

SREERAM COACHING POINT

ACCOUNTING STANDARD - 11

**The Effect of Changes in
Foreign Exchange Rates**

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Applicability of AS -11

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graph TD; A[Applicability of AS -11] --> B[Accounting for Transaction in Foreign Currency  
[Including Forward Exchange Contract]]; A --> C[Translating the Financial Statements of Foreign Operations];
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**Accounting for Transaction
in Foreign Currency**

**[Including Forward
Exchange Contract]**

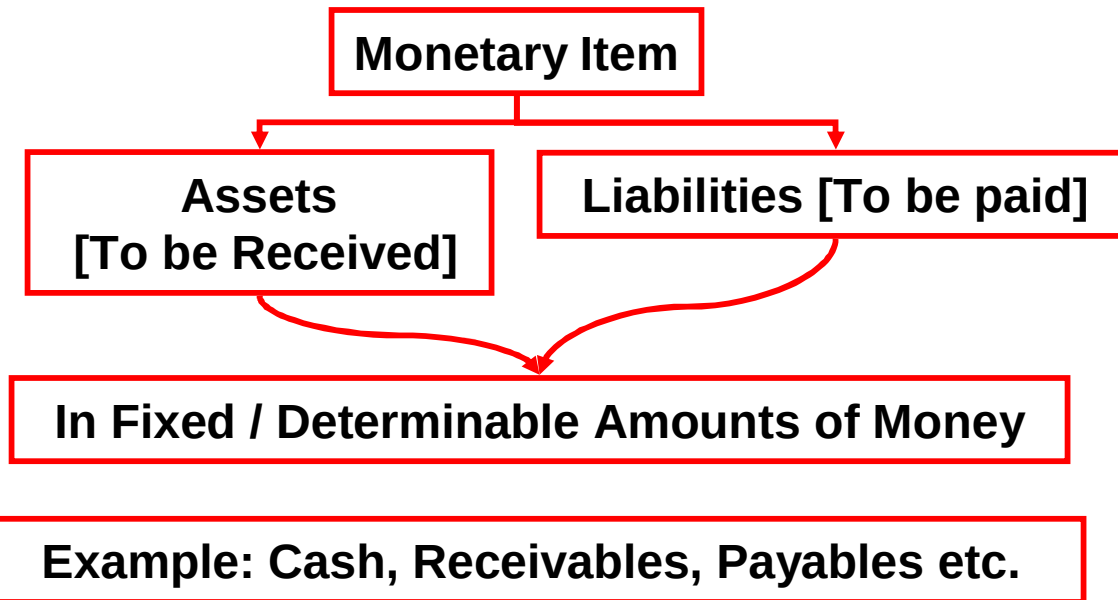
**Translating the
Financial Statements of
Foreign Operations**

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**Reporting Currency is the Currency used in
presenting the Financial Statement**

**Foreign Currency is the Currency other than
Reporting Currency**

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Non-Monetary Item is “Other than Monetary item”

Example: Land, Building, Stock, Investment in equity etc.

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Foreign Currency Transaction

1. A transaction which is denominated or requires settlement in a Foreign Currency

2. It includes

a. Buy/Sell goods or services

b. Borrow/Lend Funds

c. Party to an unperformed forward exchange contract

d. Acquires/Disposes assets/liabilities

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Initial Recognition of Foreign Currency Transaction

$$\begin{array}{c} \text{Foreign Currency Amount} \\ \times \\ \text{Exchange Rate at the Date of transaction} \end{array}$$

Note: Exchange Rate would mean exchange rate between reporting currency and foreign currency

