

AS 11 Foreign Exchange Rates

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Scope

❖ **AS 11 deals with**

- ✓ Accounting for transactions in foreign currencies;
- ✓ Translating financial statements of foreign operations to reporting currency; and
- ✓ Accounting for foreign currency transactions in the nature of forward exchange contracts

❖ The standard however *does not cover the following issues:*

- ✓ It does not specify the currency in which an enterprise should present its financial statements;
- ✓ Restatement of an enterprise's financial statements from its reporting currency into another currency;
- ✓ Presentation in cash flow statements, of cash flows arising from transactions in foreign currency and translation of cash flows of a foreign operation (AS 3 Cash Flow Statements); and
- ✓ Exchange differences arising from foreign currency borrowings to the extent they are regarded as adjustment to interest costs (AS 16 Borrowing costs)

Key Terms

- ❖ **Transaction date rate:** exchange rate as at the date of transaction
- ❖ **Closing Rate:** exchange rate as at the Balance Sheet date.
- ❖ **Average Rate:** is the mean of the exchange rates in force during a period.
- ❖ **Forward Rate:**
- ❖ **Reporting Currency:** currency used in presenting the financial statements
- ❖ **Foreign Currency:** currency *other than* the reporting currency of the enterprise
- ❖ **Foreign Operation:** is a subsidiary, associate, joint venture, or branch of a reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.
- ❖ **Monetary items:** are money held and assets and liabilities to be received and paid in fixed or determinable amounts of money.

Net Investment in a Non Integral Foreign Operation

- ❖ Net investment in a non integral foreign operation, refers to a **monetary item** that is receivable or payable to a foreign operation.

The two important features for an item to qualify as net investment in a non integral foreign operation are:-

1. It is a *monetary item* in the financial statements of the foreign operation;
2. The settlement of the monetary item is *neither planned nor likely to occur* in the foreseeable future.

Examples of Net investment in a non integral foreign operation **include** long term receivables or long term loans.

They **do not include** trade receivables, trade payables and other short term monetary items.

Measurement – Foreign Currency transactions

- ❖ The term measurement under the standard refers to the exchange rate that should be used in converting the foreign currency transactions for presentation in the reporting entity's financial statements.

Measurement FOREIGN CURRENCY TRANSACTIONS – reporting entity's financial statements

	The foreign currency item	Applicable exchange rate for translation into functional currency
1	All foreign currency transaction items – INITIAL RECOGNITION (<i>whether monetary or non monetary</i>)	At SPOT exchange rate between the reporting currency and foreign currency on the date of transaction
2	SUBSEQUENT REPORTING PERIODS	
A	All Monetary items	Closing rate
B	Non Monetary items	
	Carried at Historical cost	Transaction date rate
	Carried at Fair Value	Exchange rate when fair value was measured
C	Contingent Liabilities	Closing Rate

- ❖ **The transaction date** is the date on which an item of income and expense or asset and liability qualifies for recognition in the financial statements of an enterprise
- ❖ Use of average rate is permitted *provided* exchange rates do not fluctuate significantly

Measurement FOREIGN CURRENCY TRANSACTIONS – recognition of exchange gains and losses

- ❖ Exchange gain or loss in case of a foreign currency transaction, pertaining to a **monetary item** can arise in the following situations:
 - ✓ Settlement of the monetary item arising from foreign currency transactions;
 - ✓ Reporting the monetary item in the financial statement, at a rate which is different from the transaction date rate; and
 - ✓ Reporting the monetary item in the current period financial statements, at an exchange rate which is different from the exchange rate used in the previous year's financial statement

- ❖ **Transaction settled during the same accounting period:** Where a transaction is settled within the same accounting period as that in which it occurred, all exchange differences are recognised in the that period.

