

Exposure Draft

Accounting Standard (AS) 23

Borrowing Costs

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Accounting Standards Board
The Institute of Chartered Accountants of India

Exposure Draft

Accounting Standard (AS) 23

Borrowing Costs

(The Indian Accounting Standards (Ind AS), as notified by the Ministry of Corporate Affairs in February, 2015, have been applicable to the specified class of companies. For other class of companies, i.e., primarily the unlisted entities having net worth less than Rs. 250 crores, Accounting Standards, as notified under Companies (Accounting Standards) Rules, 2006, have been applicable. However, the Ministry of Corporate Affairs has requested the Accounting Standards Board of The Institute of Chartered Accountants of India (ICAI) to upgrade Accounting Standards, as notified under Companies (Accounting Standards) Rules, 2006, to bring them nearer to Indian Accounting Standards. Accordingly, the Accounting Standards Board, ICAI, initiated to upgrade these standards which will be applicable to all companies having net-worth less than Rs. 250 crores including non-corporate entities. While formulating these Accounting Standards, the Accounting Standards Board, ICAI, decided to maintain the consistency with the numbering of Standards of the Indian Accounting Standards).

Following is the Exposure Draft of the Accounting Standard (AS) 23, Borrowing Costs, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, for comments. The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

How to Comment

Comments can be submitted using one of the following methods so as to receive not later than 31st October, 2017:

1. *Electronically: Visit the following link*
<http://www.icai.org/comments/asb/>
2. *Email: Comments can be sent at* commentsasb@icai.in
3. *Postal: Secretary, Accounting Standards Board,*
The Institute of Chartered Accountants of India, ICAI Bhawan, Post
Box No. 7100, Indraprastha Marg, New Delhi – 110 002

Further clarifications on any aspect of this Exposure Draft may be sought by e-mail to asb@icai.in.

*(This Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)*

Core principle

- 1 **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.**

Scope

- 2 **An entity shall apply this Standard in accounting for borrowing costs.**
- 3 The Standard does not deal with the actual or imputed cost of equity, including preference share capital.
- 4 An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:
 - (a) a qualifying asset measured at fair value, for example, a biological asset within the scope of AS 41, *Agriculture*¹; or
 - (b) inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis.

Definitions

- 5 **This Standard uses the following terms with the meanings specified:**

***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 necessarily takes a substantial period of time to get ready for its intended use or sale.**

- 5A What constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.
- 6 Borrowing costs may include:

¹ AS 41, *Agriculture*, is under formulation.

- (a) interest expense calculated in accordance with AS 109, *Financial Instruments*²;
- (b) [Refer Appendix 1]
- (c) [Refer Appendix 1]
- (d) finance charges in respect of finance leases recognised in accordance with AS 19, *Leases*; and
- (e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

The application of this clause is illustrated in the Illustration given in Appendix A.

6A. With regard to exchange difference required to be treated as borrowing costs in accordance with paragraph 6(e), the manner of arriving at the adjustments stated therein shall be as follows:

- (i) **the adjustment should be of an amount which is equivalent to the extent to which the exchange loss does not exceed the difference between the cost of borrowing in local currency when compared to the cost of borrowing in a foreign currency.**
- (ii) **where there is an 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.**

7 Depending on the 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.

² AS 109, *Financial Instruments*, is under formulation.

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.

Recognition

- 8 **An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them.**
- 9 Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset. Such borrowing costs are capitalised as part of the cost of the asset when it is probable that they will result in future economic benefits to the entity and the costs can be measured reliably.

Borrowing costs eligible for capitalisation

- 10 The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. When an entity borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.
- 11 It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an entity is co-ordinated centrally. Difficulties also arise when a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other entities in the group. Other complications arise through the use of loans denominated in or linked to foreign currencies and from fluctuations in exchange rates. As a result, the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgement is required.
- 12 **To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.**
- 13 The financing arrangements for a qualifying asset may result in an entity obtaining borrowed funds and incurring associated borrowing costs before some

or all of the funds are used for expenditures on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.

- 14 To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.**
- 15 In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.

Excess of the carrying amount of the qualifying asset over recoverable amount

- 16 When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Standards.

Commencement of capitalisation

- 17 An entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:**
 - (a) it incurs expenditures for the asset;**
 - (b) it incurs borrowing costs; and**
 - (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.**
- 18 Expenditures on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of

interest-bearing liabilities. Expenditures are reduced by any progress payments received and grants received in connection with the asset (see AS 20, *Accounting for Government Grants*). The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalisation rate is applied in that period.

- 19 The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits prior to the commencement of the physical construction. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. 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 do not qualify for capitalisation.

