INDAS 23 –
BORROWING COSTS

(TOTAL NO. OF QUESTIONS – 9)

INDEX

RTPs QUESTIONS

Q1 (May 18) – assumption added

An entity constructs a new head office building commencing on 1st September 20X1, which continues till December 20X1. Directly attributable expenditures at the beginning of the month on this asset are ₹100,000 in September 20X1 and ₹250,000 in each of the months of October to December 20X1.

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. During the year, the entity had issued 10% debentures with a face value of ₹20 lacs and had an overdraft of ₹500,000, which increased to ₹750,000 in December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%.

Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'.

Solution — Suggested Solution by ICAI

Since the entity has only general borrowing hence the first step will be to compute the capitalisation rate. The capitalisation rate of the general borrowings of the entity during the period of construction is calculated as follows:

Finance cost on Rs. 20 lacs 10% debentures during September – December 20X1	66,667
Interest @ 15% on overdraft of Rs. 5,00,000 in September 20X1	6,250
Interest @ 16% on overdraft of Rs. 5,00,000 in October and November 20X1	13,333
Interest @ 16% on overdraft of Rs. 750,000 in December 20X1	10,000
Total finance costs in September – December 20X1	**96,250**

Weighted average borrowings during period

= (20,00,000x4) + (500,000 x 3) + (750,000 x 1) / 4

= ₹ 25,62,500

Capitalisation rate = Total finance costs during the construction period / Weighted average borrowings during the construction period = 96,250 / 25,62,500 = **3.756%**

Suggested Solution as per Author's View:

Finance cost on Rs. 20 lacs 10% debentures for whole year	200000
Interest @ 15% on overdraft of Rs. 5,00,000 in April to September 20X1	56,250
Interest @ 16% on overdraft of Rs. 5,00,000 in October and November 20X1	13,333
Interest @ 16% on overdraft of Rs. 750,000 in December 20X1	10,000
Total finance costs for Whole Year	**2,79,583**

Weighted average borrowings during period

= (20,00,000x12/12) + (500,000 x 11/12) + (750,000 x 1/12)

= ₹ 25,20,833

Capitalisation rate = Total finance costs / Weighted average borrowings = 2,79,583 / 25,20,833 = **11.09% p.a.; and for 4 Months = 11.09x4/12 = 3.70%**

Assumption – Debentures and overdraft were existing from the beginning of the year. Question asks to compute the total borrowing cost capitalization rate. Total borrowing cost using this rate will then be divided between capitalized and expense.

Q2 (Nov. 18)

K Ltd. began construction of a new building at an estimated cost of Rs 7 lakhs on 1st April, 2017. To finance construction of the building it obtained a specific loan of Rs 2 lakhs from a financial institution at an interest rate of 9% per annum.

The company's other outstanding loans were:

Amount	Rate of Interest per annum
Rs 7,00,000	12%
Rs 9,00,000	11%

The expenditure incurred on the construction was:

April, 2017	Rs 1,50,000
August, 2017	Rs 2,00,000
October, 2017	Rs 3,50,000
January, 2018	Rs 1,00,000

The construction of the building was completed by 31st January, 2018. Following the provisions of Ind AS 23 'Borrowing Costs', calculate the amount of interest to be capitalized and pass necessary journal entries for capitalizing the cost and borrowing cost in respect of the building as on 31st January, 2018.

Solution

Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (Rs)	Rate of interest	Amount of interest (Rs)	
7,00,000	12%	=	84,000
9,00,000	11%	=	99,000
16,00,000			1,83,000
Weighted average rate of interest (1,83,000/16,00,000) x100		=	11.4375%

Computation of borrowing cost to be capitalized for specific borrowings and general borrowings based on weighted average accumulated expenses

Date of incurrence of expenditure	Amount spent	Financed through	Calculation	Rs
1st April, 2017	1,50,000	Specific borrowing	1,50,000 x 9% x 10/12	11,250
1st August, 2017	2,00,000	Specific borrowing	50,000 x 9% x 10/12	3,750
		General borrowing	1,50,000 x 11.4375% x 6/12	8,578.125
1st October, 2017	3,50,000	General borrowing	3,50,000 x 11.4375% x 4/12	13,343.75
1st January, 2018	1,00,000	General borrowing	1,00,000 x 11.4375% x 1/12	953.125
				37,875

Note: Since construction of building started on 1st April, 2017, it is presumed that all the later expenditures on construction of building had been incurred at the beginning of the respective month.

