Frequently Asked Questions on AS 11 notification – Companies (Accounting Standards) Amendment Rules, 2009 (G.S.R. 225 (E) dt. 31.3.09) issued by Ministry of Corporate Affairs

ASB Guidance in the form of FAQs on AS 11 notification – Companies (Accounting Standards) Amendment Rules, 2009 (G.S.R. 225 (E) dt. 31.3.09) issued by Ministry of Corporate Affairs does not form part of the Standard. The purpose of this Guidance is to illustrate and to assist in clarifying the application of the notification.

(1) The notification uses the term 'depreciable capital asset'. What is meant by the term 'depreciable capital asset' as none of the accounting standards uses this terminology?

Response

The notification dated 31.03.2009 issued by the Ministry of Corporate Affairs seeks to insert paragraph 46 after paragraph 45 in the Accounting Standard (AS) 11 relating to the "*The Effects of Changes in Foreign Exchange Rates*". It requires that exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period (in respect of accounting periods commencing on or after 7th December 2006) or reported in previous financial statements, in so far as it relates to the acquisition of a depreciable capital asset can be added to or deducted from the cost of the asset. The notification also requires that depreciation on such capital asset be provided over the balance life of such an asset. The term "depreciable capital asset" has not been used in the accounting standards or the "Guidance Note on Terms used in Financial Statements". The nearest term available is "depreciable assets" in paragraph 3.2 of AS 6, reproduced below:

"*Depreciable assets* are assets which

(i) are expected to be used during more than one accounting period; and
(ii) have a limited useful life; and
(iii) are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business."

Further paragraph 3.1 of AS 6 states: "Depreciation includes amortisation of assets whose useful life is predetermined".

Accordingly, in the view of the ASB, the term "depreciable capital asset" would cover tangible fixed assets and intangible assets that are subject to depreciation, amortisation or impairment.

(2) ***Would the notification cover exchange differences including those arising in terms of paragraph 36 of the Standard which deals with the forward exchange contracts***?

Response

The notification would cover exchange differences including those arising in terms of paragraph 36 of AS 11 which deals with the forward exchange contracts provided such exchange differences relate to long term foreign currency monetary items as per the notification.

(3) ***Which other category of long term monetary assets would be covered apart from the depreciable capital asset? For example will this cover Fixed Deposits with a foreign bank held for more than 12 months as well as the amounts payable for a period exceeding 12 months?***

Response

The notification covers the exchange differences arising on reporting of long term foreign currency monetary items and would cover all the long term monetary assets in foreign currency which have a term of 12 months or more at the date of the origination of the asset or liability.

(4) ***Will the assets acquired in India by payment in foreign currency also be covered by the notification? If this presumption is correct will it contradict the requirements of Schedule VI to the Companies Act 1956?***

Response

The notification would apply to all the depreciable capital assets which are acquired using the long term foreign currency monetary items as no distinction is made with regard to the place of acquisition of assets. It may be added that Schedule VI has simultaneously been amended so as to delete the paragraph dealing with the increase or decrease in original cost of fixed asset acquired from a country outside India as a consequence of change in the exchange rate. This paragraph was a part of the Horizontal form of Balance Sheet under heading "Instructions in accordance with which assets should be made out".

(5) ***The exemption provided by the notification is in respect of those items which are covered in paragraph 15 which deals with monetary items that in substance form part of the net investment in a non-integral foreign operation of the***

enterprise. Whether the monetary items in case of integral foreign operation will be covered by the notification?

Response

The notification specifically exempts exchange differences dealt with in accordance with paragraph 15 of AS 11 which deals with monetary items that in substance form part of the net investment in a non-integral foreign operation of the enterprise. However, monetary items in the case of integral foreign operations will be covered by the notification provided it falls under the definition of "long term foreign currency monetary items".

(6) How the transitional account under head 'Foreign Currency Monetary Item Translation Difference Account' is to be amortised?

Response

Illustration

An example illustrating application of the amendments in AS 11 is given below:

A company borrowed US $ 100000 on 1st April 2005 which has been used for other than acquiring depreciable assets repayable in full, after a period of 6 years. Exchange rate on that date was $ 1 equal to Rs. 40. The company follows the financial year as its accounting year. The details of the exchange rates and the accounting treatment made by the company in subsequent years is as follows:

Year ending	Exchange rate $ 1 equal to Rs.	Accounting treatment
March 31, 2006	41	Loss of Rs. 1,00,000 recognised in profit and loss
March 31, 2007	39	Rs. 2,00,000 gain recognised in profit and loss
March 31, 2008	48	Rs. 9,00,000 loss recognised in profit and loss
March 31, 2009	50	—
March 31, 2010	51 (assumed)	----
March 31, 2011	52 (assumed)	----

The company has opted to follow the Companies (Accounting Standards), Amendment Rules, 2009.

