UNIT 2 :
INDIAN ACCOUNTING STANDARD 21 : THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

LEARNING OUTCOMES

After studying this unit, you will be able to:

- Describe the objective and scope of the standard
- Define the terms used in the standard like closing rate, exchange difference, exchange rate, fair value, foreign currency, foreign operation, functional currency, monetary items, group, net investment in a foreign operation, presentation currency and spot exchange rate
- Report foreign currency transactions in the functional currency
- Report at the end of subsequent reporting periods foreign currency monetary and non-monetary items
- Recognise and account for the exchange differences
- Apply the translation procedures in case of change in functional currency
- Recognise the presentation currency and translate the items into it from the functional currency
- Incorporate the results and financial position of a foreign operation on translation
- Apply the provisions of translation in case of consolidation
- Deal with the disposal or partial disposal of a foreign operation
- Compute tax effects of all exchange differences
- Comply with the disclosure requirements given in the standard

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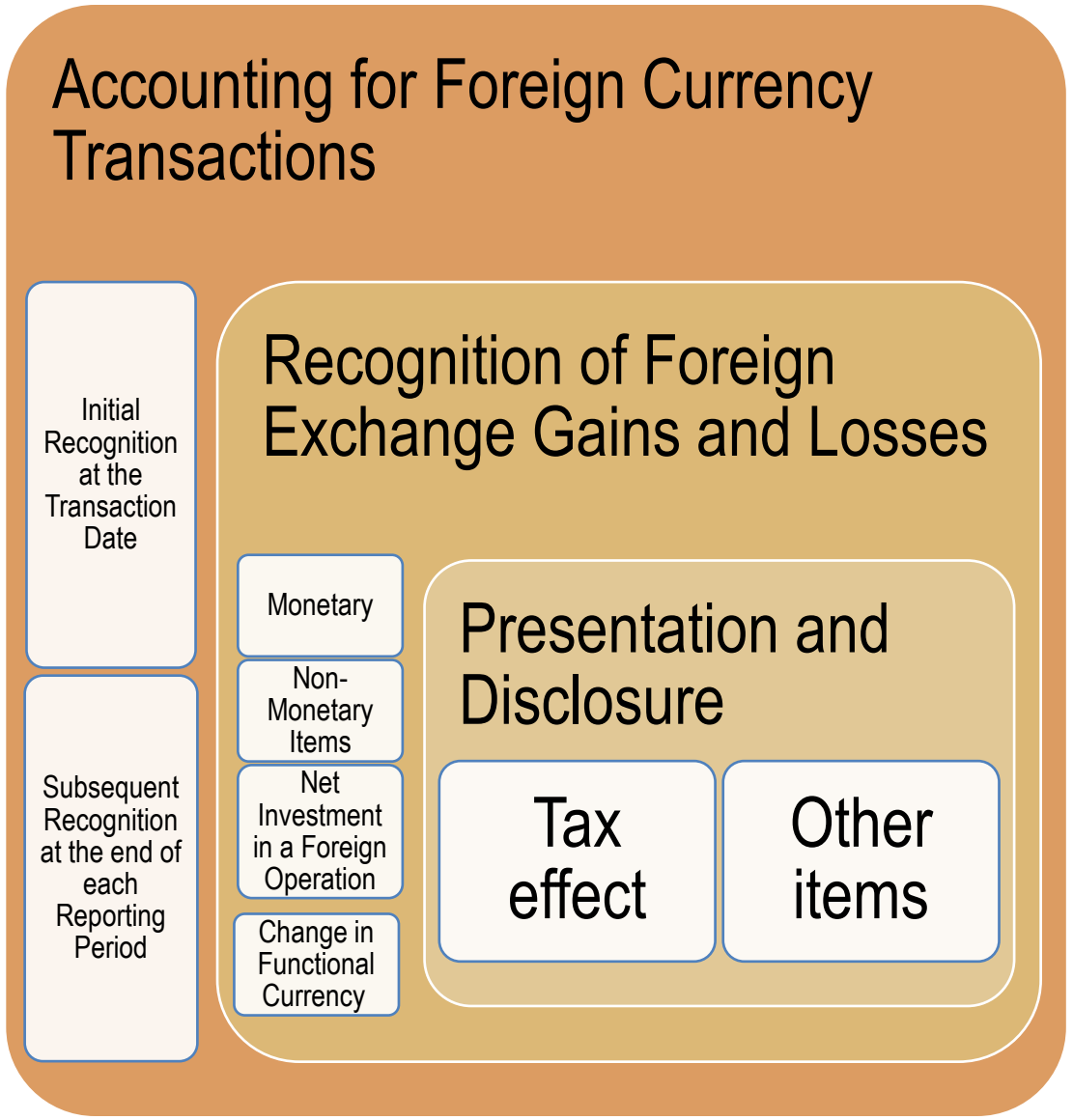
UNIT OVERVIEW



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2.1 OBJECTIVE

The objective of the Standard is to address the accounting for foreign activities which include:

- transactions in foreign currencies; or
- foreign operations.

Considering that an entity may present its financial statements in a foreign currency, the Standard also seeks to prescribe how to translate financial statements into a presentation currency.

In this context, the Standard defines ***foreign currency*** as a currency other than the functional currency of the entity.

1. ***Functional currency*** is the currency of the primary economic environment in which the entity operates.

   In this regard, the primary economic environment will normally be the one in which it primarily generates and expends cash i.e. it operates. The functional currency is normally the currency of the country in which the entity is located. It might, however, be a different currency.

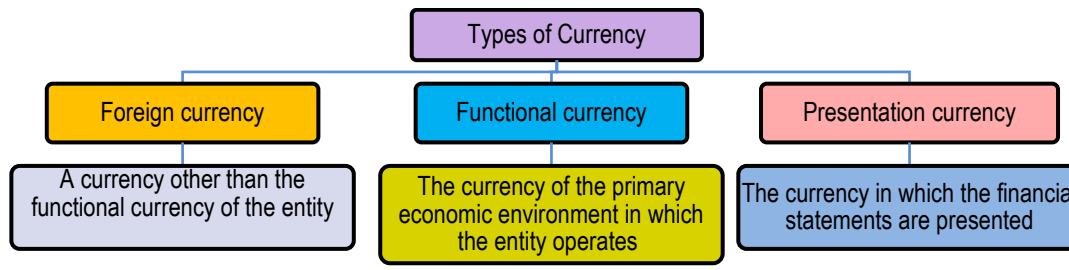
2. ***Foreign operation*** has been defined as an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

3. ***Presentation currency*** is the currency in which the financial statements are presented, the presentation currency may be different from the entity's functional currency.

4. **Spot exchange rate** is the exchange rate for immediate delivery.

5. **Closing rate** is the spot exchange rate at the end of the reporting period.

6. **Exchange difference** is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates is the exchange rate for immediate delivery.



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2.2 SCOPE

- Ind AS 21 shall be applied:

  (a) in accounting for transactions and balances in foreign currencies, except for derivative transactions and balances covered by Ind AS 109.

  Foreign currency derivatives not covered by Ind AS 109 (e.g., some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard.

  The Standard also applies for translation of amounts relating to derivatives from functional currency to presentation currency.

  (b) in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation or the equity method; and

  (c) in translating an entity's results and financial position into a presentation currency.

- Ind AS 21 **does not apply** to:

  (a) hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation; Ind AS 109 should be applied for hedge accounting;

  (b) presentation of cash flows from transactions in a foreign currency or to translation of cash flows of a foreign operation in the statement of cash flows (Refer Ind AS 7, Statement of Cash Flows); and

  (c) long term foreign currency monetary items for which an entity has opted for the exemption as per Ind AS 101. Such an entity may continue to apply the accounting policy as opted for such long term foreign currency monetary items.

2.3 FUNCTIONAL CURRENCY

- An entity measures its assets, liabilities, equity, income and expenses in its functional currency.
- All transactions in currencies other than the functional currency are foreign currency transactions.

Ind AS 21 requires each entity to determine its functional currency.

