FAR-1 — FINANCIAL ACCOUNTING & REPORTING 1

Topic: BORROWING COSTS — IAS 23

1 TOPIC OVERVIEW

WHAT IS IT?
IAS 23 prescribes the accounting for interest and other costs incurred in connection with borrowing funds — specifically when such costs must be added to the cost of an asset instead of expensed.

WHY IMPORTANT?
Determines whether finance cost hits profit or loss immediately or is capitalised into a qualifying asset's cost — directly affecting reported profit, asset value and depreciation in future years.

CORE PRINCIPLE
Borrowing costs directly attributable to acquiring, constructing or producing a qualifying asset are capitalised as part of that asset's cost. All other borrowing costs are expensed as incurred.

2 KEY DEFINITIONS

Borrowing costs: Interest and other costs incurred in connection with borrowing of funds — interest expense (effective interest method), loan processing fees, commissions, documentation charges, legal charges, and exchange differences on foreign currency borrowings.

Not a borrowing cost: Actual/imputed cost of equity (incl. preferred share capital not classified as a liability) — dividends are never a borrowing cost.

Qualifying asset: An asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Specific borrowings: Funds borrowed specifically for the purpose of obtaining a qualifying asset.

General borrowings: Funds borrowed generally and used for a qualifying asset (or other operating needs) — not raised for one specific asset.

Capitalisation rate: Weighted average of borrowing costs applicable to all general borrowings outstanding during the period.

3 QUALIFYING ASSET — RECOGNITION TEST

Does the asset necessarily take a SUBSTANTIAL PERIOD OF TIME to get ready for intended use or sale?

▼

✔ CAN BE QUALIFYING ASSETS

- Inventories (IAS 2) with long maturing/production periods
- Manufacturing plants (IAS 16)
- Power generation facilities (IAS 16)
- Intangible assets (IAS 38)
- Investment properties (IAS 40)

✘ NEVER QUALIFYING ASSETS

- Financial assets (cash, investments, etc.)
- Inventories manufactured/produced routinely in large quantities over a short period
- Assets ready for intended use or sale when acquired

WORKED CHECK [Example 01 pattern]
A bridge taking 6 years, a power plant taking 10 months, a customer-order machine taking 11 months, and an office building taking 8 months → **all qualifying assets** (substantial period). Mass-produced integrated circuits (short cycle, high volume) and equipment usable immediately on delivery → **not** qualifying assets.

4 RECOGNITION RULE — CAPITALISE OR EXPENSE?

CAPITALISE (as part of asset cost)	Borrowing costs **directly attributable** to acquisition/construction/production of a qualifying asset — i.e. costs that would have been avoided if the expenditure on the asset had not been made — AND (a) probable future economic benefits will flow to the entity, and (b) the cost can be measured reliably.
EXPENSE (in period incurred)	All other borrowing costs — i.e. those not directly attributable to a qualifying asset (including borrowing costs on non-qualifying assets, or general finance costs unrelated to any construction).

MEASUREMENT — SPECIFIC & GENERAL BORROWINGS

5 SPECIFIC BORROWINGS — AMOUNT ELIGIBLE FOR CAPITALISATION

BORROWING COST ELIGIBLE FOR CAPITALISATION (SPECIFIC LOAN)

Actual borrowing costs incurred on that borrowing during the period – Temporary investment income on the unused funds

WORKED LOGIC [Example 02 pattern]

Rs. 10m borrowed @15% for the whole period, but Rs. 7m of it sat idle for 1 month earning 9% before being paid to the contractor → capitalise **[10m × 15% × time] – [7m × 9% × 1/12]**. Only income earned *during the qualifying/temporary-investment period* is netted off; income earned *before* construction/borrowing period begins is taken to P&L as investment income, not netted.

6 GENERAL BORROWINGS — AMOUNT ELIGIBLE FOR CAPITALISATION

CAPITALISATION RATE

Borrowing costs incurred on general borrowings ÷ Weighted average general borrowings outstanding

COST ELIGIBLE FOR CAPITALISATION

Σ (Expenditure on qualifying asset × Capitalisation rate × time)

CAP ON CAPITALISATION

Borrowing costs capitalised during a period must **never exceed** the total actual borrowing costs incurred during that period. Specific borrowings are excluded from the general-pool weighted average.

7 JOURNAL ENTRIES — CAPITALISATION vs EXPENSING

Capitalised borrowing cost (added to qualifying asset)		
Qualifying asset (capital work in progress)	✓	
Bank / Interest payable / Borrowing cost		✓
Non-capitalised borrowing cost (expensed as incurred)		
Finance cost / Borrowing cost expense (P&L)	✓	
Bank / Interest payable		✓
Temporary investment income on unused specific-loan funds		
Bank / Receivable	✓	
Qualifying asset (netted off during capitalisation period) / Investment income (P&L, if outside the capitalisation period)		✓

8 CALCULATION ROADMAP — BORROWING COST QUESTIONS

1. **Identify specific vs general borrowings** →
2. **Confirm qualifying asset & capitalisation period dates** →
3. **Compute borrowing cost incurred (time-apportioned)** →
4. **Deduct temporary investment income (specific) or apply cap. rate (general)** →
5. **Exclude suspension period(s)** →
6. **Capitalise into asset cost; balance to P&L**

ADD / DEDUCT QUICK REFERENCE

ADD to asset cost: borrowing cost incurred on specific/general funds during the capitalisation period. **DEDUCT** from capitalisable cost: temporary investment income (specific borrowings only), progress payments received, grants received. **TRANSFER/CAPITALISE**: net eligible amount → qualifying asset. **EXPENSE**: borrowing costs incurred outside the capitalisation period (before commencement, during suspension, after completion) and all non-qualifying-asset borrowing costs.

