THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES

AS 11

Scope	AS-11 should be applied in ❖ Accounting for transactions in foreign currencies ❖ Translating the financial statements of foreign operations. ❖ Accounting for foreign currency transactions in the nature of forward exchange contracts	
FOREIGN CURRENCY TRANSACTIONS		
Meaning	It is a transaction which is denominated or requires settlement in a foreign currency.	
Examples	➢ Buying and selling of goods or services in foreign currency ➢ Lending or borrowing in foreign currency. ➢ Acquisition and disposition of asset denominated in foreign currency.	
Initial recognition	→ All transactions should be recorded at spot rate i.e. rate of foreign exchange at the date of transaction. → If spot rate is not given then average rate of week or month can be used	
Subsequent recognition /reporting at subsequent balance sheet dates	*Monetary Item*	These are the items which are receivable or payable in fixed or determinable amounts of money. Example: Cash, debtors, creditors, etc. *Use exchange rate at the balance sheet date*
	Non-monetary item	These all assets and liabilities other than monetary items. Example: Fixed assets, inventories and investments in equity shares. *Use exchange rate at the date of transaction.* If item carried at fair value, then use the exchange rate that existed when the values were determined
Recognition of exchange differences	*Monetary Item*	To be recognized as expenses or income i.e. to be debited or credited to P & L A/c
	Non-monetary item	No subsequent recognition is required, there does not arise any exchange difference.
SPECIAL CASE (MONETARY ITEMS) PARA 46 AND 46A		
Applicability	Exchange differences arising or reporting of long-term foreign currency monetary items. (LTFCMI). Application of this Para is optional but once exercised it is irrevocable & applies to all such foreign currency monetary items.	
Meaning of LTFCMI	An asset or liability should be designated as LTFCMI if – ➢ Asset or liability is expressed in a foreign currency and ➢ Has a term of 12 months or more at the date of origination of the asset or liability.	
Exchange difference on LTFCMI	*Related to depreciable capital assets*	Add to/deduct from cost of asset and depreciate over the balance life of the asset

	Others	Accumulate in FCMITDA and amortize over the balance period of such long term item FCMITDA: Foreign Currency Monetary Item Translation Difference Account *Disclosed under Reserve & Surplus as separate line item*
Disclosure requirements	• Fact of such option • Amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized.	
FOREIGN OPERATIONS		
Integral Foreign Operations	• It is a foreign operation, the activities of which are integral part of those of the reporting enterprise. The business of IFO is carried on as if it were an extension of the reporting enterprises operations.	
Non- Integral Foreign Operations	• It is a foreign operation that is not an integral foreign operation. The business of NIFO is carried on in substantially independent way by accumulating cash & other monetary items, incurring expenses, generating income & arranging borrowing in its own local currency.	
FORWARD EXCHANGE CONTRACTS		
Meaning	It means an agreement to exchange different currencies at a forward rate. Forward rate is the specified exchange rate for exchange of two currencies at a specified future date.	
Categories	*For Trading or speculation purposes*	Gain or loss recognized in the Statement of P&L for the period. The premium or discount on the forward exchange contract is not recognised separately. At each balance sheet date the value of contract is marked to its current market value and the gain or loss on the contract is recognised.
	Not for Trading or speculation	Premium or discount – amortize as expense or income over the life of contract.

DISCLOSURE REQUIREMENTS

- An enterprise should disclose:
  - (a) The amount of exchange differences included in the net profit or loss for the period.
  - (b) Net exchange differences accumulated in foreign currency translation reserve as a separate component of shareholders' funds, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.
- When the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.
- When there is a change in the classification of a significant foreign operation, an enterprise should disclose:
  - (a) The nature of the change in classification
  - (b) The reason for the change
  - (c) The impact of the change in classification on shareholders' funds and
  - (d) The impact on net profit or loss for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.

