

AS 16 – BORROWING COSTS

Illustration 1

PRM Ltd. obtained a loan from a bank for ₹ 120 lakhs on 30-04-20X1. It was utilised as follows:

Particulars	Amount (₹ in lakhs)
Construction of a shed	50
Purchase of a machinery	40
Working Capital	20
Advance for purchase of truck	10

Construction of shed was completed in March 20X2. The machinery was installed on the date of acquisition. Delivery of truck was not received. Total interest charged by the bank for the year ending 31-03-20X2 was ₹ 18 lakhs. Show the treatment of interest.

Solution

Qualifying Asset as per AS 16 = ₹ 50 lakhs (construction of a shed)

Borrowing cost to be capitalised = $18 \times 50/120 = ₹ 7.5$ lakhs

Interest to be debited to Profit or Loss account = ₹ $(18 - 7.5)$ lakhs = ₹ 10.5 lakhs

Illustration 2 (RTP May'24)

X Ltd. began construction of a new building on 1st January, 20X1. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 20X1 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	20X1	2,00,000
April	20X1	2,50,000
July	20X1	4,50,000
December	20X1	1,20,000

Building was completed by 31st December 20X1. 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) Computation of weighted average accumulated expenses

		₹
₹ 2,00,000 x 12 / 12	=	2,00,000
₹ 2,50,000 x 9 / 12	=	1,87,500
₹ 4,50,000 x 6 / 12	=	2,25,000
₹ 1,20,000 x 1 / 12	=	<u>10,000</u>
		6,22,500

(ii) Calculation of weighted average interest rate other than for specific borrowings

	Qualifying Asset	Interest to be capitalized ₹	Interest to be charged to Profit & Loss A/c ₹	
Construction of sea-link	Yes	62,50,000		[80,00,000x(25/32)]
Purchase of equipment and machineries	No		7,50,000	[80,00,000x(3/32)]
Working capital	No		5,00,000	[80,00,000x(2/32)]
Purchase of vehicles	No		1,25,000	[80,00,000x(0.5/32)]
Advance for tools, cranes etc.	No		1,25,000	[80,00,000x(0.5/32)]
Purchase of technical know-how	No		2,50,000	[80,00,000x(1/32)]
Total		62,50,000	17,50,000	

*It is assumed that work held up for a month due to high water level is normal during the construction of sealink and capitalization of borrowing cost should not be suspended for necessary temporary delay.

Illustration 9 (MTP March'23) (RTP Nov 20)

Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.20X1 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.20X2. Due to surplus fund out of ₹ 150 crores, income of ₹ 3.50 crores were earned and credited to profit and loss account.

Comment on the above treatment of accountant with reference to relevant AS.

(5 Marks)

Solution:

Para 10 of AS 16 'Borrowing Costs' states "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."

The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Thus, the treatment of accountant of Rainbow Ltd. is incorrect.

Amount of borrowing costs capitalized should be calculated as follows:

Particulars	₹ in crores
Actual interest for 20X1-20X2 (11% of ₹ 150 crores)	16.50
Less: Income on temporary investment from specific borrowings	(3.50)
Borrowing costs to be capitalized during year 20X1-20X2	13.00

Illustration 10 (RTP Nov '22)

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
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	₹	₹	₹	₹
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:

Computation of amount to be capitalized

No.	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	30,00,000
	Loan amount = $\frac{2,21,00,000}{3,30,317} \times 98,00,000$	(approx.)
7.	Interest on loan used for Phases III & IV, based on	16,69,683
	proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	(approx.)

Accounting treatment

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.

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.

Question 4 (MTP Nov'21, April 23)

ABC Limited has started construction of an asset on 1st December, 2021, which continues till 31st March, 2022 (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 2021 and ₹ 4 lakh in each of the months of January to March 2022. 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, 2022; Interest was paid on the overdraft at 10% until 1st January, 2022 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 (5 Marks)

Solution:

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of Outstanding balance	Amount of loan(Rs.)	Rate of interest p.a.	Weighted average amount of Interest (Rs.)
	a	b	c	d=[bXc]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

$$= (20,00,000 \times (12/12)) + (4,00,000 \times (11/12)) + (8,00,000 \times (1/12)) = 24,33,334$$

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.

