

## Study on Capitalization of Borrowing Cost

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**Abstract:** The new loan expenses standard allowa the capitalization of borrowing costs in the range of assets, with the calculation methods being changed, resulting in a new space for earnings management, affecting the quality of accounting information disclosure. Based on the background of the loan expenses rule reform, the paper summaries the domestic and foreign literature on the borrowing costs of the new standards, makes a comparative analysis on the capitalization of borrowing costs related to economic consequences, and puts forward a series of targeted measures.

### 1. Introduction

The concept of the old and new accounting standards on the definition of borrowing costs are basically the same, the enterprise because of loan of interest, amortization of discounts or premiums and ancillary expenses arising from foreign currency borrowing and exchange balance are designated as borrowing costs accounting category. "The capitalization of borrowing costs is the borrowing costs incurred by enterprises the purchase or construction enterprise shall be directly included in the inventory, fixed assets, construction projects in the cost of capital, resulting in the increase in corporate assets, reduce the financial costs, inflated current profits, but in the period of benefit to asset depreciation and amortization way in the future gradually compensated, increase enterprise profits after the period." The cost of borrowing costs. It is the cost of borrowing directly included in the current profits and losses, the financial costs, directly affect the old accounting standards of current profits of enterprises to start the implementation of the definition of.2001 in January 1st The capitalization of borrowing costs relative to the coverage of the new accounting standards are much smaller. The old standards require the capitalization of the borrowing costs of borrowing is a special loan, but the new standards will expand the scope of the loan to the general borrowing.

### 2. Literature Review

The new guidelines released, the domestic and foreign scholars, practitioners pay more attention and debate. In general, the new criteria for discussion on borrowing costs, can be summed up as the interpretation of new standards of specific application, study confirm the capitalization of borrowing costs and questioned the value of borrowing cost capitalization value.

#### 2.1 Study on the specific application of the interpretation of the new standards.

Guijuan Zhao, Ling Wang carried out a detailed exposition and Analysis on the borrowing cost capitalization criteria; Qingzhen Zhu, Xiaoyan Yan analyzed the calculation method of the rate of borrowing costs and the amount of capital, analyzes the new criterion with respect to supplement the old criterion, modified and corrected, presents a general method of application of the new guidelines; Mingjun Han, Xingyan Zhao compared the provisions of the old and new standards the cost of borrowing, analyzes the adverse effects of the new guidelines may be generated in the process of borrowing costs of the proposed new guidelines for application of accounting treatment procedures. These studies for the enterprise learning, understanding, and application of relevant provisions of the new accounting standards in the borrowing costs provided sufficient documents.

## **2.2 Agree with the "borrowing cost capitalization" positive.**

The new standards promulgated by the international well-known accounting firm KPMG (KPMG) appreciation, the firm believes that the new accounting standards can choice, to enable enterprises to provide accounting information more reliable, help investors to understand the financial information and make a useful decision. German Telecom also believes that the new standards will reduce the cost of making financial statements, the company the shareholders through statements to better understand the financial situation of the company. At home, a large number of literature interpretations of the new accounting standards also support the positive role of borrowing cost capitalization "in a certain sense. Donghui Liu affirmed the positive value of the new guidelines to expand the capitalization of the borrowing costs of assets, the provision is conducive to enhance the real the real estate enterprises and the relatively long production cycle performance of manufacturing enterprises. From the angle of beam Qi inventory cost of borrowing costs capitalization, case analysis The form, analyzes the new accounting method standard of borrowing costs and its impact on corporate performance indicators, affirmed the long-term storage properties of stock the capitalization of borrowing costs more in line with the importance of the principle and essence of accounting is more important than form principle.

