UNIT 4 :
INDIAN ACCOUNTING STANDARD 23 :
BORROWING COSTS

LEARNING OUTCOMES

After studying this unit, you will be able to:

- Appreciate the core principle and scope of this standard
- Define borrowing cost, qualifying asset and other related terms
- Recognise various conditions and pre-conditions for capitalisation of borrowing costs
- Evaluate suspension and cessation of capitalization of such borrowing cost
- Comply with the disclosure requirements of the standard
- Differentiate between Ind AS 23 and AS 16.
Core Principle
Capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

Scope - exclusions
• qualifying asset measured at fair value
• inventories produced in large quantities
• actual or imputed cost of equity

Borrowing costs eligible for capitalisation
• Specific borrowings
• General borrowings
• Calculation of capitalisation rate

Period of capitalisation:
Commencement
Suspension
Cessation

Disclosures
4.1 CORE PRINCIPLE

This standard requires borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset. Other borrowing costs are recognised as an expense.

“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.

4.2 SCOPE

- An entity shall apply this standard in accounting for borrowing costs.
- The Standard does not apply to actual or imputed cost of equity, including preferred capital not classified as a liability.

For example: Dividend paid on equity shares, cost of issuance of equity, cost on irredeemable preference share capital will not be included as borrowing cost within the purview of this standard.

- An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:

  (a) a qualifying asset measured at fair value, for example, a biological asset accounted for under Ind AS 41; or

  (b) 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.
4.3 RELEVANT DEFINITIONS

- Borrowing Cost and Qualifying asset are the two key pillars of this standard. In reference to this standard, borrowing cost states what needs to be capitalised and qualifying asset states on which asset these cost should be capitalised.

Let us see the definitions and inclusion of these two key words.

1. **Borrowing costs** are interest and other costs that an entity incurs in connection with the borrowing of funds.

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

- Borrowing costs may include:
  
  (a) interest expense calculated using the effective interest method as described in Ind AS 109 Financial Instruments;

  (b) finance charges in respect of finance leases recognised in accordance with Ind AS 17 Leases; and

  (c) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

4.3.1 Exchange difference to be included in borrowing costs

- With regard to exchange difference required to be treated as borrowing costs, the manner of arriving at the adjustments stated therein should be as follows:

  (i) the adjustment should be of an amount which is equivalent to the extent to which the exchange loss does not exceed the difference between the cost of borrowing in functional currency when compared to the cost of borrowing in a foreign currency.

**Example:**

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

If the exchange rate on March 31, 20X2, is $ 1 = ₹ 41. The exchange loss is ₹ 1,000 [($ 1,000 – (₹ 41 – ₹ 40)]. The entity will treat the entire exchange loss as an eligible borrowing cost as total cost of the borrowing ₹ 3,000 (₹ 2,000 + ₹ 1,000) in foreign currency does not exceed the cost of borrowings in functional currency, i.e., ₹ 4,800.

If the exchange rate on March 31, 20X2, is $ 1 = ₹ 39. There is an exchange gain of is ₹ 1,000 [(₹ 1,000 x (₹ 40 – ₹ 39)]. The eligible borrowing cost will be ₹ 2,000 being interest paid to the foreign lender.

(ii) 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: Continuing with the aforesaid example:

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

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

If the exchange rate on March 31, 20X3, is $ 1 = ₹ 44 and part of loan is repaid; the exchange rate on March 31, 20X2, being $ 1 = ₹ 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 ₹ 704 (₹ 400 x 4% x ₹ 44). There is an exchange gain of ₹ 2,400 (₹ 400 x (₹ 50 – ₹ 44)). The unrealised exchange loss of earlier year is ₹ 4,000 (₹ 400 x (₹ 50 – ₹ 40)) out of which ₹ 1,120 (₹ 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 ₹ 1,120 as this is unrealised exchange loss.
Illustration 1

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 ₹ 45 per USD. The exchange rate on the reporting date i.e March 31, 20X2 is ₹ 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 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:

\[ \text{USD 20,000 x 5\%} = \text{USD 1,000} \]

