

# Ind As 23 - BORROWING COSTS

B. cost  $\rightarrow$  Interest cost.  
Processing fees

Ind As 23 states that  $\frac{a}{b}$

Borrowing cost that are directly attributable to **Acquisition, const<sup>n</sup> or Prod<sup>n</sup> of QUALIFYING ASSETS** are included in the cost of Asset.

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

Borrowing cost may include

1. Interest Expenses calculated using effective interest rate method. (Ind AS 109 - FI)

2. Exchange Difference from Foreign Currency Borrowings to the extent adjusted as interest cost. (discussed below)

3. Interest in respect of lease liabilities recognised as per Ind AS 116.

No definition but usually 12 months considered as substantial period.

Qualifying Assets  $\rightarrow$  that necessarily takes substantial period of time to get ready for its intended use or sale

Depending on the circumstances, **any** of the following may be qualifying assets:

<i>Inventories</i>	<i>manufacturing plants</i>	<i>power generation facilities</i>
<i>intangible assets</i>	<i>investment properties</i>	<i>bearer plants.</i>

This standard does not apply to **Actual or Imputed cost of Equity**.

e.g. Dividend paid on Equity shares, issue cost of Equity, cost on preference sh. Capital not classified as liability  $\rightarrow$  Eq. sh. holders are owners (Moral)

This standard **not apply** to

Qualifying assets measured at Fair value.  
(e.g. Biological assets)

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. Whiskey, wines etc.)

# Exchange Difference to be included in Cost of Equity.

An Entity may borrow funds in other than Functional Currency  
 (e.g. company with (£) functional currency borrows funds in (\$) for Asset Development  
 This may be done because interest on \$ borrowing is cheaper than £ borrowing even after allowing for Exchange Differences losses.

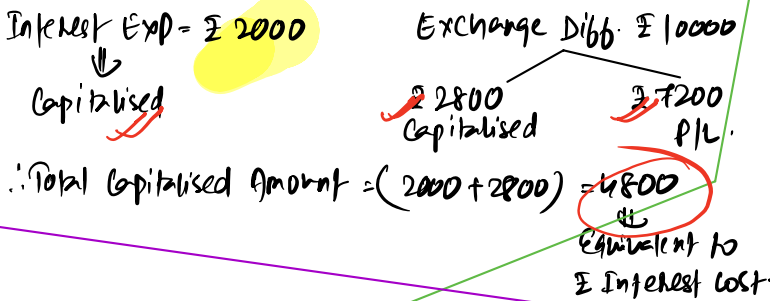
## Examples to Explain Capitalisation of Exchange Differences on Foreign Currency Borrowings.

On 1/4/01, Indian Entity borrows \$ 1000 @ 4% when  
 $1 \$ = ₹ 40$ . Equivalent ₹ amount  $(1000 \times 40) = ₹ 40000$   
 It can borrow @ 12% in Functional Currency  
 $40000 \times 12\% = 4800$

1st yr End (31.3.02)  $\Rightarrow$  Exchange rate  $1 \$ = ₹ 50$   
 Interest Expenses  $\Rightarrow 1000 \$ \times 4\% \text{ interest} \times ₹ 50/\$$   
 $\Rightarrow ₹ 2000$   
 Exchange Difference  $\Rightarrow 1000 \$ \times ₹ (50 - 40)$   
 $\Rightarrow ₹ 10000$

The Question is Can we Capitalise both Interest Expenses of ₹ 2000 and Exchange Difference of ₹ 10000.

Here, we should check what amount should have been Capitalised in case of ₹ Borrowing  $\Rightarrow ₹ 40000 \times 12\% = ₹ 4800$   
 Therefore Ind AS 23 states that Maximum Exchange Difference that can be Capitalised  $= (4800 - 2000) = 2800$   
 out of ₹ 10000 exchange difference, ₹ 2800 Capitalised as B. loss and rest ₹ 7200 charged to P/L.



1st year End Alternative scenario - E.R.  $\rightarrow 1 \$ = ₹ 41$   
 Suppose the Exchange rate on 31.3.2002 would have been ₹ 41/\$.  
 Then Int. Cost  $= (1000 \$ \times 4\% \times 41) = ₹ 1640$   
 E. Diff.  $= (1000 \$ \times (41 - 40)) = ₹ 1000$   
 $\Rightarrow ₹ 2640$

Max Exchange Diff allowed to be Capitalised  $\Rightarrow (4800 - 1640) = ₹ 3160$   
 But Exchange loss only ₹ 1000  
 $\therefore$  Entire Exchange loss of ₹ 1000 can be Capitalised.

