

AS 11 – THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Illustration 1

Classify the following items as monetary or non-monetary item:

Inventories

Trade Receivables

Investment in Equity Shares

Property, Plant and Equipment.

Solution:

Inventories	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Property, Plant and Equipment	Non-monetary

Illustration 2 (RTP Nov 18, Nov 20)

	Exchange Rate per \$
Goods purchased on 1.1.20X1 for US \$ 15,000	₹ 75
Exchange rate on 31.3.20X1	₹ 74
Date of actual payment 7.7.20X1	₹ 73

You are required to ascertain the loss/gain to be recognized for financial years ended 31st March, 20X1 and 31st March, 20X2 as per AS 11.

Solution

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.20X1 and corresponding creditors would be recorded at ₹ 11,25,000 (i.e. \$15,000 × ₹ 75)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditors of US \$15,000 on 31.3.20X1 will be reported at ₹ 11,10,000 (i.e. \$15,000 × ₹ 74) and exchange profit of ₹ 15,000 (i.e. 11,25,000 – 11,10,000) should be credited to Profit and Loss account in the year ended 31st March, 20X1.

On 7.7.20X1, creditors of \$15,000 is paid at the rate of ₹ 73. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹ 15,000 (i.e. 11,10,000 – 10,95,000) will be credited to Profit and Loss account in the year ended 31st March, 20X2.

Illustration 3 (MTP Sep '22, Past Exam May '18)

Kalim Ltd. borrowed US\$ 4,50,000 on 01/01/20X1, which will be repaid as on 31/07/20X1. Kalim Ltd. prepares financial statement ending on 31/03/20X1. Rate of exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/20X1 1 US\$ = ₹ 48.00

31/03/20X1 1 US\$ = ₹ 49.00

31/07/20X1 1 US\$ = ₹ 49.50

(5 Marks)

Solution

Journal Entries in the Books of Kalim Ltd.

Date	Particulars	₹ (Dr.)	₹ (Cr.)
20X1 Jan. 01	Bank Account (4,50,000 x 48) Dr. To Foreign Loan Account	216,00,000	216,00,000
March 31	Foreign Exchange Difference Account Dr. To Foreign Loan Account [4,50,000 x (49-48)]	4,50,000	4,50,000
July 01	Foreign Exchange Difference Account Dr. [4,50,000 x (49.5 - 49)] Foreign Loan Account Dr. To Bank Account	2,25,000 220,50,000	2,22,75,000

Illustration 4 (MTP May'20) (RTP May'18, Nov'19, Nov'21, May'19, May 20) (Past Exam Nov.'18)

Rau Ltd. purchased a plant for US\$ 1,00,000 on 01st February 20X1, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognise the profit or loss on forward contract in the books of Rau Ltd.?

Solution

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount US\$	1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000

Contract period 3 months (2 months falling in the year ended 31st March, 20X1)

Loss to be recognised $(30,000/3) \times 2 = ₹ 20,000$ in the year ended 31st March, 20X1. Rest ₹ 10,000 will be recognised in the following year.

In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

Illustration 5

Mr. A bought a forward contract for three months of US\$ 1,00,000 on 1st December at 1 US\$ = ₹ 47.10 when exchange rate was US\$ 1 = ₹ 47.02. On 31st December when he closed his books exchange rate was US\$ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognised in the books.

Solution:

Since the forward contract was for speculation purpose the premium on contract i.e. the difference between the spot rate and contract rate will not be recorded in the books. Only when the contract is sold the difference between the contract rate and sale rate will be recorded in the Profit & Loss Account.

Sale Rate	₹ 47.18
Less: Contract Rate	(₹ 47.10)
Premium on Contract	₹ 0.08
Contract Amount	US\$ 1,00,000
Total Profit (1,00,000 x 0.08)	₹ 8,000

Illustration 6 (MTP Oct '22)(RTP May 20)

Assets and liabilities and income and expenditure items in respect of foreign branches (integral foreign operations) are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to the statement of profit and loss. Comment.

Solution

The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in AS 11. The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS 22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11.

