CHAPTER 1 AS 16 - BORROWING COSTS

1. Capitalisation of Borrowing cost: Borrowing costs that are directly attributable
   - ➢ to the acquisition, construction or production of a qualifying asset
   - ➢ are capitalised as part of the cost of the qualifying asset.

   ⇨ Other borrowing costs are recognised as an expense (P&L A/c).

2. A qualifying asset: is an asset
   - ➢ that necessarily takes
   - ➢ a substantial period of time [a period of 12 months or more. (ASI-1)]

3. Commencement of capitalization: when all the following conditions are satisfied:
   (a) Expenditure on a qualifying asset is being incurred.
   (b) Borrowing costs are being incurred.
   (c) Necessary activities are in progress.

4. Suspension of capitalization: if active development is interrupted, then
   - ➢ Capitalization of borrowing costs is to be suspended, during extended periods in which it suspends active development of a qualifying asset.

5. Cessation of capitalisation: If any one condition is fulfilled out of following two:-
   (a) when the qualifying asset for its intended use or sale are complete; or
   (b) Borrowing has been repaid.

   Note: When an entity completes the construction of a Q.A. in parts & each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs on that part.

6. Calculation of amount of borrowing cost capitalized:

Particulars	Amount
Specific Borrowing Cost (Note 2)	XXX
(+) General borrowing cost	
{Weighted average of expenditure incurred on Q.A. from general borrowing} X {Capitalisation rate / general borrowing rate}	XXX
	XXX

Note 1: Expenditures on a qualifying asset include:

Those expenditures that have resulted in payments of cash	XXX
Transfers of other assets	XXX
Assumption of interest bearing liabilities	XXX
Amount of borrowing cost already capitalised	XXX
(-)Any progress payments received and grants received	(XXX)
	XXX

Note 2: Specific borrowing cost:

Actual borrowing cost incurred on specific borrowing	XXX
(-) Any income on temporary investment of borrowed funds	(XXX)
	XXX

Note 3: General Borrowing Rate/Capitalisation Rate

Total general borrowing costs for the period(excluding specific borrowings) X100
Weighted average total general borrowings(excluding specific borrowings)

Notes:
(1) Borrowing cost does not include notional cost of capital.
(2) Always use first specific borrowing then use general borrowing.

7. Meaning of Borrowing costs: It includes:
   (i) interest and commitment charges.
   (ii) amortisation of discounts or premiums relating to borrowings;
   (iii) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
   (iv) finance charges in respect of assets acquired under finance leases; and
   (v) Foreign exchange loss: shall be capitalized at lower of two:
      (a) Foreign exchange loss; or
      (b) Local borrowing cost in excess of foreign borrowing cost.

8. No borrowing cost shall be capitalized once asset get ready for its intended use or sale.

9. Qualifying Assets may be any of the following: (Depending on the circumstances)
   (a) PPE (b) inventories (c) intangible assets (d) investment properties

PRACTICAL QUESTIONS

1. M/s First Ltd began construction of a new factory building on 1st April, 2017. It obtained Rs. 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further, expenditure on construction of the factory building was financed through other non-specific loans. Detailed of other outstanding non-specific loans were:

Amounts (Rs)	Rate of Interest per annum
4,00,000	9%
5,00,000	12%
3,00,000	14%

The expenditures that were made on the factory loading construction were as follows:

Date	Amounts (Rs.)
1st April, 2017	3,00,000
31st May 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3.60,000

The constriction of factory building was completed by 31st March, 2018. As per the provisions of AS-16, you are required to:
(1) Calculate the amount of interest to be capitalized.
(2) Pass journal entry for capitalizing the cost and borrowing cost in respect of the factory building.

Solution: As per AS-16, "Borrowing Cost"

(1) Calculation of amount of borrowing cost capitalized

(Rs.)

Date	Amount	Nature of Borrowing	Amount of Borrowing Cost Capitalised (Periods used in Months)
01/04/2017	3,00,000	Specific Rs. 2,00,000 General Rs. 1,00,000	2,00,000 x 8% x 12/12 = Rs. 16,000 1,00,000 x 11.50% x 12/12=Rs. 11,500
31/05/2017	2,40,000	General	2,40,000 x 11.50% x 10/12=Rs. 23,000
01/08/2017	4,00,000	General	4,00,000 x 11.50% x 8/12=Rs. 30,667
31/12/2017	3,60,000	General	3,60,000 x 11.50% x 3/12=Rs. 10,350
Total	13,00,000		91,517

(2) **Journal Entry**

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
31.03.18	Building account	Dr.	13,91,517	
	To Bank account (13,00,000 + 91,517)			13,91,517
	(Being amount of cost of building and borrowing cost thereon capitalised)			

Working Note: Calculation of average interest rate other than for specific borrowings

$$\frac{(4,00,000 \times 9\%) + (5,00,000 \times 12\%) + (3,00,000 \times 14\%)}{4,00,000 + 5,00,000 + 3,00,000}$$

