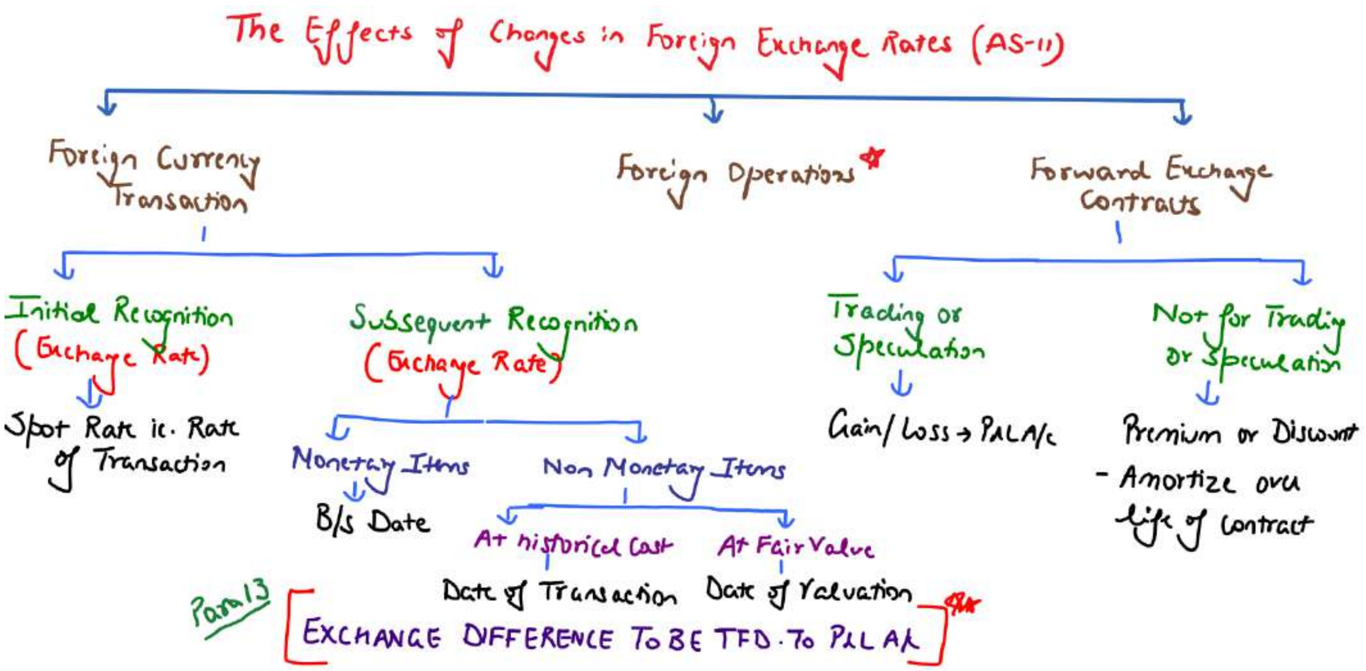
AS-11: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