Rupees in Lakhs

Year Ending	**Opening Balance**	**Exchange difference**	**Total**	**Amount to be recognised in P&L Account**	**Closing Balance**	**Remarks**
March 31,	NIL	(1.00)	(1.00)	1.00	NIL	No change

2006						
March 31, 2007	NIL	2.00	2.00	2.00	NIL	No change
March 31, 2008	NIL	9.00	9.00	2.25	6.75	*
March 31, 2009	6.75	2.00	8.75	2.92	5.83**	Total is amortised over a period of 3 years
March 31, 2010	5.83	1.00	6.83	3.41	3.42***	Total is amortised over a period of 2 years
March 31, 2011	3.42	1.00	4.42	4.42	NIL	Full amount is amortised

* On 1.4.2008, Rs. 6.75 Lakhs would be credited to general reserve and debited to Foreign Currency Monetary Items Translation Difference Account in the year ended 31.03.2009.

** (8.75 minus 2.25 + 1/3 of Rs.2.00 lakh)

*** (5.83 minus 2.92 + 1/2 of Rs.1.00 lakh)

(7) Will exercising the option under the Companies (Accounting Standards) Amendment Rules, 2009 be a change in the accounting policy?

Response

As the notification involves the adoption of an option available (a different accounting policy), it will be treated as change in accounting policy and it should be disclosed in accordance with Para 32 of AS 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.*

(8) Is the option once exercised irreversible? If an enterprise does not want to adopt the treatment as per the new paragraph, can it do so? Can it exercise the option?

Response

As per the notification, if the option is exercised, the fact of exercise of such option and of the amount remaining to be amortised in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortised should be disclosed. The option once exercised is irrevocable.

The company has a discretion not to adopt the treatment as per the notification and can follow the principles stated in AS 11. A decision with regard to the exercise of the option will have to be taken in first financial statements approved on or after the date the notification comes into force, i.e. March 31, 2009.

However, in case a company did not have any long term foreign currency monetary items, in such accounting period (being a period commencing on or after 7th December 2006) but such liability is incurred say in a subsequent accounting period, i.e., the accounting period ending on 31st March 2010, it may be possible for such a company to exercise the option in such subsequent year ending on 31st March 2010.

(9) What will be the status of the ICAI announcement regarding derivatives? Will derivatives also be valued on the basis of this notification or the announcement of ICAI would continue to be applicable?

Response

The notification applies to long-term foreign currency monetary items (including foreign currency derivatives) to which AS 11 applies. If the company has opted for early adoption of AS 30, *Financial Instruments: Recognition and Measurement*, it should continue to apply the treatment enunciated in AS 30. In other cases, ICAI announcement dated 29.03.08 regarding derivatives will apply.

(10) Will the recognition of income and expense in accordance with the notification be treated as an item of unusual nature referred to in paragraph 12 and 13 of AS 5?

Response

Paragraph 12 of AS 5 requires as under:

> ***"When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."***

Paragraph 13 of the said Standard also states that although the items of income and expense described in paragraph 12 are not extra ordinary items, the nature and amount of such items may be relevant to users of the financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Paragraph 13 also requires the disclosure of such information which is sometimes made in the notes to financial statements.

The compliance of these paragraphs will have to be made in case the circumstances described in the said two paragraphs are applicable to the exchange differences dealt with by the aforesaid notification. This is a matter of judgment by the management and the management needs to consider whether the said paragraphs apply in the circumstances of their case.

(11) Will assets acquired from foreign currency monetary item that are not depreciated but amortised be included?

Response

As per paragraph 3.1 of AS 6, depreciation includes amortisation of assets whose useful life is predetermined. Hence assets acquired from long term foreign currency monetary items that are not depreciated but amortised are covered by notification.

(12) In case the foreign currency monetary item is not fully utilised for acquisition of fixed assets, then will proportionate adjustment be permissible in the fixed asset cost and balance of exchange fluctuation will be adjusted to Foreign Currency Monetary Items Translation Difference Account?

Response

Proportionate adjustment based on actual application of funds should be done to the fixed asset cost and 'Foreign Currency Monetary Item Translation Difference Account'.

(13) If the long term foreign currency monetary item is received in instalments whether the installment received within a period of 12 months should be treated as short term in nature?

