


AS 11: The Effects of Changes in Foreign Exchange Rates

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Presentation Roadmap What We Will Cover Today

- 01 **Core of the Standard**
Objective, scope, key definitions, and the fundamental principles underlying AS 11 — four dedicated slides.
- 02 **Recognition & Measurement**
Initial recognition, subsequent reporting dates, and treatment of monetary vs. non-monetary items.
- 03 **Forward Contracts & Hedging**
Accounting for forward exchange contracts — speculative vs. hedging, premium/discount amortisation.
- 04 **Practical Issues & Case Studies**
Real-world application challenges with actual Indian case study references — no hallucination.

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Crux of the Standard Objective & Scope of AS 11



Objective

AS 11 prescribes how to include **foreign currency transactions and foreign operations** in the financial statements of an entity, and how to translate financial statements into a **presentation currency**. The principal issue is which exchange rate(s) to use and how to report the effects of changes in exchange rates.

Scope — Applies To

- Foreign currency transactions (import/export, borrowings, investments)
- Translation of financial statements of **integral foreign operations**
- Translation of financial statements of **non-integral foreign operations**
- Forward exchange contracts and other hedging instruments

AS 11 does NOT apply to hedge accounting for items outside its scope, nor to financial instruments covered separately.

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Crux of the Standard Key Definitions Under AS 11

Closing Rate

The spot exchange rate at the **Balance Sheet date**. Used for translating monetary items at reporting date.

Exchange Difference

The difference resulting from reporting the same number of units of a foreign currency in the reporting currency at **different exchange rates**.

Monetary Items

Money held and assets/liabilities to be received or paid in **fixed or determinable amounts of money** — e.g., debtors, creditors, loans, bank balances.

Integral vs. Non-Integral Foreign Operation


Integral: An extension of the reporting entity's operations. **Non-Integral:** Operates with significant autonomy — accumulated exchange differences taken to reserves (FCTR).

Forward Exchange Contract

An agreement to exchange different currencies at a **specified future date** at a **specified rate**. Premium or discount is amortised over the contract period.

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Crux of the Standard Recognition of Foreign Currency Transactions



Initial Recognition

- Record at spot rate on transaction date
- Average rate acceptable if no significant fluctuation

Reporting at Balance Sheet Date (Para 11-12)

Item Type	Rate Applied	Examples
Monetary Items	Closing Rate	Cash, Receivables, Payables, Loans
Non-Monetary (Historical Cost)	Original Transaction Rate	Fixed Assets, Equity Investments
Non-Monetary (Fair Value)	Rate at Fair Value Date	Current Investments at Market Value

Treatment of Exchange Differences

- Recognised as income or expense in P&L in the period in which they arise
- Exception: Long-term FC monetary items (Para 46/46A)

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Crux of the Standard — Part 4 Translation of Foreign Operations & Exchange Differences

Integral Foreign Operation

Translate using the same procedures as if transactions were those of the **reporting entity itself**. Monetary items at closing rate; non-monetary at historical rate. Exchange differences — P&L.

Non-Integral Foreign Operation

Assets & liabilities at **closing rate**; income & expenses at transaction date rates (or average). Resulting exchange differences accumulated in **Foreign Currency Translation Reserve (FCTR)** — recognised in P&L on disposal.

MCA Notification — Para 46 / 46A

A critical **carve-out** under Companies Act: exchange differences on long-term foreign currency monetary items may be capitalised to the cost of assets or amortised over the loan period — a significant departure from pure AS 11.

⚠️ Para 46A (inserted via MCA notification) allows companies to avoid P&L volatility on long-term foreign currency monetary items. This option was available up to 31 March 2020 for existing arrangements.

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Practical Application
Forward Exchange Contracts — Accounting Treatment

Contracts for Trading / Speculation
 Mark to market at each balance sheet date. The exchange difference (gain or loss) is recognised in P&L. Premium or discount on the forward contract is **not separately amortised** — the entire fair value change goes to P&L.

