

CHAPTER 11

BORROWING COSTS (IND AS 23)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: A company deals in production of dairy products. It prepares and sells various milk products like ghee, butter and cheese. The company borrowed funds from bank for manufacturing operation. The cheese takes substantial longer period to get ready for sale.

State whether borrowing costs incurred to finance the production of inventories (cheese) that have a long production period, be capitalised?

Ans: Ind AS 23 does not require the capitalisation of borrowing costs for inventories that are manufactured in large quantities on a repetitive basis. However, interest capitalisation is permitted as long as the production cycle takes a 'substantial period of time', as with cheese.

Q2: A company is in the process of developing computer software. The asset has been qualified for recognition purposes. However, the development of computer software will take substantial period of time to complete.

- a) Can computer software be termed as a 'qualifying asset' under Ind AS 23?
- b) Is management intention considered when assessing whether an asset is a qualifying asset?

Ans: a) Yes. An intangible asset that takes a substantial period of time to get ready for its intended use or sale is a 'qualifying asset'. This would be the case for an internally generated computer software in the development phase when it takes a 'substantial period of time' to complete.

- b) Yes. Management should assess whether an asset, at the date of acquisition, is 'ready for its intended use or sale'. The asset might be a qualifying asset, depending on how management intends to use it. For example, when an acquired asset can only be used in combination with a larger group of fixed assets or was acquired specifically for the construction of one specific qualifying asset, the assessment of whether the acquired asset is a qualifying asset is made on a combined basis.

Q3: A telecom company has acquired a 3G license. The licence could be sold or licensed to a third party. However, management intends to use it to operate a wireless network. Development of the network starts when the license is acquired.

Should borrowing costs on the acquisition of the 3G license be capitalised until the network is ready for its intended use?

Ans: Yes. The license has been exclusively acquired to operate the wireless network. The fact that the license can be used or licensed to a third party is irrelevant. The acquisition of the license is

the first step in a wider investment project (developing the network). It is part of the network investment, which meets the definition of a qualifying asset under Ind AS 23.

Q4: A real estate company has incurred expenses for the acquisition of a permit allowing the construction of a building. It has also acquired equipment that will be used for the construction of various buildings.

Can borrowing costs on the acquisition of the permit and the equipment be capitalised until the construction of the building is complete

Ans: With respect to Permit

Yes, since permit is specific to one building. It is the first step in a wider investment project. It is part of the construction cost of the building, which meets the definition of a qualifying asset.

With respect to Equipment

No, since the equipment will be used for other construction projects. It is ready for its 'intended use' at the acquisition date. Hence, it does not meet the definition of a qualifying asset.

Q5: Is interest on a lease of a qualifying asset capitalised as borrowing costs?

Ans: Yes, interest incurred for a lease is specific to an asset. Interest is capitalised if the asset is a qualifying asset or is used solely for the construction of a qualifying asset. For example, a crane or a dockyard is leased for the purpose of constructing a ship. The ship is a qualifying asset. The interest on the lease of the crane or dockyard is capitalised as borrowing costs. Borrowing costs on the lease can only be capitalised up to the point when the construction of the qualifying asset is complete.

Q6: XYZ Ltd. has taken a loan of USD 10,000 on April 1, 20X3, for a specific project at an interest rate of 5% p.a., payable annually. On April 1, 20X3, the exchange rate between the currencies was ₹ 45 per USD. The exchange rate, as at March 31, 20X4, is ₹ 48 per USD. The corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of 11 per cent per annum as on April 1, 20X3. Calculate borrowing cost and exchange loss. What will be your answer if interest rate on local currency borrowings is assumed to be 13%

[MTP May 2019]

Ans: The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 6(e) of IND AS 23:

Interest for the period = USD 10,000 x 5% x ₹ 48/USD = ₹ 24,000/-

Increase in the liability towards the principal amount = USD 10,000 x (48-45) = ₹ 30,000/-

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

= USD 10000 x 45 x 11%). = ₹ 49,500

Difference between interest on local currency borrowing and foreign currency borrowing

= ₹ 49,500 - ₹ 24,000 = ₹ 25,500

Therefore, out of ₹ 30,000 increase in the liability towards principal amount, only ₹ 25,500 will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 49,500 being the aggregate of interest of ₹ 24,000 on foreign currency borrowings (covered by paragraph 6(a) of IND AS 23) plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 25,500. Thus, ₹ 49,500 would be considered as the borrowing cost to be accounted for as per IND AS 23 and the remaining ₹ 4,500 would be considered as the exchange difference to be accounted for as per IND AS 21, The Effects of Changes in Foreign Exchange Rates.

In the above example, if the interest rate on local currency borrowings is assumed to be 13% instead of 11%, the entire exchange difference of ₹ 30,000 would be considered as borrowing costs, since in that case the difference between the interest on local currency borrowings and foreign currency borrowings (i.e., ₹ 34,500 (₹ 58,500 - ₹ 24,000) is more than the exchange difference of ₹ 30,000. Therefore, in such a case, the total borrowing cost would be ₹ 54,000 (₹ 24,000 + ₹ 30,000) which would be accounted for under IND AS 23 and there would be no exchange difference to be accounted for under IND AS 21.