ASSIGNMENT QUESTIONS

Question 1 *(RTP Nov 2018) / (RTP Nov 2020) (ICAI Study Material)* Pg no._____

	Exchange Rate per $
Goods purchased on 1.1.2021 of US $ 15,000	₹ 75
Exchange rate on 31.3.2021	₹ 74
Date of actual payment 7.7.2021	₹ 73

Ascertain the loss/gain for financial years 2020-21 and 2021-22, also give their treatment as per AS 11. Pass Journal entries.

Question 2 *(RTP Nov 2022)* Pg no._____

A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2021, 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, 2021 when the exchange rate was ₹ 47 per US Dollar. However, on 31st March, 2021, the rate of exchange was ₹ 48 per US Dollar. The company passed an entry on 31st March, 2021 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

Question 3 *(ICAI Study Material)* Pg no._____

Kalim Ltd. borrowed US$ 4,50,000 on 01/01/2021, which will be repaid as on 31/07/2021. Kalim Ltd. prepares financial statement ending on 31/03/2021. Rate of exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2021 1 US$ = ₹ 48.00 31/03/2021 1 US$ = ₹ 49.00 31/07/2021 1 US$ = ₹ 49.50

Pass Journal entries.

Question 4 *(RTP May 2022)* Pg no._____

Kumar Ltd. borrowed US $ 3,00,000 on 31-12-2020 which will be repaid (settled) as on 30-6-2021. Kumar Ltd. prepares its financial statements ending on 31-3-2021. Rate of exchange between reporting currency (Rupee) and foreign currency (US $) on different dates are as under:

31-12-2020 1 US $ = ₹ 44.00; 31-3-2021 1 US $ = ₹ 44.50; 30-6-2021 1 US $ = ₹ 44.75

(i) Calculate borrowings in reporting currency to be recognised in the books on above mentioned dates & also show journal entries for the same.

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

Question 5 *(RTP Nov 2019) / (ICAI Study Material)* Pg no._____

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3.2021

a) Trade receivables as on 31.3.2021 in the books of XYZ Ltd. include an amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US $ 1= ₹ 58.50.

b) 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 on 31.3.2021.

Question 6 Pg no._____

Beekay Ltd. purchased fixed assets costing ₹ 5,000 lakh on 01.04.2021 payable in foreign currency (US$) on 05.04.2022. Exchange rate of 1 US$ = ₹ 50.00 and ₹ 54.98 as on 01.04.2021 and 31.03.2022 respectively. The company also obtained a soft loan of US$ 1 lakh on 01.04.2021 payable in three annual equal instalments. First instalment was due on 01.05.2022.
You are required to state, how these transactions would be accounted for in the books of accounts ending 31st March, 2022.

Question 7 *(ICAI Study Material)* Pg no._____

A Ltd. has borrowed USD 10,000 in foreign currency on April 1, 2021 at 5% p.a. annual interest and acquired a depreciable asset. The exchange rates are as under:
01/04/2021 1 US$ = ₹ 48.00
31/03/2022 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 2022 is paid on the same date.

Question 8 Pg no._____

Option Ltd. is engaged in the manufacturing of steel. For its steel plant, it required machineries of latest technology. It usually resorts to Long Term Foreign Currency Borrowings for its fund requirements. On 1st April, 2021, it borrowed US $1 million from International Funding Agency, USA when exchange rate was 1 $ = ₹ 52. The funds were used for acquiring machineries on the same date to be used in three different steel plants. The useful life of the machineries is 10 years and their residual value is ₹ 20,00,000.
Earlier also company used to purchase machineries out of foreign borrowings. The exchange differences arising on such borrowings were charged to profit and loss account and were not capitalised even though the company had an option to capitalise it as per notified AS 11 (notification issued by MCA in 2009).

Now for this new purchase of machinery, Option Ltd, is interested to avail the option of capitalising the same to the cost of asset. Exchange rate on 31st March, 2022 is 1 US $ = ₹ 51. Assume that on 31st March, 2022, Option Ltd. is not having any old Long term foreign currency borrowings except for the amount borrowed for machinery purchased on 1st April, 2021.

Can Option Ltd. capitalise the exchange difference to the cost of asset on 31st March, 2022? If yes, then calculate the depreciation amount on machineries as on 31st March, 2022.