Illustration 7 (Past Exam Nov'19)

A business having the Head Office in Kolkata has a branch in UK. The following is the trial balance of Branch as at 31.03.20X4:

Account Name	Amount in £	
	Dr.	Cr.
Machinery (purchased on 01.04.20X1)	5,000	
Debtors	1,600	
Opening Stock	400	
Goods received from Head Office Account (Recorded in HO books as ₹ 4,02,000)	6,100	
Sales		20,000
Purchases	10,000	
Wages	1,000	
Salaries	1,200	
Cash	3,200	
Remittances to Head Office (Recorded in HO books as ₹ 1,91,000)	2,900	
Head Office Account (Recorded in HO books as ₹ 4,90,000)		7,400
Creditors		4,000

- Closing stock at branch is £ 700 on 31.03.20X4.
- Depreciation @ 10% p.a. is to be charged on Machinery.
- Prepare the trial balance after been converted in Indian Rupees.
- Exchange rates of Pounds on different dates are as follows:

01.04.20X1– ₹ 61; 01.04.20X3– ₹ 63 & 31.03.20X4 – ₹ 67

(5 Marks)

Solution

Trial Balance of the Foreign Branch converted into Indian Rupees as on March 31, 20X4

Particulars	£ (Dr.)	£ (Cr.)	Conversion Basis	₹ (Dr.)	₹ (Cr.)
Machinery	5,000		Transaction date rate	3,05,000	
Debtors	1,600		Closing Rate	1,07,200	
Opening Stock	400		Opening Rate	25,200	
Goods Received from HO	6,100		Actuals	4,02,000	
Sales		20,000	Average Rate		13,00,000
Purchases	10,000		Average Rate	6,50,000	
Wages 1,000 Average Rate	65,000				
Salaries	1,200		Average Rate 78,000		
Cash	3,200		Closing Rate	2,14,400	
Remittance to HO	2,900		Actuals	1,91,000	
HO Account		7,400	Actuals		4,90,000
Creditors		4,000	Closing Rate		2,68,000
Exchange Rate Difference			Balancing Figure	20,200	
	31,400	31,400		20,58,000	20,58,000
Closing Stock	700		Closing Rate	46,900	
Depreciation	500		Fixed Asset Rate	30,500	

Illustration 8

A Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1.1.20X1 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.1.20X1 and 31.12.20X1 respectively. First instalment was paid on 31.12.20X1. The entire difference in foreign exchange has been capitalised.

You are required to state, how these transactions would be accounted for.

Solution

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = $\frac{3,000 \text{ lakhs}}{40} = 75 \text{ lakhs US Dollars}$

Exchange difference = 75 lakhs US Dollars x (42.50 – 40.00) = ₹187.50 lakhs

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

Note: The above answer has been given on the basis that the company has not exercised the option of capitalisation available under paragraph 46 of AS 11. However, if the company opts to avail the benefit given in paragraph 46A, then nothing is required to be done since the company has done the correct treatment.

Illustration 9

A Ltd. has borrowed USD 10,000 in foreign currency on April 1, 20X1 at 5% p.a. annual interest and acquired a depreciable asset. The exchange rates are as under:

01/04/20X1 1 US\$ = ₹ 48.00

31/03/20X2 1 US\$ = ₹ 51.00

You are required to pass the journal entries in the following cases:

- (i) Option under Para 46A is not availed.
- (ii) Option under Para 46A is availed.
- (iii) The loan was taken to finance the operations of the entity (and not to procure a depreciable asset).

In all cases, assume interest accrued on 31 March 20X2 is paid on the same date.

Solution

Journal Entries in the Books of A Ltd.

(i) Option under Para 46A is not availed

Date	Particulars	₹ (Dr.)	₹ (Cr.)
20X1 Apr. 01	Bank Account (10,000 x 48) Dr. To Foreign Loan Account	4,80,000	4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51) To Bank Account	25,500	25,500
Mar 31	Foreign Exchange Difference Account (P/L) Dr. To Foreign Loan Account [10,000 x (51-48)]	30,000	30,000

In this case, since the option under Para 46A is NOT availed, the Exchange Loss of ₹ 30,000 is recognised as an expense in the Statement of Profit and Loss for the year ending 31 March 20X2.

(ii) Option under Para 46A is availed

Date	Particulars	₹ (Dr.)	₹ (Cr.)
20X1 Apr. 01	Bank Account (10,000 x 48) Dr. To Foreign Loan Account	4,80,000	4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51) To Bank Account	25,500	25,500
Mar 31	Foreign Exchange Difference Account Dr. To Foreign Loan Account [10,000 x (51-48)]	30,000	30,000
Mar 31	Property, Plant and Equipment Dr. To Foreign Exchange Difference Account	30,000	30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is capitalized in the cost of Property, Plant and Equipment, which will indirectly get recognized in the Profit & Loss A/c by way of increased depreciation over the remaining useful life of the asset.

