

Borrowing Cost
AS16
Question for Practice

PQ No. 1: (4 marks Nov 10) On 1st April, 2009, amazing construction ltd. Obtained a loan of ₹ 32 crores to be utilized as under:

(i)	Construction of sealink across two cities: (work was held up totally for a month during the year due to high water levels)	₹ 25 crores
(ii)	Purchase of equipments and machineries	₹ 3 crores
(iii)	Working capital	₹ 2 crores
(iv)	Purchase of vehicles	₹ 50,00,000
(v)	Advance for tools/cranes etc.	₹ 50,00,000
(vi)	Purchase of technical know-how	₹ 1 crores
(vii)	Total interest charged by the bank for the year ending 31 st March, 2010	₹ 80,00,000

Show the treatment of interest by amazing construction ltd.

Answer: According to Para 3 of as 16 'Borrowing Costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per Para 6 of the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset, other borrowing costs should be recognised as an expense in the period in which they are incurred.

Therefore, the treatment of interest by amazing Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalized ₹	Interest to be charged to P & L a/c ₹	Working

Construction of sea link	Yes	62,50,000	---	[80,00,000(25/32)]
Purchase of equipments and machineries	No		7,50,000	[80,00,000(3/32)]
Working capital	No		5,00,000	[80,00,000(2/32)]
Purchase of vehicles	No		1,25,000	[80,00,000(5/32)]
Advance for tools, cranes etc	No		1,25,000	[80,00,000(5/32)]
Purchase of technical know how	No		2,50,000	[80,00,000(1/32)]
Total		62,60,000	17,50,000	

PQ No. 2: (5 marks, May 10 & Nov 11) On 25th April, 2010, Neel limited obtained a loan from the bank for ₹ 70 lakh to be utilized as under:

	₹ In lakhs
Construction of factory shed	28
Purchase of machinery	21
Working capital	14
Advance for purchase for truck	7

In March, 2011, construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31st March, 2011 was ₹ 12 Lakhs. Show the treatment of interest under accounting standard 16.

Answer: Treatment of Interest as Per AS 16

	Particulars	Nature	Interest amount to be capitalized	Interest amount to be charged to P & L account
1.	Construction of factory shed	Qualifying asset	₹ 12 lakhs × 28/70 = ₹ 4.80 lakhs	
2.	Purchase of machinery	Not a qualifying asset		₹ 12 lakhs × 21/70 = ₹ 2.40 lakhs

3.	Working capital	Not a qualifying asset		₹ 12 lakhs × 14/70 = ₹ 2.40 laksh
4.	Advance for purchase of truck	Not a qualifying asset		₹ 12 lakhs × 7/70 = ₹ 1.20 laksh
	Total		₹ 4.80 lakhs	₹ 7.20 lakhs

Note:

1. It is assumed that construction of factory shed was completed at the end of March, 2011. Accordingly, interest for the full year has been capitalized.
2. It is assumed that machinery was ready to use at the time of purchase only and on this basis it has been treated as non-qualifying asset.

PQ No. 3: (5 Marks, May 14) Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakh on 01.05.2013, to be utilized as under:

Particulars	Amount (₹ In lakh)
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2014, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2014 was ₹ 11,00,000. During the year 2013-14, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

Answer: According to Para 6 of AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised 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 recognised as an expense in the period in which they are incurred.

Also, Para 10 of AS 16 "Borrowing Costs" 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 capitalisation 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 = ₹ 11,00,000 - ₹ 2,00,000 = ₹ 9,00,000

	Particulars	Nature of assets	Interest to be Capitalized (₹)	Interest to be Charged to P & L A/c (₹)
i	Construction of factory building	Qualifying Asset*	$9,00,000 \times 40/100$ = ₹ 3,60,000	NIL
ii	Purchase of Machinery	Not a Qualifying Asset	NIL	$9,00,000 \times 35/100$ = ₹ 3,15,000
iii	Working Capital	Not a Qualifying Asset	NIL	$9,00,000 \times 25/100$ = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

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

PQ No. 4: X Ltd. began construction of a new building on 1st January, 2023. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 2023 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 5,00,000	11%
₹ 9,00,000	13%

The expenditures that were made on the building project were as follows:

		₹
January	2023	2,00,000
April	2023	2,50,000
July	2023	4,50,000

December	2023	1,20,000
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Building was completed by 31st December 2023. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalised and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building.

Solution: (i) Calculation of weighted average interest rate other than for specific borrowings

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
5,00,000	11%	= 55,000
9,00,000	13%	= 1,17,000
14,00,000		= 1,72,000

Weighted average rate of interest = $(1,72,000 / 14,00,000) \times 100 = 12.285\%$

(ii) Computation of Interest on weighted average accumulated expenses

		₹
Specific borrowings (₹ 1,00,000 x 10%) =		10,000
Non-specific borrowings =		
(₹ 1,00,000 x 12.285%)	12,285	
(₹ 2,50,000 x 12.285% x 9/12)	23,034	
(₹ 4,50,000 x 12.285% x 6/12)	27,641	
(₹ 1,20,000 x 12.285% x 1/12)	1,229	64,189
Amount of interest to be capitalized =		74,189

(iii) Total expenses to be capitalised for building

	₹
Cost of building ₹ (2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)	10,20,000
Add: Amount of interest to be capitalised	74,189
	10,94,189

(iv) Journal Entry

Date	Particulars		Dr. (₹)	Cr. (₹)
31.12. 2023	Building account To Bank account (Being amount of cost of building and borrowing cost thereon capitalised)	Dr.	10,94,189	10,94,189