Question 9 Pg no._____

Om Ld. Purchased an item of property, plant and equipment for US $ 50 Lakh on 01.04.2021 and the same was fully financed by the foreign currency loan (US $) repayable in 5 equal instalments annually. Exchange rate at the time of purchase was 1 US $ = ₹ 60. As on 31.03.2022 the first instalment was paid when 1 US $ = ₹ 62.
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.

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's a long term foreign currency monetary item. Thus the entire exchange loss due to variation of ₹ 20 Lakh on 31.03.2022 on payment of US $10 Lakh, 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 unamortized depreciable amount should also be provided.

Calculation of Exchange Loss:

Foreign Currency Loan (in ₹) = $ 50 Lakh x 60 = ₹ 3,000 Lakh
Exchange Loss on outstanding loan on 31.03.2022 = US $ 40 Lakh x (62-60) = ₹ 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 2021-22 = 20% of (3,000+100) = ₹ 620 Lakh.

Question 10 – *(RTP Nov 2018) / (RTP Nov 2020) / (RTP Nov 2023)* *Pg no._____*

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) Investment in Equity Shares
(iii) Trade Receivables
(iv) Property, Plant & Equipment.

Solution

As per AS 11, 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 realised 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 realised from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investment in Equity Shares	Non-monetary
Property, Plant & Equipment	Non-monetary

Question 11 *Pg no._____*

Stem Ltd. purchased a Plant for US$ 30,000 on 30th November, 2021 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 62.15 per dollar. On 30th November, 2021; the exchange rate was ₹ 60.75 per dollar. How will you recognise the profit or loss on forward contract in the books of Stem Ltd. for the year ended 31st March, 2022?

Question 12 *(ICAI Study Material)* Pg no.______

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 recognized in the books.

Question 13 Pg no.______

"The company had a engineering contract with a foreign government, work to be carried out in foreign country and payments to be received in dollars. The work was completed in the year 2021, and the entire contracted amount was duly recorded in the books of the company at the prevalent exchange rate on the date of completion of the work. However, payments to the extent of ₹ 40 crores could not be released by the Foreign Government because of temporary foreign exchange crisis in that country. These ₹40 crores unrealized at the end, if converted at the yearend rate would amount to ₹ 40.50 crores. The Company has adopted and follows the following accounting policy:

"In respect of foreign currency transactions, current assets and current liabilities are revalued at year end rates. However, if there is a net loss, due to exchange difference, the same is charged off to the P&L account, but if there is a net gain, the same is ignored in view of the prudent accounting policies of not recording unrealized gains due to exchange rate fluctuations".

Comment on the appropriateness of the above.

Solution

In given case the recoverability of ₹ 40 Crores is not doubtful or uncertain but just deferred temporarily hence it should be translated using exchange rates at the close of the year. Further AS-11 clearly mentions that net difference shall be transferred to profit and loss account. Hence, we can say that exchange difference favourable or unfavorable both shall be considered at the yearend rather to ignore the gains and recording just losses.

Question 14 *(Inter Nov 2023) (5 Marks)* Pg no.______

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 & 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:

a) To show value at which above items will appear in Balance sheet as on 31st March, 2023.

b) To calculate the amount of gain/loss on each of above transactions on account of exchange differences, if any.

PRACTICE QUESTIONS

Question 1 Pg no._____

Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2021, when the exchange rate was ₹ 44 per US Dollar. The transaction was recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2021, when the exchange rate was ₹ 48 per US Dollar. At the year end 31st March, 2021, the rate of exchange was ₹ 49 per US Dollar.

The Chief Accountant of the company passed an entry on 31st March, 2021 adjusting the cost of raw material consumed for the difference between ₹ 48 and ₹ 44 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).

Solution

As per AS 11, initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 25th February 2021, the raw material purchased and its creditors will be recorded at US dollar 9,000 × ₹ 44 = ₹ 3,96,000.

