



**Ind AS Implementation Committee
The Institute of Chartered Accountants of India**

Ind AS - 23

Borrowing Costs

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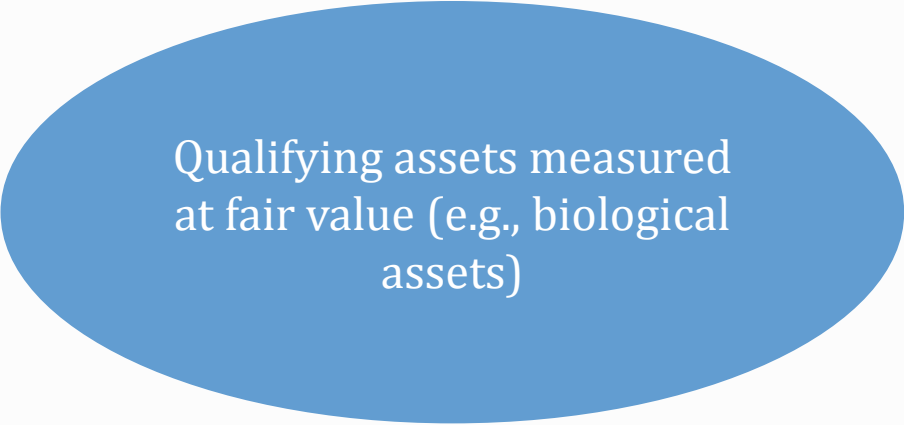
Agenda

- ❑ Objective and Scope
- ❑ Definitions
- ❑ Recognition
- ❑ Capitalisation
- ❑ Disclosure Requirements

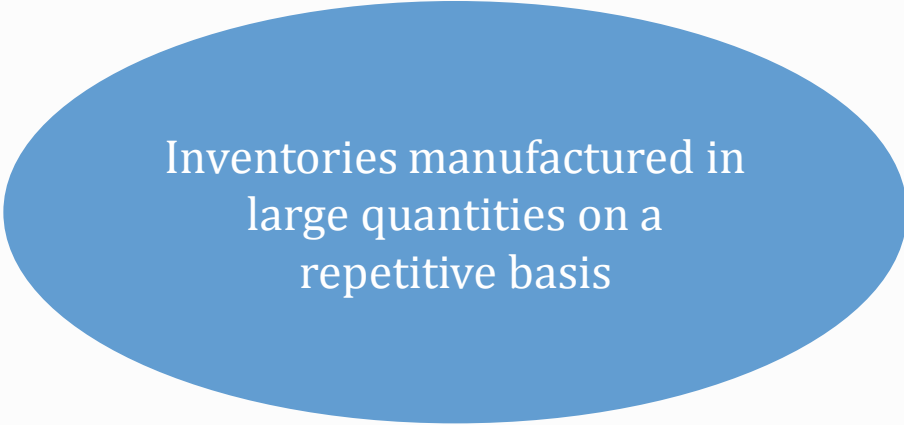
Objective and scope

- ❑ 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.

Ind AS 23 does not apply to:



Qualifying assets measured at fair value (e.g., biological assets)



Inventories manufactured in large quantities on a repetitive basis

Definitions

Borrowing Costs

These are interest and other costs incurred by an entity in connection with borrowing of funds which includes:

- ❑ Interest expense (calculated using the effective interest rate method in accordance with Ind AS 109)
- ❑ Finance charges on finance leases (Ind AS 17)
- ❑ Exchange differences on foreign currency borrowings to the extent they are regarded as adjustment to interest costs

Exchange differences – treated as borrowing cost

- ❑ exchange loss does not exceed the difference between the cost of borrowing in functional currency when compared to the cost of borrowing in a foreign currency.
- ❑ unrealised exchange loss which is treated as an adjustment to interest and subsequently there is a realised or unrealised gain in respect of the settlement or translation of the same borrowing, the gain to the extent of the loss previously recognised as an adjustment should also be recognised as an adjustment to interest.

