TOPIC 11

INDAS – 23 BORROWING COSTS

INDEX

Quote:-

Start where you are. Use what you have. Do what you can. –Arthur Ashe

MEANING OF BORROWING COST

Borrowing Cost is the:

(a) Interest and

(b) Other cost

that is incurred by an enterprise in connection with borrowing of funds.

The following points should be considered for the purpose of borrowing cost:-

- Interest Exp. calculated ***using the effective interest method*** as described in INDAS - 109 Financial Instruments.
- Amount of Interest (finance charges) should also be included as a part of borrowing cost which is paid or payable for finance lease agreement (INDAS – 17 / INDAS 116).
- Exchange Diff arising from Foreign Currency Borrowings to the extent of difference in Interest cost (INDAS – 21).

> **Note:** This standard does not deal with actual or imputed cost of equity including preferred capital not classified as liability. **(Dividend on Equity, cost of issuance of equity or irredeemable Preference shares is not Borrowing Cost)**

MEANING OF QUALIFYING ASSETS

Qualifying Asset means:

- An ASSET
- that takes Substantial period of time
- to get ready for intended use or sale.

Normally a period of 12 months is considered to be the substantial period of time. But longer period or short term period than 12 month period may also be considerable as substantial period based on reasonable facts and judgments.

Depending on the circumstances, any of the following may be Qualifying Asset:

Fixed Assets: Manufacturing Plants, Power Generation Facilities, Bearer Plants, Intangible Assets

Investments: *For e.g. Investment properties.*

Investment in shares or debentures cannot be recognized as Qualifying assets because conditions of substantial period is not applicable on securities.

Inventories: *However inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets.*

Also INDAS 23 does not apply to those **Inventories** *that are manufactured, or otherwise produced,* ***in large quantities*** *on* **a repetitive basis** *and that* **take a substantial period** *to get ready for sale. For example, whisky, wines etc. takes substantial period of time, may be years to get ready for the intended purpose are out of scope from the purview of this standard.*

RECOGNITION

As per INDAS – 23, amount of borrowing cost which is directly atributable to:

- **Acquisition;**
- **Construction; or**
- **Production of**

any Qualifying Asset is Capitalized.

Therefore such borrowing cost that would have been avoided if the expenditure on the qualifying asset had not been made.

If any borrowing cost is not having any connection with Q.A. than such amount should be transfer to P/L a/c as an exp.

COMMENCEMENT OF CAPITALIZATION OF BORROWING COSTS:

As per the provision of standard, any enterprise can capitalize its borrowing cost only if the following three conditions are satisfied.

(1) *Expenditure for the*

- *Acquisition;*
- *Construction; or*
- *Production*

of a qualifying asset is being incurred.

Example:

Payment of Cash

Transfer of Other Assets

Assumption of Interest bearing Liabilities

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Note: If any amount is still pending for expenditure purpose out of borrowing funds than the pending amount will not be considered for capitalization purposes.

(2) Borrowing Costs are being incurred.

(3) Necessary Activities for preparation of qualifying assets for its intended use or sale are undertaken.

Examples:

Technical and Administration work prior to the commencement of physical construction, such as obtaining permission or licence or permit.

SUSPENSION OF CAPITALIZATION OF BORROWING COSTS:

Capitalization of Borrowing Costs to be suspended **during the extended periods** in which Active Development is Suspended/Interrupted.

Such costs are costs of holding partially completed assets and do not qualify for capitalisation.

Exception: Suspension not to taken place in case temporary delays are necessary for preparation of qualifying assets (e.g. Seasonal Rains).

Example:

Capitalisation continues during the extended period that **high water levels** delay construction of a bridge, if such high water levels are common during the construction period in the geographical region involved.

Example: Suspension of Capitalisation

(a) Construction suspended between October 20X1 to January 20X2 during which period certain heavy construction equipments under use was shifted to another site.

In this case, capitalization of borrowing costs needs to be suspended since active development is interrupted.

(b) When Qualifying Asset construction is about to complete, there was temporary delay of 20 days on account of some technical reasons.

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In this case, capitalization of borrowing costs shall be continued.

Note: Borrowing costs which are related to the suspension period should be transferred to P/L a/c as an exp.