(iii) Option under Para 46A is availed

Date	Particulars	₹ (Dr.)	₹ (Cr.)
20X1 Apr. 01	Bank Account (10,000 x 48) Dr. To Foreign Loan Account	4,80,000	4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51) To Bank Account	25,500	25,500
Mar 31	Foreign Exchange Difference Account Dr. To Foreign Loan Account [10,000 x (51-48)]	30,000	30,000
Mar 31	Foreign Currency Monetary Item Translation Difference A/c (FCMITDA) Dr. To Foreign Exchange Difference Account	30,000	30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is accumulated in the FCMITD A/c, which will be subsequently spread over and debited to P&L A/c over the tenure of the loan.

Illustration 10

Explain “monetary item” as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date?

Solution:

As per AS 11 ‘The Effects of Changes in Foreign Exchange Rates’, Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Illustration 11

Distinguish Non-Integral Foreign Operation (NFO) with Integral Foreign Operation (IFO) as per AS 11.

Solution:

As per AS 11, Integral foreign operation (IFO) is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In contrast, a non-integral foreign operation (NFO) is a foreign operation that is not an integral operation.

Illustration 12 (RTP Nov 19) (Past Exam Nov'18, Jan'21) (PYP Nov'18) (MTP Apr'23)

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US \$ 1 = ₹58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US \$ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction.

US \$ 1 = ₹61.20 was on 31.3. 20X1.

(5 Marks)

Solution:

As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, exchange differences arising on the settlement of monetary items or on reporting an enterprise’s monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

However, at the option of an entity, exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency

Monetary Item Translation Difference Account" in the enterprise's financial statements and amortised over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Trade receivables	Foreign Currency Rate	₹
Initial recognition US \$8,547 (5,00,000/58.50)	1 US \$ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US \$ = ₹ 61.20	
Exchange Difference Gain US \$ 8,547 X (61.20-58.50)		23,077
Treatment: Credit Profit and Loss A/c by ₹ 23,077		
Long term Loan		
Initial recognition US \$ 1,07,913.67 (60,00,000/55.60)	1 US \$ = ₹ 55.60	60,00,000
Rate on Balance sheet date	1 US \$ = ₹ 61.20	
Exchange Difference Loss US \$ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment: Credit Loan A/c		
And Debit FCMITD A/C or Profit and Loss A/c by ₹ 6,04,317		

Thus Exchange Difference on Long term loan amounting ₹ 6,04,317 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on debtors amounting ₹ 23,077 is required to be transferred to Profit and Loss A/c.

MTP / RTP / Past Exam

Question 1 (MTP Oct 20, Oct 21) (RTP Sep'24)

Om Ltd. purchased an item of property, plant and equipment for US \$ 50 lakhs on 01.04.2019 and the same was fully financed by the foreign currency loan [US \$] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US \$ = ₹ 60). As on 31.03.2020 the first instalment was paid when 1 US \$ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold. Om Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment. **(5 Marks)**

Solution:

Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be adjusted in the carrying amount of the respective item of property, plant and equipment as Om Ltd. has exercised the option and it is long term foreign currency monetary item. Thus, the entire exchange loss due to variation of ₹ 20 lakh on 31.03.2020 on payment of US \$ 10 lakhs, should be added to the carrying amount of an item of property, plant and equipment and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakhs \$ x ₹ 60) = ₹ 3,000 lakh

Exchange loss on outstanding loan on 31.03.2020 = ₹ 40 lakh

US \$ x (62.00-60.00) = ₹ 80 lakh. So, ₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment. The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh. Total depreciation to be provided for the year 2019 - 2020 = 20% of (₹ 3,000 Each + 100 lakh) = ₹ 620 lakh.

Question 2 (MTP Nov '21 & April '23)

“Explain “monetary item” as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non- monetary item:

- (i) Share Capital
- (ii) Trade Receivables
- (iii) Investments
- (iv) Property Plant & Equipment.

