

## CHAPTER 25

# THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES (IND AS 21)

### QUESTIONS FROM ICAI STUDY MATERIAL

**Q1:** 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\$. What is the functional currency of Future Ltd.?

**Ans:** The functional currency of Future Ltd. is the L\$. Looking at the primary indicators, the facts presented indicate that the currency that mainly influences 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.

**Q2:** Small India Private Limited, a subsidiary of Big Inc., takes orders from Indian customers for Big's merchandise and then bills and collects for the sale of the merchandise. 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. What is Small's functional currency?

**Ans:** Small, although based in India with its cash inflows generated within India, is essentially a "pass through company" established by its parent. Small is totally reliant on Big for financing and goods to be sold, despite the fact that goods are sold within India and in Indian Rupees. Therefore, Small is not a self contained entity within India, but rather an entity that relies on its parent. This reliance translates into a reliance on the parent's functional currency, the US Dollar. Therefore, the primary economic environment is US and thus the functional currency is the US Dollar. Therefore, Small India Private Limited would have the US Dollar as its functional currency and hence any receivables or payables of the branch or subsidiary denominated in currencies other than the US Dollar would be remeasured into the US Dollar at the current rate, and changes in the exchange rate would result in an exchange gain or loss to be included in net income.

**Q3:** 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 INR. 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 INR and remaining 30% costs in USD.

Since B is located in India can it can presume its functional currency to be INR?

**Ans:** No, B cannot presume INR 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.

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 INR. 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 INR.

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

**Q4:** S Ltd is a company based out of India which got listed on Bombay Stock Exchange in the financial year ended 31st March, 2011. Since then the company's operations have increased considerably. The company was engaged in the business of trading of motor cycles. The company only deals in imported Motor cycles. These motor cycles are imported from US.

After importing the motor cycles, 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 motor cycles is in USD because the vendor(s) from whom these motor cycles 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 INR

Currently, its customers are both corporate and private in the ratio of 70:30 approximately. The USD denominated prices of motor cycles 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 INR.

What would be the functional currency of this company?

**Ans:** The functional currency of S Ltd is INR.

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 motor cycles are mainly influenced by the competitive forces and regulations in India. The market for motor cycles 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 motor cycles 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, INR should be considered as the functional currency of the company.

**Q5:** 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.

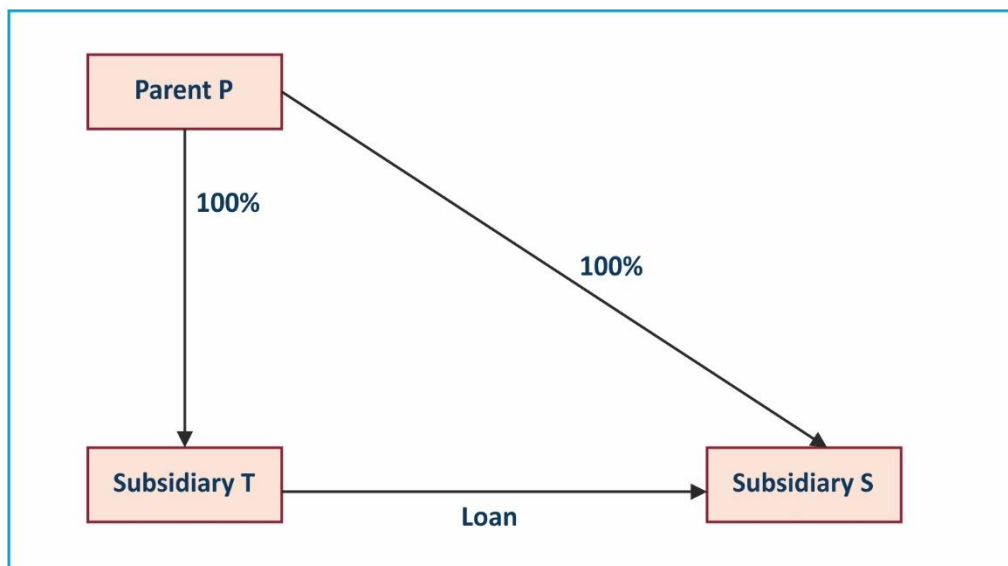
**Ans:** The exchange gain or loss will arise in the books of accounts of P in respect of its trading balance with S and the same should be recognised in profit or loss. This being a balance for in the nature of trade receivable for P, it would not be considered as its net investment in a foreign operation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

**Q6:** In the above Question, 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.

**Ans:**



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.

**Q7:** 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. How should the exchange differences be accounted for in the consolidated financial statements?

**Ans:** At year-end, S should revalue its accounts payable to EURO 220, recognising a loss of 20 in its standalone 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 i.e., USD 100 which will get eliminated against the receivable in the books of P but the EURO 20 exchange loss recorded in the subsidiary's statement of profit and loss has no equivalent gain in the parent's financial statements. Therefore, the EURO 20 loss will remain in the consolidated statement of profit and 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 parent company. The

subsidiary must go out and buy USD to settle the obligation to the parent, so the Group as a whole has an exposure to foreign currency risk.

**Q8.** 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 the operations of M Ltd are very large and hence to cater to its shortfall, G Ltd also purchases the bottles from other companies. Purchases are made at the competitive prices.

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 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 Euro = ₹ 83

Exchange rate on 31st March, 20X1 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. **[Exam Nov 23 (4 Marks); IBS CS 23]**

**Ans:** Accounting treatment in the books of M Ltd (Functional Currency INR)

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 receivable 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 inventory on 1<sup>st</sup> February, 20X1 of Euro 12 lacs which will also be its closing stock at year end.