CESSATION OF CAPITALIZATION OF BORROWING COSTS:

- Capitalization should **cease** when **substantially** all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

- Cessation to take place in part if construction of qualifying asset is completed in parts and a part is capable of being used separately.

A business park comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being usable while construction continues on other parts.

An example of a qualifying asset that needs to be complete before any part can be used is an industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

Example: 1

H Limited, a real estate company, gives immovable property on rent. It has completed on May 31, 20X1, a commercial complex consisting of various offices that could be rented out. It expects that the commercial complex will be completely rented out by June 30, 20X1. However, due to adverse market conditions, only 10% of the commercial complex could be rented out by its reporting date of March 31, 20X2. H Limited wants to capitalise the eligible borrowing costs incurred up to March 31, 20X2.

H Limited should capitalise borrowing costs only up to May 31, 20X1. The borrowing cost incurred thereafter cannot be capitalised as the asset was ready for its intended use on May 31, 20X1. The fact that only a small portion could be rented out by March 31, 20X2, is immaterial.

Example: 2

An entertainment park consisting of several rides and facilities, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being usable while construction continues on other parts. On the other side in a case of an industrial undertaking such as a steel mill, all parts have to be completed before any earlier completed part can be put to use.

IMPORTANT POINT:

As per INDAS 23, if any enterprise has earned temporary income by investment of unused borrowed funds then amount of temporary income should be adjusted against total borrowing cost and only thereafter principals of recognition should be applied.

FOREIGN EXCHANGE FLUCTUATION:

With regard to Exchange Difference required to be treated as borrowing Cost, the manner of arriving at the adjustments stated therein shall be as follows:

(a)

Adjustment should be of an amount which is equivalent to the extent to which the Exchange loss **does not exceed:**

- Difference between:
  - "Cost of borrowing in Functional currency"
  - "Cost of borrowing in a Foreign currency"

Lower of the following will be eligible for capitalisation:

(i) Actual Exchange Loss; or

(ii) Diff between cost of borrowing in Functional currency & Foreign currency.

(b)

Where there is an unrealised exchange loss which is treated as an Adjustment to interest and **subsequently there is a realised or unrealised gain** in respect of the settlement or translation of the same borrowing:

The **Gain to the extent of the loss previously recognised** as an adjustment should also be recognised as an adjustment to interest.

Example 1:

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows \$ 1,000 @ 4% on April 1, 20X1 when \$ 1 = Rs 40. The equivalent amount in functional currency is Rs 40,000. Interest is payable on March 31, 20X2. On March 31, 20X2, exchange rate is \$ 1 = Rs 50. The loan is not due for repayment. The exchange loss in this case is Rs 10,000 [\$ 1000 x (Rs 50- Rs 40)]. The borrowing cost is Rs 2,000 (\$ 1,000 x 4% x Rs 50). Had the entity borrowed in functional currency the borrowing cost would have been Rs 4,800 (Rs 40,000 x 12%). The entity will treat exchange difference up to Rs 2,800 (Rs 4,800 – Rs 2,000) as a borrowing cost that may be eligible for capitalization under this Standard. Thus the total eligible borrowing cost is Rs 4,800 (Rs 2,000 + Rs 2,800) equivalent to the cost of borrowing cost in functional currency.

If the exchange rate on March 31, 20X2, is \$ 1 = Rs41. The exchange loss is Rs 1,000 [\$ 1,000 – (Rs 41 – Rs 40)]. The entity will treat the entire exchange loss as an eligible borrowing cost as total cost of the borrowing Rs 2,640 (Rs 1,640 = \$1000*4%*41) + Rs 1,000) in foreign currency does not exceed the cost of borrowings in functional currency, i.e., Rs 4,800.

If the exchange rate on March 31, 20X2, is \$ 1 = Rs39. There is an exchange gain of is Rs 1,000 [(\$ 1,000 x (Rs 40 – Rs 39)]. The eligible borrowing cost will be Rs 1,560 (\$1000*4%*39) being interest paid to the foreign lender, since there is exchange gain only.