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- In determining its functional currency, an entity emphasises the currency that determines the pricing of the transactions that it undertakes, rather than focusing on the currency in which those transactions are denominated.
- The following are the factors that may be considered in determining an appropriate functional currency (**Primary indicators**):

  (a) the currency:

  (i) that mainly influences sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and

  (ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

  (b) the currency that mainly influences labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.
- Other factors that may provide supporting evidence to determine an entity's functional currency are (**Secondary indicators**):

  (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and

  (b) the currency in which receipts from operating activities are usually retained.
- **If an entity is a foreign operation**, additional factors are set out in this Standard which should be considered to determine whether its functional currency is the same as that of the reporting entity of which it is a subsidiary, branch, associate or joint venture:

  (a) Whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy;

  > **An example of the former is when** the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it.
  >
  > **An example of the latter** is when the foreign operations accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency.

  (b) Whether the transactions with the reporting entity are a high or a low proportion of the foreign operation's activities;

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(c) Whether cash flows from the activities of the foreign operations directly affect the cash flows of the reporting entity and are readily available for remittance to it.

(d) Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.

These factors also demonstrate whether the entity is integral to the reporting entity or not. In practice, the functional currency of a foreign operation that is integral to the parent / reporting entity will usually be the same as that of the parent / reporting entity.

- Determining an entity's functional currency depends on the facts and circumstances.
- When the above indicators are mixed and the functional currency is not obvious, the management will be required to use its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management has to give priority to the primary indicators before considering the other indicators, which are designed to provide additional supporting evidence to determine an entity's functional currency.

Illustration 1

Future Ltd. sells a revitalising energy drink that is sold throughout the world. Sales of the energy drink comprise over 90% of the revenue of Future Ltd. For convenience and consistency in pricing, sales of the energy drink are denominated in USD. All financing activities of Future Ltd. are in its local currency (L$), although the company holds some USD cash reserves. Almost all of the costs incurred by Future Ltd. are denominated in L$.

Determine the functional currency of Future Ltd.

Solution

The functional currency of Future Ltd. is L$ looking at the primary indicators. The facts presented indicate that the currency that mainly influence the cost of producing the energy drink is the L$. As stated in the fact pattern, pricing of the product in USD is done for convenience and consistency purposes; there is no indication that the sales price is influenced by the USD.

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Illustration 2

Small India Private Limited (Small), a subsidiary of Big Inc., takes orders from Indian customers for Big Inc's merchandise and then bills and collects for the sale of the merchandise in Rupees. Small also has a local warehouse in India to facilitate timely delivery and ensures that it remits to its parent all cash flows that it generates as the operations of Small are primarily financed by Big Inc. Big Inc is based out of US and has its functional currency as USD.

Determine the functional currency of Small India Private Limited.

Solution

Small, although based in India with its cash flows generated in India, is essentially a "pass through company" established by its parent. Small is totally reliant on Big Inc. for financing and goods to be sold, despite the fact that goods are sold within India and in Rupees (₹). Therefore, Small is not a self-contained entity in India, rather an entity that is dependent on its parent.

Due to this dependence of Small on its parent company, it can be said that the primary economic environment for Small is that of US and thus, its functional currency should also be USD.

Hence all the transactions of Small which are denominated in any currency other than USD should be recorded in USD at the spot rate and any changes in the exchange rate would result in an exchange gain or loss to be taken to the statement of profit or loss.

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Illustration 3

A is an Oman based company having a foreign operation, B, in India. The foreign operation was primarily set up to execute a construction project in India. The functional currency of A is OMR.

78% of entity B's finances have been raised in USD by way of contribution from A. B's bank accounts are maintained in USD as well as Rupees (₹). Cash flows generated by B are transferred to A on a monthly basis in USD in respect of repayment of finance received from A.

Revenues of B are in USD. Its competitors are globally based. Tendering for the construction project happened in USD.

B incurs 70% of the cost in Rupees (₹) and remaining 30% costs in USD.

Comment since B is located in India, can it presume its functional currency to be Rupees (₹).

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Solution

No, B cannot presume Rupees (₹) to be its functional currency on the basis of its location. It needs to consider various factors listed in Ind AS for determination of functional currency.

Primary indicators:

1. the currency that mainly influences
   (a) sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
   (b) labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.
2. Other factors that may provide supporting evidence to determine an entity's functional currency are (**Secondary indicators**):
   (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and
   (b) the currency in which receipts from operating activities are usually retained.
3. **If an entity is a foreign operation**, additional factors set out in Ind AS 21 should be considered to determine whether its functional currency is the same as that of the reporting entity of which it is a subsidiary, branch, associate or joint venture:
   (a) Whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy;
   (b) Whether the transactions with the reporting entity are a high or a low proportion of the foreign operation's activities;
   (c) Whether cash flows from the activities of the foreign operations directly affect the cash flows of the reporting entity and are readily available for remittance to it.
   (d) Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.

On the basis of additional factors mentioned in point 3 above, B cannot be said to have functional currency same as that of A Ltd.

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Hence primary and secondary indicators should be used for the determination of functional currency of B giving priority to primary indicators. The analysis is given below:

- Its significant revenues and competitive forces are in USD.
- Its significant portion of cost is incurred in Rupees (₹). Only 30% costs are in USD.
- 78% of its finances have been raised in USD.
- It retains its operating cash flows partially in USD and partially in Rupees (₹).

Keeping these factors in view, USD should be considered as the functional currency of B.

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Illustration 4

S Ltd is a company based out of India which got listed on Bombay Stock Exchange in the financial year ended 31st March, 20X1. Since then, the company's operations have increased considerably. The company was engaged in the business of trading of motorcycles. The company only deals in imported motorcycles. These motorcycles are imported from US.

After importing the motorcycles, these are sold across India through its various distribution channels. The company had only private customers earlier, but the company also started corporate tie-up and increased its customer base to corporates also. The purchase of the motorcycles are in USD because the vendor(s) from whom these motorcycles are purchased those are all located in US.

All other operating expenses of the company are incurred in India only because of its location and they generally happen to be in Rupees (₹).

Currently, its customers are both corporate and private in the ratio of 70:30 approximately. The USD denominated prices of motorcycles in India are different from those in other countries.

The company is also expecting that in the coming years, its customers base will increase significantly in India and the current proportion may also change.

Currently, the invoices are raised to the corporate customers in USD for the purpose of hedging. However, private customers don't accept the same arrangement and hence invoices are raised to them in Rupees (₹).

Determine the functional currency of the company.

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Solution

The functional currency of S Ltd is Rupees (₹).

Following factors need to be considered for determination of functional currency:

Primary indicators

1. the currency that mainly influences
   (a) sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
   (b) labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.
2. Other factors that may provide supporting evidence to determine an entity's functional currency are (**Secondary indicators**):
   (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and
   (b) the currency in which receipts from operating activities are usually retained.

Primary and secondary indicators should be used for the determination of functional currency of S Ltd. giving priority to primary indicators.

The analysis is given below:

Ind AS 21 gives greater emphasis to the currency of the economy that determines the pricing of transactions, as opposed to the currency in which transactions are denominated.

Sales prices for motorcycles are mainly influenced by the competitive forces and regulations in India. The market for motorcycles depends on the economic situation in India and the company is in competition with importers of other motor cycle brands.

Even though 70% of the revenue of the company is denominated in USD, Indian economic conditions are the main factors affecting the prices. This is evidenced by the fact that USD denominated sales prices in India are different from USD denominated sales prices for the same motorcycles in other countries.

Management is able to determine the functional currency because the revenue is clearly influenced by the Indian economic environment and expenses are mixed.

On the basis of above analysis, Rupees (₹) should be considered as the functional currency of the company.

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2.4 ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS

2.4.1 Initial recognition at the transaction date

- A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency (i.e., a currency other than the functional currency of the entity), including transactions arising when an entity:

  (a) buys or sells goods or services whose price is denominated in a foreign currency;

  (b) borrows or lends funds with amounts denominated in a foreign currency; or

  (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

- A foreign currency transaction is initially recorded by translation in the entity's functional currency at the exchange rate on the transaction date.

