AS 16

BORROWING COSTS

Objective	✓ The objective is accounting for borrowing costs. It does not deal with the actual or imputed cost of owner's equity including preference share capital not classified as liability.
Meaning	✓ These are the interest and other costs incurred by an enterprise in connection with the borrowing of funds.
Inclusions	✓ It includes the following: ❖ Interest & related charges on bank borrowings (short term & long term) ❖ amortization of discounts or premiums relating to borrowings ❖ amortization of ancillary costs incurred ❖ finance charges in respect of assets acquired under finance leases ❖ exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Capitalisation of Borrowing Costs
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.
These are treated as directly attributable when such borrowing costs would have been avoided if the expenditure on the qualifying asset have not been made. Determination of such directly attributable amount is an exercise of judgement.
Borrowing cost on any item other than the qualifying asset should be written off in the P&L A/c in the period in which they are incurred.
To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the <u>*actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.*</u>
To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation 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. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

QUALIFYING ASSETS

Meaning	✓ A qualifying asset is an asset (tangible or intangible) that necessarily takes a substantial period of time to get ready for its intended use or sale.
Substantial Period	✓ Substantial period of time depends on the facts & circumstances of each case. However, a period of 12 months may be considered a substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case

Inclusions	✓ Following assets take >= 12 months to get ready to use : ❖ Assets that are constructed for own use of enterprise like manufacturing plants, power generation facilities, etc. ❖ Inventories where time is major factor to bring a change in their condition e.g. Liquor & Timber ❖ Investment Properties (Building meant for capital appreciation and earning rental income)
Exclusions	✓ Assets that are ready for intended use when acquired are not qualifying asset.

COMMENCEMENT OF CAPITALISATION

The capitalisation of borrowing costs should commence when all the following conditions are satisfied:

- expenditure for acquisition, construction or production of a qualifying asset is being incurred
- borrowing costs are being incurred
- activities that are necessary to prepare the asset for its intended use or sale are in progress.

SUSPENSION OF CAPITALISATION

General Rule	✓ Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.
Exception	✓ Capitalisation of borrowing costs is not normally suspended during period when substantial technical and administrative work is being carried out. ✓ 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 extended period needed for inventories to mature or the extended period during which high water levels delay construction of a bridge, if such high water levels are common during construction period in the geographic region involved.

CESSATION OF CAPITALISATION

- 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.
- 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
- Construction in Parts: 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, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities of that part are complete.

DISCLOSURE REQUIREMENTS

The financial statements should disclose:

- the accounting policy adopted for borrowing costs
- the amount of borrowing costs capitalised during the period.

ASSIGNMENT QUESTIONS

Question 1 Pg no.______

X Limited began construction of a new plant on 1st April 2021 and obtained a special loan of 8 lakhs to finance the construction of the plant. The rate of interest on loan was 10 % per annum. The expenditure that was made on the construction project of plant was as follows:

Date	Amount (in ₹)
1st April 2021	10,00,000
1st August 2021	24,00,000
1st January 2022	4,00,000

The Company's other outstanding non - specific loan was ₹ 46,00,000 at an interest of 12% p.a. The construction of the plant was completed on 31-3-2022.
Calculate the amount to be capitalized including amount of interest as per provision of AS 16.

Question 2 *(ICAI Study Material)* Pg no.______

X Ltd. began construction of a new building on 1st January, 2021. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 2021 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹5,00,000	11%
₹9,00,000	13%

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

Month	Amount (in ₹)
January 2021	2,00,000
April 2021	2,50,000
July 2021	4,50,000
December 2021	1,20,000

Building was completed by 31st December, 2021. Following the principles prescribed in AS 16 '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.

Question 3 Pg no.______

Small Limited began construction of a building on 1st April, 2021 which is expected to cost ₹ 25,00,000. The construction of the building was financed through a special loan of ₹ 5,00,000 obtained at an interest rate of 10% per annum on 1st April, 2021. Further, expenditure on the building was financed through other non-specific finance arrangements of the company. Details of non-specific finance arrangements are as under:

Amount	Rate of Interest
₹ 30,00,000	12% p.a.
₹ 20,00,000	15% p.a.

