Indian Accounting Standard (Ind AS) 21
The Effects of Changes in Foreign Exchange Rates

AJSH & Co LLP
Chartered Accountants

AJSH & Co LLP
Chartered Accountants

INDEX

AJSH & Co LLP
Chartered Accountants

INDEX

1

OBJECTIVE AND SCOPE

AJSH & Co LLP
Chartered Accountants

Objective and Scope

Objective

- To prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

Scope

- Accounting for transactions and balance in foreign currency.
- Translation of results and financial position of foreign operations.
- Translation of financial statements into presentation currency.

AJSH & Co LLP
Chartered Accountants

2 Important Definitions

AJSH & Co LLP
Chartered Accountants

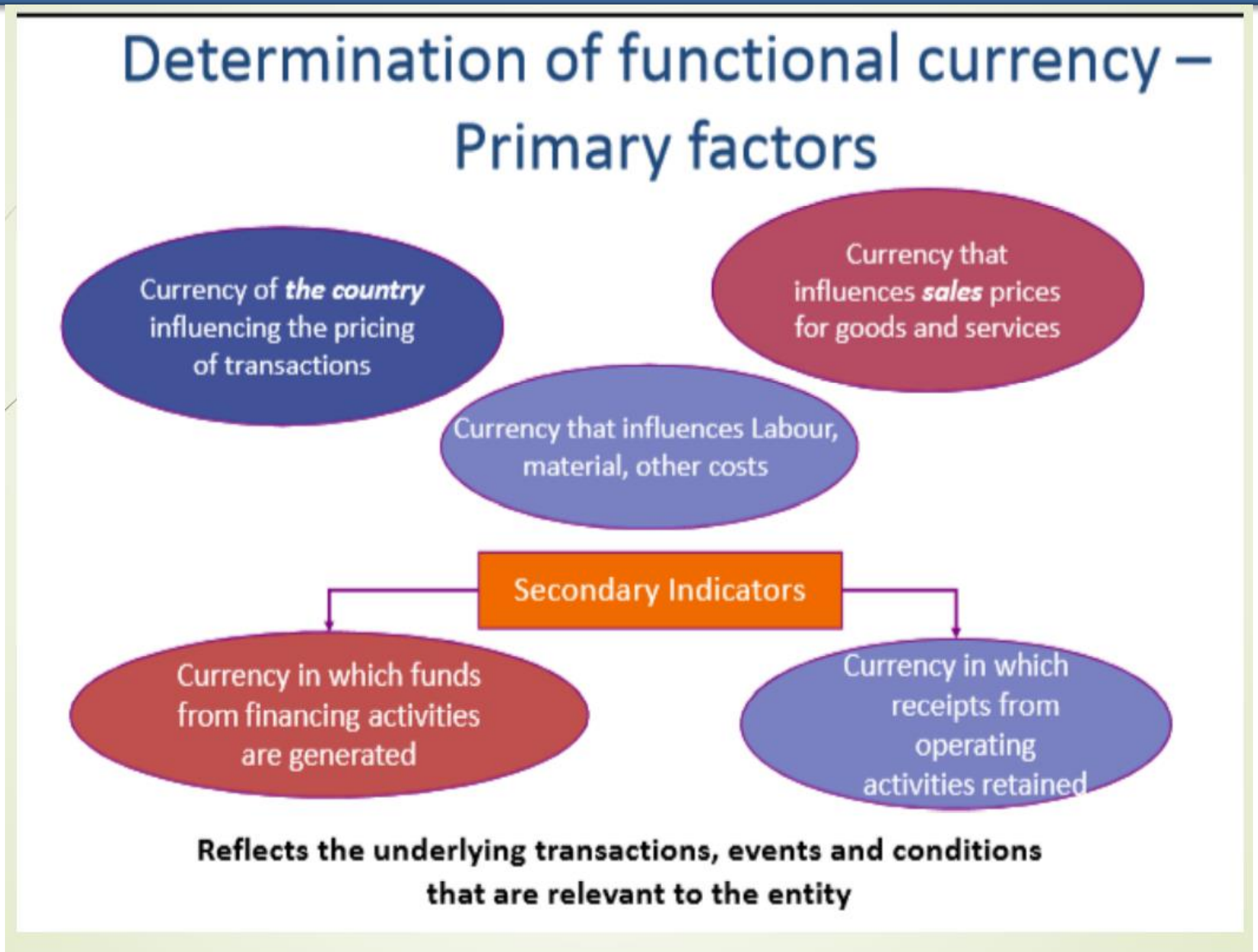
Important Definitions

- **Functional Currency**:- The currency of the primary economic environment in which the entity operates.
- **Foreign currency** is a currency other than the functional currency of the entity.
- **Presentation Currency:-** The currency in which financial statements are presented.
- **Foreign Operations**:- A subsidiary, associate, joint venture, or branch whose activities are based in the country other than that of the reporting entity.
- **Monetary items** are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency
- **Closing rate**:- Is the spot exchange rate at the end of the reporting period.
- **Fair value**:- The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction

3

Factors for determining the functional currency

Factors for determining the functional currency:



Factors for determining the functional currency:

The Currency:

- the currency in which sales prices for its goods and services are denominated and settled.
- of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
- the currency in which such costs are denominated and settled.

