Ind AS 23: Borrowing Cost

1. Introduction

- Borrowing cost refers to the cost incurred by an entity in connection with the borrowing of funds. It includes-
  - interest expenses calculated using the effective interest method
  - finance charges in respect of finance leases
  - Exchange difference on borrowed funds to the extent they are regarded as adjustment to the interest cost.

Note:- Preference Share classified as liability is also covered under Ind AS-23.

2. Treatment of Borrowing cost

Borrowing Cost

- Directly Attributable to acquisition, Production or Construction of Qualifying Asset.
  ↓
  Capitalised with the cost of Asset, if recognition criterial met.
- Others
  ↓
  Revenue expenditure, hence transferred to P/L.

Notes:-

i. Qualifying Assets

- It is an asset (tangible or intangible) that necessarily takes Substantial period of time to get ready for its inteded use or sale.

- Ind AS-23 does not Provide any guidance on what contitutes a Substantial Period of time. The specific facts and circumstances should be considered in each case. eg; it is likely that a period of 12 months or more might be considered substantial.

- Assets that are ready for its intended use or sale when acquired are not qualifying assets.

ii. This standard does not deal with actual or imputed cost of Equity.

iii. An entity is not required to apply the Standard to borrowing directly attributable to the acquisition, construction or production of a-
  - qualifying assets measured at fair value eg., biological asset. or,
  - inventories that are manufactured or otherwise produced in large quantities on a repetitive basis.

iv. Directly Attributable Cost
  - It means borrowing cost could have been avoided, if qualifying asset had not been made.

v. Recognition criteria is same as in case of Ind AS-16/38.

3. Types of Borrowing

i) Specific Borrowing

- Entity borrows funds specially for the purpose of obtaining a particular asset i.e, where borrowing cost directly related to that asset can be readily identified.

- Following can be capitalised

Actual Borrowing Cost incurred	✓
less:- Any income on temporary investment out of those borrowings.	(✓)
	✓

- Borrowing cost should be calculated @ actual rate of interest.

ii) General Borrowings

- Borrowed funds will be used for obtaining qualifying asset and for other purposes also.

- Capitalisation should be made using the capilisation rate i.e., wieghted average rate.

= Expenditure on qualifying Asset × Capitalisation Rate

- Capitalisation Rate

$$= \frac{\text{Borrowing cost of general Borrowings}}{\text{Total general Borrowings during the period}} \times 100.$$

Note:- Borrowing cost capitalised during a period should not exceed actual borrowing cost during that period.

4. Steps for Capitalisation of Borrowing Cost

Step 1:- Compute average accumulated cost
Step 2:- Compute Capitalisation Rate
Step 3:- Amount of Interest to be capitalised

Average Accumulated Cost (A)

↓ Specific Borrowing (B) × Rate of Interest

↓ General Borrowing (A-B) × Capitalisation Rate on general borrowings.

- However, we cannot calculate borrowing cost to be capitalised by following above steps if the-

  i) entire amount of specific borrowing has not been utilised on the beginning of capitalisation period.

  or

  ii) Average accumulated expenditure incurred on qualifying asset is less than the amount of specific borrowing.

5: Period of Capitalisation

i) Commencement of Capitalisation

- Capitalisation should start from the date when all of following conditions are satisfied-
  a. Borrowing cost is incurred.
  b. Expenditure on qualifying asset is being incurred
  c. Activities necessary to prepare the asset for its intended use or sale is in process.

Note:- Necessary activities include technical and administrative work prior to commencement of physical construction.

ii) Suspension of Capitalisation

- Capitalisation of borrowing cost should be suspended during extended periods in which active development is interrupted.

- Suspension is generally done due to abnormal reasons e.g., court stay, strike, etc.

- Borrowing cost during this period should be expensed in P/L.