2nd yr End (31.3.2003)  $\Rightarrow 1 \$ = ₹ 48$  1st Alternative  
 Interest cost  $\Rightarrow (1000 \$ \times 4\% \times 48) = ₹ 1920$  (Capitalised)  
 Exchange GAIN  $\Rightarrow (1000 \$ \times (48 - 50)) = ₹ 2000$   
 (Adjusted as previously Capitalised ₹ 2800)

B/Sheet		Qualifying Asset	
Loan	50000	(+) Int. Cost Capitalised (1st)	2000
(+) Int. $(1000 \times 4\% \times 48)$	1920	(+) Exch. loss Cap. (1st)	2800
(-) Paid in Cash	(1920)	(+) Int. Cost Capitalised (2nd)	1920
(-) Exch. Gain	6000	(-) Exch. Gain Adjusted	2800 (2000)*
Repayment $(1000 \times 48)$	48000	(Adj. less than 2800)	

\* PINK COLOUR  $\rightarrow$  Carried from Previous Year  
 \* Prev. year Exch. loss Capitalised = ₹ 2800  
 \* Current year Exch. Gain Adjusted = ₹ 2000  
 (Maximum 2800 reversal) (Reversal)

2nd yr End (31.3.2003)  $1 \$ = ₹ 44$  2nd Alternative.  
 Interest cost  $(1000 \times 4\% \times 44) = ₹ 1760$  (Capitalised)  
 Exch. Gain  $(1000 \times (44 - 50)) = ₹ 6000$   
 Previously Capitalised Exch. loss of ₹ 2800 will be adjusted and remaining ₹ 3200 credited to P/L.  
 P/L (E. Gain)  $(6000 - 2800) = 3200$  Exch. Gain Adj. (2800)  
 Liability reduced by (6000)

B/Sheet (1st yr End)		B/Sheet (2nd yr End)	
P/L		Loan	₹ 40000
Int. Capitalised	NIL	(+) Interest Exp.	2000
E. Diff. not Capitalised	7200	(-) Interest Paid	(2000)
		(+) E. Diff. (B. diff)	10000
		Repayment of loan $(1000 \$ \times 50)$	50000
		Bank (loan taken)	₹ 40000
		" (Int. Paid)	₹ (2000)

monetary item is remeasured

monetary item (Ind AS 21)



2nd yr end (31.3.03) \$1 = £44 and Part of loan Repaid (3rd Alternative)

\$ 600 of the Borrowings Paid on 31.3.02 (1st yr end)

Exch. Rate on 31.3.02 → £1\$ = 50  
on 31.3.03 → £1\$ = 44

1680 (600\$)  
1120 (400\$)

Explanation to Exch. Gain Adjustment of £1120.

Previously on 31.3.02 Exch. Gain Capitalised on \$1000 = £2800

But Previously out of \$1000 loan, \$600 Repaid

i.e. out of Exch. loss Capitalised £2800

Exch. loss related to \$600 paid  
£2800 ×  $\frac{\$600}{\$1000}$   
OR  
£2800 × 60%  
= £1680

Exch. loss related to \$400 still unpaid.  
£2800 ×  $\frac{\$400}{\$1000}$   
OR  
£2800 × 40%  
= £1120

\$600 already paid last year so no further Adjustment.

Now Exch. Gain £2400 related to \$400 which can be adjusted to the extent of 1120

i.e. 1120 Adjusted & (2400-1120) 1280 Credited to P/L.

Simple si but the E. Gain \$400 me hua ke toh usi se related E. loss me adjust hoga.

B/sheet

Pink colour - Carried from previous year

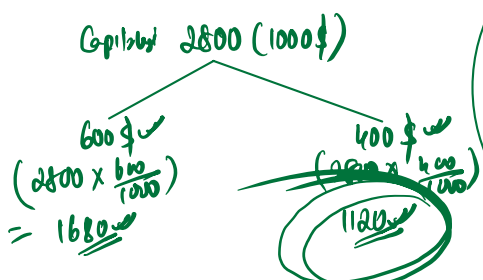
PLC	
Int. Capitalised	7200
E. Dibb. not Capitalised	
Loan	£40000
(+) Ant. Interest Exp.	2000
(-) Interest Paid	(2000)
(+) E. Dibb. (B. bly)	10000
Repayment of loan	50000
(-) \$600 paid	(30000)
(-) \$600 × 50	
(+) \$400 × 50	20000
(+) Int (400\$ × 4% × 44)	704
(-) Int Paid	(704)
(-) Exch. Gain (400\$)	2400
Repayment (400\$ × 44)	17600