Also, as per standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. ₹ 49 per US dollar (USD 9,000 x ₹ 49 = ₹ 4,41,000) at 31st March, 2021, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of ₹ 5 (49 – 44) per US dollar i.e. ₹ 45,000 (USD 9,000 x ₹ 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2021 and will not be adjusted against the cost of raw materials.

In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of ₹ 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between ₹ 49 and ₹ 48 per US dollar i.e. ₹ 9,000.

Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11

Question 2 *(Inter May 2018) (5 Marks)* Pg no._____

ABC Ltd. borrowed US $ 5,00,000 on 01/01/2021, which was repaid as on 31/07/2021. ABC Ltd. prepares financial statement ending on 31/03/2021. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2021	1 US$ =	68.50
31/03/2021	1 US$ =	69.50
31/07/2021	1 US$ =	70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

Solution

Date	Particulars	Dr.	Cr.
Jan. 01, 2021	Bank A/c (5,00,000*68.50) Dr.	3,42,50,000	
	To Foreign Loan A/c		3,42,50,000
Mar. 31, 2021	Foreign Exchange Difference A/c Dr.	5,00,000	
	To Foreign Loan A/c		5,00,000
	[5,00,000*(69.50-68.50)]		
Mar. 31, 2021	Profit & Loss A/c Dr.	5,00,000	
	To Foreign Exchange Difference A/c		5,00,000
Jul. 31, 2021	Foreign Loan A/c Dr.	3,47,50,000	

	Foreign Exchange Difference A/c Dr.	2,50,000	
	To Bank A/c		3,50,00,000
	Profit & Loss A/c Dr.	2,50,000	
	To Foreign Exchange Difference A/c		2,50,000

Question 3

Pg no._____

Explain briefly the accounting treatment needed in the following cases as per AS 11:

(i) Sundry Debtors include amount receivable from Ted of U.S., ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at $1 = ₹ 38.70.

(ii) Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at $1 = ₹ 35.60, taking exchange rate prevailing at the date of transactions.

Exchange rates at the end of the year were as under:

$1 Receivable = ₹ 45.80 $ 1 Payable = ₹ 45.90

Solution

AS 11 provides that exchange differences attributable to monetary items should be taken to Statement of Profit and Loss. In case option under para 46A is exercised, exchange differences arising on long-term foreign currency monetary items can be adjusted in the cost of depreciable capital asset or in other cases transferred in Foreign Currency Monetary Item Translation Difference A/c (FCMITD) and amortised.

Trade Receivables

Particulars	Foreign currency	Rate	₹
Initial recognition	US $ 12,919.90	38.70	5,00,000
Rate on B/S date		45.80	
Exchange Difference	US $ 12,919.90	7.10	91,731
Gain or loss			Gain
Treatment			Credit to Profit & Loss A/c ₹ 91,731

Long Term loan

Particulars	Foreign currency	Rate	₹
Initial recognition	US $ 1,68,539.33	35.60	60,00,000
Rate on B/S date		45.90	
Exchange Difference	US $ 1,68,539.33	10.30	17,35,955
Gain or loss			Loss
Treatment			Debit to Profit & Loss A/c ₹ 17,35,955 or transfer to FCMITD A/c and amortise.

Question 4 *(Inter Nov 2018) (5 Marks)*

Pg no._____

(i) ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to ₹ 30,00,000. It was recorded at US $1 = ₹ 60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2022) was US $1 = ₹ 62.00.

(ii) Trade receivable includes amount receivable from Preksha Ltd., ₹ 10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 59.00. The exchange rate on balance sheet date (31.03.2022) was US $1 = ₹ 62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd.

