AS 16 – Borrowing Cost (Summary Notes)

1) Borrowing Cost means any Cost to be incurred in arrangement of funds.

2) Borrowing Cost Exclusively Consist of :-

a) Interest Cost (including Dividend on Pref. Shares)

b) Amortised part of Ancilliary Charges such as Stamp duty, processing fees, Legal Charges Brokerage etc.

Ex:- Loan taken from Bank 50 lacs. @ 10% P.a. processing Charges & other Legal Charges are 2%. Loan Term = 10 yrs.

Interest Cost = 500000 ⟶ BC

Processing & Other Charges (amortised part) = 100000 / 10 = 10000 P.a BC

Refer Q107

c) Amortised part of Discount on issue (or) premium on Redemption of Debentures.

(Interest)

d) Finance Charges Under Finance Lease for Lessee (AS 19)

Loan

e) Exchange Loss in Case of Foreign Currency Loan to the Extent of Saving in Interest Cost.

↳ Lower of (i) Exchange Loss
(OR)
(ii) Saving of Interest due to FC Loan

Example 1: - (Foreign Exchange Difference)

Vsmart took FC Loan of $50,000 on 1/4/22 @4% interest p.a. Same loan Could have been borrowed in ₹ @10.5% p.a. Exchange Rate 1/4/22 = $1 = 81.26/- & 31/3/23 = 84.57/-. Calculate Total Borrowing Cost.

Solution

Only For Understanding (OFU)

1/4/22	Bank a/c Dr.	4063000	
	To FC Loan		4063000
	($50000 × 81.26)		
31/3/23	Interest Cost Dr.	169140	
	To FC Loan/Bank		169140
	($50000 × 4% = $2000 × 84.57)		
31/3/23 (AS 11)	Exchange Loss a/c Dr.	165500	
	To FC Loan		165500
	[$50000 × (84.57 − 81.26)]		

Calculation of Total Borrowing Cost (AS 16)

Step 1:- Calculate actual Interest on Fc Loan

$50000 × 4.1. × 84.57 = 169140/-

This is 1st Borrowing Cost.

Step 2:- Calculate Saving in Interest due to Fc Loan

Interest in ₹ Loan ⇒ ($50000 × 81.26) × 10.5%

⇒ 426,615

(-) Actual Interest ⇒ 169,140

Saving ⇒ 257475

Step 3:- Calculate Ex-Loss

$50000 × (84.57 − 81.26) = 165500

Step 4:- BC also includes Ex. Loss to the Extent of Interest Saving

Lower of a) BC = 165500

b) Saving in Interest = 257475

2nd BC = 165500

Hence, Total BC = 169140 + 165500
= 334640/-

OFU :- Interest Cost a/c Dr. 165500
To Ex. Loss a/c 165500

3) Treatment Of Borrowing Cost

First of all, we have to Understand "Qualifying Asset"

→ Any Asset that takes "Substantial Time" to get Ready For Use or Sale
↓ PPE ↓ Inventory

Substantial time generally Covers 12 months or more, however a period of less than 12 months Can also be Substantial based on Entity's Judgement.

Examples :- Building Construction / Factory Development
P&M Installation if takes Subst. Time (Power plants)
Liquour / aircraft / Ships

If Borrowed Amt (Loan Amt.) is Utilized in Acquisition / Construction / Production of Qualifying Asset, then BC shall be Capitalised in such QA.

In all other Cases, BC shall be transfer to P&L.

Journal Entry

If Capitalised => Asset a/c Dr.
To Interest Cost

If transfer to P&L => P&L a/c Dr.
To Interest Cost

4) Types of Borrowings and Borrowing Costs

a) Specific Borrowing :- It is taken for A/C/P of Specific Qualifying Asset

b) General Borrowing :- Not for any Specific Use/Asset, i.e End Use is not fixed. It Can be Utilized For Multiple purpose.

Specific Borrowing Cost

Specific Borrowing Cost shall be Capitalised to the QA based on following Capitalisation period :-

Date of 1st Expenditure on QA (OR) Date of Loan (Whichever is later) — to — Date of Completion of Asset (OR) Date of Loan Repayment (Whichever is earlier)

Any Income from Temporary Investment of Unused Borrowed funds shall be deducted from total Borrowing Cost before Capitalisation.

Example 6: - (Specific Borrowing)

Entity took a SBI Loan of 25,00,000 @12% p.a. on 1/4/22 for Building Construction:

Exp.
- 1/5/22 = 15,00,000 ✓
- 1/Aug/22 = 10,00,000

Construction Completed on 28/Feb/23

Calculate Borrowing Cost to be Capitalised.

