

TOPIC – 6

ACCOUNTING STANDARD – 16

BORROWING COSTS

TOTAL NO. OF QUESTIONS - 16

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SERIES 100 – BASIC QUESTIONS

Q.AS16.SM.101 (Cessation of Capitalisation)

H Ltd. incurs borrowing costs for the purpose of construction of a qualifying asset for its own use. The construction gets completed on May 31, 20X1. However, decoration work is under process which is expected to be completed by November 20X1 after which H Ltd. will be able to start using the said asset for its own use. H Ltd. wants to capitalize the eligible borrowing costs incurred up to November 20X1.



Q.AS16.OM.102: Commencement Date

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

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

Q.AS16.SM.103: (Qualifying Asset)

Take Ltd. has borrowed ₹30 lakhs from State Bank of India during the financial year 20X1-20X2. The borrowings are used to invest in shares of give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost ₹50 lakhs. As on 31st March, 20X2, since the said project was not complete, the directors of Take Ltd. resolved to capitalise the interest accruing on borrowings amounting to ₹4 lakhs and add it to the cost of investments. Comment.



Q.AS16.SM.104: (Also in RTP May 19)

On 1st April, 2011, Amazing Construction Ltd. obtained a loan of ₹32 crores to be utilized as under:



(i) Construction of sealink across two cities	: ₹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 31st March, 2012	: ₹80,00,000

Show the treatment of interest by Amazing Construction Ltd.

Q.AS16.SM.105: (Also in 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 accounting standard.

Q.AS16.RMP.106: (RTP May22)

- (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 months. However, on installation, certain calibrations are required to achieve the desired level of production before it is finally commissioned. This process is expected to take approximately 2 months during which test runs will be made. Should the borrowing costs attributable to borrowings pertaining to the 2 months test run period be capitalized?
- (b) Should capitalization of borrowing costs be continued when the qualifying asset has been constructed but marketing activities to sell the asset are still in progress?



Q.AS16.RMP.107: (RTP Jan'25)

How will interest be capitalized when qualifying assets are funded by borrowings in the nature of bonds that are issued at a discount?

X Ltd. issued in year 1, a 3 year 10% p.a. (interest paid annually) bond with a face value of Rs. 1,00,000 at a price of Rs. 90,000 to finance a qualifying asset which is ready for intended use at the end of year 2. Compute the amount of borrowings costs to be capitalized if the company uses for amortization of discount straight line basis.

SOLUTIONS OF ABOVE QUESTIONS OF SERIES 100**SOLUTION Q101**

The capitalization of borrowing costs shall cease when substantially all the activities necessary to prepare the qualifying assets for its intended use or sale is completed.

In the given case, H Ltd. should capitalize borrowing costs only up to May 31, 20X1. The borrowing cost incurred thereafter cannot be capitalized as the asset was ready for its intended use on May 31, 20X1. The fact that decoration work was being carried out should not be considered as the asset was ready for its intended use on May 31, 20X1.

SOLUTION Q102

In the above case, the three conditions to be tested for commencement date would be:

Borrowing cost has been incurred on: 15 May 20X1

Expenditure has been incurred for the asset on: 19 June 20X1

Activities necessary to prepare asset for its intended use or sale: 2 June 20X1

Commencement date would be the date when the above three conditions would be satisfied in all i.e., 19 June 20X1

SOLUTION: Q103

As per AS 13 (Revised) "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. ₹4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 20X2.

SOLUTION Q104

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.

Assumption: Additional Assets is used for same restoration, Hence QA.

The treatment of interest by Amazing Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalized	Interest to be charged to Profit & Loss A/c	
Construction of sea-link	Yes	62,50,000		[80,00,000*(25/32)]
Purchase of Equipment 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		62,50,000	17,50,000	

Solution Q105

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

SOLUTION Q106

(a) As per AS 16 Borrowing Costs "Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". On installation of the equipment, an evaluation has to be made to conclude whether substantially all the activities necessary to prepare the asset are complete. After an equipment has been installed it is usually tested and adjusted for commercial production before it is finally commissioned. The calibrations and adjustments required during this period are performed in order to bring the equipment up to the stage at which it is ready to commence commercial production. Until the asset reaches the stage when it is ready to support commercial levels of production, it is not appropriate to conclude that substantially all the activities necessary to prepare the asset are complete. Thus, the borrowing cost incurred during the normal period of test runs (after the installation) are required to be capitalized.

