Issues Related to the Accounting of the Expanses of Loan Use

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Registration of the expenses related to the use of the loan is regulated by the International Accounting Standards (IAS) 23 and is characterized by the peculiarities. The article discusses the costs associated with the use of the loan, the peculiarities of their accounting with the basic method of accounting. Also, the capitalization of the expenses related to the use of the loan is the case when the loan is directly related to the acquisition, production or construction of a particular asset.

Keywords: loan expenses; special asset; interest expense; effective interest rate; recognition of expenses; financial expenses; capitalization of expenditures.

The funds used in the activities of enterprises are often used as loans. Using loan is always associated with certain expenses, counting of which is characterized by peculiarities. Recognizing the costs associated with the use of the loan, their accounting regulations are controlled by IAS 23 - "Cost-related Use of Loan".

According to the IAS, the cost related to the use of the loan is the interest and other expenses that the enterprise is engaged in relation with the borrowing funds.

Costs relating to the usage of the loan includes:
- Interest cost, which is calculated according to effective interest rate method IAS 39 - Financial Instruments: Recognition and Evaluation;
- Financial costs related to the financial lease is calculated according to the IAS 17 – Lease;
- The amount of interest difference arising in relation to the loan taken in foreign currency if it is considered as adjustment of the interest costs.

Effective interest rate by IAS is the rate that accurately precedes the acceptable cash flow fees for being paid during the term of the financial instrument, or during a short period of net carrying value of a financial asset or financial liability. In calculating the effective interest rate, the enterprise must evaluate cash flows from financial instruments taking into consideration all the terms of the contract and should not consider future credit losses.

The cost related to the use of the loan should be recognized by the basic method of bookkeeping as the cost of the period when these expenses were rendered.

Therefore, the principal accounting method is recognized as the cost of all types of expenses related to the use of the loan as soon as they are rendered, regardless of how the loan is used.

Recognition of the interest rate of the bank's overdraft, short-term and long-term loans will be reflected in the accounting recording:
- Debts - interest expense;
- Credit - payable interest rates; or
- Credit - reports on cash flows

Amortization of concessions and supplements related to the use of loan is made by a uniform reciprocity method and is recognized as the cost of that period.

Writing (amortization) of the organizational expenses related to the loan is made in the same manner.

Financial (interest) leases related to the financial costs are part of the lease liability and will be allocated by discounting the total amount of the lease liability. The interest expenses on financial leases should be allocated for the entire period of lease, as required by the IAS. Financial expenses shall be allocated for each settlement period during the entire period of the lease to generate a permanent periodic interest rate on the liability balance. Conditional lease payments are recording as expenses during the period when it has been rendered.

Financial expenses are recognized in the lessee's accounting record and are reflected by putting:
- Debts - interest expense;
- Credit - payable interest rates.

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The difference in the interest rate in foreign currencies is recognized as an expense if it causes adjustment of interest costs.

IAS is permitted to capitalize expenses related to the use of the loan when the loan is directly related to the acquisition, production or construction of a particular asset. “Expenditure on the use of a loan directly related to the acquisition, production or construction of a particular asset shall be accounted for in the prime cost of the asset. Other expenses related to the use of the loan should be recognized as the cost of the period when it has been rendered.” (IAS 23).

Definition of the capitalized part of the cost-related expenditure is determined in accordance with the standard requirements and is related to the acquisition, production or construction of a particular asset.

A special asset is an asset that requires a significant period of time for the preparation to use as a purpose or for sale.

The exclusive asset can be the commodity-material values whose manufacture or construction is intended for use or preparation for the purpose of a large period of time, as well as production facilities and buildings, power plants, equipment and investment property, other types of investments, long-term financial transactions.

Other types of financial investments, as well as commodity-material values that can be serially produced within a short period of time, or assets that are already ready to use for its purpose at the time of purchase or for selling are not included in the name special assets. Consequently, the accounting record of the expenses related to the use of loan for these purposes is made by the basic method and is recognized as the cost of the period.

Costs of loan consumption directly related to acquisition, production or construction of a special asset shall be capitalized, will be included in balance cost of these assets, if in the future it is expected to receive economic benefits from these assets and reliable assessment of expenses are possible. All other expenses, which do not meet these conditions, should be recognized as cost of the period at the time of their implementation.