**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 includes two components—

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

At the time of consolidation, the two elements 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)			

**Q9:** 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.

**Ans:** P's gain on disposal would be calculated in the following manner:

	(₹ in Lakhs)
Sale proceeds	1500

Net assets of S	(1000)
NCI derecognised	100
Foreign currency translation reserve	180
Gain on disposal	780

**Q10:** Entity A, whose functional currency is ₹, 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.

In A's consolidated financial statements, can the perpetual debt be considered, in accordance with 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?

**Ans:** 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.

**Q11:** 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 is the statement of financial position of Infotech Global Ltd. 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
Profit for the year	20,000	
Accounts payable	8,40,000	

Accrued liabilities	47,000	
Total equity and liabilities	9,85,000	

**Required:**

Translate the statement of financial position 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

[MTP May 2025]

**Ans:** Translation of the financial statements

	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
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 (proof below)			24,376
Total equity and liabilities L\$			8,71,682

Working of the cumulative balance of the FCTR

Particulars	Actual translated amount in L\$	Amount	Difference translated at closing rate of 1.13
Issued capital	30,055	44,247	14,192
Opening retained earnings	15,274	24,779	9,505
Profit for the year	17,021	17,699	678
[Difference of 1 is rounding]	62,350	86,725	24,375

**Q12:** 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. Prepare the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21. Tax rate is 30%  
[RTP May 2018; Exam Dec 21; MTP Nov 2023; Nov 2024]

**Ans:** Journal Entries

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

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

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	
			20,000
To Creditor - Machinery			
Machinery A/c	Dr.	30,000	
			30,000
To Revaluation Surplus (OCI)			
[Being Machinery revalued to USD 5,500; (₹ 60 x (USD 5,500 - USD 5,000))]			
Machinery A/c	Dr.	27,500	
			27,500
To Revaluation Surplus (OCI)			
(Being Machinery measured at the exchange rate on 31-03-20X1 [USD 5,500 x (₹ 65 - ₹60)])			
Revaluation Surplus (OCI)	Dr.	17,250	
			17,250
To Deferred Tax Liability			
(DTL created @ of 30% of the total OCI amount)			

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

		₹	₹
Creditor - Machinery A/c (5,000 x \$65)	Dr.	3,25,000	
Profit & loss A/c [(5,000 x (\$ 67 - \$ 65))]	Dr.	10,000	
			3,35,000
To Bank A/c			

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)			

**Q13:** On 1st January, 2018, 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, 2018. Rupees strengthened against the \$ in the three months following purchase and by 31st March, 2018 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, 2018 as per Ind AS. [RTP Nov 2018]

**Ans:** 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, 2018. 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, 2018. 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 or 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  $\frac{1}{4}$  x 3/12) would be charged to profit or loss for the year ended 31st March, 2018.

The closing balance in property, plant and equipment would be ₹ 1,27,50,000 (₹ 1,36,00,000 – ₹ 1,30,00,000). This would be shown as a non-current asset in the statement of financial position.

**Q14:** Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1st January, 2018 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and revenue is recognised on 31st March, 2018. USD 30 million is received on 1st April, 2018 in full and final settlement of the purchase consideration.

State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 2018 and 31st March, 2018 are ₹ 72 per USD and ₹ 75 per USD respectively. [RTP May 2019; MTP May 2023]

**Ans:** This is the case of Revenue recognised at a single point in time with multiple payments. As per the guidance given in Appendix B to Ind AS 21:

A Ltd. will recognise a non-monetary contract liability amounting ₹ 1,440 million, by translating USD 20 million at the exchange rate on 1st January, 2018 ie ₹ 72 per USD.

A Ltd. will recognise revenue at 31st March, 2018 (that is, the date on which it transfers the goods to the customer).

A Ltd. determines that the date of the transaction for the revenue relating to the advance consideration of USD 20 million is 1st January, 2018. Applying paragraph 22 of Ind AS 21, A Ltd. determines that the date of the transaction for the remainder of the revenue as 31st March, 2018.

On 31st March, 2018, A Ltd. will:

- derecognise the non-monetary contract liability of USD 20 million and recognise USD 20 million of revenue using the exchange rate as at 1st January, 2018 ie ₹ 72 per USD; and
- recognise revenue and a receivable for the remaining USD 30 million, using the exchange rate on 31st March, 2018 ie ₹ 75 per USD.
- The receivable of USD 30 million is a monetary item, so it should be translated using the closing rate until the receivable is settled.

**Q15:** Global Limited, an Indian company acquired on 30th September, 20X1 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Global Limited is Rupees and its financial year end is 31st March, 20X2.

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

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

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

(ii) Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31st March, 20X2. The exchange rate on the date of purchase by Global Limited was ₹ 83 / EURO and on 31st March, 20X2 was ₹ 84 / EURO. The entire goods purchased from Mark Limited are unsold as on 31st March, 20X2. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements. **[RTP Nov 2019; May 21; Exam May 22 (6 Marks); MTP SEP 25]**

**Ans:**

(i) Para 47 of Ind AS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42. In this case the amount of goodwill will be as follows:

Net identifiable asset	Dr.	23 million	
Goodwill(bal. fig.)	Dr.	1.4 million	
To Bank			17.5 million
To NCI (23 x 30%)			6.9 million

Thus, goodwill on reporting date would be 1.4 million EURO x ₹ 84 = ₹ 117.6 million

(ii) Particulars	EURO in million
Sale price of Inventory	4.20
Unrealised Profit [a]	1.80
Exchange rate as on date of purchase of Inventory [b] ₹ 83 / Euro	
Unrealized profit to be eliminated [a x b]	₹ 149.40 million

As per para 39 of Ind AS 21 “income and expenses for each statement of profit and loss presented (ie including comparatives) shall be translated at exchange rates at the dates of the transactions”.