<table>
<tr><td>Scope</td><td colspan="2">AS-11 should be applied in
❖ Accounting for transactions in foreign currencies
❖ Translating the financial statements of foreign operations.
❖ Accounting for foreign currency transaction in the nature of forward exchange contract</td></tr>
<tr><td colspan="3">FOREIGN CURRENCY TRANSACTIONS</td></tr>
<tr><td>Meaning</td><td colspan="2">It is a transaction which is denominated or requires settlement in a foreign currency</td></tr>
<tr><td>Examples</td><td colspan="2">➢ Buying and selling of goods or services in foreign currency
➢ Lending or borrowing in foreign currency
➢ Acquisition and disposition of asset denominated in foreign currency</td></tr>
<tr><td>Initial recognition</td><td colspan="2">→ All transactions should be recorded at <u>spot rate</u> i.e. rate of foreign exchange at the date of transaction.
→ If spot rate is not given then average rate of a week or month can be used.</td></tr>
<tr><td rowspan="2">Subsequent recognition /reporting at subsequent balance sheet dates:</td><td>Monetary Item</td><td>These are the items which are receivable or payable in fixed or determinable amounts of money.
<u>Example</u>: Cash, debtors, creditors, etc
<u>Use exchange rate at the balance sheet date</u></td></tr>
<tr><td>Non-monetary item</td><td>These all assets and liabilities other than monetary items.
<u>Example</u>: Fixed assets, inventories and investments in equity shares.
a) <u>Items which are carried in terms of Historical Cost</u>: Use exchange rate at the date of transaction.
b) <u>Items which are carried at Fair Value</u>: Use exchange rate that existed when fair value determined.</td></tr>
<tr><td rowspan="2">Recognition of exchange differences</td><td>Monetary Item (Para 13)</td><td>To be recognized as expenses or income i.e. to be debited or credited to P & L a/c</td></tr>
<tr><td>Non-monetary item</td><td>No subsequent recognition is required, there does not arise any exchange difference</td></tr>
<tr><td colspan="3">SPECIAL CASE (MONETARY ITEMS) PARA 46 AND 46A (FOR COMPANY ONLY)</td></tr>
<tr><td>Applicability</td><td colspan="2">Exchange differences arising or reporting of long-term foreign currency monetary items. (LTFCMI)</td></tr>
<tr><td>Meaning of LTFCMI</td><td colspan="2">An asset or liability should be designated as long term foreign currency monetary item if –
➢ Asset or liability is expressed in a foreign currency and
➢ Has a <u>term of 12 months or more</u> at the date of origination of the asset or liability.</td></tr>
</table>

Exchange difference on LTFCMI	**Related to depreciable fixed assets**	Add to/deduct from cost of asset and depreciate over the balance life of the asset
	Others	Accumulate in FCMITDA and amortize over the balance period of such long term item FCMITDA: Foreign Currency Monetary Item Translation Difference Account
FORWARD EXCHANGE CONTRACTS		
Meaning	It means an agreement to exchange different currencies at a forward rate. Forward rate is the specified exchange rate for exchange of two currencies at a specified future date.	
Categories	**For Trading or speculation purposes**	Gain or loss recognized in the Statement of P&L for the period.
	Not for Trading or speculation purposes	Premium or discount – amortize as expense or income over the life of contract.



PARA 46 & 46A : SPECIAL CASE

↓

Company Only → Optional

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Long Term Foreign Currency Monetary Item [LTFCMI]

(≥ 12 Months)

↓

Exchange Difference

Related to Depreciable Fixed Assets	Others
↓	↓
Adjust Cost of Asset (+, -)	Accumulate in FCMITDA & amortise over period

Foreign Operations

	Integral Foreign Operation	Non Integral Foreign Operation
1) Expense / Income	Actual Rate (If not, then Avg. Rate)	Actual Rate (If not, then Avg. Rate)
2) Opening Stock	Opening Rate	Opening Rate
3) Closing Stock	Actual Rate (If not, then closing Rate)	Closing Rate
4) Fixed Assets	Actual Rate	Closing Rate
5) Monetary Items (Debtors, B/R, Creditors, etc.)	Closing Rate	Closing Rate
6) Goods Sent to HO / HO Balance	Actual	Actual
7) Exchange Difference	P&L A/c	Foreign Currency Translation Reserve

Question 1

Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2019, when the exchange rate was Rs. 64 per US Dollar. The transaction was recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2019, when the exchange rate was Rs. 68 per US Dollar. At the year end 31st March, 2019, the rate of exchange was Rs. 69 per US Dollar.

The Chief Accountant of the company passed an entry on 31st March, 2019 adjusting the cost of raw material consumed for the difference between Rs. 68 and Rs. 64 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).

Solution

As per AS 11, initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 25th February 2019, the raw material purchased and its creditors will be recorded at US dollar 9,000 × Rs. 64 = Rs. 5,76,000.