Q7: Alpha Ltd on 1st April 20X1 borrowed 9% ₹ 30,00,000 to finance the construction of two qualifying assets. Construction started on 1st April 20X1. The loan facility was availed on 1st April 20X1 and was utilized as follows with remaining funds invested temporarily at 7%.

	Factory Building	Office Building
1st April 20X1	5,00,000	10,00,000
1st October 20X1	5,00,000	10,00,000

Calculate the cost of the asset and the borrowing cost to be capitalized.

[MTP SEP 2025]

Ans: The cost of the asset and the borrowing cost to be capitalized is calculated as under:

Particulars	Factory Building	Office Building
Borrowing Costs	(10,00,000*9%) 90,000	(20,00,000*9%) 1,80,000
Less: Investment Income	(5,00,000*7%*6/12) (17,500)	(10,00,000*7%*6/12) (35,000)
	72,500	1,45,000
Cost of the asset:		
Expenditure incurred	10,00,000	20,00,000
Borrowing Costs	72,500	1,45,000
Total	10,72,500	21,45,000

Q8: On 1st April, 20X1, A Ltd. took a 8% loan of ₹ 50,00,000 for construction of building A which is repayable after 6 years ie on 31st March 20X7. The construction of building was completed on 31st March 20X3. A Ltd. started constructing a new building B in the year 20X3-20X4, for which he used his existing borrowings. He has outstanding general purpose loan of ₹ 25,00,000, interest on which is payable @ 9% and ₹ 15,00,000, interest on which is payable @ 7%.

Is the specific borrowing transferred to the general borrowings pool once the respective qualifying asset is completed? Why

Ans: Yes. If specific borrowings were not repaid once the relevant qualifying asset was completed, they become general borrowings for as long as they are outstanding.

Q9: Beta Ltd had the following loans in place at the end of 31st March 20X2:

Loan	(Amounts in ₹ 000s)	
	1st April 20X1	31st March 20X2
18% Bank Loan	1,000	1,000
16% Term Loan	3,000	3,000
14% Debentures	-	2,000

14% debenture was issued to fund the construction of Office building on 1st July 20X1 but the development activities has yet to be started.

On 1st April 20X1, Beta Ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: ₹ 500,000 on 1st April 20X1 and ₹ 2,500,000 on 1st January 20X2.

Required : Calculate the borrowing cost that can be capitalised for the plant.

Ans::

Capitalisation rate		16.5%
Borrowing Costs	$(500,000 \times 16.5\%) + (2,500,000 \times 16.5\% \times 3/12)$	₹1,85,625

Q10: 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.

Ans: 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

Q11: A subsidiary (or jointly controlled entity or associate) finances the construction of a qualifying asset with an inter-company loan. Are borrowing costs incurred on the inter-company loan

capitalised in the separate financial statements of the subsidiary (or jointly controlled entity or associate)?

Ans: Yes. Borrowing costs are capitalised to the extent of the actual costs incurred by the subsidiary (or jointly controlled entity or associate).

Q12: Marine Transport Limited ordered 3 ships for its fleet on April 1, 20X0. It pays a down payment of 25% of the contract value of each of the ship out of long term borrowings from a scheduled bank. The delivery has to commence from the financial year 20X7. On March 1, 20X2, the ship builder informs that it has commenced production of one ship. There is no progress on other 2 ships. Marine Transport Limited prepares its financial statements on financial year basis.

Is it permissible for Marine Transport Limited to capitalise any borrowing costs for the financial year ended March 31, 20X1 or March 31, 20X2. [MTP May 2025]

Ans: As per paragraph 5 of Ind AS 23, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

As per paragraph 17 of Ind AS 23, an entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:

- (a) It incurs expenditures for the asset.
- (b) It incurs borrowing costs.
- (c) It undertakes activities that are necessary to prepare the asset for its intended use or sale. The ship is a qualifying asset as it takes substantial period of time for its construction. Thus the related borrowing costs should be capitalised.

Marine Transport Limited borrows funds and incurs expenditures in the form of down payment on April 1, 20X0. Thus condition (a) and (b) are met. However, condition (c) is met only on March 1, 20X1, and that too only with respect to one ship. Thus there is no capitalisation of borrowing costs during the financial year ended March 31, 20X1. Even during the financial year ended March 31, 20X2, borrowing costs relating to the 'one' ship whose construction had commenced from March 1, 20X2 will be capitalised from March 1, 20X2 to March 31, 20X2. All other borrowing costs are expensed.

Q13: X Limited has a treasury department that arranges funds for all the requirements of the Company including funds for working capital and expansion programs. During the year ended March 31, 20X2, the Company commenced the construction of a qualifying asset and incurred the following expenses:

Date	Amount (₹)
July 1, 20X1	2,50,000
December 1, 20X1	3,00,000

The details of borrowings and interest thereon are as under:

Particulars	Average Balance (₹)	Interest (₹)
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Long term loan @ 10%	10,00,000	1,00,000
Working capital loan	5,00,000	65,000
15,00,000	1,65,000	
Compute the borrowing costs that need to be capitalised.		