  For practical reasons, a rate that approximates the actual exchange rate is often used.

Example

An average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period.

However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

2.4.2 Monetary vs non-monetary items

S. No.	Particulars	Monetary items	Non-monetary item
1.	Units of currency	Units of currency held and assets and liabilities to be received or paid are in a fixed or determinable number of units of currency.	There is no fixed or determinable number of units of currency

- Examples of monetary items include:
  - pensions and other employee benefits to be paid in cash;
  - provisions that are to be settled in cash;
  - lease liabilities;
  - cash dividends that are recognised as a liability;

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- contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value* to be received (or delivered) equals a fixed or determinable number of units of currency.
- Most debt securities are considered as monetary items because their contractual cash flows are fixed or determinable.

Note: Fair value is the price that would be recovered to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

- Examples of non-monetary items include:
  - amounts prepaid for goods and services and income received in advance, on the basis that no money will be paid or received in the future;
  - goodwill;
  - intangible assets;
  - inventories;
  - property, plant and equipment;
  - right-of-use assets;
  - provisions that are to be settled by the delivery of a non-monetary asset.

2.4.3 Subsequent recognition at the end of each reporting period

- At the reporting date, assets and liabilities denominated in a foreign currency are translated as follows:
  (a) **monetary items** are translated at the exchange rate at the reporting date i.e., closing rate;
  (b) **non-monetary items measured at historical cost** are translated at the exchange rate at the date of the transaction; and
  (c) **non-monetary items measured at fair value in a foreign currency** are translated at the exchange rate on the date the fair value was determined.
- The carrying amount of the item is determined applying the relevant Accounting Standard.

Example

Property, plant and equipment may be measured at fair value or historical cost as per Ind AS 16, *Property, Plant and Equipment*.

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The carrying amount so determined, be it on the basis of historical cost or fair value, if in foreign currency, is translated into the functional currency in accordance with this Standard.

- In some cases, the carrying amount of items is determined by comparing two or more amounts e.g.:
  - Inventories - measured at lower of cost and net realisable value.
  - Asset subject to impairment loss - lower of an asset's carrying amount and its recoverable amount.

If such an asset is non-monetary and measured in a foreign currency, the carrying amount is determined by comparing:

(a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (i.e. the rate at the date of the transaction for an item measured in terms of historical cost); and

(b) the net realisable value or recoverable amount, as appropriate, translated at the exchange rate at the date when that value was determined (eg. the closing rate at the end of the reporting period).

The above may result in an impairment loss being recognised in the functional currency but not in the foreign currency, or vice versa.

Example 1

A foreign currency asset amounting to Euro 2,00,000 is recorded at the date of purchase when the exchange rate was ₹ 52 at ₹ 104 lacs.

The recoverable amount of the asset on the reporting date is calculated as Euro 1,75,000. The exchange rate on the date of valuation was ₹ 60 to a Euro.

The carrying value of the foreign currency asset will be determined based on the recoverable amount of the asset converted into functional currency at the exchange rate on valuation date which is ₹ 105 lacs.

The impairment loss of Euro 25,000 in foreign currency is not recognised.

- Where a country has multiple exchange rates, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

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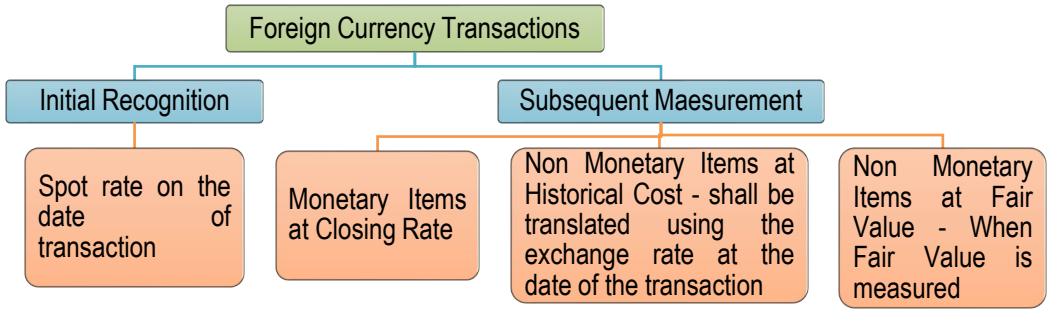

2.4.4 Recognition of foreign exchange gains and losses

- Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.
- When the transaction occurs and settles within the same accounting period, all the exchange difference is recognized in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference is recognised in each period till settlement date based on change in exchange rates during each period.

2.4.4.1 Monetary items

Exchange differences arising on the settlement of monetary items or on translating monetary items are recognised in profit or loss, except:

(i) for accounting of exchange difference as required by application of hedge accounting under Ind AS 109. For example - Ind AS 109 requires that exchange differences on monetary items that qualify as hedging instruments in a cash flow hedge should be recognised initially in other comprehensive income to the extent that the hedge is effective;

(ii) for monetary items that in substance form part of the reporting entity's net investment in a foreign operation (discussed below);

(iii) for long-term foreign currency monetary items in case the entity has exercised the option for recognising exchange differences on such items in equity (discussed below).

2.4.4.2 Non-monetary items

- Ind AS requires certain gains and losses to be recognised in other comprehensive income.

> **For example**, revaluation gain or loss on property, plant and equipment is recognised in other comprehensive income as per Ind AS 16. When such an asset is measured in a foreign currency and its revalued amount is translated as per this Standard using the rate at the date the fair value was determined, the resulting exchange gain or loss is also recognised in other comprehensive income.

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- If the gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss is also recognized in profit or loss.

2.4.4.3 Net investment in a foreign operation

- **Net investment in a foreign operation** is the amount of the reporting entity's interest in the net assets of that operation.
- A monetary item receivable from or payable to a foreign operation may form part of the net investment in a foreign operation if the settlement of the monetary item is neither planned nor likely to occur in the foreseeable future.

  A loan to a foreign entity which is repayable on demand might seem to be a short-term item, rather than part of capital. However, if there is demonstrably no intent or expectation to demand repayment (e.g., the short-term loan is getting rolled over continuously, whether or not the foreign subsidiary is able to repay it), the loan has the same economic effect as that of a capital contribution.

  On the other hand, when there is a long-term loan with a fixed maturity period (say, 10 to 15 years) it does not automatically qualify to be treated as being part of the net investment simply because it is of a long duration, unless management has expressed its intention to renew the loan at maturity and accordingly, the period of repayment is not foreseeable.

  It lies on the management to document its intention to renew by auditable evidence, such as board minutes. Otherwise, in the absence of management's intention to renew, the loan's maturity date implies that its settlement is planned in the foreseeable future.
- Such monetary items may include long-term receivables or loans but do not include trade receivables or trade payables.
- Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation (i.e. a subsidiary, associate or joint venture) should be treated as follows:
  - Such exchange differences are recognised in profit or loss in the separate financial statements of the reporting entity and/or the individual financial statements of the foreign operation, as appropriate:
    - If such an item is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements.

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- ❖ If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements.
- ❖ If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements.

➢ In the financial statements that include the foreign operation and the reporting entity (e.g., consolidated financial statements when the foreign operation is a subsidiary, associate or joint venture), such exchange differences are recognised initially in other comprehensive income and then reclassified from equity to profit or loss on disposal of the net investment.

Illustration 5

Functional currency of parent P is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S and a transaction for the same was made for USD 300 during the year. At the year end, a balance of the same amount is outstanding as receivable from S. It has been observed that such balance amount has been continuing as receivable from S year on year and even though the payments in respect of these balances are expected to be received in the foreseeable future but if we look at the year-end then we see this balance as outstanding every year.

In addition to the trading balances between P and S, P has lent an amount of USD 500 to S that is not expected to be repaid in the foreseeable future.

Analyse whether the exchange difference, if any, should be recognised in the profit and loss.

Solution

The exchange gain or loss will arise in the books of accounts of P in respect of its trading balance with S and the same should be recognised in profit or loss. This being a balance for in the nature of trade receivable for P, it would not be considered as its net investment in a foreign operation (i.e. S).

The amount lent by P should be regarded as its net investment in S (i.e. foreign operation). Thus, the exchange gain or loss incurred by P on the USD 500 loan should be recognised in profit or loss in P's separate financial statements and in other comprehensive income in its consolidated financial statements.

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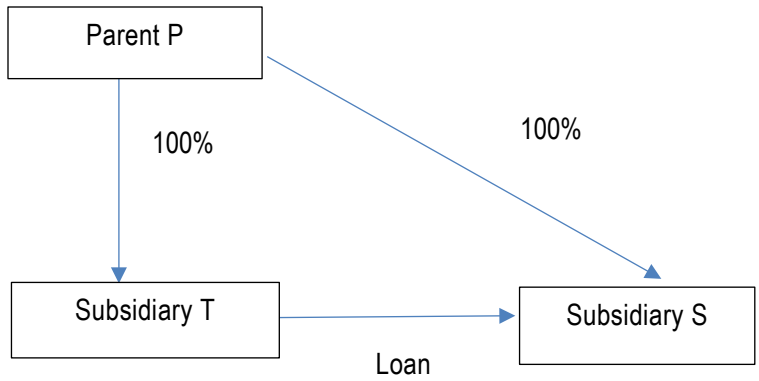
Illustration 6

In the above illustration, suppose that for tax reasons, the 'permanent' funding (i.e. loan amount) extended to S is made via another entity in the group, T, rather than from P directly. That is, on the directions of P, T gives the loan to S. T is also a subsidiary of P.

Demonstrate where should the exchange difference, if any, be recognised.

Solution



Any exchange difference in respect of the loan is recognised in other comprehensive income in the consolidated financial statements because from the group's point of view the funding relates to an investment in a foreign operation. This is the case irrespective of the currency in which the loan is denominated. So, if the loan is denominated in T's functional currency, and this is different from that of S, then exchange differences still should be recognised in other comprehensive income in the consolidated financial statements.

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2.4.5 Change in functional currency

- Once an entity has determined its functional currency, it is not changed unless there is a change in the relevant underlying transactions, events and conditions.
- If circumstances change and a change in functional currency is appropriate, then the change is accounted for prospectively from the date of the change.

For example, a change in the currency that mainly influences the sales price of goods and services may lead to a change in an entity's functional currency.

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- For accounting the effect of a change in functional currency prospectively:
  - All items are translated into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost.
  - Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income are not reclassified from equity to profit or loss until the disposal of the operation.
  - Exchange gain or loss from long-term monetary items accumulated in equity (where such option is exercised) are not transferred to profit or loss immediately on change of the entity's functional currency; the balance would be transferred to profit or loss as per the manner provided by the option.
    - Since entities prefer to present financial statements in their functional currency, a change in functional currency may be accompanied by a change in presentation currency. The choice of presentation currency represents an accounting policy, and any change should be applied retrospectively in accordance with Ind AS 8, unless impracticable. This means that the change should be treated as if the new presentation currency had always been the entity's presentation currency, with comparative amounts being restated into the new presentation currency.

2.4.6 Lack of Exchangeability for Foreign Currencies

Amendment in Ind AS notification G.S.R. 291(E) dated 7th May, 2025

The Ministry of Corporate Affairs (MCA) issued the Companies (Indian Accounting Standards) Amendment Rules, 2025 on May 7, 2025, primarily amending Ind AS 21 regarding a "lack of exchangeability" for foreign currencies, effective for annual periods starting on or after April 1, 2025. These amendments align Ind AS 21 with IAS 21, guiding how to determine the spot rate when a currency cannot be exchanged into another currency.

Under Ind AS 21, The Effects of Changes in Foreign Exchange Rates, a company on initial recognition, uses a spot exchange rate when translating a foreign currency transaction at the date of the transaction. Additionally, Ind AS 21 requires the use of a spot exchange rate when an entity reports foreign operation's results and financial position in its financial statements. A spot exchange rate is the exchange rate for immediate delivery.

However, in rare circumstances, it is possible that one currency cannot be exchanged into another. This lack of exchangeability can have a significant accounting impact over affected companies.

In this regard, the Ministry of Corporate Affairs (MCA) notified the Companies (Indian Accounting

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Standards) Amendment Rules, 2025, on May 7, 2025, amending Ind AS 21, The Effects of Changes in Foreign Exchange Rates. Effective for annual periods beginning on or after April 1, 2025, the amendments address the lack of exchangeability between two currencies by explaining

- when a currency is exchangeable,
- providing guidance on estimating spot rates, and
- enhancing disclosure requirements.

Key highlights of the Amendment in Ind AS 21

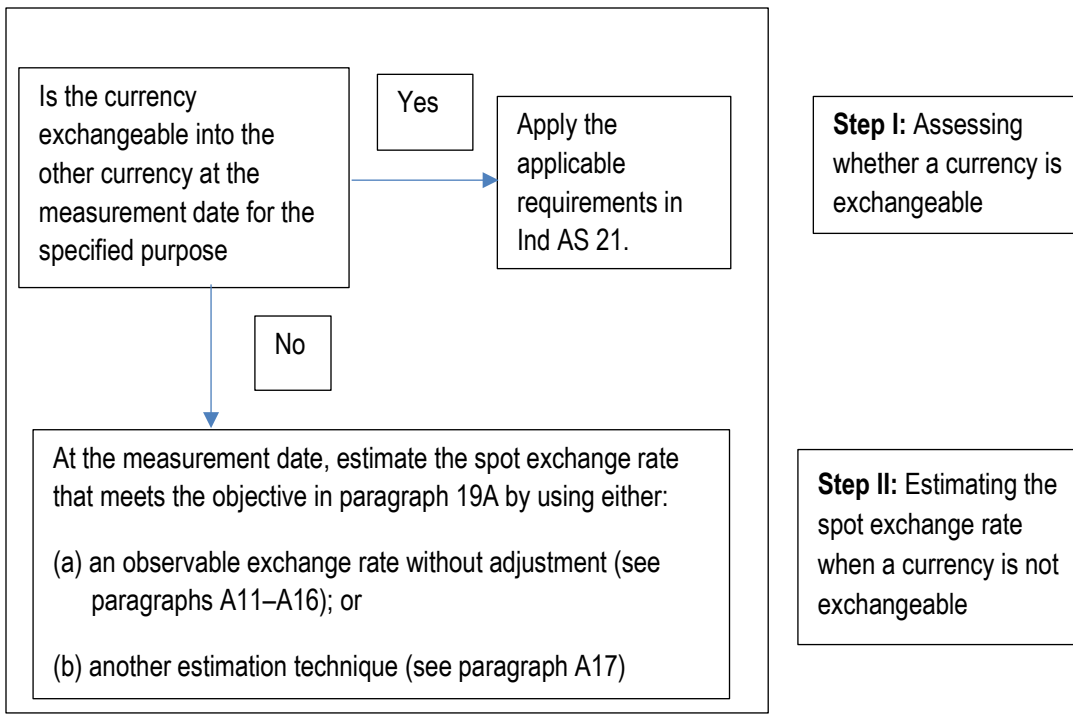
❖ **Definition of Exchangeability:** A currency is exchangeable into another when an entity can **obtain the other currency within a time frame allowing for normal administrative delay**, through a mechanism that **creates enforceable rights**.

❖ **Estimate Spot Rate:** If exchangeability is lacking, the entity must estimate the spot rate to translate transactions, ensuring it reflects an orderly transaction.

❖ **Two-Step Approach**

TWO-STEP APPROACH:

The following diagram is to help entities assess whether a currency is exchangeable and estimate the spot exchange rate when a currency is not exchangeable.



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STEP I: ASSESSING WHETHER A CURRENCY IS EXCHANGEABLE

An entity might determine that currency PC is not exchangeable into currency LC, even though currency LC is exchangeable into currency PC.

Following key factors are required to be considered when determining that a currency is exchangeable:

1. **Time frame:** An exchange transaction might not always complete instantaneously because of legal or regulatory requirements, or for practical reasons such as public holidays. A normal administrative delay in obtaining the other currency does not preclude a currency from being exchangeable into that other currency. What constitutes a normal administrative delay depends on facts and circumstances.

2. **Ability to obtain the other currency:** In assessing whether a currency is exchangeable into another currency, an entity shall consider its ability to obtain the other currency, rather than its intention or decision to do so. A currency is exchangeable into another currency if an entity is able to obtain the other currency either directly or indirectly, even if it intends or decides not to do so. For example, regardless of whether the entity intends or decides to obtain PC, currency LC is exchangeable into currency PC if an entity is able to either exchange LC for PC, or exchange LC for another currency (FC) and then exchange FC for PC.

3. **Markets or exchange mechanisms:** In assessing whether a currency is exchangeable into another currency, an entity shall consider only markets or exchange mechanisms in which a transaction to exchange the currency for the other currency would create enforceable rights and obligations. It depends on facts and circumstances.

4. **Purpose of obtaining the other currency:** Different exchange rates might be available for different uses of a currency. This could affect an entity's ability to obtain those currencies and thus, lead to lack of exchangeability. Hence, it would be important for an entity to consider the purpose for which it obtains the other currency.

5. **Ability to obtain only limited amounts of the other currency:** A currency is not exchangeable into another currency if an entity is able to obtain no more than an insignificant amount of the other currency. An entity shall assess the significance of the amount of the other currency it is able to obtain for a specified purpose by comparing that amount with the total amount of the other currency required for that purpose.

For example, an entity with a functional currency of LC has liabilities denominated in currency FC. The entity assesses whether the total amount of FC it can obtain for the purpose of settling those liabilities is no more than an insignificant amount compared with the aggregated amount (the sum) of its liability balances denominated in FC.

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Where a currency is exchangeable into another currency, then the existing principles of Ind AS 21 would be applied for translation of the foreign currency transaction. But, where a currency is not exchangeable, an entity has to apply Step II.

STEP II: ESTIMATING THE SPOT EXCHANGE RATE WHEN A CURRENCY IS NOT EXCHANGEABLE

When a currency is not exchangeable, a company needs to estimate a spot rate. A company's objective when estimating a spot rate is only that it reflects the rate at which an orderly exchange transaction would take place at the measurement date between market participants under prevailing economic conditions.

To estimate a spot rate, a company should consider using:

1. An observable exchange rate without adjustment

A company can use an observable rate if that rate satisfies the estimation objective – i.e. the rate reflects the price at which an orderly exchange transaction would take place at the measurement date between market participants under prevailing economic conditions.

To assess whether the exchange rates reflect the prevailing economic conditions, following needs to be considered:

- Whether several observable exchange rates exist
- The purpose for which the currency is exchangeable
- The nature of the exchange rate; and
- The frequency with which exchange rates are updated

Examples of an observable exchange rate include:

- A spot exchange rate for a purpose other than that for which the company is assessing exchangeability.
- The first exchange rate at which a company is able to obtain the other currency for its specified purpose after exchangeability is restored. If a company opts to use this rate as an observable rate, then it would also need to consider
  - the time between the measurement date and the date at which exchangeability is restored,
  - inflation rates.

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2. Using another estimation technique

When estimating a spot rate, the other alternative is that a company may use any observable exchange rate and adjust it as necessary. This includes using rates from exchange transactions in markets or exchange mechanisms that do not create enforceable rights and obligations- and adjust that rate, as necessary, to meet the estimation objective.

DISCLOSURE WHEN A CURRENCY IS NOT EXCHANGEABLE

An entity shall disclose:

(a) the currency and a description of the restrictions that result in that currency not being exchangeable into the other currency;

(b) a description of affected transactions;

(c) the carrying amount of affected assets and liabilities;

(d) the spot exchange rates used and whether those rates are:

  i. observable exchange rates without adjustment (see paragraphs A12–A16); or

  ii. spot exchange rates estimated using another estimation technique (see paragraph A17);

(e) a description of any estimation technique the entity has used, and qualitative and quantitative information about the inputs and assumptions used in that estimation technique; and

(f) qualitative information about each type of risk to which the entity is exposed because the currency is not exchangeable into the other currency, and the nature and carrying amount of assets and liabilities exposed to each type of risk.

When a foreign operation's functional currency is not exchangeable into the presentation currency or, if applicable, the presentation currency is not exchangeable into a foreign operation's functional currency, an entity shall also disclose:

(a) the name of the foreign operation; whether the foreign operation is a subsidiary, joint operation, joint venture, associate or branch; and its principal place of business;

(b) summarised financial information about the foreign operation; and

(c) the nature and terms of any contractual arrangements that could require the entity to provide financial support to the foreign operation, including events or circumstances that could expose the entity to a loss.

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2.5 USE OF A PRESENTATION CURRENCY OTHER THAN THE FUNCTIONAL CURRENCY

2.5.1 Translation to the presentation currency

- An entity measures items in its financial statements; but it may decide to present its financial statements in a currency or currencies other than its functional currency.

  For example, an entity with Rupees (₹) functional currency may choose to present its financial statements in US Dollar because of its reporting requirement in US.

- There can be situations wherein a group comprises operations with a number of functional currencies. Under Ind AS 21, there is no concept of a "group" functional currency. Rather the group has a presentation currency only. Each entity in the group prepares financial statements in its own functional currency and translates these financial statements into the group's presentation currency (if different) for consolidation purposes.

- The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy are translated into a different presentation currency as follows:

  (a) **assets and liabilities** for each balance sheet presented (i.e., including comparatives) are translated **at the closing rate** at the date of that balance sheet;

  (b) **income and expenses** are translated at exchange rates at the dates of relevant transactions; **average rates** for the period if often used if they are a reasonable approximation;

  (c) all **resulting exchange differences** should be **recognised in other comprehensive income** as they have little or no direct effect on the present and future cash flows from operations and are presented in a separate component of equity (generally referred to as the foreign currency translation reserve or currency translation adjustment) until disposal of the foreign operation;

  (d) cash flows are translated at exchange rates at the dates of the relevant transactions, although an appropriate average rate may be used.

- When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to non-controlling interests are allocated to, and recognized as a part of, non-controlling interest in the consolidated balance sheet.

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- The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency as follows:

  (a) all amounts (i.e. assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent balance sheet, except that

  (b) when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

    - When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with Ind AS 29 before applying the translation method set out above, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy.

2.6 TRANSLATION OF FOREIGN OPERATIONS

- The guidance provided on determining an entity's functional currency equally applies to determine the functional currency of a foreign operation of the entity.
- Effectively, the translation procedures those for translating foreign operations are the same as those followed when an entity presents its financial statements in a presentation currency that is different from its functional currency:

  (a) assets and liabilities are translated at the exchange rate at the reporting date;

  (b) items of income and expense are translated at exchange rates at the dates of the relevant transactions, although appropriate average rates may be used;

  (c) the resulting exchange differences are recognised in other comprehensive income and are presented in a separate component of equity (generally referred to as the foreign currency translation reserve or currency translation adjustment) until disposal of the foreign operation; and

  (d) cash flows are translated at exchange rates at the dates of the relevant transactions, although an appropriate average rate may be used.

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- In addition to the exchange difference as stated above, the foreign currency translation reserve may include exchange differences arising from loans that form part of the parent's net investment in the foreign operation and gains and losses related to hedges of a net investment in a foreign operation.

2.7 DIFFERENCE IN THE REPORTING DATES

- When there is difference in the year end of foreign operation and that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements.
- When such financial statements are not prepared, Ind AS 110 allows the use of a different date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates.
- In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the end of the reporting period of the foreign operation.
- Adjustments are made for significant changes in exchange rates up to the end of the reporting period of the reporting entity in accordance with Ind AS 110.
- A similar approach is used in applying the equity method to associates and joint ventures in accordance with Ind AS 28, *Investment in Associates and Joint Ventures.*

2.8 INTRA-GROUP TRANSACTIONS

- Although intra-group balances are eliminated on consolidation, any related foreign exchange gains or losses will not be eliminated. This is because the group has a real exposure to a foreign currency since one of the entities will need to obtain or sell foreign currency in order to settle the obligation or realise the proceeds received.
- Accordingly, in the consolidated financial statements of the reporting entity, the exchange difference arising on such intra group transactions is recognised in the statement of profit or loss account, unless it arises from a monetary item that forms part of a reporting entity's net investment in a foreign operation in which case it is taken to other comprehensive income.

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- A Group may have intra-group transactions like sale and purchase of various assets such as property, plant and equipment, intangible assets or inventory. These transactions could result in intra-group profits or losses. At the time of consolidation, these profits / losses are eliminated until the profit or loss is realized i.e. when the asset is sold outside the group, depreciated, amortised or written off as per the requirements of Ind AS 110. The elimination of intra-group profits / losses arising from such transactions, like sales between entities that are consolidated, should be based on the spot rate i.e. the exchange rate of the date of the sale.

Example 2

Parent P has USD as its functional currency and Subsidiary S has Euro as its functional currency. P, whose reporting date is 31st March, lends USD 100 to S on 30th September, 20X1. S converted the loan amount received into Euro on receipt.

	USD		EURO
Exchange rate at 30th September, 20X1	1	=	1.5
Exchange rate at 31st March, 20X2	1	=	2.0

Entries in the books of account of S			**Debit (EURO)**	**Credit (EURO)**
Date	Particulars			
30th September, 20X1	Bank A/c	Dr.	150	
	To Intra-group payable			150
	(To recognize intra-group loan)			
31st March, 20X2	Exchange loss A/c	Dr.	50	
	To Intra-group payable			50
	(To recognize exchange loss on intra-group loan)			

In S's second entry, the liability is remeasured at 31st March, 20X2 and a translation loss is recorded.

Entries in the books of account of P

			Debit (USD)	**Credit (USD)**
30th September,20X1	Intra group receivable	Dr.	100	
	To Bank			100
	(To recognize intra-group loan on issue)			

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On consolidation at 31st March, 20X2, the receivable and payable (in respect of Intra-group receivable and payable) will be eliminated. However, an exchange loss equivalent to EURO 50 for the year ended 31st March, 20X2 will remain on consolidation. This is appropriate because S will need to obtain USD in order to repay the liability. Therefore, the group has a foreign currency exposure. The exchange loss will be taken to consolidated profit or loss, unless the loan forms part of P's net investment in S in which case it will be transferred to other comprehensive income at the time of consolidation.

Illustration 7

The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = Euro 2. At year-end, the amount is still due, and the exchange rate is USD 1 = Euro 2.2.

Advise how should the exchange difference, if any, be accounted for in the consolidated financial statements.

Solution

At year-end, S should restate its accounts payable to EURO 220, recognising a loss of Euro 20 in its profit or loss. Thus, in the books of S, the balance payable to P will appear at EURO 220 while in the books of P the balance receivable from S will be USD 100.

For consolidation purposes, the assets and liabilities of S will be translated to USD at the closing rate.

At the time of consolidation, USD 100 which will get eliminated against the receivable in the books of P but the exchange loss of EURO 20 recorded in the subsidiary's statement of profit or loss has no equivalent gain in the parent's financial statements. Therefore, exchange loss of EURO 20 will remain in the consolidated statement of profit or loss.

The reason for this is that the intra-group balance represents a commitment to translate Euro into USD and this is similar to holding a foreign currency asset in the books of the parent company. i.e. the subsidiary would be required to buy USD to settle the obligation to the parent, so the Group has an exposure to foreign currency risk.

*****

Illustration 8

M Ltd is engaged in the business of manufacturing of bottles for pharmaceutical companies and non-pharmaceutical companies. It has a wholly owned subsidiary, G Ltd, which is engaged in the business of pharmaceuticals. G Ltd purchases the pharmaceutical bottles from its parent company. The demand of G Ltd is very high and hence to cater to its shortfall, G Ltd also purchases the bottles from other companies. Purchases are made at the competitive prices.

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M Ltd sold pharmaceuticals bottles to G Ltd for Euro 12 lacs on 1st February, 20X1. The cost of these bottles was ₹ 830 lacs in the books of M Ltd at the time of sale. At the year-end i.e. 31st March, 20X1, all these bottles were lying as closing stock and payable with G Ltd.

Euro is the functional currency of G Ltd. while Indian Rupee is the functional currency of M Ltd.

Following additional information is available:

Exchange rate on 1st February, 20X1 *1 Euro = ₹ 83*

Exchange rate on 31st March, 20X1 *1 Euro = ₹ 85*

Provide the accounting treatment for the above in books of M Ltd. and G Ltd. Also show its impact on consolidated financial statements. Support your answer by Journal entries, wherever necessary, in the books of M Ltd.

Solution

Accounting treatment in the books of M Ltd (Functional Currency Rupees (₹))

M Ltd will recognize sales of ₹ 996 lacs (12 lacs Euro x 83)

Profit on sale of inventory =₹ 996 lacs – ₹ 830 lacs = ₹ 166 lacs.

On balance sheet date, receivables from G Ltd. will be translated at closing rate i.e. 1 Euro = ₹ 85. Therefore, unrealised forex gain will be recorded in standalone profit and loss of ₹ 24 lacs. (i.e. (85 - 83) x 12 Lacs)

Journal Entries

		₹ (in Lacs)	₹ (in Lacs)
G Ltd. A/c	Dr.	996	
To Sales			996
(Being revenue recorded on initial recognition)			
G Ltd. A/c	Dr.	24	
To Foreign exchange difference (unrealised)			24
(Being foreign exchange difference recorded at year end)			

Accounting treatment in the books of G Ltd (Functional currency EURO)

G Ltd will recognize purchases on 1st February, 20X1 of Euro 12 lacs which will also be its closing stock at year end.

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Journal Entry

		(in Euros)	(in Euros)
Purchases	Dr.	12 lakhs	
To M Ltd.			12 lakhs

Accounting treatment in the consolidated financial statements

Receivable and payable in respect of above-mentioned sale / purchase between M Ltd and G Ltd will get eliminated.

The closing stock of G Ltd will be recorded at lower of cost or NRV.

	Euro (in lacs)	Rate	₹ (in lacs)
Cost	12	83	**996**
NRV (Assumed Same)	12	85	1020

Therefore, no write off is required.

The amount of closing stock of ₹ 996 lacs includes two components–

- Cost of inventory for ₹830 lacs; and
- Profit element of ₹166 lacs; and

At the time of consolidation, the second element amounting to ₹166 lacs will be eliminated from the closing stock.

Journal Entry

		₹ (in Lacs)	₹ (in Lacs)
Consolidated P&L A/c	Dr.	166	
To Inventory			166
(Being profit element of intragroup transaction eliminated)			

*****

2.8.1 Dividends

If a subsidiary pays a dividend to the parent during the year the parent should record the dividend at the rate ruling when the dividend was declared. An exchange difference will arise in the parent's own financial statements if the exchange rate moves between the declaration date and the date the dividend is actually received. This exchange difference is required to be recognised in profit or loss and will remain there on consolidation.

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The same will apply if the subsidiary declares a dividend to its parent on the last day of its financial year and this is recorded at the year-end in both entities' financial statements. There is no problem in that year as both the intragroup balances and the dividends will eliminate on consolidation with no exchange differences arising. However, as the dividend will not be received until the following year an exchange difference will arise in the parent's financial statements in that year if exchange rates have moved in the meantime. Again, this exchange difference should remain in consolidated profit or loss as it is no different from any other exchange difference arising on intragroup balances resulting from other types of intragroup transactions. It should not be recognised in other comprehensive income.

It may seem odd that the consolidated results can be affected by exchange differences on inter-company dividends. However, once the dividend has been declared, the parent now effectively has a functional currency exposure to assets that were previously regarded as part of the net investment. In order to minimise the effect of exchange rate movements entities should, therefore, arrange for inter-company dividends to be paid on the same day the dividend is declared, or as soon after the dividend is declared as possible.

2.9 GOODWILL AND FAIR VALUE ADJUSTMENTS ARISING FROM A BUSINESS COMBINATION

- Any goodwill and any fair value adjustments to the carrying amounts of assets and liabilities arising on a foreign operation's acquisition are treated as assets and liabilities of the foreign operation.
- Hence, they are expressed in the functional currency of the foreign operation and should be translated at the closing exchange rate as is the case for other assets and liabilities.

2.10 DISPOSAL OR PARTIAL DISPOSAL OF FOREIGN OPERATIONS

2.10.1 Full disposal

- A disposal may arise, for example, through sale, liquidation or repayment of share capital. On disposal of the foreign operation, the cumulative exchange differences relating to that foreign operation recognised in other comprehensive income and accumulated in equity are reclassified from equity to profit or loss (reclassification adjustment) when the gain or loss on disposal is recognised.

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- On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences related to that foreign operation that have been attributed to the non-controlling interests is derecognised, but it is not reclassified to profit or loss.
- In addition to the disposal of an entity's entire interest in a foreign operation, the following partial disposals are accounted for as disposals:
  - when the partial disposal involves the loss of control of a subsidiary that includes a foreign operation, regardless of whether the entity retains a non-controlling interest (NCI) in its former subsidiary after the partial disposal; and
  - when the retained interest after the partial disposal of an interest in a joint arrangement or a partial disposal of an interest in an associate that includes a foreign operation is a financial asset that includes a foreign operation.

Example 3

Parent P owns 100 percent of foreign subsidiary S. P sells 70 percent of its investment and loses control of S. The entire balance in the foreign currency translation reserve in respect of S is reclassified to profit or loss.

2.10.2 Partial disposal

A partial disposal of an entity's interest in a foreign operation is any reduction in an entity's ownership interest in a foreign operation, except for those reductions that are accounted for as disposals.

In the case of the partial disposal of a subsidiary that includes a foreign operation, the entity re-attributes the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the NCI in that foreign operation.

In any other partial disposal of a foreign operation, the entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

Examples 4 & 5

4. Parent P owns 100 percent of foreign subsidiary S. P sells 10 percent of its investment and retains control over S. Therefore, 10 percent of the balance in the foreign currency translation reserve is reclassified to NCI.
5. Parent P owns 35 percent of foreign associate B. P sells a 5 percent stake and retains significant influence over B. Therefore, one-seventh (5/35) of the balance in the foreign currency translation reserve is reclassified to profit or loss.

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A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

2.11 TAX EFFECT OF ALL EXCHANGE DIFFERENCES

Ind AS 12, Income Taxes, applies to tax effects of gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency.

2.12 DISCLOSURES

Ind AS 21 requires following disclosures:

(a) amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with Ind AS 109;

(b) net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity, along with the reconciliation of the amount at the beginning and end of the period;

(c) when the presentation currency is different from the functional currency - that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency;

(d) in case of change in functional currency of either the reporting entity or a significant foreign operation:

  (i) fact of such change;

  (ii) reason for the change and;

  (iii) date of change in functional currency;

(e) if presentation currency is different from functional currency, the financial statements can be described as complying with Ind AS only if all Ind AS including the translation method of this Standard is complied with.

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However, if an entity presents its financial statements or supplementary financial information in a currency other than its functional or presentation currency:

(i) the information should be clearly identified as supplementary information to distinguish it from the information that complies with Ind AS;

(ii) the currency in which the supplementary information is displayed should be disclosed; and

(iii) the entity's functional currency and the method of translation used to determine the supplementary information should be disclosed.

2.13 EXTRACTS OF FINANCIAL STATEMENTS OF LISTED ENTITY

Following is the extract from the financial statements of the listed entity 'Tata Consultancy Services Limited' for the financial year 2021-2022 with respect to Ind AS 21 'The Effects of Changes in Foreign Exchange Rates'.

Basis of preparation

The functional currency of the Company and its Indian subsidiaries is the Indian Rupee (₹). The functional currency of foreign subsidiaries is the currency of the primary economic environment in which the entity operates. Foreign currency transactions are recorded at exchange rates prevailing on the date of the transaction. Foreign currency denominated monetary assets and liabilities are retranslated at the exchange rate prevailing on the balance sheet dates and exchange gains and losses arising on settlement and restatement are recognised in the statement of profit and loss. Non-monetary assets and liabilities that are measured in terms of historical cost in foreign currencies are not retranslated.

Foreign currency translation reserve

The exchange differences arising from the translation of financial statements of foreign operations with functional currency other than Indian Rupee is recognised in other comprehensive income and is presented within equity in the foreign currency translation reserve.

(Source: Annual Report for 2021-2022 of Tata Consultancy Services Limited)

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2.14 SIGNIFICANT DIFFERENCES IN IND AS 21 VIS-À-VIS AS 11

S. No.	Particulars	Ind AS 21	AS 11
1.	*Forward Exchange Contracts and other similar Financial Instruments*	Excludes from its scope forward exchange contracts and other similar financial instruments, which are treated in accordance with Ind AS 109.	AS 11 deals with accounting for forward exchange contracts (except forward exchange contracts entered into to hedge the foreign currency risks of future transactions in respect of which firm commitments are made or which are highly probable forecast transactions).
2.	*Exchange Differences arising on Translation of Certain Long-term Monetary Items from Foreign Currency to Functional Currency*	Ind AS 21 does not give the above option. However, Ind AS 21 does not apply to long-term foreign currency monetary items recognised in the financial statements before the beginning of the first Ind AS financial reporting period as per the previous GAAP, i.e. AS 11. However, as provided in Ind AS 101, such an entity may continue to apply the accounting policy so opted for such long-term foreign currency monetary items as per the previous GAAP.	AS 11, gives an option to recognise exchange differences arising on translation of certain long-term monetary items from foreign currency to functional currency directly in equity, to be transferred to profit or loss over the life of the relevant liability/asset if such items are not related to acquisition of depreciable capital assets; where such items are related to acquisition of depreciable capital assets, the foreign exchange differences can be recognised as part of the cost of the asset. (paragraphs 46 and 46A of AS 11)
3.	*Approach for Translation*	Ind AS 21 is based on functional currency approach. An entity is required to determine its	Under AS 11 there is no concept of functional currency. The method used to translate the financial statements of a

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		functional currency which can be different from its presentation currency based on factors envisaged in the standard.	foreign operation depends on the classification of foreign operation (integral foreign operation or non-integral foreign operation).
4.	*Presentation Currency*	As per Ind AS 21, presentation currency can be different from local currency and it gives detailed guidance in this regard.	AS 11 does not explicitly state so.
5.	*Exchange differences on monetary items, forming part of net investment in a foreign operation*	As per Ind AS 21 (paragraph 32), exchange differences on monetary items, that in substance, form part of net investment in a foreign operation, are recognised in profit or loss in the period in which they arise in the separate financial statements and in other comprehensive income in the consolidated financial statements and reclassified from equity to profit or loss on disposal of the net investment.	As per AS 11, exchange differences on monetary items, that in substance, form part of net investment in a foreign operation, are recognised in 'Foreign Currency Translation Reserve' both in the separate and consolidated financial statements until the disposal of the net investment, at which time income or expense on the same are recognised in profit or loss.
6.	*Guidance on foreign Currency Transactions and Advance Consideration*	Ind AS 21 includes Appendix B which gives guidance on foreign Currency Transactions and Advance Consideration	AS 11 does not contain such guidance.

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TEST YOUR KNOWLEDGE

Questions

1. Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for ₹ 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is ₹ 100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of ₹ 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of ₹ 180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is ₹ 20 lakhs

   Calculate P's gain on disposal in its consolidated financial statements.