In the given case, purchase of inventory is an expense item shown in the statement profit and loss account. Hence, the exchange rate on the date of purchase of inventory is taken for calculation of unrealized profit which is to be eliminated on the event of consolidation.

**Q16:** On 1<sup>st</sup> April, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. It incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 20X2. The loan is repayable in FCY on 31st March, 20X7 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

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

What would be the appropriate accounting treatment for the foreign currency loan in the books of Makers Ltd. for the FY 20X1-20X2? Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain / loss. **[RTP May 2020]**

**Ans:** Initial carrying amount of loan in books

Loan amount received	=	60,00,000 FCY
Less: Incremental issue costs	=	2,00,000 FCY
		58,00,000 FCY

Ind AS 21, "The Effect of Changes in Foreign Exchange Rates" states that foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized.

Loan to be converted in INR = 58,00,000 FCY x ₹ 2.50/FCY = ₹ 1,45,00,000

Therefore, the loan would initially be recorded at ₹ 1,45,00,000.

**Calculation of amortized cost of loan (in FCY) at the year-end:**

Period	Opening Financial Liability (FCY) A	Interest @ 12% (FCY) B	Cash Flow (FCY) C	Closing Financial Liability (FCY) A+B-C
20X1-20X2	58,00,000	6,96,000	6,00,000	58,96,000

The finance cost in FCY is 6,96,000

The finance cost would be recorded at an average rate for the period since it accrues over a period of time.

Hence, the finance cost for FY 20X1-20X2 in INR is ₹ 16,84,320 (6,96,000 FCY x ₹ 2.42 / FCY)

The actual payment of interest would be recorded at 6,00,000 x 2.75 = INR 16,50,000

The loan balance is a monetary item so it is translated at the rate of exchange at the reporting date.

So the closing loan balance in INR is 58,96,000 FCY x INR 2.75 / FCY = ₹ 1,62,14,000

The exchange differences that are created by this treatment are recognized in profit and loss.

In this case, the exchange difference is

₹ [1,62,14,000 - (1,45,00,000 + 16,84,320 - 16,50,000)] = ₹ 16,79,680.

This exchange difference is taken to profit and loss.

### QUESTIONS FROM RTP/MTP/EXAMS

**Q17:** An Indian entity, whose functional currency is rupees, purchases USD denominated bond at its fair value of USD 1,000. The bond carries stated interest @ 4.7% p.a. on its face value. The said interest is received at the year end. The bond has maturity period of 5 years and is redeemable at its face value of USD 1,250. The fair value of the bond at the end of year 1 is USD 1,060. The exchange rate on the date of transaction and at the end of year 1 are USD 1 = ₹ 40 and USD 1 = ₹ 45, respectively. The weighted average exchange rate for the year is 1 USD = ₹ 42.

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

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

Calculate gain or loss to be recognised in Profit & Loss and Other Comprehensive Income for year 1. Also pass journal entry to recognise gain or loss on above. (Round off the figures to nearest rupees)  
[RTP Nov 20; MTP Nov 22; MTP May 24; May 25]

**Ans:** Computation of amounts to be recognized in the P&L and OCI:

Particulars	USD	Exchange rate	₹
Cost of the bond	1,000	40	40,000
Interest accrued @ 10% p.a.	100	42	4,200
Interest received (USD 1,250 x 4.7%)	(59)	45	(2,655)
Amortized cost at year-end	1,041	45	46,845
Fair value at year end	1,060	45	47,700
Interest income to be recognized in P & L			4,200
Exchange gain on the principal amount [1,000 x (45-40)]			5,000
Exchange gain on interest accrual [100 x (45 - 42)]			300
Total exchange gain/loss to be recognized in P&L			5,300
Fair value gain to be recognized in OCI [45 x (1,060 - 1,041)]			855

Journal entry to recognize gain/loss

Bond (₹ 47,700 – ₹40,000)	Dr.	7,700	
Bank (Interest received)	Dr.	2,655	
To Interest Income (P & L)			4,200
To Exchange gain (P & L)			5,300
To OCI (fair value gain)			855

**Q18:** Monsoon Limited acquired, on 30 September, 20X2, 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Monsoon Limited is Indian Rupee and its financial year ends on 31 March, 20X3.

The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30 September, 20X2.

The exchange rates as on 30 September, 20X2 was ₹ 82 per EURO and at 31 March, 20X3 was ₹ 84 per EURO.

On acquisition of Mark limited, what is the value at which the goodwill/capital reserve has to be recognized in the financial statements of Monsoon Limited as on 31 March 20X3?

**Ans:** Para 47 of Ind AS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42.

In this case, the amount of goodwill will be as follows:

Net identifiable asset	Dr.	₹ 23 million	
Goodwill (bal. fig.)	Dr.	₹ 1.4 million	
	To Bank (Purchase consideration)		₹ 17.5 million
	To NCI (23 x 30%)		₹ 6.9 million

Thus, goodwill on reporting date in the books of Monsoon Limited would be

= 1.4 million EURO x ₹ 84 = ₹ 117.6 million.

**Q19:** PQR Holdings Limited is based in London and has Pound sterling ("GBP") as its functional and presentation currency. On 1st April, 20X1, PQR Holdings Limited incorporated PQR India Limited as its wholly owned subsidiary in India. PQR India will be engaged in trading of items purchased from PQR Holdings. The shares of PQR India, having a face value of ₹ 10 each amounting to total of ₹ 500 crore, were issued to PQR Holdings in GBP on 1st April, 20X1.

