Ind AS 21
The Effects of Changes in Foreign Exchange Rates

Presentation by
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Scope

- Accounting for transactions and balances in foreign currencies
- Translation of results and financial position of foreign operations
- Translation of financial statements into a presentation currency
Exclusions

- Derivative transactions and balances that are within the scope of Ind AS 39 (Financial Instruments: Recognition and Measurement). However, this standard applies to translation of derivatives from functional currency to presentation currency.
- Hedge accounting for foreign currency items, including net investment in foreign operation – covered by Ind AS 39.
- Presentation in statement of cash flows of transactions in a foreign currency or of a foreign operation (Ind AS 7 Statement of Cash Flows).
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Key Definitions

- **Foreign currency** is a currency other than the functional currency of the entity.
- **Functional currency** is the currency of the primary economic environment in which the entity operates.
- **Foreign operation** is an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.
- **Presentation currency** is the currency in which the financial statements are presented.
AS 11

- **Reporting currency** is the currency in which an enterprise **presents** its financial Statements.

Ind AS 21

- **Functional currency** is the currency of the **primary economic environment** in which the entity operates.
In which entity primarily generates and expends cash

Primary Indicators

(i) Currency that mainly influences SALE PRICE of goods and services and
(ii) currency of the country whose competitive forces and regulations determine the sales prices of its goods and services.

Other Indicators

Currency that mainly influences COST-Labour, Material and other cost

Currency in which funds from financing activities are generated

Currency in which receipts from operating activities are retained
Primary Economic Environment

Additional indicators for functional currency for Foreign Operation are:-

• Foreign Operation is an extension of reporting entity
• Transaction with reporting entity are a high or low proportion of foreign operation’s activities
• Cash Flows from activities of foreign operation affect the cash flows of reporting entity
• Cash Flows from activities of foreign operations are sufficient to service the normally expected debt obligation without funds made available by reporting entity

If a foreign operation is integral to group, functional currency would normally be that of the parent
1. An entity does not have a free choice of functional currency
2. An entity cannot change functional currency unless facts and circumstances relevant to its determination change
Functional currency – Summary

Primary economic environment: Currency and economy influencing sales prices and operating costs

Currency in which financing funds are received and operating receipts are retained

Extent of integration with reporting entity (foreign operations only)

Primary indicator

Supporting evidence

Mixed indicators- Use judgement to choose FC that most faithfully presents economic effects of underlying transactions
Example

A Ltd.:
- Does International trading only and its purchase and sale are in $
- US Economic Environment influences the Sales and Purchase Prices
Solution

A Ltd.

 Functional Currency = **US Dollars**

 Financial Statements presented in **USD**

 If wants to present FS statements in **Indian Rupee** – USE TRANSLATION PROCEDURES as per Ind AS

 The STATUTORY Financial Statements will also be required to be drawn in ₹.
Example

Branch L sells only the goods imported from I Ltd. at prices determined by I Ltd.

Branch J generates and expends cash substantially in its own currency.
AS 11

- BRANCH L – Presentation of Financial Statements in local currency i.e.- £
- BRANCH J - Presentation of Financial Statements in local currency i.e.- ¥

IND AS 21

- BRANCH L – Presentation of Financial Statements in Currency of I Ltd. i.e. - ₹
- BRANCH J - Presentation of Financial Statements in local currency i.e.- ¥
Illustration

A’s functional currency is €. A accounts for 47% in Z, a US company, using the equity method of accounting. During the current year, Z entered into a € 50 million third party borrowing. Most of Z’s operations, labour costs and purchases are denominated in $ and incurred in domestic market.