Total expenses to be capitalized for building

	Rs
Cost of building Rs (1,50,000 + 2,00,000 + 3,50,000 + 1,00,000)	8,00,000
Add: Amount of interest to be capitalized	37,875
	8,37,875

Journal Entry

Date	Particulars		Rs	Rs
31.1.2018	Building account	Dr.	8,37,875	
	To Bank account			8,00,0000
	To Interest payable (borrowing cost)			37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

Note: In the above journal entry, it is assumed that interest amount will be paid at the end of the year. Hence, entry for interest payable has been passed on 31.1.2018.

Alternatively, following journal entry may be passed if interest is paid on the date of capitalization:

Date	Particulars		Rs	Rs
31.1.2018	Building account	Dr.	8,37,875	
	To Bank Account			8,37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

Assumption – 10 months in the given case is assumed to be a significant period.

Q3 (RTP Nov. 19 & MTP Oct. 20)

On 1st April, 20X1, entity A contracted for the construction of a building for 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 20X2, and during the period the following payments were made to the contractor:

Payment Date	Amount (Rs. in 000)
1^{st} April 20X1	200
30^{th} June 20X1	600
31^{st} December 20X1	1200
31^{st} March 20X2	200
Total	**2200**

Entity A's borrowings at its year end of 31st March, 20X2 were as follows:

1. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 20X2 amounted to Rs. 7,00,000. Interest of Rs. 65,000 was incurred on these borrowings during the year, and interest income of Rs. 20,000 was earned on these funds while they were held in anticipation of payments.
2. 12.5% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to Rs.1,000,000& remained unchanged during the year; &
3. 10% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to Rs.1,500,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?

Solution

As per Ind AS 23, when an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity should determine the amount of borrowing costs eligible for capitalisation as-

the actual borrowing costs incurred on that borrowing during the period (less) any investment income on the temporary investment of those borrowings.

The amount of borrowing costs eligible for capitalization, in cases where the funds are borrowed generally, should be determined based on the expenditure incurred in obtaining a qualifying asset. The costs incurred should first be allocated to the specific borrowings.

Analysis of expenditure:

Date	Expenditure	Amount allocated in Gen. Borrowings	Weighted for period outstanding
1^{st} April	200	0	0
30^{th} June	600	100*	100x9/12 = 75
31^{st} Dec	1200	1200	1200x3/12 = 300
31^{st} March	200	200	200x0/12 = 0
Total	**2200**		**375**

*Specific borrowings of 7,00,000 fully utilized on 1st April & on 30th June to the extent of 5,00,000 hence remaining expenditure of 1,00,000 allocated to general borrowings.

The expenditure rate relating to general borrowings should be the weighted average of the borrowing costs applicable to the entity's borrowings that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Capitalisation Rate = [(10,00,000x12.5%) + (15,00,000x10%)] / [10,00,000+15,00,000] = 11%

Borrowing Cost to be Capitalised	Amount
On Specific Loan of 7,00,000	65,000
On general borrowing (375000x11%)	41,250
Total	**1,06,250**

Less interest income on specific borrowing	-20,000
Amount Eligible for Capitalisation	**86,250**

Q4 (RTP May. 21)

How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of Rs.2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

Solution

Capitalisation Method

As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalisation of borrowing cost should cease where substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Thus, only that portion of the amortized discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Capitalisation of Interest

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalised and the borrowing cost relating to year 3 & 4 should be expensed.

Quantum of Borrowing

The value of the bond to Y Ltd. is the transaction price i.e. Rs.1,80,000 (2,00,000 – 20,000) Therefore, Y Ltd will recognize the borrowing of Rs. 1,80,000.

Computation of the amount of Borrowing Cost to be Capitalised

Y Ltd will capitalise the interest (borrowing cost) using the effective interest rate of 13.39% for two years as the qualifying asset is ready for intended use at the end of the year 2, the details of which are as follows:

Year	Operating Borrowing	Interest expenses @13.39% to be capitalized	Total	Interest	Closing Borrowing
	(1)	(2)	(3) = (1+2)	(4)	(5) = (3)-(4)
1	1,80,000	24,102	2,04,102	20,000	1,84,102
2	1,84,102	24,65,	2,08,753	20,000	1,88,753
		48,753			

Accordingly, borrowing cost of Rs. 48,753 will be capitalized to the cost of qualifying assets.

