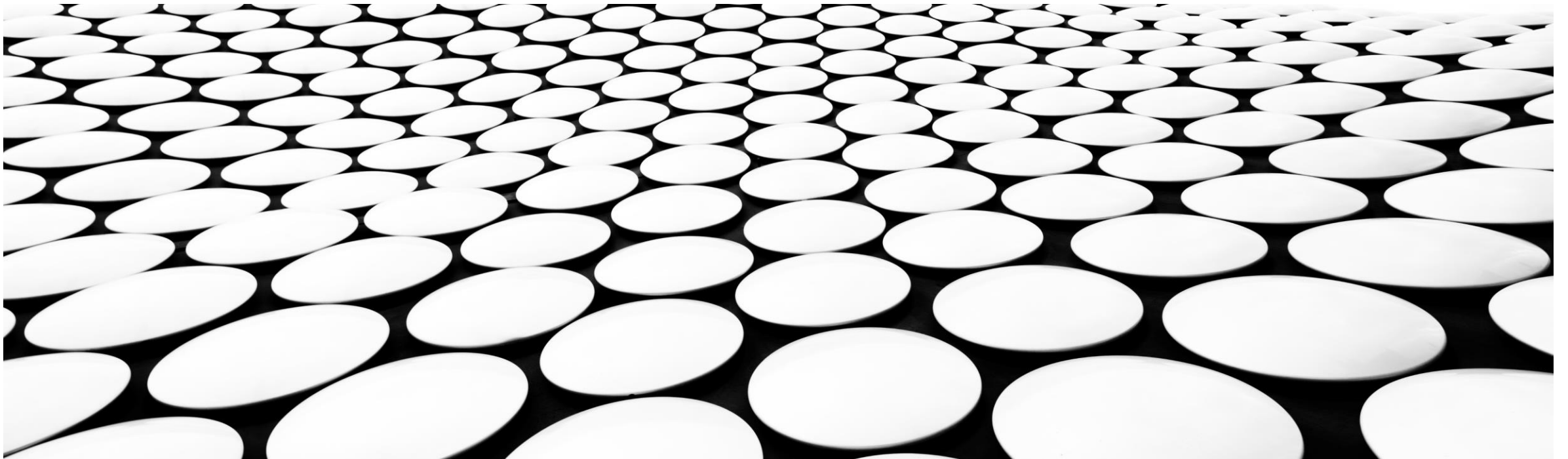

INTERNATIONAL FINANCIAL REPORTING STANDARDS

BORROWING COST – IAS 23

B D CHATTERJEE FCA, ACMA, ACS, DIP IFR (ACCA) – UNITED KINGDOM





INTERNATIONAL FINANCIAL REPORTING STANDARDS BORROWING COST - IAS 23

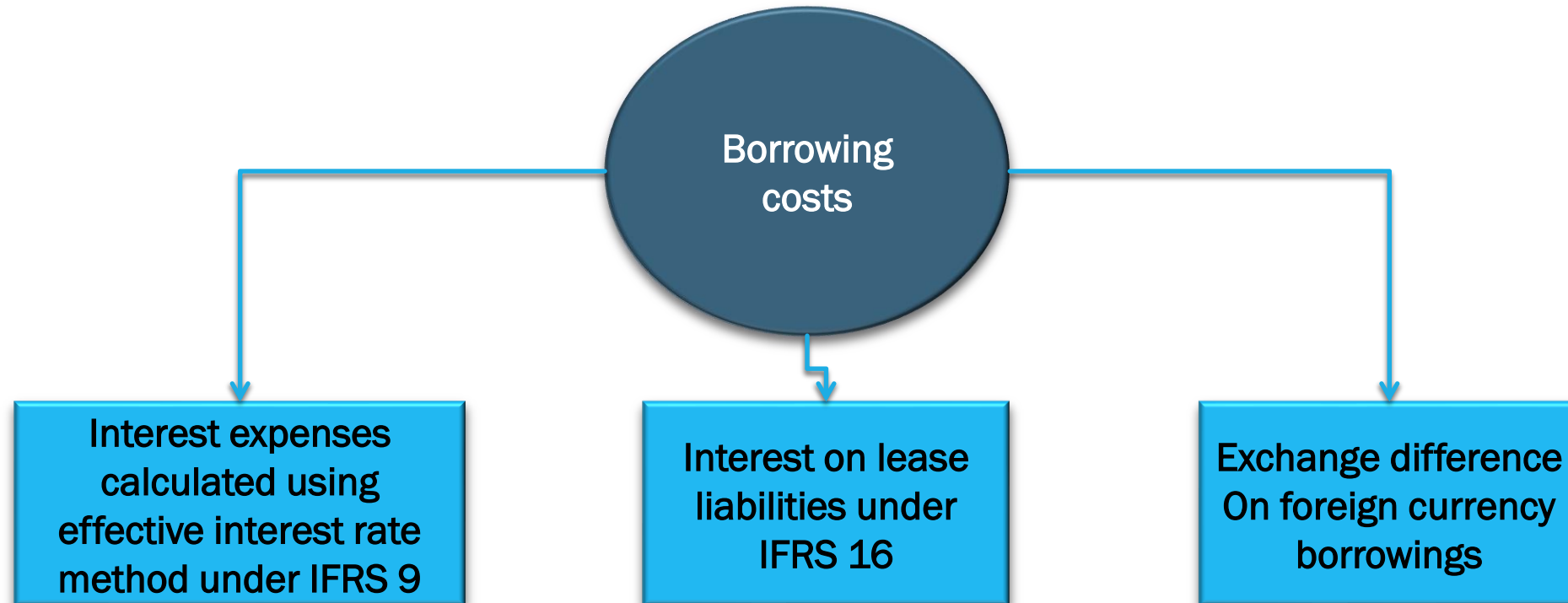
BORROWING COST - IAS 23

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 recognised as an expense.

BORROWING COSTS - IAS 23

include



BORROWING COSTS – IAS 23

- **Borrowing costs** are interest and other costs that an entity incurs in connection with the borrowing of funds
- A **qualifying asset** is an asset that takes substantial period of time to get ready for its intended use. It can be
 - inventories,
 - manufacturing plants,
 - power generation facilities
 - intangible assets
 - investment property
 - 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.

- **Where funds are part of general pool**, the eligible amount is determined by applying a capitalization rate which is the weighted average of borrowing cost applicable to general pool