Z’s functional currency is $. Since majority of Z’s operations are in $, and USA is the country that drives the competitive forces and regulations, Z should continue using $ as its functional currency.
Case Study 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 A Inc. for financing its activities.
The above conclusions are based on Primary indicators

<table>
<thead>
<tr>
<th>Factors (M Ltd.)</th>
<th>Influenced by which currency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>USD</td>
</tr>
<tr>
<td>Sales Market influenced by</td>
<td>USD</td>
</tr>
<tr>
<td>Expenses</td>
<td>INR</td>
</tr>
<tr>
<td>Purchases</td>
<td>USD</td>
</tr>
<tr>
<td>Financing</td>
<td>USD</td>
</tr>
<tr>
<td>Cash Flows</td>
<td>INR/USD</td>
</tr>
<tr>
<td>Functional currency (based on above answers)</td>
<td>USD</td>
</tr>
</tbody>
</table>
Case Study 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

<table>
<thead>
<tr>
<th>Factors (N Ltd.)</th>
<th>Influenced by which currency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>INR</td>
</tr>
<tr>
<td>Sales Market influenced by</td>
<td>USD</td>
</tr>
<tr>
<td>Expenses</td>
<td>INR</td>
</tr>
<tr>
<td>Purchases</td>
<td>USD</td>
</tr>
<tr>
<td>Financing</td>
<td>USD</td>
</tr>
<tr>
<td>Cash Flows</td>
<td>INR/USD</td>
</tr>
<tr>
<td>Functional currency (based on above answers)</td>
<td>USD</td>
</tr>
</tbody>
</table>
Case Study 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

<table>
<thead>
<tr>
<th>Factors (Dragon Ltd.)</th>
<th>Influenced by which currency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>AUD</td>
</tr>
<tr>
<td>Sales Market influenced by</td>
<td>INR</td>
</tr>
<tr>
<td>Expenses</td>
<td>INR</td>
</tr>
<tr>
<td>Purchases</td>
<td>INR/USD</td>
</tr>
<tr>
<td>Financing</td>
<td>INR</td>
</tr>
<tr>
<td>Cash Flows</td>
<td>INR/USD/AUD</td>
</tr>
<tr>
<td>Functional currency (based on above answers)</td>
<td>INR</td>
</tr>
</tbody>
</table>

The above conclusions are based on Primary indicators
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.
Net investment in a foreign operation

- It is the amount of the reporting entity’s interest in the net assets of that operation
- Monetary items receivable from / payable to (other than trade receivables / payables) for which settlement is neither planned nor likely to occur in foreseeable future
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Foreign Currency Transactions

Steps to account and report for foreign currency transactions:

• Determine the functional currency of all reporting entities as explained above
• Translate the foreign transactions/items into its functional currency
• Record and report the effect of such translation
Type of transactions

• Buying or selling goods or services where price is denominated in foreign currency
• Borrowing or lending funds when amounts are denominated in foreign currency
• Acquires or disposes of assets, or incurs or settles liabilities, denominated in foreign currency
Initial recognition

- Recognise transaction at the spot rate on the transaction date
- May use e.g. average rate for week or month as a practical approximation
  - Average rate not reliable if currency fluctuates significantly
Subsequent measurement

- Monetary items
  - Rate at the reporting date

- Non-monetary items at historical cost
  - Rate at the date of transaction

- Revalued non-monetary items
  - Rate at date of valuation
Illustration on Revaluation

1. Company Apple’s reporting currency is INR
2. On 01.01.2012 company buys a building for US$100,000
3. The exchange rate is INR 54.48:US$1
4. Company Apple’s year end, 31st March
5. The building is not depreciated as it is not yet available for use
6. On 31.03.2012 the exchange rate is INR 55.54:US$1 and the value of building is US$110,000
Illustration …. Solution

Initial Recognition

• On 01.01.2012 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 Ind AS 16 for PPE, Building is carried at its historical cost, hence no adjustment to be made

• If revaluation model adopted as accounting policy under Ind AS 16 for PPE, value of building to be adjusted for revised value.
Illustration .... Solution

- 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
  \[ (\$ 100000 \times (55.54-54.48)) + (\$ 10000 \times 55.54) \]
Translation when amounts to be compared

- Inventories – cost or NRV whichever is lower

<table>
<thead>
<tr>
<th>Date</th>
<th>Cost ($)</th>
<th>$ - ₹</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>25.02.2013</td>
<td>10,000</td>
<td>50</td>
<td>500,000</td>
</tr>
<tr>
<td>31.03.2013</td>
<td>9,500</td>
<td>53</td>
<td>503,500</td>
</tr>
</tbody>
</table>

- Similar situation also for impairment – carrying amount or recoverable value whichever is lower
Monetary assets – Exchange gains and losses