## **2.3 Question the capitalization of borrowing costs "positive.**

International Association of Chartered Financial Analyst has consistently opposed the capitalization of borrowing costs, so the new criterion is not optimistic that the new criterion in compatibility has made progress, but may be contrary to the financial statements to investors, creditors and other users of accounting statements to provide true, reliable and objective accounting information, the principle. Hong Yang etc, from the accounting standards the market system, many aspects of project investment, in-depth analysis of the capitalization of borrowing costs is not reasonable, that the loan interest capitalization and accounting principles are not consistent. Weiqing Tan affirmed the new criterion of borrowing cost capitalization is conducive to enhance the comparability of accounting information, to achieve international standards, embodies the principle of substance over form, but also lurking allowed for the capitalization of borrowing to expand the scope of the borrowing costs of capital assets to expand the scope and amount of capitalization of interest cost calculation method to adjust the standards permit, To some extent, increase the enterprise profit manipulation space. Yong Deng thinks that the new criterion in the current financial costs while reducing the tax shield has played a positive role, but with the depreciation in subsequent period by the tax deduction, only to beautify the current financial statements for Jia Li confirmed by case analysis form provisions of the capitalization of the borrowing costs could be the earnings management means, through the analysis of the specific application methods of criterion, finally puts forward the preventive measures of the enterprise earnings management through borrowing costs capitalization criteria.

## **3. Problems in Capitalization of Borrowing Costs of Listed Companies in China**

### **3.1 The human capital of the borrowing cost is suspended and stopped, which causes the book value of the inflated assets.**

The enterprise accounting standards, for the purchase of fixed assets, inventories and other assets and long-term loans, at before the intended use or sale of these assets cost interest shall be capitalized, included in the cost of the related assets. "Provisions in the new accounting standards in article eleventh of the qualified assets in the acquisition and construction or production the process is interrupted abnormally, and the interruption of 3 months continuous over time, the capitalization of the borrowing costs shall be suspended. The borrowing costs incurred during such period shall be recognized as expenses, profit or loss, assets until the acquisition and construction or production activities start. If the interruption is the acquisition and construction or production to meet the capital the condition of the asset for the intended use or sale of necessary procedures, the capitalization of the borrowing costs shall continue." this provision to some enterprises exaggerated

Asset size provides some opportunity. Enterprises can fixed assets is still in the debugging status as an excuse to postpone the formalities for completion of final accounts, or long-term projects in the qualitative, the borrowing costs should be included in the initial value of related assets accounted for infinite expansion, these people extend the capitalization of interest cost means to inflated assets book value with the actual market, serious discrepancies, and lead to distortion of accounting information distortion, including solvency indicators of asset liability ratio, operation ability index of fixed asset turnover and inventory turnover rate and other related indicators of profitability and financial ratios, bring difficulties to the users of financial statements make useful decisions.

### **3.2 The loss of national tax benefits caused by the expansion of the scope of assets that allows the capitalization of borrowing costs.**

The old standard, the scope of assets allows the capitalization of borrowing costs is limited to fixed assets, and the new standards in the range of borrowing cost capitalization assets include fixed assets, investment real estate, inventories and other assets. The new guidelines allow the capitalization of the borrowing costs for the first time to expand the stock, that provide policy support to real estate enterprises the export of real estate development, and the long production cycle to achieve external sales of large mechanical equipment enterprise reasonable allocation of costs. However, if some enterprises require the use of standards, especially the new standards will also occur due to the ancillary expenses of special loan in accordance with the conditions of capital is included in the cost of the relevant assets, provide more opportunities for enterprises. Enterprises such as opportunistic first expense interest expense ingeniously capitalized, resulting in the value of inventory inflated, with assets impairment means Reduce the pin has been finished products or the use of profit; standards will be a lot of borrowing costs capitalized, included in the cost of fixed assets, and then reduce the carrying value of the asset impairment of assets to be sold by means of fixed assets when exaggerated into operating value expenditure will eventually reduce the corporate income tax.