9 FINANCIAL STATEMENT IMPACT

STATEMENT OF PROFIT OR LOSS

- Finance cost — only the non-capitalised portion of borrowing cost
- Investment income — temporary investment income earned before the capitalisation period begins (not netted)
- Borrowing cost during suspension periods — expensed

STATEMENT OF FINANCIAL POSITION

- Qualifying asset (capital work in progress / non-current asset) — cost includes capitalised borrowing cost
- Loan / borrowing — non-current or current liability per repayment terms

CAPITALISATION PERIOD, DISCLOSURE & QUICK RECAP

10 CAPITALISATION PERIOD — 3-STAGE DECISION TREE

① COMMENCEMENT	Begins on the date ALL THREE are met: (a) expenditure on the asset incurred; (b) borrowing costs incurred; (c) activities necessary to prepare the asset for use/sale are underway (includes technical/admin work like obtaining permits — not just physical construction).
② SUSPENSION	Suspend during **extended periods** in which active development is suspended. Do **NOT** suspend for substantial technical/admin work, or for a temporary delay that is a necessary part of getting the asset ready (e.g. usual high-water-level delays common to the region).
③ CESSATION	Ceases when substantially all activities to prepare the asset for use/sale are complete (physical construction done, even if routine admin continues, or only minor finishing/decoration remains). For assets completed in **separately usable parts**, cease per part as each part is substantially complete; for assets needing full completion before any part can be used (e.g. a steel mill), cease only when the whole asset is complete.

11 EXPENDITURE ON QUALIFYING ASSET — ADJUSTMENTS

Expenditure = only amounts resulting in payments of cash or transfers of other assets (average carrying amount incl. previously capitalised borrowing cost is a reasonable proxy). Expenditure is **reduced by**:

- Any progress payments received (e.g. from the customer/government funding the project)
- Grants received in connection with the asset (IAS 20)

Adjustment	Effect on expenditure base
Progress payment received	Deduct from cumulative net expenditure
Grant received	Deduct from cumulative net expenditure

12 DISCLOSURE [IAS 23:26]

An entity shall disclose:

- The amount of borrowing costs capitalised during the period
- The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation

! ⚠ EXAM TRAPS — COMMON MISTAKES

- Capitalising borrowing cost **before** all three commencement conditions are met (expenditure + borrowing cost + development activity) — capitalisation cannot start on the loan drawdown date alone.
- **Forgetting** to net off temporary investment income against specific-borrowing costs during the capitalisation period.
- **Netting off** investment income that was earned **before** the capitalisation period started — this should go to P&L instead.
- Failing to **suspend** capitalisation during an extended halt in active development, or wrongly suspending it during routine technical/admin work or a normal weather-related delay.
- Continuing to capitalise **after** the asset is substantially complete, just because minor finishing/admin work continues.
- Using the **wrong capitalisation rate** base — including specific borrowings in the general-pool weighted average, or vice versa.
- Capitalising borrowing cost **in excess of** actual borrowing costs incurred during the period.
- Forgetting to **deduct progress payments and grants** from expenditure before applying the capitalisation rate.
- Confusing **qualifying asset** (substantial time to prepare) with any non-current asset — routine equipment ready to use on delivery is never a qualifying asset.
- Treating **dividends** or cost of equity as a borrowing cost — IAS 23 only covers debt-related costs.

13 QUICK DECISION TREE — ANSWERING ANY IAS 23 QUESTION

1 Question given → 2 Qualifying asset? Specific or general borrowing? → 3 Apply the rule → 4 Calculate cost (time-apportioned) → 5 Adjust (temp. income / progress pmts / grants / suspension) → 6 Capitalise / expense split → ✔ Final answer

IAS 23 — BORROWING COSTS IN 60 SECONDS

Capitalise if: directly attributable to a qualifying asset + probable benefit + reliably measurable.

Qualifying asset: takes a substantial period to get ready for use/sale — never financial assets or items ready-to-use on acquisition.

Specific loan: Actual cost incurred − temporary investment income.

General pool: Capitalisation rate = borrowing cost ÷ weighted average general borrowings; applied to expenditure. Never exceed actual cost incurred.

Deduct from expenditure: progress payments received + grants received.

3-stage period: Commence (3 conditions) → Suspend (extended halts only) → Cease (substantially complete, or per usable part).

Journal: Dr Qualifying asset / Cr Bank-Interest (capitalised); Dr Finance cost / Cr Bank-Interest (expensed).

Disclose: amount capitalised + capitalisation rate used.

Never a borrowing cost: dividends / cost of equity.