= 11.50%

2. On 1st April, 2023, Green Limited started the construction of an Office Building (qualified asset). The land under the building is regarded as a separate asset and is not a part of qualifying asset.
For the purpose of construction of building, the company raised a specific loan of ₹14 lakhs from a Bank at an interest rate of 12% per annum. An interest income of ₹15,000 was earned on this loan while it was held in anticipation of payments. The company's other outstanding loans on 1 April, 2023 were as follows:

Amount of Loan	Rate of Interest per annum
₹ 20,00,000	15%
₹ 30,00,000	8%

The construction of building started on 1st April, 2023 and was completed on 31st January, 2024 when it was ready for its intended use. Up to the date of completion of the building, the following payments were made to the contractor:

Payment date	**Amount in (₹)**
1st April 2023	4,00,000
1st August, 2023	10,00,000
1st December, 2023	25,00,000
31st January, 2024	5,00,000

The life of building is estimated to be 20 years and depreciation is calculated on straight line method.
You are required to:

(i) Calculate the amount of borrowing cost to be capitalized.
(ii) Pass initial journal entry to recognise the cost of building.
(iii) Depreciation on building for the year ending 31st March, 2024.
(iv) Carrying value of building on 31st March, 2024.

Solution:

(i) Computation of borrowing cost to be capitalized for specific borrowings and general borrowings based on weighted average accumulated expenses

Date of incurrence of expenditure	**Amount spent**	**Financed through**	**Calculation**	**₹**
1st April, 2023	4,00,000	Specific borrowing	4,00,000 X 12% X 10/12	40,000
1st August, 2023	10,00,000	Specific borrowing	10,00,000 X 12% X 10/12	1,00,000
1st December, 2023	25,00,000	General borrowing	25,00,000 X 10.80% x 2/12	45,000
31st January, 2024	5,00,000	General borrowing	5,00,000 X 10.80% x 0/12	0
Total				1,85,000
Less: Interest income on specific borrowings				(15,000)
Amount eligible for capitalization				1,70,000

(ii) **Journal Entry**

Date	**Particulars**		**Rs.**	**Rs.**
31.01.2024	Building account (WN 2)	Dr.	45,70,000	
	To Bank account			44,00,000
	To Interest payable (borrowing cost)			1,70,000
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

Alternatively, following journal entry may be passed if interest is paid on the date of capitalization:

Date	Particulars		Rs.	Rs.
31.01.2024	Building account (WN 2)	Dr.	45,70,000	
	To Bank account			45,70,000
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

(iii) Calculation of amount of depreciation on Building for the year ended 31/03/2024

Depreciation from 1st February 24 to 31st March 24

= (45,70,000 / 20 Years) X 2/12

= Rs. 38,083

(iv) Calculation of carrying amount of Building as on 31/03/2024

Particulars	Amount (Rs.)
Capitalised amount of building as on 31st Jan 24	45,70,000
(-) Amount of depreciation	(38,083)
	45,31,917

Working Notes:

(1) Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (₹)	Rate of interest		Amount of interest (₹)
20,00,000	15%	=	3,00,000
30,00,000	8%	=	2,40,000
50,00,000			5,40,000

Weighted average rate of interest (5,40,000/50,00,000) x 100 = 10.80%

(2) Total expenses to be capitalized for building

Cost of building (4,00,000 + 10,00,000 + 25,00,000 + 5,00,000)	44,00,000
Add: Amount of interest to be capitalized	1,70,000
	45,70,000

Note: Alternative way of Calculation of Amount of Borrowing cost Capitalised

(1) The costs incurred should first be allocated to the specific borrowings and then allocated to General Borrowing. Analysis of expenditure from general borrowings:

Date	Expenditure	Amount allocated in general borrowings	Weighted for period outstanding
1st April, 2023	4,00,000	0	0
1st August, 2023	10,00,000	0	0
1st December, 2023	25,00,000	25,00,000	25,00,000 X 2/12 = 4,16,667
31st January, 2024	5,00,000	5,00,000	5,00,000 × 0/12 = 0
Total			4,16,667

(2) Calculation of amount of borrowing cost to be capitalized:

		Amount (Rs.)
On specific borrowings (14,00,000 X 12% X 10/12)	1,40,000	
Less: interest income on specific borrowings	(15,000)	1,25,000
On General borrowing (4,16,667 × 10.80%)		45,000
Total		1,70,000

3. Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.2019. Money raised from debentures to be utilized as under:

Intended Purpose	Amount ₹ in lakhs
Construction of factory building	40
Working Capital	30
Purchase of Machinery	15
Purchase of Furniture	2
Purchase of truck	13

Additional Information:

(i) Interest on debentures for the Financial Year 2019-2020 was paid by the Company.

(ii) During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of ₹ 50,000.

(iii) In March, 2020 construction of factory building was not completed (it is expected that it will take another 6 months).

(iv) In March 2020, Machinery was installed and ready for its intended use.

(v) Furniture was put to use at the end of March 2020.

(vi) Truck is going to be received in April, 2020.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 2020 in the Books of Expert Limited.

