

Overview on Exposure Drafts of AS 23 *Borrowing Costs* and AS 24 *Related Party Disclosures*



ICAI proposes to issue new accounting standards on borrowing costs and related party disclosures to incorporate the key principles of corresponding Ind AS relating to borrowing costs and related party disclosures. These new standards shall be applicable to entities to whom the requirements of Ind AS do not apply. In this article, the author endeavours to provide an overview of the requirements contained in the Exposure Drafts on AS 23 and AS 24 and also highlight key differences between: Exposure Drafts and the corresponding existing Accounting Standards, i.e. AS 16 and AS 18, notified under the Companies (Accounting Standard) Rules, 2006 (the 'AS Rules'); and EDs and the corresponding existing Indian Accounting Standards, i.e. Ind AS 23 and Ind AS 24, notified under the Ind AS Rules. Read on...



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Background

Accounting Standard Board (ASB) of The Institute of Chartered Accountants of India (ICAI) issued the Exposure Draft (ED) of Accounting Standard (AS) 23 *Borrowing Costs* and Accounting Standard (AS 24) *Related Party Disclosures*, in October 2017. These two EDs have been issued to align the existing accounting standards namely AS -16 *Borrowing Costs* and AS -18 *Related*

Party Disclosures to the corresponding Indian Accounting Standards (Ind AS) as notified by the Ministry of Corporate Affairs (MCA) under the Companies (Indian Accounting Standards) Rules, 2015 (the 'Ind AS Rules'). The AS 23 *Borrowing Costs* and AS 24 *Related Party Disclosures* will be applicable to class of entities (including non-corporate entities) to whom the Ind AS rules are not applicable.

Let us understand the requirements of ED on AS 23 *Borrowing Costs* and ED on AS 24 *Related Party Disclosures* and how it impacts the reporting requirements for entities to whom these EDs are expected to be applicable.

ED on AS 23 *Borrowing Costs*

A) Overview of requirements of ED on AS 23

1. **Scope of the Standard:** The entities to whom the AS rules are applicable will be required to apply this standard for accounting for borrowing costs except for the borrowing costs directly attributable to the acquisition, construction or production of:
 - a) Qualifying asset measured at fair value, for example, a biological asset within the scope of Exposure Draft of AS 41, *Agriculture*
 - b) Inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis.
2. **Key definitions under ED on AS 23:**
 - a) *Borrowing costs:* As per ED on AS 23, borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds and may include the following:
 - interest expense calculated in accordance with AS 109, *Financial Instruments*
 - finance charges in respect of finance leases recognised in accordance with AS 19, *Leases*
 - exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs
 - b) *Qualifying assets:* As per ED on AS 23, a qualifying asset is an asset that necessarily takes a substantial period of time to get

ready for its intended use or sale. It further states that 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.

3. Recognition of borrowing costs

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset provided it is probable that they will result in future economic benefits to the entity and the costs can be measured reliably.
- In case of funds borrowed specifically for the purposes of acquisition or construction of a qualifying assets, actual borrowing costs on such specific borrowing as reduced by the amount of investment income on the temporary investment of those borrowings shall be eligible for capitalisation.
- In case the funds are borrowed generally the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures incurred for the purposes of acquisition or construction of a qualifying assets provided that 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. The capitalisation rate shall be the weighted average of the borrowing costs applicable to the general borrowings of the entity outstanding during the period.

4. Commencement of Capitalisation:

Entity shall commence capitalisation of borrowing costs when it first meets all the following conditions:

- (a) entity incurs borrowing costs and expenditures for the qualifying asset and
- (b) entity undertakes activities that are necessary to prepare the asset for its intended use or sale.

Accounting

5. Suspension and Cessation of capitalisation of borrowing costs:

- An entity shall suspend capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset unless temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.
- 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. 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.

- 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.

B) Key Differences between ED on AS 23, AS 16 and Ind AS 23

Following table highlights the key differences between ED on AS 23, AS 16 and Ind AS 23:

Particulars	ED on AS 23	AS 16	Ind AS 23
Scope of Application	ED on AS 23 excludes from its scope borrowing costs directly attributable to the acquisition, construction or production of : a) Qualifying asset measured at fair value, for example, a biological asset within the scope of Exposure Draft of AS 41, <i>Agriculture</i> or b) Inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis.	AS 16 does not prescribe any such scope exclusions	Same as ED on AS 23
Definition of Qualifying assets	ED on AS 23 states that a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. It states that 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.	Same as ED on AS 23	Ind AS 23 defines qualifying assets as an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. It does not prescribe any time period which would ordinarily be considered as substantial period of time as is the case under AS 16 and ED on AS 23. Determination of substantial period is based on management professional judgement.

