AS 1

Disclosure of Accounting Policies

Opposite of closure (Hiding) SHOW

Fundamental Accounting Assumptions	Consideration For Selection of AP	Changes in AP [Exceptions to Consistency]
* Going Concern	* Prudence	* Change in law
* Accrual	* Materiality	* Requirements by any AS
* Consistency	* Substance over Form	* Better Presentation

Going Concern

An organisation neither has the intention, nor the necessity to close down its business in the near future.

Accrual

Transactions should be recorded as and when they happen and not merely when settled in cash

Accounting System → Accrual/Mercantile → Business Concern

Accounting System → Cash → Service Concern

Consistency.

Accounting Principles and Policies to be followed from one accounting period to another should be same

Prudence [Conservatism]

Account for all expected expenses and losses, but not all expected profits and gains

Substance Over Form

Accounting Reality prevails over mere legality

Materiality

All facts and figures affecting the decision making of the users of financial statements

AS-2

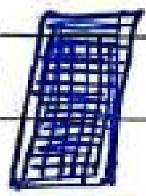
Valuation of Inventories

Goods held for the purpose of Production / sale

* Raw Materials [0% processed]

cotton

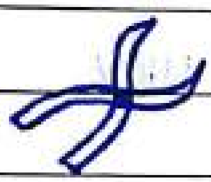
* Work in Progress [0-100% process]



cloth

* Finished Goods [100% processed]

Stores and Spares



Exclusions

* Services
* Producer Goods or Commodities [Agricultural Produce]
* Securities AS 13
* Construction contracts AS 7

Para 5

Inventory should be valued at Cost or NRV, whichever is LOWER

Note

Comparison between Cost and NRV should be Independent and not collective

	Cost	NRV	lower
A	$\boxed{100}$	120	100
B	80	$\boxed{60}$	60
C	40	$\boxed{30}$	30
	220	$\boxed{210}$	190
		✗	✓

Cost

Cost = Purchase Price + Expenses + Overheads (other costs)

- Purchase Price
  - Tax
    - Input Credit Available → Included ✗
    - Input Credit not available → Included ✓
- Expenses
  - Incurred to bring goods to current location and position
- Overheads (other costs)
  - Variable OH → per unit price → part of cost
  - Fixed OH → absorbed on the basis of
    - ✓ normal capacity
    - ✗ actual capacity
      - unless → Very high Production — Adjust the Cost
      - Very low production — No Change

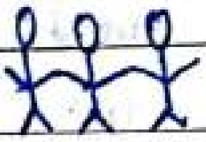
Thumb Rule for Treatment of Fixed Overheads

Fixed Overheads should be charged based on normal production. However, if actual production is very high (abnormal), then it must be calculated based on actual production (decrease cost of production per unit)

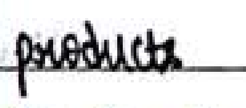
Allocation of Expenses in case of Joint Products & By Products

Joint Products

[intention to produce]

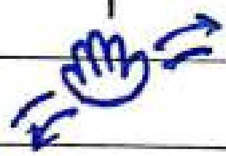


Expenses are apportioned between the products



By-Products

[no intention to produce]



Treated as Scrap.

Sale consideration of By-Products will reduce the cost of production of Joint Products

Net Realisable Value

Sale consideration
Less: Expenses for Affecting Sales
[commission to broker and
other expenses]

Net Realisable Value

Note: In the absence of any information relating to NRV consider Replacement Price as NRV

Methods to Calculate Cost

Goods are Replaceable

* FIFO First in First Out ✓
* LIFO Last in First Out ✗
* SAM Simple Average Method ✗
* WAM Weighted Average Method ✓
* BPM Base Price Method ✗

Goods are Not Replaceable

SIM Specific Identification Method ✓

Para 24

Comes into relevance when Finished Goods are sold below cost.