Example: 2

Continuing with the aforesaid example:

If the exchange rate on March 31, 20X3, is \$ 1 = Rs. 48; the exchange rate on March 31, 20X2, being \$ 1= Rs 50, the borrowings are still not due for payment. The entity will recognise a borrowing cost of Rs 1,920 (\$ 1,000 x 4% x Rs 48). There is an exchange gain of Rs 2,000 (\$ 1,000 x (Rs 50 – Rs48). This will be adjusted in the borrowing cost as there is unrealised exchange loss and the adjustment is less than the exchange loss of Rs. 2,800 recognised in earlier year.

If the exchange rate on March 31, 20X3, is \$ 1 = Rs44; the exchange rate on March 31, 20X2, being \$ 1 = Rs 50, the borrowings are still not due for payment. The entity will recognise a borrowing cost of Rs 1,760 (\$ 1,000 x 4% x Rs 44). There is an exchange gain of Rs 6,000 [\$ 1,000 x (Rs 50 – Rs 44)]. This will be adjusted in the borrowing cost upto Rs 2,800 as there is unrealised exchange loss and the adjustment of the exchange loss recognised in earlier years is of Rs 2,800.

If the exchange rate on March 31, 20X3, is $ 1 = Rs44 and part of loan is repaid; the exchange rate on March 31, 20X2, being $ 1 = Rs 50; $ 600 of the borrowings was paid on March 31, 20X2, $ 400 of the borrowings are still not due for payment. The entity will recognise a borrowing cost of Rs 704 ($ 400 x 4% x Rs 44). There is an exchange gain of Rs 2400 [$ 400 x (Rs 50 – Rs 44)]. The unrealised exchange loss of earlier year is Rs 4,000 [$ 400 x (Rs 50 – Rs 40)] out of which Rs 1,120 (Rs 2,800 x $ 400 / $ 1000) was charged in March 31, 20X1, as borrowing cost. Thus there will be an adjustment in the borrowing cost upto Rs 1,120 as this is unrealised exchange loss.

TYPES OF BORROWING:

Two types of borrowing are specified in the statement as follows:-

A. Specific Borrowing

B. General Borrowing

General Borrowing Costs

When a qualifying asset is funded from a pool of general borrowings, the amount of the borrowing costs eligible for capitalisation is not so obvious. It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided.

Such a difficulty occurs, for example, when the financing activity of an entity is coordinated centrally. Difficulties also arise when a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other entities in the group.

To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset.

The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

Total general borrowing costs for the period (excluding specific ÷ Total general borrowing costs for the period (excluding specific + Total general borrowing costs for the period (excluding specific

Expenditure to which capitalisation rate is applied

- *In calculation of borrowing costs to be capitalised, the amount of expenditure on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities.*
- *Expenditures **are reduced by any progress payments received and grants received** in connection with the asset (see Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance).*
- *The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalisation rate is applied in that period.*

Ind AS 23 decides "Eligibility" of the amount to be captialised – Are there any other consideration to be satisfied?

Yes,

When

- Carrying amount (for Asset)

  Or
- Expected ultimate cost (for Inventory)

Of the Qualifying Asset exceeds its:

- Recoverable amount (for Assets)

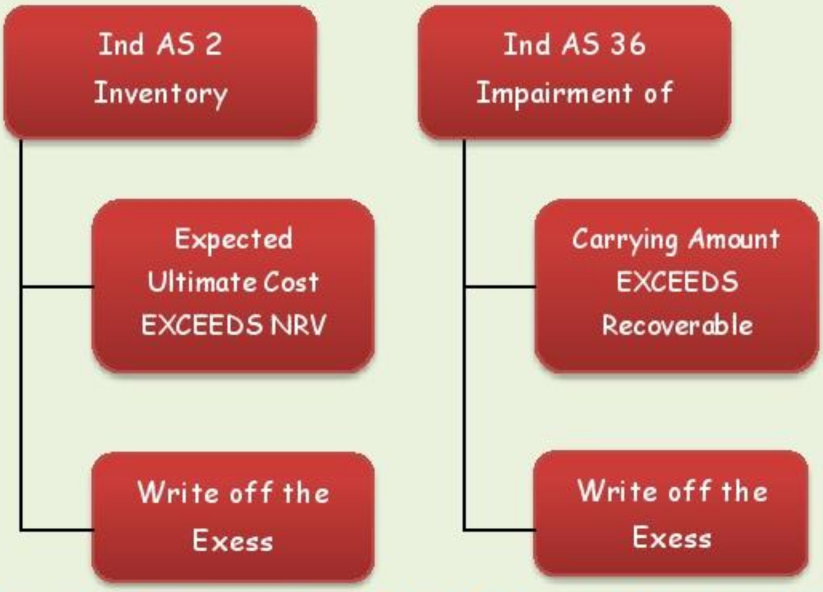
  Or
- Net Realisable value (for Inventory)