- However during following Period, borrowing cost should not be suspended -

a. during a period when substantial technical and administrative work is being carried out.

b. during temprory delay is a necessary part of the process of getting an asset ready for its intended use or sale.

c. activities interrupted due to high water levels which is common during the construction period in the geographical region involved.

iii) Ceasation of Capitalisation

- Capitalisation of borrowing cost should be be ceases if any of the following condition is satisfied-

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

OR

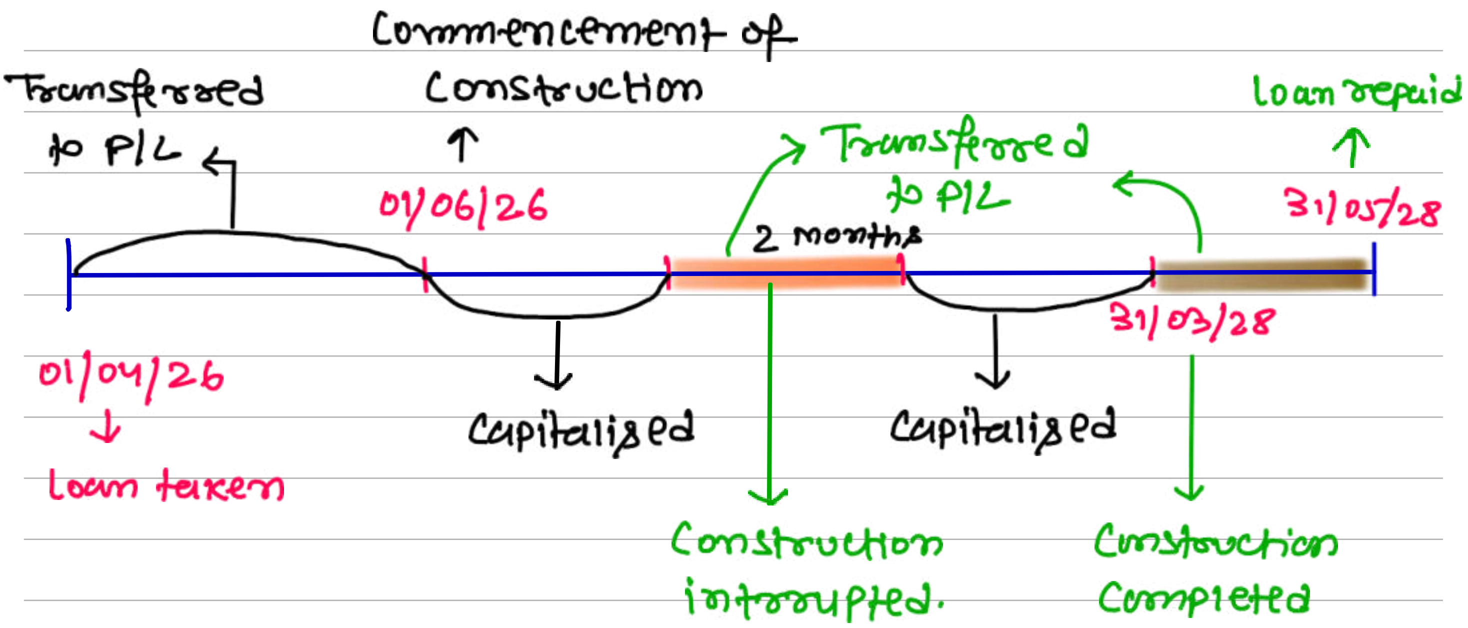
b. borrowing cost is not being incurred.

Note:-

- An asset is normally ready for intended use or sale when its physical construction or production is complete even though routine admin work or minor modification (e.g., decoration work) might still continue.

- When construction of assets is completed in parts or phase wise then borrowing cost related to that part should be ceased on completion of respective part or phase.

e.g., construction of business park comprising several buildings.



6. Exchange Differences on Foreign Currency Borrowings

- Funds may be borrowed in foreign currency and in such case apart from interest cost, liability for increase in exchange difference also arises and same will be treated as borrowing cost to the extent of amount of interest if loan would have been taken in local currency.

- Following steps are applied -

Step 1:- Calculate interest on foreign currency loan

= Loan × Rate of interest × Exchange rate on reporting date

Step 2:- Calculate increase in Liability

= Amount of loan × increase in currecny Rate

Step 3:- Calculate interest on local currency

= loan × Currency Rate on date of loan × Rate of interest on local currency borrowings

Step4:- Calculate Borrowing Cost

- Increase in liability (Step 2) to the extent of difference of interest on the local currency borrowing and foreign currency borrowings i.e., Step 3 – Step 1 will be treated as borrowing cost and excess part, if any shall be treated as exchange difference as per Ind AS-21.

- However, if there is an unrealised exchange loss which is treates 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.