000
<b>Total</b>	<b>700,000</b>		<b>7,833</b>

Interest that can be capitalized

$$\text{RM}60,000 \times 0.07 \times 2/12 = \text{RM}6,700$$

Interest that charged as an expenses

$$\text{RM}7,833 - \text{RM}6,700 = \text{RM}1,133$$

Dr. Warehouse	RM6,700
Dr. Interest expense	RM1,133
Cr. Bank	RM7,833

# DISCLOSURE

The following information should be disclosed in the financial statements:

- a. The amount of borrowing costs capitalized during the period
- b. The capitalization rate used to determine the amount of borrowing costs eligible for capitalization.



# TUTORIAL EXERCISE

## Question 1

Micron Bhd had the following loans in place in 2022:

- A RM280,000 bank loan B at 7% per annum and RM70,000 at 5.5% debenture stock were taken on 1 January 2022 for no specific purpose and Micron Bhd used them to finance general spending and the construction of a new machinery.
- Micron Bhd used RM80,000 for the construction of the machinery on 1 Feb 2022 and RM35,000 on 1 September 2022.

**You are required to:**

- i. Calculate the capitalization rate
- ii. Find the amount of interest that can be capitalized in December 2022.

## Question 2

a) Identify **FIVE (5)** circumstances to be qualifying assets.

Company A borrowed RM 9,000,000 @ 15% per annum to fund a project on 1st Jan 2020. The following expenditures were made on the project during the year ending 31 December 2022 .

Date: 1st March 2022: RM 2,500,000

Date: 1st October 2022: RM 4,200,000

Date: 1<sup>st</sup> December 2022: RM 2,300,000

Surplus funds were invested @10% whenever available.

The project activities started on 1 March 2022. Work on the project was suspended during the month of August and resumed in early September. Construction was completed on 31 December 2022.

**Required:**

- b) Calculate the borrowing costs to be capitalized and interest expenses.

### Question 3

On 1 January 2022 Cooka Industries Limited (CIL) borrowed RM15 million to finance the production of two assets, both of which were expected to take a year to build. Work started during 2022. The loan facility was drawn down and incurred on 1 January 2022, and was utilized as follows, with the remaining funds invested temporarily.

	Asset X (RM'million)	Asset Y (RM'million)
1 January 2022	2.5	5
1 July 2022	2.5	5

The loan rate was 7% and CIL can invest surplus funds at 5%.

#### Required:

Determine the borrowing costs which may be capitalized for each of the assets and consequently the cost of each asset as at 31 December 2022.

### Question 4

Tik Tok Bhd had the following loans in 2022:

- RM2 million 6% loan finance per annum and RM500,000 at 5.5% debenture stock. It constructed a new machine which cost RM1.8 million and this was funded out of the existing loan finance. The construction began on 1 April 2022 and was completed on 31 December 2022.

#### You are required:

- To the nearest thousand, calculate the borrowing costs that should be capitalized for the factory.
- Determine the interest to be charged as expenses in 2022.


**Question 5**

Khan Limited (KL) has the following loan arrangements as at 1 January 2022:

	(RM'million)
7% Debentures	55
8% Loan notes	110
12% Line of credit	85
10% Running finance arrangement	150

On the 1 January 2022, KL commenced the construction of a new factory. The construction of the factory will cost RM100 million, and the company funded the construction with the existing borrowings.

The factory was completed on 31 August 2022 but was not available for use until 31 January 2023 as a result of minor modification. During the construction period, active work was interrupted, and the building construction was stopped for two months as a result of adverse weather conditions.

**Required:**

Calculate the borrowing cost to be capitalized and the cost of the building to be recognized upon initial recognition.


**Question 6**

Geld Limited began the construction of a new building on 1 February 2022. Construction costs incurred in 2022 were paid as follows:

Payment Date	RM
On 1 February 2022	500,000
On 1 July 2022	600,000
On 1 November 2022	800,000

The construction of the building ended on 1 December 2022 when the building was complete and ready for its intended use. This building is to be depreciated over 10 years to a nil residual value using the straight-line method.

The construction was financed by a loan of RM 1 900 000 from Cash Limited. The loan was raised on 1 January 2022 specifically to facilitate the construction of the building. The interest rate is 25% per annum. There were no capital repayments during the year. Surplus funds were invested at 20% per annum. The interest is compounded annually.

**Required:**

- a) Calculate the total interest incurred and the total borrowing costs that must be capitalized during the year ended 31 December 2022.
- b) Calculate the depreciation for the year ended 31 December 2022.
- c) Calculate the carrying amount of the building as at 31 December 2022.
- d) Prepare the financial statement on 31<sup>st</sup> December 2022
  - i. Statement of Profit and Loss (extract)
  - ii. Statement of financial position (extract)

Scan the QR code to see the solution



<https://drive.google.com/drive/folders/1BKwcx3SsQo0PhMWU2-1yhUjzVvwuaiBH?usp=sharing>

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