PQR India has adopted Ind AS with effect from its incorporation. In accordance with Ind AS, management of PQR India has concluded that its functional currency is Indian Rupee ("INR"). Following is the summarized trial balance of PQR India as on 31st March, 20X2, being the reporting date of PQR India and PQR Holdings:

(Note: All amounts in the below mentioned trial balance are ₹ in crore)

S. No.	Particulars	Debit Balances	Credit Balances
1.	Share capital	-	500.0
2.	Securities premium reserve on issue of equity shares	-	150.0
3.	Retained earnings	-	110.0
4.	Long-term borrowings	-	30.0
5.	Deferred tax liability	-	10.0
6.	Income tax payable	-	25.0
7.	Import duty payable	-	5.0
8.	Employee benefits payable	-	7.5
9.	Sundry trade payables	-	2.5
10.	Property, plant and equipment (net of depreciation)	550.0	-
11.	Computer software (net of amortisation)	70.0	-
12.	Inventories purchased on 15th March, 20X2 (there is no indicator of impairment)	200.0	-
13.	Cash and bank balance	5.0	-
14.	Sundry trade receivables	17.0	-
15.	Allowance for doubtful trade receivables	-	2.0
	Total	842.0	842.0

Additional information relating to property, plant and equipment, and computer software:

Line item	Date of acquisition
Property, plant and equipment	30th April, 20X1
Computer software	5th May, 20X1

**PQR India has adopted the following accounting policy in relation to shareholders' funds to translate equity:**

Share capital	To be translated using historical exchange rate
Securities premium	To be translated using historical exchange rate
Retained earnings	To be translated using average exchange rate

**Since the presentation currency of PQR Holdings is GBP, PQR India is required to translate its trial balance from INR to GBP. Following table provides relevant foreign exchange rates:**

Closing spot rate as on 1st April, 20X1	1 INR = 0.0123 GBP
Closing spot rate as on 30th April, 20X1	1 INR = 0.0120 GBP
Closing spot rate as on 5th May, 20X1	1 INR = 0.0119 GBP
Closing spot rate on 15th March, 20X2	1 INR = 0.0108 GBP
Closing spot rate as on 31st March, 20X2	1 INR = 0.0109 GBP
Average exchange rate for the year ended 31st March, 20X2	1 INR = 0.0116 GBP

**As the accountant of PQR India, you are required to do the following for its separate financial statements:**

- Explain the principle of monetary and non-monetary items. Based on this principle, bifurcate the line items of the trial balance into monetary and non-monetary items.
- Translate the trial balance of PQR India from INR to GBP. [MTP Nov 2021]

**Ans:**

- 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. Para 15 of Ind AS 21 states that 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. Similarly, a 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 is a monetary item.

Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency.

On the basis of above principles, the line items of trial balance should be bifurcated as follows:

Particulars	Monetary item / Non-monetary item
Share Capital	Non-monetary item

Securities Premium reserve on issue of equity shares	Non-monetary item
Retained earnings	Non-monetary item
Long-term borrowings	Monetary item
Deferred tax liability	Non-monetary item
Income tax payable	Monetary item
Import duty payable	Monetary item
Employee benefits payable	Monetary item
Sundry trade payables	Monetary item
Property, plant and equipment (net of depreciation)	Non-monetary item
Computer software (net of amortization)	Non-monetary item
Inventories purchased (there is no indicator of impairment)	Non-monetary item
Cash and bank balance	Monetary item
Sundry trade receivables	Monetary item
Allowance for doubtful trade receivables	Monetary item

As per para 38 of Ind AS 21, an entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

**b) Translation of the balances for the purpose of consolidation**

Particulars	INR in crore	Rate (GBP)	Amount in GBP
Property, plant and equipment (net of depreciation)	550.0	0.0109	5.995
Computer software (net of amortization)	70.0	0.0109	0.763
Inventories	200.0	0.0109	2.18
Cash and bank balance	5.0	0.0109	0.0545
Sundry trade receivables net of allowance for doubtful trade receivables (17.0-2.0)	15.0	0.0109	0.1635
<b>Total Assets</b>	<b>840.0</b>		<b>9.156</b>
Share Capital	500.0	0.0123	6.15
Securities Premium reserve	150.0	0.0123	1.845
Retained earnings	110.0	0.0116	1.276
Long-term borrowings	30.0	0.0109	0.327
Deferred tax liability	10.0	0.0109	0.109

Income tax payable	25.0	0.0109	0.2725
Import duty payable	5.0	0.0109	0.0545
Employee benefits payable	7.5	0.0109	0.08175
Sundry trade payables	2.5	0.0109	0.02725
Foreign Currency Translation reserve recognised in OCI (balancing figure)			(0.987)
<b>Total Equity and liabilities</b>	<b>840.0</b>		<b>9.156</b>

**Q20:** The UK entity with a sterling functional currency has a property located in US, which was acquired at a cost of US\$ 1.8 million when the exchange rate was £1 = US\$ 1.60. The property is carried at cost. At the balance sheet date, the recoverable amount of the property (as a result of an impairment review) amounted to US\$ 1.62 million, when the exchange rate £1 = US\$ 1.80. Compute the amount which is to be reported in Profit & Loss of UK entity as a result of impairment, if any. Ignore depreciation. Also analyse the total impairment loss on account of change in value due to impairment component and exchange component. [RTP Nov 2020]

**Ans:** Ignoring depreciation, the loss that would be reported in the Profit and Loss as a result of the impairment is as follows:

	£
*Carrying value at balance sheet date-US\$ 16,20,000 @ £ 1.8 =	9,00,000
Historical cost- US\$ 18,00,000 @ £ 1.6 =	11,25,000
Impairment loss recognized in profit and loss	(2,25,000)
The components of the impairment loss can be analyzed as follows:	
Change in value due to impairment = US\$ 1,80,000 @ £ 1.8 =	(1,00,000)
Exchange component of change =	
US\$ 18,00,000 @ 1.8 – US\$ 18,00,000 @ £ 1.6	(1,25,000)

\*Recoverable amount being less than cost becomes the carrying value.