Usually

Raw Materials	Work-in-Progress	Finished Goods
@ COST	@ COST	@ lower of COST or NRV

Para 24

Raw Materials	Work-in-Progress	Finished Goods
@ lower of COST or NRV	@ lower of COST or NRV	@ lower of COST or NRV

SP $\neq$ Total Cost

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Incremental Profit

Profit calculated by ignoring the past cost and only considering the cost to be incurred

Incremental Profit = Selling Price − Cost to be incurred

Total Profit = Selling Price − [Cost to be Incurred + Cost Incurred]

Total Profit = Incremental Profit − Cost Incurred

Relationship between Total Profit and Incremental Profit

Total Profit

Incremental Profit

Δ

Past cost or Cost Incurred

Always compute incremental profit as a part of the solution while answering questions based on INVENTORY VALUATION

Our logic vs. ICAI logic

	Para 24		Raw Materials Valued @
Our logic	✗	Profit ≥ 0	COST
	✓	Profit < 0 (i.e, loss)	COST or NRV } WIL
ICAI's logic	✗	IP ≥ cost	COST
	✓	IP < cost	COST or NRV } WIL

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Disclosure Requirements

* Method of Valuation of Inventory [FIFO or WAM]
* Cost Formula
* Carrying Amount of Inventories [Amount to be shown in Financial statement
* Inventory classification by the Organisation

AS-3

Cash Flow Statement

Cash Flow Statement is an advanced level of Cash Book

What? Statement ✓
Account ✗

When? Along with Financial Statements
(usually, end of the years)

Sec.129, Companies Act 2013

* Balance sheet
* Statement of P&L
* Cash Flow Statement
* Notes to Accounts
* Statement showing Changes in Equity
* Consolidated Financial Statements

Why? To analyse flow (inflow and outflow) of Cash and Cash Equivalents from
* Operating Activities
* Investing Activities
* Financing Activities

What is Cash & Cash Equivalents?

Cash refers to currency issued by RBI which are currently in use

Characteristics of Cash Equivalents
* Readily convertible
* Insignificant Risk
* Short term instruments (< 3 months)
* Highly liquid

Cash Book Vs Cash Flow Statement

	Cash Book	CashFlow Statement
Cash	✓	✓
Cash Equivalents	✗	✓

Format

Particulars	Amount	Amount
1. Cash Flow From Operating Activities		XXXX
2. Cash Flow From Investing Activities		
Cash Inflow From IA	XXX	XXXX
less: Cash Outflow From IA	XXX	
3. Cash Flow From Financing Activities		XXXX
Cash Inflow from FA	XXX	
less: Cash Outflow from FA.	XXX	
4. Opening Cash and Cash Equivalents		XXXX
5. Closing cash and cash Equivalents		XXXX
[5 = 1 + 2 + 3 + 4]		

AS-10 ®

Property, Plant and Equipment

Applicability

To all tangible assets

Exceptions

* Biological Assets
* Wasting Assets

Learning Objective

* Recognition of Assets
* Determination of Carrying Amount
* Computation of Depreciation
* Recognition of Impairment Loss.

Impairment loss arises when

Carrying Amount > Recoverable Amount

Property, Plant and Equipment

It is an asset that satisfies the following conditions ★

* Held for
  → Renting to others
  → Administrative Purposes
  → Production of Goods or Supply of Services
* Held for a minimum period of 12 months

Biological Assets

Any living being (other than humans).

Livestock

currently, AS10® is applicable, but when the new AS on agriculture is ready, it will no longer be applicable.

Plants

Bearer Plant

(Agricultural Produce for more than 12 months)
AS10® applies if ★ conditions are satisfied

Producer Plant

AS 10® is applicable

Recognition of Assets

Thumb Rule

Recognise as asset if

* Probable Future Economic Benefit
* Reliable Measurement

Are Spare Parts and Standby Equipments Assets?

It depends on the definition criteria.

If ★ conditions are followed, i.e. satisfied. AS-10® applies.
else, AS-2 applies

Should Repairs and Maintenance costs form a part of Carrying amount?

Day-to-day expenses will be recognised in P&L A/c.

If it is capital in nature, it will be part of carrying amount.

Should Cost of Replaced parts form the cost to be recognised?