Q5 (RTP Nov. 21)

Nikka Limited has obtained a term loan of Rs. 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 20X2. An expenditure of Rs. 510 lacs was incurred on installation of Plant and Machinery, Rs. 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of Rs. 56 lacs has been used for working capital purposes. Management of Nikka Limited considers the 12 months period as a substantial period of time to get the asset ready for its intended use.

The company has paid total interest of Rs. 68.20 lacs during financial year 20X1-20X2 on the above loan. The accountant seeks your advice on 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, 20X2?

Solution

As per Ind AS 23, Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

Where, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Accordingly, the treatment of Interest of Rs. 68.20 lacs occurred during the year 20X1-20X2 would be as follows:

(i) When construction of asset completed on 30th April, 20X2

The treatment for total borrowing cost of Rs. 68.20 lakhs will be as follows:

Purpose	Nature	Interest to be capitalised	Interest to be charged to profit and loss account
		Rs. in lakhs	Rs. in lakhs
Modernisation and renovation of plant and Machinery	Qualifying asset	[68.20 x (510/620)] = 56.10	
Advance to Suppliers for additional assets	Qualifying asset	[68.20 x (54/620)] = 5.94	
Working Capital	Not a qualifying asset		[68.20 x (56/620)] = 6.16
		62.04	**6.16**

(ii) When construction of assets is completed by 28th February, 20X2

When the process of renovation gets completed in less than 12 months, the plant and machinery and the additional assets will not be considered as qualifying assets (until and unless the entity specifically considers that the assets took a substantial period of time for completing their construction). Accordingly, the whole of interest will be required to be charged off / expensed off to Profit and loss account.

MTPs QUESTIONS

Q6 (April 19)

ABC Ltd. has taken a loan of USD 20,000 on April 1, 20X1 for constructing a plant at an interest rate of 5% per annum payable on an annual basis.

On April 1, 20X1, the exchange rate between the currencies i.e. USD vs Rupees was Rs. 45 per USD. The exchange rate on the reporting date i.e. March 31, 20X2 is Rs. 48 per USD.

The corresponding amount could have been borrowed by ABC Ltd. from State bank of India in local currency at an interest rate of 11% per annum as on April 1, 20X1.

Compute the borrowing cost to be capitalized for the construction of the plant by ABC Ltd.

Solution

a) Interest on Foreign currency loan for the period:

USD 20,000 x 5% = USD 1,000

Converted in Rs.: USD 1,000 x Rs. 48/USD = Rs. 48,000

Increase in liability due to change in exchange difference: USD 20,000 x (48 - 45) = Rs. 60,000

b) Interest that would have resulted if the loan was taken in Indian Currency:

USD 20,000 x Rs. 45/USD x 11% = Rs. 99,000

c) Difference between Interest on Foreign Currency borrowing and local Currency borrowing:

Rs. 99,000 - 48,000 = Rs. 51,000

Hence, out of Exchange loss of Rs. 60,000 on principal amount of foreign currency loan, exchange loss to the extent of Rs. 51,000 is considered as borrowing costs.

Total borrowing cost to be capitalized is as under:

(a)	Interest cost of borrowing	Rs. 48,000
(b)	Exchange difference to the extent considered to be an adjustment to Interest cost	Rs. 51,000
		Rs. 99,000

The exchange difference of Rs. 51,000 has been capitalized as borrowing cost and the remaining Rs. 9,000 will be expensed off in the Statement of Profit and loss.

Q7 (October 20)- Same as Q.3.

On 1 April 2019, entity A contracted for the construction of a building for Rs. 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying asset. The building was completed at the end of March, 2020, and during the period the following payments were made to the contractor:

Payment date	Amount (Rs.)
1 April 2019	2,00,000
30 June 2019	6,00,000
31 December 2019	12,00,000
31 March 2020	2,00,000
Total	**22,00,000**

Entity A's borrowings at its year end of 31 March 2020 were as follows:

a. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31 March 2020 amounted to Rs. 7,00,000. Interest of Rs. 65,000 was incurred on these borrowings during the year, and interest income of Rs. 20,000 was earned on these funds while they were held in anticipation of payments.

b. 12.5% 10-year note with simple interest payable annually; debt outstanding at 1 April 2019 amounted to Rs. 10,00,000 and remained unchanged during the year; and

c. 10% 10-year note with simple interest payable annually; debt outstanding at 1 April 2019 amounted to Rs. 15,00,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?

