UNIT 2:
INDIAN ACCOUNTING STANDARD 21: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

LEARNING OUTCOMES

After studying this unit, you will be able to:

- Understand the objective and scope of the standard
- Define the terms used in the standard like closing rate, exchange difference, exchange rate, fair value, foreign currency, foreign operation, functional currency, monetary items, group, net investment in a foreign operation, presentation currency and spot exchange rate.
- Report foreign currency transactions in the functional currency
- Report at the ends of subsequent reporting periods foreign currency monetary and non-monetary items
- Recognise exchange differences
- Apply the translation procedures in case of change in functional currency
- Use presentation currency and translate the items into it from the functional currency
- Incorporate the results and financial position of a foreign operation on translation.
- Apply the provisions of translation in case of consolidation.
- Deal with the disposal or partial disposal of a foreign operation
- Compute tax effects of all exchange differences
- Comply with the disclosure requirements given in the standard.
# Accounting for Foreign Currency Transactions

## Initial Recognition at the Transaction Date
- [Monetary](#)
- [Non-Monetary Items](#)
- [Net Investment in a Foreign Operation](#)
- [Change in Functional Currency](#)

## Subsequent Recognition at the end of each Reporting Period
- [Recognition of Foreign Exchange Gains and Losses](#)
- [Presentation and Disclosure](#)
  - [Tax effect](#)
  - [Other items](#)

© The Institute of Chartered Accountants of India
2.1 OBJECTIVE

The objective of the Standard is to address the accounting for foreign activities which include:

- transactions in foreign currencies; or
- foreign operations.

Considering that an entity may present its financial statements in a foreign currency, the Standard also seeks to prescribe how to translate financial statements into a presentation currency.

In this context, the Standard defines **foreign currency** as a currency other than the functional currency of the entity.

1. **Functional currency** is the currency of the primary economic environment in which the entity operates.
   
   In this regard, the primary economic environment will normally be the one in which it primarily generates and expends cash i.e. it operates.

2. **Foreign operation** has been defined as 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.

3. **Presentation currency** is the currency in which the financial statements are presented, the presentation currency may be different from the entity’s functional currency.

2.2 SCOPE

- Ind AS 21 applies to:
  
  (a) in accounting for transactions and balances in foreign currencies, except for derivative transactions and balances covered by Ind AS 109.
Foreign currency derivatives not covered by Ind AS 109 (e.g., some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard.

The Standard also applies for translation of amounts relating to derivatives from functional currency to presentation currency.

(b) in translating the results and financial position of foreign operations; and

(c) in translating an entity’s results and financial position into a presentation currency.

- Ind AS 21 **does not apply** to:
  
  (a) hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation; Ind AS 109 should be applied for hedge accounting;

  (b) presentation of cash flows from transactions in a foreign currency or to translation of cash flows of a foreign operation in the statement of cash flows (refer to Ind AS 7).

- This standard also does not apply to long term foreign currency items for which an entity has opted for the exemption as per Ind AS 101.

- Such an entity may continue to apply the accounting policy as opted for such long term foreign currency monetary items.

### 2.3 FUNCTIONAL CURRENCY

- An entity measures its assets, liabilities, equity, income and expenses in its functional currency.

- All transactions in currencies other than the functional currency are foreign currency transactions.

  **Ind AS 21 requires each entity to determine its functional currency.**

- In determining its functional currency, an entity emphasises the currency that determines the pricing of the transactions that it undertakes, rather than focusing on the currency in which those transactions are denominated.

- The following are the factors that may be considered in determining an appropriate functional currency:

  (a) the currency that mainly influences sales prices for goods and services; this often will be the currency in which sales prices are denominated and settled;

  (b) the currency of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services; and
(c) the currency that mainly influences labour, material and other costs of providing goods and services; often this will be the currency in which these costs are denominated and settled.