Cumulative expenses incurred on the building were as follows:

	₹
1st April, 2021	5,00,000
1st July, 2021	13,00,000
1st November, 2021	20,00,000
31st January, 2022	25,00,000

Construction of the building was completed on 31st March, 2022. Following the principles specified in AS 16 'Borrowing Cost', calculate the amount of interest to be capitalized.

Question 4 — *(Inter May 2022) (5 Marks)* Pg no._____

Zebra Limited began construction of a new plant on 1st April,2021 and obtained a special loan of ₹ 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:

	₹
1st April,2021	10,00,000
1st April,2021	24,00,000
1st January,2022	4,00,000

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

a) Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".

b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

Solution

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

	₹
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

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

Working Note:

Computation of interest to be capitalized:

	Expenditure			₹
1st April, 2021	10,00,000	On specific borrowing	₹ 10,00,000 x 10%	1,00,000
1st August, 2021	24,00,000	On specific borrowing	₹ 10,00,000 x 10%	1,00,000
1st August, 2021		On non-specific borrowings	₹ (14,00,000 x 8 x12%)/12	1,12,000
1st January, 2022	4,00,000	On non-specific borrowings	₹ (4,00,000 x 3 x 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 x 12/12	10,00,000
1st August, 2021	10,00,000 x 12/12	10,00,000
	14,00,000 x 8/12	9,33,333
1st January, 2022	4,00,000 x 3/12	1,00,000
		30,33,333

Computation of interest to be capitalized:

		₹
On specific borrowing	₹ 20,00,000 x 10%	2,00,000
On non-specific borrowing	₹ (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.

Question 5 Pg no.______

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 ₹ 10 lakh in December 2020 and ₹ 4 lakh in each of the months of January to March 2021.

At the beginning of the year, the entity had taken Inter Corporate Deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh 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'

Question 6 *(ICAI Study Material) (Similar)* Pg no.______

GHI Limited obtained a loan for ₹ 70 lakhs on 15th April, 2021 from JKL Bank, to be utilized as:

Particulars	Amount (in ₹ Lakhs)
Construction of Factory shed	25
Purchase of Machinery	20
Working capital	15
Advance for purchase of Truck	10

In March 2022, construction of the factory shed was completed and machinery, which was ready for its intended use, was installed. Delivery of Truck was received in the next financial year. Total interest of ₹ 9,10,000 was charged by the bank for the financial year ending 31-03-2022. Show the treatment of interest under AS 16 and also explain the nature of Assets.

Question 7 *(RTP May 2020) (Similar)* Pg no.______

Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2021, to be utilized as:

Particulars	Amount (in ₹ Lakhs)
Construction of Factory shed	40
Purchase of Machinery	35
Working capital	25

In March 2022, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2022 was ₹ 11,00,000. During the year 2021-22, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000. Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

Question 8 *(RTP May 2019)* Pg no._____

M/s. Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

S. No.	Particulars	Amount (in ₹)
1.	Construction of Hill link road in Kedarnath:(work was held up totally for a month during the year due to heavy rain which are common in the geographic region involved)	50 crores
2.	Purchase of equipments and machineries	6 crores
3.	Working capital	4 crores
4.	Purchase of vehicles	1 crore
5.	Advance for tools/cranes etc.	1 crore
6.	Purchase of technical know-how	2 crores
7.	Total interest charged by bank for year ending 31st March, 2022	1.60 crores

Show the treatment of interest according to Accounting Standard by M/s. Zen Bridge Construction Limited.