- ❖ **Transaction NOT settled during the same accounting period:** exchange difference is recognised in each intervening period up to the settlement date, at exchange rates during that period

Measurement FOREIGN CURRENCY TRANSACTIONS – recognition of exchange gains and losses

- ❖ In case of **non monetary foreign currency items**, no exchange gain or loss arises at subsequent reporting dates as they are reported in the financial statements either at the transaction date exchange rate or in case the items are carried at revalued amounts, then at the exchange rate as at the date of revaluation.

	The foreign currency item	Measurement	Recognition of Gain / Loss
1	Monetary items settled during the same accounting period	Amount of foreign currency monetary item X (transaction date rate – settlement date rate)	In Profit and loss of the period in which they arise (as income / expense)
2	Closing Monetary item	Amount of foreign currency monetary item X (transaction date rate – Closing rate)	--same--
A	Monetary items settled in subsequent period	Amount of foreign currency monetary item X (settlement date rate – previous Closing rate)	--same--

Long Term - Foreign Currency Monetary Item

- ❖ *Para 46 (new) in the standard – applicable only to Companies registered under the companies Act*
- ❖ **A Long term foreign currency monetary item (LTFCMI) does not include** net investment in a non integral foreign operation
- ❖ Has a maturity of 12 months or more at the date of its origination
- ❖ Recognition of exchange differences in case of a long term foreign currency monetary item

Particulars	Recognition
LTFCMI relates to purchase of depreciable asset (tangible or intangible)	Exchange differences will be added to or deducted from the historical cost of the asset
Others	Exchange differences will be recognised in Foreign Currency Monetary Item translation Difference Account (FCMITDA)

- ❖ Balance in FCMITDA will be amortised over the balance period of such long term monetary asset or a monetary liability *but not beyond 31 March 2012*

Foreign Operation

- ❖ **Foreign Operation:** is a subsidiary, associate, joint venture, or branch of a reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.
- ❖ A Foreign Operation can be **Integral** or **Non Integral**. The true test to determine whether a foreign operation is integral or Non integral, is whether change in exchange rates between the two currencies have a direct impact on the cash flows from operations of the reporting entity or not (*Para 18 and 19 of AS 11*)
- ❖ In the consolidated financial statements of the reporting entity, translation of foreign operation financial statements into the reporting entity's currency *depends on whether the foreign operation is **integral** or **non integral**.*

Integral - Foreign Operation

- ❖ **Integral Foreign Operation:** is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.

In other words, an integral foreign operation is an extension of the operations of the reporting entity. Any change in the exchange rate between the reporting entity and exchange relating to the foreign operations will have an immediate impact on the cash flows from operations of the reporting entity (*Para 18 of AS 11*)

- ❖ **Non Integral Foreign Operation:** is a foreign operation that is not an integral foreign operation. A non integral foreign operation accumulates cash and other monetary items, incurs expenses, generates income and perhaps arranges borrowings *all substantially in its local currency (Para 19 of AS 11)*

When there is a change in the exchange rate between the reporting currency and the currency of the foreign operation, there is little or no direct impact on the present and future cash flows from operations of either the non integral foreign operation or the reporting entity. (*Para 19 of AS 11*)

Indicators that a foreign operation is non integral to the reporting entity

- ✓ activities of the foreign operation are carried out with a significant degree of autonomy from those of the reporting enterprise;
- ✓ Transactions with the reporting enterprise are **not** a high proportion of the foreign operation's activities;
- ✓ Activities of foreign operation are mainly financed from its own operations and local borrowings, no dependence on the funds from reporting enterprise;
- ✓ Costs of production of foreign operations are mainly settled in local currency than in the currency of the reporting entity;
- ✓ Existence of an active local sales market for the foreign operation's products.
- ✓ Foreign operation's sales are mainly in currency other than the reporting currency

(Para 20 of AS 11)

- ❖ *In determining whether a foreign operation is integral or non integral to the reporting entity, **reporting entity's ability to exercise control is not necessarily the only determinant factor***

Translation of foreign operation

❖ **Integral Foreign Operation:**

Since an integral foreign operation carries on its business, just as an extension of the reporting enterprise's business, the same principles and procedures for converting foreign currency transactions of the reporting enterprise, apply. The individual items in the financial statements of the foreign operation are translated as if all the transactions have been entered into by the reporting enterprise itself. *(Para 21 of AS 11)*

In other words, the exchange rates as applicable for converting foreign currency transactions of the reporting enterprise apply in translating financial statements of an integral foreign operation for incorporation in the reporting enterprise's financial statements.