It doesn't include **actual or imputed cost of equity**, including preferred capital not classified as a liability

Definitions

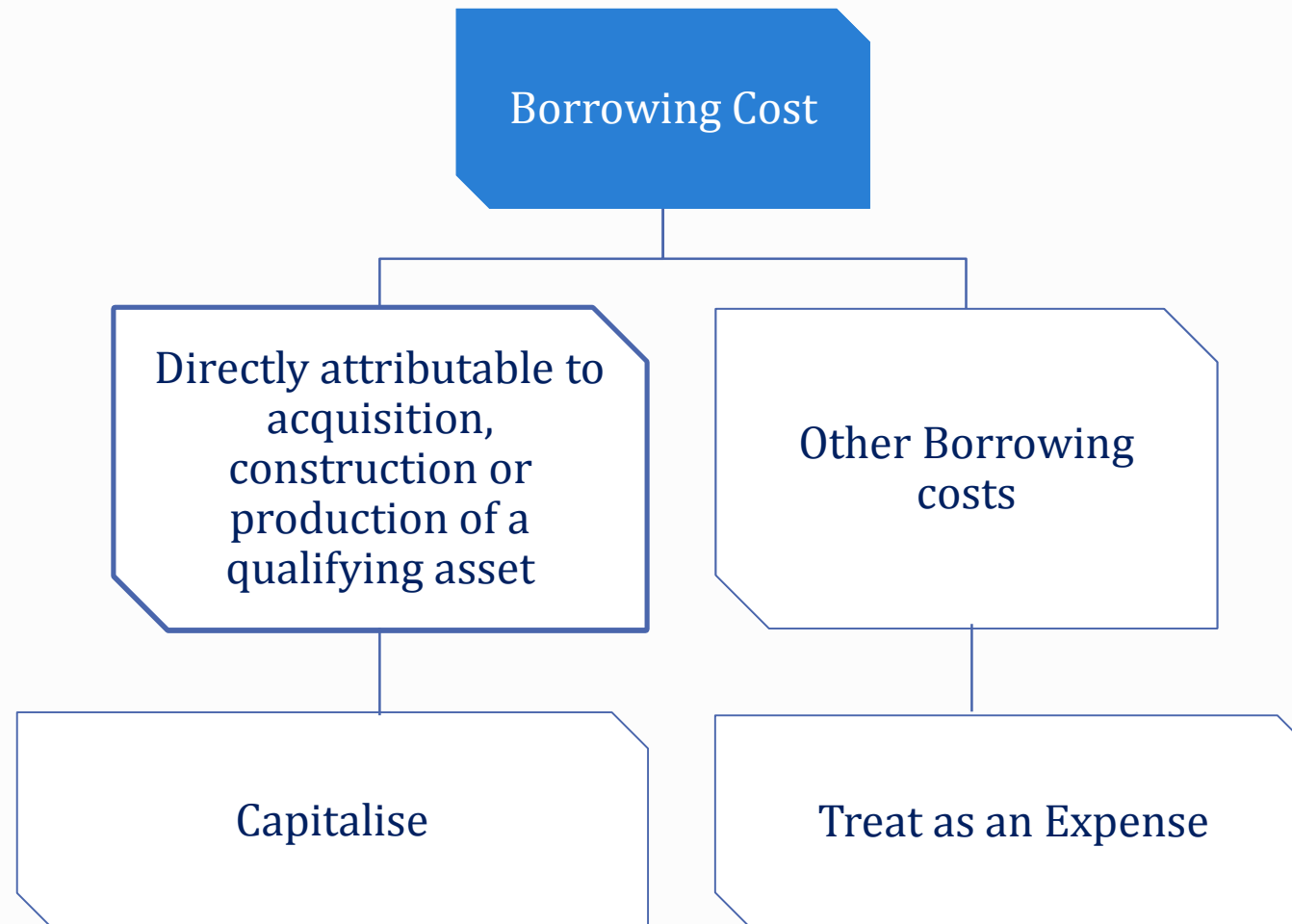
Qualifying Asset

- ❑ An asset that necessarily takes a substantial period of time to get ready for its intended use or sale
- ❑ But does not include assets ready for use or sale when acquired

Examples

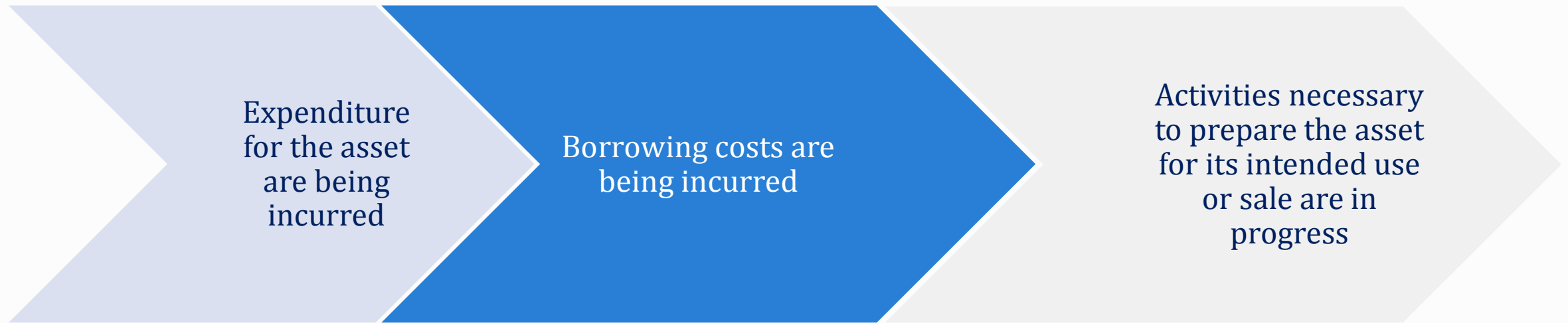
- ❑ A power plant which will take a substantial period of time to get ready to generate electricity
- ❑ A hydroelectric dam that serves the needs of a town and can take several years to get ready
- ❑ A toll bridge which takes can take a couple of years to construct before it can be opened for the public to use
- ❑ Inventories that require a substantial period of time to bring them to a saleable condition