Question 9 Pg no._____

Rohini Limited has obtained loan from an Institution for ₹ 500 lacs for modernization and renovation of its plant and machinery. The installation of plant and machinery was completed on 31.3.2022 amounting to ₹ 320 lacs and ₹ 50 lacs were advanced to suppliers of additional assets and the balance of ₹ 130 lacs has been utilized for working capital requirements. Total interest paid for the above loan amounted to ₹ 65 lacs during 2021-22.

You are required to state how the interest on institutional loan is to be accounted for in the year 2021-22.

Question 10 *(RTP Nov 2023)* Pg no._____

Raj & Co. has taken a loan of US$ 20,000 at the beginning of the financial year for a specific project at an interest rate of 6% per annum, payable annually. On the day of taking loan, the exchange rate between currencies was ₹ 48 per 1 US$. The exchange rate at the closing of the financial year was ₹ 50 per 1 US$. The corresponding amount could have been borrowed by the company in Indian Rupee at an interest rate of 11 % per annum. Determine the treatment of borrowing cost in the books of accounts.

Question 11 Pg no._____

XYZ Ltd. has taken a loan of US$20,000 on April 1, 2021 for a specific project at 5% payable annually. On April 1, 2021 the exchange rate between the currencies was ₹ 40 per US$. The exchange rate as at March 31, 2022 is ₹ 43 per US$.

Calculate the amount of exchange difference arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs, if the corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of

(a) 11% p.a. and

(b) 13% p.a. as on April 1, 2021

Question 12 *(RTP Nov 2020) (Similar) / (ICAI Study Material)* *Pg no._____*

Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.2021 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 31.3.2022. Due to surplus fund out of ₹ 150 crores, income of ₹ 3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant AS.

Solution

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 capitalisation 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 capitalisation 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 Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2021-2022 should be calculated as follows

	₹ in crores
Actual Interest for 2021-22 (11% of 150 crores)	16.50
Less: Income on temporary investment from specific borrowings	(3.50)
Borrowing costs to be capitalized during year 2021-22	13.00

Question 13 *(RTP Nov 2018)* *Pg no._____*

A company incorporated in June 2021, 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. 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.

Solution

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, Explanation to the above para 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 justified 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.

The above paras imply that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

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.

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 capitalised although it has taken less than 12 months for the asset to get ready to use.

Question 14 *(ICAI Study Material)* Pg no._____

Take Ltd. has borrowed ₹ 30 lakhs from State Bank of India during the financial year 2021-22. 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, 2022, since the said project was not complete, the directors of Take Ltd. resolved to capitalize the interest accruing on borrowings amounting to ₹ 4 lakhs and add it to the cost of investments. Comment

Solution

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 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, 2022.

Question 15 *(RTP May 2022)* Pg no._____

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?

Solution:

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.

Question 16 *(RTP Nov 2022) / (ICAI Study Material)* Pg no._____

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 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.

Solution:

	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*98,00,000)/2,21,00,000 =	13,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount	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 17 *(Inter Nov 2023) (5 Marks)* *Pg no._____*

Glen Ltd. began construction of a new building on 1st January, 2022.

On 1st April, 2022, following two loans were obtained to fund the construction cost:

(i) Loan of ₹ 60,00,000 from Data Bank Ltd. was taken at interest rate of 8% per annum. This loan was fully utilized for construction of the new building.

(ii) Loan of ₹ 20,00,000 from Satya Bank Ltd. Out of this, loan amount of ₹ 6,00,000 was utilized for working capital purpose. Total interest of ₹ 1,92,000 were paid to Satya Bank Ltd. for the financial year 2022-23.

Construction of the new building was completed on 31st January, 2023 and was ready for its intended use on the same date. None of the loan was repaid during the year. The building is a qualifying asset for the purpose of AS-16. Out of loan from Data Bank Ltd., surplus funds were temporarily invested for the short period of time. This temporary investment earned interest of ₹ 30,000.

You are required to calculate the amount of interest (a) to be capitalized, (b) to be charged to profit and loss account from the total interest incurred as borrowing cost during the year 2022-23. (as per AS-16).