**Q21.** Infotech Global Ltd. (a stand-alone entity) has a functional currency of USD and needs to translate its financial statements into the presentation currency (INR). The following is the draft financial statements of Infotech Global Ltd. prepared in accordance with its functional currency.

#### Balance Sheet

Particulars	31st March, 20X3	31st March, 20X2
	USD	USD
Property, plant and equipment	50,000	55,000
Trade Receivables	68,500	56,000
Inventory	8,000	5,000
Cash	40,000	35,000
<b>Total assets</b>	<b>1,66,500</b>	<b>1,51,000</b>

Share Capital	50,000	50,000
Retained earnings	29,500	18,000
<b>Total Equity</b>	<b>79,500</b>	<b>68,000</b>
Trade payables	40,000	38,000
Loan	47,000	45,000
<b>Total liabilities</b>	<b>87,000</b>	<b>83,000</b>
<b>Total equity and liabilities</b>	<b>1,66,500</b>	<b>1,51,000</b>

#### Statement of Profit and Loss

Particulars	USD
Revenue	1,77,214
Cost of sales	1,13,100
<b>Gross Profit</b>	<b>64,114</b>
Distribution costs	2,400
Administrative expenses	18,000
Other expenses	11,000
Finance costs	12,000
<b>Profit before tax</b>	<b>20,714</b>
Income tax expense	6,214
<b>Profit for the year</b>	<b>14,500</b>

#### Extracts from Statement of Changes in Equity

Particulars	31st March, 20X3 (USD)
Retained earnings at the beginning of the year	18,000
Profit for the year	14,500
Dividends	(3,000)
Retained earnings at the end of the year	29,500

- Share capital was issued when the exchange rate was USD 1 = INR 70.
- Retained earnings on 1st April, 20X1 was INR 4,00,000.
- At 31st March, 20X2, a cumulative gain of INR 4,92,000 has been recognised in the foreign exchange reserve, which is due to translation of entity's financial statements into INR in the previous years.
- Entity paid a dividend of USD 3,000 when the rate of exchange was USD 1 = INR 73.5

- Profit for the year 20X1-20X2 of USD 8,000, translated in INR at INR 5,72,000.
- Profit for the year 20X2-20X3 of USD 14,500, translated in INR at INR 10,72,985.

For the sake of simplicity, items of income and expense are translated at weighted average monthly rate as there has been no significant exchange rate fluctuation during the entire year and the business of the entity is not cyclical in nature.

Relevant exchange rates are as follows:

- Rate at 31st March, 20X2 USD 1= INR 73
- Rate at 31st March, 20X3 USD 1= INR 75

Prepare financial statements of Infotech Global Ltd. translated from functional currency (USD) to presentation currency (INR). [RTP Nov 2023]

**Ans.** As per paragraph 39 of Ind AS 21, all assets and liabilities are translated at the closing exchange rate, which is USD 1 = INR 73 on 31st March, 20X2 and USD 1 = INR 75 on 31st March, 20X3.

In the given case, share capital is translated at the historical rate USD 1 = INR 70. The share capital will not be restated at each year end. It will remain unchanged.

Accordingly, the translated financial statements will be as follows:

**Note 1: Retained earnings at 31st March, 20X3 and 31st March, 20X2:**

Particulars	31st March, 20X3	31st March, 20X2
	INR	INR
Opening retained earnings	9,72,000	4,00,000
Profit for the year	10,72,985	5,72,000
Dividends paid (USD 3,000 x INR 73.5)	(2,20,500)	-
Closing retained earnings	18,24,485	9,72,000

**Balance Sheet**

Particulars	31st March, 20X3			31st March, 20X2		
	USD	Rate	INR	USD	Rate	INR
Property, plant and equipment	50,000	75	37,50,000	55,000	73	40,15,000
Trade Receivables	68,500	75	51,37,500	56,000	73	40,88,000
Inventory	8,000	75	6,00,000	5,000	73	3,65,000
Cash	40,000	75	30,00,000	35,000	73	25,55,000
Total assets	1,66,500		1,24,87,500	1,51,000		1,10,23,000
Share Capital	50,000	70	35,00,000	50,000	70	35,00,000

Retained earnings (Refer note 1)	29,500		18,24,485	18,000		9,72,000
Foreign Exchange reserve (Balancing figure)			6,38,015	-		4,92,000
<b>Total Equity</b>	<b>79,500</b>		<b>59,62,500</b>	<b>68,000</b>		<b>49,64,000</b>
Trade payables	40,000	75	30,00,000	38,000	73	27,74,000
Loan	47,000	75	35,25,000	45,000	73	32,85,000
<b>Total liabilities</b>	<b>87,000</b>		<b>65,25,000</b>	<b>83,000</b>		<b>60,59,000</b>
<b>Total equity and liabilities</b>	<b>1,66,500</b>		<b>1,24,87,500</b>	<b>1,51,000</b>		<b>1,10,23,000</b>

The foreign exchange reserve is the exchange difference resulting from translating income and expense at the average exchange rate and assets and liabilities at the closing rate.