Again, only ★ conditions will answer this question

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Determination of Carrying Amount

Measurement is based on instances

At the time of recognition
Cost Model

After Recognition
* Cost Model
* Revaluation Model

Cost

Inclusions
* Purchase Price
* Directly Attributable Costs
* Decommissioning and restoration liabilities

Exclusions
* Setup or Opening Cost
* Advertising/Promotion costs
* Cost for alternate business location during setup process
* Administrative and other general overheads

Purchase Price = Consideration + Import Duty or Tax (if not refundable) − Trade Discount (rebate)

Directly Attributable cost

Any cost incurred to bring the asset to its current location and condition to make it capable of operating

Inclusions

* Site Preparation
* Delivery and Handling
* Installation and Assembly
* Testing and Trial Run
* Professional fee (for installation)

Exclusions

* Any cost after it is capable of operation
* Initial Operating Loss
* Relocation costs

Decommissioning

Cost for removal of asset at the end of useful life [if there is subsequent change in decommission charges, then adjust cost]

* It is incurred at the time of removal
* However, it must be recognised and accounted for at the time of initial recognition

So, it is an Accounting Estimate

Cost Model at the time of recognition

It is based on consideration

Paid at once, in cash	Deferred payments in cash	Non-cash consideration
Cash Price	Cash Price Equivalent + Interest, if required by AS-16	Fair Value of Asset
		Unless:
		* There is no commercial substance
	If interest is not required to be capitalised by AS-16, it is a Revenue Item	* It cannot be reliably measured

Determination of carrying amount after recognition

It is an Accounting Policy, so the enterprise can choose

Cost Model	Revaluation Model
Cost	Fair Value
Less: Accumulated Depreciation	**Less**: Accumulated Depreciation
Less: Impairment loss	**Less**: Impairment Loss

Note: revaluation is to be done for the entire class and not a single asset

How Frequent should Revaluation be?

Sufficient Regularity

If fair value experience leads to

* significant and volatile changes ⇒ annually
* Only insignificant changes ⇒ at an interval of 3 to 5 Years

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What is Fair value and how do we get it?

Fair value is determined by Market Based Evidence provided by professional valuers.

If no fair value is available, then Income Approach is to be followed

[Present value of Future cash flows]

What is Impairment Loss?

* Loss arising when the recoverable amount is lesser than the carrying amount.
* AS 28 → Impairment loss
* If the recoverable amount is greater than the carrying amount, no adjustment is to be made due to conservatism.

What happens to accumulated depreciation on Revaluation?

It is eliminated by adjusting it against the Gross Block and restated to the revalued amount

Revaluation

Increase

Transfer to Reserves and Surplus i.e., to the Revaluation Reserve

Decrease

Transfer to Profit and Loss A/c

Exception

If previously, any expense is recognised in Profit and Loss A/c, then it is first adjusted

Exception

If previously any reserve is recognised in reserves and surplus (Balance Sheet), then it is recognised first

Revaluation reserves are to be transferred to the Revenue Reserves on a proportionate basis over the asset life

However, grouping is possible if the components have
* Same useful life, and
* Same depreciation method

Method of Depreciation

Straight Line Method	Diminishing Balance Method	Production Units Method
Same amount of depreciation over the useful life, unless the useful life changes	Decreasing Charge Over the useful life	Depreciation is based on the output

Review on change is done on a Yearly Basis

Depreciation as an Accounting Policy	Depreciation as an Accounting Estimate
Consideration for Selection of Method	Basis for Selection of Method
* Prudence * Substance Over Form * Materiality	Pattern of Future Economic Benefit from the asset to reflect depreciation a.k.a., usage pattern

Depreciation Method has to be Consistent

Exception

* Change in Pattern of Consumption
* To comply with the Statute, i.e, law

Change in Method of Depreciation is a change in accounting estimate

Depreciable Amount

= Cost or Revalued Amount
Less: Residual Value

* To be allocated on a systematic basis, over the Useful Life
* Has to be reviewed every year

Depreciation is calculated on the Depreciable Amount

Change in useful life and residual value is a change in accounting estimate

Book Value / Carrying Amount ≠ Depreciable Amount

Commencement of Period for charging Depreciation

Earlier	Now
AS-10	AS-10 (R)
Ready to Use	Available for Use

Cessation of Depreciation

* Residual Value > carrying Amount

* Asset is Retired or Derecognised

Land and Building

Accounting is done separately, even though they are acquired together.