- Other factors that may provide supporting evidence to determine an entity’s functional currency are:
  
  (a) the currency in which funds from financing activities i.e., issuing debt and equity instruments) are generated;
  
  (b) the currency in which receipts from operating activities are usually retained.

- If an entity is a foreign operation, additional factors are set out in the Standard which should be considered to determine whether its functional currency is the same as that of the reporting entity of which it is a subsidiary, branch, associate or joint venture:
  
  (a) whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy.

  If the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it, this will be an example of the former. An example of the latter is when the foreign operations accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency;

  (b) transactions with the reporting entity as a proportion of the foreign operation’s activities;

  (c) impact of cash flows from the activities of the foreign operations on the cash flows of the reporting entity and whether such cash flows are readily available for remittance;

  (d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.

In practice, the functional currency of a foreign operation that is integral to the group will usually be the same as that of the parent.

- Management will be required to use its judgment to determine the functional currency for which they have to give priority to the primary indicators before considering the other indicators which are designed to provide additional supporting evidence to determine an entity’s functional currency.
Illustration 1

*Future Ltd. sells a revitalising energy drink that is sold throughout the world. Sales of the energy drink comprise over 90% of the revenue of Future Ltd. For convenience and consistency in pricing, sales of the energy drink are denominated in USD. All financing activities of Future Ltd. are in its local currency (L$), although the company holds some USD cash reserves. Almost all of the costs incurred by Future Ltd. are denominated in L$. What is the functional currency of Future Ltd.?*

**Solution**

The functional currency of Future Ltd. is the L$. Looking at the primary indicators, the facts presented indicate that the currency that mainly influences the cost of producing the energy drink is the L$. As stated in the fact pattern, pricing of the product in USD is done for convenience and consistency purposes; there is no indication that the sales price is influenced by the USD.

Illustration 2

*Small India Private Limited, a subsidiary of Big Inc., takes orders from Indian customers for Big’s merchandise and then bills and collects for the sale of the merchandise. Small also has a local warehouse in India to facilitate timely delivery and ensures that it remits to its parent all cash flows that it generates as the operations of Small are primarily financed by Big Inc. What is Small’s functional currency?*

**Solution**

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

2.3.1 Currency of a Hyperinflationary Economy as a Functional Currency

An entity cannot adopt a functional currency other than that determined in accordance with this Standard. If the functional currency of an entity is the currency of a hyperinflationary economy, it cannot avoid restatement in accordance with Ind AS 29 by selecting some other currency as its functional currency.
## 2.4 MONETARY VS. NON-MONETARY ITEMS

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>Monetary items</th>
<th>Non-monetary item</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Units of currency</td>
<td>Units of currency held and assets and liabilities to be received or paid are in a fixed or determinable number of units of currency.</td>
<td>There is no fixed or determinable number of units of currency</td>
</tr>
</tbody>
</table>

- Examples of Monetary items include:
  - pensions and other employee benefits to be paid in cash;
  - provisions that are to be settled in cash;
  - cash dividends that are recognised as a liability;
  - contract to receive (or deliver) a variable number of the entity’s own equity instruments or a variable amount of assets in which the fair value* to be received (or delivered) equals a fixed or determinable number of units of currency.

**Note:** Fair value is the price that would be recovered to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Most debt securities are considered as monetary items because their contractual cash flows are fixed or determinable.

- Examples of non-monetary items include:
  - amounts prepaid for goods and services (e.g., prepaid rent) and income received in advance, on the basis that no money will be paid or received in the future;
  - goodwill;
  - intangible assets;
  - inventories;
  - property, plant and equipment;
  - provisions that are to be settled by the delivery of a non-monetary asset.
2.5 BRIEF APPROACH UNDER THE STANDARD

The following is a summary of the approach under Ind AS 21 to foreign currency translation:

- **Determine the functional currency of the entity** - each entity, whether a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch) should determine its functional currency. Foreign currency transactions (i.e., transactions not in entity’s functional currency) are translated into the entity’s functional currency at the transaction date.