(5 Marks)

Solution:

As per AS 11 ‘The Effects of Changes in Foreign Exchange Rates’, Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realized from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
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Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

Question 3 (RTP May '22)

Kumar Ltd. borrowed US \$ 3,00,000 on 31-12-2020 which will repaid as on 30-06-2021. Kumar Ltd. prepares its financial statements ending on 31-03-2021. Rate of exchange between reporting currency (Rupee) and foreign currency (US\$) on different dates are as under:

31-12-2020	1 US \$ = ₹ 44.00
31-03-2021	1 US \$ = ₹ 44.50
30-06-2021	1 US \$ = ₹ 44.75

(i) Calculate Borrowings in reporting currency to be recognized in the books on above mentioned dates and also show journal entries for the same.

(ii) If borrowings were repaid on 28-2-2021 on which date exchange rate was 1 US \$ = ₹ 44.20 then what entry should be passed?

Solution:

(i) As per AS 11 'The Effect of Changes in Foreign Exchange Rates', a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. Moreover, at each balance sheet date, foreign currency monetary items should be reported using the closing rate; Accordingly, on 31;12;2020 borrowings will be recorded at ₹ 1,32,00,000 (i.e., ₹ 3,00,000 × ₹ 44;00); On 31;3;2021 borrowings (monetary items) will be recorded at ₹ 1,33,50,000 (i.e; \$ 3,00,000 × ₹ 44.50).

Journal of Kumar Ltd.

Date	Particular		Dr; (₹)	Cr; (₹)
31-12-2020	Bank A/c	Dr	1,32,00,000	
	To Foreign Loan Account			1,32,00,000
31-03-2021	Foreign Exchange A/c Difference Account	Dr	1,50,000	
	To Foreign Loan Account			1,50,000
30-06-2021	Foreign Loan Account A/c	Dr.	1,33,50,000	
	Foreign Exchange Difference Account A/c		75,000	
	To Bank A/c			1,34,25,0000

In case borrowings were repaid before Balance Sheet Date, then the entry would be as follows:

Date	Particular		Dr; (₹)	Cr; (₹)
28-02-2021	Foreign Loan Account A/c	Dr	1,32,00,000	
	Foreign Exchange Difference Account A/c	Dr.	60,000	
	To Bank A/c			1,32,60,000

Working Notes:

- (i) The exchange difference of ₹ 1,50,000 is arising because the transaction has been reported at different rate (₹ 44;50 = 1 US \$) from the rate initially recorded (i.e., ₹ 44 = 1 US \$) from the rate initially recorded (i.e., ₹ 44 = 1 US \$)
- (ii) The exchange difference of ₹ 75,000 is arising because the transaction has been settled at an exchange rate (₹ 44;75 = 1 US\$) different from the rate at which reported in the last financial statements (₹ 44;50 = 1 US\$).
- (iii) The exchange difference of ₹ 60,000 is arising because the transaction has been settled at a different rate (i.e., ₹ 44;20 = 1 US \$) than the rate at which initially recorded (1 US \$ = ₹ 44;00)

Question 4 (RTP Nov'22)

A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2022, when the exchange rate was ₹ 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2022 when the exchange rate was ₹ 47 per US Dollar. However, on 31st March, 2022, the rate of exchange was ₹ 48 per US Dollar. The company passed an entry on 31st March, 2022 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US Dollar. In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss

Solution:

As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Trade payables is a monetary item, hence should be valued at the closing rate i.e., ₹ 48 at 31st March, 2022 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of ₹ 5 (₹ 48-₹ 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2022 and is not to be adjusted against the cost of raw materials. In the subsequent year, the company would record an exchange gain of ₹ 1 per US dollar, i.e., the difference between ₹ 48 and ₹ 47 per US dollar. Hence, the accounting treatment adopted by the company is incorrect.