Solution

Amount of Exchange difference and its Accounting Treatment

	Long term Loan	Foreign Currency Rate	₹
(i)	Initial recognition US $ 50,000 ₹ (30,00,000/60)	1 US $ = ₹ 60	30,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Loss US $ 50,000 x ₹ (62 – 60)		1,00,000
	Treatment: Credit Loan A/c and Debit FCMITD A/c or Profit and Loss A/c by ₹ 1,00,000		
	Trade receivables		
(ii)	Initial recognition US $ 16,949.152* (₹10,00,000/59)	1 US $ = ₹ 59	10,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Gain US $ 16,949.152* x ₹ (62-59)		50,847.456*
	Treatment: Credit Profit and Loss A/c by ₹ 50,847.456* and Debit Trade Receivables		

Thus, Exchange Difference on Long term loan amounting ₹ 1,00,000 may either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account but exchange difference on trade receivables amounting ₹ 50,847.456 is required to be transferred to Profit and Loss A/c.

Question 5 *(Inter Jan 2021) (5 Marks)* *Pg no._____*

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.03.2022

(i) Debtors include amount due from Mr. S ₹ 9,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 72.00
US $ 1= ₹ 73.50 on 31st March, 2022
US $ 1= ₹ 72.50 on 1st April, 2021.

(ii) Long term loan taken on 1st April, 2021 from a U.S. company amounting to ₹ 75,00,000. ₹ 5,00,000 was repaid on 31st December, 2021, recorded at US $ 1 = ₹ 70.50. Interest has been paid as and when debited by the US company.
US $1= ₹ 73.50 on 31st March, 2022
US $1=1 ₹ 72.50 on 1st April, 2021

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.

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 non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

	Foreign Currency Rate	Amount (₹)
Debtors		
Initial recognition US $12,500 (9,00,000/72)	1 US $ = ₹72	9,00,000

Rate on Balance sheet date	1 US $ = 73.50	
Exchange Difference Gain US $ 12,500 X (73.50 - 72)		18,750
Treatment: Credit Profit and Loss A/c by ₹ 18,750		
Long term Loan		
Initial recognition US $ 1,03,448.28 (75,00,000/72.50)	1 US $ = 72.50	75,00,000
Rate on Balance sheet date	1 US $ = 73.50	
Exchange Difference Loss after adjustment of exchange gain on repayment of ₹ 5,00,000 ₹ 67,987.48 [82,171.88 (US $ 96,356.08 X ₹ 73.5 less ₹ 70,00,000) less profit 14,184.40 [US $ 7,092.2 (5,00,000/70.5) X ₹ 2)] NET LOSS		67,987.48*
Treatment: Credit Loan A/c and Debit FCMITD A/C or Profit and Loss A/c by ₹ 67,987.48		

Thus, Exchange Difference on Long term loan amounting ₹ 67,987.48 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 ₹ 18,750 is required to be transferred to Profit and Loss A/c.

NOTE 1: *Exchange Difference Loss (net of adjustment of exchange gain on repayment of ₹ 5,00,000) has been calculated in the above solution. Alternative considering otherwise also possible.

NOTE 2: Date of sales transaction of ₹ 9 lakhs has not been given in the question and hence it has been assumed that the transaction took place during the year ended 31 March 2022

Question 6 *(Inter Dec 2021) (5 Marks)* *Pg no._____*

(i) PP Ltd. an Indian Company acquired long term finance from WW (P) Ltd. a U.S. company, amounting to ₹ 40,88,952. The transaction was recorded at US $1 = ₹ 72.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹ 73.60.

(ii) Trade receivables of PP Ltd. include amount receivable from Preksha Ltd., ₹ 20,00,150 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 73.40. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹ 73.60. Exchange rate on 1st April, 2020 is US $1 = ₹ 74.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of PP Ltd.

Solution

(i) Long term Finance

	Foreign Currency Rate	₹
Initial recognition US $ 56,791 (40,88,952/72)	1 US $ = ₹ 72	40,88,952
Rate on Balance sheet date	1 US $ = ₹ 73.60	
Exchange Difference Loss [US $ 56,791 x (73.60 – 72)]		90,866 (rounded off)

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.