PRACTICE QUESTIONS

Question 1 Pg no.____

Axe Limited began construction of a new plant on 1st April, 2021 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 expenditure that were made on the project of plant were as follows:

Date	Amount (in ₹)
1st April 2021	5,00,000
1st August 2021	12,00,000
1st January 2022	2,00,000

The company's other outstanding non-specific loan was ₹ 23,00,000 at an interest rate of 12%. The construction of the plant completed on 31st March, 2022. You are required to:
(a) Calculate amount of interest to be capitalized as per provisions of AS 16 "Borrowing Cost".
(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

Solution

Total expenses to be capitalized for Plant

Cost of Plant ₹ (5,00,000+12,00,000+2,00,000)	19,00,000
Add: Amount of interest to be capitalized	1,54,000
	20,54,000

Journal Entry

Date	Particulars	L.F.	Dr.	Cr.
31.03.2022	Plant account Dr.		20,54,000	
	To Bank account			20,54,000
	(Being amount of cost of Plant and borrowing cost thereon capitalized)			

Working Note: Computation of average accumulated expenses

5,00,000 x 12 / 12	5,00,000
12,00,000 x 8/ 12	8,00,000
2,00,000 x 3 / 12	50,000
	13,50,000

Interest on average accumulated expenses

Specific borrowings (₹ 4,00,000 x 10%)	40,000
Non-specific borrowings (₹ 9,50,000* x 12.00%)	1,14,000
Amount of interest to be capitalized	1,54,000

*(₹ 13,50,000 – ₹ 4,00,000)

Question 2 Pg no.____

G Ltd. began construction of a new building on 1st January, 2021. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 2021 at an interest rate of 11%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 3,00,000	12%
₹ 7,00,000	14%

The expenditures that were made on the building project were as follows

	₹
January 2021	1,60,000
May 2021	2,70,000

August 2021	4,20,000
December 2021	1,50,000

Building was completed by 31st December, 2021. Following the principles prescribed in AS 16 '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.

Solution

Computation of average accumulated expenses

1,60,000 x 12 / 12	1,60,000
2,70,000 x 8/ 12	1,80,000
4,20,000 x 5 / 12	1,75,000
1,50,000 x 1 / 12	12,500
	5,27,500

Calculation of average interest rate other than for specific borrowings

Amount of loan	Rate of Interest	Amount of interest
3,00,000	12%	36,000
7,00,000	14%	98,000
10,00,000		1,34,000
Weighted average rate of interest {(1,34,000/ 10,00,000) x 100}		13.40%

Interest on average accumulated expenses

Specific borrowings (₹ 1,00,000 x 11%)	11,000
Non-specific borrowings (₹ 4,27,500* x 13.40%)	57,285
Amount of interest to be capitalized	68,285

*(₹ 5,27,500 – ₹ 1,00,000)

Total expenses to be capitalized for building

Cost of building ₹(1,60,000+2,70,000+4,20,000+1,50,000)	10,00,000
Add: Amount of interest to be capitalized	68,285
	10,68,285

Journal Entry

Date	Particulars	L.F.	Dr.	Cr.
31.12.2021	Building account Dr.		10,68,285	
	To Bank account			10,68,285
	(Being amount of cost of building and borrowing cost thereon capitalized)			

Question 3 (Inter May 2019) (5 Marks) Pg no.______

First Ltd. began construction of a new factory building on 1st April, 2021. It obtained ₹ 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2021 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	Rate of Interest p.a.
4,00,000	9%
5,00,000	12%
3,00,000	14%

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

Date	Amount
1st April, 2021	3,00,000
31st May, 2021	2,40,000

1st August, 2021	4,00,000
31st December, 2021	3,60,000

The construction of factory building was completed by 31st March, 2022.
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 cost & borrowing cost in respect of factory building

