

## KCO BLOGS 2020

This blog is written by **Mr. Adil Ihsan**. Please read this blog and provide your valued comments

### IAS-23 (BORROWING COST)

#### Scope of IAS 23

An entity shall apply this standard in accounting for borrowing costs

Two types of assets that would otherwise be qualifying assets are excluded from the scope of IAS 23:

- Qualifying assets measured at fair value, such as biological assets accounted for under IAS 41 Agriculture
- Inventories that are manufactured or otherwise produced, in large quantities on a repetitive basis and that take a substantial period to get ready for sale.

#### Borrowing cost

Borrowing cost is the cost that is directly attributable to the acquisition, construction, or production of a qualifying asset is added to the cost of asset.

#### Qualifying Asset

Asset that require substantial period of time to get ready for its intended use.

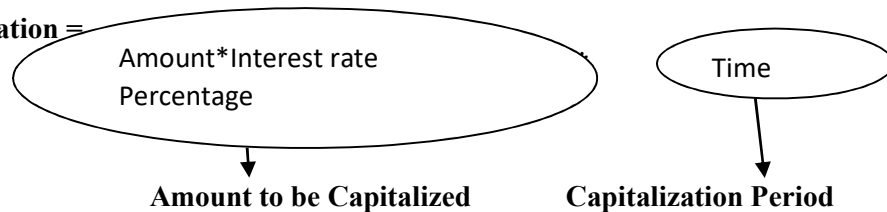
Time period should be at least in months. E.g Building Construction, Plant & Machinery, Internally Generated Intangible, Inventories.

**Borrowings include** → Loan, Bank Overdraft/Running Finance, Redeemable Preference Shares, Term Finance Certificate/Loan notes.

**Borrowing Costs** → Markup, Preference dividend, Processing Cost/Commitment fees, Discounts/Premium on redemption, Documentation charges.

**Recognizing Borrowing Costs** → Borrowing costs directly related to acquisition, contribution, construction & manufacturing of qualifying asset is capitalized and Other than that cost is recognized in Profit & loss.

**Formula to calculate Capitalization =**



## Capitalization Period

Capitalization period starts when all of the following conditions are met

- Entity incurs Expenditure on Assets. I.e. Payments
- Entity incurs borrowing cost. I.e. Loan Obtained
- Entity undertakes necessary Activities (Activities include Technical and administrative work prior to physical construction)

Capitalization period is stopped only if suspension of work is abnormal. If suspension of work is a part to complete the asset then capitalization period continues.

An entity shall not suspend capitalization when temporary delay is necessary or an entity carries out substantial technical and administrative work.

## Two types of borrowing

- ❖ Specific Borrowing
- ❖ General Borrowing

### Specific Borrowing

In specific borrowing loan is obtained specifically for that asset, so interest rate is applied on that specific loan with the boundary of capitalization and if a part of loan is invested somewhere and income is received from there then that temporary investment income received is reduced from the interest cost of capitalization.

### General Borrowing

The loan amount is obtained for other activities but it is also used for the construction of asset, so in that case capitalization to expenditure on asset is applied on time proportionate basis.

The amount which is used out of general borrowing is capitalized by applying the rate of interest.

If there is more than one loan then capitalization rate is the weighted average interest rate of general borrowing outstanding during the period.

For example	Loan	Interest	≤	WX
	240	11%		26.4
	360	14%		50.4
	200	16%		32

**Total                      800**

**108.8/800 = 13.6% → Capitalization Rate**

**Note:** All amounts are in millions

**108.8** →

Khilji & Co. Chartered Accountants

Islamabad | Islamabad II | Peshawar

ISB : Plot no 2 Mezzanine Floor Khumrial Plaza I & T Centre Street no 22, G-8/4, Islamabad

ISB: (DHA): Plot No 16, Second Floor, Sector A, Iqbal, Boulevard,

Defence Housing Authority, Phase II, Islamabad.

PES: Flat No. 203, Second Floor, Creative House, Phase 3 Chowk Main Jamrud Road, Peshawar

General loans do not remain same through the period. They may be obtained in different months so capitalization will start from the month when loan is obtained and capitalization conditions are met.

If any general loan is repaid then capitalization of borrowing cost on asset will be stopped.

If loan amount is not specified that it is general loan or specific loan then see if loan amount is much greater than amount spent on asset then it is general loan **OR** If amount spent is near to expenditure on asset then it is specific.

In general loan Investment income is not reduced from borrowing cost amount added in cost of asset rather than it is recorded as other income in profit & loss.

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