Recognition



Commencement of capitalisation

Capitalisation should commence when all conditions met:



Expenditures are reduced by any progress payments received and grants received (Ind AS 20) in connection with the asset.

Commencement of capitalisation – example

For example:

- ☐ Borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken.
- ☐ However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity having commenced do not qualify for capitalisation.

Suspension of capitalisation

Capitalisation should be suspended during extended periods in which active development is interrupted.

Capitalisation is not suspended when:

- ❑ Substantial technical and administrative work is being carried out
- ❑ Temporary delay is a necessary part to prepare an asset for its intended use or sale

Cessation of capitalisation

Capitalisation should cease when: (in case of asset as a whole)

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

In case routine administrative work or minor modifications, such as the decoration of a property are outstanding, it will still be considered that substantially all the activities are complete.

Cessation of capitalisation

Capitalisation should cease when: (in case of asset in parts)

- ❑ In case of construction of a qualifying asset is in parts and each part is capable of being used while construction continues, when substantially all the activities necessary to prepare the part for its intended use or sale are complete.
- ❑ For e.g.: A business park comprising several buildings, each of which can be used individually

Example

- ❑ Apex issued an unsecured loan on 1 April 2015.
- ❑ The loan was specifically issued to finance the building of the new store which meets the definition of a qualifying asset in Ind AS 23. Construction of the store commenced on 1 May 2015 and it was completed and ready for use on 28 February 2017, but did not open for trading until 1 April 2017.
- ❑ During the year Apex suspended the construction of the new store for a two-month period during July and August 2016.

Example (contd.)

- ❑ Capitalisation commences from when expenditure is incurred (1 May 2015) and must cease when the asset is ready for its intended use (28 February 2017); in this case a 22- month period.
- ❑ However, interest cannot be capitalised during a period where development activity is suspended; in this case the two months of July and August 2016.

Length of substantial period of time

Under Indian GAAP, ordinarily,

- ❑ a period of twelve months is considered as substantial period of time,
- ❑ unless a shorter or longer period can be justified

Under Ind AS

- ❑ IFRS (also Ind AS) is silent on this aspect
- ❑ This would call for significant judgement, e.g., an entity may considering the nature of asset, amount of interest costs, etc. may decide capitalising interest costs on an asset requiring say 8 months for its completion

Example

- ❑ Apex issued a \$10 million unsecured loan with a coupon (nominal) interest rate of 6% on 1 April 2015. The loan is redeemable at a premium and the effective finance cost is 7.5% per annum.
- ❑ The loan was specifically issued to finance the building of the new store which meets the definition of a qualifying asset in Ind AS 23. Construction of the store commenced on 1 May 2015 and it was completed and ready for use on 28 February 2016, but did not open for trading until 1 April 2016.
- ❑ During the year trading at Apex's other stores was below expectations so Apex suspended the construction of the new store for a two-month period during July and August 2015. The proceeds of the loan were temporarily invested for the month of April 2015 and earned interest of \$40,000.

Calculate the net borrowing cost that should be capitalized as part of the cost of the new store and the finance cost that should be reported in the statement of profit or loss for the year ended 31 March 2016.

Solution

The effective rate is 7.5%, so the total finance cost for the year ended 31 March 2016 is \$750,000 ($\$10 \text{ million} \times 7.5\%$).

Capitalization commences from when expenditure is incurred (1 May 2015) and must cease when the asset is ready for its intended use (28 February 2016); in this case a 10- month period.

However, interest cannot be capitalized during a period where development activity is suspended; in this case the two months of July and August 2015. Thus only eight months of the year's finance cost can be capitalized = \$500,000 ($\$750,000 \times 8/12$).

The remaining four-months finance costs of \$250,000 must be expensed.

