Comments on the Exposure Draft of Accounting Standard (AS) 23, Borrowing Costs issued by the Accounting Standards Board (ASB) of The Institute of Chartered Accountants of India

Thank you so much for giving us an opportunity to comment on the Exposure Draft of Revised Accounting Standard (AS) 23 *Borrowing Costs*. Our comments on the same are given below:

1. It is not clear as to what ASB is seeking to achieve by amending the existing AS similar to Ind AS. The Institute of Chartered Accountants of India (ICAI) published a concept paper of convergence with IFRS. In a similar manner, the ASB should first prepare a concept paper for revision of existing Accounting Standards which should be given wide publicity and comments on the same invited. Revision to existing standards should be done only when the concept paper is finalised after consideration of all comments received by ASB and in a central council meeting subsequently. All exposure drafts of revised accounting standards should also contain a copy of the finalised concept paper.
2. The revised AS 23 is in line with Ind AS 23 that requires borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall form part of the cost of the asset. In this regard, we have the following comments to offer:
    a. It is well established principle that the way a business is financed and the way a business is operated are independent of each other. Borrowing costs are period costs representing time value of money, credit risk and margins of the lender. Therefore, borrowing costs should not affect the depreciation charge which is based on the pattern of consumption of the asset and has nothing to do with the interest risk. The capitalisation of borrowing costs distorts depreciation cost, finance cost and inventory cost.
    b. Having the principles in Ind AS in line with IFRS was a constraint. However, for Accounting Standards, there is no such constraint. The ASB should undertake a research on accounting for borrowing costs before amending AS 16. The ASB may view this as a golden opportunity to show leadership rather than followership.
    c. The Accounting Standards are meant for smaller entities. The Concept of capitalisation is complex to apply especially the capitalisation of indirect borrowing costs. Requiring all borrowing cost to be recognised as an expense in the Statement

of Profit and Loss will not only make financial reporting simple and easy to apply but also lead to significant improvement in financial reporting.

d. The concept of capitalisation permits hedge accounting without hedge accounting principles being followed as it changes the timing of recognition of borrowing costs in the Statement of Profit and Loss from over the term of the borrowing to over the useful life of the qualifying asset. A borrowing creates interest rate exposure. However, capitalisation of interest converts the interest exposure into depreciation exposure which misleads the user of the financial statements and impairs true and fair view. Therefore, all borrowing costs should be recognised in profit or loss for the period.

e. Paragraph 17(b) of AS 10, Property, Plant and Equipment, states as under:

   "*The cost of an item of property, plant and equipment comprises:*

   (a) …

   (b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management

   (c) …"

   Thus, for any costs to be considered as cost of an item of property, plant and equipment, it needs to satisfy the test of 'directly attributable' and 'necessary'. The incurrence of borrowing costs does not satisfy the second test of necessity. The principle of capitalisation of borrowing costs is solely based on the first test of directly attributable and hence is inconsistent with the principles enunciated in AS 10 (Revised). The ASB should either amend AS 10 (Revised) to remove the test of 'necessary' and bring it in line with AS 10 *Accounting for Fixed Assets* or amend AS 16 *Borrowing Costs* to make it consistent with AS 10 (Revised) *Property, Plant and Equipment* by including the principle of 'necessary'. The impact of amending AS 16 by including the principle of necessity will be that none of the borrowings costs shall be eligible for capitalisation as incurrence of borrowing costs is not necessary for the asset to be capable of operating in the manner intended by management.

f. Removing the requirement of capitalisation will also remove the headache of identifying qualifying asset and the play with the term "substantial period of time".

g. Paragraph 6(e) recognises interest parity theorem but does not apply it consistently in the standard. The accounting for borrowing costs should be similar to accounting for exchange differences if the theorem is applied in accounting. AS 11 as was revised in 2003 required all exchange differences to be recognised in the Statement of Profit and Loss. It was Ministry of Corporate Affairs that inserted paragraph 46A of AS 11 and distorted the financials of not only the companies but also banks and financial institutions as such accounting has an adverse cascading effect on the economy as a whole. Similar to AS 11 as was issued by The ICAI in 2003, all borrowing costs should be recognised in the Statement of Profit and Loss unless the borrowing is designated in an effective hedging relationship.