The Carrying amount is written down or written off in accordance with the requirement of other Standards (Ind AS 2 and 36)

Note:

In certain circumstance, the amount of the write – amount or write – off is written back in accordance with those other Standard (Ind AS 2 and 36)

We can summaries as under:



Thus we need to apply the parameters of Ind AS 2 and 36 to decide the amount which can be captialised as a part of the cost of the assets.

Clarification on DDT:

Can Dividend Distribution Tax (DOT) paid on distribution of dividend to preference shareholders that are classified as liability as per Ind AS 32 be capitalised as borrowing costs with the qualifying asset in accordance with the principles of Ind AS 23?

Answer

If a financial instrument is classified as debt, the dividend or interest thereon is in the nature of interest which is charged to profit or loss.

The Guidance Note on Ind AS Schedule III provides following guidance in respect of dividend on redeemable preference shares:

Dividend on preference shares, whether redeemable or convertible, is of the nature of 'interest expense', only where there is no discretion of the issuer over the payment of such dividends. In such case, the portion of dividend as determined by applying the effective interest method should be presented as 'Interest expense' under 'Finance cost'. Accordingly, the corresponding Dividend Distribution Tax on such portion of non-discretionary dividends should also be presented in the Statement of Profit and Loss under 'Interest expense'.

In the given case, assuming that the requirements of Ind AS 23 for capitalisation are met then the dividend on the preference shares that are classified as a liability, in accordance with the principles of Ind AS 32 would be treated as interest and DDT paid thereon will be treated as cost eligible for capitalisation.

Thus, in the given case, DDT is in the nature of incremental cost that an entity incurs in connection with obtaining the funds for qualifying asset. Hence DDT should be capitalised along with interest.

Further, dividend distribution tax paid on such dividend will from part of the effective interest rate calculation (EIR) to compute the effective interest expense to be capitalized with the qualified asset.

PRACTICAL QUESTIONS

Q85:

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 annual basis.

On April 1, 20X1, the exchange rate between the currencies i.e USD Vs INR was Rs45 per USD. The exchange rate on the reporting date i.e March 31, 20X2 is Rs48 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 plant by ABC Ltd.

Solution:

In the above situation, the Borrowing cost needs to determine for interest cost on such foreign currency loan and eligible exchange loss difference if any.

(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, only 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 on borrowing	Rs 48,000
(b) Ex. Dif. to the extent considered to be an adjustment to Interest cost	Rs 51,000
Total	**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.

Q86:

Beta Ltd had the following loans in place at the end of 31st March 20X2:

(Amounts in Rs. 000s)

Loan	1st April 20X1	31st March 20X2
18% Bank Loan	1,000	1,000
16% Term Loan	3,000	3,000
14% Debentures	-	2,000

14% debenture was issued to fund the construction of Office building on 1st July 20X1 but the development activities has yet to be started.

On 1st April 20X1, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: Rs 500,000 on 1st April 20X1 and Rs 2,500,000 on 1st January 20X2.

Required

Calculate the borrowing cost that can be capitalised for the plant.

Solution:

Capitalisation rate	(18% x 1000)/1000+3000 + (16% x 3000)/1000+3000	16.5%
Borrowing Costs	(500,000 x 16.5%)+(2,500,000 x16.5% x 3/12)	Rs. 1,85,625

Q87: Commencement Date

X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:

(i) 15 May 20X1: Loan interest relating to the project starts to be incurred

(ii) 2 June 20X1 : Technical site planning commences

(iii) 19 June 20X1 : Expenditure on the project started to be incurred

(iv) 18 July 20X1 : Construction work commences

Identify commencement date.

