

Non-Compliance with Reporting Obligations observed by the Financial Reporting Review Board relating to AS 11 'The Effects of changes in Foreign Exchange Rates'

With a view to apprise the members of the Institute and others concerned about the major non-compliances observed during the review, the Financial Reporting Review Board (FRRB) compiles such non-compliances from time to time and publishes the same in the Journal of the Institute. Continuing the same practice, published below are some of the common non-compliances observed by the Board during the review of general-purpose financial statements of certain enterprises and auditors' reports thereon, in relating to AS 11, 'The Effects of changes in Foreign Exchange Rates':

1. Some enterprises state in their accounting policies that foreign currency transactions relating to purchases and sales of goods and services are translated at the rate prevailing at the time of settlement of the transactions. It is contrary to the requirement of AS 11. It may be noted that as per the paragraph 9 of AS 11, the foreign currency transactions should be recorded by applying the exchange rate prevailing on the date of the transaction, i.e. when purchase or sale have taken place rather than translating the same at the rate prevailing at the time when such transactions are settled.
2. Different enterprises have adopted different accounting policies relating to revenue recognition on export sales or services. Some of them state as follows:
 - Sales include realised exchange fluctuation on exports.
 - Service charges for transportation of shipments of a courier company are recognised as income, when shipments are manifested and represent the amount invoiced, net of service tax, exchange fluctuation and all discounts and allowances.

It was observed that amount of sales/service charges have been adjusted for exchange fluctuation. Considering the definition of 'revenue' as given under paragraph 4.1 of AS 9 and requirements of paragraph 13 and 40(a) of AS 11, it was viewed that foreign exchange gain or loss is independent of sales or services transaction. Accordingly, any gain or loss, arising due to exchange fluctuation should be shown separately in the profit & loss

account instead of adjusting the same against the revenue.

3. The accounting policy on foreign currency transactions and additional disclosures made in pursuance to Part II of Schedule VI to the Companies Act indicate that often the companies are involved in importing raw materials, exporting goods and incur heavy expenditures involving foreign currency. However, neither profit and loss account nor notes to accounts of such enterprises discloses any such gain or loss on account of exchange differences. It was observed that as the company was engaged into foreign currency transactions it should have incurred exchange gain or loss and accordingly, non disclosure of the same is against the requirements of paragraph 40(a) of AS 11. In case, if there is nil effect due to foreign exchange gains in some transactions being set off against the losses of other transactions, then it is viewed that such effect should be disclosed separately by way of notes to accounts rather than omitting the same from the financial statements.
4. While the accounting policies relating to foreign currency transactions of certain enterprises states that "Foreign currency assets and liabilities at the yearend are recognised at the exchange rates prevailing on the balance sheet date", other enterprises states that "Current assets and liabilities denominated in foreign currency as at the Balance sheet date are converted at exchange rate prevailing on balance sheet date except in case of short term loans." It is viewed that as per paragraph 11(a) of AS 11, only assets and liabilities in the nature of monetary items should be converted at the closing exchange rate and not all the foreign currency assets and liabilities which may include non-monetary assets/liabilities as well. Further, it was also observed that the latter accounting policy with regard to short-term loans is also not in line with AS 11. Being monetary items, the short-term loans in foreign currency should also be translated at the exchange rate prevailing on the balance sheet date rather than using any other alternate rate until or unless such rate meet the requirements of paragraph 11(a) of AS 11. ■