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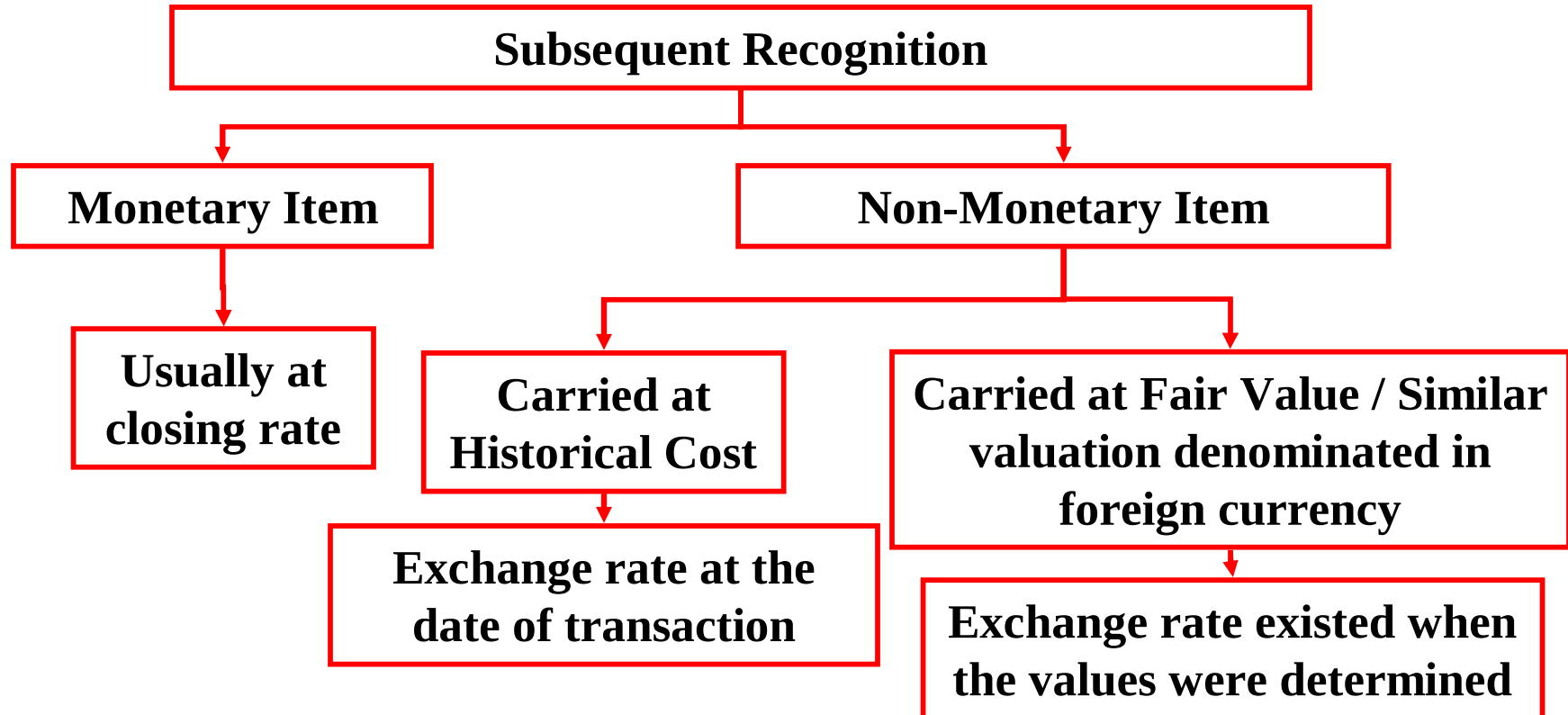
Note:

1. For practical purpose, any rate that approximates actual can be used

Example: An average rate for a week/month

Use of average rate will not reliable if the exchange rates fluctuates

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Note:

1. Contingent Liability will be disclosed using closing rate

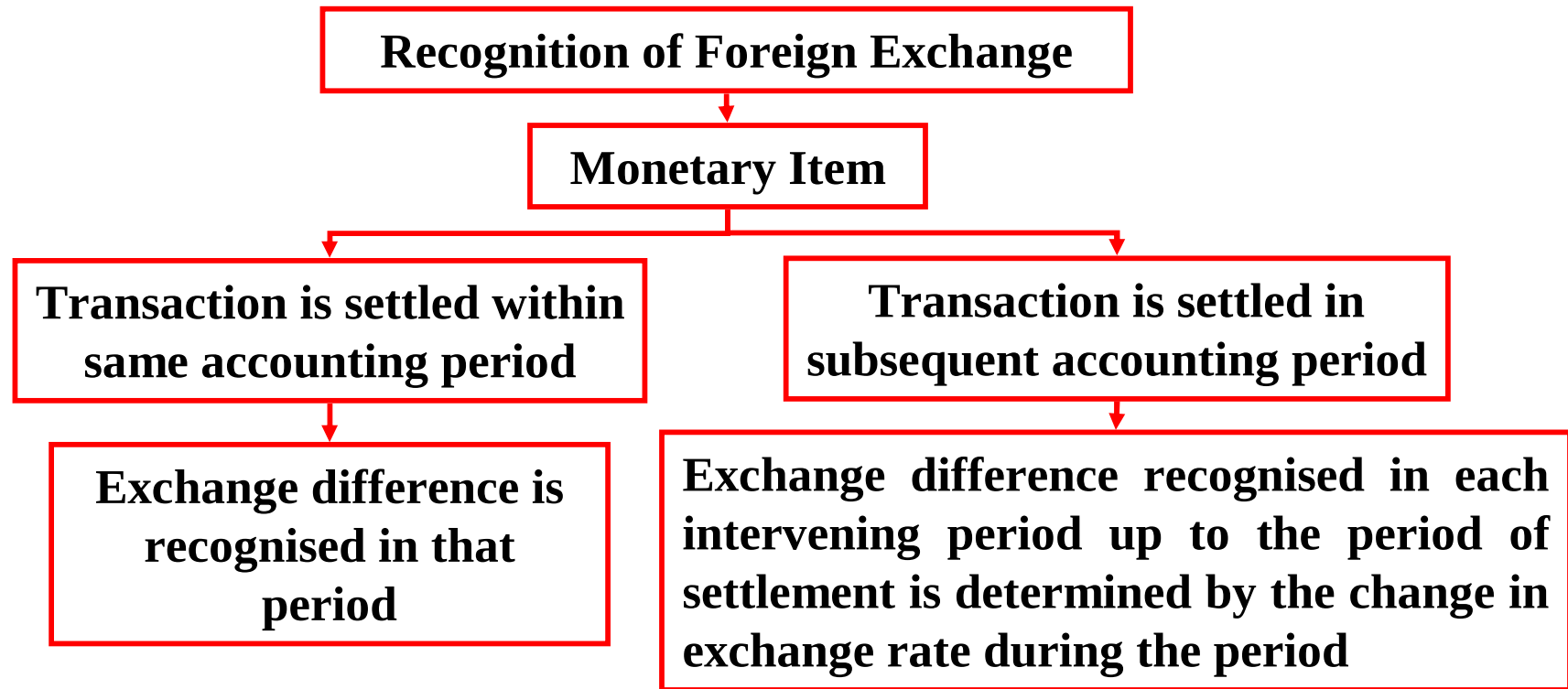
2. Monetary item are to be reported using closing rate. However in certain circumstances it may not be appropriate to report the monetary item at closing rate

Example:

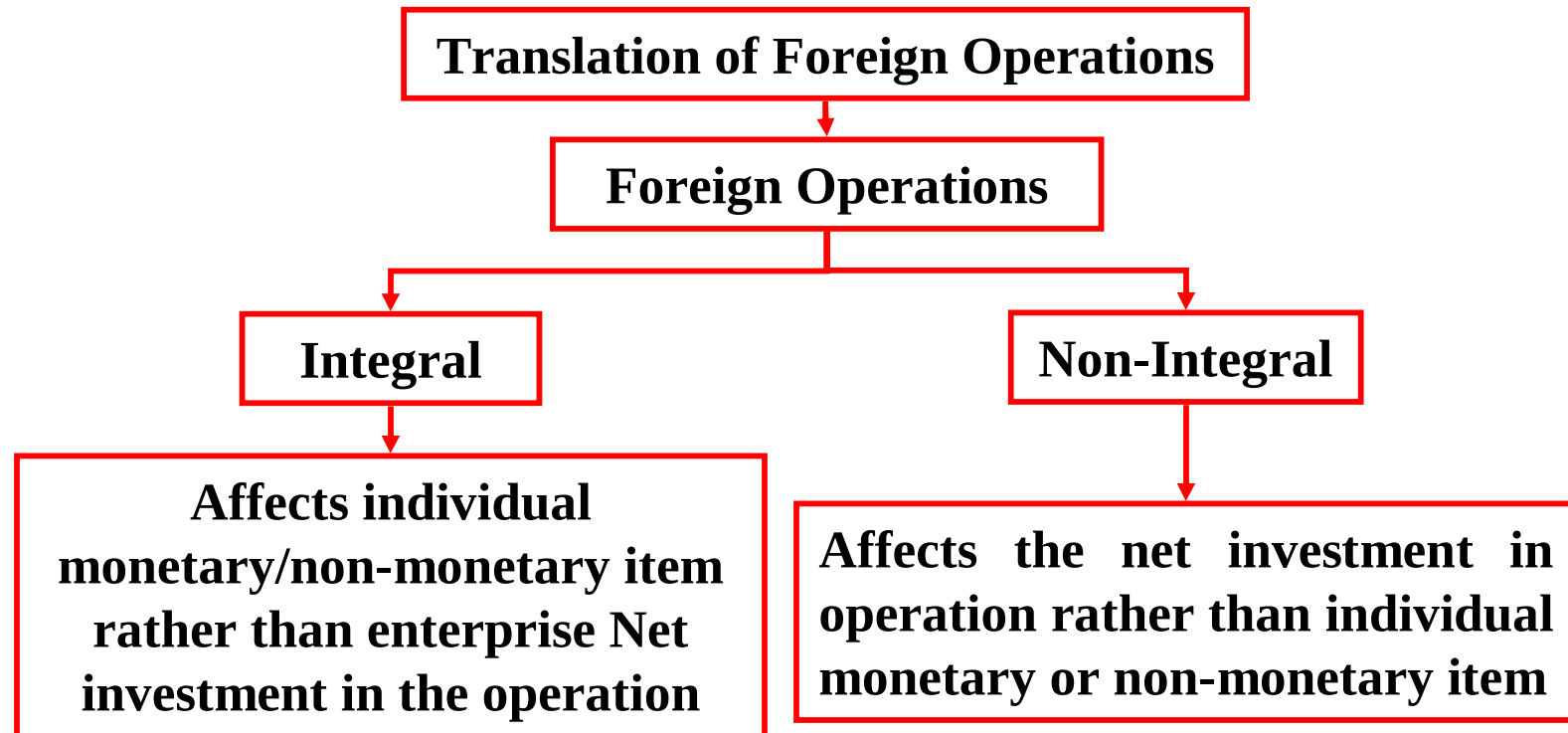
- a. Restriction on remittances or**
- b. Closing rate is unrealistic and not possible to effect a transaction at that rate etc.**

In above cases, Monetary item should be reported at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date

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18. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. For example, such a foreign operation might only sell goods imported from the reporting enterprise and remit the proceeds to the reporting enterprise. In such cases, a change in the exchange rate between the reporting currency and the currency in the country of foreign operation has an almost immediate effect on the reporting enterprise's cash flow from operations. Therefore, the change in the exchange rate affects the individual monetary items held by the foreign operation rather than the reporting enterprise's net investment in that operation.

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19. In contrast, 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. It may also enter into transactions in foreign currencies, including transactions in the reporting currency. When there is a change in the exchange rate between the reporting currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise. The change in the exchange rate affects the reporting enterprise's net investment in the non-integral foreign operation rather than the individual monetary and non-monetary items held by the non-integral foreign operation.