### **3.3 Capitalized borrowing costs are complex when allocating assets.**

If an asset only corresponds to a special loan or a general borrowing, then the calculation of borrowing cost capitalization is granted an easy job to do work. However, in the accounting practice, a number of general borrowing, borrowing a number of special projects, often at the same time, and the new standards will be scope for borrowing cost capitalization range can be extended to all the capitalization of assets, it will inevitably lead to the amount and distribution of the capitalization of the borrowing costs of accounting become a very complicated work. Accounting practice, special borrowing costs should be in accordance with the general distribution of the assets in the special loan expenditure in the proportion of the standard, but if in the construction project are built at different times, during the construction period different, so will cause the borrowing cost allocation is not clear, at this point in the current standards not specified in general. There are also borrowing costs distribution at in a similar problem, with a general borrowing often has two or more than two of the capitalization rate, resulting in the amount of borrowing cost capitalization cannot be accurately calculated. In addition, the new criteria for the acquisition and construction or production of qualified assets and occupy the general borrowing situation, enterprises should be based on the accumulated assets of more than the weighted average capital expenditure multiplied by the number of special borrowing part occupied by the general borrowing by the capitalization rate of the general borrowing calculation should be capitalized amount of interest. However, the enterprise funds include funds, borrowing, etc. the three part of the special loan, how to determine the total assets expenditure over specific borrowing part of the assets, is difficult to accurately calculate the generally, the capitalization of borrowing costs, but the current guidelines did not give accurate description.

### **3.4 The new regulations on the loan cost regulations are not standardized, and may become the means of enterprise profit adjustment.**

Under the new standards, there are some regulations that are not standardized for the

capitalization or expense of borrowing costs due to borrowing, which provides some convenience for enterprises to adjust profits these irregularities included but not limited to the following aspects. First, when borrowing costs can be used as a profit deduction included in finance costs also. Can meet the cost of the related assets directly included in certain conditions, so the borrowing costs or the cost of capital to a large extent depends on the accounting personnel occupation accomplishment, if not honest and impartial can become the essence and goal of accounting personnel occupation ethics, then the interest cost accounting will become a the means of profit manipulation of financial enterprises, the accuracy and authenticity of the information will become empty. Second, allowing the capitalization of the borrowing costs of the project in the new standard is not comprehensive, especially now popular BOT, BT, PPP, involving multi stakeholder project management mode of construction has not been stipulated in the new accounting standards. In third, the new criterion does not provide loan source, exist in the legal form of the entrusted loans is likely to become one of the important means of earnings management the enterprise. Third, when the capitalization of borrowing costs have increased the effect of corporate assets but not to reduce the current profit, such as enterprise by artificially adjusting capital borrowing costs in selling, distribution between unsolvable product cost, which can reduce the cost of selling products, achieve inflated profits, exaggerated financial results and can improve inventory; the cost reached inflated assets, whitewash financial situation, the capitalization of borrowing costs will become an important means to beautify the financial statements. Fourth, because the assets reached the pre- borrowing costs before the production, sale, or use of the state can be capitalized, and the new borrowing cost guidelines enable people to extend inventory, making it possible for fixed assets to reach a predetermined state of time.

### **3.5 The information disclosure of borrowing cost capitalization is not perfect.**

The new loan expenses standard fifteenth requirements: the enterprise shall be disclosed in the amount of the borrowing costs and borrowing costs for capitalized in the current period and the current is used for calculating and determining the amount of borrowing cost capitalization rate. However, the amount of disclosure is included because inventories, fixed assets, the total index of construction projects in the loan assets the cost of capital, can make the accounting information users to understand the capitalization of the borrowing costs amount of their own, have no way of knowing the cost of borrowing funds assets.

## **4. The Measures and Countermeasures Strengthening of Borrowing Cost Capitalization Management Start Borrowing Cost Capitalization**

### **4.1 Specification, pause and stop condition.**

The new loan expenses standard defines the beginning of capitalization of the borrowing costs, pause and stop conditions. But in practice, should be further introduced to interpret the rules provisions. On the start time of borrowing cost capitalization, the provisions of the asset expenditures have been incurred should especially have cash, non cash or interest bearing debt expenditure; borrowing costs have been incurred debt refers to funds already in place and began to interest; to prepare the asset for its intended use state required purchase activity has occurred refers to the entity construction has already begun, but should eliminate construction assets will not be changed form. At the same time, the definition of the asset for its intended use state also made no further the criteria for interpretation should be clearly defined to avoid a similar situation; in the real estate development enterprise time indefinite extension of the capitalization of borrowing costs have inflated asset value. The moratorium on the capitalization of borrowing costs and the stop condition, the definition of "non normal interruption" conditions are not specific, should be explicitly excluded because of the engineering progress inspection, quality inspection and other normal procedures need all kinds of work, or define the capitalization of borrowing costs to suspend and stop labor disputes the quality of engineering materials, disputes, supply timely and other specific circumstances, to reduce the possibility of financial staff because of occupation experience different

and make different judgments the principle of distinction.