Response

Yes, each loan installment should be treated as a separate monetary item. The principle should be to amortise the exchange difference proportionately over the period of the monetary item and not to carry forward any unamortised amount beyond the settlement of the monetary item to which the exchange difference relates. Treating the entire loan as a single monetary item would result in the exchange difference relating to the loan instalment which is settled being amortised in accounting periods even after such settlement.

(14) How 'Foreign Currency Monetary Item Translation Difference Account' should be presented in the Balance Sheet?

Response

The 'Foreign Currency Monetary Item Translation Difference Account' should be shown as a separate line item in the Balance Sheet, in line with treatment given to Deferred Tax Asset/Liability, i.e. after the head 'Investments' or after the head

‘Unsecured Loans’ as the case may be and separately from current assets and current liabilities.

(15) ***Does this notification apply to exchange difference arising on forward exchange contracts entered into to hedge the foreign currency risks of future transactions in respect of which firm commitments are made or which are highly probable forecast transactions or only to forward contracts foreign currency items included in Para 36 of AS 11?***

Response

The notification does not cover the contracts entered into to hedge the foreign currency risks of future transactions in respect of which firm commitments are made or which are highly probable forecast transactions. AS 30 or the announcement issued by ICAI dated 29.3.08 will apply in such cases.

The amendment is applicable only to foreign currency items referred to in paragraph 36 of AS 11.

(16) ***Whether the notification applies to non-corporate entities which are not covered by Companies Act?***

Response

The notification applies to Companies registered under the Companies Act, 1956. In respect of all other entities, AS 11 as issued by ICAI is required to be followed.

(17) ***Does the notification also apply to those exchange differences which are regarded as an adjustment to interest costs in terms of paragraph 4(e) of Accounting Standard (AS) 16, Borrowing Costs?***

Response

No. Paragraph 6 of AS 11 excludes from the scope of the Standard exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs under paragraph 4(e) of AS 16. Paragraph 6 of AS 11 and paragraph 4(e) of AS 16 have not been amended by the notification. Thus, the exchange differences referred to above still remain outside the scope of AS 11 and within the scope of AS 16. Accordingly, these exchange differences should continue to be accounted for in accordance with AS 16.

(18) ***Should we capitalise exchange differences arising on settlement of long term foreign currency monetary items?***

Response

As per paragraph 7.3 of AS 11, exchange differences include differences arising out of settlement also. Hence, such differences also should be capitalised.

(19) The notification refers to the acquisition of depreciable capital assets. Will it include the self constructed assets and acquired by other means?

Response

The term acquisition is wide enough to include self constructed assets and assets acquired by other means in case a long term foreign currency monetary item is incurred in relation to such acquisition.

(20) Suppose a company has got two separate long term foreign currency monetary items; one for use in connection with acquisition of a depreciable asset and second for use in working capital. Should the treatment suggested in the notification be followed only for acquisition of depreciable assets?

Response

The company should capitalise the exchange difference relating to a depreciable capital asset on the basis of the notification. The difference relating to the long term monetary liability in respect of working capital should be adjusted through 'Foreign Currency Monetary Items Translation Difference Account'. The accounting treatment in the notification, if opted for, would need to be applied to all long-term foreign currency monetary items.

(21) If capitalisation of exchange differences results in carrying value greater than recoverable amount. Is it permissible?

Response

The provisions of AS 28, *Impairment of assets,* will apply in such cases.

(22) If the company exercises the option, what are the implications on current tax and deferred tax?

Response

Where the option is not exercised by the company, the foreign exchange losses and gains would continue to be treated as per the present practice for determining the current tax liability. However, the accounting treatment as per the option in the notification may give rise to timing differences under AS 22, *Accounting for Taxes on Income*.

Adjustment to the general reserves should be made on a net of tax basis. This is supported by the approach taken by the ICAI in other cases. Thus, the deferred tax asset/liability arising in the event of the option being exercised is to be recognised against the corresponding net adjustment to the general reserves.

(23) What are the disclosures to be furnished in the financial statements if the option is exercised?

Response

The exercise of the option will be a change in accounting policy. This would require a disclosure as per the requirements of Paragraph 32 of AS 5 apart from the following additional disclosures.

Additional disclosures are:

a) That the company has chosen to avail the option.

b) Amount of amortisation charged to the Profit and Loss Account

c) Amount remaining to be amortised in financial statements of the period in which such option is exercised and in every subsequent period so long as the exchange differences remain unamortised.

d) Comparative figures should be furnished based on last audited figures.

e) The effect of adjustment (relating to amounts previously recognised) made through general reserve or if no balance is available through the balance in opening surplus/deficit in Profit and Loss Account.