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20. The following are indications that a foreign operation is a non-integral foreign operation rather than an integral foreign operation:

- (a) while the reporting enterprise may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from those of the reporting enterprise;
- (b) transactions with the reporting enterprise are not a high proportion of the foreign operation's activities;
- (c) the activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise;
- (d) costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency;

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- (e) the foreign operation's sales are mainly in currencies other than the reporting currency;
- (f) cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation rather than being directly affected by the activities of the foreign operation;
- (g) sales prices for the foreign operation's products are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation; and
- (h) there is an active local sales market for the foreign operation's products, although there also might be significant amounts of exports.

The appropriate classification for each operation can, in principle, be established from factual information related to the indicators listed above. In some cases, the classification of a foreign operation as either a non-integral foreign operation or an integral foreign operation of the reporting enterprise may not be clear, and judgement is necessary to determine the appropriate classification.

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Practical Example

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Action to be taken by banks

3.2. Paragraphs 18 and 19 of the Standard explain "integral foreign operation" and "non-integral foreign operation". Paragraph 20 of the Standard provides indications as to when a foreign operation is a non-integral foreign operation rather than an integral foreign operation. Taking into consideration the operation of the foreign branches of Indian banks and the indicators listed in paragraph 20, foreign branches of Indian banks would be classified as "non-integral foreign operations". Similarly, Offshore Banking Units (OBUs) set up in India by banks would also be classified as "non-integral foreign operations". Taking into consideration the operation of the representative offices of banks set up abroad and the explanation in paragraph 18 of the Standard, Representative Offices would be classified as "integral foreign operations". These classifications are for the limited purpose of compliance with the Standard.

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The Representative Office may facilitate contacts between the bank and customers by:

- a. gathering financial and commercial information**
- b. soliciting banking business among non-residents**
- c. following up transactions initiated and discharged outside**

Note:

A Representative Office may not engage in any form of banking business or other direct financial transactions

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UNION BANK OPENS REPRESENTATIVE OFFICE IN SHANGHAI

Union Bank of India took a major step towards establishing a presence abroad on 18th May 2007. The Bank's first representative office was inaugurated at Shanghai, Peoples' Republic of China. The office was inaugurated by Mr. Vishnu Prakash, Consul General of India at Shanghai in the presence of Mr. M.V. Nair, Chairman and Managing Director, Union Bank of India and other dignitaries and representatives of industry and the business community at Shanghai.

The Representative Office will primarily carry out a liaison function that will facilitate trade and business opportunities between India and PRC. It will be a point to provide consultation and offer market information services to Chinese industrialists and entrepreneurs aiming to establish their businesses in India and vice versa. The office which will be headed by an Executive of Union Bank, Mr. R.S. Pandey, will also work towards developing correspondent relationships with Banks in China. It will also offer information support to Chinese business entrepreneurs to set up business relationships with Indian counterparts.