Question 5 (RTP May 23)

ABC Builders Limited had borrowed a sum of US \$ 15,00,000 at the beginning of Financial year 2020- 21 for its residential project at London Interbank Offered Rate (LIBOR) + 4 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, the exchange rate was ₹ 72 per US \$ and the rate as on 31st March, 2021 was ₹ 76 per US \$. If ABC Builders Limited borrowed the loan in Indian Rupee equivalent, the pricing of loan would have been 9.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2021 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

Solution:

- (i) Interest for the period 2020-21
= US \$ 15 lakhs × 5% × ₹ 76 per US \$ = ₹ 57 lakhs
- (ii) Increase in the liability towards the principal amount
= US \$ 15 lakhs × ₹ (76 - 72) = ₹ 60 lakhs
- (iii) Interest that would have resulted if the loan was taken in Indian currency
= US \$ 15 lakhs × ₹ 72 × 9.5% = ₹ 102;60 lakhs
- (iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹
102;60 lakhs less ₹ 57 lakhs = ₹ 45;60 lakhs;

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 45.60 lakhs will be considered as the borrowing cost; Thus, total borrowing cost would be ₹ 102;60 lakhs being the aggregate of interest of ₹ 57 lakhs on foreign currency borrowings plus the exchange difference to the extent of

difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 45;60 lakhs; Hence, ₹ 102;60 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 “Borrowing Costs” and the remaining ₹ 14;4 lakhs (60 - 45.60) would be considered as the exchange difference to be accounted for as per AS 11 “The Effects of Changes in Foreign Exchange Rates”;

Question 6 (Past Exam Nov '22)

Trade Payables of Jared Limited includes amount due to Sterling Limited ₹ 9,75,000 recorded at the prevailing exchange rate on the date of purchase- transaction recorded at US \$ 1 = ₹ 75.00. The exchange rate on Balance Sheet date (31st March,2022) was US \$ 1 = ₹ 79.00 The payment was made on 1st May,2022 when the exchange rate was US \$ 1 = ₹ 78.30.

You are required to calculate the amount of exchange difference on 31st March, 2022 and 1st May, 2022 and also explain the accounting treatment needed in the above case as per AS 11 in the books of Jared Limited. **(2.5 Marks)**

Solution:

As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, exchange differences arising on the settlement of monetary items or on reporting an enterprise’s monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expenses in the period in which they arise.

Trade payables	Foreign Currency Rate	Amount ₹
Initial recognition US \$13,000 (9,75,000/75)	1 US \$ = ₹ 75	
Exchange Rate on Balance sheet date	1 US \$ = ₹ 79	
Exchange Difference Loss US \$ 13,000 X (79-75)		52,000
Exchange Rate on Settlement date	1 US \$ = ₹ 78;30	
Exchange Difference Profit US \$ 13,000x(79- 78.30)		9,100

For the year ended 31st March, 2022 exchange difference loss amounting ₹ 52,000 will be charged to statement of Profit & Loss A/c.

However, there is exchange difference gain of ₹ 13,000 x (79-78.30) = 9,100 on 1st May, 2022. Thus, gain of ₹ 9,100 will be credited to statement of Profit & Loss A/c for the year ended 31st March, 2023;

Question 7 (Past Exam May '23)

Trower Limited is an Indian importer. It imports goods from True View Limited situated at London. Trower Limited has a payable of £50,000 to True View Limited as on 31st March, 2023. True View Limited has given Trower Limited the following two options:

- Pay immediately with a cash discount of 1% on the payable.
- Pay after 6 months with interest @ 5% p.a. on the payable.

The borrowing rate for Trower Limited in rupees is 15% p.a.

The following are the exchange rates:

Date	₹
31st March,2023	97
30th September, 2023	99

You are required to give your opinion to Trower Limited on which of the above two options to be chosen.

(5 Marks)

Solution:

Option (i) Pay immediately with Cash discount of 1% on the payable

	₹
Total amount payable as on 31.3.2023 (50,000 x ₹ 97)	48,50,000
Less: Cash discount	(48,500)
	48,01,500
Add: Borrowing cost @ 15% p.a. for 6 months	3,60,112
If payment made immediate	51,61,612

Option (ii) Pay after 6 months with interest @ 5% p.a. on the payable

	₹
Total amount payable as on 31.3.2023 (50,000 x ₹ 99)	49,50,000
Interest for 6 months @ 5%	1,23,750
If payment made after 6 months	50,73,750

Thus, Option (iii) is beneficial to Trower Limited as the Rupee outflow will be lower by
₹ (51,61,612 – 50,73,750) = ₹ 87,862 in option (ii).