- **Translation of assets and liabilities denominated in foreign currency at the reporting date** - At the reporting date assets and liabilities denominated in foreign currency are translated into functional currency as follows:
  - Monetary items: at the exchange rate at the reporting date i.e., closing date.
  - Non-monetary items measured at historical cost: not retranslated/restated.
  - Non-monetary items measured at fair value: at the exchange rate on the date of fair value determination.

- A reporting entity may comprise branches, subsidiaries, associates or joint ventures. The functional currency of each entity should be determined separately. This may or may not be the same as the reporting entity.

- The Standard permits an entity to present its financial statements in any currency (or currencies). Accordingly, the financial statements of the parent, branches, subsidiaries, associates and joint ventures to be translated into group presentation currency by any of the following two methods:
  - **Step by step method**: Financial operations translated into functional currency of any intermediate parent which is then translated into functional currency (or presentation currency, if different) of the ultimate parent.
  - **Direct method**: Financial operations translated into functional currency (or presentation currency, if different) of the ultimate parent.

- Overall result is the presentation of the financial statements of the entity (or its consolidated financial statements) being presented in functional currency (or presentation currency, if different) of the parent entity.

2.6 ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS

2.6.1 Initial Recognition at the Transaction Date

- A foreign currency transaction is a transaction that is denominated or requires settlement in
a foreign currency (i.e., a currency other than the functional currency of the entity), including transactions arising when an entity:

(a) buys or sells goods or services whose price is denominated in a foreign currency;
(b) borrows or lends funds with amounts denominated in a foreign currency; or
(c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

- A foreign currency transaction is initially recorded by translation in the entity’s functional currency at the exchange rate on the transaction date (or at rate that approximates the actual exchange rate).
- An average exchange rate for a specific period may be used as an approximate rate if the exchange rate does not fluctuate significantly.

2.6.2 Subsequent Recognition at the end of each Reporting Period

- At the reporting date, assets and liabilities denominated in a foreign currency are translated as follows:
  (a) monetary items are translated at the exchange rate at the reporting date i.e., closing rate;
  (b) non-monetary items measured at historical cost are not retranslated and instead remain at the exchange rate at the date of the transaction; and
  (c) non-monetary items measured at fair value in a foreign currency are translated at the exchange rate on the date the fair value was determined.

- The carrying amount of the item to be translated is determined applying the relevant Accounting Standard.

For example, property, plant and equipment may be measured at fair value or historical cost as per Ind AS 16, *Property, Plant and Equipment*.

- The carrying amount so determined, be it on the basis of historical cost or fair value, if in foreign currency, is translated into the functional currency in accordance with this Standard.
- In some cases, the carrying amount of items is determined by comparing two or more amounts e.g.:
  - Inventories - measured at lower of cost and net realisable value.
  - Asset subject to impairment loss - lower of an asset’s carrying amount and its recoverable amount.
If such an asset is non-monetary and measured in a foreign currency, then for the comparison:

(a) the cost or carrying amount, as appropriate, is translated at the exchange rate at the date when that amount was determined; and

(b) the net realisable value or recoverable amount, as appropriate, is translated at the exchange rate at the date when that value was determined.

The above may result in an impairment loss being recognised in the functional currency but not in the foreign currency, or vice versa.

Where a country has multiple exchange rates, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

### 2.6.3 Recognition of Foreign Exchange Gains and Losses

- When an entity directly enters into foreign currency transactions, it is exposed to the cash flow effects of changes in value of the foreign currency. An entity is required to convert foreign currency items into its functional currency for recording those items in its books of account as per the requirements of this Standard. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. Once recorded, exchange differences will arise where changes in exchange rates affect the recorded balances.

- Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

- When the transaction occurs and settles within the same accounting period, all the exchange
difference is recognized in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference is recognised in each period till settlement date based on change in exchange rates during each period.