Monetary assets

Realised exchange differences

Unrealised exchange differences

Recognised in P/L (both gains and losses)

Except two cases
Exception: Case 1

In Consolidated financial statements

Foreign exchange difference arises from monetary item that forms part of net investment in foreign operation

To be recognized in OCI and accumulated in Equity

To be reclassified from Equity to P/L on disposal of the net investment
Exception: Case 2

An irrevocable option provided for long term monetary items

Long term monetary item will be with a maturity period of 12 months or more from initial recognition

Option is to recognize and accumulate exchange differences arising on restatement of long-term foreign currency monetary items, directly in separate component of equity in equity

Accumulated amount will be transferred to P/L over the period of maturity, in an appropriate manner

Option not available to items classified as at fair value through P/L in accordance with Ind AS 39
Non-monetary assets – Exchange gains and losses

Non-monetary assets

- Gain or loss
  - Recognised in P/L
  - Exchange component
    - Recognised in P/L

- Gain or loss
  - recognised in OCI
  - Exchange component
    - Recognised in OCI
Change in functional currency

1. Only if there is a change to the underlying transactions, events and conditions

2. Translation procedures should be applied to the new functional currency prospectively from the date of the change
   i. All items are translated into the new functional currency using the exchange rate at the date of change
   ii. Resulting translated amounts for non-monetary items are treated as their historical costs
   iii. Exchange differences earlier recognised in equity shall continue to be recognised as such
   iv. Irrevocable option if exercised the accumulated exchange differences will continue in the same manner as before
Illustration

A, located in Germany, is a wholly owned subsidiary of Z. $ is Z’s functional currency. € is A’s functional currency as all sales, purchases and labour costs were in €. Z started using A’s facility to meet its orders. A closed down its sales department as 80% of its supplies would be to Z. Z built a new facility to produce materials required in its manufacturing process and A started receiving all material from Z. A now expects cash inflows and outflows, except for wages in $.

The currency of revenues has changed from € to $. It seems to be permanent as the sales dept. has been closed. Currency of outflows has changed from € to $. Position of A within Z’s overall operating strategy has changed from self-supporting, stand alone entity to a manufacturing facility of Z. There will be a change in the functional currency from € to $.
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Foreign currency financial statements

• If the presentation currency differs from the entity’s functional currency, it translates its results and financial position into the presentation currency.

• For consolidation purpose, if 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.
Translation to presentation currency

Entity translating the financial statements into presentation currency

- Its functional currency is not currency of a hyperinflationary economy
  - Convert as per treatment 1

- Its functional currency is currency of a hyperinflationary economy
  - Convert as per treatment 2
Characteristics of hyperinflationary economy (Ind AS 29)

- Preference of investment of wealth in a relatively stable foreign currency/ non monetary assets
- All monetary amounts are quoted in relatively stable currency rather than local currency
- Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short
- Interest rates, wages and prices are linked to a price index
- The cumulative inflation over three years is approaching, or exceeds, 100 per cent
Translation to presentation currency - Treatment 1

Assets and liabilities → Rate at reporting date

Income and expenses and Capital transactions → Rate at date of transaction (or average rate)

All resulting exchange differences classified as OCI

Such differences to be transferred to P/L on disposal
Translation to presentation currency - Treatment 2

All amounts i.e. assets, liabilities, equity items, income and expenses, including comparatives

$\Rightarrow$

closing rate at the date of the most recent statement of financial position

Currency to which if translated is currency of a non-hyperinflationary economy, comparative amounts shall not adjusted for subsequent changes in price level or subsequent changes in exchange rate.
Translation of a foreign operation

• Minority interest allocated share of accumulated exchange difference
• Goodwill and fair value adjustments arising from a business combination are treated as assets/liabilities of the foreign operation translated at the reporting date
• Exchange gains and losses on intra-group items are taken to P/L
• Different year-ends
  i. 3 month lag permitted
  ii. Adjust for significant changes between reporting dates
Disposal of Foreign Operation

1. On disposal of foreign operation transfer cumulative amount of exchange difference from equity to profit and loss

2. On Partial disposal of foreign operation transfer proportionate share of cumulative amount of exchange difference from equity to profit and loss