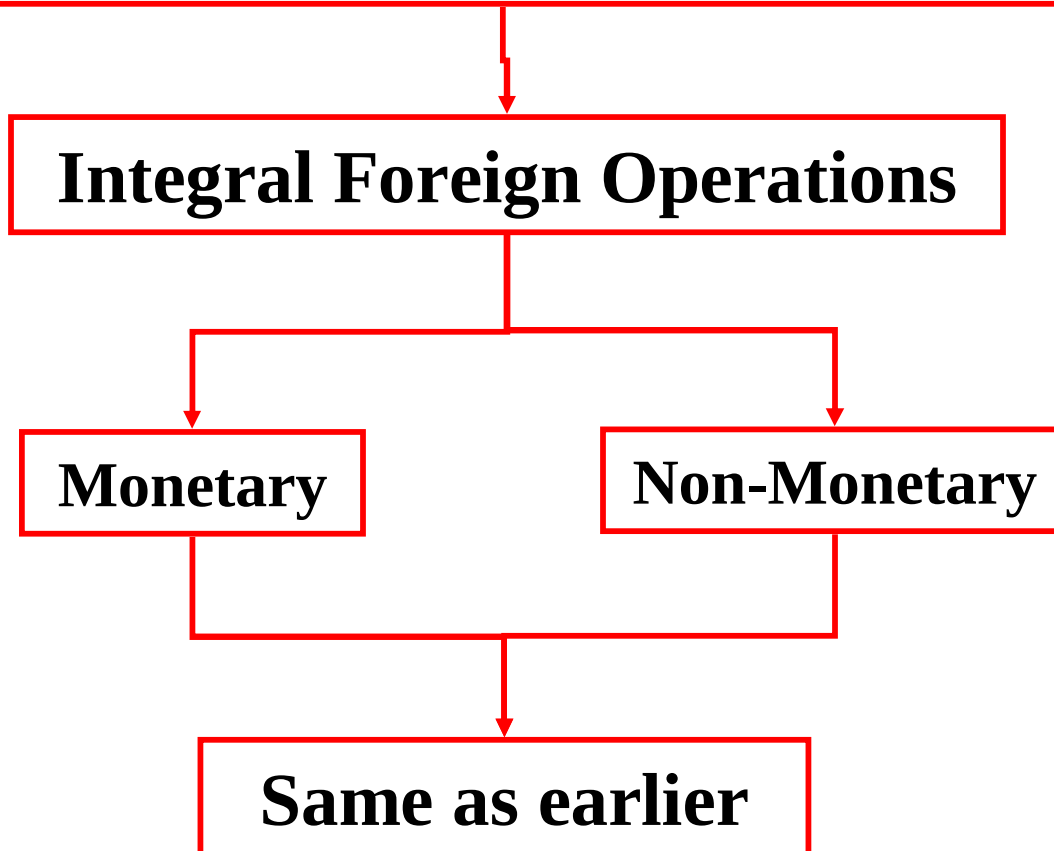
The Bank has also received approval from Reserve Bank of India for opening branches at Hong Kong and Doha and representative offices at Beijing and Guangdong in PRC and in the UAE.