Ans: The capitalisation rate is:

Total borrowing costs / Weighted average total borrowings: $1,65,000/15,00,000 = 11\%$ Interest will be capitalised as under:

— On ₹ 2,50,000 @ 11% p.a. for 9 months = ₹ 20,625

— On ₹ 3,00,000 @ 11% p.a. for 4 months = ₹ 11,000

Total interest to be capitalised is ₹ 31,625

Q14: An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1 (*and is expected to go beyond a year*). Directly attributable expenditure at the beginning of the month on this asset are ₹ 100,000 in September 20X1 and ₹ 250,000 in each of the months of October to December 20X1.

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. During the year, the entity had issued 10% debentures with a face value of ₹ 20 lacs and had an overdraft of ₹ 500,000, which increased to ₹ 750,000 in December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%.

Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'.
[RTP May 2018; Exam Nov 2019]

Ans: Since the entity has only general borrowing hence first step will be to compute the capitalisation rate. The capitalisation rate of the general borrowings of the entity during the period of construction is calculated as follows:

Finance cost on ₹ 20 lacs 10% debentures during September – December 20X1	₹ 66,667
Interest @ 15% on overdraft of ₹ 5,00,000 in September 20X1	₹ 6,250
Interest @ 16% on overdraft of ₹ 5,00,000 in October and November 20X1	₹ 13,333
Interest @ 16% on overdraft of ₹ 750,000 in December 20X1	₹ 10,000
Total finance costs in September – December 20X1	₹ 96,250

Weighted average borrowings during period

$$= (20,00,000 \times 4) + (500,000 \times 3) + (750,000 \times 1) / 4 = ₹ 25,62,500$$

Capitalisation rate = Total finance costs during the construction period / Weighted average borrowings during the construction period

$$= 96,250 / 25,62,500 = 3.756\% \text{ for capitalization period i.e., 4 Months}$$

Alternative Solution

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of outstanding balance	Amount of loan (₹)	Rate of interest p.a.	Weighted average amount of interest (₹)
	a	B	c	d = [(b x c) x (a/12)]
10% Debentures	12 months	20,00,000	10%	2,00,000
Bank overdraft	9 months	5,00,000	15%	56,250
	2 months	5,00,000	16%	13,333
	1 month	<u>7,50,000</u>	16%	<u>10,000</u>
		<u>46,00,000</u>		<u>2,79,583</u>

Weighted average cost of borrowings

$$= \{20,00,000 \times (12/12)\} + \{5,00,000 \times (11/12)\} + \{7,50,000 \times (1/12)\}$$

$$= 25,20,833$$

Capitalisation Rate = (Weighted average amount of interest / Weighted average of general borrowings) x 100

$$= (2,79,583 / 25,20,833) \times 100 = 11.09\% \text{ p.a.}$$

Q15: K Ltd. began construction of a new building at an estimated cost of 7 lakh on 1st April, 20X1. To finance construction of the building it obtained a specific loan of 2 lakh from a financial institution at an interest rate of 9% per annum.

The company's other outstanding loans were

Amount	Rate of Interest per annum
7,00,000	12%
9,00,000	11%

The expenditure incurred on the construction was:

April, 20X1	1,50,000
August, 20X1	2,00,000
October, 20X1	3,50,000
January, 20X2	1,00,000

The construction of building was completed by 31st January, 20X2.

Following the provisions of Ind AS 23 'Borrowing Costs', calculate the amount of interest to be capitalized and pass necessary journal entry for capitalizing the cost and borrowing cost in respect of the building as on 31st January, 20X2. [MTP Jan 2026]

Ans: Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (₹)	Rate of interest		Amount of interest (₹)
7,00,000	12%	=	84,000
<u>9,00,000</u>	11%	=	<u>99,000</u>
<u>16,00,000</u>			<u>1,83,000</u>
Weighted average rate of interest (1,83,000/16,00,000) x 100		=	11.4375%

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, 20X1	1,50,000	Specific borrowing	1,50,000 x 9% x 10/12	11,250
1 st August, 20X1	2,00,000	Specific borrowing	50,000 x 9% x 10/12	3,750
		General borrowing	1,50,000 x 11.4375% x 6/12	8,578.125
1 st October, 20X1	3,50,000	General borrowing	3,50,000 x 11.4375% x 4/12	13,343.75
1 st January, 20X2	1,00,000	General borrowing	1,00,000 x 11.4375% x 1/12	953.125
				37,875

Note: Since construction of building started on 1st April, 20X1, it is presumed that all the later expenditures on construction of building had been incurred at the beginning of the respective month.

Total expenses to be capitalized for building

	₹
Cost of building (1,50,000 + 2,00,000 + 3,50,000 + 1,00,000)	8,00,000
Add: Amount of interest to be capitalized	<u>37,875</u>
	<u>8,37,875</u>

Journal Entry

Date	Particulars		
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		₹	₹
31.1.20X2	Building account Dr. To Bank account To Interest payable (borrowing cost) (Being expenditure incurred on construction of building and borrowing cost thereon capitalized)	8,37,875	8,00,000 37,875

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 31.1.20X2.