The currency:

- in which funds from financing activities are generated.
- in which receipts from operating activities are usually retained.

Factors for determining the functional currency:

If entity is foreign operation, additional factors set out by Standard to determine whether its functional currency is same as that of Reporting Entity of which it is a subsidiary, branch, Associate or Joint venture etc.

- Activities carried out with significant degree of autonomy or is an extension.
- Majority transaction with Reporting Entity.
- Foreign Operation's cash flows directly affect Reporting Entity's cash flows.

AJSH & Co LLP
Chartered Accountants

Factors for determining the functional currency:

Determination of functional currency – Additional factors

Foreign Operations

Degree of independence of a foreign operation from its parent

Proportion of transactions between a foreign operation and its parent

Influence of a foreign operation's ***cash flows*** on its parent's cash flows

Financial autonomy (self sufficient) of a foreign operation

AJSH & Co LLP
Chartered Accountants

4

Reporting foreign currency transactions in the functional currency

AJSH & Co LLP
Chartered Accountants

Reporting foreign currency transactions in the functional currency:

A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

- buys or sells goods or services whose price is denominated in a foreign currency;
- borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency;
- otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
- **A foreign currency transaction shall be recorded in the functional currency at the spot exchange rate at the date of the transaction.**

AJSH & Co LLP
Chartered Accountants

5 Net Investment in Foreign Operations

AJSH & Co LLP
Chartered Accountants

Net Investment in Foreign Operations:

- A monthly item Receivable /Payable to foreign operation may form part of Net Investment in foreign operation, if settlement neither planned not likely to occur in foreseeable future. Such Monetary items include long term Receivables loans but do not include trade receivables/ trade payables.

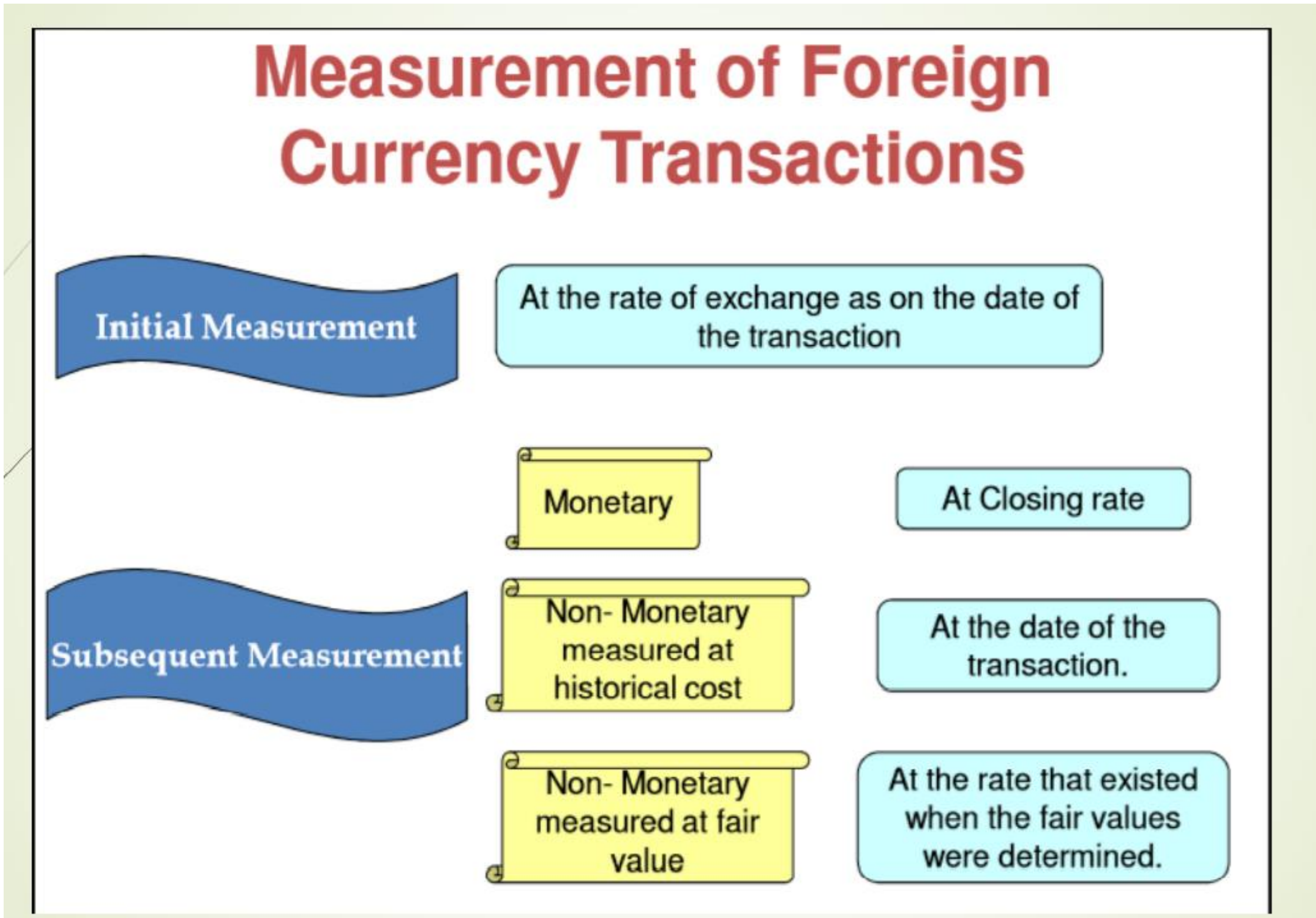
- In Separate FS- Exchange difference recognised in P&L