Land

* unlimited Useful life

* Depreciation ✗

Building

* Limited Useful life

* Depreciation ✓

Exceptions

Quarrying

Mining sites

Recognition of Impairment Loss

Impairment Loss = De-recognition of Asset

Retirement of Asset → PPE is not in active use OR held for disposal

Then, it is valued at carrying amount or net realisable value } w.l.

Carrying amount of asset is derecognised when

Disposed by Sale, Financial Lease, Donation, i.e., change in possession and ownership (substantial)

There is no future economic benefit

Exception

Date ______
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Disclosure Requirements

* Measurement Model (Revaluation Model / Cost Model)
* Depreciation Method
* Useful life or Depreciation Rate
* Gross Block and Accumulated Depreciation
* Pledge or Hypothecation (if any)
* Contractual Commitments (if any)
* Assets realised and disposed
* Revaluations
  - → Date of Revaluation
  - → Details of valuer
  - → Assumptions in Estimation of Fair Value
  - → Change in Revaluation Surplus

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AS 11

Accounting for Effects of Changes in Foreign Exchange Rates

Always, accounts should be maintained in the reporting currency. If not, the reason for the same must be disclosed accordingly

Applicable to

* Transactions using foreign currency
* Contract → Foreign forward contract
* Financial Statement Translation

  Translation of financial statements of the following into reporting currency

  → Subsidiaries in Foreign Countries
  → Associates or Joint Ventures in Foreign Countries
  → Branch in Foreign Countries

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Not Applicable to

* Restatement from Reporting Currency to Foreign Currency
* Cash Flow Statement w.r.t. forex transactions
* Exchange Differences relating to Interest costs

What is Foreign Currency Transaction?

* It is a transaction in foreign currency; or
* a transaction which needs to be settled in foreign currency.

What is Reporting Currency?

Currency of country in which financial statements are prepared

What is Foreign Currency?

Any currency other than Reporting Currency

Exchange Rate

The rate at which foreign currency is converted into reporting currency

Types of Exchange Rate

Average Rate	Closing Rate	Forward Rate
Average Exchange Rate for a period	Exchange Rate as on the date of Balance sheet	Exchange Rate agreed between two parties for 2 currencies on a specific forward rate

Classification of Items

Monetary Items	Non-Monetary Items
* Money * Assets/Liabilities receivable or payable in fixed or determinable money	Assets and Liabilities other than monetary items

Accounting for ECIFER

Foreign Currency Transactions	Translation of Financial Statements (operations)	Forward Foreign Exchange Contracts
* Buying and selling of goods or services	* Foreign subsidiaries	* Risk or Hedge Management
* Lending and Borrowings	* Foreign Associate or Joint Venture	* Speculative or Trading
* Acquisition or disposal of assets	* Foreign Branch	
	[integrated / not integrated]	

Transaction should be Recorded at?

	Average Rate	Closing Rate	Forward Rate	Transaction Rate
Initial Recognition	✓	–	–	✓ ★
Valuation on Balance Sheet Date				
* Monetary Items	–	✓	–	–
* Non-Monetary Items	–	–	–	✓
Contingent Liabilities	–	✓	–	–

Initial Recognition

Usually, transaction rate is to be considered. Alternatively, average rate can be used if there are no significant fluctuations

Monetary Items

If closing rate is unrealistic [not possible to realise at that rate], then consider the most likely rate i.e. a realistic value

