

# Applicability of AS 11 (1994) to transactions entered into before 1.4.2004

*The following is the brief version of an opinion given by the Expert Advisory Committee of the Institute in response to query sent by a member. This is being published for the information of readers.*

## A. Facts of the Case

**1** A public sector company in the power sector enters into mainly three types of foreign exchange transactions, viz., (i) borrowings in foreign currencies to partly finance its capacity addition programme; (ii) contracts for supply, erection, testing and commissioning of power plant equipment; and (iii) purchase of stores and spares for operation and maintenance of power plants. The accounting policy of the company regarding foreign currency transactions is as under:

- (a) Foreign currency transactions are initially recorded at the rates of exchange ruling at the date of transaction.
- (b) Foreign currency loans/deposits/liabilities are reported with reference to the rates of exchange ruling at the year-end and the difference resulting from such transaction as well as due to payment/discharge of liabilities in foreign currency related to fixed assets/capital work-in-progress is adjusted in their carrying cost and that related to current assets is recognised as revenue/expenditure during the year.

**2** The contracts for supply of power plant equipment are long gestation contracts with execution time spreading over 4 to 5 years from award to completion. As per the terms of the contract, generally 15% of the contract price is payable as advance, 55% on despatch,

20% on receipt at site and the balance 10% on successful completion of the performance and guarantee tests of the equipment. On each despatch of a shipment (FOB port of despatch), besides making the payment due on despatch, the company adjusts the advance and also creates a liability in its books for the balance 30% of price payable on receipt and on successful completion of the performance and guarantee tests. The payments made and liabilities accrued under the contract are recorded at the exchange rate on the respective dates of transaction and the outstanding liabilities are updated on the balance sheet date at the closing rate. The resultant exchange differences are adjusted in the carrying cost of the related capital work-in-progress/fixed assets in line with the accounting policy of the company and provisions of Accounting Standard (AS) 11, 'Accounting for the Effects of Changes in Foreign Exchange Rates' (revised 1994).

**3** Similarly, the foreign currency borrowings of the company are made to partly finance the capital cost of its power projects. The loans have maturities ranging from 5 to 15 years and the repayments are either as per the agreed amortisation schedule or by 'bullet repayment' at the end of the loan tenure. The outstanding principal amount of the loan at the balance sheet date is converted at the closing rate and the resultant exchange differences are adjusted in the carrying cost of the related capital work-in-progress/fixed assets.

**4** The querist has made reference to the 'applicability' paragraph of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates' (revised 2003), issued by the Institute of Chartered Accountants of India, which states as under:

*1. The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.*

*2. The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in 22 volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.*

"Accounting Standard (AS) 11, The Effects of Changes in Foreign Exchange Rates (revised 2003), issued by the Council of the Institute of Chartered Accountants of India, comes into

effect in respect of accounting periods commencing on or after 1.4.2004 and is mandatory in nature from that date. The revised Standard supersedes Accounting Standard (AS) 11, Accounting for the Effects of Changes in Foreign Exchange Rates (1994), except that in respect of accounting for transactions in foreign currencies entered into by the reporting enterprise itself or through its branches before the date this Standard comes into effect, AS 11 (1994) will continue to be applicable.”

**5** According to the querist, it is understood from the above paragraph that the intent of the provisions in AS 11 (revised 2003) is that all contracts such as, for supply of equipment or loan agreements for borrowings in foreign currency, entered into before 1<sup>st</sup> April, 2004, are to be governed by AS 11 (revised 1994) although such contracts may give rise to events/individual transactions such as, supplies of equipment, payments for supplies, further drawals of loan, repayment of loans or updation of liabilities on the balance sheet date, etc., that take place after 1<sup>st</sup> April, 2004.

**6** As per the querist, the above would ensure that the exchange differences arising under the same contract or loan agreement are uniformly accounted for by the reporting enterprise. Further, while making the decision for purchase of the equipment or foreign currency borrowings, the enterprise would have, *inter alia*, been guided by the provisions of AS 11 (revised 1994) regarding accounting for the exchange differences and it would only be appropriate that the enterprise is not required to change the treatment of exchange differences as the same may have impact on the project viability.

### **B. Query**

**7** The querist has sought the opinion of the Expert Advisory Committee as to whether the understanding of the querist as stated in paragraph 5 above is in compliance with the provisions of AS 11 (revised 2003).

### **C. Points considered by the Committee**

**8** The Committee notes the ‘applicability’ paragraph of AS 11 (revised 2003), as reproduced in paragraph 4 above.

**9** The Committee notes that the issue is that what should be considered as a ‘transaction’ for the purpose

of application of AS 11 (revised 2003). The Committee is of the view that where a binding contract is a package deal for a composite price comprising supply of equipment, erection, testing and commissioning thereof at different dates, the ‘transaction’ should be considered to have been entered into at the date when the binding commitment of the parties to the contract arise under the contract even though, for accounting purposes, the recognition criteria are met at a later date, e.g., at the time of the supply of equipments. The Committee is of the view that in case of foreign currency loans also, the ‘transaction’ would be considered to have been entered into when the parties to the contract become legally bound as per the terms and conditions thereof even though disbursements are made later.

### **D. Opinion**

**10** On the basis of the above, the Committee is of the opinion that in case contracts of the nature described in paragraph 9 above are entered into before 1<sup>st</sup> April, 2004, AS 11 (revised 1994) would apply and not AS 11 (revised 2003).

## Announcement

The Corporate and Allied Laws Committee of the Institute of Chartered Accountants of India brings out Publications/Books on the various subjects related to Corporate and Allied Laws. In this regard various Meetings are held and Study Groups are constituted to consider the basic drafts prepared by various authors. The Committee invites the members of the Institute/Experts to become members of the Study Groups and participate in the discussions, which will enhance the value and quality of the publications. It will also serve the participating members as medium of knowledge sharing. (For more details log on to the knowledge page of the Corporate and Allied Laws Committee on the Institute’s website at [www.icaai.org](http://www.icaai.org).)

The Committee also requests the members to intimate the names of the Resource Persons who are experts in different areas/fields and can associate themselves with the Institute in the above task.

The interested Members/Experts/Resource Persons are requested to send their Names highlighting their personal details and subject of interest or expertise to [corporatelaws@icaai.org](mailto:corporatelaws@icaai.org) or to:

-- Secretary, Corporate and Allied Laws Committee,  
ICAI, Indraprastha Marg, New Delhi – 110 002.