Ind AS 23 - Borrowing Costs.

Ind AS 23 states that :-

Borrowing cost that are directly attributable to Acquisition, construction or production of QUALIFYING ASSETS are included in the cost of Asset

Other Borrowing Costs recognised as expenses in the period in which they are incurred.

Qualifying Assets are those that necessarily takes Substantial Period of time to get ready for its intended use or sale.

{Usually 12 months or more considered as substantial period.}

Borrowing Cost may include :-

1. Interest Expenses calculated using Effective Interest rate method.
2. Exchange Difference from Foreign Currency Borrowings to the extent adjusted as Interest Cost.
3. Interest in respect of lease liabilities recognised as per Ind AS 116.

Depending on Circumstances, any of the following may be Qualifying Assets

a) Inventories b) Manufacturing plants c) Power Generation Facilities.
d) Intangible Assets e) Investment Properties f) Bearer Plants.

This standard does not apply to Actual or Imputed cost (opportunity cost) of Equity.

{E.g. Dividend Paid on Equity Shares, issue cost of Equity, Cost on Preference Shares not classified as liability}

Borrowing cost are capitalised as part of the cost of Qualifying Assets if below conditions are satisfied :-

a) Probability of FEB. b) Costs can be measured reliably.

<u>Borrowing Costs eligible for Capitalisation</u>

The Borrowing cost that are eligible for capitalisation are those borrowing cost that would have been avoided if the expenditure on Qualifying Asset had not been made.

<u>This standard includes separate requirements for Specific Borrowings and General Borrowings.</u>

20l × 10%

= 2l − 80k

= 1.2k

<u>Specific Borrowings</u>

If an Entity borrows Funds specifically to obtain a Qualifying Assets, it is Specific Borrowings.

<u>Borrowing cost eligible for capitalisation would be :-</u>

Actual Borrowing cost incurred during the period **less** Any investment income on temporary investment of those Borrowings.

<u>Note</u> :- A notional Borrowing cost where entity uses it own cash cannot be Capitalised.

<u>General Borrowings.</u>

All borrowings that are not specific represents General Borrowings.

Here, Capitalisation rate is calculated which is weighted Average of Borrowing cost applicable to all outstanding General Borrowings.

$$\text{Capitalisation rate} = \frac{\text{Weighted Avg. B. Cost on o/s Borrowings \{Excl. Specific Borrowings\}}}{\text{Total o/s Borrowings \{Excl. Specific Borrowings\}}}$$

Note ÷ The Amount of Borrowing Cost capitalised shall not exceed Borrowing Cost incurred during that Period.

Note* ÷ If funds Borrowed for specific Assets and related assets gets ready for its intended use, but borrowings still outstanding, Then it becomes part of General Borrowings.

Commencement of Capitalisation ⟨ Expenditure incurred, B.cost incurred, Activities started ⟩

Commencement Date is the date when Entity first meets all below Conditions ÷

i) It incurs Expenditure* for the Asset. 1.5.01

ii) It incurs Borrowing Costs. 1.4.01

iii) It undertakes activities necessary to prepare Asset for its intended use or sale. ⇒ 1.6.01

Activities includes technical and Administrative work prior to Physical Construction.

⟨E.g. obtaining permits prior to Physical Const^n⟩.

it Excludes holding of Asset when no production or development that changes asset's condition is taking place.

E.g. B.cost incurred while land is under Development are capitalised during the period in which activities related to development are undertaken.

However, B.cost incurred while land is held without any development activity do not qualify for capitalisation.

* Expenditure means payment of cash, transfer of other Assets, Assumption of interest bearing liabilities. Expenditure reduced by any progress payments received or Grants received in connection with the asset.

Suspension of Capitalisation

Capitalisation of B. cost shall be suspended during extended periods in which active development of Qualifying Assets suspended.

Eg ÷ Cost of holding partially completed asset do not qualify for capitalisation

Capitalisation is not suspended when temporary delay is a necessary part for getting assets ready for its intended use or sale.

{Eg. Capitalisation continues when high water levels delay construction of a bridge if such high water levels common in geographical region involved.}

Note ÷ Capitalisation continues when there is temporary delay due to some technical reasons.

Cessation of Capitalisation

An Entity should cease capitalising B. Cost when substantially all the activities are complete.

⇓

Physical construction complete even though routine Administration work continues.

{Eg. minor modification like Decoration etc.}

This means All Activities substantially complete.

When Entity completes construction of a Qualifying Assets in parts ÷

Each part is capable of being used while construction on other parts continues.	Each part is not capable of being used separately.
⇓	⇓
Cease capitalisation of B. cost on each such parts whose construction completes.	Capitalisation continues untill all parts are ready.