2. Entity A, whose functional currency is Rupees (₹), has a foreign operation, Entity B, with a Euro functional currency. Entity B issues to A perpetual debt (i.e. it has no maturity) denominated in euros with an annual interest rate of 6 per cent. The perpetual debt has no issuer call option or holder put option. Thus, contractually it is just an infinite stream of interest payments in Euros.

   Analyse in A's consolidated financial statements, whether the perpetual debt can be considered in accordance with para 15 of Ind AS 21, a monetary item "for which settlement is neither planned nor likely to occur in the foreseeable future" (i.e. part of A's net investment in B), with the exchange gains and losses on the perpetual debt therefore being recorded in equity?

3. Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$).

   The following balances appear in the books of Infotech Global Ltd. at the year-end prior to translation:

	USD	L$
Property, plant and equipment	50,000	
Receivables	9,35,000	
Total assets	**9,85,000**	
Issued capital	50,000	30,055
Opening retained earnings	28,000	15,274

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Profit & Loss A/c (Profit for the year)	20,000
Accounts payable	8,40,000
Accrued liabilities	47,000
Total equity and liabilities	**9,85,000**

Translate the above balances of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre-populated.)

Prepare a working of the cumulative balance of the foreign currency translation reserve.

Additional information:

Relevant exchange rates are:

Rate at beginning of the year L$ 1 = USD 1.22

Average rate for the year L$ 1 = USD 1.175

Rate at end of the year L$ 1 = USD 1.13

4. On 30th January, 20X1, A Ltd. purchased a machinery for $ 5,000 from USA supplier on credit basis. A Ltd.'s functional currency is Rupees. The exchange rate on the date of transaction is 1 $ = ₹ 60. The fair value of the machinery determined on 31st March, 20X1 is $ 5,500. The exchange rate on 31st March, 20X1 is 1$ = ₹ 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1$ = ₹ 67. The fair value of the machinery remains unchanged for the year ended on 31st March 20X2. Tax rate is 30%. A Ltd. follows revaluation method in respect of Plant & Machinery.

   Pass the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21.

5. On 1st January, 20X2, P Ltd. purchased a machine for $ 2 lakhs. The functional currency of P Ltd. is Rupees. At that date the exchange rate was $1= ₹ 68. P Ltd. is not required to pay for this purchase until 30th June, 20X2. Rupees strengthened against the $ in the three months following purchase and by 31st March, 20X2 the exchange rate was $1 = ₹ 65. CFO of P Ltd. feels that these exchange fluctuations wouldn't affect the financial statements because P Ltd. has an asset and a liability denominated in rupees, which was initially the same amount. He also feels that P Ltd. depreciates this machine over four years so the future year-end amounts won't be the same.

   Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 20X2 as per Ind AS.

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Answers

1. P's gain on disposal in its consolidated financial statements would be calculated in the following manner:

	(₹ in Lakhs)
Sale proceeds	1,500
Net assets of S	(1,000)
NCI derecognised	100
Foreign currency translation reserve	180
Gain on disposal	780

2. Yes, as per Ind AS 21 net investment in a foreign operation is the amount of the reporting entity's interest in the net assets of that operation.

As per para 15 of Ind AS 21, an entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

Analysis on the basis of above mentioned guidance

Through the origination of the perpetual debt, A has made a permanent investment in B. The interest payments are treated as interest receivable by A and interest payable by B, not as repayment of the principal debt. Hence, the fact that the interest payments are perpetual does not mean that settlement is planned or likely to occur. The perpetual debt can be considered part of A's net investment in B.

In accordance with para 15 of Ind AS 21, the foreign exchange gains and losses should be recorded in equity at the consolidated level because settlement of that perpetual debt is neither planned nor likely to occur.

3. **Translation of the balances for the purpose of consolidation**

	USD	Rate	L$
Property, plant and equipment	50,000	1.13	44,248
Receivables	9,35,000	1.13	8,27,434
Total assets	**9,85,000**		**8,71,682**

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Issued capital	50,000	—	30,055
Opening retained earnings	28,000	—	15,274
Profit for the year	20,000	1.175	17,021
Accounts payable	8,40,000	1.13	7,43,363
Accrued liabilities	47,000	1.13	41,593
Total equity and liabilities USD	**9,85,000**		**8,47,306**
Foreign Currency Translation Reserve (Refer WN-1)			**24,376**
Total equity and liabilities L$			**8,71,682**

Working Note

1 Cumulative balance of the FCTR

Particulars	Actual translated amount in L$	Amount (Refer WN-2)	Difference
	A	B	B-A
Issued capital	30,055	44,248	14,193
Opening retained earnings	15,274	24,779	9,505
Profit for the year	17,021	17,699	678
	62,350	**86,726**	**24,376**

2 Translated amount if the same conversion rate is applied to following items as applied on other items

			Translated amount
Issued capital	50,000	1.13	44,248
Opening retained earnings	28,000	1.13	24,779
Profit for the year	20,000	1.13	17,699
	98,000		**86,726**

4. Journal Entries

Purchase of Machinery on credit basis on 30th January 20X1:

		₹	₹
Machinery A/c ($ 5,000 x ₹ 60)	Dr.	3,00,000	
To Creditors-Machinery A/c			3,00,000
(Initial transaction will be recorded at exchange rate on the date of transaction)			

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Exchange difference arising on translating monetary item on 31st March 20X1:

		₹	₹
Profit & Loss A/c [($ 5,000 x ₹ 65) – ($ 5,000 x ₹ 60)]	Dr.	25,000	
To Creditors-Machinery A/c			25,000
Machinery A/c	Dr.	30,000	
To Revaluation Surplus (OCI)			30,000
[Being Machinery revalued to USD 5,500; (₹ 60 x ($ 5,500 - $ 5,000)]			
Machinery A/c	Dr.	27,500	
To Revaluation Surplus (OCI)			27,500
(Being Machinery measured at the exchange rate on 31.3.20X1 [$ 5,500 x (₹ 65 - ₹ 60)]			
Revaluation Surplus (OCI)	Dr.	17,250	
To Deferred Tax Liability			17,250
(DTL created @ of 30% of the total OCI amount)			

Exchange difference arising on translating monetary item and settlement of creditors on 31st March 20X2:

		₹	₹
Creditors-Machinery A/c ($ 5,000 x ₹ 65)	Dr.	3,25,000	
Profit & loss A/c [(5,000 x (₹ 67 -₹ 65)]	Dr.	10,000	
To Bank A/c			3,35,000
Machinery A/c [{$ 5,500 x (₹ 67 - ₹ 65)}]	Dr.	11,000	
To Revaluation Surplus (OCI)			11,000
Revaluation Surplus (OCI)	Dr.	3,300	
To Deferred Tax Liability			3,300
(DTL created @ of 30% of the total OCI amount)			

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5. As per Ind AS 21 'The Effects of Changes in Foreign Exchange Rates' the asset and liability would initially be recognised at the rate of exchange in force at the transaction date ie 1st January, 20X2. Therefore, the amount initially recognised would be ₹ 1,36,00,000 ($ 2,00,000 x ₹ 68).

The liability is a monetary item, so it is retranslated using the rate of exchange in force at 31st March, 20X2. This makes the closing liability of ₹ 1,30,00,000 ($ 2,00,000 x ₹ 65).

The gain on re-translation of ₹ 6,00,000 (₹ 1,36,00,000 – ₹ 1,30,00,000) is recognised in the Statement of profit and loss.

The machine is a non-monetary asset carried at historical cost. Therefore, it continues to be translated using the rate of ₹ 68 to $ 1.

Depreciation of ₹ 8,50,000 (₹ 1,36,00,000 x ¼ x 3/12) would be charged to profit or loss for the year ended 31st March, 20X2.

The closing balance in property, plant and equipment would be ₹ 1,27,50,000 (₹ 1,36,00,000 – ₹ 8,50,000). This would be shown as a non-current asset in the balance sheet.

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