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 non-depreciable capital asset can be accumulated in a “Foreign Currency Monetary Item Translation Difference Account” in the enterprise’s financial statements and amortized over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.
Treatment needed in this case: PP Ltd. can either Debit Foreign Currency Monetary Item Translation Difference (FCMITD) A/c or Debit Profit & Loss A/c by ₹ 90,866 & Credit Loan A/c

(ii) Trade Receivables

	Foreign Currency Rate	₹
Initial recognition US $ 27,250 (20,00,150/ 73.40)	1 US $ = ₹ 73.40	20,00,150
Rate on Balance sheet date	1 US $ = ₹ 73.60	
Exchange Difference Gain [US $ 27,250 X (73.60-73.40)]		5,450

As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, exchange differences on trade receivables amounting ₹ 5,450 is required to be transferred to Profit and Loss A/c.
Treatment needed in this case: Credit Profit and loss account by ₹ 5,450.

Question 7 Pg no._____

Legal Ltd. is engaged in the manufacturing of rubber. For its plant, it required machineries of latest technology. It usually resorts to Long Term Foreign Currency Borrowings for its fund requirements. On 1st April, 2021, it borrowed US $1 million from International Funding Agency, USA when exchange rate was 1 $ = ₹ 63. The funds were used for acquiring machineries, on the same date, to be used in three different plants. The useful life of the machineries is 10 years and their residual value is ₹ 30,00,000.
Earlier also the company used to purchase machineries out of foreign borrowings. The exchange differences arising on such borrowings were charged to P&L A/c and were not capitalized even though the company had an option to capitalize it as per notified AS 11.

Now for this new purchase of machinery, Legal Ltd, is interested to avail the option of capitalizing the same to the cost of asset. Exchange rate on 31st March, 2022 is 1 US $ = ₹ 62. Assume that on 31st March, 2022, Legal Ltd. is not having any old long term foreign currency borrowings except for the amount borrowed for machinery purchased on 1st April, 2021.

Comment whether Legal Ltd. can capitalize the exchange difference to the cost of asset on 31st March, 2022. If yes, then calculate the depreciation amount on machineries as on 31st March, 2022.

Solution

As per paragraph 46A of AS 11, ‘The Effects of Changes in Foreign Exchange Rates’, in respect of accounting periods commencing on or after 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 or not (such option to be irrevocable and to be applied to all such foreign currency monetary items), the 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 shall be depreciated over the balance life of the asset.

Accordingly, though Legal Ltd. had not earlier exercised the option, yet it can avail the option to capitalize the exchange difference to the cost of machinery by virtue of para 46A of AS 11. Further, since Legal Ltd. has no earlier long term foreign currency borrowings, it is not required to apply capitalization option to earlier borrowing also.

Exchange difference to be capitalized and depreciation amount

Cost of the asset in $	1 million
Exchange rate on 1st April, 2021	1$ = ₹ 63
Cost of the asset in ₹ (1 million x ₹ 63)	63 million
Less: Exchange differences as on 31st March, 2022 (63-62) x $ 1 million (Gain)	(1 million)
	62 million
Less: Depreciation for 2021-22 (62 million - 3 million) /10 years	(5.90 million)
	56.10 million

Question 8

Pg no._____

Opportunity Ltd. purchased an equipment costing ₹ 24,00,000 lakhs on 1.4.2021 and the same was fully financed by foreign currency loan (US Dollars) payable in four annual equal installments. Exchange rates were 1 Dollar = ₹ 60.00 and ₹ 62.50 as on 1.4.2021 and 31.3.2022 respectively. First installment was paid on 31.3.2022. The entire difference in foreign exchange has been capitalized. You are required to state that how these transactions would be accounted for.

Solution

As per AS 11, exchange differences arising on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, should be recognized 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 will be recognized as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = ₹ 24,00,000/60 = 40,000 US Dollars

Exchange difference = 40,000 US Dollars × (62.50-60.00) = ₹ 1,00,000

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 1,00,000 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 availed the option for capitalisation of exchange difference as per para 46/ 46A of AS 11.

However, as per para 46A of the standard, the 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, 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 shall be depreciated over the balance life of the asset

Accordingly, in case Opportunity Ltd. opts for capitalizing the exchange difference, then the entire amount of exchange difference of ₹ 1,00,000 will be capitalised to 'Equipment account'. This capitalized exchange difference will be depreciated over the useful life of the asset.