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

Date	Particulars	₹	₹
31.1.20X2	Building account Dr. To Bank account (Being expenditure incurred on construction of building and borrowing cost thereon capitalized)	8,37,875	8,37,875

Q16: On 1st April, 20X1, entity A contracted for the construction of a building for ₹ 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 20X2, and during the period the following payments were made to the contractor:

Payment date	Amount (₹ '000)
1st April, 20X1	200
30th June, 20X1	600
31st December, 20X1	1,200
31st March, 20X2	200
Total	2,200

Entity A's borrowings at its year end of 31st March, 20X2 were as follows:

- 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 20X2 amounted to ₹7,00,000. Interest of ₹65,000 was incurred on these borrowings during the year, and interest income of ₹20,000 was earned on these funds while they were held in anticipation of payments.
- 12.5%, 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ₹1,000,000 and remained unchanged during the year; and

- c. 10%, 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ₹1,500,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?

[MTP May 2025]

Ans: As per Ind AS 23, when an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity should determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

The amount of borrowing costs eligible for capitalization, in cases where the funds are borrowed generally, should be determined based on the expenditure incurred in obtaining a qualifying asset. The costs incurred should first be allocated to the specific borrowings.

Analysis of expenditure:

Date	Expenditure (₹'000)	Amount allocated in general borrowings (₹'000)	Weighted for period outstanding (₹'000)
1st April 20X1	200	0	0
30th June 20X1	600	100*	100×9/12=75
31st Dec 20X1	1,200	1,200	1,200×3/12=300
31st March 20X2	200	200	200×0/12=0
Total	2,200		375

*Specific borrowings of ₹ 7,00,000 fully utilized on 1st April & on 30th June to the extent of ₹ 5,00,000 hence remaining expenditure of ₹ 1,00,000 allocated to general borrowings.

The expenditure rate relating to general borrowings should be the weighted average of the borrowing costs applicable to the entity's borrowings that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Capitalisation rate = $(10,00,000 \times 12.5\%) + (15,00,000 \times 10\%) / 10,00,000 + 15,00,000 = 11$

Borrowing cost to be capitalized:	Amount (₹)
On specific loan	65,000
On General borrowing (3,75,000 × 11%)	41,250
Total	1,06,250
Less interest income on specific borrowings	(20,000)
Amount eligible for capitalization	86,250

Therefore, the borrowing costs to be capitalized are ₹ 86,250.

Q17: In a group with Parent Company "P" there are 3 subsidiaries with following business:
"A" – Real Estate Company

“B” – Construction Company

“C” – Finance Company

- Parent Company has no operating activities of its own but performs management functions for its subsidiaries.
- Financing activities and cash management in the group are coordinated centrally.
- Finance Company is a vehicle used by the group solely for raising finance.
- All entities in the group prepare Ind AS financial statements.

The following information is relevant for the current reporting period 20X1-20X2:

Real Estate Company

- Borrowings of ₹ 10,00,000 with an interest rate of 7% p.a.
- Expenditures on qualifying assets during the period amounted to ₹ 15,40,000.
- All construction works were performed by Construction Company. Amounts invoiced to Real Estate Company included 10% profit margin.

Construction Company

- No borrowings during the period.
- Financed ₹ 10,00,000 of expenditures on qualifying assets using its own cash resources.

Finance Company

- Raised ₹ 20,00,000 at 7% p.a. externally and issued a loan to Parent Company for general corporate purposes at the rate of 8%.

Parent Company

- Used loan from Finance Company to acquire a new subsidiary.
- No qualifying assets apart from those in Real Estate Company and Construction Company.
- Parent Company did not issue any loans to other entities during the period.

What is the amount of borrowing costs eligible for capitalisation in the financial statements of each of the four entities for the current reporting period 20X1-20X2?

Ans: Following is the treatment as per Ind AS 23:

Finance Company

No expenditure on qualifying assets have been incurred, so Finance Company cannot capitalise anything.

Real Estate Company

Total interest costs in the financial statements of Real Estate Company is ₹ 70,000. Expenditures on qualifying assets exceed total borrowings, so the total amount of interest can be capitalised.

Construction Company

No interest expense has been incurred, so Construction Company cannot capitalise anything.

Consolidated financial statements of Parent Company:

Total general borrowings of the group: ₹ 10,00,000 + ₹ 20,00,000 = ₹ 30,00,000

Although Parent Company used proceeds from loan to acquire a subsidiary, this loan cannot be excluded from the pool of general borrowings.

