

Accounting Standard (AS) 11 *
(revised 1994)

Accounting for the Effects of Changes in Foreign Exchange Rates

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the Preface to the Statements of Accounting Standards¹.)*

The following is the text of Accounting Standard (AS) 11, 'Accounting for the Effects of Changes in Foreign Exchange Rates', issued by the Council of the Institute of Chartered Accountants of India.

This Standard will come into effect in respect of accounting periods commencing on or after 1.4.1995 and will be mandatory in nature. ²

Objective

An enterprise may have transactions in foreign currencies or it may have foreign branches. Foreign currency transactions should be expressed in the enterprise's reporting currency and the financial statements of foreign branches should be translated into the enterprise's reporting currency in order to include them in the financial statements of the enterprise.

The principal issues in accounting for foreign currency transactions and foreign branches are to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.

* This Standard has again been revised in 2003. The revised AS 11 (2003) comes into effect in respect of accounting periods commencing on or after 1-4-2004 and is mandatory in nature from that date. The revised Standard (2003) supersedes AS 11 (1994), except that in respect of accounting for transactions in foreign currencies entered into by the reporting enterprise itself or through its branches before the date the revised AS 11 (2003) comes into effect, AS 11 (1994) continues to be applicable. The revised Standard (2003) is published elsewhere in this Compendium.

1 Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

2 Reference may be made to the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium for a detailed discussion on the implications of the mandatory status of an accounting standard.

Scope

1. ***This Statement should be applied by an enterprise :***

- a. ***in accounting for transactions in foreign currencies; and***
- b. ***in translating the financial statements of foreign branches for inclusion in the financial statements of the enterprise.*** ³

3 The Council of the Institute of Chartered Accountants of India has clarified that this Standard is not applicable to forward exchange transactions which are entered into by authorised foreign exchange dealers, in view of the fact that the nature of such transactions has certain special features which need to be addressed specifically. The Standard shall, however, apply to translation of financial statements of foreign branches of the foreign exchange dealers. (see 'The Chartered Accountant', April 1999, pp. 78-79.)

Definitions

2. ***The following terms are used in this Statement with the meanings specified :***

Reporting currency is the currency used in presenting the financial statements.

Foreign currency is a currency other than the reporting currency of an enterprise.

Exchange rate is the ratio for exchange of two currencies as applicable to the

realisation of a specific asset or the payment of a specific liability or the recording of a specific transaction or a group of inter-related transactions.

Average rate is the mean of the exchange rates in force during a period.

Forward rate is the exchange rate established by the terms of an agreement for exchange of two currencies at a specified future date.

Closing rate is the exchange rate at the balance sheet date.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money, e.g., cash, receivables, payables.

Non-monetary items are assets and liabilities other than monetary items e.g. fixed assets, inventories, investments in equity shares.

Settlement date is the date at which a receivable is due to be collected or a payable is due to be paid.

Recoverable amount is the amount which the enterprise expects to recover from the future use of an asset, including its residual value on disposal.

Foreign Currency Transactions

Exchange Rate

3. A multiplicity of foreign exchange rates is possible in a given situation. In such a case, the term 'exchange rate' refers to the rate which is applicable to the particular transaction.
4. The term 'exchange rate' is defined in this Statement with reference to a specific asset, liability or transaction or a group of inter-related transactions. For the purpose of this Statement, two or more transactions are considered inter-related if, by virtue of being set off against one another or otherwise, they affect the net amount of reporting currency that will be available on, or required for, the settlement of those transactions. Although the exchange rates applicable to realisations and disbursements in a foreign currency may be different, an enterprise may, where legally permissible, partly use the receivables to settle the payables directly, in which case the payables and receivables are reported at the exchange rate as applicable to the net amount of receivable or payable. Further, where realisations are deposited into, and disbursements made out of, a foreign currency bank account, all the transactions during a period (e.g. a month) are reported at a rate that approximates the actual rate during that period. However, where transactions cannot be considered inter-related as stated above, by set-off or otherwise, the receivables and payables are reported at the rates applicable to the respective amounts even where these are receivable from, or payable to, the same foreign party.

Recording Transactions on Initial Recognition

5. ***A transaction in a foreign currency should be recorded in the reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction, except as stated in para 4 above in respect of inter-related transactions.***
6. A transaction in a foreign currency is recorded in the financial records of an enterprise as at the date on which the transaction occurs, normally using the exchange rate at that date. This exchange rate is often referred to as the spot rate. For practical reasons, a rate that approximates the actual rate is often used, for example, an average rate for all transactions during the week or month in which the transactions occur. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Reporting Effects of Changes in Exchange Rates Subsequent to Initial Recognition

7. ***At each balance sheet date :***
 - a. ***monetary items denominated in a foreign currency (e.g. foreign currency***

notes, balances in bank accounts denominated in a foreign currency, and receivables, payables and loans denominated in a foreign currency) should be reported using the closing rate. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g., where there are restrictions on remittances or where the closing rate is unrealistic and it is not possible to effect an exchange of currencies at that rate at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from, or required to disburse, such item at the balance sheet date;

- b. non-monetary items other than fixed assets, which are carried in terms of historical cost denominated in a foreign currency, should be reported using the exchange rate at the date of the transaction;*
- c. non-monetary items other than fixed assets, which are carried in terms of fair value or other similar valuation, e.g. net realisable value, denominated in a foreign currency, should be reported using the exchange rates that existed when the values were determined (e.g. if the fair value is determined as on the balance sheet date, the exchange rate on the balance sheet date may be used); and*
- d. the carrying amount of fixed assets should be adjusted as stated in paragraphs 10 and 11 below.*