Non-Monetary Items

Few non-monetary items should be recorded at fair value

Treatment of Exchange Difference

Reporting Rate ⟵ vs. ⟶ Initial Recognition Rate

Settlement Rate ⟵ vs. ⟶ Reporting Rate

Change in Exchange Rate is transferred to P&L A/C

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Exceptions

* Non-Integral Foreign Branch ⇒ Exchange Difference Reserve
* Long-term monetary Item ⇒ Capitalised

Operations

Integral Financial Foreign Operations	Non-Integral Financial Foreign Operations
Operations are treated as extention of reporting enterprise	No definition
	* Independent, i.e, no dependence on reporting enterprise
	* Transactions with the reporting enterprise are not high in proportion
	* Not financially dependent
	* w.r.t. sales, expenses and market, It is self-reliant

Integral Foreign Operations

Usually at Transaction Rate
Alternatively at Average Rate

Translation should be Item wise
* Items in Financial Statements
  → Fixed Assets
    – Historical Cost ⇒ Transaction Rate
    – Fair Value ⇒ Rate as on Date of Valuation
  → Inventory
    – Cost ⇒ Transaction Rate
    – NRV ⇒ Closing Rate

Any change in exchange rate as above goes to P&L A/c

  → Long-Term Monetary Item
    – Asset
    – Liability

Any change in exchange rate is transferred to FCMITD A/c [Foreign Currency Monetary Item Translation Difference A/c]

FCMITD A/c

It is an Accounting Policy

Amortize

Exchange Difference is to be transferred to P&L A/c over the useful life of the asset

Capitalise

Exchange Difference is to be adjusted with COST, effecting the depreciation.

Non-Integral Foreign Operations

* All Balance Sheet Items ⇒ closing rate
  [Monetary / Non-Monetary]

* P&L Items ⇒ usually. transaction rate
  [income / expenditure] alternatively. average rate

Any change in exchange rate is transferred to FCTR [Foreign currency Translation Reserve]

Net Investments

Unplanned & unforeseen settlement (capital)

Examples:

→ Sale of Business

→ Liquidation

Dividend, Redemption and Buy-back are partial disposal.

Change in Classification

Integrated to Non-Integrated	Non-Integrated to Integrated
Exchange Difference should be transferred to Foreign currency Translation Reserve	Exchange Difference cannot be recognised as expense and income till disposal. Exchange difference arising after change in classification can be transferred to P&L A/c

Forward Contract

An agreement between two parties to buy or sell an asset on a specific forward date at an Agreed Rate

Date of contract

Date on which contract is signed SPOT RATE

Date of Execution

Date on which Asset is Bought/Sold FORWARD RATE

Premium on contract

Treatment of Premium (Positive/Negative) on Contract

Depends upon Forward Contract

For Hedge or Minimising Risk	For speculation or Trading
Transferred to P&L over the term of Forward contract	Recorded when Contract is Executed

Disclosure Requirements

* The amount of exchange differences included in the net profit or loss for the period
* Net Exchange Differences accumulated in foreign currency translation reserve as a separate component of shareholders' funds and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

* when the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for the same should be disclosed.
The reason for change in the reporting currency should also be disclosed.

* where there is a change in the classification of a significant foreign operation, an enterprise should disclose the following

i) The nature of change in classification
ii) The reason for the change
iii) The impact of the change in classification on shareholders' funds
iv) The impact on net profit or loss for each prior period presented had the change in classification occured at the beginning of the earliest prior period presented.

AS 12

Accounting for Government Grants

Scope of the Standard

AS 12 deals with Accounting for Government Grants such as subsidies, cash incentives, duty drawbacks, etc. It also describes the treatment of non monetary government grants, presentation of grants related to specific fixed assets and revenue, and those in the nature of promoter's contribution, treatment of refund of government grants, etc.

The standard does not deal with

* The special problems arising in accounting for government grants in financial statements reflecting in the effects of changing prices or in supplementary information of a similar nature.
* Government assistance other than in the form of grants
* Government participation in the ownership of the enterprise

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The receipt of government grant by an enterprise is significant for the preparation of financial statements for 2 reasons:

a) Firstly, if the government grant has been received, the method of accounting applied for receipt of grant should be appropriate.

b) Secondly, it is desirable to give an indication of the extent to which the enterprise has benefitted from such a grant during the reporting period.

