Accounting Standards Interpretation (ASI) 1[1]

Substantial Period of Time

Accounting Standard (AS) 16, Borrowing Costs

ISSUE

1. Accounting Standard (AS) 16, Borrowing Costs, defines the term 'qualifying asset' as "an asset that necessarily takes a substantial period of time to get ready for its intended use or sale".

2. The issue is what is the meaning of the expression 'substantial period of time' for the purpose of this definition.

CONSENSUS

3. The issue as to 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 should be considered.

4. The following assets ordinarily take twelve months or more to get ready for intended use or sale unless the contrary can be proved by the enterprise:

(i) assets that are constructed or otherwise produced for an enterprise's own use, e.g., assets constructed under major capital expansions.

(ii) assets intended for sale or lease that are constructed or otherwise produced as discrete projects (for example, ships or real estate developments).

5. In case of inventories, substantial period of time is considered to be

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[1] Published in 'The Chartered Accountant', June 2002, pp. 1512. The authority of this ASI is the same as that of the Accounting Standard to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standard
to which it relates. ASI is intended to apply only to material items.

involved where time is the major factor in bringing about a change in the condition of inventories. For example, liquor is often required to be kept in store for more than twelve months for maturing.

BASIS FOR CONCLUSIONS

6. Paragraph 6 of AS 16 provides that *"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. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Statement. Other borrowing costs should be recognised as an expense in the period in which they are incurred"*.

This paragraph recognises that borrowing costs should be expensed except where they are directly attributable to acquisition, construction or production of a qualifying asset. To qualify for capitalisation of borrowing costs, the asset should take a long period of time to get ready for its intended use or sale.

7. Paragraph 5 of AS 16 gives examples of manufacturing plants, power generation facilities etc. as qualifying assets. In these cases, normally a period of more than twelve months is required for getting them ready for their intended use. Therefore, a rebuttable presumption of a period of twelve months is considered "substantial" period of time.

8. Paragraph 5 of AS 16 provides, inter alia, that *"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."* Paragraph 12 of Accounting Standard (AS) 2, Valuation of Inventories, provides that *"Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories"*. It is only in exceptional cases, where time is a major factor in bringing about change in the condition of inventories that borrowing costs are included in the valuation of inventories.