Particulars	ED on AS 23	AS 16	Ind AS 23
Components of borrowing costs	Borrowing costs includes interest expense calculated in accordance with AS 109, <i>Financial Instruments</i> . Interest expenses calculated under AS 109 is expected to include impact for amortisation of premium/discounts and ancillary costs incurred in connection borrowings and hence those are not separately specified as in case of AS 16.	Borrowing costs under AS 16 includes interest and commitment charges on borrowings, amortisation of discounts or premiums relating to borrowings and amortisation of ancillary costs incurred in connection with the arrangement of borrowings.	Same as ED on AS 23
Borrowing of Group	ED on AS 23 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.	AS 16 does not prescribe inclusion of borrowing of the entire group for calculation of weighted average of the borrowing costs.	Same as ED on AS 23
Disclosures	ED on AS 23 requires disclosure for the amount of borrowing costs capitalised during the period.	Same as ED on AS 23	Ind AS 23 requires disclosure for : 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.

ED on AS 24 *Related Party Disclosures*

A) Overview of requirements of ED on AS 24

- i. **Scope of the standard:** AS 24 will be applied in identifying & reporting related party relationships and transactions between a reporting entity and its related parties in the financial statements of reporting entity and to the consolidated financial statements presented by a holding Company.
 - ii. Standard deals only with related party relationships as described below:
 - a) entities that directly or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting entity (this includes holding companies, subsidiaries and fellow subsidiaries);
 - b) associates and joint ventures of the

Accounting

reporting entity and the investing party or venturer in respect of which the reporting entity is an associate or a joint venture;

- c) individuals owning, directly or indirectly, an interest in the voting power of the reporting entity that gives them control or significant influence over the entity, and relatives of any such individual;
- d) key management personnel and relatives of such personnel; and
- e) entities over which any person described in (c) or (d) is able to exercise significant influence. This includes entities owned by directors or major shareholders of the reporting entity and entities that have a member of key management in common with the reporting entity.

iii. Disclosure Requirements under AS 24:

ED on AS 24 requires following disclosures in the financial statements:

- a) Name of the related party and nature of the related party relationship where control exists shall be disclosed irrespective of whether or not there have been transactions between the related parties.
- b) If there have been transactions between related parties, during the existence of a related party relationship, the reporting entity shall disclose the following:
 - i) Name of the transacting related party and description of the relationship between the parties;
 - ii) Description of the nature and amounts of transactions with related parties
 - iii) Amounts of outstanding items pertaining to related parties at the balance sheet date, provisions for doubtful debts due from such parties at that date and amounts written off or written back in the period in respect of debts due from or to related parties.
- iv) Any other elements of the related party transactions necessary for an understanding of the financial statements. An example of such a disclosure would be an indication that the transfer of a major asset had taken place at an amount materially different from that obtainable on normal commercial terms.

- c) ED on AS 24 provides that items of a similar nature may be disclosed in aggregate by type of related party except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting entity. However, material related party transactions, which are in excess of 10% of total related party transaction of same type or of the nature that are not entered into in the normal course of the business of the reporting entity, are required to be shown separately.

ED on AS 24 provides that items of a similar nature may be disclosed in aggregate by type of related party except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting entity.

iv. Exemptions from Disclosure Requirements under AS 24:

ED on AS 24 provides exemptions from disclosure requirements of related party transactions and outstanding balances including commitments with

- a) state related entity that has control or joint control of or significant influence over the reporting entity and
- b) another entity which is under control, joint control or significant influence of state related entity which also controls, have joint control or exercises significant influence over the reporting entity.

State-related entity is defined in AS 24 as an entity that is controlled, jointly controlled or significantly influenced by the Central, State, and/or any local Government.

In situations where the reporting entity applies the above exemption, it shall disclose the following about the transactions, related outstanding balances & commitments:

- (a) Name of the state-related entity and the nature of its relationship with the reporting entity;
- (b) Nature and amount of transaction on

aggregate basis to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements.

B) Key Differences between ED on AS 24, AS 18 and Ind AS 24

Following table highlights the key differences between ED on AS 24, AS 18 and Ind AS 24:

Particulars	ED on AS 24	AS 18	Ind AS 24
Related Party Definition	<p>Under ED on AS 24 Related party is defined as parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.</p> <p>ED on AS 24 refers to the definition of the terms 'control', 'significant influence', 'associate', 'joint control' and 'joint-venture' as contained in the relevant Accounting Standards.</p> <p>ED on AS 24 deals only with related party relationships described in (a) to (e) below:</p> <p>(a) entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting entity (this includes holding companies, subsidiaries and fellow subsidiaries);</p> <p>(b) associates and joint ventures of the reporting entity and the investing party or venturer in respect of which the reporting entity is an associate or a joint venture;</p> <p>(c) individuals owning, directly or indirectly, an interest in the voting power of the reporting entity that gives them control or significant influence over the entity, and relatives of any such individual;</p> <p>(d) key management personnel and relatives of such personnel; and</p> <p>(e) entities over which any person described in (c) or (d) is able to exercise significant influence. This</p>	<p>Same as ED on AS 24 except that the definition of the term 'control', 'significant influence', 'associate', 'joint control' and 'joint-venture' are specified in AS 18 itself.</p>	<p>Under Ind AS 24, a related party is a person or entity that is related to the reporting entity.</p> <p>(a) A person or a close member of that person's family is related to a reporting entity if that person:</p> <p>(i) has control or joint control of the reporting entity;</p> <p>(ii) has significant influence over the reporting entity; or</p> <p>(iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.</p> <p>(b) An entity is related to a reporting entity if any of the following conditions applies:</p> <p>(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).</p> <p>(ii) One entity is an associate or joint venture of the other entity or an associate or joint venture of a member of a group of which the other entity is a member.</p> <p>(iii) Both entities are joint ventures of the same third party.</p> <p>(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.</p>