(b) As per provisions of AS 16, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Further, the standard also explains that "An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete". The emphasis in the Standard is on "to prepare the qualifying asset for its intended use or sale" and not the actual activity of sale. Therefore, where the physical construction of the asset is complete, substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, in the given case, the borrowing costs pertaining to the period during which the marketing activities to sell the asset are still in progress should not be capitalized as part of the

cost of the asset.

SOLUTION Q107

As per AS 16, "Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds". Further, as per para 4 (b) of the standard, "amortization of discounts or premiums relating to borrowings" as a component of borrowing costs. Thus, the borrowing costs comprise the periodic interest payable on the bonds in question and the amount of discount amortised during the period.

Paragraph 6 of the Statement, inter-alia, states that "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".

Further, paragraph 19 states that "Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". Thus, only that portion of the amortised discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Straight line basis

(Amount in Rs.)

Years	Interest	Amortisation of discount	Total borrowing costs
Year 1	10,000	3,333	13,333
Year 2	10,000	3,333	13,333
Year 3	10,000	3,334	13,334

In the above case, the amount of borrowing costs capitalized would be Rs. 13,333 in Year 1 and Year 2. The borrowing costs of Rs. 13,334 incurred in Year 3 would be expensed since the asset is ready for its intended use at the end of Year 2.

SERIES 200 – SPECIFIC AND GENERAL BORROWING COST**Q.AS16.SM.201 (Borrowing Cost in Foreign Currency)**

XYZ Ltd. has taken a loan of USD 10,000 on 1.04.2003 for a specific project at an interest rate of 5% p.a., payable annually. On 1 April, 2003, the exchange rate between the currencies was Rs. 45 per \$. The exchange rate, as at March, 31st, 2004 is Rs. 48 per \$. The Corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of 11% p.a. as on 1 April, 2003.

Q.AS16.RMP.202. (RTP May'21) (Similar to Q201)

Shan Builders Limited has borrowed a sum of US \$ 10,00,000 at the beginning of Financial Year 2019-20 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment, exchange rate was Rs. 56 per US \$ and the rate as on 31st March, 2020 Rs. 62 per US \$. If Shan Builders Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. You are required to compute Borrowing Cost and exchange difference for the year ending 31st March 2020 as per applicable Accounting Standards.

Q.AS16.SM.203:

X Ltd. began Construction of a new building on 1st January, 2007. It obtained Rs. 1 lakh special loan to finance the construction of the building on 1st January, 2007 at an interest rate of 10%. The company's outstanding two non-specific loans were:

Amount	Rate
5,00,000	11%
9,00,000	13%

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

January 2007	Rs. 2,00,000
April, 2007	Rs. 2,50,000
July, 2007	Rs. 4,50,000
December, 2007	Rs. 1,20,000

Building was completed by 31st December, 2007. Following the principles prescribed in AS – 16 Borrowing Cost. Calculate the amount of interest to be capitalized and pass one Journal Entry for capitalization of Cost and borrowing cost in respect of the building.

Q.AS16.RMP.204: (EXAM May22)

Zebra limited began construction of a new plant on 1st April, 2021 and obtained a special loan of Rs. 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:

	Rs.
1 st April, 2021	10,00,000



1 st August, 2021	24,00,000
1 st January, 2022	4,00,000

The company's other outstanding non-specific loan was Rs. 46,00,000 at an interest rate of 12%
The construction of the plant completed on 31st March, 2022.

You are required to:

- Calculate the amount of interest to be capitalized as per the provision of AS 16 "Borrowing Cost".
- Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant

Q.AS16.SM.205:

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
	₹	₹	₹	₹
Cash expenditure	10	30	25	30
Building Material 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.