Costs directly related to the acquisition, production or construction of a particular asset belong to the expenses related to the use of the loan that could be avoided if it was not necessary to pay any special expenses related to special assets. If the enterprise loan has been taken only for the purpose of acquisition, production or construction of a particular asset, it is possible to safely determine the part of the expenses related to the use of the loan which is directly related to the given asset.

If a loan taking is made for a particular special asset purchase, manufacture or construction, then the capitalized part of the cost related to the use of the loan shall be determined from the actual expenses related to the use of the loan during the reporting period by the deductible amount of investment revenues derived from short-term financing of the loan. Often, the loan taken to purchase special asset, to manufacture or build is not entirely or partially used as intended. The enterprise may invest the temporary free part of the loan in short-term assets. In such a case, when determining the capitalized cost of the expenditure of the given period, the expenses related to the use of the loan should be deducted from the investment income received from short-term financial transactions.

There may be an opposite case, the fact that the enterprise receives the usual general purpose loan, but will use to buy special asset or to manufacture or build. In this case, the capitalization rate of the expenditures on this asset is used to determine the capitalization norm of the expenses related to the use of the loan. It is the ratio of the average weighted cost related of the use of loan expenses to the part of the borrowed funds deferred by the enterprise during the reporting period which is not intended to purchase, manufacture or build exceptional assets. In addition, the amount of capitalized expenses of the given period shall not exceed the amount of the expenses related to the use of the loan. The time of capitalization of the expenses related to the use of the loan is defined by standards. The enterprise shall capitalize the cost of loan benefits, ie, recognition as part of the cost of a particular asset these expenses shall begin from the date of the start of capitalization. The date of capitalization is considered to be the date when:

- The first expenses are spent on special assets;
- The first expenses related to the use of the loan are provided;
- The necessary works have been initiated in order to use the given asset for its purpose or to bring in the condition to sale.

Costs on special assets include expenditures that result in the expulsion of the assets (expenditure) from enterprise or creating the interest liability.

The period of capitalization of the benefit of loan-related expenditures is still continuing until the active works of the technical or administrative nature of the asset are completed, which is an integral part of the preparation of the asset for the production or sale of the asset.

Capitalization related to the benefit of loan expenditures may be temporarily suspended or terminated.

Capitalization related to the benefit of loan expenditures should be temporarily suspended at the moment when the process of active works on the asset is obstructed, and should be terminated when all the active work necessary for preparing to the use of the asset or the sale of the asset will be completed.

For example, if the enterprise acquired the device and issued the bill of exchange with the following conditions: Annual interest rate of the bill of exchange - 12%. Payment period - 4 years, payment in fairly equal amount, with interest. Period for preparation and maintenance of device - 12 months. Preparatory works will be launched immediately after delivery of the device to the enterprise. The enterprise should reflect these givens in accountant reporting taking into consideration the following:

1. Because of the period after purchase device to passing on to the exploitation is defined for a period of 12 months, the device is considered as a special asset, so the capitalization of benefit from loan-related expenses (loan interest rate) should be made. Acquisition of the device in the accounting reporting must be reflected in the “Machine installations” in debit and “Cashing exchange of bills” of the balance in credit in the value of the acquired asset;
2. Every year, the current part of long-term liabilities of bills of exchange should be allocated, which should be reflected in balance and “Cashing exchange of bills” in debit and “Current part of long-term liabilities” of balance in credit;

3. For the purpose of capitalizing the cost related to the use of the loan should be defined:
   - Time of capitalization start-up - as soon as the device is manufactured;
   - Period of capitalization – 12 months;
   - Amount of capitalization - N, (amount of the bills of exchange obligation X 12\% X 4);
   - Amount of one month of capitalization - total amount of payable interest / 12);

The beginning of capitalization shall be reflected the balance “machine-installations” in debit and the balance “deferred paying interests” in the credit and so on, monthly, during 12 months. Consequently, after 12 months, the balance “deferred paying interests” will be accumulated in the amount of credit needed to cover the loan expenses (interest) taken for a particular asset.

4. Establishment of interest liabilities, accruing interest payments, during payment period for 4 years, will annually be reflected in the balance of “deferred paying interests” debit and in the balance of “paying interests” credit.

After the end of active works and capitalization, the value of the asset will increase with the interest rate related to the use of the loan.

After the asset’s exploitation, paying of the principal amount of interest and liabilities will start, which will be reflected annually by the relevant funds in the balances of “current part of long-term liabilities” and “paying interests” debit with the correspondence of the balance “national currency in bank” debit.