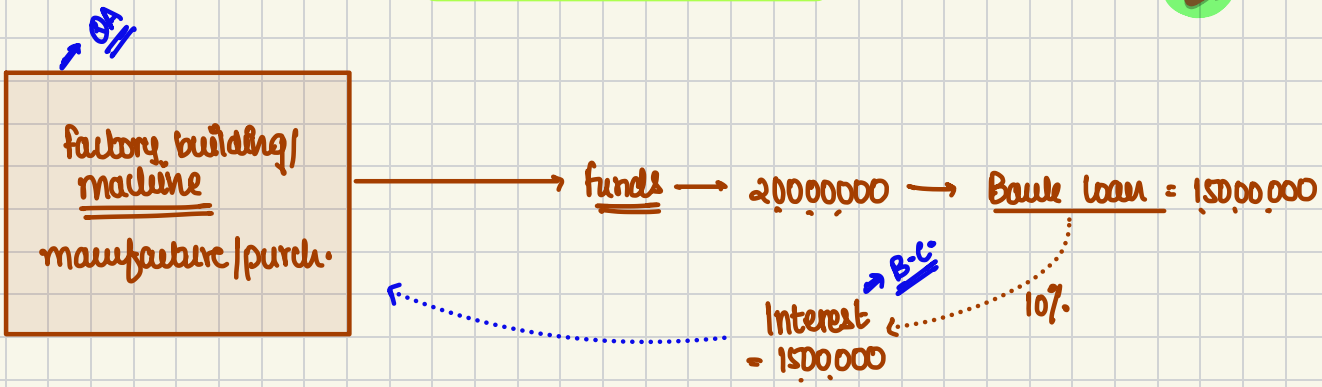
AS-16: BORROWING COSTS

L4



AS-16 discusses whether this interest i.e. borrowing can be added to the cost of building/machine or it should be debited to P&L a/c.

QUALIFYING ASSET

CA TEJAS SUCHAK
ACCOUNTANCY ACE

→ Any asset
- Fixed Asset → factory building
- Inventory (C.A.) → Alcohol

↳ substantial period of time to get ready
- Generally considered as 12 months
  - If a lesser or a greater time can be justified, the same can be considered as substantial period of time.

↳ for its intended use or sale
- Intended use → Im going to use it myself → factory building machine
- Sale → Alcohol

Example :- Nidar ltd. is constructing a complex machine. The machine generally takes 14 months to get ready for its intended use. However, Nidar ltd. is using latest cutting edge technology to construct the machine and is to complete the construction in 9 months time. Can this machine be considered as a qualifying asset ?

Solution :-

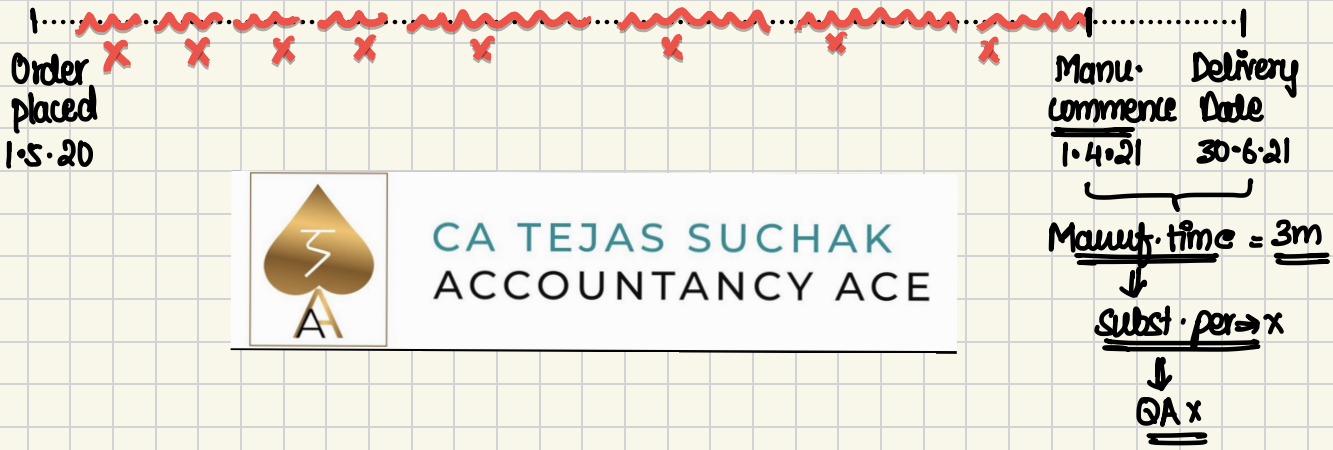
If entire industry takes 9 months to complete the construction
↓
Then it will not be considered a qualifying asset.