#### Other Comprehensive Income

Exchange differences on translating from USD to INR (6,38,015 - 4,92,000)	INR 1,46,015
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#### Statement of Changes in Equity (INR)

Particulars	Share capital	Retained Earnings	Foreign exchange reserve	Total
Balance at 1st April, 20X2	35,00,000	9,72,000	4,92,000	49,64,000
Dividends	-	(2,20,500)	-	(2,20,500)
Profit for the year	-	10,72,985	-	10,72,985
Exchange difference (transferred to OCI)	-	-	1,46,015	1,46,015
Balance at 31st March, 20X3	35,00,000	18,24,485	6,38,015	59,62,500

**Q22:** Simran's one of the biggest construction project was being executed in India at Amritsar through Sim Contractors Pvt. Ltd., another company based in India, shortly known as "SIMCO", which is a foreign operation of Simran Constructions GmbH, primarily set up to execute construction projects in India. The functional currency of Simran Constructions GmbH is Euros. 78% of SIMCO's finances have been raised in USD by way of contribution from Simran Constructions GmbH. SIMCO's bank accounts are maintained in USD as well as in INR. Cash flows generated by it are transferred to the German Company on a monthly basis in USD in respect of repayment of finance received from the German Company. Revenues of SIMCO are in USD. Its competitors are globally based. Tendering for the construction project happened in USD. SIMCO incurs 80% of the cost in INR and remaining 20% costs in USD.

## Can INR be presumed as the Functional Currency for SIMCO?

[IBS MTP May 24]

**Ans:** Here, primary and secondary indicators should be used for the determination of its functional currency 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 INR. Only 20% 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 INR.

Keeping these factors in view, USD should be considered as the functional currency of Sim Contractors Pvt. Ltd.

**Q23:** P Ltd., incorporated in India owns 70% interest in foreign entity, S Ltd. P Ltd. has INR (₹) as its functional currency while S Ltd. has US dollars as its functional currency. P Ltd. sells its entire investment in S Ltd. for ₹ 3,200 thousand. The following information is provided:

Particulars	₹ in thousand		
	S's Total	P's share (70%)	NCI (30%)
Net assets	4,000	2,800	1,200
Foreign currency translation reserve gain	900	630	270

Required: How does an entity account for cumulative translation adjustment (CTA) on disposal of a foreign subsidiary?  
[RTP May 2025; MTP Jan 2026]

**Ans:** As per paragraphs 48 and 48B of Ind AS 21, on the disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation, recognised in other comprehensive income and accumulated in the separate component of equity, shall be reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised (see Ind AS 1, Presentation of Financial Statements).

Further, the standard states that on disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation that have been attributed to the non-controlling interests shall be derecognised, but shall not be reclassified to profit or loss.

Where the subsidiary is partially owned (that is, where a non-controlling interest exists) and the parent has sold its entire interest, the amount of the CTA that has been allocated to the non-controlling interest is derecognised, but it is not transferred to profit or loss. Derecognition of the non-controlling interest (that includes the non-controlling interest's share of CTA) will form part of the journal entry to recognise the gain or loss on disposal of the subsidiary.

In P Ltd.'s consolidated financial statements, the following amounts (₹ in thousand) have been recognised in relation to its investment in S Ltd.:

- net assets of ₹ 4,000 and associated non-controlling interests of ₹ 1,200;

- foreign exchange gains of ₹ 900 were recognised in other comprehensive income, of which ₹ 270 was attributable to non- controlling interests and is therefore included in the ₹ 1,200 non- controlling interests;
- ₹ 630 of foreign exchange gains have been accumulated in a separate component of equity relating to P Ltd.'s 70% share in S Ltd.

P Ltd. sells its 70% interest in S Ltd. for ₹ 3,200 and records the following amounts:

Cash/Bank A/c	Dr.	3,200	
NCI	Dr.	1,200	
OCI	Dr.	630	
To Net assets			4,000
To Profit on disposal {630+(3,200-2,800)}			1,030

It can be seen that ₹ 630 of the foreign currency gains previously recognised in OCI, i.e. the amount attributed to P Ltd. is reclassified to profit or loss (profit on disposal) and adjusted from OCI. However, ₹ 270 of such gains attributed to the non-controlling interests is not reclassified to profit or loss and is derecognised as a part of the NCI balance.

**Q24:** PQR Ltd. has entered into a fixed price contract on 1st February, 20X2 to provide annual maintenance services worth USD 10,000 which is rendered uniformly throughout the year over a period of two years (1st April, 20X2 – 31st March 20X4) to a foreign customer. As per the terms of the contract, it has received advance payment of USD 3,000 on 1st February, 20X2 and the balance is to be received on 31st March, 20X4. The entity recognises revenue at the end of every year. How should the entity account for the said transactions, where the consideration is received in advance? **[RTP SEP 2025]**

**Ans:** If the advance received from the customer is determined to be in the nature of prepayments or progress payments, these are treated as non- monetary items. Accordingly, in the instant case, PQR Ltd. receives the advance payment of USD 3,000 on 1st February which it translates into its functional currency using the exchange rate on 1st February, 20X2. Applying paragraph 23(b) of Ind AS 21, the entity does not update the translated amount of the nonmonetary liability. Applying Ind AS 115, Revenue from Contracts with Customers, it recognises revenue over a period of two years. Since, the entity recognises revenue at the end of the year, revenue of USD 5,000 will be recognised at the end of the first year. PQR Ltd. has determined that the consideration of USD 3,000 relates to the service it has rendered in the first year. At the end of year 1, the entity is entitled to an unconditional right to USD 2,000 of the remaining consideration. Accordingly, at the end of the first year, on 31st March 20X3, it recognises revenue of USD 5,000 out of which USD 3,000 will be recognised by derecognising the contract liability and no exchange fluctuation will be involved. Balance of USD 2,000 revenue will be recognised by translating the exchange rate at the date of transaction and a receivable (monetary asset) will be recognised and translated at the exchange rate as at 31st March 20X3. It will update the translated amount of the receivable until the receivable is settled on 31st March 20X4 and recognises the corresponding gain or loss in profit or loss. At the end of the

second year on 31st March 20X4, it recognises the balance revenue of USD 5,000 using the exchange rate at the date of the transaction.