Solution
Computation of average accumulated expenses

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

Calculation of average interest rate other than for specific borrowings

Amount of loan	Rate of Interest	Amount of interest
4,00,000	9%	36,000
5,00,000	12%	60,000
3,00,000	14%	42,000
12,00,000		1,38,000
Weighted average rate of interest {(1,38,000/ 12,00,000) x 100}		11.50%

Interest on average accumulated expenses

Specific borrowings (₹ 2,00,000 x 8%)	16,000
Non-specific borrowings (₹ 6,56,667* x 11.50%)	75,517
Amount of interest to be capitalized	91,517

*(₹ 8,56,667 – ₹ 2,00,000)
Total expenses to be capitalized for building

Cost of building ₹(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	L.F.	Dr.	Cr.
31.03.2022	Building account Dr.		13,91,517	
	To Building WIP A/c*			13,00,000
	To Borrowing Costs A/c			91,517
	(Being amount of cost of building and borrowing cost thereon capitalized)			

*Considering that ₹ 13,00,000 was debited to Building WIP A/c earlier.

Question 4 *(RTP May 2023)* Pg no._____

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.2021. Money raised from debentures to be utilized as under:

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

Additional Information:

(i) Interest on debentures for the Financial Year 2021-2022 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, 2022 construction of factory building was not completed (it is expected that it will take another 6 months).
(iv) In March 2022, Machinery was installed and ready for its intended use.
(v) Furniture was put to use at the end of March 2022.
(vi) Truck is going to be received in April, 2022.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 2022 in the Books of Expert Limited.

Solution

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 x 12% x 10/12) – ₹ 50,000 = ₹ 9,50,000

Particulars	Nature of assets	Interest to be Capitalized	Interest to be charged to P&L A/c
Construction of factory building	Qualifying Asset	9,50,000x40/100 = 3,80,000	Nil
Purchase of Machinery	Not a Qualifying Asset	Nil	9,50,000x15/100 = 1,42,500
Working Capital	Not a Qualifying Asset	Nil	9,50,000x30/100 = 2,85,000
Purchase of Furniture	Not a Qualifying Asset	Nil	9,50,000x2/100 = 19,000
Purchase of Truck	Not a Qualifying Asset	Nil	9,50,000x13/100 = 1,23,500
		3,80,000	5,70,000

Question 5 *(Inter Nov 2020) (5 Marks)* *Pg no._____*

On 15th April, 2021 RBM Ltd. obtained a Term Loan from the Bank for ₹ 320 lakhs to be utilized as under:

	₹ (in lakhs)
Construction for factory shed	240
Purchase of Machinery	30
Working capital	24
Purchase of Vehicles	12
Advance for tools/cranes etc.	8
Purchase of technical know how	6

In March, 2022 construction of shed was completed & machinery was installed. Total interest charged by the bank for the year ending 31st March, 2022 was ₹ 40 lakhs. In the context of provisions of AS 16, show the treatment of interest and also explain the nature of Assets

Solution

As per AS 16 A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Other investments and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets. 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.

Construction of factory shed amounting ₹ 240 lakhs is qualifying asset in the given case. The interest for this amount during the year will be added to the cost of factory shed. All others (purchase of machinery, vehicles and technical know how, working capital, advance for tools/cranes) are non-qualifying assets & related borrowing cost will be charged to P&L A/c.

Qualifying Asset as per AS 16 (construction of a shed) = ₹ 240 lakhs

Borrowing cost to be capitalized = ₹ 40 lakhs x 240/320 = ₹ 30 lakhs

Interest to be debited to Profit or Loss account: ₹ (40 – 30) = ₹ 10 lakhs.

Note: Assumed that construction of factory shed completed on 31st March, 2022.

Question 6 *(ICAI Study Material)* Pg no.______

On 1st April, 2021, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilized as:-

S. No.	Particulars	Amount (in ₹)
1.	Construction of sealink across two cities:(work was held up totally for a month during the year due to high water levels)	25 crores
2.	Purchase of equipments and machineries	3 crores
3.	Working capital	2 crores
4.	Purchase of vehicles	50 Lakhs
5.	Advance for tools/cranes etc	50 Lakhs
6.	Purchase of technical know-how	1 crore
7.	Total interest charged by bank for year ending 31st March, 2022	80 Lakhs

Show the treatment of interest by Amazing Construction Ltd.