Question 5 (RTP May'18, Nov 19, Nov 21)

In May, 2020, Omega Ltd. took a bank loan from a Bank. This loan was to be used specifically for the construction of a new factory building. The construction was completed in January, 2021 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2021 amounted to ₹ 25 lakhs. the company wants to treat ₹ 25 lakhs as part of the cost of factory building and thus capitalize it on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

Solution:

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building up to the date of completion (January, 2021) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 6 (RTP May '22)

a) An enterprise has constructed a complex piece of equipment (qualifying asset) that is to be installed on the production line of a manufacturing plant. The equipment has been constructed over a period of 15

assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets. 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.

Other borrowing costs should be recognized as an expense in the period in which they are incurred. Construction of factory shed amounting ₹ 240 lakhs is qualifying asset in the given case. The interest for this amount during the year will be added to the cost of factory shed. All others (purchase of machinery, vehicles and technical know how, working capital, advance for tools/cranes) are nonqualifying assets and related borrowing cost will be charged to Profit and Loss statement. Qualifying Asset as per AS 16 (construction of a shed) = ₹ 240 lakhs Borrowing cost to be capitalized = ₹ 40 lakhs x 240/320 = ₹ 30 lakhs Interest to be debited to Profit or Loss account: ₹ (40 – 30) = ₹ 10 lakhs;

Note: Assumed that construction of factory shed completed on 31st March, 2020.

Question 9 (Past Exam May'19)

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. Details of other outstanding non-specific loans were:

Amount (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 building construction were as follows:

Date	Amount (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 construction 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 & borrowing cost in respect of the factory building (5 Marks)

Solution:

(i) Computation of average accumulated expenses

		Rs.
Rs. 3,00,000 x 12 / 12	=	3,00,000
Rs. 2,40,000 x 10 / 12	=	2,00,000
Rs. 4,00,000 x 8 / 12	=	2,66,667
Rs. 3,60,000 x 3 / 12	=	90,000
		8,56,667

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (Rs.)	Rate of interest	Amount of interest (₹)

4,00,000	9%	= 36,000
5,00,000	12%	= 60,000
3,00,000	14%	= 42,000
Weighted average rate of interest $\left(\frac{1,38,000}{12,00,000} \times 100\right)$		1,38,000
		= 11.5%

(iii) Amount of interest to be capitalized**Interest on average accumulated expenses:**

	Rs.
Specific borrowings (Rs. 2,00,000 x 8%)	= 16,000
Non-specific borrowings (Rs. 6,56,667* x 11.5%)	= 75,517
Amount of interest to be capitalised	= 91,517

(iv) Total expenses to be capitalized for building

	Rs.
Cost of building Rs. (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000)	13,00,000
Add: Amount of interest to be capitalized	91,517
	13,91,517

(v) Journal Entry

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
31.3.2018	Building A/c Dr.	13,91,517	
	To Building WIP* A/c		13,00,000
	To Borrowing costs A/c		91,517
	(Being amount of cost of building and borrowing cost thereon capitalized)		

Question 10 (Past Exam May'22)

Zebra Limited began construction of a new plant on 1st April, 2021 and obtained a special loan of ₹ 20,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

The expenditure that was incurred on the construction of plant was as follows:

	₹
1st April, 2021	10,00,000
1st August, 2021	24,00,000
1st January, 2022	4,00,000

The company's other outstanding non-specific loan was ₹ 46,00,000 at an interest rate of 12%;

The construction of the plant completed on 31st March, 2022. You are required to:

- a) Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".

b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant. **(5 Marks)**

Solution:

Total expenses to be capitalized for borrowings as per AS 16 "Borrowing Costs":

	₹
Cost of Plant (10,00,000 + 24,00,000 + 4,00,000)	38,00,000
Add: Amount of interest to be capitalized (W.N.)	3,24,000
	41,24,000

Journal Entry

		₹	₹
31st March, 2022	Plant A/c Dr.	41,24,000	
	To Bank A/c		41,24,000
	[Being amount of cost of plant and borrowing cost thereon capitalized]		

Working Note:

Computation of interest to be capitalized:

	Expenditure			₹
1st April, 2021	10,00,000	On specific borrowing	₹ 10,00,000 × 10%	1,00,000
1st August, 2021	24,00,000	On specific borrowing	₹ 10,00,000 × 10%	1,00,000
1st August, 2021		On non-specific borrowings	₹ 14,00,000 × $\frac{8}{12}$ × 12%	1,12,000
1st January, 2022	4,00,000	On non-specific borrowings	₹ 4,00,000 × $\frac{8}{13}$ × 12	12,000
				3,24,000

Alternatively, interest cost to be capitalized can be derived by computing average accumulated expenses in the following manner.

Computation of Average Accumulated Expenses:

1st April, 2021	10,00,000 × 12/12	10,00,000
1st August, 2021	10,00,000 × 12/12	10,00,000
	14,00,000 × 8/12	9,33,333
1st January, 2022	4,00,000 × 3/12	1,00,000
		30,33,333

Computation of interest to be capitalized:

		₹
On specific borrowing	₹ 20,00,000 × 10%	2,00,000
On non-specific borrowing	₹ (30,33,333- 20,00,000) × 12%	1,24,000
		3,24,000

NOTE: Since specific borrowings are earmarked for construction of a particular qualifying asset, it cannot be used for construction of any other qualifying asset except for temporary investment. Therefore, once the

commencement of capitalization of borrowing cost criteria are met, actual borrowing cost incurred on specific borrowing shall be capitalized irrespective of the fact that amount had been utilized in parts.

Question 11 (Past Exam May '23)

On 1st April, 2022 Workhouse Limited took a loan from a Financial Institution for ₹ 25,00,000 for the construction of Building. The rate of interest is 12%.

In addition to above loan, the company has taken multiple borrowings as follows:

- | | |
|-----------------------|-------------|
| (i) 8% Debentures | ₹ 15,00,000 |
| (ii) 15% Term Loan | ₹ 30,00,000 |
| (iii) 10% Other Loans | ₹ 18,00,000 |

The company has utilised the above funds in construction / purchase of the following assets:

- | | |
|-------------------------|-------------|
| (i) Building | ₹ 70,00,000 |
| (ii) Furniture | ₹ 22,00,000 |
| (iii) Plant & Machinery | ₹ 90,00,000 |
| (iv) Factory Shed | ₹ 43,00,000 |

The construction of Building, Plant & Machinery and Factory Shed was completed on 31st March 2023. Readymade Furniture was purchased directly from the market. The factory was ready for production on 1st April 2023.

You are required to calculate the borrowing cost for both qualifying and non-qualifying assets. **(5 Marks)**

Solution:

Interest to be Capitalized (on qualifying asset)

	Particulars	Computation	₹
i.	On specific Borrowings	25,00,000x12%	3,00,000
ii.	On non-specific borrowings	(W.N.1)	6,67,500
iii.	Amount of interest to be Capitalised	(i+ii)	9,67,500

Interest transferred to P&L (on non-qualifying asset)

	Particulars	Computation	₹
i.	On non-specific Borrowings	(W.N.1)	82,500

Working note:

1. Treatment of interest under AS 16 on non-specific borrowings

	Particulars	Qualifying asset	# Computation	Interest-Capitalized	Interest charged to P&L A/c
i.	Building	Yes	$45,00,000 / 2,00,00,000 \times 63,00,000 \times 11.9048\%$	1,68,750	-
ii.	Furniture	No	$22,00,000 / 2,00,00,000 \times 63,00,000 \times 11.9048\%$	-	82,500
iii.	Plant &	Yes	$90,00,000 / 2,00,00,000 \times 63,00,000 \times$	3,37,500	-

