

Limited Revision to Accounting Standard (AS) 11 (revised 2003)

The Effects of Changes in Foreign Exchange Rates

The following is the text of the limited revision to AS 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates, issued by the Institute of Chartered Accountants of India.

In view of Accounting Standard (AS) 30, *Financial Instruments: Recognition and Measurement*, AS 11 (revised 2003) is modified as under (modifications are shown as double-underline/strike-through):

1. Scope Paragraphs of the Standard are amended as follows:

Scope

1. This Statement should be applied:

- (a) *in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of AS 30, *Financial Instruments: Recognition and Measurement*; and***
- (b) *in translating the financial statements of foreign operations.***

2. This Statement also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.¹

¹ It may be noted that on the basis of a decision of the Council at its meeting held on June 24-26, 2004, an Announcement titled 'Applicability of Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates, in respect of exchange differences arising on a forward exchange contract entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction' has been issued. The Announcement clarifies that AS 11 (revised 2003) does not deal with the accounting of exchange difference arising on a forward exchange contract entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction. It has also been separately clarified that AS 11 (revised 2003) continues to be applicable to exchange differences on all other forward exchange contracts. [For full text of the Announcement 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.]

2. AS 30 applies to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Statement. However, those foreign currency derivatives that are not within the scope of AS 30 (e.g., some foreign currency derivatives that are embedded in other contracts) are within the scope of this Statement.

2A. This Statement does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. AS 30 applies to hedge accounting.

3. This Statement does not specify the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, this Statement requires disclosure of the reason for using that currency. This Statement also requires disclosure of the reason for any change in the reporting currency.

4. This Statement does not deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

5. This Statement does not deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation (see AS 3, *Cash Flow Statements*).

6. This Statement does not deal with exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs (see paragraph 4(e) of AS 16, *Borrowing Costs*).

2. From the definition paragraph, the definitions of the terms 'Forward exchange contract' and 'Forward rate' are deleted.

3. Paragraph 8 is amended as follows:

8. A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:

- (a) buys or sells goods or services whose price is denominated in a foreign currency;
- (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
- (c) becomes a party to an unperformed forward exchange contract; or
- (dc) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

4. A new paragraph no. 12A is added under the existing heading ‘Recognition of Exchange Differences’. This is the first paragraph under this heading and appears as follows:

12A. As noted in paragraph 2A, AS 30 applies to hedge accounting for foreign currency items. The application of hedge accounting requires an enterprise to account for some exchange differences differently from the treatment of exchange differences required by this Statement. For example, AS 30 requires that exchange differences on monetary items that qualify as hedging instruments in a cash flow hedge are reported initially in an appropriate equity account, e.g., Hedging Reserve Account, to the extent that the hedge is effective.

5. The heading ‘Forward Exchange Contracts’ and paragraphs 36 to 39, given under the heading, are deleted.

6. Paragraph 40, given under the heading ‘Disclosures’, is amended as follows:

40. An enterprise should disclose:

- (a) *the amount of exchange differences included in the net profit or loss for the period except for those arising on financial instruments measured at fair value through profit or loss in accordance with AS 30; and***
- (b) *net exchange differences accumulated in foreign currency translation reserve as a separate component of shareholders’ funds, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.***

7. The name of AS 21, appearing in paragraphs 29 and 30 of the Standard, is changed to reflect the new name of AS 21, viz., the following:

AS 21, Consolidated Financial Statements and Accounting for Investments in Subsidiaries in Separate Financial Statements

8. The name of AS 23, appearing in paragraph 30 of the Standard, is changed to reflect the new name of AS 23, viz., the following:

AS 23, Accounting for Investments in Associates

9. Alongwith the proposed Limited Revision to AS 11 (revised 2003), Comparison with IAS 21, *The Effects of Changes in Foreign Exchange Rates* (revised 1993), contained in

Appendix to AS 11 (revised 2003) is replaced by the following Comparison with IAS 21, *The Effects of Changes in Foreign Exchange Rates* (revised 2003):

Appendix

Note: This Appendix is not a part of the Accounting Standard. The purpose of this appendix is only to bring out the major differences between Accounting Standard 11 (revised 2003) and corresponding International Accounting Standard (IAS) 21 (revised 2003).

Comparison with IAS 21, *The Effects of Changes in Foreign Exchange Rates* (revised 2003)

AS 11 (revised 2003) is based on the integral and non-integral foreign operations approach, i.e., the approach which was followed in the earlier IAS 21 (revised 1993). The International Accounting Standards Board (IASB) has, in 2003, revised IAS 21 to adopt the functional currency approach. It has been observed that in all except one of the situations there is effectively no difference between the financial statements prepared under IAS 21 and AS 11. The only difference is that IAS 21 also lays down the method where the reporting enterprise's functional currency, i.e., the currency of the primary economic environment in which the enterprise operates, is different as compared to its presentation currency, i.e., the currency in which financial statements are presented, whereas AS 11 only requires certain disclosures in such a case. However, it may be mentioned that in the context of most of the Indian enterprises, the functional currency and the presentation currency will be the same, i.e., the rupees, except there may be some Indian enterprises which are an integral foreign operation of a foreign enterprise. Therefore, only in very limited cases the application of the principles of IAS 21 will make a difference as compared to AS 11.

AS 11 (revised 2003) has recently become effective, i.e., from 1-4-2004. The Indian corporates have recently started applying this Standard. It is, therefore, felt that it is not appropriate to totally revise AS 11 (revised 2003) at this stage to adopt the IAS 21 which became effective from 1-1-2005.

The limited revision comes into effect in respect of accounting periods commencing on or after the date on which Accounting Standard (AS) 30, *Financial Instruments: Recognition and Measurement*, comes into effect.