Combined Application of AS 11 & AS 16

Herein I will deal with the combined application of AS 11 and AS 16. I have dealt with a situation in which the exchange difference shall be treated as both borrowing cost as per AS 16 and exchange difference as per AS 11.

In simple words the exchange difference shall be bifurcated into ***'interest portion'*** (to be accounted for as per AS 16) and ***'exchange gain/loss'*** (to be charged to P&L as per AS 11).

Paragraph 4(e) of AS 16 deals with capitalization of interest portion of exchange difference arising from foreign currency borrowings.

Paragraph 4(e) provides that borrowing cost may include "exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to interest costs".

Paragraph 4(e) covers exchange difference on the amount of principal of the foreign currency borrowings to the extent of differences 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*.

Example 1 – XYZ Industries Limited takes a loan of US$ 1,00,000 on 1st April, 2010 at an interest rate of 5% per annum, payable annually. On 1st April, 2010, the exchange rate was Rs 45 per US$. On 31st March, 2011 the exchange rate was Rs 48 per US$.

The corresponding amount could have been borrowed by XYZ Industries Limited in local currency @ 11% per annum.

Computation of Borrowing Cost for the purpose of paragraph 4(e) of AS 16

(a) Interest for the period = US$ 1,00,000*5%*Rs 48 per US$ = Rs. 2,40,000
(b) Increase in liability towards the principal amount = US$ 1,00,000*(48-45) = Rs. 3,00,000
(c) Interest that would have resulted if the loan was taken in Indian currency US$ 1,00,000*45*11% = Rs. 4,95,000

(d) Difference between interest on local currency borrowings and foreign currency borrowings
Rs. 4,95,000 – Rs. 2,40,000 = Rs. 2,55,000

(i) Total increase in liability towards principal amount= Rs. 3,00,000
(ii) Borrowing cost out of increase = Rs. 2,55,000 (as computed in point d)
(iii) Total borrowing cost for the period = Rs. (2,40,000 + 2,55,000) = Rs. 4,95,000. This will be accounted as per AS 16.
(iv) Exchange difference to be charged to P&L = Rs. (3,00,000 – 2,55,000) = Rs. 45,000.

Example 2 – If in the above example, the interest rate was 13% instead of 11%

Computation of Borrowing Cost for the purpose of paragraph 4(e) of AS 16

(a) Interest for the period = US$ 1,00,000*5%*Rs 48 per US$ = Rs. 2,40,000
(b) Increase in liability towards the principal amount = US$ 1,00,000*(48-45) = Rs. 3,00,000
(c) Interest that would have resulted if the loan was taken in Indian currency
US$ 1,00,000*45*13% = Rs. 5,85,000
(d) Difference between interest on local currency borrowings and foreign currency borrowings
Rs. 5,85,000 – Rs. 2,40,000 = Rs. 3,45,000

(i) Total increase in liability towards principal amount= Rs. 3,00,000
(ii) Borrowing cost out of increase = Rs. 3,00,000 (as difference in interest on local borrowings and foreign currency borrowings is more than the increase in the principal amount)
(iii) Total borrowing cost for the period = Rs. (2,40,000 + 3,00,000) = Rs. 5,40,000. This will be accounted for as per AS 16.
(iv) Exchange difference to be charged to P&L = NIL

In this case, no exchange difference arises.