	Machinery		11.9048%		
iv.	Factory shed	Yes	$43,00,000 / 2,00,00,000 \times 63,00,000 \times 11.9048\%$	1,61,250	-
	Total			6,67,500	82,500

NOTE: Alternative manner of presentation for Treatment of interest under AS 16 on non-specific borrowings:

	Particulars Qualifying asset		Expenses Share in Incurred borrowings		Interest-Capitalized ₹	Interest charged to P&L A/c ₹
			₹	₹		
i.	Building	Yes	45,00,000	$7,50,000 \times 45/200$	1,68,750	-
ii.	Furniture	No	22,00,000	$7,50,000 \times 22/200$	-	82,500
iii.	Plant & Machinery	Yes	90,00,000	$7,50,000 \times 90/200$	3,37,500	-
iv.	Factory shed	Yes	43,00,000	$7,50,000 \times 43/200$	1,61,250	-
	Total		2,00,00,000		6,67,500	82,500

2. Weighted Average interest rate for non-specific borrowings

Particulars	Amount of loan (a)	Rate of interest (b)	Amount of interest (c) = (a) x (b)
Debentures	15,00,000	8%	1,20,000
Term loan	30,00,000	15%	4,50,000
Other loans	18,00,000	10%	1,80,000
	63,00,000		7,50,000
		# Weighted Average Rate of Interest $= 7,50,000 / 63,00,000 \times 100 = 11.9048\%$	

Question 12 (Past Exam Nov'23)

Answer the following questions:

Glen Ltd. began construction of a new building on 1st January, 2022. On 1st April, 2022, following two loans were obtained to fund the construction cost:

- Loan of ₹ 60,00,000 from Data Bank Ltd. was taken at interest rate of 8% per annum. This loan was fully utilized for construction of the new building.
- Loan of ₹ 20,00,000 from Satya Bank Ltd. Out of this, loan amount of ₹ 6,00,000 was utilized for working capital purpose. Total interest of ₹ 1,92,000 were paid to Satya Bank Ltd. for the financial year 2022-23.

Construction of the new building was completed on 31st January, 2023 and was ready for its intended use on the same date.

None of the loan was repaid during the year. The building is a qualifying asset for the purpose of AS-16.

Out of loan from Data Bank Ltd., surplus funds were temporarily invested for the short period of time. This temporary investment earned interest of ₹ 30,000.

You are required to calculate the amount of interest (a) to be capitalized, (b) to be charged to profit and loss account from the total interest incurred as borrowing cost during the year 2022-23 (as per AS-16).

Solution:

(5 Marks)

According to AS 16 "Borrowing Costs", 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 recognised as an expense in the period in which they are incurred.

The standard 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 on Loan of data bank to be capitalized:

$$= ₹(60,00,000 \times 8\%) \times 10/12 - ₹30,000$$

$$= ₹4,00,000 - ₹30,000$$

$$= ₹3,70,000$$

Loan	Particulars	Nature of assets	(a) Interest to be Capitalized (₹)	(b) Interest to be charged to Profit & Loss Account (₹)
Data bank	Construction of factory building	Qualifying Asset	3,70,000	(4,80,000 - 4,00,000) 80,000
Satya Bank	Construction of factory building	Qualifying Asset	$(1,92,000 \times 14/20) \times 10/12 = 1,12,000$	$(1,92,000 \times 14/20) \times 2/12 = 22,400$
Satya Bank	Working Capital	Not a Qualifying Asset	NIL	$(1,92,000 \times 6/20) = ₹57,600$
	Total ₹		4,82,000	₹1,60,000

Note: Loan from Satya bank is considered to be specific borrowings.

