

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 Ancillary Charges such as Stamp duty, processing Fees, Legal Charges Brokerage etc.

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

Interest Cost = 500000 $\rightarrow$ BC

Processing & other Charges = $\frac{100000}{10} = 10000$
(amortised part) P.a.
BC

Refer Q107

- c) Amortised part of Discount on issue (or) premium on Redemption of Debentures.
- d) Finance Charges Under Finance Lease for Lessee (AS 19)
(Interest)
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. 40,630.00
To FC Loan 40,630.00
(\$50,000 × 81.26)

31/3/23 Interest Cost Dr. 16,914.00
To FC Loan/Bank 16,914.00
(\$50,000 × 4% = \$2,000 × 84.57)

31/3/23 Exchange Loss a/c Dr. 16,550.00
(AS 11) To FC Loan 16,550.00
[\$50,000 × (84.57 - 81.26)]

Calculation of Total Borrowing Cost (As 16)

Step 1:- Calculate **actual Interest** on FC Loan

$$\$50000 \times 4\% \times 84.57 = 169140/-$$

This is 1st Borrowing Cost.

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

$$\text{Interest in ₹ Loan} \Rightarrow (\$50000 \times 81.26) \times 10.5\%$$

$$\Rightarrow 426615$$

$$(-) \text{ Actual Interest} \Rightarrow 169140$$

$$\text{Saving} \Rightarrow \underline{257475}$$



Step 3:- Calculate Ex-Loss

$$\$50000 \times (84.57 - 81.26) = 165500$$



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

Lower of a) $BC = 165500$

b) $\text{Saving} = 257475$
in Interest

$$2^{\text{nd}} \text{ Bc} = 165500$$

$$\begin{aligned}\text{Hence, Total Bc} &= 169140 + 165500 \\ &= 334640/-\end{aligned}$$

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)
Liquor / aircraft / ships

If Borrowed Amount (Loan Amount) 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 $\Rightarrow$ Asset a/c Dr.
To Interest Cost

If transfer to $\Rightarrow$ P&L a/c Dr.
P&L 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)	to	Date of Completion of Asset (OR)
Date of loan (whichever is later)		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:

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:-

$$\text{Bc to be Capitalised} = 25,00,000 \times 12\% \times \frac{10}{12} = 250,000/-$$

$$\begin{aligned}\text{Bc Charged to P\&L} &= \text{Total Bc} - \text{Bc Capitalised} \\ &= 300,000 - 250,000 \\ &= 50,000\end{aligned}$$

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.

$$\text{Total BC} = 300000$$

$$\text{BC to be Capitalised} = 250000$$

(10 months)

$$(-) \text{Temp. Income} = (10000)$$

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

$$\text{Net BC Capitalised} = 240000$$

$$\text{BC (P&I)} = 300000 - 240000 = 60000$$

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

1 st April	SBI Loan @10%	20 lakhs
1 st June	HDFC Loan @12%	25 lakhs
1 st 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	$20,00,000 \times 10\% \times 12/12 = 2,00,000$
1/6	25,00,000	$25,00,000 \times 12\% \times 10/12 = 2,50,000$
1/12	30,00,000	$30,00,000 \times 10.5\% \times \frac{4}{12} = 1,05,000$
		<u>5,55,000</u>

$$\begin{aligned} \text{WABR (for General Borrowing)} &= \frac{\text{Total General Bc incurred during the year}}{\text{Total Borrowings Outstanding during the year (date wise Time weight)}} \times 100 \\ &= \frac{5,55,000}{\left(20,00,000 \times \frac{12}{12}\right) + \left(25,00,000 \times \frac{10}{12}\right) + 30,00,000 \times \frac{4}{12}} \\ &= 10.918\% \text{ P.a.} \end{aligned}$$

