Exposure Draft

Accounting Standard (AS) 16 (Revised)

(Corresponding to IAS 23)

Borrowing Costs

(Last date for Comments: August 10, 2009)

Issued by
Accounting Standards Board

The Institute of Chartered Accountants of India

Exposure Draft

Accounting Standard 16 (Revised) (Corresponding to IAS 23)

BORROWING COSTS

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Exposure Draft

Accounting Standard 16 *(revised)*[1]
(Corresponding to IAS 23)

Borrowing Costs

Following is the Exposure Draft of the Accounting Standard (AS) 16 (Revised), 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.

Comments should be submitted in writing to the Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to be received not later than ***August 10, 2009****. Comments can also be sent by e-mail at edcommentsasb@icai.org or asb@icai.org.*

(This Exposure Draft of the revised Accounting Standard includes paragraphs set in ***bold*** *type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. This Exposure Draft of the revised Accounting Standard should be read in the context of its objective and the Preface to the Statements of Accounting Standards[2]).*

[1] This Exposure Draft is issued pursuant to the decision to converge with IFRSs in respect of accounting periods commencing on or after April 1, 2011. All existing Accounting Standards and new Accounting Standards which are referred to in this Exposure Draft are also being revised or formulated, as the case may be, to converge with IFRSs from the aforesaid date. References to the other standards may be viewed accordingly.

[2] Attention is specifically drawn to paragraph 4.3 of the Preface, according to which accounting standards are intended to apply only to items which are material.

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 preferred capital not classified as a liability.

4 (a) An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value, for example, a biological asset;

(b) An entity shall not apply the standard to borrowing costs directly attributable to the acquisition, construction or production of 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.**

6 Borrowing costs may include:

(a) interest expense calculated using the effective interest rate method as described in AS 30 *Financial Instruments: Recognition and Measurement*;

(b) [deleted by IASB]

(c) [deleted by IASB]

(d) finance charges in respect of finance leases recognised in accordance with AS 19 (Revised) *Leases*; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

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.

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. When an entity applies AS… *Financial Reporting in Hyperinflationary Economies*, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period in accordance with paragraph 21 of that Standard.

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, when the group operates in highly inflationary economies, 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 12 (Revised) *Accounting for Government Grants and Disclosure of Government Assistance*). 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; and

(b) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Transitional provisions

27 When application of this Standard constitutes a change in accounting policy, an entity shall apply the Standard to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after the effective date.

28 [Deleted by ICAI]

Effective date

29 An entity shall apply this Accounting Standard for accounting periods commencing on or after 1st April 2011 and will be mandatory in nature[3] from that date.

29A [Deleted by ICAI]

Withdrawal of AS 16 (issued 2000)

30 This Standard supersedes AS 16 *Borrowing Costs* (issued 2000).

[3] This implies that, while discharging their attest function, it will be the duty of the members of the Institute to examine whether this Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from this Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

Appendix A:

References to matters contained in other Accounting Standards

This Appendix is an integral part of Accounting Standard 16 (Revised).

1. Appendix ----(*Changes in Existing Decommissioning, Restoration and Similar Liabilities*) (corresponding to IFRIC 1) contained in AS 10 *Property, Plant and Equipment* (revised) makes reference to this Standard also.

2. Appendix A (*Service Concession Arrangements* (Corresponding to IFRIC 12) contained in AS 7 (revised), *Construction Contracts*, makes reference to this Standard also.

Appendix B

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) 16 (Revised) and the corresponding International Accounting Standard (IAS) 23, Borrowing Costs.

Comparison with IAS 23, *Borrowing Costs*

As per paragraph 4 of IAS 23, " An entity **is not required** to apply the Standard to borrowing costs that are directly attributable to the acquisition, construction or production of inventories that are manufactured or otherwise produced in large quantities on a repetitive basis". (Emphasis supplied). Accordingly, IAS 23 does not specifically prohibit an entity to apply the Standard to such inventories. The exposure draft of revised AS 16, on the other hand, specifically states that an entity shall not apply this Standard to such inventories in view of the apparent intention of IASB in this regard as contained in paragraph BC 6 of the Basis for Conclusions accompanying IAS 23.

Appendix C

Note: This Appendix is provided to bring out the major differences between the exposure draft of revised AS 16 and existing AS 16(Issued 2000) with a view to facilitate commentators in sending their comments on the exposure draft of revised AS 16.

Major differences between the exposure draft of AS 16 (revised), *Borrowing Costs*, and existing AS 16 (issued 2000)

(i) The exposure draft of revised AS 16 does not require an entity to apply this standard to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value, for example, a biological asset whereas the existing AS 16 does not provide for such scope relaxation.

The exposure draft of revised AS 16 excludes the application of this Standard to borrowing costs directly attributable to the acquisition, construction or production of inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis whereas existing AS 16 does not provide for such scope relaxation and is applicable to borrowing costs related to all inventories that require substantial period of time to bring them in saleable condition.

(ii) As per existing AS 16, Borrowing Costs, inter alia, include the following:

(a) interest and commitment charges on bank borrowings and other short-term and long-term borrowings;
(b) amortisation of discounts or premiums relating to borrowings;
(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

In the exposure draft of revised AS 16, item (a) above has been amended to calculate the interest expense using the effective interest rate method as described in AS 30 *Financial Instruments: Recognition and Measurement*. Items (b) and (c) above have been deleted, as some of these components of borrowing costs are broadly equivalent to the components of interest expense calculated using the effective interest rate method.

(iii) Existing AS 16 gives explanation for meaning of ‘substantial period of time’ appearing in the definition of the term ‘qualifying asset’. It also gives explanation for computation of exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to interest costs. This explanation is also illustrated. Both these explanations and the illustration are not included in the exposure draft of revised AS 16.

(iv) The exposure draft of revised AS 16 provides that when *the Standard on Financial Reporting in Hyperinflationary Economies* is applied, part of the borrowing costs that compensates for inflation should be expensed as required by that Standard (and not capitalised in respect of qualifying assets). The existing AS 16 standard does not contain a similar clarification because at present, in India, there is no Standard on *Financial Reporting in Hyperinflationary Economies.*

(v) The exposure draft of revised AS 16 specifically provides that 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 while in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings. This specific provision is not found in the existing AS 16.

(vi) The exposure draft of revised AS 16 requires disclosure of capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation. The existing AS 16 does not have this disclosure requirement.

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