

Meaning & Treatment of Borrowing Costs

(1) Meaning of Borrowing Costs:-

It means costs incurred for borrowing the funds including

→ Interest Costs

→ Exchange Difference on Foreign Currency Borrowing upto some extent

(2) Treatment of Borrowing Costs:-

If Borrowing is taken for Acquisition or Construction of a Qualifying Asset

↓
Capitalise it to the Cost of that Asset

Otherwise

↓
Recognise as an Expense in P&L

Note: Qualifying Asset:-

→ It means any Asset [Example: Inventory, PPE, Intangible Assets, Investment Property, etc.] which takes substantial period of time to get ready for its intended use or sale [i.e. Installation or Construction of Asset is taking substantial period of time]

→ 'Substantial Period of Time' is not defined under the Ind AS. It will be as per the judgement of the Entity. In silent question, we will assume that Asset is taking substantial period of time to get ready.

Period of Capitalisation of Borrowing Costs

Commencement Date of Capitalisation of Borrowing Costs

↓
Capitalisation of Borrowing Costs should start from Later of following dates:

(i) Loan Taken

(ii) Development Activities on the Asset has been Started

(iii) Expense is incurred on the Asset

Cessation Date of Capitalisation of Borrowing Costs

↓
• Capitalisation of Borrowing Costs should stop on the date when the Asset gets ready for its intended use or sale.

• If Entity is completing construction of Asset in Parts & each part can be used individually, then Entity should stop capitalisation of Borrowing Costs on completed part on the date when that part gets ready for its intended use or sale.

[Example: Building Construction Project in Phases]

Note:- If Entity pause development work on the Asset for unnecessary season, then Capitalisation of Borrowing Costs on that Asset will be suspended for such period.

Capitalisation of Borrowing Costs

Entity can have 2 types of Borrowings as follows:-



It is assumed that:

- Specific Borrowings are firstly used to incur expense on qualifying asset, and then
- General Borrowings are used to incur remaining expense on qualifying asset

Calculation of Borrowing Cost to be Capitalised on Qualifying Asset during the year as follows:-

Step 1: Specific Borrowing Cost:

Actual Interest Cost incurred on Specific Borrowings irrespective of expense incurred on qualifying asset on different dates

xxx

$$\left[\begin{array}{l} \text{Specific Borrowing Amount} \times \text{Interest Rate on Specific Borrowing} \times \frac{\text{Months}}{12} \\ \text{Here, Months will be taken} \\ \left\{ \begin{array}{l} \text{FROM} \Rightarrow \text{Later of} \left\{ \begin{array}{l} \text{Commencement Date of Capitalisation} \\ \text{Year Beginning} \end{array} \right. \\ \text{TO} \Rightarrow \text{Earlier of} \left\{ \begin{array}{l} \text{Cessation Date of Capitalisation} \\ \text{Year End} \end{array} \right. \end{array} \right. \end{array} \right]$$

(-) Investment Income on Temporary Investment of these Specific Borrowings [if any] (xxx)
Specific Borrowing Cost to be Capitalised xxx

Step 2: General Borrowing Cost:

(i) Calculate Capitalisation Rate [Weighted Average Borrowing Rate]

$$\Rightarrow \frac{\text{Total Actual Interest on All General Borrowings}}{\text{Total Amount of General Borrowings weighted average on time basis}} \times 100$$

(ii) Calculate Eligible General Borrowing Cost

$$\Rightarrow \frac{\text{Expense incurred on Qualifying Asset on each date (after utilising Specific Borrowing)}}{\text{Total Amount of General Borrowings weighted average on time basis}} \times \text{Capitalisation Rate} \times \frac{\text{Months}}{12}$$

Here, Months will be taken

$$\left\{ \begin{array}{l} \text{FROM} \Rightarrow \text{Later of} \left\{ \begin{array}{l} \text{Commencement Date of Capitalisation} \\ \text{Respective Expense Incurred Date} \\ \text{Year Beginning} \end{array} \right. \\ \text{TO} \Rightarrow \text{Earlier of} \left\{ \begin{array}{l} \text{Cessation Date of Capitalisation} \\ \text{Year End} \end{array} \right. \end{array} \right.$$