2.6.3.1 Monetary Items

Exchange differences arising on the settlement of monetary items or on translating monetary items are recognised in profit or loss, except:

(i) for accounting for exchange difference as required by application of hedge accounting under Ind AS 109 – for example Ind AS 109 requires that exchange differences on monetary items that qualify as hedging instruments in a cash flow hedge should be recognised initially in other comprehensive income to the extent that the hedge is effective;

(ii) for monetary items that in substance form part of the reporting entity’s net investment in a foreign operation (discussed below);

(iii) for long-term foreign currency monetary items in case the entity has exercised the option for recognising exchange differences on such items in equity (discussed below).

2.6.3.2 Non-Monetary Items

- Ind AS require certain gains and losses to be recognised in other comprehensive income.

For example, revaluation gain or loss on property, plant and equipment is recognised in other comprehensive income as per Ind AS 16. When such an asset is measured in a foreign currency and its revalued amount is translated as per this Standard using the rate at the date the value is determined, the resulting exchange gain or loss is also recognised in other comprehensive income.

- If the gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss is also recognized in profit or loss.

2.6.3.3 Net Investment in a Foreign Operation

- The Standard defines net investment in a foreign operation as the amount of the reporting entity’s interest in the net assets of that operation. A monetary item receivable from or payable to a foreign operation may form part of the net investment in the foreign operation if the settlement of the monetary item is neither planned nor likely to occur in the foreseeable future. Such monetary items may include long-term receivables or loans but do not include trade receivables or trade payables.

- The entity that has the monetary item receivable or payable may be the reporting entity or any subsidiary in the group (i.e., parent and all its subsidiaries). However, an investment in a foreign operation made by an associate of the reporting entity is not part of the reporting
entity’s net investment in that operation because an associate is not a group entity.

• Exchange differences arising on a monetary item that forms part of a reporting entity’s net investment in a foreign operation have to be recognised in profit or loss in the separate financial statements of the reporting entity and/or the individual financial statements of the foreign operation, as appropriate:
  - If such an item is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation’s individual financial statements.
  - If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity’s separate financial statements.
  - If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity’s separate financial statements and in the foreign operation’s individual financial statements.

• In the financial statements that include the foreign operation and the reporting entity (e.g., consolidated financial statements when the foreign operation is a subsidiary, associate or joint venture), such exchange differences are recognised initially in other comprehensive income and then reclassified from equity to profit or loss on disposal of the net investment.

**Illustration 3**

Functional currency of parent P is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S for EURO 300. At the reporting date, though the amount is yet to be received from S, the payment is expected to be made in the foreseeable future. In addition to the trading balances between P and S, P has lent an amount of EURO 500 to S that is not expected to be repaid in the foreseeable future. Should the exchange difference be recognised in the profit and loss account?

**Solution**

The exchange gain or loss incurred by P on the trading balance should be recognised in profit or loss. Even if repayment was not due for three years (for example) or even longer, but if repayment is still planned, then the gain or loss should be recognised in profit or loss.

The amount lent by P should be regarded as part of its permanent funding to S. Thus, the exchange gain or loss incurred by P on the EURO 500 loan should be recognised in profit or loss in P’s separate financial statements, but recognised in other comprehensive income and presented within equity in the consolidated financial statements.

**Illustration 4**

Modifying the above illustration, suppose that for tax reasons, the ‘permanent’ funding extended to S is made via another entity in the group, T, rather than from P directly i.e., on the directions of P, T gives the loan to S. Where should the exchange differences be recognised?
Any exchange difference in respect of the loan is recognised in other comprehensive income in the consolidated financial statements because from the group’s point of view the funding relates to an investment in a foreign operation. This is the case irrespective of the currency in which the loan is denominated. So if the loan is denominated in T’s functional currency, and this is different from that of S, then exchange differences still should be recognised in other comprehensive income in the consolidated financial statements.

### 2.6.4 Change in Functional Currency

- Once an entity has determined its functional currency, it is not changed unless there is a change in the relevant underlying transactions, events and conditions.