Also, as per standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. Rs. 69 per US dollar (USD 9,000 x Rs. 69 = Rs. 6,21,000) at 31st March, 2019, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of Rs. 5 (69 – 64) per US dollar i.e. Rs. 45,000 (USD 9,000 x Rs. 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2019 and will not be adjusted against the cost of raw materials.

In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of Rs. 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between Rs. 69 and Rs. 68 per US dollar i.e. Rs. 9,000.

Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11

25/2 Purchase A/c - Dr 576000
To Creditors A/c 576000
(9000 X 64)

31/3 Exchange Diff. A/c - Dr 45000
To Creditors A/c 45000
(9000 x 5)

31/3 P&L A/c - Dr 45000
To Exchange Diff. A/c 45000

10/4 Creditors A/c - Dr 621000
(9000 X 68) To Bank A/c 612000
(9000 X 1) To Exchange Diff A/c 9000

Exchange Diff. A/c - Dr 9000
To P&L A/c 9000

Question 2

ABC Ltd. borrowed US $ 5,00,000 on 01/01/2019, which was repaid as on 31/07/2019. ABC Ltd. prepares financial statement ending on 31/03/2019. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2019	1 US$ =	68.50
31/03/2019	1 US$ =	69.50
31/07/2019	1 US$ =	70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

Solution

Date	Particulars	Dr.	Cr.
Jan. 01, 2019	Bank A/c (5,00,000*68.50) Dr.	3,42,50,000	
	To Foreign Loan A/c		3,42,50,000
Mar. 31, 2019	Foreign Exchange Difference A/c Dr.	5,00,000	
	To Foreign Loan A/c		5,00,000
	[5,00,000*(69.50-68.50)]		

Mar. 31, 2019	Profit & Loss A/c Dr.	5,00,000	
	To Foreign Exchange Difference A/c		5,00,000
Jul. 31, 2019	Foreign Loan A/c Dr.	3,47,50,000	
	Foreign Exchange Difference A/c Dr.	2,50,000	
	To Bank A/c		3,50,00,000
	Profit & Loss A/c Dr.	2,50,000	
	To Foreign Exchange Difference A/c		2,50,000

Question 3

(i) ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to Rs. 30,00,000. It was recorded at US $1 = Rs. 60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2020) was US $1 = Rs. 62.00.

(ii) Trade receivable includes amount receivable from Preksha Ltd., Rs. 10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = Rs. 59.00. The exchange rate on balance sheet date (31.03.2020) was US $1 = Rs. 62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd.

Solution

Amount of Exchange difference and its Accounting Treatment

	Long term Loan	**Foreign Currency Rate**	**Rs.**
(i)	Initial recognition US $ 50,000 Rs. (30,00,000/60)	1 US $ = Rs. 60	30,00,000
	Rate on Balance sheet date	1 US $ = Rs. 62	
	Exchange Difference Loss US $ 50,000 x Rs. (62 – 60)		1,00,000
	Treatment: Credit Loan A/c and Debit FCMITD A/c or Profit and Loss A/c by Rs. 1,00,000		
	Trade receivables		
(ii)	Initial recognition US $ 16,949.152* (Rs.10,00,000/59)	1 US $ = Rs. 59	10,00,000
	Rate on Balance sheet date	1 US $ = Rs. 62	
	Exchange Difference Gain US $ 16,949.152* x Rs. (62-59)		50,847.456*
	Treatment: Credit Profit and Loss A/c by Rs. 50,847.456*		
	and Debit Trade Receivables		

Thus, Exchange Difference on Long term loan amounting Rs. 1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on trade receivables amounting Rs. 50,847.456 is required to be transferred to Profit and Loss A/c.

Question 4

Legal Ltd. is engaged in the manufacturing of rubber. For its plant, it required machineries of latest technology. It usually resorts to Long Term Foreign Currency Borrowings for its fund requirements. On 1st April, 2019, it borrowed US $1 million from International Funding Agency, USA when exchange rate was 1 $ = Rs. 63. The funds were used for acquiring machineries, on the same date, to be used in three different plants. The useful life of the machineries is 10 years and their residual value is Rs. 30,00,000.