Note: The above answer be presented in the alternative manner given as below:

Option (i) Pay immediately with Cash discount of 1% on the payable

	₹
Total amount payable on 31.3.2023	50,000
Less: Cash discount (50,000 x 1 / 100)	(500)
	49,500
	48,01,500
49,500 x ₹ 97	3,60,112
Add: Borrowing cost @ 15% p.a. for 6 months	₹ 51,61,612
If payment made immediate	

Option (ii)

Pay after 6 months with interest @ 5% p.a. on the payable

	₹
Total amount payable on 31.3.2023	50,000
Interest for 6 months @ 5% (50,000 x 5 / 100 x 6 / 12)	1,250
	51,250
If payment made after 6 months (51,250 x 99)	50,73,750

Thus, Option (ii) is beneficial to Trower Limited as the Rupee outflow will be lower by ₹ (51,61,612 – 50,73,750) = ₹ 87,862 in option (ii).

Question 8 (Past Exam Nov'23)

Karna Ltd., an Indian Company, has the following foreign currency transactions during the financial year 2022-23:

- (i) On 1st July, 2022, imported goods from Try Ltd., a German based company, amounting to ₹ 30,96,000.
- (ii) On 1st October, 2022, imported plant and machinery from Lucy Ltd., a German based company, for € 18,500. The amount was paid on the date of import itself. (Ignore depreciation).
- (iii) On 1st December, 2022, exported good on credit to Cream Ltd., a German based company, amounting to ₹ 50,40,000.

All the above transactions were recorded in the books of account at the prevailing exchange rate on the date of the transactions. Ignore taxes and duty on the above transactions.

Payment due from Cream Ltd. and payment due to Try Ltd. is outstanding as on 31st March, 2023.

Rate of exchange between reporting currency (₹) and foreign currency (€) on different dates are as under:

On 1st July, 2022	1 € = ₹ 86
On 1st October, 2022	1 € = ₹ 88
On 1st December, 2022	1 € = ₹ 84
On 31st March, 2023	1 € = ₹ 90

You are required, as per AS-11:

- (i) To show value at which above items will appear in Balance sheet as on 31st March, 2023;
- (ii) To calculate the amount of gain/loss on each of above transactions on account of exchange differences, if any. **(5 Marks)**

Solution:

As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, Foreign currency monetary items should be reported using the closing rate. Non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction. Exchange differences arising on the settlement of monetary items or on reporting an enterprise’s monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise.

(i) Items given in the question will appear in the Balance Sheet at the following values:

Trade Payables (30,96,000/86= 36,000 German Currency) x ₹ 90 = ₹ 32,40,000

Plant and Machinery 18,500 German Currency X ₹ 88 = ₹16,28,000

Trade Receivables (50,40,000/84= 60,000 German Currency) x ₹ 90 = ₹ 54,00,000

(ii) Amount of gain / loss on each transaction on account of exchange difference:

Exchange loss on Transaction of import of goods from Try Ltd. = ₹ (1,44,000)

[36,000 German Currency X ₹ 4 (i.e. 90-86)]

Exchange gain on Transaction of export of goods to Cream Ltd = ₹ 3,60,000

[60,000 German Currency X ₹ 6 (i.e. 90-84)]

MCQ

1. As per AS 11 assets and liabilities of non-integral foreign operations should be converted at _____ rate.
 - (a) Opening
 - (b) Average
 - (c) Closing
 - (d) Transaction

2. The debit or credit balance of “Foreign Currency Monetary Item Translation Difference Account”
 - (a) Is shown as “Miscellaneous Expenditure” in the Balance Sheet
 - (b) Is shown under “Reserves and Surplus” as a separate line item
 - (c) Is shown as “Other Non-current” in the Balance Sheet
 - (d) Is shown as “Current Assets” in the Balance Sheet

3. If asset of an integral foreign operation is carried at cost, cost and depreciation of tangible fixed asset is translated at
 - (a) Average exchange rate
 - (b) Closing exchange rate
 - (c) Exchange rate at the date of purchase of asset
 - (d) Opening exchange rate

4. Which of the following can be classified as an integral foreign operation?
 - (a) Branch office serving as an extension of the head office in terms of operations
 - (b) Independent subsidiary of the parent company
 - (c) Branch office independent of the head office in terms of operational decisions
 - (d) None of the above

5. Which of the following items should be converted to closing rate for the purposes of financial reporting?
 - (a) Items of Property, Plant and Equipment
 - (b) Inventory
 - (c) Trade Payables, Trade Receivables and Foreign Currency Borrowings
 - (d) All of the above

Answers/Solution

1. (c) 2. (b) 3. (c) 4. (a) 5. (c)