- If circumstances change and a change in functional currency is appropriate, then the change is accounted for prospectively from the date of the change.

**For example, a change in the currency that mainly influences the sales price of goods and services may lead to a change in an entity’s functional currency.**

- For accounting the effect of a change in functional currency prospectively:
  - All items are translated into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost.
  
  - Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income are not reclassified from equity to profit or loss until the disposal of the operation.

  - Exchange gain or loss from long-term monetary items accumulated in equity (where such option is exercised) are not transferred to profit or loss immediately on change of the entity’s functional currency; the balance would be transferred to profit or loss as per the manner provided by the option.
• Since entities prefer to present financial statements in their functional currency, a change in currency functional currency may be accompanied by a change in presentation currency. A change in presentation currency is accounted for as a change in accounting policy.

2.7 USE OF A PRESENTATION CURRENCY OTHER THAN THE FUNCTIONAL CURRENCY

2.7.1 Translation to the Presentation Currency

• An entity measures items in its financial statements in its functional currency; but it may decide to present its financial statements in a currency or currencies other than its functional currency.

For example, an entity with INR functional currency may choose to present its financial statements in US Dollar because its primary business is in the United States.

• There can be situations wherein a group comprises operations with a number of functional currencies. Under Ind AS 21, there is no concept of a “group” functional currency. Rather the group has a presentation currency only. Each entity in the group prepares financial statements in its functional currency and translates these financial statements into the group presentation currency (if different) for consolidation purposes.

• The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy are translated into a different presentation currency as follows:
  
  (a) assets and liabilities for each balance sheet presented (i.e., including comparatives) are translated at the closing rate at the date of that balance sheet;
  
  (b) income and expenses are translated at exchange rates at the dates of relevant transactions; weighted average rates may be used if they are a reasonable approximation;
  
  (c) all resulting exchange differences should be recognised in other comprehensive income as they have little or no direct effect on the present and future cash flows from operations and are presented in a separate component of equity until disposal of the foreign operation.

• When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, an appropriate proportion of the exchange difference arising on translation of the foreign operation must be allocated to the non-controlling interest, if applicable.

• In case of an entity whose functional currency is the currency of a hyperinflationary economy, the translation into a different presentation currency, also being the currency of a hyperinflationary economy, is done by translating all amounts (i.e., assets, liabilities, equity
items, income and expenses, including comparatives) at the closing rate at the date of the most recent balance sheet.

In other words, when the entity’s functional as well as presentation currency is a currency of hyperinflationary economies, all items in the financial statements (current period and comparatives) are translated into the presentation currency at the closing rate at the end of the most recent period presented after being restated for the effects of inflation.

The financial statements should be restated in accordance with Ind AS 29 before translating into the presentation currency.

When the economy ceases to be hyperinflationary and the entity no longer restates its financial statements in accordance with Ind AS 29, the amounts restated to the price level at the date the entity ceased restating its financial statements should be used as the historical costs for translation into the presentation currency.

However, when amounts of an entity whose functional currency is the currency of a hyperinflationary economy are translated for presentation into the currency of a non-hyperinflationary economy, comparative amounts are those that were presented as current year amounts in the relevant prior year financial statements (i.e., not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

### 2.8 TRANSLATION OF FOREIGN OPERATIONS

- The guidance provided on determining an entity’s functional currency equally applies to determine the functional currency of a foreign operation of the entity.

- Effectively, the translation procedures those for translating foreign operations are the same as those followed when an entity presents its financial statements in a presentation currency that is different from its functional currency:
  
  (a) assets and liabilities are translated at the exchange rate at the reporting date;

  (b) items of income and expense are translated at exchange rates at the dates of the relevant transactions, although appropriate average rates may be used;

  (c) the resulting exchange differences are recognised in other comprehensive income and are presented in a separate component of equity (generally referred to as the foreign currency translation reserve or currency translation adjustment) until disposal of the foreign operation; and

  (d) cash flows are translated at exchange rates at the dates of the relevant transactions, although an appropriate average rate may be used.
In addition to the exchange difference as stated above, the foreign currency translation reserve may include exchange differences arising from loans that form part of the parent’s net investment in the foreign operation and gains and losses related to hedges of a net investment in a foreign operation.