Accounting

Particulars	ED on AS 24	AS 18	Ind AS 24
	<p>includes entities owned by directors or major shareholders of the reporting entity and entities that have a member of key management in common with the reporting entity.</p> <p>ED on AS 24 refers to the definition of the terms 'control', 'significant influence', 'associate', 'joint control' and 'joint-venture' as contained in the relevant Accounting Standards.</p>		<p>(v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.</p> <p>(vi) The entity is controlled or jointly controlled by a person identified in (a) above.</p> <p>(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity or of a parent of the entity.</p>
Government related entity	<p>ED on AS 24 provides partial exemption from disclosures requirements in case of <u>state related entity</u>. Refer para A (iv) above for details.</p>	<p>No disclosure is required in the financial statements of <u>state-controlled enterprises</u> as regards related party relationships with other state-controlled enterprises and transactions with such enterprises. State-controlled enterprise is defined as an enterprise which is under the control of the Central Government and/or any State Government(s).</p> <p>The above exemption is not applicable in case of enterprises where government exercises significant influence or joint control.</p>	<p>Ind AS 24 also provides similar partial exemption from disclosure requirements as mentioned in ED on AS 24 for related party transactions and outstanding balances including commitments with :</p> <p>i) government that has control or joint control of, or significant influence over, the reporting entity; and</p> <p>ii) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.</p> <p>ED on AS 24 refers to state related entity whereas Ind AS 24 refers to Government and Government related entity which are defined under Ind AS 24 as:</p> <p>a) Government refers to government, government agencies and similar bodies whether local, national or international.</p> <p>b) Government-related entity is an entity that is controlled, jointly controlled or significantly influenced by a government.</p>

Particulars	ED on AS 24	AS 18	Ind AS 24
Key Management Personnel (KMP)	<p>ED on AS 24 defines KMP as Key Management Personnel are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting entity. It also states that in the case of a company, the managing director(s), whole time director(s), manager, and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.</p> <p>ED on AS 24 covers KMP of the reporting entity only and does not extend to KMP of parent or an entity or a group providing KMP services to the reporting entity or parent of reporting entity.</p>	<p>Definition of KMP under AS 18 is same as ED on AS 24. Explanation to para 14 of AS 18 further states that a non-executive director of a company is not considered as a key management person under AS 18 by virtue of merely his being a director unless he has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.</p>	<p>Ind AS 24 defines KMP as Key Management Personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director <u>(whether executive or otherwise) of that entity.</u></p> <p>Under Ind AS 24, members of key management personnel of parent of the reporting entity or entity, or any member of a group of which it is a part, providing key management personnel services to the reporting entity or to the parent of the reporting entity is also considered as a related party of the reporting entity.</p>
KMP Disclosures	<p>Compensation to KMP is required to be disclosed on an aggregated basis.</p>	<p>Same as ED on AS 24</p>	<p>Ind AS requires disclosure of compensation of KMP in the following categories: a) Short term employee benefits b) post-employment benefits c) Other long term employee benefits d) Termination benefits and e) Share based payment.</p>
Post-employment benefit plans	<p>ED on AS 24 does not specify Post – employment benefit plans for the benefit of employees of either the reporting entity or an entity related to the reporting entity as related party.</p>	<p>Same as ED on AS 24</p>	<p>Ind AS 24 specify post-employment benefit plans for the benefit of employees of either the reporting entity or an entity related to the reporting entity as related party.</p>
Disclosure of commitments	<p>ED on AS 24 requires disclosures of commitments with related parties.</p>	<p>Under AS 18, there is no requirements to disclose commitments with related parties.</p>	<p>Ind AS 24 requires disclosure of commitments with related parties to do something if a particular event occurs or does not occur in the future, including executory contracts (recognised and unrecognized).</p>

Conclusion

ICAI's intent to align the existing Accounting Standards notified under AS rules with Ind AS is a welcome effort to improve the consistency of financial reporting framework for the unlisted companies and non-corporate entities (for whom the Ind AS rules are not applicable) with the companies governed by Ind AS rules.

Once the revised AS on above topics become applicable, entities would need to evaluate the changes to the existing Accounting Standards and consider necessary updation to their existing systems, controls, books and records to gather information to ensure compliance with those standards. ■