Cost of the asset on the reporting date

Initial cost of Equipment	₹ 24,00,000
Add: Exchange difference as on 31.3.2022	₹ 1,00,000
Total cost on the reporting date	₹ 25,00,000

Question 9 *(ICAI Study Material)* Pg no._____

A Ltd. purchased fixed assets costing ₹3,000 lakhs on 1.1.2021 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 & ₹ 42.50 as on 1.1.2021 & 31.12.2021 respectively. First instalment was paid on 31.12.2021. 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 recognized 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 recognized as income or expense.

Calculation of Exchange Difference:
Foreign currency loan = 3,000 lakhs/40 = 75 lakhs US Dollars
Exchange difference = 75 lakhs US Dollars × (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 capitalization available under para 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.

Question 10 *(RTP May 2021)* Pg no._____

(a) Classify the following items into Monetary and Non-monetary:
 (i) Share capital; (ii) Trade Payables; (iii) Cash balance; (iv) Property, plant and equipment
(b) Trade payables of CAT Ltd. include amount payable to JBB Ltd., ₹ 10,00,000 recorded at the prevailing exchange rate on the date of transaction, transaction recorded at US \$1 = ₹ 80.00. The exchange rate on balance sheet date (31.03.2022) was US \$1 = ₹ 85.00. You are required to calculate the amount of exchange difference and also explain the accounting treatment needed for this as per AS 11 in the books of CAT Ltd.

Solution

(a) Share capital - Non-monetary; Trade Payables - Monetary
 Cash balance – Monetary; Property, plant and equipment - Non-monetary
(b) Amount of Exchange difference and its Accounting Treatment

	Foreign Currency Rate	₹
Trade Payables		
Initial recognition US \$ 12,500* (₹10,00,000/80)	1 US \$ = ₹ 80	10,00,000
Rate on Balance sheet date	1 US \$ = ₹ 85	
Exchange Difference Loss US \$ 12,500* x ₹ (85-80)		62,500
Treatment: Debit Profit and Loss A/c by ₹ 62,500		
and Credit Trade Payables		

Thus, Exchange Difference on trade payables amounting ₹ 62,500 is required to be transferred to Profit and Loss

Question 11 *(ICAI Study Material)* Pg no._____

Classify the following items into Monetary and Non-monetary:

(i) Inventories; (ii) Trade Receivables; (iii) Investment in Equity Shares; (iv) Property, plant & equipment

Solution

Inventories- Non-monetary;

Trade Receivables - Monetary

Investment in Equity Shares – Non-monetary;

Property, Plant & Equipment - Non-monetary

Question 12 *(RTP May 2019) / (ICAI Study Material) / (RTP Nov 2021) (Similar)* Pg no._____

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2021, 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 recognize the profit or loss on forward contract in the books of Rau Ltd.

Solution

Calculation of profit or loss to be recognized in the books of Rau Ltd.

	₹
Forward contract rate	49.15
Less: Spot rate	(48.85)
Loss/Premium on Contract	0.30
Forward Contract Amount	$1,00,000
Total loss on entering into forward contract = ($1,00,000 × ₹ 0.30)	₹ 30,000
Contract period	3 months
Loss for the period 1st February, 2021 to 31st March, 2021 i.e. 2 months falling in the year 2020-2021 will be ₹ 30,000*2/3 =	₹ 20,000

Balance loss of ₹ 10,000 (i.e. ₹ 30,000 – ₹ 20,000) for the month of April, 2021 will be recognized in the financial year 2021-2022.

Question 13 *(RTP May 2018) / (RTP Nov 2019)* Pg no._____

Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2021 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 64.25 per Dollar. On 31st October, 2021, the exchange rate was ₹ 61.50 per Dollar. You are required to recognise the profit or loss on forward contract in the books of company for year ended 31st March, 2022

Solution

Calculation of profit or loss to be recognized in the books of Power Track Limited

	₹
Forward contract rate	64.25
Less: Spot rate	(61.50)
Loss/Premium on Contract	2.75
Forward Contract Amount	$50,000
Total loss on entering into forward contract = ($50,000 × ₹ 2.75)	₹ 1,37,500
Contract period	6 months
Loss for the period 1st November, 2021 to 31st March, 2022 i.e. 5 months falling in the year 2021-2022 will be ₹ 1,37,500*5/6 =	₹ 1,14,583

Thus, the loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2022.