**Q25:** Parent A Ltd. is the reporting entity that has net investment in foreign operations in its two foreign Subsidiaries, B Ltd. and C Ltd. In all the following scenarios, loans made between group entities are permanent in nature (that is, settlement is neither planned nor likely to occur):

### Scenario 1

Parent A Ltd., with sterling as its functional currency, is preparing its financial statements to 31st March, 20X5. It has a loan receivable of US\$ 1 million from its Subsidiary C Ltd. that has been outstanding for some time. The parent notified the subsidiary at the beginning of the financial year that no repayment of the amount will be requested for the foreseeable future.

The relevant exchange rate are as follows:

	31st March, 20X5	31st March, 20X4
£1=	US\$1.82	US\$1.45

### Scenario 2

The facts are the same as in the above Scenario 1, except that Parent A Ltd. has a loan receivable from Subsidiary C Ltd. of £ 2,00,000 that has been outstanding for some time. The loan is treated by Parent A Ltd. as forming part of its net investment in Subsidiary C Ltd.

### Required:

Determine the treatment of exchange differences in Standalone Financial Statements of both subsidiary and parent company and in Consolidated Financial Statements of parent company under both the scenarios. **[RTP JAN 2025]**

**Ans:** **Scenario 1:** The following exchange differences will arise in the financial statements of the individual entities if the loan is re-translated at the closing rate:

	31 <sup>st</sup> March, 20X5
<b>Standalone Financial Statements of Subsidiary C Ltd.</b>	
No exchange difference arises in the foreign subsidiary because the loan payable is denominated in its functional currency	
<b>Standalone Financial Statements of Parent A Ltd.</b>	
Exchange difference on long-term loan receivable:	£
On closing rate - US\$ 1 million / \$ 1.82/£	5,49,450
On opening rate - US\$ 1 million / \$ 1.45/£	6,89,655
Exchange loss	1,40,205

In Parent A Ltd.'s separate financial statements, the loan is regarded as a monetary item and any exchange difference is taken to profit or loss.

On consolidation, the re-translated long-term loan is regarded as part of the net investment in Subsidiary C Ltd., so the related exchange loss is recognised in other comprehensive income

and accumulated as a separate component of equity as per para 32 of Ind AS 21. There would also be a corresponding exchange gain included in other comprehensive income, arising as part of the re-translation of the net assets (which include the US dollar loan creditor) of Subsidiary C Ltd. under the closing rate/net investment method.

**Scenario 2:** In the financial statements of the individual entities, the following exchange differences will arise if the loan is re-translated at the closing rate.

**Parent A Ltd.:** There is no exchange difference in the parent's financial statements in respect of the loan because it is denominated in sterling.

**Subsidiary C Ltd.:** Exchange difference on long-term loan payable:

	US \$
On closing rate – £ 2,00,000 @ \$ 1.82/£	3,64,000
On opening rate - £ 2,00,000 @ \$ 1.45/£	<u>2,90,000</u>
Exchange loss	<u>74,000</u>
Exchange loss translated in £ at the closing rate @ \$ 1.82/£	£ 40,659

The exchange loss of US \$ 74,000 on the sterling loan is recognised in Subsidiary C Ltd.'s income statement, because the subsidiary is exposed to the foreign currency risk.

On consolidation, the inter-company loan will be cancelled. However, because the long-term loan is regarded as part of the net investment

in the subsidiary, the exchange loss of £ 40,659 is recognised in other comprehensive income and accumulated as a separate component of equity in the consolidated financial statements. There is a corresponding exchange gain included in other comprehensive income, arising as part of the re-translation of the net assets of Subsidiary C Ltd. The effect is that the consolidated income statement will not reflect any exchange difference on the loan, which is consistent with the fact that the loan has no impact on group cash flows, unless the investment is sold.

**Q26:** Drape Ltd. took a long-term loan of USD 30,000 from an entity registered in U.S.A. on 1st April, 2024. Interest of USD 2,400 is payable annually on 31st March, starting from 31st March, 2025. The loan is repayable in USD on 31st March, 2030 and the effective annual interest rate implicit in the loan is 11%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

- 1st April, 2024-USD 1 = ₹ 74.
- 31st March, 2025-USD 1 = ₹ 78.
- Average rate for the year ended 31st March, 2025 - USD 1 = ₹ 72. The functional currency of the group is Indian Rupee.

Calculate (a) the initial measurement amount for the loan, (b) finance cost for the year 2024-2025, (c) closing balance of loan as at 31st March 2025 and (d) exchange gain / loss for the year 2024-2025. **[Exam Sep 2025 (8 Marks)]**

**Ans: (i) Initial carrying amount of loan in books:**

Loan amount received = USD 30,000

Present value of loan Cash flow of interest USD 30,000 x 8% = 2,400 for 6 years.

