Group Ind AS Accounting Manual

ABC

**Table of** **Contents**

[**1.4. Borrowing costs** 2](#_Toc132388085)

[**1.4.1. Objective and scope:** 2](#_Toc132388086)

[**1.4.2. Definitions:** 2](#_Toc132388087)

[**1.4.3. Recognition and measurement:** 2](#_Toc132388088)

[***Capitalization rate:*** 3](#_Toc132388089)

[**1.4.4. Disclosure:** 9](#_Toc132388090)

[**1.4.5. GAAP differences between Ind AS and IFRS:** 9](#_Toc132388091)

# **1.4.** **Borrowing costs**

|  |  |
| --- | --- |
| **Description:** | **Borrowing costs** |
| **Reference:** | **Ind AS 23/ IAS 23** |
| **Purpose:** | **To ensure proper accounting of borrowing costs** |

## **1.4.1. Objective and scope:**

The objective of this accounting manual is to explain the requirements of Ind AS and highlight specific differences between Ind AS and IFRS, wherever applicable. This manual describes the accounting of borrowing costs in accordance with Ind AS.

The Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.

An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:

1. a qualifying asset measured at fair value, for example, a biological asset; or
2. inventories that are manufactured or otherwise produced, in large quantities on a repetitive basis.

## **1.4.2. Definitions:**

“*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.

“Borrowing Costs” are interest and other costs incurred in connection with borrowing of funds. It includes following:

* + - **Interest expenses** calculated as per effective interest rate method *(Refer accounting manual “Ind AS 109 – Financial Instruments”)*;
    - **Finance charges** in respect of leases *(Refer accounting manual “Ind AS 116 – Leases”)*;
    - **Exchange differences** arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

“*Qualifying Asset*” is an asset, which **necessarily takes substantial period to get ready** for its intended use or sale. (*12 months or more for installation or construction, for its intended use or sale from the date of acquisition)*

## **1.4.3. Recognition and measurement:**

The borrowing **cost shall be capitalized** when:

* + It is directly attributable to **acquisition, construction or production of qualifying asset**;
  + It is probable that it will **result in future economic benefits**; and
  + Cost can be **measured reliably**.

If the above criteria are **not satisfied**, then **it should be expensed**.

### ***Capitalization rate:***

*The process to calculate the capitalization rate is as follows:*

1. The utilisation of the sources and application of long-term funds will be ascertained on a year to date basis, every month.
2. The interest expense for the month for all the borrowings will be ascertained based on effective interest rate.
3. The interest expense will be plotted against each of the above borrowing including short-term borrowings and credit will be taken for surplus parked in short term investments together with interest thereon.
4. Based on the net interest and total utilised funds, an appropriate amount will be ascertained towards interest on qualifying capital work-in progress on a pro-rata based on qualifying CWIP divided by total utilization of the funds multiplied by the total interest expense for the period.
5. The above calculation will be updated every quarter on a year to date basis and the amount of capitalization will be ascertained based on quarterly balance of CWIP.
6. In case of subsidised rate loan from government, for the purpose of calculation of capitalization rate, market rate of borrowing is used.

*Capitalization of foreign exchange differences as borrowing costs:*

1. A quarterly estimate shall be made for foreign currency exchanges eligible for capitalization.
2. The foreign exchange fluctuation applicable on loans for the quarter shall be ascertained (e.g. restatement exchange difference on loan denominated in USD);
3. The amount of interest applicable for the foreign currency borrowing for the quarter shall be worked out (e.g. amount of interest calculated on USD loan);
4. The notional amount of interest for the quarter on borrowings in India of similar maturity shall be ascertained (e.g. interest is calculated at the market interest rate applicable in India on USD Loan converted into INR)
5. Amount of difference between (iii) and (ii) shall be ascertained (e.g. difference amount due to interest rate difference between India and South Africa)
6. Lower of (i) and (iv) shall be eligible for capitalization (e.g. difference amount can be capitalized only up to restatement exchange difference)
7. Where unrealized exchange loss is capitalized in previous quarter and subsequently there is a realized or unrealized gain in current quarter, the gain to the extent of the loss previously capitalized as borrowing cost should also be recognized as adjustment to borrowing cost, that is, deducted from borrowing costs.

*Note: The amount of borrowing costs capitalized shall not exceed the amount of cost incurred during the period.*

There may be situation where general borrowings are used for purchase of qualifying assets and the allocation of borrowing costs is difficult and a matter of judgement. In such situation, the group entities shall consult Corporate Finance Team for the purpose of allocation.

**[THIS SPACE IS INTENTIONALLY LEFT BLANK]**

Applicability of *Ind AS 23: Borrowing Costs*

N

N

N

N

Y

N

**Y**

Y

Y

Y

Y

Y

*Facts of the example -*

* **B** is a wholly owned subsidiary of **A** and **C** is a wholly owned subsidiary of **B**.
* **A** lends USD 200 from its **retained earnings** to **B** at an interest rate of 10% per annum.
* **B** further lends the USD 200 received from **A to C** atan interest rate of 8% per annum.
* The group **B** capitalizes interest costs at 7% and the borrowing cost in its subsidiaries’ books are capitalized on the same rate.
* Loan taken by **C** is for construction of a qualified asset and borrowing cost on the same can be capitalized.

>> In **standalone** financial statements of A, B and C –

1. **Interest income and expense** will accounted for normally in **profit or loss**.
2. **Loans** are recorded in the balance sheet at **amortised cost**.
3. **Borrowing costs** incurred on these loans are **capitalized** on in the qualifying assets.