Solution:

In the above case, the three conditions to be tested for commencement date would be:

Borrowing cost has been incurred on: 15 May 20X1

Expenditure has been incurred for the asset on: 19 June 20X1

Activities necessary to prepare asset for its intended use or sale: 2 June 20X1

Commencement date would be the date when the above three conditions would be satisfied in all i.e., 19 June 20X1

Q88. Marine Transport Limited ordered 3 ships for its fleet on April 1, 20X0. It pays a down payment of 25% of the contract value of each of the ship out of long term borrowings from a scheduled bank. The delivery has to commence from the financial year 20X7. On March 1, 20X2, the ship builder informs that it has commenced production of one ship. There is no progress on other 2 ships. Marine Transport Limited prepares its financial statements on financial year basis.

Is it permissible for Marine Transport Limited to capitalise any borrowing costs for the financial year ended March 31, 20X1 or March 31, 20X2.

Solution:

As per paragraph 5 of Ind AS 23, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

As per paragraph 17 of Ind AS 23, an entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:

(a) It incurs expenditures for the asset.

(b) It incurs borrowing costs.

(c) It undertakes activities that are necessary to prepare the asset for its intended use or sale.

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The ship is a qualifying asset as it takes substantial period of time for its construction. Thus the related borrowing costs should be capitalised.

Marine Transport Limited borrows funds and incurs expenditures in the form of down payment on April 1, 20X0. Thus condition (a) and (b) are met. However, condition (c) is met only on March 1, 20X1, and that too only with respect to one ship. Thus there is no capitalisation of borrowing costs during the financial year ended March 31, 20X1. Even during the financial year ended March 31, 20X2, borrowing costs relating to the 'one' ship whose construction had commenced from March 1, 20X2 will be capitalised from March 1, 20X2 to March 31, 20X2. All other borrowing costs are expensed.

Q89. X Limited has a treasury department that arranges funds for all the requirements of the Company including funds for working capital and expansion programs. During the year ended March 31, 20X2, the Company commenced the construction of a qualifying asset and incurred the following expenses:

Date Amount	**(Rs)**
July 1, 20X1	2,50,000
December 1, 20X1	3,00,000

The details of borrowings and interest thereon are as under:

Particulars	Average Balance (Rs)	Interest (Rs)
Long term loan @ 10%	10,00,000	1,00,000
Working capital loan	5,00,000	65,000
	15,00,000	**1,65,000**

Compute the borrowing costs that need to be capitalised.

Solution:

The capitalisation rate is:

Total borrowing costs / Weighted average total borrowings: 1,65,000/15,00,000 = 11% Interest will be capitalised as under:

— On Rs 2,50,000 @ 11% p.a. for 9 months = Rs 20,625

— On Rs₹ 3,00,000 @ 11% p.a. for 4 months = Rs11,000

Q90. The borrowings profile of Santra Pharmaceuticals Ltd. set up for the manufacture of antibiotics at Navi Mumbai is as under:

Date	Nature of borrowings	Amount borrowed	Purpose of Borrowings	Incidental Expenses	Effective Interest
1/1/08	15% Demand Loan	60 Lakhs	Acquisition of Fixed Assets	8.33%	21%
1/7/08	14.5% Term Loan	40 Lakhs	Acquisition of Plant & Machinery	5%	18.5%
1/10/08	14% Bonds	50 Lakhs	Acquisition of Fixed Assets	8%	18%

Fixed assets considered as Qualified as Under:

Sterling Manufacturing Shed Rs. 10,00,000

Plant & Machinery (Total) Rs. 90,00,000

Other Fixed Assets Rs. 10,00,000

The project is completed on 1^{st} January 2009 and is ready for commercial production. Show the capitalization of the borrowing cost.

Solution:

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Q91. Paras Ltd. had the following borrowings during a year in respect of capital expansion.

Plant (QA)	Cost of Asset	Remarks
Plant P	100 Lakhs	No Specific Borrowings
Plant Q	125 Lakhs	Bank Loan of Rs. 65 lakhs at 10%
Plant R	175 Lakhs	9% Debentures of Rs. 125 lakhs were issued.