#### **4.2 Distinguish the principle of enterprise assets expenditure occupying all kinds of loans.**

Enterprises use the capitalization of the borrowing costs of earnings management, the implementation of profit manipulation methods in accounting practice including but not limited to the following four aspects. Generally exaggerate the capitalization of borrowing costs. The amount of new borrowing costs accounting standards can clearly be the general borrowing costs capitalization, proposed a general borrowing is used for the purchase of construction or production of qualified assets and the enterprise shall, according to the cumulative capital expenditure over the weighted average assets expenditure multiplied by the number of special borrowing part occupied by the general borrowing by the capitalization rate calculation to determine the general borrowing should be capitalized amount of interest ", the conditions prescribed by the general borrowing and capital expenditure direct, clear, correspondence tracking. In order to avoid the enterprise all the general borrowing costs capitalization to exaggerate the current assets, financial personnel must be strictly Implementation of standards, if the enterprise financial personnel not between general borrowing funds and capital expenditure both to establish corresponding relation, general treatment should be the cost of borrowing and spending, not included in the capital asset value. The liquidity loan interest allows capitalization. China issued by the Banking Regulatory Commission "Interim Measures for the administration of working capital loans" expressly provided shall not be used for long-term capital liquidity borrowing for fixed assets. Therefore, loan interest capital liquidity policy is not allowed. This requires financial personnel in the capitalization of borrowing costs accounting, we must distinguish the short-term and long-term loan interest loan interest, be strictly defined the capitalization of the borrowing range. The fixed assets investment projects have the minimum capital limit and special loan total fixed asset investment projects exaggerated Grant of borrowing cost capitalization amount. When some investment projects are the minimum capital requirement, if capital in place is much lower than the standard, more than for the capitalization of the borrowing costs of borrowing, financial personnel should exceed the loan interest cost of the processing part, to avoid exaggerating the capitalization of borrowing costs for the special loan of fixed assets. Investment borrow, borrowing costs more than the total investment in fixed assets should also be part of the cost of treatment. (4) Artificially extend the trial production period led to the capitalization of borrowing costs. In accordance with international practice, some projects may need to go through the national authority acceptance can be counted as intended use, waiting for the approval period of due to the trial production of the borrowing costs shall be capitalized. However, if no reason to extend the trial production period, so the cost of borrowing costs must be treated, to avoid exaggerating the carrying value of the assets.

#### **4.3 Improve the calculation method; regulate the distribution of borrowing costs in a number of assets in the amount of capital.**

The new loan expenses standard shall be added clear capitalization of borrowing costs amount by the distribution of the order, in a number of assets between the proportions of loan interest rate method to determine the related basis, so as to reduce the accounting personnel occupation judgment into more subjective color. Because of the capitalization of borrowing costs of special Borrower shall specify a reasonable allocation in accordance with the assets of the proportion of expenditure for capital borrowing costs generally the borrower should be defined in accordance with the proportion of the actual expenditure as assets to determine the weight of the weighted average capitalization rate, the reasonable allocation of borrowing cost capitalization. In relation to the interests of funds, borrowing, borrowing special sources of funds, should regulate the use of funds in accordance with the first order, the best special funds to its own funds, arrangements for the use of funds in order to last borrowing. At the same time, will be based on comparable The quality of accounting information demand, once the enterprise determine the distribution method of the amount of borrowing cost capitalization in the assets of the order and the calculation method of the cost of general borrowing capitalization rate, in the absence of national policy or based on increasing the quality of accounting information under the conditions considered in the later period

should be kept consistent with the previous accounting methods. In addition, in order to avoid due to the capitalization of the borrowing costs of inflated asset value, the fair value of the assets of enterprises shall be compared and the purchase cost to low as assets; or asset impairment test on the balance sheet date, once found contains capital interest in net realizable value of assets is lower than the book value, to the loss of asset impairment Confirmation immediately, the provision for impairment of assets, in order to improve the authenticity of the enterprise asset value.