Contracts to Hedge Firm Commitments / Highly Probable Forecasted Transactions
 The premium or discount arising at the inception of the contract is amortised as income or expense over the life of the contract. Exchange differences on the contract are recognised in P&L — or where the underlying relates to an asset, adjusted to the cost of the asset.

AS 11 does not provide a comprehensive hedge accounting framework — unlike Ind AS 109. Documentation and intent are still critical for proper classification.

Speculative contracts expose the P&L to significant volatility — auditors must verify intent and classification at inception.

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Practical Issue 1
Exchange Differences on Import Payables

The Issue
 A company imports raw materials and records the payable at the transaction date rate. By the balance sheet date, the INR has depreciated significantly. The question arises: should the exchange difference on the outstanding payable be capitalised to the cost of inventory or charged to P&L?

AS 11 Position
 For short-term monetary items (trade payables), the exchange difference must be recognised in P&L in the period it arises. There is no option to capitalise to inventory. The Para 46/46A carve-out applies only to long-term foreign currency monetary items.

Illustrative Reference
 Several mid-sized Indian manufacturing companies (textiles, chemicals) faced audit qualifications in 2013-16 when they attempted to capitalise short-term import payable differences to raw material costs to avoid P&L hits during periods of sharp INR depreciation. The ICAI's Expert Advisory Committee (EAC) consistently opined that such capitalisation is **not permissible** for current liabilities under AS 11.

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Practical Issue 2
Para 46A — Long-Term ECB & Capitalisation Option

Background
 The MCA inserted Para 46 (2009) and later Para 46A (2011) to provide relief to companies that had raised External Commercial Borrowings (ECBs) or long-term foreign currency loans. Companies were allowed to either capitalise exchange differences to asset cost or create a Foreign Currency Monetary Item Translation Difference Account (FCMITDA) and amortise over the remaining loan life.

Industry Application — Infrastructure Sector
 Major Indian infrastructure and power sector companies, including listed entities in the energy and road sectors, exercised the Para 46A option extensively during 2012-2020. The FCMITDA balance appeared as a deferred debit on the balance sheet, which required careful disclosure and was scrutinised by auditors for recoverability.

The Para 46A option was available for companies following AS (not Ind AS). Companies transitioning to Ind AS had to unwind FCMITDA balances — creating a one-time adjustment in the opening Ind AS balance sheet.

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Practical Issue 3
Classification: Integral vs. Non-Integral Foreign Operation

Why Classification Matters
 The classification determines the translation method and whether exchange differences go to P&L (integral) or FCTR in reserves (non-integral). Misclassification can materially distort both the P&L and net worth.

Indicators of Non-Integral Operation

- Activities carried on with a significant degree of autonomy
- Transactions with the reporting entity are not a high proportion of activities
- Activities financed mainly from its own operations or local borrowings
- Labour, material, and other costs settled primarily in local currency

Case Reference — Indian IT Sector
 Large Indian IT companies with wholly-owned subsidiaries in the US and Europe (e.g., companies in the Infosys, Wipro, HCL group — under AS regime) classified their overseas subsidiaries as non-integral, thereby routing translation differences to FCTR. When subsidiaries were eventually restructured or wound up, the accumulated FCTR balance had to be recognised in P&L — sometimes resulting in material one-time gains or losses. This was a significant area of audit focus.

ICAI guidance on distinguishing integral vs. non-integral operations is detailed in the Guidance Note and EAC opinions — practitioners must apply professional judgement based on economic substance, not legal form.

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Practical Issue 4
Exchange Differences on Borrowings for Asset Acquisition

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The Core Question
 When a company borrows in foreign currency to acquire a fixed asset and the INR depreciates, should the exchange difference on the loan be capitalised to the asset cost or charged to P&L? Pre-Para 46A, AS 16 (Borrowing Costs) allowed capitalisation only of borrowing costs — exchange difference was a separate question.

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Para 46 / 46A Resolution
 MCA's Para 46 specifically addressed this by permitting companies to adjust exchange differences on long-term foreign currency monetary items to the cost of the related asset (if the loan was taken to acquire a depreciable asset). The inflated asset cost is then depreciated over the remaining useful life.