Qualifying Asset = xxx
(+) Int. lost Capitalised = 2000
(+) E. Dibb. Capitalised = 2800*
(+) Int. lost Capitalised = 704
(+) Exch. Gain Adjustment = 1120
(2800 × 40%)

Bank (loan taken)	£40000
" (Int. Paid)	£(2000)
Bank (\$600 paid)	£(30000)
Int Paid	£(704)

2nd yr. end  
Int = 400\$ × 4% × 44 = (16\$ × 44) = 704

Reverse: whether P/L or Capitalised



B/s	
PLC 1680	Exch. Gain adj → (1120)
Liab (2400)	

Borrowing costs are Capitalised as part of the cost of Qualifying Asset if below conditions are satisfied. 0

A. Probability of FES

B. Costs can be measured reliably.

# Borrowing cost eligible for Capitalisation

↳ Borrowing cost incurred on Qualifying Assets.

Here, the standard includes separate requirements for SPECIFIC BORROWINGS and GENERAL BORROWINGS.

## SPECIFIC BORROWINGS Refer illustration 6

When Entity borrows funds specifically for the purpose of obtaining a Qualifying Assets.

A Notional Borrowing cost where entity uses its own cash cannot be Capitalised.

An Entity may obtain borrowed funds and incur associated B. cost before all funds are used for expenditure on Q.A.

In such circumstances, funds often temporarily invested pending their exp. on Q.A. Any investment income earned on such funds is deducted from B. cost

## Borrowing cost Eligible for Capitalisation

Actual Borrowing cost incurred during the period - Any Investment Income on temporary investment of those borrowings.

Ex: On 1st April 2022, Entity borrowed ₹ 1000000 @ 9% for const<sup>n</sup> of factory building (specific borrowing). Const<sup>n</sup> started on 1st April 2022

Funds utilised  
1st April 2021 → 400000 } Remaining Funds invested temporarily @ 7%  
1st Sept. 2021 → 600000 }  
400000 + 600000

Sol<sup>n</sup>: B. cost to be Capitalised (1000000 x 9%) = 90000 (12m)  
(Entirely in specific Borrowings)  
No time weights

(-) Income on Temporary Investment = (17500)

← 600000 x 7% x 5/12  
Funds free till August  
April, May, June, July, August

B. cost Capitalised = 72500

## GENERAL BORROWINGS Refer illustration 8

All borrowings that are not specific represents General Borrowings.

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.

In case of General Borrowings, Capitalisation rate is calculated which is WEIGHTED AVG. of B. cost applicable to all OUTSTANDING General Borrowings.

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The Amount of B. cost Capitalises shall not exceed B. cost incurred during that period.

Capitalisation Rate =  $\frac{\text{Weighted Avg. B. cost on o/s Borrowings (Excl. specific Borrowings)}}{\text{Total o/s Borrowings (Excl. specific Borrowings)}}$

Ex:  
18% Bank loan (1st April 01) = 1000000 (General)  
16% Term loan (1st April 01) = 3000000 (General)  
14% Debentures (1st July) = 2000000 (const<sup>n</sup> of office Building) (specific)

Development activities on office building yet to start

On 1st April 01, const<sup>n</sup> of a plant began using existing borrowings  
Expenditure - 1st April 01 → 500000 x 16.5% x 12/12  
1st Jan 02 → 2500000 x 16.5% x 3/12

∴ Capitalisation Rate =  $18\% \times \frac{1000000}{1000000+3000000} + 16\% \times \frac{3000000}{1000000+3000000} = 16.5\%$

Borrowing costs = 500000 x 16.5% x 12/12 + 2500000 x 16.5% x 3/12  
= 82500 + 103125

Since in case of 14% Debenture, Development Activities not yet started.  
Therefore Capitalisation of B.Cost will not commence.  
B.Cost incurred will be charged to P/L.

$$60000 \times 7\% \times \frac{9}{12} = 17500$$

QA	→	1000000
(+) B.Cost	→	90000
(-) Adv	→	(17500)
		<u>1072500</u>

= 185625

Alternatively

$$\begin{aligned} \text{Interest lost (Total)} &= 1000000 \times 18\% + 2000000 \times 16\% \\ &= 180000 + 480000 \\ &= 660000 \end{aligned}$$

$$\begin{aligned} \therefore \text{Capitalisation rate} &= \frac{660000}{1000000 + 2000000} \times 100 \\ &= 16.5\% \quad \text{Weighted Avg. Bop. rate.} \end{aligned}$$

$$\begin{aligned} \therefore \text{B.Cost} &= 500000 \times 16.5\% \times \frac{9}{12} + 2500000 \times 16.5\% \times \frac{3}{12} \\ &= 82500 + 103125 \\ &= \underline{185625} \end{aligned}$$

