AS 16 Borrowing Costs

Borrowing Cost : Interest → Qualifying Asset → subst. period of time
incurr generally : 12m

Question 1

A company incorporated in June 2020, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company and the company is able to justify the reasons for the same. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16. **(MTP 5 Marks April 21, April 22, RTP Nov'18)**

Answer 1

Quote

As per 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. Further, the standard states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be jus tified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

It may be implied that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Analysis

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa. The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Conclusion

Therefore, if the factory is constructed in 8 months, then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalized although it has taken less than 12 months for the asset to get ready to use.

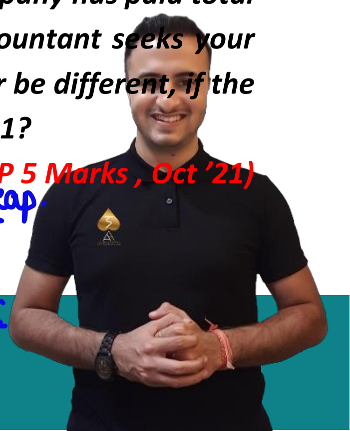
BC = 68.2 → P/e/A ; QA → cost cap. ⇒ 564/620 × 68.2 = 62.04L cap.
for other purp → P&L Dr. = 6.16L P&L

Question 2

U Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernization of its Factory on 1st April, 2020. Plant and Machinery was acquired under the modernization scheme and installation was completed on 30th April, 2021. An expenditure of ₹ 564 lacs was incurred on this Plant and Machinery and the balance loan of ₹ 56 lacs has been used for working capital purposes. The company has paid total interest of ₹ 68.20 lacs during financial year 2020-2021 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, 2021? **(MTP 5 Marks , Oct '21)**

Borrowing → QA
564L Int + P&M ⇒ 564/620 × 68.2 = 62.04 cap
56L → Other purpose ⇒ 56/620 × 68.2 = 6.16 P&L Dr.

Answer 2



(iii) *Interest that would have resulted if the loan was taken in Indian currency = US $ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs*

(iv) *Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs − ₹ 24.80 lakhs = ₹ 34 lakhs.* AS-16

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 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 ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 − 34) would be considered as the exchange difference to be accounted for as per AS 11.

Spec. Borrowing → SIR (10%) → $\boxed{\text{Interest}}$ capitalise
↳ Temp. Inv → $\boxed{\text{Income}}$ → deduct: Net Int → Cap.

150 × 13% = 19.5

Question 4

Vital Limited borrowed an amount of ₹150 crores on 1;4;2021 for construction of boiler plant @ 10% 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 Vital Ltd; capitalized ₹ 19;50 crores for the accounting period ending on 31;3;2022; Due to surplus fund out of ₹150 crores, an income of ₹ 1;50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

QA

(MTP 5 Marks March '23, RTP Nov 20)

Answer 4

Para 10 of AS 16 'Borrowing Costs' states that to the extent the 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.

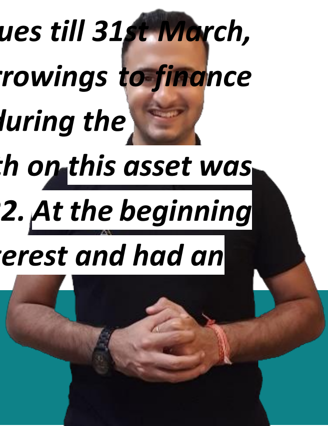
The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Vital Ltd. is incorrect.

The amount of borrowing costs capitalized for the financial year 2021−22 should be calculated as follows:

Actual interest for 2021−22 (10% of ₹ 150 crores)	*₹ 15.00 crores*
Less: Income on temporary investment from specific borrowings	*(₹ 1;50 crores)*
Borrowing costs to be capitalized during year 2021−22	***₹ 13.50 crores***

Question 5

ABC Limited has started construction of an asset on 1st December, 2021, which continues till 31st March, 2022 (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 ₹ 10 lakh in December 2021 and ₹ 4 lakh in each of the months of January to March 2022. At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an



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. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalization of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

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Question 8

Zen Bridge Construction Limited obtained a loan of Rs. 64 crores to be utilized as under:

(i)	*Construction of Hill link road in Kedarnath* QA	*Rs. 50 crores* → 50/64 x 1.6 = 1.25 Cap.
(ii)	*Purchase of Equipment and Machineries* x	*Rs. 6 crores*
(iii)	*Working Capital* x	*Rs. 4 crores*
(iv)	*Purchase of Vehicles* x	*Rs. 1crore* → 14/64x1.6=0.35 P&L Dr.
(v)	*Advances for tools/cranes etc.* x	*Rs. 1crore*
(vi)	*Purchase of Technical Know how* x	*Rs. 2 crores*
(vii)	*Total Interest charged by the Bank for the year ending 31st March, 2018*	*Rs. 1.6 crores*

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

(RTP May 19)

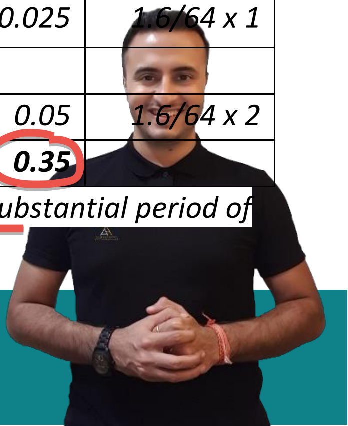
Answer 8

According to 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 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. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

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

	Qualifying Asset	***Interest to be capitalized Rs. in crores***	***Interest charged to Profit & Loss A/c Rs. in crores***	
*Construction of hill road**	*Yes*	*1.25*		*1.6/64 x 50*
Purchase of equipment and machineries	*No*		*0.15*	*1.6/64 x 6*
Working capital	*No*		*0.10*	*1.6/64 x 4*
Purchase of vehicles	*No*		*0.025*	*1.6/64 x 1*
Advance for tools, cranes etc.	*No*		*0.025*	*1.6/64 x 1*
Purchase of technical know–how	*No*	*1.25*	*0.05*	*1.6/64 x 2*
Total			***0.35***	

****Note:** It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.*



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 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. ***(RTP Nov '22)***

Answer 10

	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 × 98,00,000*	*13,30,317 (approx.)*
7.	*Interest on loan used for Phases III & IV, based on proportionate Loan amount 30,00,000 / 2,21,00,000 × 1,23,00,000*	*16,69,683 (approx.)*

Accounting treatment:

1. *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.

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.

Question 11

First Ltd. began construction of a new factory building on 1st April, 2017. It obtained Rs. 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further, expenditure on construction of the factory building was financed through other non-specific loans. Details of other outstanding non-specific loans were:

Amount (Rs.)	Rate of Interest per annum
4,00,000	9%
5,00,000	12%
3,00,000	14%

WAIR → represents 12m

Total expenditure = 1300000

The expenditures that were made on the factory building construction were as follows:

Date	Amount (Rs.)
1st April, 2017	3,00,000
31st May, 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3,60,000

→ Int : 12m
→ Int : 10m
→ Int : 8m
→ Int : 3m

12m 12m

= 1100000 × WAIR

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS 16, you are required to:

(1) Calculate the amount of interest to be capitalized.

(2) Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building.

(PYP May '19, 5 Marks)

Answer 11

(i) Computation of average accumulated expenses

		Rs.
Rs. 3,00,000 x 12 / 12	=	3,00,000
Rs. 2,40,000 x 10 / 12	=	2,00,000
Rs. 4,00,000 x 8 / 12	=	2,66,667
Rs. 3,60,000 x 3 / 12	=	90,000
		8,56,667

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (Rs.)	Rate of interest	Amount of interest (₹)
4,00,000	9%	= 36,000
5,00,000	12%	= 60,000
3,00,000	**14%**	**= 42,000**
Weighted average rate of interest 1,38,000/ 12,00,000 × 100		1,38,000
		= 11.5%

(iii) Amount of interest to be capitalized

Interest on average accumulated expenses:	Rs.
Specific borrowings (Rs. 2,00,000 x 8%)	= 16,000
Non–specific borrowings (Rs. 6,56,667* x 11.5%)	= 75,517
Amount of interest to be capitalised	**= 91,517**

Question 11 :- 8marks

Expenditure on QA × Interest Rate = Interest to be capitalised

Weighted Average Expenditure

= 300000 × 12/12 + 240000 × 10/12 + 400000 × 8/12 + 360000 × 3/12
= 300000 + 200000 + 266667 + 90000
= 856667 ⟶ represents 12m

Specific Borrowing 200000	×	8% (SIR)	=	16000
General Borrowing 656667	×	11.5% (WAIR)	=	75517
Interest to be capitalised			=	91517

Interest to be charged to P&L a/c = 138000 − 75517 = 62483/-

Calculation of weighted average interest rate

L1	=	400000	× 9%	=	36000
L2	=	500000	× 12%	=	60000
L3	=	300000	× 14%	=	42000
		1200000			138000

WAIR = $\frac{138000}{1200000}$
= 11.5%

IR = 10% p.a.