Solution

According to Ind AS 23 interest earned from the temporary investment of specific loans should be deducted from the amount of finance costs that can be capitalized. However, in this case, the interest was earned during a period in which the finance costs were **not** capitalized. Thus the \$40,000 interest received would be credited to profit or loss and not to the capitalized finance costs.

In summary:

Profit or loss for the year ended 31 March 2016:	\$000
Finance cost (debit)	(250)
Investment income (credit)	40

Statement of financial position as at 31 March 2016:

Property, plant and equipment (finance cost element only)	500
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Types of borrowings



Specific Borrowings

The diagram consists of two large blue arrows pointing towards each other. The left arrow points right and contains the text 'Specific Borrowings'. The right arrow points left and contains the text 'General Borrowings'.

General Borrowings

Specific borrowings

To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset

The amount capitalised should be the actual borrowing costs net of any income earned on the temporary investment of those borrowings.

Case study – calculation of amount to be capitalised

- ❑ On 1 Apr 2014, a company engages in the development of a property, which is expected to take five years to complete, at a cost of \$ 6 million. For this purpose, a bank loan of \$ 6 million with an effective interest rate at 6% was taken out on 31 March 2014 and fully drawn.
- ❑ Interest income earned at 3% on the unapplied funds during the period was \$ 114,000.
- ❑ What is the amount of interest to be capitalised for the year ended 31 Dec 2014?

Case study – calculation of amount to be capitalised

Solution

- ❑ Total interest charge for the year ended 31 Dec 2014 is \$270,000.
- ❑ Amount to be capitalised is \$156,000 (i.e., \$270,000 less \$114,000)

General borrowings

$$\text{Borrowing costs to be capitalised} = \text{Capitalisation rate} \times \text{Expenditures on the related asset.}$$

Weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period,
other than specific borrowings

Borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period

Case study – calculation of capitalisation rate

An entity has three sources of borrowing in the period. All the borrowings are used to finance the production of qualifying assets.

	Outstanding liability	Interest
5 years bank loan	\$6 million	\$0.8m
20 years bank loan	\$10million	\$0.6m
Bank Overdraft (average)	\$4 million	\$0.5m

Calculate the appropriate capitalisation rate.

Case study – calculation of capitalisation rate

Particulars	Loan	Interest
5 Year Bank Loan	\$ 6 million	\$0.8m
20 years bank loan	\$10million	\$0.6m
Bank Overdraft (average)	\$4 million	\$0.5m

- ❑ Capitalisation rate is
- ❑ $(0.8+0.6+0.5)/(6+10+4) = 9.50\%$

Case study

- ❑ On July 1 20X9 entity A were contracted for the construction of a building for \$2.2m. The land under the building is regarded as a separate asset and is not part of the qualifying assets.
- ❑ The building was completed at the end of the June 20Y0, and during the period the following payments were made to the contractor:

Payment date	Amount (\$'000)
1 July 20X9	200
30 September 20X9	600
31 March 20Y0	1,200
30 June 20Y0	200
Total	2,200

Case study

- ❑ Entity A's borrowings at its year end of 30 June 20Y0 were as follows:
 - ❑ 10% 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding at 30 June 20Y0 amounted to \$700,000. Interest of \$ 65,000 was incurred on these borrowings during the year and interest income of \$ 20,000 was earned on these funds while they were held in anticipation of payments;
 - ❑ 12.5% 10-year note with simple interest payable annually; debt outstanding at 1 July 20X9 amounted to \$ 1,000,000 and remained unchanged during the year end
 - ❑ 10% 10-year note with simple interest payable annually; debt outstanding at 1 July 20X9 amounted to \$ 1,500,000 and remained unchanged during the year.

- ❑ What amount of the borrowing costs may be capitalized at year end?

Case study – solution

Analysis of Expenditure

Date	Expenditure (\$000)	Amount allocated to general borrowings (\$000)	Weighted for period outstanding (\$000)
1 July 20X9	200	0	0
30 September 20x9	600	100*	100 X 9/12
31 March 20Y0	1,200	1,200	1,200 X 3/12
30 June 20Y0	200	200	200 X 0/12

Case study – solution

Specific Borrowings of \$ 700,000 fully utilized hence remainder of expenditure now allocated to general borrowings.