BORROWING COSTS – IAS 23

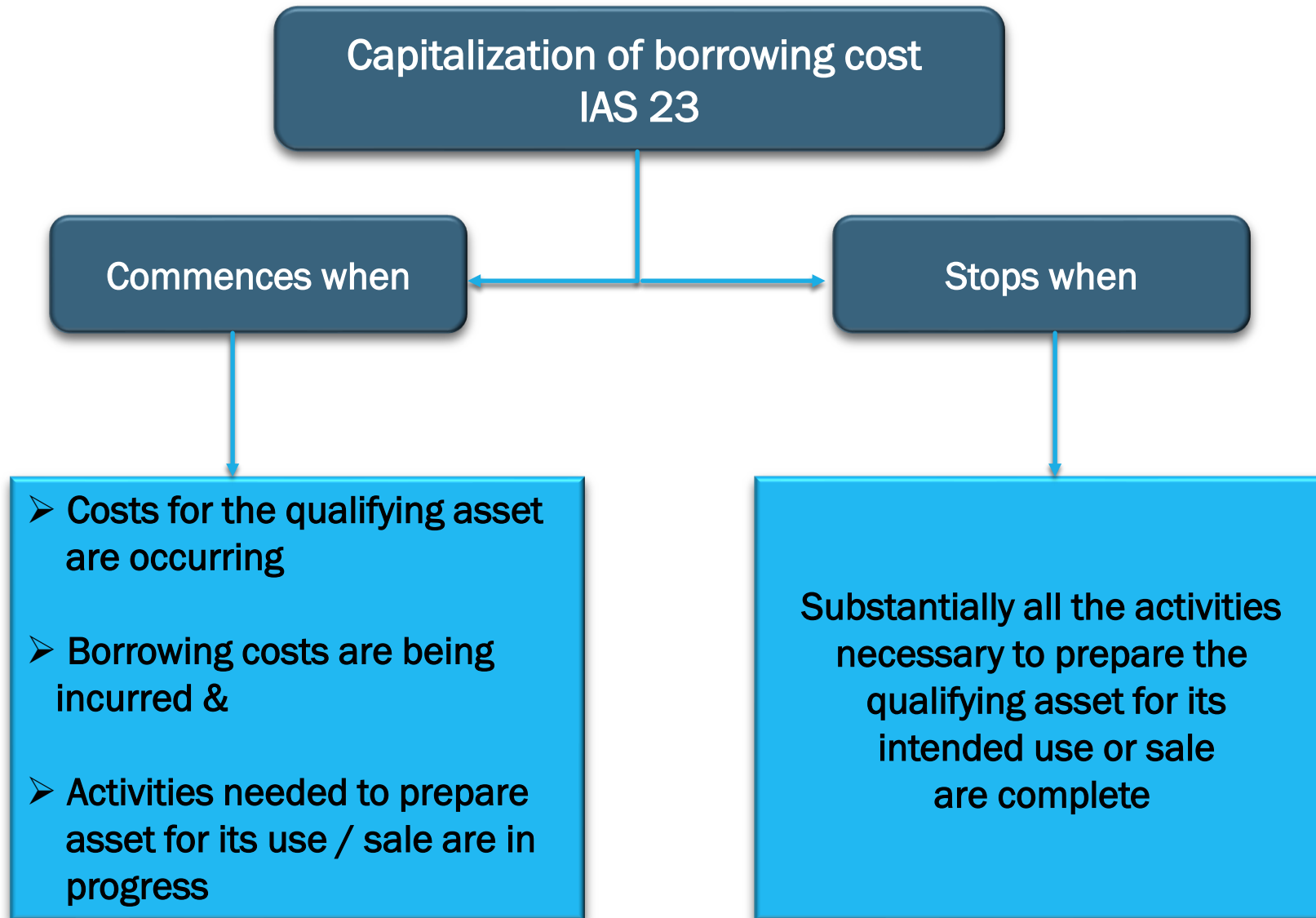
Borrowing costs

- Capitalizing borrowing costs (BC) = including BC in the cost of qualification asset
- A qualifying asset – takes substantial time to prepare for use or sale

Borrowing Cost (BC) which can be capitalized

- Interest on the funds borrowed specifically for constructing minus any investment income on temporary investment of these borrowings
- Borrowing costs on funds borrowed generally but used for obtaining a qualified asset

BORROWING COSTS – IAS 23



BORROWING COSTS – IAS 23

Accounting of borrowing costs

- Borrowing costs defined as interest and other costs incurred by an entity in connection with the borrowing of funds. IAS 23 allows two methods of accounting borrowing costs:
 - a) Borrowing costs should be recognized as expense in the period it is incurred or
 - b) Borrowing costs directly attributable to acquisition , construction or production of a qualifying asset can be capitalized when
 - it is probable that they will result in future economic benefits of the entity and
 - the costs can be measured reliably (effective interest rate method as per IFRS 9)

BORROWING COSTS – IAS 23

Illustration I

Woolworth is constructing a stadium. As on 31 October 20X2 the Construction of the stadium is completed to large extent. The Ticket booking office and the doors of the stadium are the only remaining parts to be completed. The auditor of Woolworth insists that capitalization of borrowing costs should be stopped at 31 October 20X2.

Required:

As an accountant give your opinion on this issue.

Answer:

The stadium cannot be used unless the Ticket booking office and the doors of the stadium are completed. We cannot say that it is **substantially ready** for its intended use.