Recognition of a Government Grant

AS 12 specifies that government grants should not be recognised until there is a reasonable assurance that the enterprise will comply with the conditions attached to them and the grant will be received.

Receipt of grant in itself, is not a conclusive evidence that the conditions attached to the grant have been or will be fulfilled.

Accounting Treatment For Government Grants

* Two broad approaches may be followed for the accounting treatment of government grants.

→ Capital Approach

Under this approach, a grant is treated as a part of Shareholders' Funds

→ Income Approach

Under this approach, a grant is taken to income over one or more periods.

* It is generally considered appropriate that accounting for government grants should be based on the nature of the relevant grant. That means, if the grants have the characteristics of promoters' contribution, it should be treated as a part of shareholders' funds. In other cases, the Income Approach is more appropriate

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Refund of Government Grants

* If certain conditions are not fulfilled, Government Grants sometimes becomes refundable. This should be treated as an extraordinary item as per AS 5.

* The amount refundable in respect of Government Grant related to revenue is first applied against any unamortised deferred credit and the excess amount over and above the deferred credit or where no deferred credit is existing, this amount is to be charged immediately to P&L A/c

* The amount refundable in case of a government grant related to a specified fixed asset is recorded by increasing the book value of the asset or by reducing the deferred income balance as appropriate by the amount refundable. In the first alternative. i.e. where the book value is increased, depreciation of revised book value is provided prospectively

over the residual useful life of the asset.

* where the grant which is in nature of promoter's contribution becomes refundable. the amount is reduced from capital reserve

Disclosure

* The accounting policy adopted for the government grants. including the methods of presentation in the financial statements

* The nature and extent of government grants recognized in the financial statements including grants of the non-monetary assets given at a concessional rate or free of cost.

Accounting for Government Grants

Non-monetary Grant

a) Asset/good given at a concessional rate

[Record asset/good at net of grant]

Asset A/c Dr. (Net)
  To Bank A/c

b) Asset/good given free of cost

[Record asset at a nominal value]

Asset A/c Dr.
  To P&L A/c
  To Reserve A/c
  To Capital Reserve A/c
(as the case may be)

Grants in the nature of promoter's contribution

[Credit to capital reserve]

Bank A/c Dr.
  To Capital Reserve

Grant for setting up industry in certain backward areas

[This grant has no connection with assets or revenue]

B/S

GG (CR)	

Government Grants related to revenue

a) Show it as other income

Bank A/c Dr.
  To Govt. Grant

Govt. Grant Dr.
  To P&L A/c

b) Reduce from respective expense

Bank A/c Dr.
  To Govt. Grant

Govt. Grant Dr.
  To Expenses

Expense t/f to P&L

P&L A/c Dr.
  To Expense

Grants Relating to Specific Fixed Assets

Method I :

Reduce the value of Fixed Asset Purchased

Bank A/c Dr.
To Fixed Asset A/c

Depreciation Dr.
To Fixed Asset (Net)

P&L A/c Dr.
To Depreciation

Depreciation is charged on the net value of the fixed asset

Method II :

Credit government grant to a deferred income A/c.

Bank A/c Dr.
To Deferred G.G A/c

Depreciation Dr.
To Fixed Asset (gross)

P&L A/c Dr.
To Depreciation

Deferred G.G Dr.
To P&L A/c

Depreciation is charged on the gross value of the fixed asset

Refund of Government Grants

a) Reverse entries if possible

b) Net Difference transferred to P&L A/c

c) Depreciation provided proportionately

AS-13

Accounting for Investments

Basic classification

*** Current investment**

Investment that is by nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. The intention to hold for not more than one year is to be judged at the time of purchase of investment.