Question 13 (RTP Sep'24)

Loyal Ltd. has undertaken a project for expansion of capacity as per the following details:

	Plan (₹)	Actual (₹)
October, 2023	5,00,000	4,00,000
November, 2023	6,50,000	7,95,000
December, 2023	20,00,000	-
January, 2024	2,00,000	50,000
February, 2024	9,00,000	2,00,000
March, 2024	10,00,000	12,00,000

The company pays to its bank interest at a rate of 15% p.a., which is debited on a monthly basis. During the half year, company had ₹ 20 lakh overdraft up to 31st December, surplus cash in January and again overdraft of ₹ 14 lakh from 1.2.2024 and ₹ 30 lakh from 1.3.2024. The company had a strike during December and hence could not continue the work during said period. However, the substantial administrative work related to the project was continued. Onsite work was again commenced on 1st January and all the work were completed on 31st March. Assume that expenditure was incurred on 1st day of each month.

Calculate interest to be capitalized giving reason wherever necessary. Assume overdraft will be less, if there is no capital expenditure.

Solution:

Loyal Ltd.

Month	Actual Expenditure (₹)	Interest on outstanding amount @ 15% p.a.	Interest capitalized (₹)	Outstanding amount	Cumulative amount (₹)
	1		2	3	
October, 2023	4,00,000	$4,00,000 \times 15\% \times 1/12$	5,000	4,05,000	4,05,000
November, 2023	7,95,000	$(4,05,000 + 7,95,000) \times 15\% \times 1/12$	15,000	$(4,05,000 + 7,95,000 + 15,000)$	12,15,000
December, 2023	-	$(12,15,000) \times 15\% \times 1/12$	15,188	$12,15,000 + 15,188$	12,30,188
January, 2024	50,000		-	$12,30,188 + 50,000$	12,80,188
February, 2024	2,00,000	$14,00,000 \times 15\% \times 1/12$	17,500	$12,80,188 + 2,00,000 + 17,500$	14,97,688
March, 2024	12,00,000	$(14,97,688 + 12,00,000) \times 15\% \times 1/12$	33,721	$14,97,688 + 12,00,000 + 33,721$	27,31,409
	26,45,000		86,409		

Note:

- 1) As per para 18 of AS 16, 'Borrowing Cost', capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Therefore, the interest for that period i.e. for the month of December has also been capitalized.
- 2) During January, the company did not incur any interest as there was surplus cash in January. Therefore, no amount should be capitalized during January as per para 14(b) of AS 16.
- 3) During February, actual overdraft (borrowings) was ₹ 14 lakh only. Hence, interest of ₹ 17,500 on ₹ 14,00,000 has been calculated even though actual expenditure on project exceed ₹ 14 lakh.

18. ABC Builders Limited had borrowed a sum of US \$ 15,00,000 at the beginning of Financial year 2020-21 for its residential project at London Interbank Offered Rate (LIBOR) + 4 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, the exchange rate was ₹ 72 per US \$ and the rate as on 31st March, 2021 was ₹ 76 per US \$. If ABC Builders Limited borrowed the loan in Indian Rupee equivalent, the pricing of loan would have been 9.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2021 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

18. (i) Interest for the period 2020-21

$$= \text{US \$ } 15 \text{ lakhs} \times 5\% \times \text{₹ } 76 \text{ per US \$} = \text{₹ } 57 \text{ lakhs}$$

(ii) Increase in the liability towards the principal amount

$$= \text{US \$ } 15 \text{ lakhs} \times \text{₹ } (76 - 72) = \text{₹ } 60 \text{ lakhs}$$

(iii) Interest that would have resulted if the loan was taken in Indian currency

$$= \text{US \$ } 15 \text{ lakhs} \times \text{₹ } 72 \times 9.5\% = \text{₹ } 102.60 \text{ lakhs}$$

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 102.60 lakhs less ₹ 57 lakhs = ₹ 45.60 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 45.60 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 102.60 lakhs being the aggregate of interest of ₹ 57 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 45.60 lakhs.