Solution

Treatment of Interest (Borrowing cost) as per AS 16 'Borrowing Costs'

Particulars	Whether Q.A.	Interest to be capitalized	Interest to be charged to P&L A/c
Construction of sealink across 2 cities	Yes	80,00,000*25/32= 62,50,000	
Purchase of equipments & machineries	No		80,00,000*3/32= 7,50,000
Working capital	No		80,00,000*2/32= 5,00,000
Purchase of vehicles	No		80,00,000*0.5/32= 1,25,000
Advance for tools/cranes etc	No		80,00,000*0.5/32= 1,25,000

Purchase of technical know-how	No		80,00,000*1/32= 2,50,000
		62,50,000	17,50,000

Notes:

As per AS 16, assets have been defined as 'qualifying asset' and 'non-qualifying asset'.

a) Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale; whereas,

b) Non-qualifying asset is an asset which is ready for its intended use or sale at the time of its acquisition.

c) As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets should be capitalized as part of the cost of that asset. Other borrowing costs are recognized as expense in the period in which they are incurred.

d) It is assumed that work held up for a month due to high water level is normal during the construction of sealink and capitalization of borrowing cost should not be suspended for necessary temporary delay.

Question 7 *(ICAI Study Material)* Pg no._____

The company has obtained Institutional Term Loan of ₹ 580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 2022 amounted to ₹ 406 lakhs, ₹ 58 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹ 116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹ 52.20 lakhs incurred during 2021-2022 on the entire Institutional Term Loan of ₹ 580 lakhs.

Solution

As per AS 16 'Borrowing Costs', 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. A qualifying asset is an asset that necessary takes a substantial period of time* to get ready for its intended use or sale. The treatment for total interest amount of ₹ 52.20 lakhs can be given as:

Particulars	Whether Qualifying Asset	Interest to be capitalized	Interest to be charged to P&L A/c
Modernisation and renovation of plant and machinery	Yes	52.20*406/580 = 36.54	
Advance to supplies for additional assets	Yes	52.20*58/580 = 5.22	
Working capital	No		52.20*116/580 = 10.44
		41.76	10.44

* 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 justified on the basis of the facts and circumstances of the case.

** It is assumed in the above solution that the modernisation and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹ 52.20 lakhs will be recognised as expense in the profit and loss account for year ended 31st March, 2022.

Question 8 *(RTP May 2021)* *Pg no._____*

Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2021-22 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 ₹ 56 per US $ and the rate as on 31st March, 2022 ₹ 62 per US $. If Shan Builders Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. Compute Borrowing Cost & exchange difference for the year ending 31st March, 2022 as per applicable Accounting Standards.

Solution

a) Interest for the period 2021-22 = US$ 10 lakhs x 4% × ₹ 62 per US$ = ₹24.80 lakhs
b) Increase in liability towards the principal amount = US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs
c) Interest that would have resulted if the loan was taken in Indian currency = US$ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs
d) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹34 lakhs.

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 "Borrowing Costs" and the remaining ₹ 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".

Question 9 *(RTP May 2023)* *Pg no._____*

ABC Builders Limited had borrowed a sum of US $ 15,00,000 at the beginning of Financial year 2021-22 for its residential project at London Interbank Offered Rate (LIBOR) + 4 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, the exchange rate was ₹ 72 per US $ and the rate as on 31st March, 2022 was ₹ 76 per US $. If ABC Builders Limited borrowed the loan in Indian Rupee equivalent, the pricing of loan would have been 9.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2022 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