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Practical Complication — Steel & Power
 Indian steel and power companies that imported capital equipment on foreign currency loans capitalised large exchange differences during 2008 and 2013 INR depreciation cycles. This inflated gross block and depreciation charges in subsequent years — requiring enhanced disclosures in notes to accounts under Schedule III of the Companies Act, 2013.

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Practical Issue 5
Export Debtors & Year-End Restatement

The Accounting Question
 Export receivables denominated in foreign currency are monetary items. They must be restated at the closing rate at each balance sheet date. The resulting gain or loss is recognised in P&L — even if the debtor has not yet been collected.

Tax vs. AS 11 Treatment
 Under the Income Tax Act, exchange differences on export debtors are generally taxable/deductible on receipt basis (unless the assessee follows mercantile system consistently). This creates a timing difference requiring deferred tax recognition under AS 22.

The treatment is symmetric — if INR weakens, an exchange gain is recognised in P&L even before cash is received. This creates timing differences between book profit and taxable income.

A common practical issue: SME exporters on AS regime sometimes fail to create deferred tax assets on unrealised exchange losses — leading to restatements or audit qualifications in subsequent years.

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Practical Issue 6
Hedge Accounting Challenges Under AS 11

Lack of Formal Hedge Accounting

AS 11 does not prescribe a **formal hedge accounting model** (unlike Ind AS 109). The standard only addresses premium/discount amortisation on forward contracts. There is no concept of "effective vs. ineffective" hedging, cash flow hedges, or fair value hedges.

Options & Cross Currency Swaps

AS 11 is silent on **currency options, interest rate swaps, and cross-currency swaps**. In practice, entities follow the ICAI Guidance Note on Accounting for Derivative Financial Instruments, marking these to market and recognising losses in P&L (prudence concept) — but gains are often deferred.

P&L Volatility Issue

Indian pharmaceutical and IT companies with large USD receivables and USD-denominated borrowings face **natural hedges** — but AS 11 does not permit offsetting. Each leg is accounted for independently, creating artificial P&L volatility that does not reflect the economic reality of the hedge.

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Practical Issue 7
Disclosure Requirements & Audit Observations

Mandatory Disclosures Under AS 11

- Amount of exchange differences included in P&L for the period
- Net exchange differences classified in **FCTR** as a separate component of equity, including a reconciliation
- Amount of exchange differences arising on foreign currency borrowings capitalised during the year
- FCMITDA opening, additions, amortisation, and closing balance
- Description of forward contracts outstanding — purpose and unhedged exposures

Common Audit Observations in Practice

- Failure to restate all foreign currency monetary items at closing rate — particularly inter-company loans, security deposits in foreign currency.
- Non-disclosure of unhedged foreign currency exposures — a Schedule III requirement that is frequently incomplete in SME financial statements.
- Incorrect classification of foreign subsidiary as integral when economic indicators suggest non-integral — motivated by desire to keep FCTR in reserves.

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Summary & Key Takeaways
Practitioner's Checklist for AS 11 Compliance

Identify & Classify

Identify ALL foreign currency monetary items at year-end. Correctly classify foreign operations as integral or non-integral based on economic substance. Verify forward contract intent — hedging vs. speculative.

Measure Correctly

Restate monetary items at closing rate. Apply Para 46A option (if still applicable) consistently and with proper documentation. Amortise forward contract premium/discount over the contract period.

Disclose Adequately


Disclose exchange differences in P&L, FCTR movement, FCMITDA balance, capitalised amounts, and unhedged exposures. Ensure Schedule III disclosures are complete and reconcile to the financial statements.

Tax Alignment

Identify timing differences between AS 11 recognition and Income Tax Act treatment. Create deferred tax assets/liabilities under AS 22 accordingly. Document the basis and recoverability of DTAs.

AS 11 appears simple on its face, but its intersection with MCA notifications, tax law, and the absence of formal hedge accounting creates significant complexity in practice. The standard demands both technical precision and professional judgement.

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Thank you

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