- * Expense incurred should be considered on Actual Outflow basis [Not Accrual]
- * Borrowing Costs already capitalised on Qualifying Asset till Previous Year should also be considered as Expense incurred on Qualifying Asset for calculation of Eligible General Borrowing Cost for the Current Year

(iii) Calculate General Borrowing Cost to be Capitalised

Eligible General Borrowing Cost as calculated above
OR
Total Actual Interest on All General Borrowings } Lower

Step 3: Total Borrowing Cost to be Capitalised on Qualifying Asset during the year:
⇒ Step 1 + Step 2

Note:-

(i) If Specific Borrowings are taken for More than 1 Asset, then Allocate Specific Borrowing Cost to All Asset as follows:

$$\Rightarrow \text{Total Specific Borrowing Cost} \times \frac{\text{Expense incurred on 1 Asset}}{\text{Total Expense incurred on All Assets}}$$

(ii) If Borrowing taken is in nature of Bonds issued at Discount, then EIR as per Ind AS 109 will be considered for calculation of Borrowing Costs.

Example:-

A Ltd. started construction of a building on 1st April for which it obtained a Specific Loan of ₹ 2 Lakh at 9% p.a.

A Ltd. has also taken other loans as follows:

₹ 8,00,000 @ 10% p.a.

₹ 12,00,000 @ 13% p.a.

Expense incurred on construction of Building:

Date	Amount in ₹
1 st April	1,50,000
1 st August	1,40,000
1 st October	30,000

Construction completed on 31st December. Calculate Borrowing Cost to be capitalised.

Solution:-

Step 1: Specific Borrowing Cost ⇒ ₹ 2 Lakh × 9% × $\frac{9}{12}$ = ₹ 13,500

Step 2: General Borrowing Cost:

$$(i) \text{ WABR} \Rightarrow \frac{(8,00,000 \times 10\% \times \frac{12}{12}) + (12,00,000 \times 13\% \times \frac{12}{12})}{(8,00,000 \times \frac{12}{12}) + (12,00,000 \times \frac{12}{12})} \times 100 \Rightarrow \frac{2,36,000}{20,00,000} \times 100 \Rightarrow 11.80\%$$

(ii) Eligible General Borrowing Cost on expense incurred

$$1^{\text{st}} \text{ April} \Rightarrow 1,50,000 - 1,50,000 \text{ (Specific)} = 0$$

$$\begin{aligned}
 1^{\text{st}} \text{ August} &\Rightarrow 1,40,000 - 50,000 (\text{Specific}) = 90,000 \times 11.80\% \times \frac{5}{12} = ₹ 4,425 \\
 1^{\text{st}} \text{ October} &\Rightarrow 3,00,000 \times 11.80\% \times \frac{3}{12} = ₹ 8,850 \\
 &\underline{\hspace{10em} ₹ 13,275}
 \end{aligned}$$

(iii) General Borrowing Cost to be Capitalised

Eligible General Borrowing Cost = ₹ 13,275

OR

Total Actual Interest on All General Borrowings = ₹ 2,34,000

} Lower, i.e. ₹ 13,275

Step 3: Total Borrowing Cost to be Capitalised $\Rightarrow ₹ 13,500 + ₹ 13,275 \Rightarrow ₹ 26,775$

Capitalisation of Borrowing Costs by Group Companies

(1) In SFS of each Group Company :-

- Apply Same Principles as discussed above in this Ind AS.
- Capitalise Borrowing Costs into Qualifying Asset in SFS of Company if it has taken Borrowing & has incurred Expense on Qualifying Asset.

(2) In CFS of the Group :-

- Capitalise Borrowing Costs into Qualifying Asset in CFS by considering all the borrowings taken by each company in the group & all expense incurred on qualifying assets by each Company in the group.
- If Inter Company Profit is charged on Construction of Qualifying Asset within the Group, then such profit will be eliminated in CFS while considering Expense incurred on Qualifying Assets.