1st April = 50000
1st July = 50000
1st Oct = 50000
1st Jan = 50000

doesnot 12m | 12m

~~200000~~ × 10% = 20000

125000 × 10% = 12500

1st April	= 50000	× 10%	× 12/12	⟶	5000
1st July	= 50000	× 10%	× 9/12	⟶	3750
1st Oct	= 50000	× 10%	× 6/12	⟶	2500
1st Jan	= 50000	× 10%	× 3/12	⟶	1250

12500

$$= \left(50000 \times \frac{12}{12}\right) + \left(50000 \times \frac{9}{12}\right) + \left(50000 \times \frac{6}{12}\right) + \left(50000 \times \frac{3}{12}\right)$$

$= 50000 + 37500 + 25000 + 12500$

$= 125000$

⇓

"12m represents"

(iv) Total expenses to be capitalized for building

	Rs.
Cost of building Rs. (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000)	*13,00,000*
Add: Amount of interest to be capitalized	*91,517*
	13,91,517

Journal Entry

Date	***Particulars***	***Dr. (Rs.)***	***Cr. (Rs.)***
31.3.2018	*Building A/c Dr.*	*13,91,517*	
	To Building WIP A/c*		*13,00,000*
	To Borrowing costs A/c (Being amount of cost of building and borrowing cost thereon capitalized)		*91,517*

Question 12

LA

On 1stApril, 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:

i) 8% Debentures ₹ 15,00,000 = 120000

ii) 15% Term Loan ₹ 30,00,000 = 450000

iii) 10% Other Loans ₹ 18,00,000 = 180000

63 00 000 — 750000

750000 / 630000 = 11.9% WAIR

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

QA ***(i) Building ₹ 70,00,000*** → S.B. → 2500000 × 12% = 300000 → S.B.; → G.B.

(ii) Furniture ₹ 22,00,000 → G.B. — T.A. = 22500000 - 2500000 = 20000000 → G.B.

QA ***(iii) Plant & Machinery ₹ 90,00,000*** → G.B. — Building =

QA ***(iv) Factory Shed ₹ 43,00,000*** → G.B

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 1stApril 2023.

You are required to calculate the borrowing cost for both qualifying and non-qualifying assets.

(PYP 5 Marks May '23)

Answer 12

Interest to be Capitalized (on qualifying asset)

	Particulars	***Computation***	***₹***
i.	*On specific Borrowings*	*25,00,000x12%*	*3,00,000*
ii. iii.	*On non–specific borrowings*	*(W.N.1)*	*6,67,500*
	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*

2cr → 45L
63L → x

Working note:

1. Treatment of interest under AS 16 on non–specific borrowings

L9

	Particulars	**Qualifying asset**	**# Computation** G.B= 63L	**Interest-Capitalized**	**Interest charged to P&L A/c**
i.	Building 70-25L=45L	Yes	45,00,000/2,00,00,000 x 63,00,000 x 11.9048% 63L x 45L / 2cr.	1,68,750	–
ii.	Furniture 22L	No	22,00,000/2,00,00,000 x 63,00,000 x 11.9048% 63L x 22L / 2cr	–	82,500
iii.	Plant & Machinery 90L	Yes	90,00,000/2,00,00,000 x 63,00,000 x 11.9048% 63L x 90L / 2cr	3,37,500	–
iv.	Factory shed 43L	Yes	43,00,000/2,00,00,000 x 63,00,000 x 11.9048% 63 x 43L / 2cr	1,61,250	–
	Total			**6,67,500**	**82,500**

6300000 x 11.90% = 750000 749700

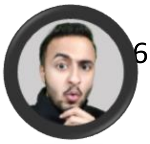
NOTE: *Alternative manner of presentation for Treatment of interest under AS 16 on non–specific borrowings:*

	Particulars	**Qualifying asset**	**Expenses borrowings**	**Share in Incurred**	**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**

1. 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%



STUDENT NOTES

Conclusion:- *Amount to be capitalized on specific borrowings is after deducting any income earned on temporary investments of borrowings.*
Hence 370 lakhs (75 -5lakh) should be capitalized along with the building cost.