- In Consolidated FS- Exchange difference initially recognised in OCI and then reclassified from Equity to P&L on disposal.

Monetary items

- The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency, (for example Lease liabilities, Debtors, creditors, loans etc).
- Exchange difference on settlement translating monetary items recognised in P&L

Measurement of foreign currency transactions



6

Change in Functional Currency

AJSH & Co LLP
Chartered Accountants

Change in Functional Currency

- if circumstances change (a change in currency that mainly influence sales price of goods services)the Change is accounted prospectively from the date of change.

- <u>Accounting Treatment:-</u>

- -All items (Assets, liabilities, Income and expenses) are translated into new functional currency using exchange rate at the date of change.

AJSH & Co LLP
Chartered Accountants

7

Use of Presentation currency other than functional currency/ Foreign Operation

Use of Presentation currency other than functional currency/ Foreign Operation

- An entity may present financial statements in currency other than its functional currency.

Translations:-

- Assets and liabilities are to be translated at closing rate.
- Income Expenses are to be translated at ER at the date of transaction (Average ER can be used).
- All resulting exchange difference shall be recognised in OCI (as it is not actual loss or gain).

8

Intra group transactions

Intra group transactions

- Intra Group Balances are eliminated on consolidation but related foreign Exchange Gains/ loss will not be eliminated.

- In CFS- ED Recognised in P&L, however it is taken to OCI if Balances forms part of Net Investment in Foreign Operation.

AJSH & Co LLP
Chartered Accountants

9 Difference in reporting dates

Difference in reporting dates

- When there is difference in the year end of foreign operation and that of the reporting entity, the FO often prepares additional statements as of the same date as the reporting entity's FS.
- When such FS are not prepared, Ind AS 110 allows the use of a different date provided that the difference is no greater than 3 months and adjustments are made for the effects of any significant transactions that occur between the different dates.
- In such case , assets and liabilities of FO are translated at ER at the end of the reporting period of the FO.

AJSH & Co LLP
Chartered Accountants

10 Disposal or partial disposal of a foreign operation

AJSH & Co LLP
Chartered Accountants

Disposal or partial disposal of a foreign operation

On the disposal of a foreign operation,

- Cumulative amount of the exchange differences relating to that foreign operation, recognised in OCI.
- To be reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised.

AJSH & Co LLP
Chartered Accountants

11 Other Comprehensive Income

Other Comprehensive Income

- In business accounting, **other comprehensive income** (OCI) includes revenues, expenses, gains, and losses that have yet to be realized and are excluded from net income on an income statement.

- other comprehensive income cannot be reported as part of a company's net income and cannot be included in its income statement. The profit or. Instead, the figures are reported as accumulated other comprehensive income **under shareholders' equity on the company's balance sheet**

Other Comprehensive Income

Balance Sheet

Assets	
Cash	200
Short-term investment	100
Inventory	700
TOTAL ASSETS	**1000**
Liabilities	
Current liabilities	100
Long-term liabilities	100
Total Liabilities	200
Shareholders' Equity	
Common shares	600
Retained earnings	150
Accumulated other comprehensive income	50
Total Shareholder's Equity	800
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	**1000**

12

Illustrations

AJSH & Co LLP
Chartered Accountants

Illustrations

Entity P has a foreign subsidiary Entity S1. The functional currencies of Entities P and S1 are Rupee and US$ respectively. Both the entities follow financial year as accounting year. Accounting Year of both the entities ends on March 31. The presentation currency for Entity P's separate as well as consolidated financial statements is Rupee.