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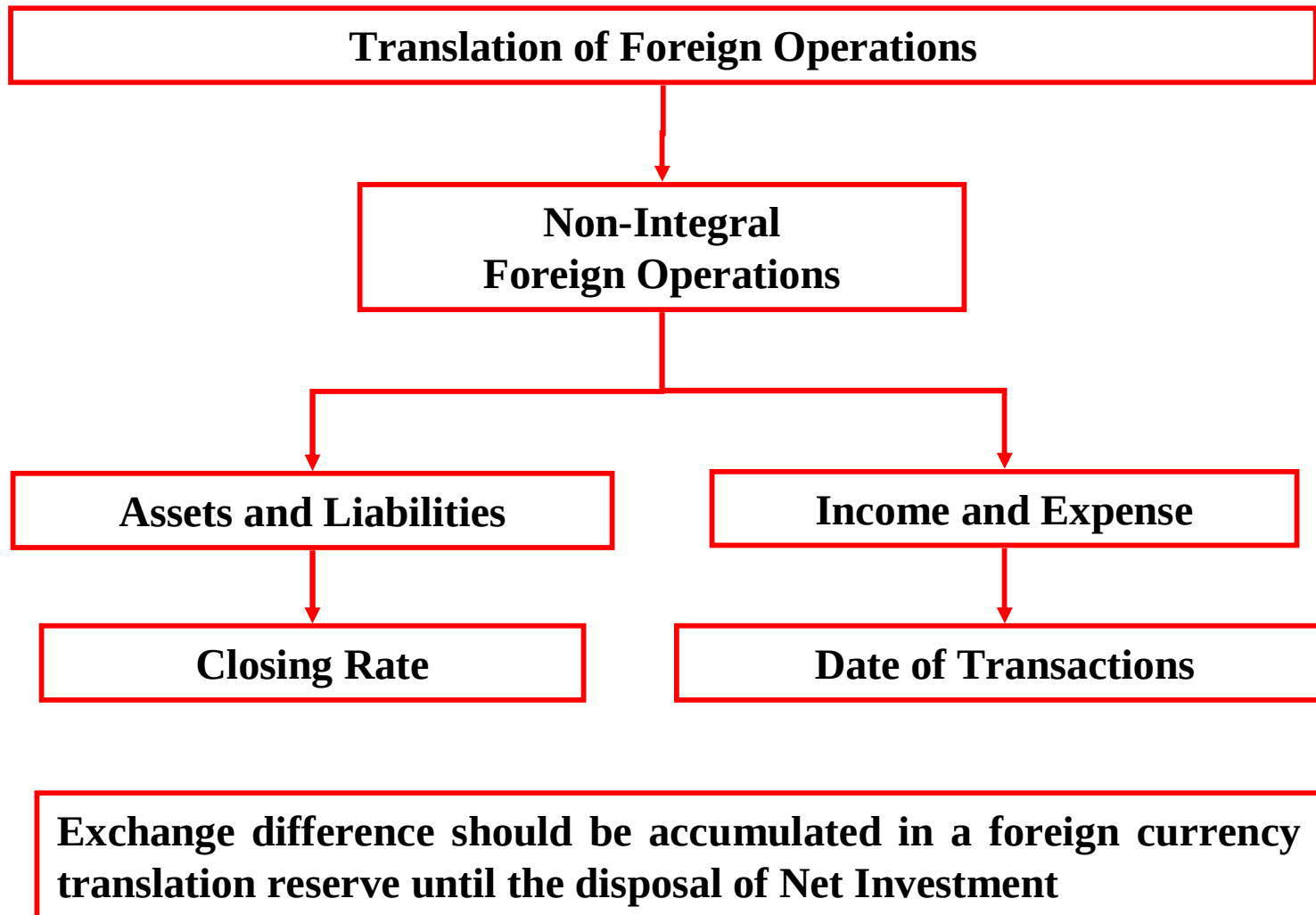
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Translation of Foreign Operations



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Note:

For practical purpose, for income and expense average rate may be used provided it approximates the actual exchange

1. Goodwill or capital reserve arising on acquisition of a NIFO is translated at closing rate

2. Contingent liability will be translated using closing rate

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Disposal of NIFO

Transfer the cumulative amount of exchange difference [deferred earlier] to Income/Expense in same period in which gain/loss on disposal is recognised

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Changes in Classification of Foreign Operation

When there is a change in classification

Translation procedures applicable to revised classification shall be applied

From the date of change in classification

To be precise, prospective effect

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Change in classification of a Foreign Operation

Integral to Non-Integral

Exchange differences arising on the translation of non-monetary assets at the date of reclassification are accumulated in a foreign currency translation reserve

Non-Integral to Integral

Translated amounts for non-monetary items at the date of change are treated as the historical cost for those items in the period of change and subsequent periods.

Exchange differences which have been deferred, are not recognised as income or expenses until the disposal of the operation

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Forward Contract

Two parties enter into agreement to purchase or sell an asset at a fixed price

In case of Forward Exchange Contract, the asset is nothing but 'Foreign Currency'

The premium or discount arising at the inception of such a forward exchange contract should be amortized as expense or income over the life of the contract

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Exchange differences on such a contract should be recognized in the statement of profit and loss in the reporting period in which the exchange rates change.

Note:

Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period

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38. A gain or loss on a forward exchange contract to which paragraph 36 does not apply should be computed by multiplying the foreign currency amount of the forward exchange contract by the difference between the forward rate available at the reporting date for the remaining maturity of the contract and the contracted forward rate (or the forward rate last used to measure a gain or loss on that contract for an earlier period). The gain or loss so computed should be recognised in the statement of profit and loss for the period. The premium or discount on the forward exchange contract is not recognised separately.

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Forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised