IND AS – 21

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

(1) Scope

(2) Definition

(3) Accounting of Foreign Currency transactions in functional currency

(4) Translation to the presentation currency from the functional currency

(5) Translation of a foreign operation

(6) Different reporting dates of foreign operation and reporting entity

(7) Disposal of foreign entity

(8) Foreign currency transactions and advance consideration (Appendix B)

(1) SCOPE :

This Standard shall be applied:

- **Reporting foreign currency transactions in the functional currency-** I
- **Translation in foreign operations-**
- **Translation to the presentation currency-**

This Standard does not apply:

- To the presentation in a statement of cash flows of the cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (Ind AS-7, Statement of Cash Flows).
- To long-term foreign currency monetary items for which an entity has opted for the exemption given in Ind AS-101. Such an entity may continue to apply the accounting policy so opted for such long-term foreign currency monetary items.

(2) DEFINITION:

Presentation currency is the currency in which the financial statements are presented; Indian companies must present the financial statements in Rupees - hence Indian Rupee is the presentation currency;

FUNCTIONAL CURRENCY - the currency of the PRIMARY ECONOMIC ENVIRONMENT in which the entity operates.

What is primary economic environment?

It is the economic environment in which an entity **primarily generates and expends cash.**

Indicators to decide Functional Currency

Primary Indicators	Secondary Indicators
Functional currency is ▸ the currency which Influence the selling price of goods/services (Mostly sales are denominated and settled in this currency); ▸ the currency of the country based on whose market forces and regulations - selling price of goods/services are determined; **(The above points are related to revenue)** ▸ The currency which influence the labour, material and other costs of providing goods or services (normally such costs are denominated and settled in that currency) **(This point related to costs) In simple words, functional currency is currency which influence the revenue and expenses.**	Management should consider the following: ▸ It is the currency in which financing activities are taking place i.e. issuing debt or equity instruments in that currency; ▸ It is the currency in which receipts from operating activities are retained i.e. savings are retained in this currency;

What is foreign currency?

A currency **other than functional currency** of the entity;

Say, A Ltd. is an Indian company, whose functional currency is US dollars (as its revenue and expenses are fully in USD). All other currencies other than USD are foreign currencies for the preparation of financial statements. In this case, Indian rupees also foreign currency, as it is other than functional currency.

Closing rate - Spot rate on the balance sheet date;

Monetary items are units of currency held and assets and liabilities to be received or paid in fixed or determinable number of units of currency.

Non-monetary items are those which are not monetary items.

Self test for you

Particulars	Monetary/Non-monetary ?
Fixed assets:	
Tangible fixed assets	
Intangible assets	
Right-of-use Asset (Ind AS 116)	
Investments:	
Investment in equity shares	
Investment in debentures	
Investment in Govt, bonds	
Current Assets, Loans and advances:	
Cash in hand & at bank	
Trade receivable (debtors)	
Bills receivable	
Inventory	
Prepaid expenses	
Advance paid to suppliers for goods	
Loan given	
Other receivables	

Secured loans & Unsecured loans:	
Debentures	
Convertible debentures	
Bank loans	
Public deposits	
Current liabilities:	
Trade payables (creditors)	
Dividend payable	
Bills payable	
Advance received from customers	
Lease liabilities	
Provisions:	
Provisions for income tax	
Provision for gratuity	
Provision for warranty	

(3) ACCOUNTING OR FOREIGN CURRENCY TRANSACTIONS IN FUNCTIONAL CURRENCY:

Initial recognition

Foreign currency transactions should be recorded initially at the spot rate of exchange at the date of the transaction. An approximate rate can be used. For example, in general, an average rate for a particular period can be used, but if exchange rates are fluctuating wildly, an average rate cannot be used.

Reporting at the ends of subsequent reporting periods

Subsequently, at each balance sheet date:

- Foreign currency monetary amounts should be reported using the closing rate.
- Non-monetary items measured at historical cost should be reported using the exchange rate at the date of the transaction.
- Non-monetary items carried at fair value should be reported at the rate that existed when the fair values were determined.

Foreign exchange rate difference

The foreign exchange difference arises in the following cases:-

(1) Transaction is initially recorded at one rate and it is settled at another rate during the same period. (Settlement means payment or receipt of consideration)

(2) Transaction is initially recorded at one rate and it is subsequently measured using another rate. (Since it is not settled till the balance sheet date)

(3) Transaction is measured on BS date using one rate and subsequently settled at another rate.

All the above foreign exchange differences should be recognised in the Profit and Loss a/c as exchange gain or loss in the year in which it occurs.

Exception

When a gain or loss on a non-monetary item is recognised in other comprehensive income (COI), any fluctuation gain or loss arising from such item shall be recognised in OCI. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.

Say an Indian entity has a building in US and cost is $ 100,000, initially recognised at ₹ 50,00,000 (when 1$ = ₹ 50). The entity is valuing the PPE using **revaluation model**. The fair value at the year end is $ 102,000 and 1$ = ₹ 52 on that date. The revaluation gain is transferred to revaluation surplus and presented in OCI as per Ind AS 16. At the same time, as per this standard, if the non-monetary asset valued at fair value, it should be restated using the rate on valuation date. In this case, the fluctuation difference **and** revaluation gain of ₹3,04,000 should be taken to OCI (but not to P&L).

(4) TRANSLATION TO PRESENTATION CURRENCY FROM THE FUNCTIONAL CURRENCY:

An entity can present its financial statements in any currency. If the presentation currency differs from the functional currency, the financial statements are retranslated into the presentation currency.

Translation approach - Translation from functional currency to presentation currency

Functional Currency	Presentation Currency
Assets / Liabilities	
♦ Current Period	Closing rate (current Balance Sheet date)
♦ Comparative period	Closing rate (Comparative Balance Sheet date)

Equity items	
♦ Current Period	Actual rates(or appropriate average for current period)
♦ Comparative period	Actual rates(or comparative average for comparative period)
Income/expenses (including those recognized directly in equity)	
♦ Current Period	Actual rates(or appropriate average for current period)
♦ Comparative period	Actual rates(or comparative average for comparative period)
Exchange differences	**Separate component of equity**

(5) TRANSLATION OF A FOREIGN OPERATION:

What is a foreign operation?

It is Foreign → Subsidiary / Associate / Joint / Branch — Whose activities are Based OR Conducted → In a Country / OR Currency — Other than those of the reporting entity

Important - read carefully

When the entity has a foreign operation (FO), one should **determine the functional currency of FO.**

If the FO is an integral part OR an extension of the reporting entity - functional currency of FO should be same functional currency as the reporting entity; (If functional currency of reporting entity and FO are same, there is no need to convert any balances ofFO)

Where the FO is set up as a special purpose entity (SPE) in a country other than the reporting entity s country, its activities are clearly being conducted on behalf of the parent entity (e.g. it may be set up for tax reasons to effect a lease or research and development activities) and the SPE is an extension of the reporting entity, it would be expected to have the same functional currency as that of the reporting entity.

Translation of a foreign operation:

The financial statements should be translated into the presentation currency as under:

- assets and liabilities for each balance sheet presented (ie., including comparatives) shall be translated at the closing rate at the date of that balance sheet;
- income and expenses for each statement of profit and loss presented (ie., including comparatives) shall be translated at exchange rates at the dates of the transactions;

The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary. However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations.

Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference is recognised in profit or loss or, if it arises from the exchange difference arising on a monetary item that forms part of reporting entity net investment in a foreign operation, it is recognised in other comprehensive income and accumulated in a separate component of equity until the disposal of the foreign operation.

Exchange differences on intra group items are recognized in profit or loss unless the difference arises on the retranslation of an entity's net investment in a foreign operation when it is classified as equity.

Dividends paid in a foreign currency by a subsidiary to its parent company may lead to exchange differences in the parent's financial statements and will not be eliminated on consolidation but recognized in profit or loss.

(6) DIFFERENT REPORTING DATES:

Different reporting dates (Balance sheet dates) of Foreign Operation & Reporting entity

- In this case foreign operation has one reporting date (say Balance sheet date say 31st Dec) whereas the reporting entity i.e. holding company has another reporting date (Say Balance date say 31st March).
- Normally in case of different reporting dates, FO often prepares its financial statements as at the same date as the reporting entity only for consolidation purpose (i.e. FO also prepares financial statements as at 31st March for consolidation purpose).

- If it is impracticable to prepare financial statements as at the same date as reporting entity, Ind AS 110 allows the use of financial statements prepared at a different reporting date (maximum allowed gap is three months between the reporting date of FO and reporting entity).
- In this case FO should be adjusted by giving effects of all significant transactions and events occurred between the different reporting dates.
- In such a case, the assets and liabilities of the FO are translated at the exchange rate at the balance sheet date of the FO and adjustments are made when appropriate for significant movements in exchange rates up to the balance sheet date of the reporting enterprises in accordance with Ind AS 110.
- The same approach is used in applying the equity method to associates and joint ventures in accordance with Ind AS 28.

(7) DISPOSAL OF FOREIGN ENTITY:

- Disposal means - entity is reducing its interest in the foreign operation. It can dispose of fully or partially through a sale, liquidation, repayment of share capital, abandonment of all or part of it.
- Writing down the carrying amount of interest in foreign operation because of impairment loss or huge losses incurred by FO does not constitute partial disposal and it need not follow the following accounting.
- On **complete sale** of foreign operation (branch, subsidiary, etc.), the accumulated balance in FCTR should be reclassified from equity to P&L statement (as a reclassification adjustment) as gain or loss on disposal; FCTR related to non controlling interest should NOT be reclassified to profit or loss but it should be derecognised.

(8) FOREIGN CURRENCY TRANSACTIONS AND ADVANCE CONSIDERATION (APPENDIX-B)

Example: On 1-2-2018 Sun Ltd enters into a contract to supply machinery for USD. 10000. The terms of the contract stipulated that an advance payment of 40% should be paid on 1-3-2018 and balance on 30-4-2018. The machinery will be delivered on 1 -4-2018. On 1 -3-2018 Sun Ltd receives USD 4,000 and recognises a non-machinery liability by converting the advance receipt at the spot exchange rate on 1-3-2018 which was 1USD = INR 60. Entry passed:

Bank A/c	Dr. ₹ 2,40,000
To Contract Liability	₹ 2,40,000

On 1-4-2018 Sun Ltd will pass the following entry (Exchange rate on this date was 1 USD = INR 62):

Contract Liability A/c	Dr. ₹ 2,40,000
Receivables A/c	Dr. 3,72,000
To Revenue (USD 10000)	₹ 6,12,000

On 30-4-2018 payment against receivable was received at exchange rate1 USD = INR 63

Bank A/c	Dr. ₹ 3,78,000
To Receivables	₹3,72,000
To Foreign Exchange Gain	₹ 6,000

(9) FIRST TIME ADOPTION OF IND AS

Long Term Foreign Currency Monetary Items (LTFCMI) (Carve out)

A first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items RECOGNISED in the financial statements for the period ending immediately before the beginning of the First Ind AS financial reporting period as per the previous GAAP.

If any LTFCMI is created after First Ind AS financial period -for those LTFCMI, this option is not available. It means foreign exchange difference arising from those should be charged to P&L i.e. complying with Ind AS 21.

It means, if they had chosen the option as per MCA notification in AS 11 - it can be continued in Ind AS at the entity's option.

QUESTIONS

Q.1. Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1st January, 2018 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and revenue is recognised on 31st March, 2018. USD 30million is received on 1st April, 2018 in full and final settlement of the purchase consideration.

State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 2018 and 31st March, 2018 are 72 per USD and 75 per USD respectively.

(May - 19)

Q.2. On 1st April, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. It incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 20X2. The loan is repayable in FCY on 31st March, 20X7 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

- 1st April, 20X1 - FCY 1 = 2.50.
- 31st March, 20X2 – FCY 1 = 2.75.
- Average rate for the year ended 31st Match, 20X2 – FCY 1 = 2.42. The functional currency of the group is Indian Rupee.

What would be the appropriate accounting treatment for the foreign currency loan in the books of Makers Ltd. for the FY 20X1-20X2?

Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain / loss. (May - 20)

Q.3. Global Limited, an Indian company acquired on 30th September, 20X1 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Global Limited is Rupees and its financial year end is 31st March, 20X2.

(i) The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30th September, 20X1.

The exchange rates as at 30th September, 20X1 was 82 / EURO and at 31st March, 20X2 was 84 / EURO.

What is the value at which the goodwill has to be recognised i n the financial statements of Global Limited as on 31st March, 20X2?

(ii) Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31st March, 20X2. The exchange rate on the date of purchase by Global Limited was 83 / EURO and on 31st March, 20X2 was 84 / EURO. The entire goods purchased from Mark Limited are unsold as on 31st March, 20X2. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements.

(Nov. 19)

Q.4. An Indian entity, whose functional currency is rupees, purchases USD dominated bond at its fair value of USD 1,000. The bond carries stated interest @ 4.7% p.a. on its face value. The said interest is received at the year end. The bond has maturity period of 5 years and is redeemable at its face value of USD 1,250. The fair value of the bond at the end of year 1 is USD 1,060. The exchange rate on the date of transaction and at the end of year 1 are USD 1 = 40 and USD 1 = 45, respectively. The weighted average exchange rate for the year is 1 USD = 42.

The entity has determined that it is holding the bond as part of an investment portfolio whose objective is met both by holding the asset to collect contractual cash flows and selling the asset. The purchased USD bond is to be classified under the FVTOCI category.

The bond results in effective interest rate (EIR) of 10% p.a.

Calculate gain or loss to be recognised in Profit & Loss and Other Comprehensive Income for year 1. Also pass journal entry to recognise gain or loss on above. (Round off the figures to nearest rupees)

(Nov. 20)