If entire industry is taking 14 months and only Nidar ltd. completes it in 9 months.
↓
Nidar ltd. can justify it as a QA because the asset generally requires 14 months to complete. Only Nidar ltd. because of

efficient working is able to complete it in 9 months.

LA

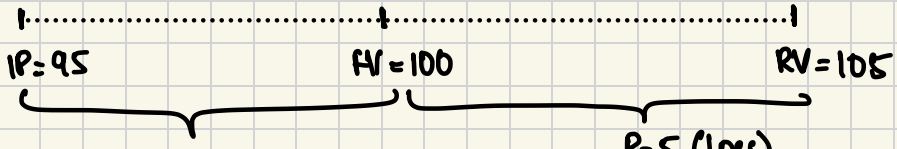
* Incase of purchase of an asset if the vendor has given a waiting period of 12m/13m/14m, that doesnot make the asset a qualifying asset.



BORROWING COST

LB

1. → Interest cost
2. → Discount & premium on borrowings. (Eg: Debentures)



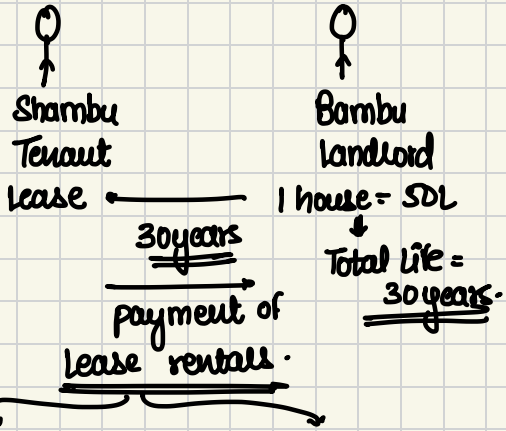
Bank	Dr.	95
Disc.	Dr.	5
To, 7% Deb.		100

Premium on Red. Dr - 5
To, premium payable 5

Preference shares issued → issue: discount, redeem: premium → Borrowing cost ✗
↓
Borrowings → ✗

3. Commitment charges on borrowings.
4. Finance charges on finance lease (AS-19)
5. Exchange difference arising on foreign currency borrowings to the extent they are an adjustment to interest cost.

"lease : Rent"



Example :-

US $ Borrowings = 100,000 $
Date :- 1.4.20
Exchange Rate : 1$ = ₹75
Interest = 4%.

31·3·21

Exchange Rate : 1 $ = 85

Principal 50 Lakh.

Interest / finance charges ↓ 20 Lakh.

Similar loan was available in India @ 11% p.a. interest

Calculate borrowing cost to be capitalised (Exam Question)

18

Solution :-

1st point to remember :-

India Loan = (100000 × 75) × 11% = 825000 → maximum borrowing cost.
(1·4·20)

2nd point :-

US loan = (100000 × 4%) × 85 = 340000
(31·3·21)

Balance = 825000 - 340000 = 485000

3rd point :-

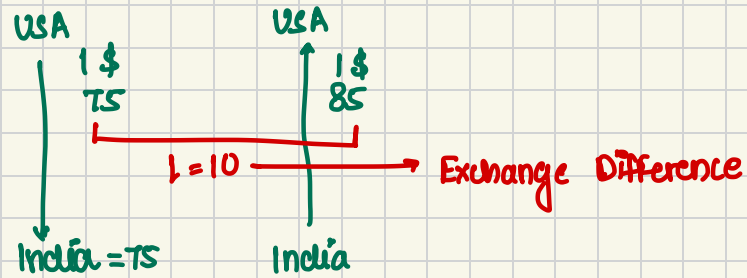
Exchange Difference :- 100000 × (85 − 75)
31·3·21 1·4·20

= 100000 × 10

Exchange loss = 1000000

Borrowing cost

1000000 - 485000 = 515000 → Loss → P&L Dr.
(As-11)



2008 :- US recession ------→ Related to AS-11 : para 46

ER : 1 $ = 40 1 $ = 65

Tata

F.C.B.

