

Accounting Standard - 16 Accounting for Borrowing Costs

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$$\begin{array}{l} \text{Loan + Business} = \text{P&L} \\ \text{Loan + Asset} = \text{AS-16} \end{array}$$

a) Applicability and Nature.

Applicable :- 1/04/2000

Nature :- Mandatory for all enterprises

b) Meaning of Borrowing Cost

As per the provisions of AS-16, Borrowing Cost is the interest and other cost which is incurred by an enterprise for arrangement of funds.

The following ~~costs~~ amounts may be included in the meaning of borrowing cost :-

i) Interest on Short term loans and long term loans
(+)

ii) Amortised Part of Direct Cost which is incurred for arrangement of funds. It may include stamp duty expenses, commissions etc.

Note 8:- As per the provisions, Amortised Part of Direct should be based on usage ratio of borrowed over the redeemable period of loans.

$$\text{Amortised Part} = \frac{\text{Direct Cost} \times \text{Annual Usage}}{\text{Total Usage}} \\ (+)$$

iii) Amortised Part of discounts and premiums ^{rel} related to arrangement of funds

Note:- As per the provisions, discounts on issue of Bonds/ Debentures and Premium on Redemption of Bonds/ Debentures should be considered as a part of borrowing cost but Premium on issue should not be considered for specified purpose.

(+)

iv) Foreign currency fluctuations on foreign currency loans to the extent of Interest Adjustments as per Paragraph 4(c)

(+)

v) Finance charges incurred for finance lease agreements (AS-19)

Statement Showing Calculation of Borrowing Cost

Interest of long Term & Short Term loan	xxxx
Amortised Part :- Direct cost	xxxx
Discounts & Premiums	xxxx
Foreign currency Adjustments (4(c))	xxxx
Borrowing cost	<u>xxxx</u>

c) Meaning of Qualifying Assets ^{imp}

As per the provisions of AS-16, Qualifying Asset is an asset that takes substantial period of time to get ready for its intended use or sale.

Note:- As per explanation on Accounting Standards, substantial period of time is the period of 12 months but longer or shorter periods may also be justified based on circumstances.

a) Fixed Assets

b) Intangible assets

c) Investments :- Properties

Note:- As per the provisions, Investments other than properties should be ignored for the application of AS-16 due to condition of substantial period.

d) Inventories [Exceptional stocks which are covered under production cycle taking substantial time]

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a) Recognition Rules :-

Rule 1:- If any borrowing cost is incurred for acquisition, production or construction of qualifying assets then it should be capitalised to cost of qualifying assets.

Journal Entries

i) Borrowing lost Dr xxx
To Bank xxx

i.) Qualifying Asset A/c Dr xxx
To Borrowing cost xxx

Rule 2:- If any borrowing cost is not incurred for acquisition, construction or production of qualifying assets, then it should be transferred to P&L A/c as an expense.