Question 11 HW

On 20.4.2017, Srinivas Ltd. obtained a loan from the Bank for 50 lakhs to be utilized under:

	₹In lakhs
Construction of a shed (Started on 1-4-2017)	20
Purchase of machinery	15
Working capital	10
Advance for purchase of truck	5
Total	50

QA ⇒ 20/50 × 9 = cap.
15/50 × 9
10/50 × 9
5/50 × 9
P&L Dr.

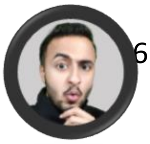
In March, 2018, construction of the shed was completed and machinery installed. Truck was not delivered by the supplier. Total interest charged by the bank for the year ending 31.3.2018 was ₹9 lakh.
Show the treatment of interest under AS-16: Borrowing Costs.
(IPCC May 2014, 2011, May 2010, PCCMay 2011)

Answer:-
Quote:- *As per AS-16: Borrowing Costs, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized.*

A qualifying asset is an asset that necessarily takes a substantial period of time (usually 12 months or more) to get ready for its intended use or sale. If an asset is ready for use or sale at the time of acquisition then it is not a qualifying asset and interest incurred on that should be charged to P&L.

Conclusion:- *In the given case, construction of a shed can be considered as a qualifying asset as it is taking a substantial period of time to make it ready for use or sale. Interest incurred on construction of shed should be capitalized to the cost of the shed.*

The other assets are ready to use at the time of acquisition hence they cannot be treated as qualifying assets. Interest incurred on such assets should be charged to P&L.



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STUDENT NOTES

Question 13 → HW

Padma Ltd. is constructing a plant and the expenditure incurred till 31-3-2018 is ₹50 lakhs. The following are the general borrowings as on 31-3-2018:

	₹ In lakhs
10% Debentures	80
12% Bank loan	20
9% Public deposits	50
Total borrowings	150

Expen. on QA × Interest × WAIR

✓ SDL

The accountant of the company has not capitalized any interest as there are no specific borrowings for plant. Is he correct? If No, how much amount should be capitalized?

Answer:-

Quote:- When the funds are borrowed generally and used for obtaining a qualifying asset - the company should apply capitalization rate (i.e. weighted average borrowing rate) on the expenditure incurred on the asset. Let us calculate the weighted average borrowing rate.

Loan	Calculation	Interest incurred (₹Lakh)
10% Debentures	80 x 10%	8.00
12% Bank loan	20 x 12%	2.40
9% Public deposits	50 x 9%	4.50
Total interest incurred		14.90

Weighted average borrowing rate:-

Average borrowing costs incurred during the year /Aggregate outstanding borrowings x 100 = 14.90/150 x 100 = 9.33%

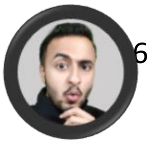
Interest to be capitalized:-

Expenditure of the asset x capitalization rate x period of construction /12

= 50 lakhs x 9.33% x 12 /12= ₹4.665 lakhs

Interest to be charged to P&L:-

14.90 - 4.665 = 10.235 lakhs.



12m 12m
1350000 × IR
400000 × 10% = 40000
950000 × 12.29% = 116755 ✓
Int. cap. = 156755
Plant Dr. 19L + 156755
Int. P&L Dr. = 209000 − 116755 = 92245

LA

STUDENT NOTES

Question 17 → Self

Complicated Limited began construction of a new plant on 1st April, 2017 and obtained a special loan of ₹4,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.
The company's other outstanding two non-specific loans were

Loan	Rate of Interest
₹ 6,00,000	11% p.a. = 66000
₹ 11,00,000	13% p.a. = 143000
1700000	✓209000

209000 / 1700000 = 12.29%

The expenditure that were made on the project of plant were as follows:

1st April, 2017	5L×12/12 = 5L	5,00,000
1st August, 2017	12 × 8/12 = 8L	12,00,000
1 st January, 2018	2 × 3/12 = 50L	2,00,000

1350000

The construction of the plant completed on 31st March, 2018. You are required to:
(a) Calculate the amount of interest to be capitalized as per the provisions of AS-16: Borrowing Costs.
(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.
(CA IPCC - May 2015 & Nov 2017)

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

Cost of Plant (5,00,000 + 12,00,000 + 2,00,000)	19,00,000
Add: Amount of interest to be capitalized (W.N.3)	1,56,755
	20,56,755