Q.AS16.RMP.206 (Exam May23)

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:

- 8% Debentures ₹ 15,00,000
- 15% Term Loan ₹ 30,00,000
- 10% Other Loans ₹ 18,00,000

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

- Building ₹ 70,00,000
- Furniture ₹ 22,00,000
- Plant & Machinery ₹ 90,00,000
- 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.

Q.AS16.RMP.207: (MTP Nov21)

ABC Limited has started construction of an asset on 1st December, 2020, which continues till 31st March, 2021 (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 Rs. 10 lakhs in December 2020 and Rs. 4 lakhs in each of the months of January to March 2021. At the beginning of the year, the entity had taken Inter Corporate Deposits of Rs. 20 lakhs at 9% rate of interest and had an overdraft of Rs. 4 lakhs, which increased to Rs. 8 lakhs on 1st March, 2021. Interest was paid on the overdraft at 10% until 1st January, 2021 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 'Borrowing Costs'.

Q.AS16.RMP.208: (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.

Q.AS16.RMP.209:

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.20X1. Money raised from debentures to be utilized as under:

Intended Purpose	Amount ₹ in lakhs
Construction of factory building	40
Working Capital	30
Purchase of Machinery	15
Purchase of Furniture	2
Purchase of truck	13

Additional Information:

- (i) Interest on debentures for the Financial Year 20X1-20X2 was paid by the Company.
- (ii) During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of ₹ 50,000.
- (iii) In March, 20X2 construction of factory building was not completed (it is expected that it will take
- (iv) In March 20X2, Machinery was installed and ready for its intended use.
- (v) Furniture was put to use at the end of March 20X2.
- (vi) Truck is going to be received in April, 20X2.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 20X2 in the Books of Expert Limited.

SOLUTIONS OF ABOVE QUESTIONS OF SERIES 200**SOLUTION: Q201**

Step - 1 = Calculation of Actual Interest:

$$\$10000 \times 5\% = \$500 \times \text{Rs. } 48 = \text{Rs. } 24000$$

Step - 2 = Calculation of Interest if borrowing in Local Currency:

$$\$10000 \times 45 \times 11\% = \text{Rs. } 49500$$

Step - 3 = Calculation of Exchange Loss on FC Borrowings

$$\$10000 \times \text{Rs}3 = \text{Rs. } 30000$$

Note: Loss to the extent of saving in interest shall be treated as borrowing cost.

i.e., Actual Saving of Interest or Actual Exchange Loss whichever is lower

(49500 - 24000) or 30000 whichever is lower = 25500/- is Borrowing cost

Remaining exchange loss is to be transferred to P&L as other expense as per AS 11

Solution Q202:

- Interest for the period 2019-20
= US \$ 10 lakhs \times 4% \times Rs. 62 per US \$ = Rs. 24.80 lakhs
- Increase in the liability towards the principal amount
= US \$ 10 lakhs \times Rs. (62 - 56) = Rs. 60 lakhs
- Interest that would have resulted if the loan was taken in Indian currency
= US \$ 10 lakhs \times Rs. 56 \times 10.5% = Rs. 58.80 lakhs
- Difference between interest on local currency borrowing and foreign currency borrowing = Rs. 58.80 lakhs - Rs. 24.80 lakhs = Rs. 34 lakhs.

Therefore, out of Rs. 60 lakhs increase in the liability towards principal amount, only Rs. 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be Rs. 58.80 lakhs being the aggregate of interest of Rs. 24.80 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 Rs. 34 lakhs. Hence, Rs. 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining Rs. 26 lakhs (60 - 34) would be considered as the

exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

SOLUTION: Q203:**Calculation of Capitalisation Rate:**

$$(500000 \times 11\% + 900000 \times 13\%) / 1400000 = 12.29\%$$

This rate is to be applied to each expenditure by considering time factor like:

January 2007 – 200000 × 12.29% × 12/12

April 2007 – 250000 × 12.29% = 9/12 and so on

1. WIP A/c Dr. 1020000
To Bank A/c 10.20

2. Building A/c Dr. 1020000
To WIP a/c 10.20

3. Interest a/c Dr 182000
To Loans a/c 182000

4. Building A/c Dr. 74216
To Interest a/c 74216

5. Profit and loss a/c Dr. (182000-74216) = 107784
To Interest a/c 107784

SOLUTION Q204:

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

	Rs.
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

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

Working Note:**Computation of interest to be capitalized:**

	Expenditure		Rs.	Rs.
1 st April, 2021	10,00,000	On specific borrowing	Rs. 10,00,000 × 10%	1,00,000
1 st August, 2021	24,00,000	On specific borrowing	Rs. 10,00,000 × 10%	1,00,000
1 st August, 2021		On non-specific borrowings	Rs. 14,00,000 × 8/12 × 12%	1,12,000
1 st January, 2022	4,00,000	On non-specific borrowings	Rs. 4,00,000 × 3/12 × 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:

		Rs.
On specific borrowing	Rs. 20,00,000 x 10%	2,00,000
On non-specific borrowing	Rs. (30,33,333- 20,00,000) x 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.

Solution Q205**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 Loan amount = $30,00,000/2,21,00,000 \times 98,00,000$	3,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount = $30,00,000/2,21,00,000 \times 1,23,00,000$	16,69,683 (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.

SOLUTION Q206**Interest to be Capitalized (on qualifying asset)**

Particulars	Computation	₹
i. On specific Borrowings	25,00,000 x 12%	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 x 63,00,000 x 11.9048%	1,68,750	-
ii. Furniture	No	22,00,000/2,00,00,000 x 63,00,000 x 11.9048%	-	82,500
iii. Plant & Machinery	Yes	90,00,000/2,00,00,000 x 63,00,000 x 11.9048%	3,37,500	-
iv. Factory shed	Yes	43,00,000/2,00,00,000 x 63,00,000 x 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 Incurred ₹	Share in borrowings ₹	Interest Capitalized ₹	-Interest - charged to P&L A/c ₹
i. Building	Yes	45,00,000	7,50,000 x 45/200	1,68,750	-
ii. Furniture	No	22,00,000	7,50,000 x 22/200	-	82,500
iii. Plant & Machinery	Yes	90,00,000	7,50,000 x 90 /200	3,37,500	-
iv. Factory shed	Yes	43,00,000	7,50,000 x 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 x 100 = 11.9048%	

SOLUTION Q207:

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 = [(b x c) xa/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

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

$$\text{Capitalisation rate} = \left[\frac{\text{Weighted average amount of interest}}{\text{Weighted average of general borrowings}} \times 100 \right] = \left[\frac{2,26,000}{24,33,334} \times 100 \right] = 9.29\% \text{ p.a.}$$

SOLUTION Q208:

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	<u>12,00,000</u>	$(14,97,688 + 12,00,000) \times 15\% \times 1/12$	<u>33,721</u>	$14,97,688 + 12,00,000 + 33,721$	27,31,409
	<u>26,45,000</u>		<u>86,409</u>		

Note:

- 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.
- 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.
- 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.

SOLUTION Q209:

According to AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use. As per the Standard, 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 recognized as an expense in the period in which they are incurred. It 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 = ₹ 10,00,000 (100 lakhs × 12% × 10/12) - ₹ 50,000 = ₹ 9,50,000

Particulars	Nature of assets	Interest to be capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
Construction of factory building	Qualifying Asset	$9,50,000 \times 40/100 = ₹ 3,80,000$	NIL
Purchase of Machinery	Not a Qualifying Asset	NIL	$9,50,000 \times 15/100 = 1,42,500$
Purchase of and furniture	Not a Qualifying Asset	NIL	$9,50,000 \times 2/100 = 19,000$
Purchase of truck	Not a Qualifying Asset	NIL	$9,50,000 \times 13/100 = 1,23,500$
Working Capital	Not a Qualifying Asset	NIL	$9,50,000 \times 30/100 = ₹ 2,85,000$
Total		₹ 3,80,000	₹ 5,70,000



Student Notes:-