Solution Specific Borrowing Cost shall be Capitalised For 10 months (Capitalisation Period) as Under :-

$$\text{BC to be Capitalised} = 2500000 \times 12\% \times \frac{10}{12} = 250000/-$$

$$\text{BC Charged to P\&L} = \text{Total BC} - \text{BC Capitalised}$$
$$= 300000 - 250000$$
$$= 50000$$

→ 12 months Interest

Class Example :- What if in above Example 6 Unused Borrowed Funds of 10,00,000 were Invested on 1st June to 31st July @ 6% p.a. Interest.

Total BC = 30,00,00

BC to be Capitalised (10 months) = 250000

(-) Temp. Income = (10000)

$10,00,000 \times 6\% \times \frac{2}{12}$

Net BC Capitalised = 240000

BC (P&L) = 300000 − 240000 = 60,000

General Borrowing Cost

General Borrowing Cost shall be Capitalised based on Weighted Avg. Capitalisation Rate on each Expenditure (date wise).

Example 7: - Financial Year 22 - 23

1st April	SBI Loan @10%	20 lakhs
1st June	HDFC Loan @12%	25 lakhs
1st Dec	ICICI Loan @10.5%	30 lakhs
		75 lakhs

Calculate Weightage Average Borrowing Rate. (all are General Borrowings)

Solution

Date	Loan	BC	
1/4	20,00,000	20,00,000 × 10% × 12/12	= 2,00,000
1/6	25,00,000	25,00,000 × 12% × 10/12	= 2,50,000
1/12	30,00,000	30,00,000 × 10.5% × $\frac{4}{12}$	= 1,05,000
			5,55,000

$$\text{WABR (For General Borrowing)} = \frac{\text{Total BC incurred during the year}^{\text{General}}}{\text{Total Borrowings Outstanding during the year (date wise Time weight)}} \times 100$$

$$= \frac{555000}{\left(2000000 \times \frac{12}{12}\right) + \left(2500000 \times \frac{10}{12}\right) + 3000000 \times \frac{4}{12}}$$

$$= 10.918\% \text{ P.a.}$$

Suppose, Expenditure on different Assets are as under :-

1/5 ⇒ P&m (QA) = 7,50,000

1/8 ⇒ P&m (QA) = 525000

30/11 ⇒ Furniture (Non QA) = 300000

1/Jan => Building Construction (QA) = 21,00,000

1/March => Building Construction (QA) = 30,00,000

Calculate Bc to be Capitalised.

Date	Particulars	Expenditure	Working	Bc Capitalised
1/5	P&m (QA)	750000	750000 × 10.918 % × 11/12	75061
1/8	P&m (QA)	525000	525000 × 10.918 % × 8/12	38213
1/Jan	Building (QA)	21,00,000	2100000 × 10.918 % × 3/12	57320
1/Mar.	Building (QA)	30,00,000	30,00,000 × 10.918 % × 1/12	27295
			Bc Capitalised =	197889

Bc (P&L) = 5,55,000 — 197889 = 3,57,111/-

5) Important Points

a) Loan taken by Holding Co. and Utilized in Investment in Shares of Subsidiary Co., Subsidiary Co. Uses the money to Invest in its Qualifying Assets (Refer Q103)

Books of Holding Co.
↓
BC Charged to P&L because Investment in Shares is not QA

Books of Subs. Co.
↓
There is NO such BC

Books of Grp Co. (Consolidation)
↓
Since the end Use of loan is in Q.A.
↓
Hence BC shall be Capitalised

b) How to Calculate BC to be Capitalised ?

- Specific: Total Expenditure × Rate × Capitalisation period
- General: Date wise Expen × WABR × T.W.

c) In Case of General Borrowings :-

Total General Borrowings are more than Total Expenditures

↓

Capitalise BC based on WABR

(Refer Q203, Q204) Ex: 10

Total General Borrowings are less than Total Expenditures

↓

☞ No need to Calculate WABR

☞ Allocate Total BC in the ratio of Expenditures

(Refer Q206) Q205

4)

Author's Note:

1. Equity Dividend is not borrowing cost.
2. Cost of issue of Equity Share Capital such as underwriting commission and other related expenses is not borrowing cost.

6) Capitalisation of Borrowing Cost

Commencement of Capitalisation: Refer Q102	Start capitalizing Borrowing cost from the later of following dates: a. Date of start of expenditure on A/C/P of Qualifying Asset b. Date of start of incurring interest c. Date when necessary activities started (Such as technical or administrative work prior to commencement of physical contruction)
Suspension of Capitalisation	Capitalization of Borrowing Costs shall be suspended during the extended periods in which Active Development is interrupted. Note: Borrowing costs which are related to the suspension period should be transferred to Profit and loss. However, if necessary activities are interrupted due to unavoidable reason (or) temporary delays is necessary then no need to suspend the capitalization of Borrowing cost. (eg. High water level during construction of bridge)
Cessation of Capitalisation Refer Q101	• Capitalization should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. • Cessation to take place in part if construction of qualifying asset is completed in parts and a part is capable of being used separately.