B.Cost Eligible for Cap.  
500000 × 16.5%

$$\begin{aligned} &18\% \times \frac{1000000}{4000000} + 16\% \times \frac{2000000}{4000000} \\ &18\% \times \frac{1}{4} + 16\% \times \frac{3}{4} \\ &= 4.5\% + 12\% \\ &= \underline{16.5\%} \end{aligned}$$

Commencement of Capitalisation → Commencement Date

Commencement Date is the Date when Entity first meets ALL BELOW CONDITIONS

- It incurs Expenditure on the Asset.   
 (Expenditure means Payment of Cash, transfer of other Assets, Assumption of interest bearing liabilities)  
 Note Expenditure reduced by any progress payment received and grants received in connection with the Asset
- It incurs Borrowing costs
- It undertakes Activities necessary to prepare Asset for its intended use on sale.   
 Includes Technical and Administrative work prior to physical const<sup>n</sup>.  
 (E.g. obtaining permits prior to physical const<sup>n</sup>)  
 Excludes holding of Asset when no prod<sup>n</sup>/development that changes Asset's condition is taking place.  
 (E.g. B.Cost incurred while land is under development = Capitalise  
 B.Cost incurred while land acquired for building = Do not Capitalise }  
 Purpose is held without any development activity

Suspension of Capitalisation (In Genuine Cases, Capitalisation not suspended)

Capitalisation of B.Cost shall be suspended during extended periods in which Active Development of a Qualifying Assets suspended. (E.g. costs of holding partially completed Assets)

Capitalisation not suspended when TEMPORARY DELAY is a necessary part for getting Assets ready for its intended use on sale. (E.g. Capitalisation continues when high water levels delay const<sup>n</sup> of a bridge if such high water levels common in region involved.)

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

# Cessation of Capitalisation

An Entity should cease capitalising Borrowing Cost when **Substantially** all the activities are complete

Physical const<sup>n</sup> complete even though routine Administration work continues  
 (e.g. Minor Modification like Decoration etc.)  
 This indicates all activities substantially complete.

When Entity completes const<sup>n</sup> of a Qualifying Assets **in Parts**

Independent Floors



EACH PART is Capable of being used while const<sup>n</sup> on other parts continues

Cease Capitalisation of B. Cost on each such parts whose const<sup>n</sup> completes

1st, 2nd, 3rd Floor ready for use and Capable of being used independently  
 Cap. ceases for 1st, 2nd, 3rd Floor  
 Cap. continues for 4th & 5th Floor.

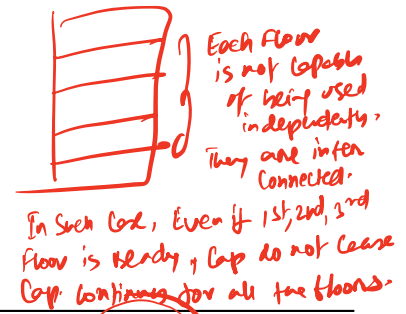
## DISCLOSURE

1. Amount of B. Cost Capitalise during the Period.
2. Capitalisation rate used.

Armani office (Part related)

EACH PART is not Capable of being used separately

Capitalisation continues until all parts are ready.



## Other Relevant Concepts:

1. Dividend Payable on shares classified as financial liabilities  
 E.g. Redeemable Pref. sh classified as financial liability

Meet the definition of B. Cost & Dividend can be Capitalised as Borrowing Cost.

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 ⇒ Capitalisation is done

In Own F/S ⇒ No Capitalisation (since another Co. who developed did not incur Borrowing Cost.)

However if another company has **Intra Group Borrowings**, then Capitalisation is done in its own financial statements.

3. For maturing inventories, it is sometimes difficult to determine when period of prod<sup>n</sup> ends. i.e. when inventories are being **'Held for Sale'** as opposed to being **'Held to Matur'**

(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.