Suppose, Expenditure on different Assets are as Under :-

$$1/5 \Rightarrow \text{P\&m (QA)} = 7,50,000$$

$$1/8 \Rightarrow \text{P\&m (QA)} = 525,000$$

$$30/11 \Rightarrow \text{Furniture (Non QA)} = 3,00,000$$

1/Jan $\Rightarrow$ Building Construction (QA) = 21,00,000

1/March $\Rightarrow$ Building Construction (QA) = 30,00,000

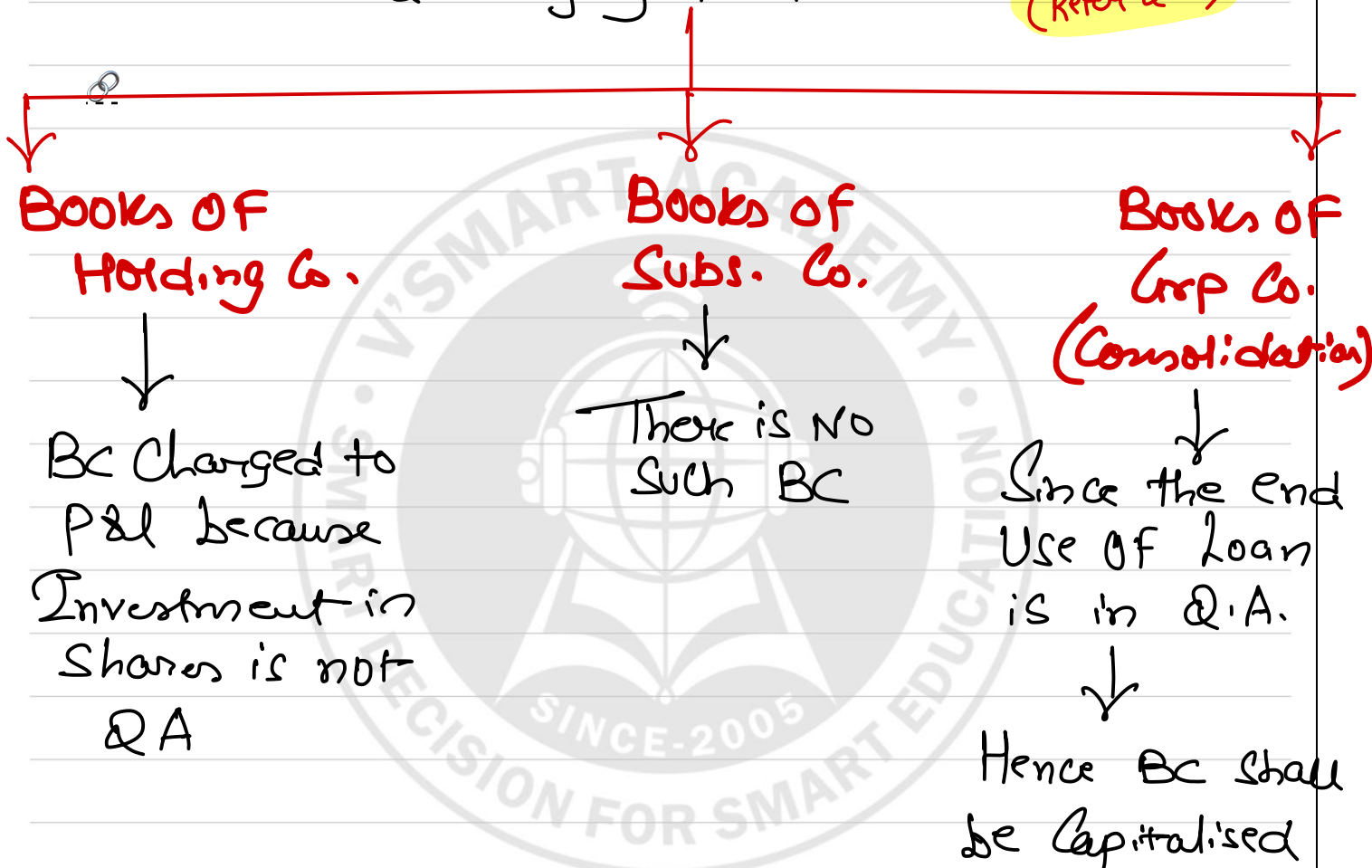
Calculate BC to be Capitalised.

Date	Particulars	Expenditure	Working	BC Capitalised
1/5	P&M (QA)	750000	$750000 \times 10.918\% \times 11/12$	75061
1/8	P&M (QA)	525000	$525000 \times 10.918\% \times 8/12$	38213
1/Jan	Building (QA)	21,00,000	$21,00,000 \times 10.918\% \times 3/12$	57320
1/Mar.	Building (QA)	30,00,000	$30,00,000 \times 10.918\% \times 1/12$	27295
BC Capitalised =				<u>1,97,889</u>

$$BC(P\&M) = 555,000 - 1,97,889 = 3,57,111/-$$

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)



- b) How to Calculate BC to be Capitalised?