3. On partial disposal of subsidiary that includes foreign operation re-attribute the proportionate share of the cumulative amount of the exchange differences recognized in other comprehensive income to the non-controlling interests in that foreign operation
Disposal of Foreign Operation

1. Disposal of entire interest in a foreign operation
2. Loss of control of a subsidiary that includes a foreign operation
3. Loss of significant influence over an associate that includes a foreign operation
4. Loss of joint control over a jointly controlled entity that includes a foreign operation
Partial Disposal

1. Partial disposal of a foreign operation is a reduction in entity’s ownership interest apart from loss of control, joint control or significant influence which would otherwise lead to disposal of the same

2. The table classifies effect of various transactions as either disposals or partial disposals
## Partial Disposal

<table>
<thead>
<tr>
<th>From</th>
<th>To</th>
<th>Subsidiary</th>
<th>Jointly Controlled Entity</th>
<th>Associate</th>
<th>Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Subsidiary</strong></td>
<td>Partial Disposal</td>
<td>Disposal</td>
<td>Disposal</td>
<td>Disposal</td>
<td>Disposal</td>
</tr>
<tr>
<td></td>
<td>(control remains)</td>
<td>(control lost)</td>
<td>(Control lost)</td>
<td></td>
<td>(Control lost)</td>
</tr>
<tr>
<td><strong>Jointly Controlled</strong></td>
<td>Not Disposal</td>
<td>Partial Disposal</td>
<td>Disposal</td>
<td>Disposal</td>
<td>Disposal</td>
</tr>
<tr>
<td><strong>Entity</strong></td>
<td></td>
<td>(Joint control remains)</td>
<td>(Joint control lost)</td>
<td></td>
<td>(Joint control lost)</td>
</tr>
<tr>
<td><strong>Associate</strong></td>
<td>Not Disposal</td>
<td>Not Disposal</td>
<td>Partial Disposal</td>
<td>Disposal</td>
<td>Disposal</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(significant influence remains)</td>
<td></td>
<td>(significant influence lost)</td>
</tr>
</tbody>
</table>
Case Study 5

A parent has 100% interest in a subsidiary for a number of years. The subsidiary has been classified as a foreign operation and CU 5 million relating to the translation differences of subsidiary has been recognised in other comprehensive income and accumulated in a separate component of equity. The parent disposes of 30% of its interest but retains control. What would be the treatment on the date of disposal?

CU 1.5 million (5*30%) of cumulative translation exchange differences are transferred within equity from foreign currency translation reserve to non-controlling interest. No amounts are reclassified to profit or loss.
A parent has 80% interest in a subsidiary for number of years. The subsidiary has been classified as a foreign operation and CU 5 million have been recognised in other comprehensive income. 80% have been accumulated in a separate component of equity and balance 20% attributed to non-controlling interest. The parent disposes 40% of its interest resulting in loss of control. What would be treatment on date of disposal?

CU 4 million (5*80%) of cumulative translation exchange differences are transferred from equity to profit and loss. CU 1 million already reflected as part of non-controlling interest are derecognised and included in the calculation of the profit or loss on disposal.
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• Exchange rate differences included in:
  i. P/L (except for financial instruments measured at FV)
  ii. Equity
  iii. Separate component of equity if irrevocable option exercised and its reconciliation of beginning and end

• Fact of presentation currency being different from functional currency, date and the reason thereof

• Change in functional currency of reporting entity or significant foreign operation the reason thereof and the date of change

• If entity displays financial statements or information in different currency without complying with Ind AS 21 few additional disclosures are required
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Key learning points

- An entity does not have a free choice of functional currency
- Translation of foreign currency assets and liabilities
  - Monetary items at the reporting date
  - Non-monetary items at the date of transaction or revaluation
  - Unrealised and realised exchange gains and losses recognised in P/L
- Monetary item forming part of a net investment in foreign operation
  - Exchange differences recognised in equity in the consolidated financial statements
- Translation into presentation currency
  - Assets and liabilities at the reporting date
  - Income, expenses and capital transactions at transaction dates
  - Translation gain or loss recognised in equity
Thank You...