Solution

(i) Interest for the period 2021-22 = US $ 15 lakhs x 5% × ₹ 76 per US $ = ₹ 57 lakhs
(ii) Increase in liability towards principal amount = US $ 15 lakhs × ₹ (76 - 72) = ₹ 60 lakhs.
(iii) Interest that would have resulted if the loan was taken in Indian currency = US $ 15 lakhs × ₹ 72 x 9.5% = ₹ 102.6 lakhs
(iv) Difference between interest on local currency borrowing and foreign currency borrowing= ₹ 102.6 lakhs - ₹ 57 lakhs = ₹ 45.6 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 45.60 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 102.60

lakhs being the aggregate of interest of ₹ 57 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 ₹ 45.60 lakhs. Hence, ₹ 102.60 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 14.4 lakhs (60 - 45.60) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

Question 10 *(RTP May 2018) / (RTP Nov 2019) / (RTP Nov 2021)* *Pg no._____*

In May, 2021, Capacity Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2022 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2022 amounted to ₹ 25 lakhs.
Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Explain the treatment in line with the provisions of AS 16.

Solution

According to AS 16 'Borrowing Costs', capitalisation of borrowing costs should cease when substantially all the activities to prepare the qualifying asset for its intended use or sale are completed.
In the given case, since the qualifying asset was ready to use in January, 2022, therefore, interest till that date can only be capitalized. Hence, interest of ₹ 18 lakhs will only be capitalized. The balance of ₹ 7 lakhs (i.e. 25-18) will be debited to Profit and Loss Account.

Question 11 *Pg no._____*

A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understating interest cost in profit and loss account. Comment on the accounting treatment done by the company in context of the relevant AS.

Solution

Investments other than investment properties are not qualifying assets as per AS-16 Borrowing Costs. Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying asset, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale. Also, where the investment properties meet the definition of 'qualifying asset', for the capitalization of borrowing costs, the other requirements of the standard such as that borrowing costs should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization have to be complied with.

Question 12 *(RTP May 2022)* *Pg no._____*

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?

Solution:

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 sill 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.

Question 13 - *(ICAI Study Material)* Pg no._____

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, 2023. However, decoration work is under process which is expected to be completed by November 2023 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 2023.

Solution:

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, 2023. The borrowing cost incurred thereafter cannot be capitalized as the asset was ready for its intended use on May 31, 2023. 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, 2023

Question 14 *(ICAI Study Material)* Pg no._____

ABC Ltd. is in the process of getting an entertainment park constructed. For this purpose, it has taken loan from a bank. The said park consists of several rides and facilities, each of which can be used individually. Three fourth part of the park has been constructed and can be opened up for public, while construction on the remaining part is continuing. Whether the capitalization of borrowing cost should continue for whole park until construction continues?

Solution:

ABC Ltd. is in process of constructing an entertainment park which consists of several rides and facilities that can operate independently for their intended use. Even though the park as whole is not complete, the individual facilities are ready for their intended use.

The cessation of capitalization depends upon the nature of the qualifying assets, particularly where the qualifying assets consists of various parts. There are qualifying assets where each part is capable of being used while the construction continues on other parts. There are qualifying assets where all parts have to be completed before any earlier completed part can be put to use.

Since in the given scenario, the individual facilities are capable of operating independently and are ready for their intended use, therefore the borrowing costs shall cease to be capitalized for the three-fourth part of the project.

Question 15 *(Inter May 2023) (5 Marks)* Pg no._____

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:
(a) 8% Debentures ₹ 15,00,000
(b) 15% Term Loan ₹ 30,00,000
(c) 10% Other Loans ₹ 18,00,000

The company has utilised the above funds in construction/purchase of the following assets:
(a) Building ₹ 70,00,000
(b) Furniture ₹ 22,00,000
(c) Plant & Machinery ₹ 90,00,000
(d) 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 1 April 2023.
You are required to calculate the borrowing cost for both qualifying and non-qualifying assets.

Solution:

Interest to be Capitalized (on qualifying asset)

	Particulars	Computation	₹
i.	On specific Borrowings	25,00,000x12%	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%		