Earlier also the company used to purchase machineries out of foreign borrowings. The exchange differences arising on such borrowings were charged to profit and loss account and were not capitalized even though the company had an option to capitalize it as per notified AS 11.

Now for this new purchase of machinery, Legal Ltd, is interested to avail the option of capitalizing the same to the cost of asset. Exchange rate on 31st March, 2018 is 1 US $ = Rs. 62. Assume that on 31st March, 2020, Legal Ltd. is not having any old long term foreign currency borrowings except for the amount borrowed for machinery purchased on 1st April, 2019.

Comment whether Legal Ltd. can capitalize the exchange difference to the cost of asset on 31st March, 2020. If yes, then calculate the depreciation amount on machineries as on 31st March, 2020.

Solution

As per AS 11, 'The Effects of Changes in Foreign Exchange Rates', the 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, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset.

Accordingly, though Legal Ltd. had not earlier exercised the option, yet it can avail the option to capitalize the exchange difference to the cost of machinery by virtue of para 46A of AS 11. Further, since Legal Ltd. has no earlier long term foreign currency borrowings, it is not required to apply capitalization option to earlier borrowing also.

Exchange difference to be capitalized and depreciation amount

Cost of the asset in $	1 million
Exchange rate on 1st April, 2019	1$ = Rs. 63
Cost of the asset in Rs. (1 million x Rs. 63)	63 million
Less: Exchange differences as on 31st March, 2020 (63-62) x $ 1 million (Gain)	(1 million)
	62 million
Less: Depreciation for 2019-20 (62 million - 3 million) /10 years	(5.90 million)
	56.10 million

Question 5

Rahul Ltd. purchased a plant for US$ 2,00,000 on 1st January 2019, payable after 5 months. Company entered into a forward contract for five months @ Rs. 64.75 per dollar. Exchange rate per dollar on 1st Jan. 2019 was Rs. 64.25. How will you recognize the profit or loss on forward contract in the books of Rahul Ltd.?

Solution

Calculation of profit or loss to be recognized in the books of Rahul Limited

	Rs.
Forward contract rate	64.75
Less: Spot rate	(64.25)
Loss/Premium on Contract	0.50
Forward Contract Amount	$2,00,000
Total loss on entering into forward contract = ($2,00,000 × Rs. 0.50)	Rs. 1,00,000
Contract period	5 months
Loss for the period 1st January, 2019 to 31st March, 2019 i.e. 3 months falling in the year 2018-2019 will be Rs. 1,00,000*3/5 =	Rs. 60,000

Balance loss of Rs. 40,000 (i.e. Rs. 1,00,000 – Rs. 60,000) for the month of April, 2019 & May 2019 will be recognized in the financial year 2019-2020.

Question 6

Mr. Y bought a forward contract for three months of US $ 2,00,000 on 1st December 2019 at 1 US $ = Rs. 44.10 when the exchange rate was 1 US $ = Rs. 43.90. On 31-12-2019, when he closed his books, exchange rate was 1 US $ = Rs. 44.20. On 31st January, 2020 he decided to sell the contract at Rs. 44.30 per Dollar. Show how the profits from the contract will be recognized in the books of Mr. Y.

Solution

As per AS 11, in recording a forward exchange contract intended for trading or speculation purpose, the premium or discount on the contract is ignored and at each balance sheet date, the value of contract is marked to its current market value and the gain or loss on the contract is recognised. Since the forward contract was for speculation purposes the premium on forward contract i.e. the difference between the spot rate and the forward contract rate will not be recorded in the books.

Only when the forward contract is sold the difference between the forward contract rate and sale rate will be recorded in the Profit & Loss Account.

	Rs.
Sale rate	44.30
Less: Contract rate	(44.10)
Profit on sale of contract per US$	00.20

Contract Amount US $ 2,00,000

Total profit (2,00,000 x 0.20) Rs. 40,000