

AS 11 - The Effects of Changes in Foreign Exchange Rates

1. Scope

Accounting for the following is discussed in AS 11:

1. Foreign currency transactions.
2. Translating the Financial Statements of foreign operations. (Discussed in Branch Accounts)
3. Accounting for forward exchange contracts.

2. Definitions

- **Reporting Currency:** It is the currency in which Financial Statements are prepared.
- **Foreign Currency:** It is the currency other than the reporting currency.
- **Monetary Items:** Monetary items are those assets and liabilities, which are to be received or paid in fixed or determinable amounts of money.
 - *Examples:* Cash and cash equivalents, Trade receivables or Debtors, Trade payables or Creditors.
- **Non-Monetary Items:** Non-monetary items are assets and liabilities, other than monetary items.
 - *Examples:* Property, Plant, and Equipment (PPE), Inventories, Share Capital, Investments in Equity shares, etc.
 - *Note:* Monetary / Non-Monetary concept is only for Balance Sheet items.

3. Accounting for Foreign Currency Transactions

- A foreign currency transaction is a transaction which is denominated or requires settlement in a foreign currency.
- *Examples of foreign currency transactions:*
 - Purchase or sale of goods and services in foreign currency.
 - Borrowing or lending of funds in foreign currency.
 - Purchase or sale of Property, Plant, and Equipment (PPE) denominated in foreign currency.

Summary of Foreign Currency Transactions

Measurement Stage	Initial Measurement	Subsequent Measurement (at year-end)
Measurement Rule	Recognize using Rate on Date of Transaction	Monetary Item: Remeasured @ Closing Rate
		Non-Monetary Item:
		Carried at Historical Cost → No need to Remeasure at year-end.
		Carried at Fair Value or Net Realizable Value (NRV) → Remeasure @ Closing Rate at year-end.

- *Examples for Non-Monetary Items:*
 - PPE @ Cost Model
 - Inventory @ Cost
 - Investments @ Cost
 - PPE @ Revaluation Model
 - Inventory @ NRV
 - Investments @ Market Value

Foreign Exchange Rate Difference

- The difference arising from remeasurement of monetary items or settlement of foreign currency transactions is **Transferred to Profit and Loss (P/L) Account**.

Shortcut for Foreign Exchange Gain/Loss (for Monetary Items)

Item	Asset (e.g., Trade Receivable)	Liability (e.g., Trade Payable)
Exchange Rate increases (↑)	Exchange Rate ↑ → Loss	Exchange Rate ↑ → Gain
Exchange Rate decreases (↓)	Exchange Rate ↓ → Gain	Exchange Rate ↓ → Loss

4. Exception to charging Exchange Gain/Loss to Profit and Loss (P/L) Account (Para 46A)

- This option is available when a company has a **Long Term foreign currency monetary item** (e.g., Long term foreign loan).
 - *(Do not apply this for Debtors/Creditors/Short term loans etc.)*
- Once the option is exercised, it is **irrevocable**.

Treatment of Exchange Difference on Long Term Foreign Currency Monetary Item

Situation	Treatment of Exchange Difference (Ex Diff)
Related to a depreciable Asset (Long term foreign loan taken for depreciable Asset)	Ex Diff on long term loan can be adjusted from the cost of Asset .
	Ex Loss → Add to cost of Asset
	Ex Gain → Less from cost of Asset
NOT related to depreciable Asset	Ex Diff shall be transferred to a separate account in the Balance Sheet named " Foreign Currency Monetary Item Translation Difference Account " (FCMITD A/c).
	The balance in the FCMITD A/c will be transferred to Profit and Loss Account over the period of the remaining loan term .

5. Translation of Financial Statements of Foreign operation

A) Classification of Foreign operation

- Integral Foreign Operation (IFO)
- Non-Integral Foreign Operation (NIFO)

B) Translation of Financial Statements

- Already covered in Branch Accounts.

C) Treatment of Exchange Difference

- IFO → Profit and Loss (P/L) Account
- NIFO → Foreign Currency Translation Reserve (FCTR)

D) Indicators for identification of Non-Integral Foreign Operation

- Non-integral foreign operation should have a **significant degree of independence** in its activities.
- Transactions with the head office are in **very low proportion**.
- Transactions and activities of foreign operation are **mainly financed from its own operations or local borrowings**.

- Cost of labour, material, and other components are **primarily paid in local currency** of foreign operation.
- Foreign operation sales are **mainly in their own currency**.
- Sales prices are **determined by local competition** of foreign operation.
- There is an **active local sales market** for foreign operation's products.

E) Changes in classification of foreign operation

Change	Treatment
Integral → Non-Integral	Exchange Gain/Loss (Ex G/L) from the date of reclassification is transferred to FCTR .
Non-Integral → Integral	Ex G/L from the date of reclassification is transferred to P/L Account .
	<i>(Old Ex Diff will continue to stay in FCTR)</i>

6. Accounting for Forward Exchange Contracts

Forward Exchange Contract entered for managing risk (Hedging)	Forward Exchange Contract entered for trading or speculation
Hedging	Speculation
Loss / Gain	Profit / Loss
Premium or discount arising at the inception of such forward contract should be amortized over the life of the contract .	Here the Profit / Loss is computed by comparing forward rate and sale rate , and such profit/loss is recorded in P/L Account .
<i>Method:</i> Compare Forward rate and Spot rate → (+) Forward Contract Book Ex G/L over the contract period	<i>Method:</i> Compare Forward rate and Sale rate Book Profit / Loss on sale date.
<i>Examples:</i> Purchase of Plant/Goods	<i>Example:</i> Only forward contract (no underlying transaction)