IAS 23 BORROWING ASSETS

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IAS 23 BORROWING COST

OBJECTIVE

The objective of IAS 23 is to prescribe the accounting treatment of borrowing cost which includes-

- Interest on bank overdraft and borrowings
- Finance charges on finance leases
- Exchange differences on foreign currency borrowings.

DEFINITIONS

Borrowing cost include-

- Interest expense calculated by the effective interest method under IAS 39.
- Finance charges in respect of finance leases recognized in accordance with IAS 17 leases.
- And exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to the interest costs.

A qualifying asset is an asset that takes a substantial period of time to get ready for its intended use or sale that could be property, plant, and equipment and investment property during the construction period.

SCOPE

Two types of asset 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.

MEASUREMENT

- Capitalization should commence when expenditure are being incurred and activities that are necessary for making the asset or use or sale are in progress.
- Capitalization should be suspended when during period when active development is suspended.
- Capitalization is ceased when all the activities for use or sale of assets are completed.

RECOGNITION

Borrowing cost that are directly attributable to the-

- Acquisition
- Construction
- Or production of a qualifying asset

form part of the cost of the asset and therefore should be capitalized.

➢ Other than above borrowing cost are recognized as expense.

When funds are **borrowed specifically**, cost for capitalization are-

Actual cost incurred (less) any income earned on the temporary investment of such borrowing

If funds are **borrowed generally :** the amount of borrowing cost eligible for capitalization are determined by applying a **capitalization rate.**

DISCLOSURES

- Amount of borrowing cost capitalized during the period.
- Capitalization rate used.

ILLUSTRATIVE DISCLOSURES

1. A construction company began construction of homes .The construction cost is expected to take 3.5 yrs. It is financed by issuance of bonds for 700000 at 12% per annum. The bonds were issued at the beginning of the construction. The bonds carry 1.5% issuance cost.

   Solution :

   the borrowing cost capitalized will be 84000(700000*12%) and 3000(700000*1.5/100*3.5)

   the interest component will be 87000(84000+3000).

2. ABC has the following loans in the beginning and the end of the year 20X6.

   10% bank loan repayable 2008- 120 AED

   9.5% bank loan repayable 2009-80 AED

   ABC began construction with the existing borrowing cost. Expenditure drawn on construction as on 1st January 20X6, AED 20 and on 1st October 2006.

   Calculate weighted average rate(W.A.R)

   W.A.R= (10% * 120/120+80) + (9.5% * 80/120+80)

   The capital rate is therefore= 9.8%

   (30*9.8%)+ (20*9.8*3/12)= 3.43 ans.