AS-16 Borrowing Cost

Objective: The object of this standard is to specify when the borrowing cost need to be capitalized and when borrowing cost need to be expensed (P&L)

Borrowing cost : Are Interest and other cost incurred by an enterprise in connection with borrowing of funds for Qualifying Asset

It does not deal: with actual are imputed cost of owners equity including preference shares capital not classified as a liability

Components of Borrowing Cost

- Exchange Fluctuation to the extent they are regarded as adjustment to the Interest cost
- Amortization of ancillary cost relating to Borrowings
- Amortization of discount/ premium on Borrowings
- Finance charges for Assets acquired on finance lease
- Interest and commitment charges on Borrowings

Adjustment to Interest Cost

It is the difference between amt of Int in the local currency and Int in Foreign currency.

Example: Loan amt 1/4/18 $1,00,000

Exchange rate on 1/4/18 $1=50; Interest rate in $ 10%

If Loan taken in India Int rate is 12%

Exchange rate on 31/3/19 $1=52

Sol: Loan Recognized $1,00,000 * 50 =50,00,000

Exchange loss $1,00,000*2(50-52)=2,00,000

AS 16	AS 11
(Adj to Int Cost) 80,000	1,20,000 (Balance Left over)

Int in Rs (50,00,000*12%) = 6,00,000

Int in $ ($1,00,000*10%=10,000*52= 5,20,000

80,000

Total Borrowing Cost = 6,00,000

Total Exchange Loss = 2,00,000

Treatment of Borrowing Cost

Borrowing Cost Related to

- i) Acquisition (Plant & Machinery)
- ii) Production (Stock, Flats)
- iii) Construction (Buildings, Roads)

Qualifying Asset

Asset which takes substantial time for getting ready for Intended use or for its sale

Need to be Capitalized

Un - Qualifying Asset

Asset which is ready for its intended use or sale at the time of acquisition.

Revenue Expenditure

Journal Entry

1/4/18 Bank a/c.........Dr 50,00,000 ($1,00,000*50)
To Foreign Currency loan 50,00,000

31/3/19 Interest a/c.........Dr 5,20,000 ($1,00,000*10%=10,000*52)
To Bank 5,20,000

31/3/19 Borrowing Cost a/c..................Dr 80,000
Exchange Fluctuations a/c.......Dr 1,20,000
To Foreign Currency Loan a/c 2,00,000 {$1,00,000*2 (52-50)}

Types of Borrowing Cost

Specific Borrowing

Specifically for the purchase of qualifying assets (less any income on temporary investment of borrowed amount).

Example:

12% Loan for Specific 500	Qualifying Asset 450
	Investments 50

Borrowed Cost of Capital = 500*12% = 60
Less Income from Investment = (4)
Net Borrowing Cost 56

General Borrowing

Compute capitalization rate based on weighted average rate of cost.
Total capitalization cannot increase the actual borrowing cost incurred

Example:

12% Loan 400	Qualifying Asset 300
15% Loan 100	Others 200

$$\text{Capitalization Rate} = \frac{\text{Borrowing Cost Incurred}}{\text{Avg Loan From Outstanding}}$$

Total Borrowed Cost = 400*12%*12/12 = 48
100*15%*12/12 = 15
63

Capitalization Rate

$$\frac{63}{(400*12/12)+(100*12/12)} *100 = 12.6\%$$

If there is any delay for 1 month then we need to take 11 months for Capitalization

Borrowed Cost to be Capitalize = 300*12.6% * 12/12 = 37.8 (Capitalized)
Borrowed cost to be Expensed = 25.20 (63-37.80) (T/F to P&L)
Note: Borrowed Cost Considered For 12 Months

PERIOD OF CAPITALIZATION

Commencement of Capitalization of Borrowing Cost:

The Following All the Conditions should be satisfied:

i) Expenses for Acquisition, Construction or Production of Q.Asset is being Incurred.
ii) Borrowing Cost is being incurred.
iii) Activities to prepare the asset are in Progress.

Suspension of Capitalization Borrowing Cost:

- If Activities to prepare Asset are Suspended due to Normal Reasons
  Continue Capitalization
- If Activities to prepare Asset are Suspended due to Abnormal Reasons
  Discontinue Capitalization for that period.

Cessation of Capitalization

i) When the activities to prepare the Asset for use or sale are Substantially complete their capitalization ceased.

ii) If the Asset is prepared in parts and the completed part is capable of its intended use independently, then stop capitalization with respect to completed part.

Disclosure Requirements

i) Accounting Policy followed with respect to Borrowing Cost.
ii) Borrowing Cost Capitalize during the Year.