Solution

As per Ind AS 23, when an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity should determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

The amount of borrowing costs eligible for capitalization, in cases where the funds are borrowed generally, should be determined based on the expenditure incurred in obtaining a qualifying asset. The costs incurred should first be allocated to the specific borrowings.

Analysis of expenditure:

Date	Expenditure (Rs.)	Amount allocated in general borrowings (Rs.)	Weighted for period outstanding (Rs.)
1 April 2019	2,00,000	0	0
30 June 2019	6,00,000	1,00,000*	1,00,000 × 9/12 = 75,000
31 Dec 2019	12,00,000	12,00,000	12,00,000 × 3/12 = 3,00,000
31 March 2020	2,00,000	2,00,000	2,00,000 × 0/12 = 0
Total	**22,00,000**		**3,75,000**

*Specific borrowings of Rs. 7,00,000 fully utilized on 1 April & on 30 June to the extent of Rs. 5,00,000 hence remaining expenditure of Rs. 1,00,000 allocated to general borrowings.

The expenditure rate relating to general borrowings should be the weighted average of the borrowing costs applicable to the entity's borrowings that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Capitalisation rate = (10,00,000 x 12.5%) + (15,00,000 x 10%) = 11%

= 10,00,000 + 15,00,000

Borrowing cost to be capitalized:	Amount
	(Rs.)
On specific loan	65,000
On General borrowing (Rs. 3,75,000 × 11%)	41,250
Total	**1,06,250**
Less: Interest income on specific borrowings	(20,000)
Amount eligible for capitalization	**86,250**
Therefore, the borrowing costs to be capitalized are Rs. 86,250.	

Q8 (March 21 & Nov. 19 Exams – 8 Marks) - Similar to Q.1.

An entity constructs a new office building commencing on 1st September, 20X1, which continues till 31st December, 20X1 (and is expected to go beyond a year). Directly attributable expenditure at the beginning of the month on this asset are Rs. 2 lakhs in September 20X1 and Rs. 4 lakhs in each of the months of October to December 20X1.

The entity has not taken any specific borrowings to finance the construction of the building but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 9% debentures with a face value of Rs. 30 lakhs and had an overdraft of Rs. 4 lakhs, which increased to Rs. 8 lakhs in December 20X1. Interest was paid on the overdraft at 12% until 1st October, 20X1 and then the rate was increased to 15%.

Calculate the capitalization rate for computation of borrowing cost for the period ending 31st December 20X1, in accordance with Ind AS 23 'Borrowing Cost'.

Solution

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of outstanding Balance	Amount of loan (Rs.)	Rate of interest p.a.	Weighted average amount of interest (Rs.)
	A	B	c	d = [(b x c) x (a/12)]
9% Debentures	12 months	30,00,000	9%	2,70,000
Bank overdraft	9 months	4,00,000	12%	36,000
	2 months	4,00,000	15%	10,000
	1 month	8,00,000	15%	10,000
		46,00,000		**3,26,000**

Weighted average cost of borrowings

= {30,00,000 x (12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)}

= 34,33,334

$$\text{Capitalisation rate} = \frac{\text{Weighted average amount of interest}}{\text{Weighted average of general borrowings}} \times 100$$

= (3,26,000 / 34,33,334) x 100 = 9.50% p.a.

Question 9: (Same Question was asked in RTP May 21)- Same as Q.4.

How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of Rs 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

Solution:

Capitalisation Method

As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalisation of borrowing cost should cease where substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Thus, only that portion of the amortized discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Capitalisation of Interest

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalised and the borrowing cost relating to year 3 & 4 should be expensed.

Quantum of Borrowing

The value of the bond to Y Ltd. is the transaction price i.e. Rs 1,80,000 (2,00,000 – 20,000) Therefore, Y Ltd will recognize the borrowing at Rs 1,80,000.

Computation of the amount of Borrowing Cost to be Capitalised

Y Ltd will capitalise the interest (borrowing cost) using the effective interest rate of 13.39% for two years as the qualifying asset is ready for intended use at the end of the year 2, the details of which are as follows:

Year	Opening Borrowing	Interest expense @ 13.39% to be capitalised	Total	Interest paid	Closing Borrowing
	(1)	(2)	(3)	(4)	(5) = (3) – (4)
1	1,80,000	24,102	2,04,102	20,000	1,84,102
2	1,84,102	24,651	2,08,753	20,000	1,88,753
		48,753			

Accordingly, borrowing cost of Rs 48,753 will be capitalized to the cost of qualifying asset.