Other Relevant Concepts

1) Dividend Payable on shares classified as Financial Liabilities meet the definition of B. cost and Dividend can be Capitalised {Eg Redeemable Pref. Sh classified as FL}

2) Capitalising B. cost in Group F/s

Borrowings taken by one Company within Group, and Qualifying Assets developed by another Company within Group.

In Group F/s → Interest cost is Capitalised.

In Own F/s → The Entity carrying out development should not capitalise any interest in its Own F/s as it has no borrowings. However if Entity has intra Group Borrowings {i.e. Borrowings from another Group members}, then interest on such Borrowings may be Capitalised in its own F/s.

3) For Maturing Inventories, it is sometimes difficult to determine when Period of Production Ends i.e. when inventories are being 'Held for sale' as opposed to being 'Held to Mature'

{Eg. whisky is matured after 3 years but goes on improving with age for many more years}

If Held for Sale / Held to mature cannot be demonstrated, inventories regarded as Held for Sale and Capitalisation ceases.

Disclosure

1. Amount of B. cost Capitalised during the period.

2. Capitalisation rate used.

Exchange Difference to be included in cost of Equity

An Entity borrow Funds in other than Functional Currency.

⟨Eg Company with ₹ Functional Currency borrows Funds in \$ for Asset Development⟩ 40000

This may be done because interest on \$ borrowing is cheaper than ₹ borrowing even after allowing for exchange difference losses.

Examples to explain capitalisation of E.D. on Foreign Currency Borrowings.

1/4/01, Indian Entity borrows \$ 1000 @ 4% when E.R. → 1\$ = ₹ 40

it can borrows funds in Functional Currency @ 12%.

1st yr end ⟨31.3.02⟩ → E.R. → 1\$ = ₹ 50

Interest cost that can be capitalised if Borrowing in F.C. = 1000 \$ × 40 × 12% = 4800

Interest Expense = 1000\$ × 4% interest × ₹ 50/\$ = ₹ 2000 ⟨capitalised⟩

Exch. loss on Principal Borrowings = 1000\$ × (50 − 40) = ₹ 10000

∴ Out of E loss of ₹ 10000 on Principal component, ₹ 2800 is capitalised and Balance ₹ 7200 is Charged to P/L. Loan Amount = 1000\$ × 50 = ₹ 50000

2nd yr End ⟨31.3.03⟩ → E.R. → 1\$ = ₹ 48

Interest cost = 1000 \$ × 4% × 48 = ₹ 1920 ⟨capitalised⟩

Exchange gain = 1000\$ × ⟨50 − 48⟩ = $\boxed{₹ 2000}$ ⟨reduced from Asset as previously ₹ 2800 capitalised⟩ Q

Amount of loan = 1000 \$ × 48 = ₹ 48000

Another Alternative :- If at 2nd yr End ⟨31.3.03⟩, 1\$ = ₹ 44 (instead of 48)

Interest Cost = 1000 \$ × 4% × 44 = ₹ 1760 ⟨capitalised⟩

Exchange Gain = 1000\$ × ⟨50 − 44⟩ = ₹ 6000 ⟨reduced from Asset to the extent ₹ 2800 previously capitalised, Balance ₹ 3200 Exchange Gain is credited to P/L.⟩

Another Alternative ÷ if at 2nd yr End {31.3.03}, 1$ = ₹ 44 and part of loan repaid

Suppose $ 600 of the Borrowings paid at 1st yr End on 31.3.02

Exchange rate

31.3.02 ⇒ 1$ = ₹ 50 , 31.3.03 ⇒ 1$ = ₹ 44

↓

1st yr End {31.3.02}

Interest Cost = 1000 $ × 4% × 50 = ₹ 2000 capitalised.

Exch. loss = 1000 $ × (50 − 40) = ₹ 10000 {2800 capitalised, 7200 in P/L}

Since loan of $ 600 paid, Balance o/s is $ 400 {60% loan paid}

Amount of Loan o/s = 400 $ × 50 = 20000

2nd yr End {₹ 1$ = 44}

Interest cost = 400 $ × 4% × 44 = ₹ 704 Capitalised.

Exchange Gain = 400$ × (50 − 44) = ₹ 2400 {reduced from Asset to the extent of 40% of 2800 capitalised earlier i.e. ₹ 1120, Balance ₹ 1280 is credited to P/L}

Note ÷ Exchange Gain earned on 400$ {i.e. 40% of loan}, therefore Amount reduced from asset to the extent of 40% of 2800 i.e. ₹ 1120

This standard does not apply to ÷

i) Qualifying Assets measured at Fair Value. {E.g. Biological Assets}

ii) Inventories manufactured / Produced in large Quantities on a repetitive basis even if they take substantial Period of time to get ready for sale {E.g. whisky, wines etc.}