

## 9. IND AS 21 – THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

### Practical Example 1 (Identification of Functional Currency)

1. M Ltd., a subsidiary in India, purchases goods from A Inc., its holding company in USA.
2. Purchases are done in USD and are based on prices in the US Market
3. It sells goods in USD and the sale price is influenced by the holding company.
4. Other expenses are incurred locally.
5. M Ltd. has an External Commercial Borrowing from AInc. For financing its activities.

#### Solution:

Factors (M Ltd.)	Influenced by which Currency
Sales	USD
Sales Market Influenced by	USD
Expenses	INR
Purchases	USD
Financing	USD
Cash flows	USD/INR
<b>Functional Currency (Based on Above)</b>	<b>USD</b>

The above conclusions are based on Primary indicators

### Practical Example 2 (Identification of Functional Currency)

1. N Ltd., a subsidiary in India, purchases goods from A Inc., its holding company in USA.
2. Purchases are done in USD and are based on prices in US Market.
3. It **sells** goods in **INR** but the sale price is influenced by the country of the holding company.
4. Other expenses are incurred locally.
5. N Ltd. has an External Commercial Borrowing from A Inc. for financing its activities.

#### Solution:

Factors (N Ltd.)	Influenced by which Currency
Sales	INR
Sales Market Influenced by	USD
Expenses	INR
Purchases	USD
Financing	USD
Cash flows	USD/INR
<b>Functional Currency (Based on Above)</b>	<b>USD</b>

The above conclusions are based on Primary indicators

### Practical Example 3 (Identification of Functional Currency)

1. USA Ltd (U) owns a subsidiary in India, Dragon Ltd (D).
2. D assembles all goods in India using a **combination** of **locally** sourced materials and materials **manufactured by U**.

3. All goods are then exported and **sold in Australia**, based on selling prices determined by U and influenced by Indian market.
4. The company has a **loan from an Indian Bank**.

### Solution:

Factors (Dragon Ltd.)	Influenced by which Currency
Sales	AUD
Sales Market Influenced by	INR
Expenses	INR
Purchases	INR/USD
Financing	INR
Cash flows	USD/INR/AUD
<b>Functional Currency (Based on Above)</b>	<b>INR</b>

The above conclusions are based on Primary indicators

### Practical Example 4 (Identification of Functional Currency)

1. X Ltd., a subsidiary in India, purchases goods from A Inc., its holding company in USA.
2. Purchases are done in USD and are based on prices in US Market.
3. It sells goods in INR and the sale price is market determined.
4. Other expenses are incurred locally.
5. It remits its proceeds to the holding company.

### Solution:

- Sales are in INR and are market determined whereas goods are purchased from USA.
- The primary indicators do not give a clear picture.
- On the basis of **additional factors**, in the given case X Ltd. is carrying out its activities as an extension of holding company's foreign operations since it only sells goods imported from the reporting entity and remits its proceeds to it, its functional currency should be **USD**.

### Practical Example 5: (FCMI)

Mr. A Purchased Goods of \$30,000 on 1/Feb for which payment to be made in next year 30/4

**Issue 1:** How to record on 1/Feb because it is in \$

**Issue 2:** What to do on Balance Sheet Date i.e., 31/3 because \$ Changes

**Issue 3:** on 30/4 Settlement is in \$ the how to Measure?

### Solution:

#### **Issue 1:**

All Foreign Currency transaction must be recorded at the rate prevailing on transaction Date (i.e. SPOT Rate)

Suppose 1<sup>st</sup> Feb \$1 = 76/-

Transaction Vale = \$30,000 × 76 = 22,80,000/-

1<sup>st</sup> Feb:

Purchase A/c	Dr.	22,80,000	
To Foreign Creditor A/c			22,80,000

#### Trading A/c

To Purchases	22,80,000		
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#### Balance Sheet

Foreign Creditors (\$30,000)	22,80,000		
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#### Issue 2:

On 31<sup>st</sup> March \$1 = ₹ 77

All Monetary Assets/Liabilities which are in foreign Currency (FCMI) should be measured at Closing Exchange Rate on Balance Sheet Date.

Revised Foreign Creditors = \$30,000 × 77 = 23,10,000

Exchange Difference (Loss) = 23,10,000 - 22,80,000 = 30,000

Exchange Loss A/c	Dr.	30,000	
To Foreign Creditor A/c			30,000

Exchange Difference due to measurement of FCMI should be transfer to P&L A/c  
31/3

P&L A/c	Dr.	30,000	
To Exchange Loss A/c			30,000

#### Trading A/c

To Purchases	22,80,000		
To Exchange Loss	30,000		

#### Balance Sheet

Foreign Creditors (\$30,000)	23,10,000		
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#### Issue 3:

At the time of settlement \$ again Change to ₹ 77.80

Amount to be paid in ₹ = \$30,000 × 77.80 = 23,34,000/-

30/4

Foreign Creditors A/c	Dr.	23,10,000	
Exchange Loss A/c	Dr.	24,000	
To Bank A/c			23,34,000

Exchange Difference at settlement shall be transferred to P&L A/c

#### Practical Example 6: (Translation of Non-Monetary Item)

1. Company Apple's Functional currency is INR
2. On 01.01.2017 company buys a building for US \$ 100,000
3. The exchange rate is INR 54.48 per US \$
4. Company Apple's year end, 31st March
5. The building is not depreciated as it is not yet available for use

6. On 31.03.2017 the exchange rate is INR 55.54 per US \$ and the value of building is US \$ 1,10,000

**SOLUTION:**

**Initial Recognition**

- On 01.01.2017 the building is capitalized at the rate at the transaction date
- |             |           |           |
|-------------|-----------|-----------|
| Building Dr | 54,48,000 |           |
| To Bank Cr  |           | 54,48,000 |

**Subsequent Recognition:**

- If cost model adopted as accounting policy under IndAS 16 for PPE, Building is carried at its historical cost, hence no adjustment to be made
- If revaluation model adopted as accounting policy under IndAS 16 for PPE, value of building to be adjusted for revised value.
- Hence the building being a non-monetary item and held at fair value, is to be translated at the date of valuation

Building Dr	661,400	
To Revaluation Reserve Cr		661,400

Revaluation reserve includes exchange component ( $\$ 100000 * (55.54 - 54.48)$ ) + ( $\$ 10000 * 55.54$ )