*** Long-term Investment**

Investment other than a current investment

Investment Re-classification

Long-term investment to current investment	Current investment to long-term investment
Transfer made at lower of Cost or Carrying amount at the date of transfer	Transfer made at lower of Cost or Fair value at the date of transfer

Determination of Cost

Cost of Acquired / Purchased investment
= Purchase Price + Acquisition charges

* If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the fair value of the securities issued or asset given up. The fair value may not necessarily be equal to the nominal or par value of the securities issued

* If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value of the asset given up or the fair value of the investment acquired, whichever is more clearly evident

* Interest paid on cum Interest purchase and pre-acquisition dividend should be reduced from the cost of investment

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Valuation of Current Investments

* Current investments are valued at cost of investment or Market value. whichever is lower.
* Cost of investment or Market value should be determined either by individual investment basis or category of investment basis

Valuation of long-term Investments

* **Carrying Amount**

long-term Investments are usually carried at cost

* **Basis**

long term investments are of individual importance to an enterprise, so carrying amount is determined on an individual basis

* **Decline in value**

→ where there is a permanent decline in the value of a long-term investment, the carrying amount is reduced in order to recognise the decline. The reduction in value shall be determined and made for each investment individually.

→ Temporary fall of the value of long-term investments need not be provided for

* **Reversal of Reduction**

When there is a rise in the value or that the reasons for reduction no longer exist, the reduction in carrying amount should be reversed. The reduction or reversal of such reduction in the carrying amount should be charged or credited to the Profit or Loss statement

* **Indicators**

Factors which indicate whether a decline is temporary or otherwise are

→ the market value of the investments
→ the investee's assets and results
→ the expected cash flows from the investment

Disposal of Investments

On disposal of an investment the difference between the carrying amount and disposal proceeds, net of expenses, is recognised in the profit and loss statement

AS 16

Borrowing Cost

Borrowing Cost

It refers to the cost of Borrowing, i.e., the cost of loan.

* Finance charges
* Interest and Commitment charges
* Discount
* Ancillary cost
* Exchange Difference

Treatment of Borrowing Cost

Capitalised	Revenue
Asset	Expense
shown in Balance sheet	Shown in P&L A/c

When to Capitalise?

When Borrowing cost is of Direct Nature relating to Acquiring, construction or Production of a Qualifying Asset

Qualifying Asset

It is an asset (that derives an enduring economic benefit) which takes a Substantial Period of time to get ready for use, production or sale.

How long is a Substantial Period?

There is no explanation given in Accounting Standards. However, AS Interpretation states that it is a period of 12 months.

A substantial period of time primarily depends on facts and circumstances of each case. However, ordinarily, a period of 12 months is considered as a substantial period of time, unless a shorter or longer period can be justified on the basis of facts and circumstances of the case.

Special Circumstances → Borrowing

Specific Borrowing	General Borrowing
Amount to be capitalised is found as follows:	Weighted Average of BC to be found which is applied on the Qualifying Asset to compute the amount of BC to be capitalised
Actual Borrowing cost less: Income on Temporary Investments of Borrowed Amount	Weighted Average Rate = $\frac{\text{Interest}}{\text{Total Borrowings}}$
	Amount to be Capitalised = Cost of Qualifying Asset × Weighted Average Rate
	Amount to be capitalised cannot exceed the Actual BC

Treatment of Exchange Difference under AS 16 read with AS 11

Calculate

i) Interest on Borrowing at Foreign Rate of interest
ii) Increase in liability due to Exchange Difference
iii) Interest on Borrowing at Domestic Rate of Interest
iv) Excess of Interest at Domestic Rate of Interest over and above interest at foreign rate of Interest

iii − i = iv

Amount to be Capitalised

= A − B

A = ii or iv, whichever is lower

B = i or iii, whichever is lower

If A is (ii), there is no exchange difference
If A is (iv), then A − (ii) = Exchange Difference as per AS 11
(ii) and (iv) are considered applying Interest Rate Parity Theorem.

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Interest Rate Parity Theorem

IRPT says that difference in interest rates between home and foreign is compensated by forward rate changes, i.e., if there is a higher Rate of Interest in the home country, it will be offset by Forward Rate as the foreign currency will be traded at a premium in the future.