Examples to Explain concepts-

To Construct Flat (5 yrs required)

↓  
Supplier  
↓

- Purchase land = 50L
- + Const = 90L
- (+) Int. Cost = 20L
- (+) Profit = 40L

200L

Sale to Customer  
for ₹ 200L

Pratik Sagati

Pratik Sagati Paid ₹ 200L to Purchase ready made flat

↓

Pratik Sagati Alternatively Can decide to self const flat

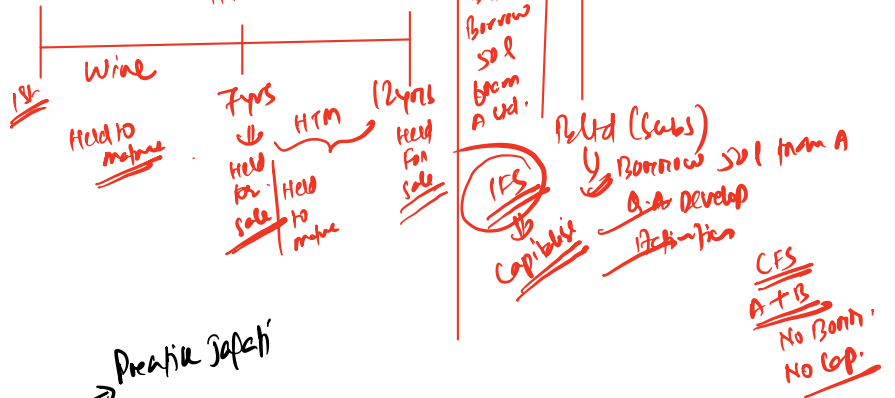
↓

- Purchase of land = 50L
- Const of land = 90L
- Int Cost Capitalised allowed as per Ind AC 23 = 20L ⇒ B. Cost Capitalised instead charging to P/L.

Note: opportunity lost Capitalisation not allowed.

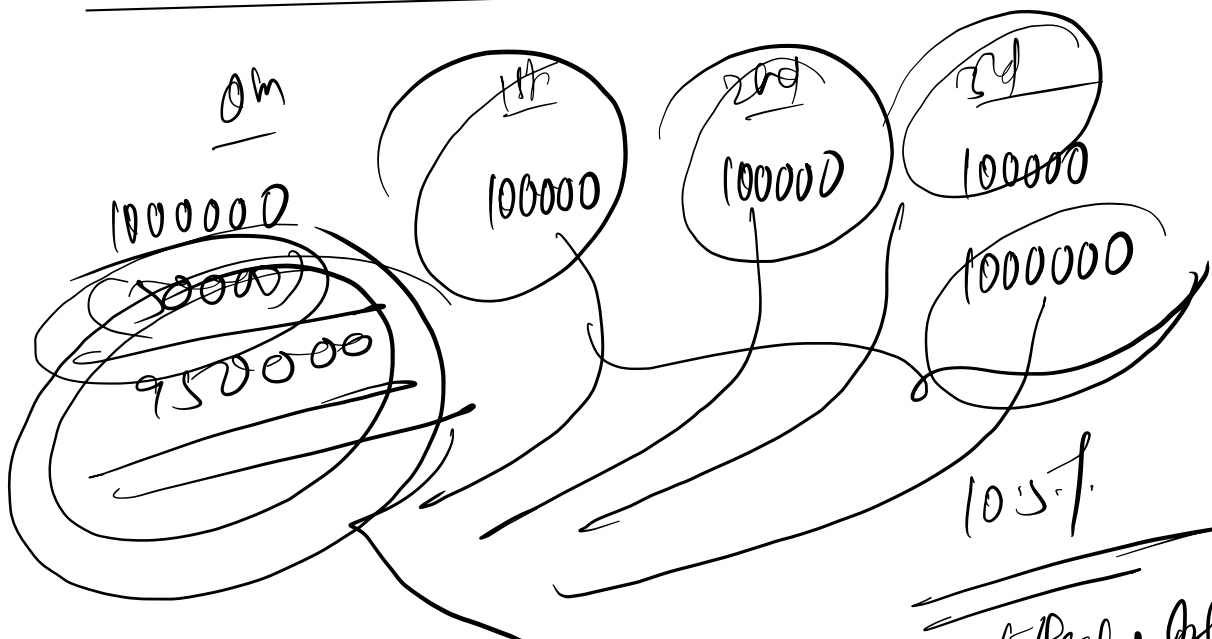
160L

No demonstration  
HFS ⇒ Cap. Rese.  
HTM ⇒ Cap. Contin.



Qualifying Assets.

Asset will take substantial period to get ready for intended use.



Effective Int. rate

## Specific

No time weight factor

Specific Int. rate in relation  
to specific Borrow

Does not matter when  
Funds are used. Entire B-cost  
will be capitalised without  
considering time weight

Temp. Inv Income on surplus  
fund adjusted with B-cost

## General

Time weight

W.A. Cap. rate.

It matters when funds are  
used and  
accordingly time  
weight factor  
is used.

No such concept  
of Temp. Inv.