Converted in ₹:

\[ \text{USD 1,000 x ₹ 48/USD} = ₹ 48,000 \]

Increase in liability due to change in exchange difference:

\[ \text{USD 20,000 x (48 - 45)} = ₹ 60,000 \]

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

\[ \text{USD 20,000 x ₹ 45/USD x 11\%} = ₹ 99,000 \]

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

\[ ₹ 99,000 - 48,000 = ₹ 51,000 \]

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

Total borrowing cost to be capitalized is as under:

(a) Interest cost on borrowing  ₹ 48,000

(b) Exchange difference to the extent considered to be an adjustment to Interest cost  ₹ 51,000

The exchange difference of ₹ 51,000 has been capitalized as borrowing cost and the remaining ₹ 9,000 will be expensed off in the Statement of Profit and loss.
4.3.2 Key Note on Qualifying Assets

Depending on the circumstances, any of the following may be qualifying assets:

(a) inventories
(b) manufacturing plants
(c) power generation facilities
(d) intangible assets
(e) investment properties
(f) bearer plants.

- Financial assets and inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

4.4 RECOGNITION

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of the qualifying asset. Such borrowing costs are capitalised when below two conditions will be satisfied:
  - when it is probable it will result in future economic benefits to the entity; and
  - the costs can be measured reliably.

- Other borrowing costs are recognised as an expense in the period in which they are incurred.

- When an entity applies Ind AS 29 Financial Reporting in Hyperinflationary Economies, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period.

4.4.1 Borrowing costs eligible for capitalisation

The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made.

4.4.1.1 Specific borrowing costs

- 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 financing arrangements for a qualifying asset may result in an entity obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.

Illustration 2

Alpha Ltd. on 1st April 20X1 borrowed 9% ₹ 30,00,000 to finance the construction of two qualifying assets. Construction started on 1st April 20X1. The loan facility was availed on 1st April 20X1 and was utilized as follows with remaining funds invested temporarily at 7%.

<table>
<thead>
<tr>
<th></th>
<th>Factory Building</th>
<th>Office Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st April 20X1</td>
<td>5,00,000</td>
<td>10,00,000</td>
</tr>
<tr>
<td>1st October 20X1</td>
<td>5,00,000</td>
<td>10,00,000</td>
</tr>
</tbody>
</table>

Calculate the cost of the asset and the borrowing cost to be capitalized.

Solution:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Factory Building</th>
<th>Office Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowing Costs</td>
<td>(10,00,000*9%) 90,000</td>
<td>(20,00,000*9%) 1,80,000</td>
</tr>
</tbody>
</table>
4.4.1.2 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.

4.4.2 Calculation of capitalisation rate

- 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.
Illustration 3

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

(Amounts in ₹ 000s)

<table>
<thead>
<tr>
<th>Loan</th>
<th>1st April 20X1</th>
<th>31st March 20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>18% Bank Loan</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>16% Term Loan</td>
<td>3,000</td>
<td>3,000</td>
</tr>
<tr>
<td>14% Debentures</td>
<td>-</td>
<td>2,000</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Capitalisation rate</th>
<th>(18% x 1,000) + (16% x 3,000)</th>
<th>16.5%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1,000 + 3,000</td>
<td></td>
</tr>
</tbody>
</table>

Borrowing Costs

| (500,000 x 16.5%) + (2,500,000 x 16.5% x 3/12) | ₹ 1,85,625 |

4.4.3 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.
4.4.4 Excess of the carrying amount over recoverable amount

When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Standards.

4.5 PERIOD OF CAPITALISATION

4.5.1 Commencement of capitalisation

- An entity is required to begin the capitalizing of 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 cumulatively on a particular date:
  
  (a) it incurs expenditures for the asset;
  (b) it incurs borrowing costs; and
  (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Explanation to the three conditions for commencement date

- Expenditures on a qualifying asset include:
  - Those expenditures that have resulted in payments of cash
  - transfers of other assets
  - assumption of interest bearing liabilities

  Expenditures are reduced by any progress payments received and grants received in connection with the asset.

- Activities necessary to prepare asset for its intended use or sale:
Includes technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits prior to the commencement of the physical construction.

- exclude the holding of an asset when no production or development that changes the asset's condition is taking place.

For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

Illustration 4 : 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

4.5.2 Suspension of capitalisation

- An entity is required to suspend the capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset. Such costs are costs of holding partially completed assets and do not qualify for capitalisation.

- An entity does not required to suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For 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 equipment 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.

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

### 4.5.3 Cessation of capitalisation

- An entity should cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

- An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser’s or user’s specification, are all that are outstanding, this indicates that substantially all the activities are complete.

- When an entity completes the construction of a qualifying asset in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.

- 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:

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:

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.

### 4.6 DISCLOSURE

Entities are required to disclose:

(a) the amount of borrowing costs capitalised during the period; and

(b) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

### 4.7 SIGNIFICANT DIFFERENCES IN IND AS 23 VIS-À-VIS AS 16

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particular</th>
<th>Ind AS 23</th>
<th>AS 16</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Qualifying Asset measured at Fair Value</td>
<td>Ind AS 23 does not require an entity to apply this standard to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value, for example, a biological asset</td>
<td>AS 16 does not provide for such scope relaxation</td>
</tr>
<tr>
<td>2.</td>
<td>Applicability to Inventories</td>
<td>Ind AS 23 excludes the application of this Standard to borrowing costs directly attributable to the</td>
<td>AS 16 does not provide for such scope relaxation and is applicable to borrowing</td>
</tr>
<tr>
<td></td>
<td></td>
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<tr>
<td>---</td>
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<td></td>
</tr>
<tr>
<td>3.</td>
<td><strong>Inclusion as Borrowing Costs</strong></td>
<td>Ind AS 23 requires to calculate the interest expense using the effective interest rate method as described in Ind AS 109. Certain items therein have been deleted, as some of those components of borrowing costs are considered as the components of interest expense calculated using the effective interest rate method.</td>
<td></td>
</tr>
</tbody>
</table>
|   |   | AS 16, Borrowing Costs, inter alia, include the following:  
|   |   | • interest and commitment charges on bank borrowings and other short-term and long-term borrowings;  
|   |   | • amortisation of discounts or premiums relating to borrowings;  
|   |   | • amortisation of ancillary costs incurred in connection with the arrangement of borrowings |
| 4. | **Explanation of Substantial Period of Time** | This explanation is not included in Ind AS 23. |
|   |   | AS 16 gives explanation for meaning of 'substantial period of time' appearing in the definition of the term 'qualifying asset'. |
| 5. | **Reporting in Hyperinflationary Economies** | Ind AS 23 provides that when Ind AS 29, ‘Financial Reporting in Hyperinflationary Economies’, is applied, part of the borrowing costs that compensates for inflation should be expensed as required by that Standard (and not capitalized in respect of qualifying assets). |
|   |   | AS 16 does not contain a similar clarification because at present, in India, there is no Standard on ‘Financial Reporting in Hyperinflationary Economies’. |
| 6. | **Borrowings of the Parent and its Subsidiaries for Computing Weighted Average** | Ind AS 23 specifically provides that in some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a |
|   |   | This specific provision is not there in AS 16. |

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7. **Disclosure of Capitalisation Rate**

Ind AS 23 requires disclosure of capitalization rate used to determine the amount of borrowing costs eligible for capitalization. AS 16 does not have this disclosure requirement.
Practical Questions

1. 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.

2. 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 (₹)
   July 1, 20X1  2,50,000
   December 1, 20X1 3,00,000

   The details of borrowings and interest thereon are as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Average Balance (₹)</th>
<th>Interest (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term loan @ 10%</td>
<td>10,00,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Working capital loan</td>
<td>5,00,000</td>
<td>65,000</td>
</tr>
<tr>
<td></td>
<td>15,00,000</td>
<td>1,65,000</td>
</tr>
</tbody>
</table>

   Compute the borrowing costs that need to be capitalised.

Answers to Practical Questions

1. 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. 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.

2. 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 ₹ 2,50,000 @ 11% p.a. for 9 months = ₹ 20,625
- On ₹ 3,00,000 @ 11% p.a. for 4 months = ₹ 11,000