#### **4.4 Strengthen the coordination of tax law and accounting standards.**

The implementation of the enterprise income tax law regulations granting tax deduction for the borrowing costs of borrowing costs incurred in enterprise production and operating activities reasonably do not need capitalization, because of the need for intangible after more than 12 months to build to the intended use or sale of state assets, fixed assets, inventory and borrowing costs occurred, which would be the cost of the asset structure of the content ,at the same time, also could be tax deductible. Some provisions are too simple, the enterprise income tax law did not explicitly calculate the amount of capital, the capitalization rate, the key problems of cost accounting and how to assist the capital of the starting point and end point judgment. In comparison, there are provisions of loan expenses standard base on the above processing, because of the differences; enterprises need to do tax adjustment. So, in order to reduce the tax adjustment of trouble, for tax department The door of tax accounting and tax supervision convenience, judicial interpretations promulgated the relevant legal system timely, coordination of tax law and accounting standards, scope and procedures to simplify tax adjustment.

#### **4.5 Improve the capitalization of the borrowing costs of information disclosure; strengthen the external supervision and inspection.**

Accounting practice, enterprise financial accounting personnel must take the profit maximization is the eternal goal of enterprise management, make full use of accounting choice, and exaggerate the short-term operating results, the beautification of the financial report data, in order to achieve their own interests. The new borrowing cost capitalization criteria increase the capitalization of borrowing costs for the amount of enterprises and reduce the cost, directly included in the financial costs, the current inflated profits and financial fraud provides policy conditions. In order to avoid causing investors making mistakes, disrupting the market economic order, improve the information disclosure; it is very important to strengthen the enterprise internal and external supervision and audit. Firstly, perfecting the information disclosure system is the key to reduce system arrangement enterprise financial fraud of listed companies. In addition to disclose the amount of borrowing cost capitalization and capitalization rate, also should be disclosed separately. The assets allocation of loan amount of capital cost and capital ratio, and calculation basis, enhance the transparency of accounting information. Secondly, the government must assume guarantee the authenticity of accounting information "parents" role. The Ministry of Finance and other relevant accounting supervision departments must clear responsibilities, reasonable division of labor, increase the punishment. First, to maintain social and economic order and stability is one of the important function of government macroeconomic management, and the quality of accounting information related to the stability of the economic order or not, this is the responsibilities of the financial sector. Second, the tax department should strengthen the financial accounting information authenticity, legitimacy, rationality review, in conjunction with the relevant national authorities to increase the intensity of accounting fraud, financial fraud the audit department should be punished. Third, the important function of nip in the bud, the enterprise that occurred in a major asset purchase, the use of large sums of money And "fraud prone, prone area and other key to carry out the audit, a careful analysis of the use of specific borrowings and general borrowings, calculated on the basis and method of capital interest, the amount of capital of the lawful and reasonable, daring to expose the illegal phenomenon, found security risks, perceived risk, and puts forward some suggestions and measures to solve the problem. Finally, to strengthen the accounting supervision need the community to create a synergy with government supervision, coordination of various departments and the community to actively participate in the integrity of the accounting supervision system.

First, we must strengthen the leadership of enterprise law consciousness, perfecting the leadership cadre examination, appointment, promotion system, institutional arrangements in the real and the legitimacy of accounting information as the cadre examination, appointment, promotion conditions. Second, strengthen the management of the original accounting data, control accounting fraud, financial fraud opportunities from the source. Third, the illegal accounting personnel, the person in charge of finance, business leaders to increase efforts to punish, increase illegal opportunity cost.

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