Recognition of Exchange Differences

- 8. Paragraphs 9 to 11 set out the accounting treatment required by this Statement in respect of exchange differences on foreign currency transactions.
- 9. *Exchange differences arising on foreign currency transactions should be recognised as income or as expense in the period in which they arise, except as stated in paragraphs 10 and 11 below.*
- 10. *Exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which are carried in terms of historical cost, should be adjusted in the carrying amount of the respective fixed assets. The carrying amount of such fixed assets should, to the extent not already so adjusted or otherwise accounted for, also be adjusted to account for any increase or decrease in the liability of the enterprise, as expressed in the reporting currency by applying the closing rate, for making payment towards the whole or a part of the cost of the assets or for repayment of the whole or a part of the monies borrowed by the enterprise from any person, directly or indirectly, in foreign currency specifically for the purpose of acquiring those assets.*
- 11. *The carrying amount of fixed assets which are carried in terms of revalued amounts should also be adjusted in the manner described in paragraph 10 above. However, such adjustment should not result in the net book value of a class of revalued fixed assets exceeding the recoverable amount of assets of that class, the remaining amount of the increase in liability, if any, being debited to the revaluation reserve, or to the profit and loss statement in the event of inadequacy or absence of the revaluation reserve.*
- 12. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, the entire exchange difference arises in that period. However, when the transaction is not settled in the same accounting period as that in which it occurred, the exchange difference arises over more than one accounting period.

Forward Exchange Contracts

- 13. *An enterprise may enter into a forward exchange contract, or another financial instrument that is in substance a forward exchange contract, to establish the*

amount of the reporting currency required or available at the settlement date of a transaction. The difference between the forward rate and the exchange rate at date of the transaction should be recognised as income or expense over the life of the contract, except in respect of liabilities incurred for acquiring fixed assets, in which case, such difference should be adjusted in the carrying amount of the respective fixed assets.

14. The difference between the forward rate and the exchange rate at the inception of a forward exchange contract is recognised as income or expense over the life of the contract. The only exception is in respect of forward exchange contracts related to liabilities in foreign currency incurred for acquisition of fixed assets.
15. ***Any profit or loss arising on cancellation or renewal of a forward exchange contract should be recognised as income or as expense for the period, except in case of a forward exchange contract relating to liabilities incurred for acquiring fixed assets, in which case, such profit or loss should be adjusted in the carrying amount of the respective fixed assets.***

Depreciation

16. ***Where the carrying amount of a depreciable asset has undergone a change in accordance with paragraph 10 or paragraph 11 or paragraph 13 or paragraph 15 of this Statement, the depreciation on the revised unamortised depreciable amount should be provided in accordance with Accounting Standard (AS) 6, Depreciation Accounting.***

Translation of the Financial Statements of Foreign Branches

17. The need for foreign currency translation arises in respect of the financial statements of foreign branches of the parent enterprise.
18. ***The financial statements of a foreign branch should be translated using the procedures in paragraphs 19 to 25 of this Statement.***
19. ***Revenue items, except opening and closing inventories and depreciation, should be translated into reporting currency of the reporting enterprise at average rate. In appropriate circumstances, weighted average rate may be applied, e.g., where the income or expenses are not earned or incurred evenly during the accounting period (such as in the case of seasonal businesses) or where there are exceptionally wide fluctuations in exchange rates during the accounting period. Opening and closing inventories should be translated at the rates prevalent at the commencement and close respectively of the accounting period. Depreciation should be translated at the rates used for the translation of the values of the assets on which depreciation is calculated.***
20. ***Monetary items should be translated using the closing rate. However, in circumstances where the closing rate does not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, the foreign currency item at the balance sheet date, a rate that reflects approximately the likely realisation or disbursement as aforesaid should be used.***
21. ***Non-monetary items other than inventories and fixed assets should be translated using the exchange rate at the date of the transaction.***

Fixed assets should be translated using the exchange rate at the date of the transaction. Where there has been an increase or decrease in the liability of the enterprise, as expressed in Indian rupees by applying the closing rate, for making payment towards the whole or a part of the cost of a fixed asset or for repayment
22. ***of the whole or a part of monies borrowed by the enterprise from any person, directly or indirectly, in foreign currency specifically for the purpose of acquiring a fixed asset, the amount by which the liability is so increased or reduced during the year, should be added to, or reduced from, the historical cost of the fixed asset concerned.***
23. ***Balance in 'head office account', whether debit or credit, should be reported at the amount of the balance in the 'branch account' in the books of the head office after adjusting for unresponded transactions.***

24. *The net exchange difference resulting from the translation of items in the financial statements of a foreign branch should be recognised as income or as expense for the period, except to the extent adjusted in the carrying amount of the related fixed assets in accordance with paragraph 22 above.*
25. *Contingent liabilities should be translated into the reporting currency of the enterprise at the closing rate. The translation of contingent liabilities does not result in any exchange difference as defined in this Statement.*

Disclosures

26. *An enterprise should disclose -*
- i. amount of exchange differences included in the net profit or loss for the period;*
 - ii. the amount of exchange differences adjusted in the carrying amount of fixed assets during the accounting period; and*
 - iii. the amount of exchange differences in respect of forward exchange contracts to be recognised in the profit or loss for one or more subsequent accounting periods, as required by paragraph 13.*
27. Disclosure is also encouraged of an enterprise's foreign currency risk management policy.

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