In all the following situations, it is assumed that the loan forms part of the entity's net investment in the foreign operation.

Situation 1:

Entity S1 owes to Entity P US$1,000 towards a loan obtained some years back. Exchange rates as at 31 March 20X0 and 31 March 20X1 were US$ 1=Rs. 48 and US$ 1=Rs. 50 respectively.

In the above situation, in the individual financial statements of Entity S1, no exchange difference arises on the loan since it is denominated in its own functional currency.

In the separate financial statements of Entity P, an exchange gain of Rs. 2,000 arises as shown below:

	Rs.
Loan asset of US$1,000 translated	
@ exchange rate as at 31 March 20X1 (Rs. 50 per US$)	50,000
@ exchange rate as at 31 March 20X0 (Rs. 48 per US$)	48,000
Exchange gain	2,000

In the consolidated financial statements of Entity P, the exchange gain of Rs. 2,000 will be recognised in other comprehensive income and accumulated in equity.

Illustrations

Situation 2:

Entity S1 owes to Entity P Rs. 48,000 towards a loan obtained some years back. For the purpose of this example, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates during the year. Exchange rates as at 31 March 20X0 and 31 March 20X1 were US$ 1=Rs. 48 and US$ 1=Rs. 50 respectively. Average exchange rate during the financial year ending 31 March 20X1 was US$ 1=Rs. 49.

In the above situation, in the separate financial statements of Entity P, no exchange difference arises on the loan since it is denominated in its own functional currency.

In the individual financial statements of Entity S1, an exchange gain of US$40 arises as shown below:

	US$
Loan liability of Rs. 48,000 translated	
@ exchange rate as at 31 March 20X1(Rs. 50 per US$)	960
@ exchange rate as at 31 March 20X0(Rs. 48 per US$)	1,000
Exchange gain	40

After translating the financial statements of Entity S1 into Rupees in accordance with paragraphs 38-47 of Ind AS 21, in the consolidated financial statements of Entity P, the exchange gain in terms of Rupee corresponding to US$40 i.e. Rs. 1,960 (US$40 @ Rs. 49)' will be recognised in other comprehensive income and accumulated in equity.

Illustrations

Situation 3:

Entity S1 owes to Entity P •1,000 towards a loan obtained some years back.

Exchange rates:

As at 31 March 20X0	As at 31 March 20X1
•1=Rs. 60	•1=Rs. 61
•1=US$1.3	•1=US$.1.4

Average exchange rate between US$ and Rupee during the financial year ending 31 March 20X1 was US$ 1= Rs. 45. For the purpose of this example, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates during the year.

In the separate financial statements of Entity P, an exchange gain of Rs. 1,000 arises as shown below:

AJSH & Co LLP
Chartered Accountants

Illustrations

In the separate financial statements of Entity P, an exchange gain of Rs. 1,000 arises as shown below:

	Rs.
Loan asset of •1,000 translated	
@ exchange rate as at 31 March 20X1(Rs. 61 per •)	61,000

Average exchange rate between US$ and Rupee during the financial year ending 31 March 20X1 was US$ 1= Rs. 45. For the purpose of this example, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates during the year.

In the separate financial statements of Entity P, an exchange gain of Rs. 1,000 arises as shown below:

Illustrations

In the individual financial statements of Entity S1, an exchange loss of US$100 arises as shown below:

	US$
Loan liability of •1,000 translated	
@ exchange rate as at 31 March 20X1(US$1.4 per •)	1,400
@ exchange rate as at 31 March 20X0(US$1.3 per •)	1,300
Exchange loss	100

After translating the financial statements of Entity S1 into Rupees in accordance with paragraphs 38-47 of Ind AS 21, in the consolidated financial statements of Entity P, the exchange loss in terms of Rupee corresponding to US$100 ie Rs. 4,500 (US$100 @ Rs. 45) will be recognised in other comprehensive income and accumulated in equity.

AJSH & Co LLP

A-94/8, Wazirpur Industrial Area,
Main Ring Road, New Delhi-110052

T: +91-11-4559 6689
E: info@ajsh.in
W: www.ajsh.in

Thank You!!

DISCLAIMER:
The contents of this presentation are confidential and intended for the named recipient(s) only. It shall not attach any liability on the originator or AJSH & Co LLP or its affiliates. Any form of reproduction, dissemination, copying, disclosure, modification, distribution and / or publication of this message without the prior written consent of AJSH & Co LLP is strictly prohibited. If you have received this presentation in error please delete it and notify the sender immediately.