Exchange Difference on Foreign Currency Borrowing to be treated as Borrowing Cost

- Exchange Loss arising on Foreign Currency Borrowing upto Saving in Interest Cost is treated as Borrowing Cost as per Ind AS 23 & Remaining Exchange Loss will be recognised in P&L as per Ind AS 21.
- Steps to be followed to solve the question :-

Step 1: Calculate Actual Interest Cost on Foreign Currency Borrowing

$$\Rightarrow \frac{\text{Foreign Currency Borrowing Amount}}{\text{Borrowing Amount}} \times \frac{\text{Foreign Currency Borrowing}}{\text{Interest Rate}} \times \frac{\text{Exchange Rate}}{\text{at Year End}}$$

Step 2: Calculate Saving in Interest Cost

$$\Rightarrow \text{Interest Cost on Functional Currency Borrowing} - \text{Interest Cost on Foreign Currency Borrowing [Step 1]}$$

$$* \text{ Interest Cost on Functional Currency Borrowing} \Rightarrow \text{Foreign Currency Borrowing Amount} \times \frac{\text{Exchange Rate on date of Borrowing}}{\text{Functional Currency Borrowing Interest Rate}}$$

Step 3: Calculate Exchange Difference on Foreign Currency Borrowing

$$\Rightarrow \text{Foreign Currency Borrowing Amount} \times \left[\text{Exchange Rate at Year End} - \text{Exchange Rate at Beginning} \right]$$

If Positive

↓
Exchange Loss

↓
→ Lower of Exchange Loss & Saving in Interest Cost [as per Step 2] will be treated as Borrowing Cost as per Ind AS 23

→ Remaining Exchange Loss (if any) will be recognised in P&L as per Ind AS 21 [Balancing figure]

If Negative

↓
Exchange Gain

↓
Recognised in P&L as per Ind AS 21
[No Treatment as per Ind AS 23 of Exchange Gain initially arising on such Loan]

Step 4: Total Borrowing Cost on Foreign Currency Borrowing

$$\Rightarrow \text{Actual Interest Cost on foreign Currency Borrowing [Step 1]} + \text{Exchange Loss arising on foreign Currency Borrowing upto Saving in Interest Cost [Step 3]}$$

Note:- If Exchange Loss on Foreign Currency Borrowing is treated as Borrowing Cost in a Year & Exchange Gain arises on that foreign Currency Borrowing in Subsequent Year, then such Exchange Gain (upto the amount of previously recorded Exchange Loss as Borrowing Cost on remaining outstanding Loan) will be deducted from the Borrowing Cost.

Example:-

A Ltd. [Indian Company] has taken a loan of \$ 1,000 on 1st April for constructing a Qualifying Asset at 4% p.a. Equivalent Amount of Loan could have been taken in Functional Currency at 12% p.a. Exchange Rate on 1st April was 1\$ = ₹ 40 and on Year end (31st March) was 1\$ = ₹ 41

(a) Calculate Total Borrowing Cost to be capitalised during the year.

(b) If Exchange Rate at 2nd Year End becomes 1\$ = ₹ 39.50, Calculate amount to be adjusted in Borrowing Cost.

Solution:-

(a) Step 1: Actual Interest Cost on foreign Currency [\$] Borrowing

$$\Rightarrow 1,000 \$ \times 4\% \times ₹ 41 \Rightarrow ₹ 1,640$$

Step 2: Saving in Interest Cost:

$$\Rightarrow ₹ 4,800 - ₹ 1,640 \Rightarrow ₹ 3,160$$

$$* \text{Interest on functional Currency [₹] Borrowing} \Rightarrow 1,000 \$ \times ₹ 40 \times 12\% \Rightarrow ₹ 4,800$$

Step 3: Exchange Loss $\Rightarrow \$ 1,000 \times (₹ 41 - ₹ 40) \Rightarrow ₹ 1,000$

Exchange Loss as Borrowing Cost \Rightarrow Lower of ₹ 1,000 & ₹ 3,160 i.e. ₹ 1,000

Step 4: Total Borrowing Cost to be capitalised during the year $\Rightarrow ₹ 1,640 + ₹ 1,000 \Rightarrow ₹ 2,640$

(b) Exchange Gain at 2nd Year End \Rightarrow \$ 1,000 ($\text{₹} 39.50 - \text{₹} 41$) \Rightarrow ₹ 1,500

So, Exchange Gain upto previous Exchange Loss recognised as Borrowing Cost i.e. ₹ 1,000 will be deducted from Borrowing Cost as per Ind AS 23 & Remaining Exchange Gain of ₹ 500 will be recognised in P&L as per Ind AS 21.