Hence, ₹ 102.60 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 14.4 lakhs (60 - 45.60) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

Question 1

- (a) 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 1st 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 ₹
1 st April, 2023	4,00,000
1 st August, 2023	10,00,000
1 st December, 2023	25,00,000
31 st 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 as on 31st March, 2024.

Answer

- (a) (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	₹
1 st April 2023	4,00,000	Specific borrowing	$4,00,000 \times 12\% \times 10/12$	40,000
1 st August 2023	10,00,000	Specific borrowing	$10,00,000 \times 12\% \times 10/12$	1,00,000
1 st December 2023	25,00,000	General borrowing	$25,00,000 \times 10.8\% \times 2/12$	45,000
31 st January 2024	5,00,000	General borrowing	$5,00,000 \times 10.8\% \times 0/12$	Nil
				1,85,000
Less: interest income on borrowing				(15,000)
Total amount borrowing cost to be capitalized				1,70,000

- (ii) **Journal Entry**

Date	Particulars	₹	₹
31.1.2024	Building account 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)		

Note: In the above journal entry, it is assumed that interest amount will be paid at the year end. Hence, entry for interest payable has been passed on 31.1.2024.

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

Date	Particulars	₹	₹
31.1.2024	Building account Dr. To Bank account (Being expenditure incurred on construction of building and borrowing cost thereon capitalized)	45,70,000	45,70,000

(iii) Depreciation on building for the year ending 31.3.2024

Cost of building 45,70,000
 Life of building = 20 years
 Depreciation = $(45,70,000/20) \times 2/12 = 38,083.33$

(iv) Carrying Value of Building on 31st March 2024:

Carrying Value = Cost of Building - Accumulated Depreciation
 = 45,70,000 - 38,083.33
 = 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
<u>30,00,000</u>	8%	=	<u>2,40,000</u>
<u>50,00,000</u>			<u>5,40,000</u>
Weighted average rate of interest $\left(\frac{5,40,000}{50,00,000} \times 100 \right)$		=	10.8%*

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	<u>1,70,000</u>
	<u>45,70,000</u>

MCQ

1. As per AS 16, all the following are qualifying assets except

- (a) Manufacturing plants and Power generation facilities
- (b) Inventories that require substantial period of time
- (c) Assets those are ready for sale.
- (d) None of the above

2. Which of the following statement is correct:

- (a) Entire exchange gain is reduced from the cost of the Qualifying asset.
- (b) Entire exchange loss is added to the cost of a Qualifying asset.
- (c) No adjustment is done for the exchange loss while computing cost of Qualifying asset.
- (d) None of the above

3. Capitalisation rate considers:

- (a) Borrowing costs on general borrowings only.
- (b) Borrowing costs on general and specific borrowings both.
- (c) Borrowing costs on specific borrowings only
- (d) None of the above

4. If the amount eligible for capitalisation in case of inventory as per AS 16 is ₹ 12,000 and cost of inventory is ₹ 40,000 and its net realizable value is ₹ 45,000; What amount can be capitalised as a part of inventory cost.

- (a) ₹ 12,000.
- (b) ₹ 5,000.
- (c) ₹ 7,000.
- (c) ₹ 10,000.

5. X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:

- (i) 15th May, 20X1: Loan interest relating to the project starts to be incurred
- (ii) 2nd June, 20X1: Technical site planning commences
- (iii) 19th June, 20X1: Expenditure on the project started to be incurred
- (iv) 18th July, 20X1: Construction work commences

Identify the commencement date for capitalisation under AS 16.

- (a) 15th May, 20X1.
- (b) 19th June, 20X1.
- (c) 18th July, 20X1.
- (d) 2nd June, 20X1

/SOLUTIONS**MCQs**

1. (c) 2. (c) 3. (a) 4. (b) 5. (b)