Therefore, capitalization of borrowing costs need not be stopped, according to the provisions of IAS 23 until these final areas are completed.

BORROWING COSTS – IAS 23

Illustration II

- Z Ltd has a building under construction being financed with Rs.8 mil of debt, Rs.6 mil of which is a construction loan directly on the building. The rest is financed by the general debt of the company. Z Ltd would the building when it is completed. The debt structure of the firm is as under:

	Rs'000
- Construction loan @ 11%	6000
- Long term debenture @ 9%	9000
- Long term subordinated debenture @ 10%	3000

The debentures and subordinated debentures were issued at the same time.

Determine :

- a) interest payable during the year
- b) the capitalized interest cost to be recorded as an asset on the balance sheet
- c) amount of interest expense to be reported on the income statement

BORROWING COSTS – IAS 23

Solution

- Calculation of interest payable during the year
 - $0.11 \times (\text{Rs. } 6000000) + 0.09 \times (\text{Rs. } 9000000) + 0.10 \times (\text{Rs. } 3000000) = \text{Rs. } 1770000$
- Capitalised interest cost to be recorded as an asset on the balance sheet will be :
 - Effective interest rate on debentures and subordinated debentures :
 $(9000000 / 12000000) \times 9\% + (3000000 / 12000000) \times 10\% = 9.25\%$
 - Effective interest rate on construction loan = 11%
 - Capitalised interest rate would be
 - = $(\text{Rs. } 6000000 / 0.11) + (\text{Rs. } 2000000 / 0.925)$
 - = $\text{Rs. } 660000 + \text{Rs. } 185000$
 - = $\text{Rs. } 845000$
- Amount of interest expense to be reported in Income statement :
 - = $\text{Rs. } 1770000 - \text{Rs. } 845000$
 - = $\text{Rs. } 925000$



THANK YOU!