

**Accounting Standards Interpretation (ASI) 10<sup>1</sup>**  
**Interpretation of paragraph 4(e) of AS 16**  
**Accounting Standard (AS) 16, Borrowing Costs**

**ISSUE**

1. Paragraph 4 (e) of AS 16, 'Borrowing Costs', provides that borrowing costs may include "exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs".
2. The issue is which exchange differences are covered under paragraph 4 (e) of AS 16.

**CONSENSUS**

3. Paragraph 4 (e) of AS 16 covers exchange differences on the amount of principal of the foreign currency borrowings to the extent of difference between interest on local currency borrowings and interest on foreign currency borrowings. For this purpose, the interest rate for the local currency borrowings should be considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings. If the difference between the interest on local currency borrowings and the interest on foreign currency borrowings is equal to or more than the exchange difference on the amount of principal of the foreign currency borrowings, the entire amount of exchange difference is covered under paragraph 4 (e) of AS 16.

The Appendix to this Interpretation illustrates the application of the above requirements.

**BASIS FOR CONCLUSIONS**

4. Enterprises often borrow in foreign currency at a lower interest rate as

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<sup>1</sup>Published in 'The Chartered Accountant', November 2003, pp. 492-493. The authority of this ASI is the same as that of the Accounting Standard to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standard to which it relates. ASI is intended to apply only to material items.

an alternative to borrowing locally in rupees, at a higher rate. However, the likely currency depreciation and resulting exchange loss often offset, fully or partly, the difference in the interest rates. In such cases, the exchange difference on the foreign currency borrowings to the extent of the difference between interest on local currency borrowing and interest on foreign currency borrowing, is regarded as an adjustment to the interest costs. This exchange difference is, in substance, a borrowing cost. In case of an enterprise, which instead of borrowing locally at a higher interest rate, borrows in foreign currency on the basis that the interest cost on foreign currency borrowings as adjusted by the exchange fluctuations, is expected to be less than the interest cost of an equivalent rupee borrowing, it is not appropriate to consider only the explicit interest cost on the foreign currency borrowing as the borrowing costs. In such a case, to the extent the exchange differences are regarded as an adjustment to the interest costs, as explained above, the same should also be considered as borrowing costs and accounted for accordingly with a view to reflect economic reality. Accordingly, such an exchange difference is covered under AS 16.

5. The explicit interest cost, including exchange difference thereon, if any, is covered under paragraph 4 (a) of AS 16, which provides that borrowing costs may include interest and commitment charges on bank borrowing and other short term and long term borrowings. Accordingly, the intention of paragraph 4(e) of AS 16 is to cover exchange differences on the amount of the principal of the foreign currency borrowings. Further, since paragraph 4 (e) uses the words 'to the extent that they are regarded as an adjustment to interest costs', the entire exchange difference on principal amount is not covered by paragraph 4 (e). Since, the difference between interest on local currency borrowings and interest on foreign currency borrowings, is regarded as an adjustment to the interest costs, only the exchange difference to the extent of such difference is covered by paragraph 4 (e) of AS 16. The entire exchange difference on the principal amount is regarded as an adjustment to the interest cost only in a situation where the difference between interest on local currency borrowings and interest on foreign currency borrowings is equal to or more than the exchange difference.

## Appendix

*Note: This appendix is illustrative only and does not form part of the Accounting Standards Interpretation. The purpose of this appendix is to illustrate the application of the Interpretation to assist in clarifying its meaning.*

### Facts:

XYZ Ltd. has taken a loan of USD 10,000 on April 1, 20X3, for a specific project at an interest rate of 5% p.a., payable annually. On April 1, 20X3, the exchange rate between the currencies was Rs. 45 per USD. The exchange rate, as at March 31, 20X4, is Rs. 48 per USD. The corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of 11 per cent per annum as on April 1, 20X3.

*The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 4(e) of AS 16:*

- (i) Interest for the period = USD 10,000 x 5% x Rs. 48/USD = Rs. 24,000/-
- (ii) Increase in the liability towards the principal amount = USD 10,000 x (48-45) = Rs. 30,000/-
- (iii) Interest that would have resulted if the loan was taken in Indian currency = USD 10000 x 45 x 11% = Rs. 49,500
- (iv) Difference between interest on local currency borrowing and foreign currency borrowing = Rs. 49,500 – Rs. 24,000 = Rs. 25,500

Therefore, out of Rs. 30,000 increase in the liability towards principal amount, only Rs. 25,500 will be considered as the borrowing cost. Thus, total borrowing cost would be Rs. 49,500 being the aggregate of interest of Rs. 24,000 on foreign currency borrowings (covered by paragraph 4(a) of AS 16) plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of Rs. 25,500. Thus, Rs. 49,500 would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining Rs. 4,500 would be considered as the exchange difference to be accounted for as per Accounting Standard (AS) 11, The Effects of Changes in Foreign Exchange Rates.

In the above example, if the interest rate on local currency borrowings is assumed to be 13% instead of 11%, the entire exchange difference of Rs. 30,000 would be considered as borrowing costs, since in that case the difference between the interest on local currency borrowings and foreign currency borrowings (i.e., Rs. 34,500 (Rs. 58,500 – Rs. 24,000)) is more than the exchange difference of Rs. 30,000. Therefore, in such a case, the total borrowing cost would be Rs. 54,000 (Rs. 24,000 + Rs. 30,000) which would be accounted for under AS 16 and there would be no exchange difference to be accounted for under AS 11.