Total interest expenditures for the group = ₹ 30,00,000 x 7% = ₹ 2,10,000

Total expenditures on qualifying assets for the group are added up. Profit margin charged by Construction Company to Real Estate Company is eliminated:

Real Estate Company – ₹ 15,40,000/1.1 = ₹ 14,00,000 Construction Co – ₹ 10,00,000

Total consolidated expenditures on qualifying assets:

₹ (14,00,000 + 10,00,000) = ₹ 24,00,000

Capitalisation rate = 7%

Borrowing costs eligible for capitalisation = ₹ 24,00,000 x 7% = ₹ 1,68,000

Total interest expenditures of the group are higher than borrowing costs eligible for capitalisation calculated based on the actual expenditures incurred on the qualifying assets. Therefore, only ₹ 1,68,000 can be capitalised.

Q18: How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of ₹ 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR. **[RTP May 2021]**

Ans: Capitalisation Method

As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalisation of borrowing cost should cease where substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Thus, only that portion of the amortized 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.

Capitalisation of Interest

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalised and the borrowing cost relating to year 3 & 4 should be expensed.

Quantum of Borrowing

The value of the bond to Y Ltd. is the transaction price ie ₹ 1,80,000 (2,00,000 – 20,000) Therefore, Y Ltd will recognize the borrowing at ₹ 1,80,000.

Computation of the amount of Borrowing Cost to be Capitalised

Y Ltd will capitalise the interest (borrowing cost) using the effective interest rate of 13.39% for two years as the qualifying asset is ready for intended use at the end of the year 2, the details of which are as follows:

Year	Opening Borrowing	Interest expense @ 13.39% to be capitalized	Total	Interest paid	Closing Borrowing
	(1)	(2)	(3)	(4)	(5) = (3) – (4)
1	1,80,000	24,102	2,04,102	20,000	1,84,102
2	1,84,102	24,651	2,08,753	20,000	1,88,753
		48,753			

Accordingly, borrowing cost of ₹ 48,753 will be capitalized to the cost of qualifying asset.

Q19: Nikka Limited has obtained a term loan of ₹620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 20X2. An expenditure of ₹ 510 lacs was incurred on installation of Plant and Machinery, ₹ 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of ₹ 56 lacs has been used for working capital purposes. Management of Nikka Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of ₹ 68.20 lacs during financial year 20X1-20X2 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 20X2?

[RTP Nov 2021; Exam May 22 (7 Marks); MTP May 23]

Ans: As per Ind AS 23, Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

Where, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Building was completed by 31st December, 2007. Following the principles prescribed in IND AS-23 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building.

Ans:

(i)	Computation of average accumulated expenses			
	$\text{₹}2,00,000 \times 12 / 12 =$			2,00,000
	$\text{₹} 2,50,000 \times 9 / 12 =$			1,87,500
	$\text{₹} 4,50,000 \times 6 / 12 =$			2,25,000
	$\text{₹} 1,20,000 \times 1 / 12 =$			10,000
				6,22,500
(ii)	Calculation of average interest rate other than for specific borrowings			
	Amount of loan (in ₹)	Rate of interest		Amount of interest (in ₹)
	5,00,000	11%		55,000
	9,00,000	13%		1,17,000
	14,00,000			1,72,000
	Weighted average rate of interest = $(1,72,000/14,00,000) \times 100 = 12.285\%$ (approx)			
(iii)	Interest on average accumulated expenses			
	Specific borrowings ($\text{₹} 1,00,000 \times 10\%$) =			10,000
	Non-specific borrowings ($\text{₹} 5,22,500 \times 12.285\%$) =			64,189
	Amount of interest to be capitalized =			74,189
	*($\text{₹} 6,22,500 - \text{₹} 1,00,000$)			
(iv)	Total expenses to be capitalized for building			
	Cost of building $\text{₹}(2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)$			10,20,000
	Add: Amount of interest to be capitalised			74,189
				10,94,189
(v)	Journal Entry			
	Date	Particulars	Dr. (₹)	Cr. (₹)
	31.12.2007	Building account To Bank account (Being amount of cost of building and borrowing cost thereon capitalized)	Dr. 10,94,189	10,94,189

Q21: X Ltd. commenced the construction of a plant (qualifying asset) on 1st September, 20X1, estimated to cost ₹ 10 crores. For this purpose, X has not raised any specific borrowings, rather it intends to use general borrowings, which have a weighted average cost of 11%. Total borrowing costs incurred during the period, viz., 1st September, 20X1 to 31st March, 20X2 were ₹ 0.5 crore.

The other relevant details are as follows:

(₹ in crore)

Month	Cost of construction Accrued	Cash outflows (paid in advance at the
-------	------------------------------	---------------------------------------

		start of each month)
September	1.50	3.00
October	0.50	1.70
November	1.50	2.50
December	0.50	-
January	1.80	1.00
February	0.70	-
March	3.00	1.50

Based on the above information, discuss the treatment of borrowing cost as per cash outflow basis and accrual basis and also suggest the appropriate amount of interest that should be capitalised to the cost of the plant in the financial statements for the year ended 31st March, 20X2?
[RTP May 2022; Nov 2024]

Ans: Paragraph 14 of Ind AS 23, inter-alia, states that to the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period. However, an entity shall exclude from this calculation borrowing costs applicable to borrowings made specifically for the purpose of obtaining a qualifying asset until substantially all the activities necessary to prepare that asset for its intended use or sale are complete. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