The capitalisation rate relating to general borrowings should be the weighted average of the borrowing costs applicable to the entity's borrowings that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset

Weighted average borrowing cost = $[(12.5\% \text{ of } 1000) + (10\% \text{ of } 1500)] / (1000 + 1500) = 11\%$

Case study – solution

Borrowing Cost to be capitalized:

	Amount (\$)
Specific Loan	65,000
General Borrowing (\$ 375,000 X 11%)	41,250
Total	116,250
Less interest income on specific borrowings	(20,000)
Amount eligible for capitalization	<u>86,250</u>

Therefore, the borrowing costs to be capitalized are \$86,250

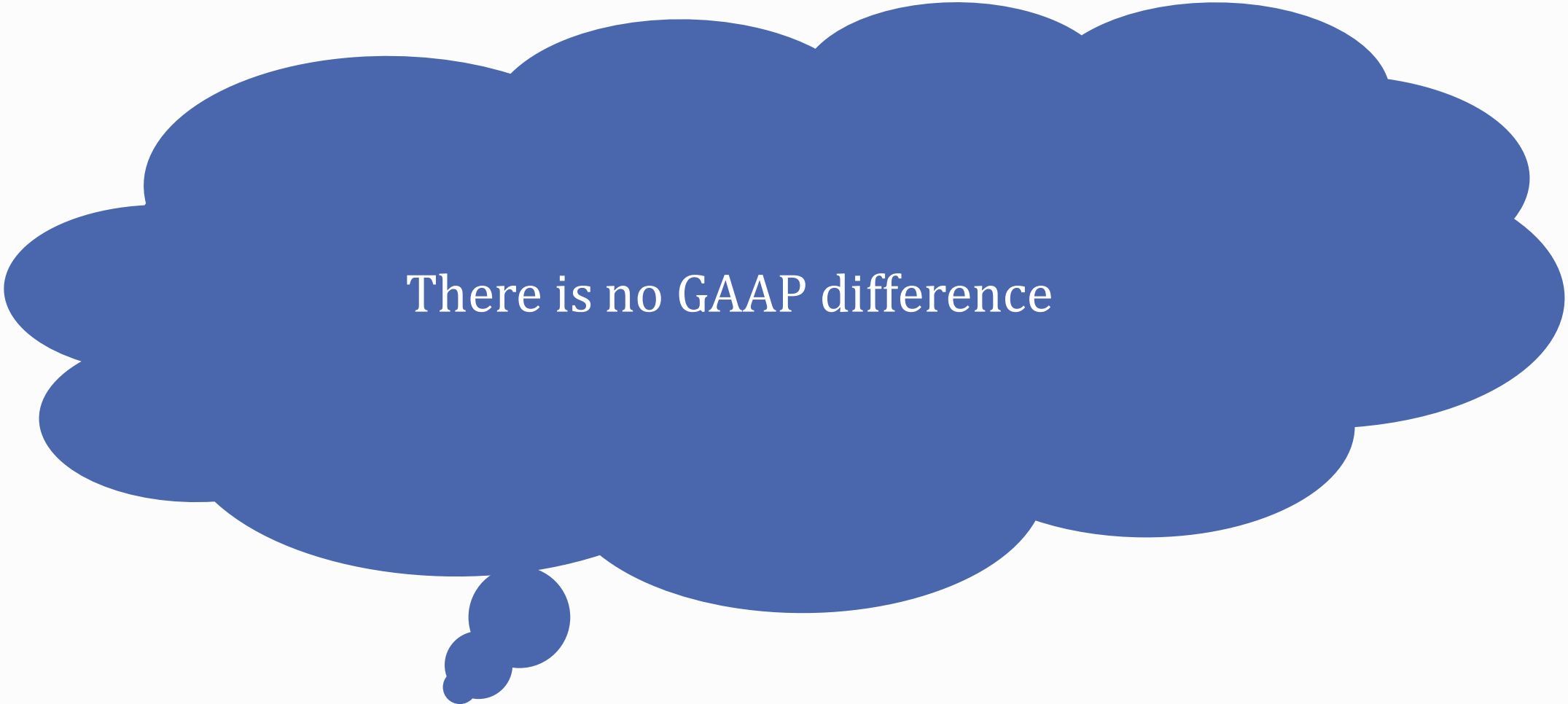
Disclosure

- ❑ The amount of borrowing costs capitalised during the period
- ❑ The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation

Key differences with IFRS and IGAAP

Difference	IAS	Indian GAAP
Scope	IAS 23 scopes out: ❑ Qualifying assets measured at fair value (e.g., biological assets) ❑ Inventories produced in large quantities on a repetitive basis.	No such scope exception
Components of borrowing costs	Reference to effective interest rate	No reference to effective interest rate
Substantial period of time	12 months ordinarily considered as a substantial period of time, unless a shorter or longer period can be justified	No such presumption; it should be determined based on management's judgement

Key differences with IFRS and Ind AS



There is no GAAP difference

Thank You

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