PV of cash flow of interest USD 2,400 x 4.2305 = 10,153.20

PV of Repayment of loan USD 30,000 x 0.5346 = 16,038.00

Total 26,191.20

When effective interest rate is different from the contractual rate, it results into transaction cost due to which the initial present value of the loan is different from the transaction price. Accordingly, here difference of USD 3,808.80 (USD 30,000 – USD 26,191.20) will be recorded as transaction cost. As per Ind AS 21, foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized. Loan to be converted in Rupees (₹) = USD 26,191.20 x ₹ 74/ USD = ₹ 19,38,149 Therefore, the loan would initially be recorded at ₹ 19,38,149.

**(ii) Calculation of Finance Cost for the year 2024-2025**

The finance cost = USD 26,191.20 x 11% = USD 2,881

The finance cost would be recorded at an average rate for the period since it accrues over a period of time. Hence, the finance cost for financial year 2024-2025 in Rupees (₹) is ₹ 2,07,432 (USD 2,881 x ₹ 72/USD)

The actual payment of interest would be recorded at USD 2,400 x ₹ 78/ USD = ₹ 1,87,200

**(iii) Calculation of closing balance of loan as at 31st March 2025**

Period	Opening Financial Liability (USD) A	Interest @ 11% EIR (USD) B	Cash outflow (USD) C	Closing balance of loan (USD) A+B-C
2024-2025	26,191.20	2,881	2,400	26,672.20

**(iv) Computation of Exchange Gain/Loss for the year 2024-2025**

The loan balance is a monetary item, so it is translated at the rate of exchange at the reporting date. So, the closing loan balance in Rupees (₹) is USD 26,672.20 x ₹ 78/USD = ₹ 20,80,432 In this case, the exchange difference is ₹ [20,80,432 - (19,38,149 + 2,07,432 – 1,87,200)] = ₹ 1,22,051. This exchange loss of ₹ 1,22,051 is taken to profit and loss account.

Note: Effective interest rate is more than the contractual rate of interest in general when an entity incurs any transaction cost or repayment of loan is not at par value. Since in the question, there is no transaction cost or no repayment information different from par value, effective interest rate should have been equivalent to contractual interest rate.

The above solution has been drawn considering Effective Interest Rate of 11%, leading to calculation of initial recognition of loan amount on the date of acquisition of loan and difference being treated as transaction cost.

However, alternatively one may draw the solution considering Effective Interest Rate of 11% (as given) only for calculation of finance cost without change in the initial recognition of loan amount on the date of acquisition of loan or considering interest rate of 8%. In both the case the solutions will be drawn as follows:

**Alternative: Considering Effective Interest Rate of 11% (as given) only for calculation of finance cost without change in the initial recognition of loan amount on the date of acquisition of loan**

**(i) Initial carrying amount of loan in books**

Loan amount received = USD 30,000

As per Ind AS 21, foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized.

Loan to be converted in Rupees (₹) = USD 30,000 x ₹ 74 / USD = ₹ 22,20,000

Therefore, the loan would initially be recorded at ₹ 22,20,000.

**(ii) Calculation of Finance Cost for the year 2024-2025**

The finance cost = USD 30,000 x 11% = USD 3,300

The finance cost would be recorded at an average rate for the period since it accrues over a period of time. Hence, the finance cost for financial year 2024-2025 in Rupees (₹) is ₹ 2,37,600 (USD 3,300 x ₹ 72

/ USD)

The actual payment of interest would be recorded at USD 2,400 x ₹ 78 / USD = ₹ 1,87,200

**(iii) Calculation of closing balance of loan as at 31st March, 2025**

Period	Opening Financial Liability (USD) A	Interest @ 11% EIR (USD) B	Cash outflow (USD) C	Closing balance of loan (USD) A+B-C
2024-2025	30,000	3,300	2,400	30,900

**(iv) Computation of Exchange Gain/Loss for the year 2024-2025**

The loan balance is a monetary item, so it is translated at the rate of exchange at the reporting date. So, the closing loan balance in Rupees (₹) is USD 30,900 x ₹ 78 / USD = ₹ 24,10,200 In this case, the exchange difference is ₹ [24,10,200 - (22,20,000 + 2,37,600 - 1,87,200)] = ₹ 1,39,800 This exchange loss of ₹ 1,39,800 is taken to profit and loss account.

**Alternative: Considering Interest rate of 8% (as computed)**

**(i) Initial carrying amount of loan in books**

Loan amount received = USD 30,000

As per Ind AS 21, foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized. Loan to be converted in Rupees (₹) = USD 30,000 x ₹ 74 USD = ₹ 22,20,000

Therefore, the loan would initially be recorded at ₹ 22,20,000.

**(ii) Calculation of Finance Cost for the year 2024-2025**

The finance cost = USD 2,400 as given in the question

The finance cost would be recorded at an average rate for the period since it accrues over a period of time. Hence, the finance cost for financial year 2024-2025 in Rupees (₹) is ₹ 1,72,800 (USD 2,400 x ₹ 72/ USD) The actual payment of interest would be recorded at USD 2,400 x ₹ 78/ USD = ₹ 1,87,200

**(iii) Calculation of closing balance of loan as at 31st March, 2025**

Period	Opening Financial Liability (USD) A	Interest @ 8% (USD) B	Interest paid	Closing Financial Liability (USD) A+B-C
2024-2025	30,000	2,400	2,400	30,000

**(iv) Computation of Exchange Gain/Loss for the year 2024-2025**

The loan balance is a monetary item, so it is translated at the rate of exchange at the reporting date. So, the closing loan balance in Rupees (₹) is USD 30,000 x ₹ 78/USD = ₹ 23,40,000 In this case, the exchange difference is ₹ [23,40,000 – (22,20,000 + 1,72,800-1,87,200)] = ₹ 1,34,400 This exchange loss of ₹ 1,34,400 is taken to profit and loss.

**NOTES**

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