100000 × 40 } Liability

100000 × 65 } Liability

Liability = loan

Liability inc. 25L

Asset Dr.

Ex. loss (P&L) Dr. 25L → Profit ↓ → shares Market ↓

Example 2 :-

Loan taken from Donald Duck Bank 500000 $
Interest Rate = 4.25%.
Date of loan = 1.4.20
Similar loan available in India @ 10.25%.
Exchange Rate : 1.4.20 : 1$ = ₹ 70
31.3.21 = 1$ = ₹ 77

Calculated the exchange difference that can be treated as borrowing cost.

Solution :-

If loan was taken in India :-

Interest = (500000 × 70) × 10.25% = 3587500

Actual interest on US $ loan

Interest = (500000 × 4.25%) × 77 = 1636250

1951250/- → adjustment slope

Exchange Difference

= 500000 (70 - 77)
= 3500000/-

Borrowing cost
1951250

Exchange loss (P&L Dr.) → AS-11
= 1548750

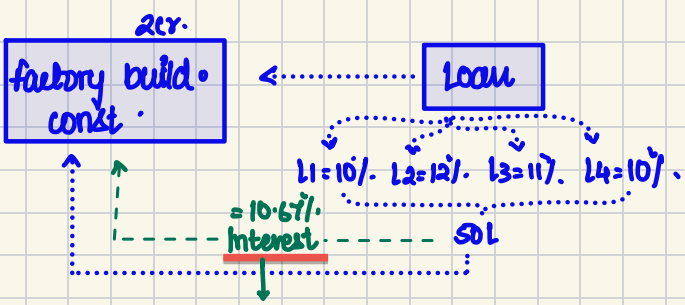
BORROWINGS

General Borrowings

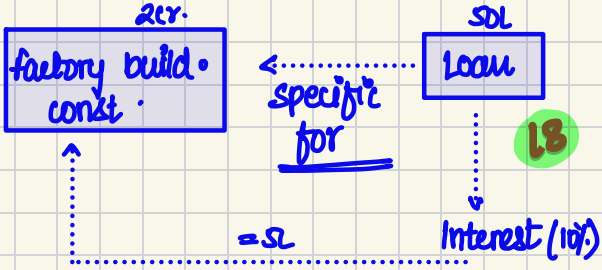
Borrowings that cannot be directly attributed for the acquisition/construction/manufacturing of a QA.

Specific Borrowings

Borrowing for the purpose of acquiring/constructing/manufacturing a QA.



Weighted Average Interest Rate



Specific Interest Rate will be used for capitalisation.

L1	= 5000000	x	IR = 10%	=	500000
L2	= 3000000	x	IR = 12%	=	360000
L3	= 6000000	x	IR = 11%	=	660000
L4	= 4000000	x	IR = 10%	=	400000
	18000000				1920000

* Income from temporary investment of specific loan will be first deducted from the amount of interest and then the balance interest will be capitalized to the cost of qualifying asset.

$$WAIR = \frac{1920000}{18000000}$$

$$WAIR = 10.67\%$$

Example :-

Niharika ltd. wants to construct a factory building for ₹ 1500000. for this purpose they used funds from the following borrowings :-

1. Bank Loan - SBI - 750000 @ 11%.
2. 9% Debentures - 500000
3. Bank Loan - HDFC - 1000000 @ 8.5%.
4. Public Deposits - 500000 @ 9.5%.

Calculate the borrowing cost to be capitalised.

Solution :-

Borrowing cost to be capitalised
= Expenditure on QA x Weighted Average Interest Rate
= 1500000 x WAIR
= 1500000 x 9.45%.
= 141750 → capitalised & added to the cost of QA.

Weighted Average Interest Rate

$$= \frac{\overset{w}{75L} \times \overset{u}{11\%} + \overset{w}{50L} \times \overset{u}{9\%} + \overset{w}{100L} \times \overset{u}{8.5\%} + \overset{w}{50L} \times \overset{u}{9.5\%}}{\underset{\uparrow}{275L}}$$

Σw

B1	= 750000	x	11%	=	82500
B2	= 500000	x	9%	=	45000
B3	= 1000000	x	8.5%	=	85000
B4	= 500000	x	9.5%	=	47500
	2750000				

2600000

$= \frac{2600000}{27500000}$

$= 9.45\%$

What amount of interest will be debited to P&L.