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **In the standalone books of A** | **In the standalone books of B** | **In the books of C** |
| Interest Expense | No Interest expense | Interest expense (Dr) $20  Entity A (Cr) $20 | Interest expense (Dr) $16  Entity B (Cr) $16 |
| Capitalization of Borrowing Cost | No qualified asset | No qualified asset | Qualified Asset (Dr) $14  Interest expense (Cr) $14 |
| Interest Income | Entity B (Dr) $20  Interest Income (Cr) $20 | Entity C (Dr) $16  Interest Income (Cr) $16 |  |

>> In **consolidated** financial statements of A and B –

1. **In the consolidated books of B interest income, loans and borrowing costs** will be **eliminated** as the transactions are inter group **except** for borrowing costs incurred by company B**.**
2. **In the consolidated books of A interest income, loans, borrowing costs** **and** **capitalization** will be **eliminated** as the transactions are inter group and there are no borrowing incurred by A.

|  |  |  |
| --- | --- | --- |
| **Particulars** | **In the consolidated books of A** | **In the consolidated books of B** |
| Reversal of Interest Income and capitalization | Interest income (Dr) $20  Interest expense of B (Cr) $6  Qualified asset (Cr) $14 | Interest income (Dr) $16  Interest expense (Cr) $16 |
| Capitalization carry forwarded | Capitalization reversed due as the loan given by A was from its retained earnings so at group level there was no borrowing costs incurred. | Qualified asset to be carry forwarded from books of C. |

Company **B** is a 100% **subsidiary** of company **A**.

Entity B has have qualifying assets to capitalize the borrowing costs. The company, which is lending to its subsidiary, earns interest income on the same. How will the interest income, loans and borrowing costs will be accounted for in separate and consolidated financial statements?

>> In **standalone** financial statements of A, B –

* + - 1. **Interest income and expense** will accounted for normally in **profit or loss**.
      2. **Loans** are recorded in the balance sheet at **amortised cost**.
      3. The group A capitalizes **interest costs at 7%** and the borrowing cost in its subsidiaries’ books are capitalized on the same rate.

|  |  |  |
| --- | --- | --- |
| **Particulars** | **In the books of A** | **In the books of B** |
| Interest Expense | Interest expense (Dr) $20  Bank/Lender (Cr) $20 | Interest expense (Dr) $16  Bank/Entity A (Cr) $16 |
| Capitalization of Borrowing Cost | No qualifying asset. | Qualified Asset (Dr) $14  Interest expense (Cr) $14 |
| Interest Income | Entity B (Dr) $16  Interest Income (Cr) $16 | No interest income. |

>> In **consolidated** financial statements of A –

* + - 1. **Interest income, loans and borrowing costs** will be **eliminated** as the transactions are inter group **except** for borrowing costs incurred by company A**.**
      2. **Borrowing costs** **(7%)** capitalized by **company B** will **be carry forwarded in the consolidated books of A** as other transactions will be eliminated.

***Journal Entries***

Interest income (Dr) $16

Interest expense (Cr) $16

As per Ind AS 109, borrowings are financial liabilities and these are to be recorded at amortised cost. Processing fees incurred for these financial liabilities shall be recognised in Statement of profit and loss over the period of loan (i.e. the fees shall not be expensed out in full at the time when the fees are actually incurred).

The processing fees shall be considered as a part of total borrowings at the time of calculating effective interest rate for the borrowing.

(Please refer above explanation)

|  |  |
| --- | --- |
| **Particulars** | **Journal Entry** |
| Capitalization of borrowing cost | Borrowing Cost (Dr)  Bank/Party (Cr)  Capital Work in Progress (Qualified Asset) (Dr)  Borrowing cost (incurred for the qualified asset) (Cr)  Please refer the measurement criteria for the amount to be capitalized. |

|  |  |
| --- | --- |
| **Particulars** | **Treatment** |
| ***When, Carrying value >Recoverable amount*** | In this case, carrying amount is written down or written off in accordance with the requirement of *Ind AS 36 – Impairment of assets*. |
| ***Commencement of capitalization*** | The commencement date for capitalization is the date when **all** of the following conditions are met:   * + expenditures are **incurred for the asset**;   + **borrowing costs** are incurred; and   + necessary **activities are undertaken** to prepare the asset for its intended use or sale.   After the commencement date, the borrowing costs can be capitalized. |
| ***If any government grant is received towards the construction of the qualifying asset*** | Eligible expense for capitalization =  Expenditure incurred  (-) Grant received/progress payment  *(Refer accounting manual “Ind AS 20 - Accounting for Government Grants and Disclosure of Government Assistance)* |
| ***Suspension of capitalization*** | * Capitalization shall be suspended during extended periods in which active development of a qualifying asset is suspended. * Capitalization of borrowing costs are generally not suspended when substantial technical and administrative work is carried out and for temporary delay caused for getting an asset ready to use or sale. |
| ***Cessation of capitalization*** | * Capitalization shall be ceased when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. * When the construction of an asset is in parts and each part is independent of the other, then capitalization shall cease when the construction of that part is completed. |

## **1.4.4. Disclosure:**

Following shall be disclosed:

* the amount of borrowing costs capitalized during the period; and
* the capitalization rate used to determine the amount of borrowing costs eligible for capitalization.

## **1.4.5. GAAP differences between Ind AS and IFRS:**

There are no GAAP difference in borrowing costs.

|  |  |
| --- | --- |
| **Approval authority** |  |
| **Version Date** |  |
| **Revision due on** |  |