In this context, a question arises whether such expenditure should be based on costs accrued or actual cash outflows. To contrast these two alternatives, presented below is the computation of borrowing costs based on both the alternatives:

Month	Cost of construction Accrued	Average capital expenditure	Cash outflows (paid in advance at the start of each month)	Average capital expenditure
September	1.50	$1.50 \times 7/12 = 0.875$	3.00	$3.00 \times 7/12 = 1.75$
October	0.50	$0.50 \times 6/12 = 0.25$	1.70	$1.70 \times 6/12 = 0.85$
November	1.50	$1.50 \times 5/12 = 0.625$	2.50	$2.50 \times 5/12 = 1.04$
December	0.50	$0.50 \times 4/12 = 0.17$	-	-
January	1.80	$1.80 \times 3/12 = 0.45$	1.00	$1 \times 3/12 = 0.25$
February	0.70	$0.70 \times 2/12 = 0.12$	-	-
March	3.00	$3.00 \times 1/12 = 0.25$	1.50	$1.50 \times 1/12 = 0.125$
	9.50	2.74	9.70	4.02

If the average capital expenditure on the basis of costs accrued is taken, the borrowing costs eligible to be capitalised would be ₹ 2.74 crore \times 11% = 0.30 crore. Whereas, if average capital expenditure on the basis of cash flows is taken, the borrowing costs eligible to be capitalised would be ₹ 4.02 crore \times 11% = 0.44 crore. Thus, there is a wide variance in the amount of borrowing cost to be capitalised, based on the accrual basis and on actual cash flows basis. This

divergence is often experienced during the implementation of large projects, for example, an advance given to a supplier involves an upfront cash outflow while the actual expenditure accrues in later periods (with the receipt of goods and services).

As per paragraph 18 of Ind AS 23, expenditures on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditures are reduced by any progress payments received and grants received in connection with the asset (see Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance). The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalization rate is applied in that period.

Where cash has been paid but the corresponding cost has not yet accrued interest becomes payable on payment of cash. Therefore, the amount so paid should be considered for determining the amount of interest eligible for capitalisation, subject to the fulfillment of other conditions prescribed in paragraph 16 of Ind AS 23. Accordingly, in the present case, interest should be computed on the basis of the cash flows rather than on the basis of costs accrued. Therefore, the amount of interest eligible for capitalisation would be ₹ 0.44 crore.

Another important factor to be noted is that paragraph 14 requires, inter alia, that the amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period. Thus, the amount of borrowing costs to be capitalised should not exceed the total borrowing costs incurred during the period, that is ₹ 0.5 crore.

Q22: 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 operational 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 lakh)			
	Phase I	Phase II	Phase III	Phase IV
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

After taking substantial period of construction, at the 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.

[RTP Nov 2022]

Ans:

	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 = $\frac{30,00,000}{2,21,00,000} \times 98,00,000$	13,30,317
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	16,69,683

Accounting treatment:**1. For Phase I and Phase II**

Since Phase I and Phase II have become operational at 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 off during the year.

2. 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.

Q23: LT Ltd. is in the process of constructing a building. The construction process is expected to take about 18 months from 1st January 20X1 to 30th June 20X2. The building meets the definition of a qualifying asset. LT Ltd. incurs the following expenditure for the construction:

1st January, 20X1	₹ 5 crores
30th June, 20X1	₹ 20 crores
31st March, 20X2	₹ 20 crores
30th June, 20X2	₹ 5 crores

On 1st July 20X1, LT Ltd. issued 10% Redeemable Debentures of ₹ 50 crores. The proceeds from the debentures form part of the company's general borrowings, which it uses to finance the construction of the qualifying asset, ie, the building. LT Ltd. had no borrowings (general or specific) before 1st July 20X1 and did not incur any borrowing costs before that date. LT Ltd. incurred ₹ 25 crores of construction costs before obtaining general borrowings on 1st July 20X1 (pre-borrowing expenditure) and ₹ 25 crores after obtaining the general borrowings (post-borrowing expenditure).

For each of the financial years ended 31st March 20X1, 20X2 and 20X3, calculate the borrowing cost that LT Ltd. is permitted to capitalize as a part of the building cost.

[RTP May 2023; MTP May 24; May 25; Exam Sep 2025 (8 Marks)]

Ans: Applying paragraph 17 of Ind AS 23 to the fact pattern, the entity would not begin capitalising borrowing costs until it incurs borrowing costs (i.e. from 1st July, 20X1). In determining the expenditures on a qualifying asset to which an entity applies the capitalisation rate (paragraph 14 of Ind AS 23), the entity does not disregard expenditures on the qualifying asset incurred before the entity obtains the general borrowings. Once the entity incurs borrowing costs and therefore satisfies all three conditions in para 17 of Ind AS 23, it then applies paragraph 14 of Ind AS 23 to determine the expenditures on the qualifying asset to which it applies the capitalisation rate.