Question 14 (Inter Nov 2018) (5 Marks) / (RTP May 2020) Pg no._____

AXE Limited purchased fixed assets costing $ 5,00,000 on 1st Jan. 2021 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2021 for five months @ ₹ 62.50 per dollar. The exchange rate per dollar was as follows:

On 1st January, 2021 ₹ 60.75 per dollar
On 31st March, 2021 ₹ 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2020-21, as per the provisions of AS 11.

Solution

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", an enterprise may enter into a forward exchange contract to establish the amount of the reporting currency required, the premium or discount arising at the inception of such a forward exchange contract should be amortized as expenses or income over the life of the contract.

Forward Rate	₹ 62.50
Less: Spot Rate	(₹ 60.75)
Premium on Contract	₹ 1.75
Contract Amount	US$ 5,00,000
Total Loss (5,00,000 x 1.75)	₹ 8,75,000
Contract period 5 months	

3 months falling in the year 2020-21; therefore loss to be recognized in 2020-21 (8,75,000/5) x 3 = ₹ 5,25,000. Rest ₹ 3,50,000 will be recognized in the following year 2021-22.

Question 15 Pg no._____

Mr. Y bought a forward contract for three months of US $ 2,00,000 on 1st December 2021 at 1 US $ = ₹ 44.10 when the exchange rate was 1 US $ = ₹ 43.90. On 31-12-2021, when he closed his books, exchange rate was 1 US $ = ₹ 44.20. On 31st January, 2022 he decided to sell the contract at ₹ 44.30 per Dollar. Show how the profits from the contract will be recognized in the books of Mr. Y.

Solution

As per AS 11, in recording a forward exchange contract intended for trading or speculation purpose, the premium or discount on the contract is ignored and at each balance sheet date, the value of contract is marked to its current market value and the gain or loss on the contract is recognised. Since the forward
contract was for speculation purposes the premium on forward contract i.e. the difference between the spot rate and the forward contract rate will not be recorded in the books.
Only when the forward contract is sold the difference between the forward contract rate and sale rate will be recorded in the Profit & Loss Account.

	₹
Sale rate	44.30
Less: Contract rate	(44.10)
Profit on sale of contract per US$	00.20

Contract Amount US $ 2,00,000
Total profit (2,00,000 x 0.20) ₹ 40,000

Question 16 *(Inter Nov 2022) (5 Marks)* Pg no._____

a) Jared Limited purchased a Machine for US $ 20,000 on 31st December, 2021 payable after four months. It entered into a forward contract for four months @ ₹ 78.85 per US $. On 31st December,2021 the exchange rate was ₹ 77.50 per US $.
How will you recognize the Profit or Loss on Forward Contract for the year ended 31st March,2022 in the books of Jared Limited?

b) 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.

Solution:

(a)

Forward Rate	78.85
Less: Spot Rate	(77.50)
Premium on Contract	1.35
Contract Amount	US$ 20,000
Total Loss (20,000 x 1.35)	₹ 27,000

Contract period 4 months (3 months falling in the year ended 31 st March, 2022)
Loss to be recognized (₹27,000x 3/4) = ₹ 20,250 in the year ended 31st March, 2022.

(b) 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 17 *(Inter May 2023) (5 Marks)* Pg no._____

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:
(a) Pay immediately with a cash discount of 1% on the payable.
(b) 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.

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	3,60,112.50
If payment made immediate	51,61,612.50

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 (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).

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
49,500 x ₹ 97	48,01,500
Add: Borrowing cost @ 15% p.a. for 6 months	3,60,112.50
If payment made immediate	51,61,612.50

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).