Translation - Non Integral foreign Operation

	The foreign currency item	Applicable exchange rate for translation into functional currency
1	All foreign currency transaction items – INITIAL RECOGNITION <i>(whether monetary or non monetary)</i>	At SPOT exchange rate (transaction date rate)
2	SUBSEQUENT REPORTING PERIODS	
A	All Monetary items	Closing rate
B	All Non Monetary items	Closing rate
C	Income and expense of non integral foreign operation	Transaction date rate
D	Goodwill or capital reserve arising on acquisition of a non integral foreign operation	Closing rate
E	Contingent liabilities in financial statements of non integral foreign operation	Closing rate

Exchange differences on translation of foreign operation

	The foreign currency item	Recognition of exchange differences
1	Translation of financial statements of an integral foreign operation	In profit and loss account (similar in case of conversion of foreign currency transactions)
2	Translation of financial statements of an NON integral foreign operation	The exchange differences resulting in gain or loss is deferred and accumulated in Foreign Currency Translation Reserve
3	<p>Monetary item being a NET investment in a non integral foreign operation</p> <p>Exchange gain or loss = Net investment X (transaction date rate – closing rate)</p>	Any exchange gain or loss (exchange difference) is not recognized in Profit and loss but is accumulated in FCTR in the reporting entity's financial statements until the disposal of the net investment.

Disposal – Foreign Operation

- ❖ Disposal of a foreign operation may either occur through sale, liquidation, repayment of share capital, or abandonment of all or part of that entity.

Disposals are categorised as



- ❖ **Reclassification:** On disposal of the non integral foreign operation or of the net investment in the non integral foreign operation, the cumulative exchange differences accumulated in FCTR which relate to that operation should be transferred to Profit and loss account as gain or loss. *(Para 31 of AS 11)*
- ❖ **In case of partial disposal** only a proportion of amount standing to the credit of FCTR (accumulated exchange differences) for that foreign operation, shall be transferred to the Profit and loss as gain or loss;
- ❖ A write down in the carrying amount of the non integral foreign operation **does not constitute partial disposal**. Hence no part of the accumulated foreign exchange differences (in FCTR) is recognized in profit and loss as gain or loss for the period. *(Para 32 AS 11)*

Change in classification from *Integral to Non Integral and vice versa*

- ❖ When there is a change in the classification of a foreign operation from integral to non-integral or vice versa, *translation procedures pertaining to revised classification should be applied from the **date of change in the classification***
- ❖ Change in classification from *Integral to Non Integral*

Items	Rate applied in case of integral foreign operation	Rate to be applied in case of non integral foreign operation	Whether any change in the exchange rate	Consequential effect in reporting enterprise's financial statements
Monetary items	Closing rate	Closing rate	NO	NA
Non monetary items	Transaction date rate	Closing rate	Yes	Exchange difference on translation as at date of reclassification in FCTR
Income and expense	Transaction date	Transaction date	NO	NA

Change in classification from NON *Integral* to *Integral*

Items	Rate applied in case of integral foreign operation	Rate to be applied in case of non integral foreign operation	Whether any change in the exchange rate	Consequential effect in reporting enterprise's financial statements
Monetary items	Closing rate	Closing rate	NO	NA
Non monetary items	Closing rate	Transaction date	Yes	Exchange difference on translation as at date of reclassification is added to historical cost of the item (Note 1)
Income and expense	Transaction date	Transaction date	NO	NA

❖ **Note 1:** In case of change in classification from non integral to integral, *the exchange difference previously recognised in FCTR is not classified to profit and loss until the disposal of the foreign operation*