Calculation of borrowing cost for financial year 20X0-20X1

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Exp
Date	Amount		
1st January 20X1	₹ 5 crore	0/3	Nil

Borrowing Costs eligible for capitalisation = NIL. LT Ltd. cannot capitalise borrowing costs before 1st July, 20X1 (the day it starts to incur borrowing costs).

Calculation of borrowing cost for financial year 20X1-20X2

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		
1 st January, 20X1	₹ 5 crore	9/12*	₹ 3.75 crore
30 th June, 20X1	₹ 20 crore	9/12	₹ 15 crore
31 st March, 20X2	₹ 20 crore	0/12	Nil
Total			₹ 18.75 crore

Borrowing Costs eligible for capitalisation = 18.75 cr. x 10% = ₹ 1.875 cr.

*LT Ltd. cannot capitalise borrowing costs before 1st July, 20X1 (the day it starts to incur borrowing costs). Accordingly, this calculation uses a capitalization period from 1st July, 20X1 to 31st March, 20X2 for this expenditure.

Calculation of borrowing cost for financial year 20X2-20X3

Expenditure		Capitalization Period (current year)	Weighted average Accumulated Expenditure
Date	Amount		

1 st January, 20X1	₹ 5 crore	3/12	₹ 1.25 crore
30 th June, 20X1	₹ 20 crore	3/12	₹ 5 crore
31 st March, 20X2	₹ 20 crore	3/12	₹ 5 crore
31 st March, 20X2	₹ 1.875 crore	3/12	₹ 0.47 crore
30 th June, 20X2	₹ 5 crore	0/12	Nil
Total			₹ 11.72 crore

Borrowing costs eligible for capitalisation = ₹ 11.72 cr. x 10% = ₹ 1.172 cr.

Q24: PQR Limited is engaged in Tourism business in India. The company has planned to construct a Holiday Resort (Qualifying Asset) at Shimla. The cost of the project has been met out of borrowed funds of ₹ 100 lakhs at the rate of 12% p.a. ₹ 40 lakhs were disbursed on 1st April 20X2 and the balance of ₹ 60 lakhs were disbursed on 1st June 20X2. The site planning work commenced on 1st June 20X2, since the Chief engineer of the project was on medical leave. The company commenced physical construction on 1st July 20X2 and the work of construction continued till 30th September 20X2 and thereafter the construction activities stopped due to landslide on the road which leads to construction site. The road blockages have been cleared by the government machinery by 31st December 20X2. Construction activities have resumed on 1st January 20X3 and has completed on 28th February 20X3.

The date of opening has been scheduled for 1st March 20X3, but unfortunately, the District Administration gave permission for opening on 16th March 20X3, due to lack of safety measures like fire extinguishers which had not been installed by then.

Determine the amount of borrowing cost to be capitalized towards construction of the resort when

- Landslide is not common in Shimla and delay in approval from District Administration Office is minor administrative work leftover.
- Landslide is common in Shimla and delay in approval from District Administration Office is major administrative work leftover.

[RTP May 2024]

Ans: As per Ind AS 23 'Borrowing Costs', the commencement date for capitalisation of borrowing cost on qualifying asset is the date when the entity first meets all of the following conditions:

- it incurs expenditures for the asset;
- it incurs borrowing costs; and
- it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Further, an entity also does not suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period that high water levels delay construction of a bridge, if such high-water levels are common during the construction period in the geographical region involved.

An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Further, paragraph 23 explains that an asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

In the given case since the site planning work started for the project on 1st June, 20X2, the commencement of capitalisation of borrowing cost will begin from 1st June, 20X2.

a) **When landslide is not common in Shimla and delay in approval from District Administration Office is minor administrative work leftover**

In such a situation, suspension of capitalisation of borrowing cost on construction work will be considered for 3 months i.e. from October, 20X2 to December, 20X2 and cessation of capitalisation of borrowing cost shall stop at the time of completion of physical activities.

Accordingly, the borrowing cost to be capitalized will be effectively for 6 months i.e. from 1st June, 20X2 to 30th September, 20X2 and then from 1st January, 20X3 to 28th February, 20X3 i.e. total 6 months. The amount of borrowing cost will be ₹ 6,00,000 $(1,00,00,000 \times 6/12 \times 12\%)$.

b) **When landslide is common in Shimla and delay in approval from District Administration Office is major administrative work leftover**

Since landslides are common in Shimla during monsoon period, there shall be no suspension of capitalisation of borrowing cost during that period.

Further, an asset can be considered to be ready for its intended use only on receipt of approvals and after compliance with regulatory requirements such as "Fire Clearances" etc. These are very important to declare the asset as ready for its scheduled operation.

In the given case, obtaining the safety approval is a necessary condition that needs to be complied with strictly and before obtaining the same the entity will not be able to use the building. Accordingly, it is appropriate to continue capitalisation until the said approvals are obtained.

Hence, the capitalisation of the borrowing cost will be for 9.5 months i.e. from 1st June, 20X2 till 15th March, 20X3. The amount of borrowing cost will be ₹9,50,000 $(1,00,00,000 \times 9.5/12 \times 12\%)$.