Suspension of capitalisation

- 20 **An entity shall suspend capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset.**
- 21 An entity may incur borrowing costs during an extended period in which it suspends the activities necessary to prepare an asset for its intended use or sale. Such costs are costs of holding partially completed assets and do not qualify for capitalisation. However, an entity does not normally suspend capitalising borrowing costs during a period when it carries out substantial technical and administrative work. An entity also does not suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographical region involved.

Cessation of capitalisation

- 22 **An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.**
- 23 An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property

to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

- 24 **When an entity completes the construction of a qualifying asset in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.**
- 25 A business park comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being usable while construction continues on other parts. An example of a qualifying asset that needs to be complete before any part can be used is an industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

Disclosure

- 26 **An entity shall disclose:**
- (a) the amount of borrowing costs capitalised during the period.**
 - (b) [Refer Appendix 1]**

Appendix A

Illustration

Note: This illustration does not form part of the Accounting Standard. Its purpose is to assist in clarifying the meaning of paragraph 6 (e) of the Standard.

Facts:

XYZ Ltd. has taken a loan of USD 10,000 on April 1, 2015, for a specific project at an interest rate of 5% p.a., payable annually. On April, 2015, the exchange rate between the currencies was Rs. 62 per USD. The exchange rate, as at March 31, 2016, is Rs. 66 per USD. The corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of 11 per cent annum as on April, 2015.

The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 6(e) of AS 23:

- (i) Interest for the period = $\text{USD } 10,000 \times 5\% \times \text{Rs. } 66/\text{USD} = \text{Rs. } 33,000$.
- (ii) Increase in the liability towards the principal amount = $\text{USD } 10,000 \times (66-62) = \text{Rs. } 40,000$.
- (iii) Interest that would have resulted if the loan was taken in Indian currency = $\text{USD } 10,000 \times 62 \times 11\% = \text{Rs. } 68,200$.
- (iv) Difference between interest on local currency borrowing and foreign currency borrowing = $\text{Rs. } 68,200 - \text{Rs. } 33,000 = \text{Rs. } 35,200$.

Therefore, out of Rs.40,000 increase in the liability towards principal amount, only Rs.35,200 will be considered as the borrowing cost. Thus, total borrowing cost would be Rs.68,200 being the aggregate of interest of Rs.33,000 on foreign currency borrowings [covered by paragraph 6(a) of AS 23] plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of Rs.35,200. Thus, Rs.68,200 would be considered as the borrowing cost to be accounted for as per AS 23 and the remaining Rs.4,800 would be considered as the exchange difference to be accounted for as per Accounting Standard (AS) 21, *The Effects of Changes in Foreign Exchange Rates*.

In the above example, if the interest rate on local currency borrowings is assumed to be 13% instead of 11%, the entire exchange difference of Rs.40,000 would be considered as borrowing costs, since in that case the difference between the interest on local currency borrowings and foreign currency borrowings [i.e. Rs.47,600 (Rs.80,600 – Rs.33,000)] is more than the exchange difference of Rs.40,000. Therefore, in such a case, the total borrowing cost would be Rs.73,000 (Rs.33,000 + Rs.40,000) which would be accounted for under AS 23 and there would be no exchange difference to be accounted for under AS 21, *The Effects of Changes in Foreign Exchange Rates*.

Appendix 1

Note: This Appendix is not a part of the Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard (AS) 23 and the corresponding Indian Accounting Standard (Ind AS) 23, Borrowing Costs.

Comparison with Ind AS 23, *Borrowing Costs*

- 1 Paragraph 3 of Ind AS 23 has been modified in AS 23 so as to align the same with the terminology commonly used in India in context of preference share capital and presentation requirements in this regard prescribed in AS 109.
- 2 Paragraph 5A is added in AS 23 to provide guidance on ‘substantial period’.
- 3 Paragraph 6(a) of Ind AS 23 has been modified in AS 23 so as to provide that the interest expense to be calculated as per AS 109. The following paragraph numbers appear as ‘Deleted’ in Ind AS 23:

(i) paragraph 6(b)

(ii) paragraph 6(c)

In order to maintain consistency with paragraph numbers of Ind AS 23, the paragraph numbers are retained in AS 23.

- 4 In paragraph 6A(i) of AS 23, to make the terminology consistent with that used in AS 21, *The Effects of Changes in Foreign Exchange Rates*, and for ease of understanding by the users, the term ‘functional currency’ is replaced with the term ‘local currency.’.
- 5 It was decided that there is no need to issue AS corresponding to Ind AS 29, *Financial Reporting in Hyperinflationary Economy*, for non Ind-AS compliant companies. Accordingly, paragraphs 9 and 11 of Ind AS 23 have been modified in AS 23.
- 6 Paragraph 26(b) regarding disclosure of capitalization rate is deleted in AS 23.
- 7 Appendix A is added in AS 23 giving Illustration to illustrate the application of clause 6(e) of AS 23.