INDIAN ACCOUNTING STANDARDS
BORROWING COST – IND AS 23

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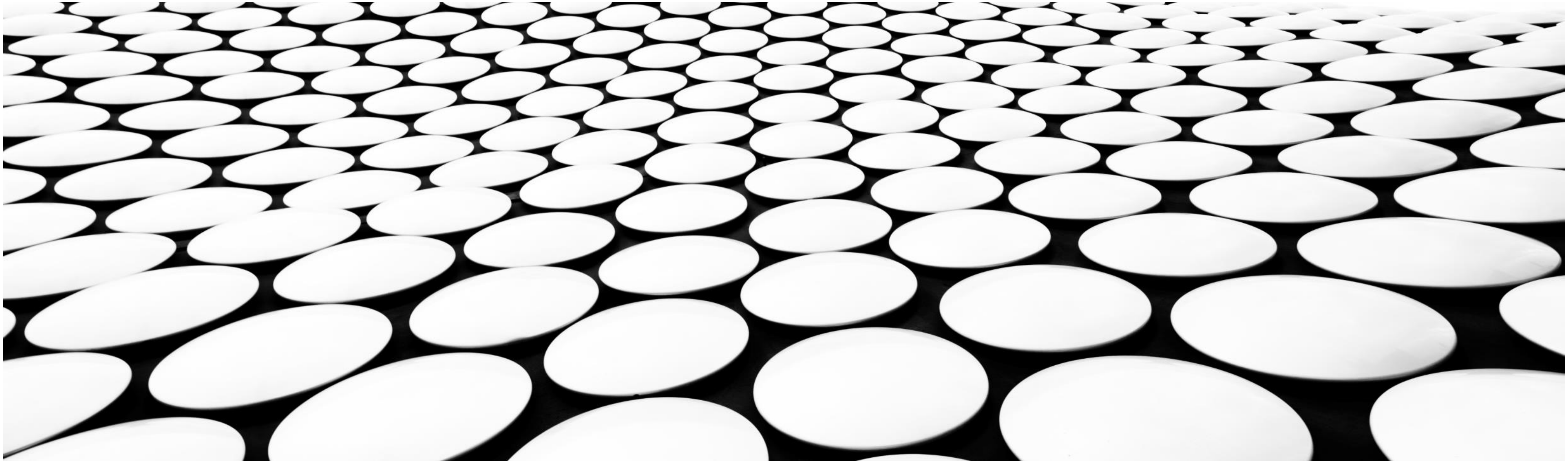

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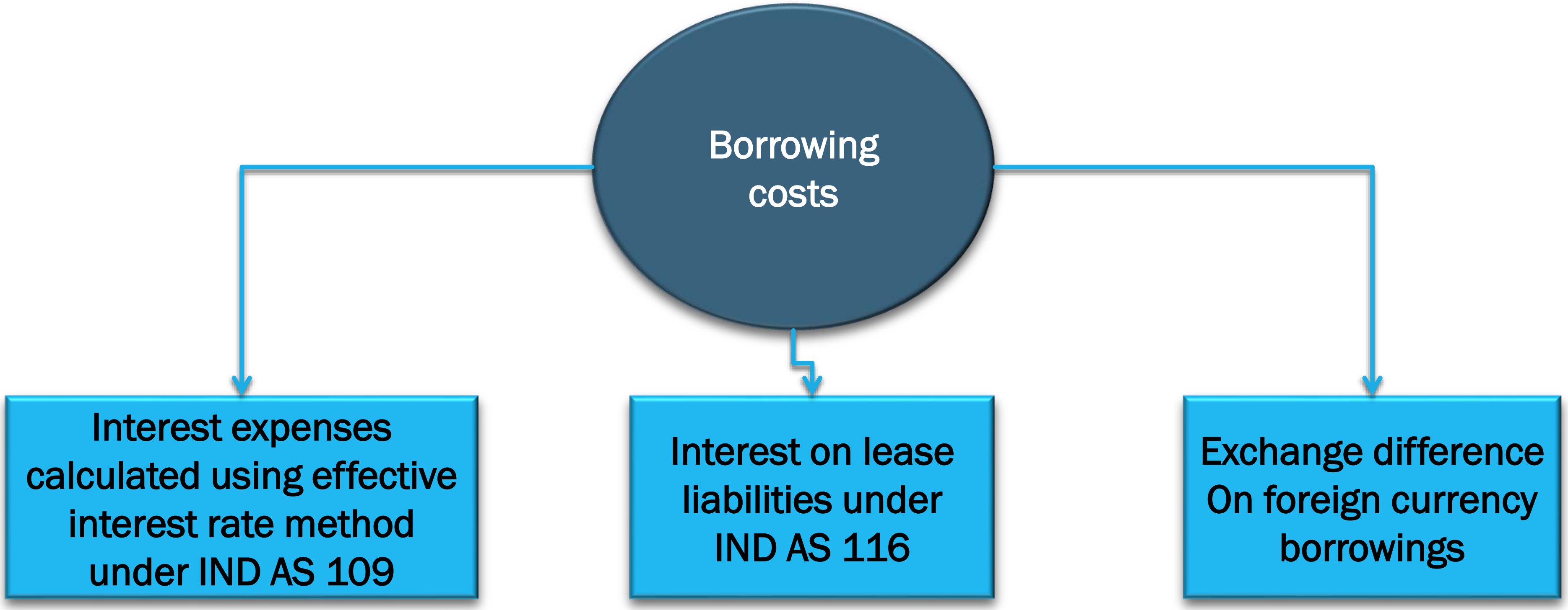
Core Principle

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 - IND AS 23

include



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- ***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

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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

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Capitalization of borrowing cost IND AS 23

Commences when

- Costs for the qualifying asset are occurring
- Borrowing costs are being incurred &
- Activities needed to prepare asset for its use / sale are in progress

Stops when

Substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete

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Accounting of borrowing costs

- Borrowing costs defined as interest and other costs incurred by an entity in connection with the borrowing of funds. Ind AS 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 Ind AS 109)

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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 Ind AS 23 until these final areas are completed.

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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

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Solution

- **Calculation of interest payable during the year**
  - 0.11 x (Rs. 6000000) + 0.09 x (Rs. 9000000) + 0.10 x (Rs. 3000000) = 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) X 9% + (3000000 / 12000000) X 10% = 9.25%

  - Effective interest rate on construction loan = 11%
  - Capitalised interest rate would be
    = (Rs.6000000 / 0.11) + (Rs.2000000 / 0.925)
    = Rs.660000 + Rs.185000
    = Rs.845000
- **Amount of interest expense to be reported in Income statement :**
  = Rs. 1770000 – Rs. 845000
  = Rs. 925000

THANK YOU!