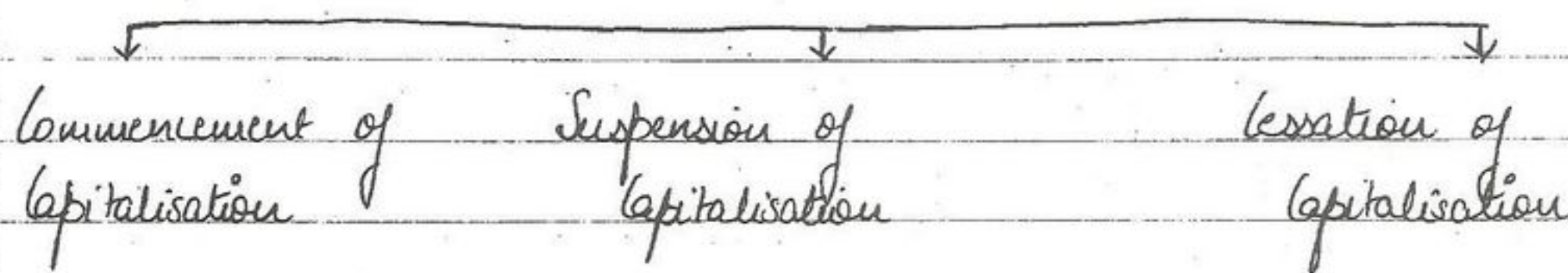
Journal Entries

i) Borrowing lost

Dr xxx	
To Bank	xxx

ii) ~~Dr~~ Dr A/c Dr xxx
To Borrowing last xxx

c) Conditions of AS-16 : Rules for Capitalisation



i) Commencement of Capitalisation :-

As per the provisions of AS-16, the following conditions should be satisfied before making any capitalisation of borrowing cost :-

Condition I :- Expenditure on qualifying assets should be incurred out of borrowed funds

Note :- As per the provisions, capitalisation of Borrowed cost will not be considered on unused funds and interest and other cost which is related to unused funds should be transferred to P&A.

(+)

Condition II :- Borrowing cost should be actual

Note :- As per the provisions, assumed interest cost cannot be capitalised. It should be incurred in actual. (Paid or qd)

(+)

Condition III :- Activities which are regular for completion of qualifying assets should be continued. These activities may be physical or administrative

ii) Suspension of Capitalisation :-

If necessary activities which are required for completion of qualifying assets are discontinued then borrowing cost for such period should be transferred to P&L A/c. It means that borrowing cost for such period should not be considered for capitalisation.

Exception:-

In case of temporary suspension, the capitalisation of borrowing cost should not be ~~discontinued~~ but it should be considered as a part of regular work.

iii) Cessation of Capitalisation :-

As per the provisions of AS-16, borrowing cost should be considered for capitalisation during the WIP stage of qualifying assets. After completion of qualifying assets, it should be transferred to P&L A/c. It can also be said that borrowing cost cannot be capitalised after the completion of work.

Note:- Completion in Parts

In case of any asset is completed in parts and any part is completed first without completing others then B. cost should be capitalised on the basis of following 2 cases:-

Case I :- If the completed part can be sold or used without completing others then it should be considered as a completed asset and borrowing cost which is related to such part should be transferred to P&L A/c.

Case II :- If the completed part cannot be sold or used without completing others then it should be considered as a part of WIP and interest should be capitalised to the cost of such part even if it is completed.

02/06/11

h) Important Points to be considered :-

i) Grants/Progress Payment → As ^{per} the provisions of AS-16, the amount of grant or progress payment should be adjusted in the calculation of Expenditure incurred for the purpose of capitalisation of borrowing cost. It means that the amount of expenditure incurred on qualifying assets should be reduced by Grant/Progress Payment.

ii) Interest Income on unutilised funds :- Income, investment income is earned by an enterprise from unutilised funds on temporary basis then the amount of investment income should be adjusted against total borrowing cost. After the specified adjustment, the commencement of capitalisation can be considered.

^{* Imp}
iii) Prepayment Premium :- As per Expert Advisory Committee's opinion, prepayment premiums should not be considered as a part of borrowing cost because the amount of prepayment premium is not related to arrangement of funds so it should be transferred to P&L as an expense. But capitalisation of such cost should not be considered.

iv) Transfer of assets :- As per the provisions of AS-16, transfer of assets should be considered as a part of expenditure incurred during the period and it should be added to cash payments for the calculation of total expⁿ on qualifying assets.

Types of Borrowed funds

↓
Specific Borrowed Funds

↓
General Funds

Treatment of Specific Borrowed funds :-

If any loan is specifically taken for a particular asset then the borrowing cost on specific funds should be capitalised directly to the related asset.

Treatment of General Borrowed funds :-

If any loan is taken for multiple qualifying assets it should be recognised as a general borrowed fund and interest on such fund should be allocated to the related qualifying asset in the ratio of expenditure incurred.