Solution: According to AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use. As per the Standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard. Other borrowing costs should be recognized as an expense in the period in which they are incurred. It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost = ₹10,00,000 (100 lakhs x 12% x 10/12) – ₹ 50,000 = ₹ 9,50,000

Particulars	**Nature of assets**	**Interest to be capitalized (₹)**	**Interest to be charged to Profit & Loss Account (₹)**
Construction of factory building	Qualifying Asset	9,50,000x40/100 = ₹ 3,80,000	NIL
Purchase of Machinery	Not a Qualifying Asset	NIL	9,50,000x15/100 = 1,42,500
Purchase of and furniture	Not a Qualifying Asset	NIL	9,50,000x2/100 =19,000
Purchase of truck	Not a Qualifying Asset	NIL	9,50,000x13/100 = 1,23,500
Working Capital	Not a Qualifying Asset	NIL	9,50,000x30/100 = ₹ 2,85,000
Total		₹ 3,80,000	₹ 5,70,000

4. Nikka Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 20X2. An expenditure of ₹ 510 lacs was incurred on installation of Plant and Machinery, ₹ 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of ₹ 56 lacs has been used for working capital purposes. Management of Nikka Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of ₹ 68.20 lacs during financial year 20X1-20X2 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 20X2?

Solution: As per AS 16, Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

Where, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Accordingly, the treatment of Interest of ₹ 68.20 lacs occurred during the year 20X1-20X2 would be as follows:

(i) When construction of asset completed on 30th April, 20X2:

The treatment for total borrowing cost of ₹ 68.20 lakh will be as follows:

Purpose	Nature	Interest to be capitalised (₹ in lakh)	Interest to be charged to profit and loss account (₹ in lakh)
Modernisation and renovation of plant and machinery	Qualifying asset	[68.20 x (510/620)] = 56.10	
Advance to suppliers for additional assets	Qualifying asset	[68.20 x (54/620)] = 5.94	
Working Capital	Not a qualifying asset		[68.20 x (56/620)] = 6.16
		62.04	6.16

(ii) When construction of assets is completed by 28th February, 20X2

When the process of renovation gets completed in less than 12 months, the plant and machinery and the additional assets will not be considered as qualifying assets (until and unless the entity specifically considers that the assets took substantial period of time for completing their construction). Accordingly, the whole of interest will be required to be charged off / expensed off to Profit and loss account.

5. Take Ltd. has borrowed Rs. 30 lakhs from State Bank of India during the financial year 2013-14. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost Rs. 50 lakhs. As on 31st March, 2014, since the said project was not complete, the directors of Take Ltd. resolved to capitalize the interest accruing on borrowings amounting tò 4 lakhs and add it to the cost of investments. Comment.

Solution: As per para 9 of AS 13 "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. Rs. 4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 2014.

6. Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be started as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year:

(₹ in lakhs)

	Phase I ₹	Phase II ₹	Phase III ₹	Phase IV ₹
Cash expenditure	10	30	25	30
Building purchased	24	34	30	38
Total expenditure	34	64	55	68
Total expenditure of all phases				221
Loan taken @ 15% at the beginning of the year				200

During mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

Solution:

S.N.	Particulars	
1	Interest expense on loan ₹ 2,00,00,000 at 15%	30,00,000
2	Total cost of Phases I and II (₹ 34,00,000 +64,00,000)	98,00,000
3	Total cost of Phases III and IV (₹ 55,00,000 + ₹ 68,00,000)	1,23,00,000
4	Total cost of all 4 phases	2,21,00,000
5	Total loan	2,00,00,000
6	Interest on loan used for Phases I & II, based on proportionate Loan amount = [(30,00,000 / 2,21,00,000) X 98,00,000]	13,30,317 (approx.)
7	Interest on loan used for Phases III & IV, based on proportionate Loan amount = [(30,00,000 / 2,21,00,000) X 1,23,00,000]	16,69,683 (approx.)

Accounting treatment:

1. **For Phase I and Phase II:** Since Phase I and Phase II have become operational at the mid of the year, half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be expensed during the year.
2. **For Phase III and Phase IV:** Interest of ₹ 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

7. ABC Limited has started construction of an asset on 1st December, 2020, which continues till 31st March, 2021 (and is expected to go beyond a year). The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. The directly attributable expenditure at the beginning of the month on this asset was ₹ 10 lakh in December 2020 and ₹ 4 lakh in each of the months of January to March 2021. At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh on 1st March, 2021. Interest was paid on the overdraft at 10% until 1st January, 2021 and then the rate was increased to 12%. You are required to calculate the annual capitalization rate for computation of borrowing cost in accordance with AS 16 'Borrowing Costs'.

Solution: Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of outstanding Balance	Amount of loan (₹)	Rate of interest p.a.	Weighted average amount of interest (₹)
	a	b	c	d = [(b x c) x (a/12)]
9% Debentures	12 months	20,00,000	9%	1,80,000
Bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000
		36,00,000		**2,26,000**

Weighted average cost of borrowings

= {20,00,000 x(12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)} = 24,33,334

Capitalisation rate = [(Weighted average amount of interest / Weighted average of general borrowings) x 100]

= [(2,26,000 / 24,33,334) x 100]

= 9.29% p.a.