In addition to the specific borrowings stated above, the company has obtained term loan from two banks (1) Rs. 100 lakhs at 10% from Corporation bank and (2) Rs. 110 lakhs at 11.50% from SBI to meet its capital expansion requirements. Determine the amount of borrowing costs to be capitalized in each of the above plants, as per INDAS 23.

Solution:

Q92. X Ltd. began Construction of a new building on 1st January, 2007. It obtained Rs. 1 lakhs special loan to finance the construction of the building on 1st January, 2007 at an interest rate of 10%. The company's outstanding two non-specific loans were:

Amount	**Rate**
5,00,000	11%
9,00,000	13%

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

Janaury 2007	Rs. 2,00,000
April, 2007	Rs. 2,50,000
July, 2007	Rs. 4,50,000
December, 2007	Rs. 1,20,000

Building was completed by 31st December, 2007. Following the principles prescribed in INDAS – 23 Borrowing Cost. Calculate the amount of interest to be capitalized and pass one Journal Entry for capitalization of Cost and borrowing cost in respect of the building.

Solution:

WIP A/c Dr. 1020000

To Bank A/c 10.20

Building A/c Dr. 1020000

To WP a/c 10.20

Interest a/c Dr 182000

To Loans a/c 182000

Building A/c Dr. 74216

To Interest a/c 74216

Profit and loss a/c dr. (182000-74216) = 107784

To Interest a/c 107784

Q93. Big Ltd. has borrowed Rs. 30 lakhs from SBI during 2003-04. The borrowings are used to invest in shares of Small Ltd. a subsidiary company of Big Ltd. which is implementing a new project estimated to cost Rs. 50 lakhs. As on 31st March, 2004 since the said project was not complete, the directors of Big Ltd. resolved to capitalize the interest accruing on borrowings amounting to Rs. 4 Lakhs and add it to the cost of investments.

Solution:

Q94. XYZ Ltd. acquired a bank loan of Rs. 40 lakhs on interest rate of 20% per annum on 1 July, 2013. The said loan was utilized by the company for three transactions as under:

(i) Construction of factory Shed Rs. 10,00,000

(ii) Purchase of Plant & Machinery Rs. 25,00,000

(iii) Balance Loan was unallocated and used generally for the purpose of business.

The accountant of the company has charged the total interest to Profit and Loss account. Comment in view of the provisions of INDAS 23.

Solution:

Q95. Calculate the amount of borrowing cost to be capitalized:

Particulars	Amounts
Expenditure incurred till 31.03.2011	7,00,000
Interest Cost capitalized for the FY 2010-11	30,000
Amount Borrowed till 31.03.2011 @ 15%	4,00,000
Amount Transferred to Construction during 11-12	2,00,000
Cash Payment during 11-12 out of above	1,00,000
Progress payments received	5,00,000
New Borrowing until 11-12 @ 15%	3,00,000

Solution:

Q96. (RTP - May 2018)

An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1. Directly attributable expenditure 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:

Since the entity has only general borrowing hence 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 ` 20 lacs 10% debentures during September – December 20X1	66,667
Interest @ 15% on overdraft of ` 5,00,000 in September 20X1	6,250
Interest @ 16% on overdraft of ` 5,00,000 in October and November 20X1	13,333
Interest @ 16% on overdraft of ` 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%

Hyperinflationary Economies

When an entity applies Ind AS 29 which deals with "Financial Reporting in Hyperinflationary Economies"

It recognises as an expense part of borrowing costs that compensates for inflation during the same period in accordance with Ind AS 29.

Q97.

Entity H, that belongs to hyperinflationary economies, borrowed $100 million @ 40% in the backdrop of 350% annual inflation. The borrowed money is invested in a qualifying asset. During 2016 the qualifying asset remained under construction. How much of the borrowing costs should the entity capitalize?

Answer:

Nominal interest rate 40%

Real interest rate 4096 x 100/350 —11.4296

Thus, the entity can capitalize $100 million x 11.42% i.e. $11.42 million Balance $ 28.58 million of the borrowing costs should be expensed.

Student Notes:-

COVID-19

Student Notes:-

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