= 2600000 − 1417500
= 1182500

Example :-

Shipra ltd. wants to construct a Qualifying Asset.
Cost = 27500000
For this purpose it took a specific loan of ₹ 10000000 @ 8.5% p.a.
It also has other general loans which are as follows :-

1. Bank Loan - SBI - 7500000 @ 11%.
2. 9% Debentures - 5000000
3. Bank Loan - HDFC - 10000000 @ 8.5%.
4. Public Deposits - 5000000 @ 9.5%.

Calculate the amount of borrowing cost to be capitalised.

Solution :-

Borrowing cost to be capitalised :-

Expenditure incurred on QA × Interest Rate

Total cost	= 27500000				
Specific loan	= 10000000	×	(SIR) 8.5%	=	850000
General loan	= 17500000	×	(WAIR) 9.45%	=	1653750
					2503750

↓ calculated in previous example.

Interest debited to P&L = 2600000 − 1653750 = 946250/-

LB

Example 3 :-

Shivok ltd. wants to construct a Qualifying Asset.
Cost = 27500000
for this purpose it took a specific loan of ₹ 10000000 @ 8.5% p.a.
It also has other general loans which are as follows :-

1. Bank Loan - SBI - 7500000 @ 11%.
2. 9% Debentures - 5000000
3. Bank Loan - HDFC - 10000000 @ 8.5%.
4. Public Deposits - 5000000 @ 9.5%.

CA TEJAS SUCHAK
ACCOUNTANCY ACE

Specific borrowings were temp. invested for 3 months and an income of 350000 was earned from the same.

General borrowings were also invested for 4 months and an income of 400000 was earned from the same.

Calculate the amount of borrowing cost to be capitalised.

Solution :-

Borrowing cost to be capitalised :-

Expenditure on Qualifying Asset x Interest Rate

Total expenditure = 27500000				
1. Specific loan	= 10000000	x	8.5%	= 850000
less: Income from temporary investment				= (350000)
				500000
2. General loan	= 17500000	x	9.45%	= 1653750

A = 2.75Cr. Int = 26L
= 26/2.75
= 9.45%.

Total Interest to be capitalised = 2153750

NOTE :- Income from temporary investment of general borrowing will not be deducted from the total interest on general borrowing. It will simply be credited to P&L a/c.

Interest debited to P&L a/c = 2600000 - 1653750 = 946250 → Dr. P&L

COMMENCEMENT, SUSPENSION & CESSATION OF CAPITALISATION

L10

Commencement of Capitalisation

1. Borrowing cost should be incurred.
2. Expenditure for produc-/ const./acquis. of QA should be incurred.
3. Activities necessary to make the QA ready for its intended use should be in progress.

Suspension of Capitalisation of Borrowing Costs

When active development is interrupted because of avoidable reasons i.e. reasons within our control, then capitalisation of borrowing costs should be suspended.

Cessation of Capitalisation

When substantially all activities necessary to prepare QA for its intended use or sale are comp., capitalisation of borrowing cost should cease.

1.4.22 — Loan taken

"Borrowing cost Incurred"

P&L Dr.

1.5.22 — Building plan sent for approval of Municipal corporation

30.6.22 → Architect hired
→ 150 labours hired
→ civil engineer hired

Capitalisation of borrowing cost commences.

Labour Strike

Borrowing cost for this period will not be capitalised. It will be charged to P&L a/c.

30.4.23 — activities necessary to make the QA ready for its intended use or sale are substantially complete.

Only this much borrowing cost can be capitalised.

Interest post this point will be Dr. to P&L.

WHEN QUALIFYING ASSET IS COMPLETED IN PARTS

Prop. Loan = 50×2/10 = 10cr. → Interest P&L Dr.

Proportionate loan = 50×8/10 = 40cr.

Interest Continue to capitalise

Loan Taken = 50crores.

Substantially complete PART

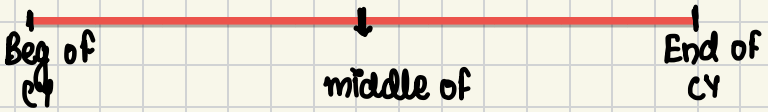
AS-2.10.16

10:00am - 10:45am

Wednesday

If this part gets completed in the middle of current year
Assume ; Interest Rate @ 11%.

Amount to be capitalised



PART I complete

Interest capitalised
= 10cr x 11% x 6/12

Interest charged to P&L
= 10cr x 11% x 6/12