Q25: An entity can borrow funds in its functional currency (₹) @ 12%. It borrows \$ 1,000 @ 4% on 1st April, 20X1 when \$ 1 = ₹ 40. The equivalent amount in functional currency is ₹ 40,000. Interest is payable on 31st March, 20X2. On 31st March, 20X2, exchange rate is \$ 1 = ₹ 50. The loan is not due for repayment.

Compute exchange loss and borrowing cost to be capitalized as on 31st March, 20X2. What will be exchange loss and borrowing cost to be capitalized as on 31st March, 20X2 if the exchange rate on 31st March, 20X2, is \$ 1 = ₹ 41?

[MTP Nov 2023]

Ans: When the exchange rate on 31st March, 20X2, is \$ 1 = ₹ 50.

The exchange loss in this case is ₹ 10,000 [$\$ 1,000 \times (\text{₹ } 50 - \text{₹ } 40)$]. The borrowing cost is ₹ 2,000 ($\$ 1,000 \times 4\% \times \text{₹ } 50$).

Had the entity borrowed funds in functional currency the borrowing cost would have been ₹ 4,800 ($\text{₹ } 40,000 \times 12\%$).

The entity will treat exchange difference upto ₹ 2,800 ($\text{₹ } 4,800 - \text{₹ } 2,000$) as a borrowing cost that may be eligible for capitalisation under this Standard.

Thus, the total eligible borrowing cost is ₹ 4,800 ($\text{₹ } 2,000 + \text{₹ } 2,800$) equivalent to the cost of borrowing cost in functional currency.

When the exchange rate on 31st March, 20X2, is \$ 1 = ₹ 41.

The exchange loss would be ₹ 1,000 [$\$ 1,000 - (\text{₹ } 41 - \text{₹ } 40)$].

The entity will treat the entire exchange loss as an eligible borrowing cost as total borrowing cost i.e. ₹ 2,640 [$(\text{₹ } 1,000 \times 4\% \times 41) + \text{₹ } 1,000$] since exchange loss in foreign currency does not exceed the cost of borrowings in functional currency, i.e., ₹ 4,800

Q26: An entity has borrowed ₹10,00,000 specifically to finance the cost of constructing a new head office. The loan was availed on 1st May 20X8. Interest was payable at 12% per annum up to 1st February 20X9, after which the rate was revised to 13% owing to an increase in the Secured Overnight Financing Rate (SOFR). Construction of the building does not begin until 1st December 20X8 and continues, without interruption, until after the year end on 31st March 20X9. During the period of construction, the entity incurs directly attributable costs of ₹1,00,000 in December 20X8 and ₹250,000 in each month from January 20X9 to March 20X9 (for simplicity, it is assumed that these costs are incurred on the first day of each month). Each month, the borrowings (less any amount that is to be expended for the building works in that month) are re-invested and earn interest at a rate of 5% per annum. For the year ended 31st March, 20X9, the entity incurred interest expense of ₹1,11,667 on the ₹10,00,000 loan and earned ₹ 37,917 as interest on the re-invested portion.

Required: Determine the amount of borrowing cost to be capitalized to the qualifying asset for the year ended 31st March, 20X9. [RTP Jan 2026]

Ans: Statement showing the interest paid and received during the period of construction

	₹
Interest payable for December 20X8 at 12% ($10,00,000 \times 12\% \times 1/12$)	10,000
Interest payable for January 20X9 at 12% ($10,00,000 \times 12\% \times 1/12$)	10,000
Interest for February 20X9 at 13% ($10,00,000 \times 13\% \times 1/12$)	10,833
Interest payable for March 20X9 at 13% ($10,00,000 \times 13\% \times 1/12$)	<u>10,834</u>
Total interest payable during the construction period till March 20X9(A)	<u>41,667</u>
Interest receivable on re-invested funds of ₹ 9,00,000 in September 20X9 [$(10,00,000 - 1,00,000) \times 5\% \times 1/12$]	3,750

Interest receivable on re-invested funds of ₹ 6,50,000 in October 20X9 [(9,00,000 – 2,50,000) x 5% x 1/12]	2,708
Interest receivable on re-invested funds of ₹ 4,00,000 in November 20X9 [(6,50,000 – 2,50,000) x 5% x 1/12]	1,667
Interest receivable on re-invested funds of ₹ 1,50,000 in December 20X9 [(4,00,000 – 2,50,000) x 5% x 1/12]	625
Total interest receivable till March, 20X9 (B)	8,750
Net interest cost (A) - (B)	32,917

The borrowing is specific to the qualifying asset and the borrowing costs eligible for capitalisation are the actual cost incurred during the construction period less any investment income on the temporary investment of the borrowings. The amount of borrowing costs that can be capitalised is ₹32,917.

Commencement of capitalization of borrowing costs will be said from the period when all the three criteria as mentioned in para 17 of Ind AS 23 are met. Although the funds were drawn down under the borrowings on 1st May 20X8, the construction started from 1st December, 20X8. Hence, the borrowing costs incurred prior to 1st December, 20X8 cannot be said to be directly attributable to the asset's construction, as no expenditure on the asset is being incurred.

NOTES

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