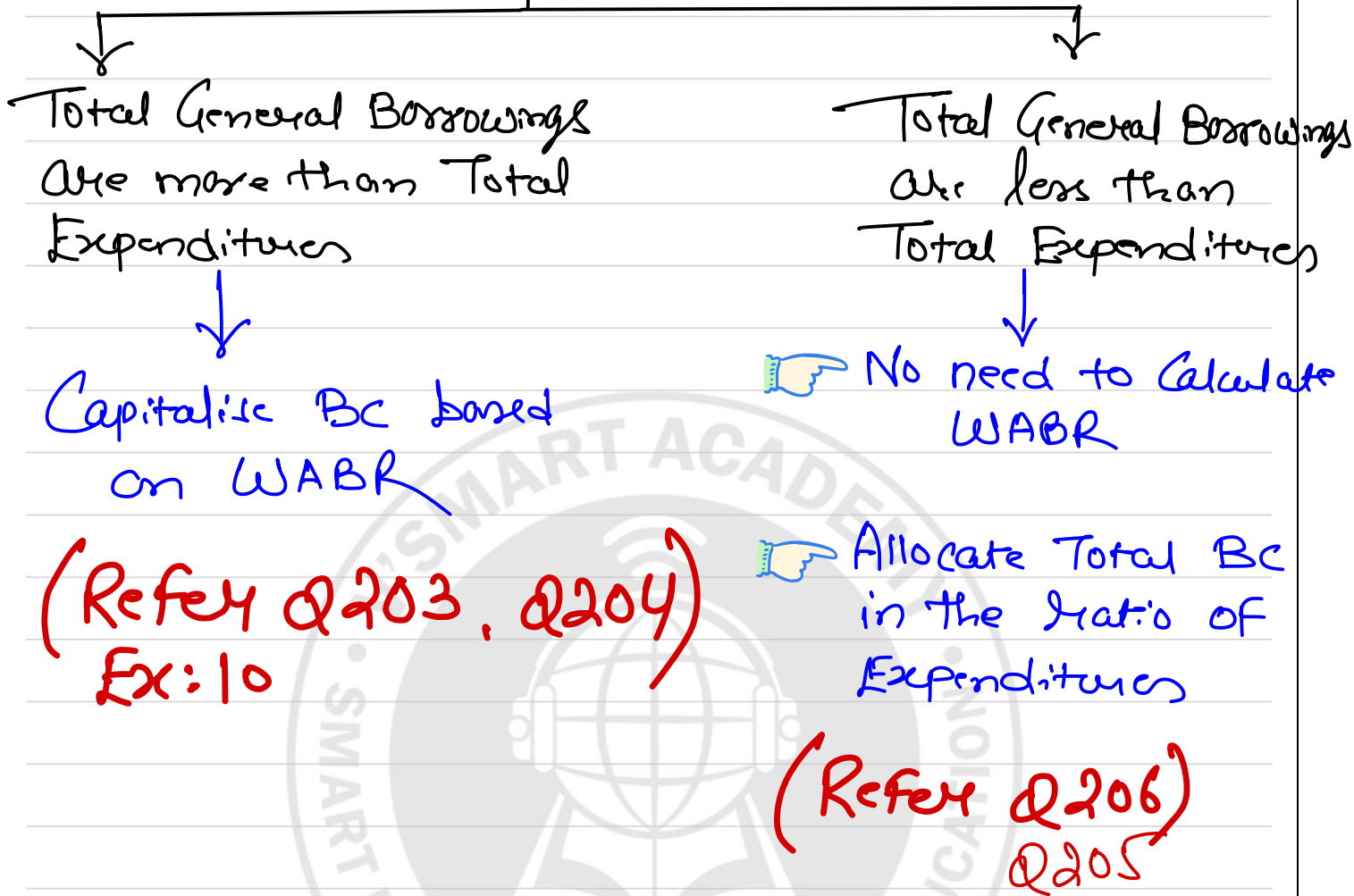
Specific

General

$\text{Total Expenditure} \times \text{Rate} \times \text{Capitalisation period}$

$\text{Date wise Expect} \times \text{WABR} \times \text{T.W.}$

C) In Case of General Borrowings :-



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: <i>Refer Q102</i>	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 construction)
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 <i>Refer Q101</i>	- 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.



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