**2.9 DIFFERENCE IN THE REPORTING DATES**

When there is difference in the year end of foreign operation and that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity’s financial statements. When such financial statements are not prepared, Ind AS 27 allows the use of a different date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the end of the reporting period of the foreign operation. A similar approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation to joint ventures in accordance with Ind AS 28, *Investment in Associates and Joint Ventures*.

**2.10 INTRA-GROUP TRANSACTIONS**

- Although intra-group balances are eliminated on consolidation, any related foreign exchange gains or losses will not be eliminated. This is because the group has a real exposure to a foreign currency since one of the entities will need to obtain or sell foreign currency in order to settle the obligation or realise the proceeds received.

- Accordingly, in the consolidated financial statements of the reporting entity, the exchange difference arising on such intra group transactions is recognised in the statement of profit or loss account unless it arises from on a monetary item that forms part of a reporting entity’s net investment in a foreign operation in which case it is taken to other comprehensive income and accumulated in a separate component of equity and reclassified to profit or loss only on disposal of the foreign operation;

**Illustration 5**

*The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = Euro 2. At year-end, the amount is still due and the exchange rate is USD 1 = Euro 2.2. How should the exchange differences be accounted for in the consolidated financial statements?*
Solution

At year-end, S should revalue its accounts payable to EURO 220, recognising a loss of 20 in its standalone profit or loss. Thus, in the books of S, the balance payable to P will appear at EURO 220 while in the books of P the balance receivable from S will be USD 100.

For consolidation purposes, the assets and liabilities of S will be translated to USD at the closing rate i.e., USD 100 which will get eliminated against the receivable in the books of P but the EURO 20 exchange loss recorded in the subsidiary’s statement of profit and loss has no equivalent gain in the parent’s financial statements. Therefore, the EURO 20 loss will remain in the consolidated statement of profit and loss.

The reason for this is that the intra-group balance represents a commitment to translate Euro into USD and this is similar to holding a foreign currency asset in the parent company. The subsidiary must go out and buy USD to settle the obligation to the parent, so the Group as a whole has an exposure to foreign currency risk.

Example

Parent P has a functional currency of USD, and Subsidiary S has a functional currency of EURO. P, whose reporting date is March 31, lends USD 100 to S on September 30, 2016. S converted the cash received into EURO on receipt.

<table>
<thead>
<tr>
<th>USD</th>
<th>EURO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1.5</td>
</tr>
<tr>
<td>1</td>
<td>2.0</td>
</tr>
</tbody>
</table>

Entries in the books of account of S

<table>
<thead>
<tr>
<th>Date</th>
<th>particulars</th>
<th>Debit (EURO)</th>
<th>Credit (EURO)</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 30, 2016</td>
<td>Cash A/c</td>
<td>Dr. 150</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>To Intra-group payable</td>
<td></td>
<td>150</td>
</tr>
<tr>
<td></td>
<td><em>(To recognise intra-group loan)</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>March 31, 2017</td>
<td>Exchange loss A/c</td>
<td>Dr. 50</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Intra-group payable</td>
<td></td>
<td>50</td>
</tr>
<tr>
<td></td>
<td><em>(To recognise exchange loss on intra-group loan)</em></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In S’s second entry, the liability is remeasured at March 31, 2017 and a translation loss is recorded.
The following entry is recorded by P.

<table>
<thead>
<tr>
<th>Debit (USD)</th>
<th>Credit (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intra-group receivable Dr.</td>
<td>100</td>
</tr>
<tr>
<td>To Cash</td>
<td>100</td>
</tr>
</tbody>
</table>

*(To recognise intra-group loan on issue)*

On consolidation at March 31, 2017, the EURO 200 will convert to USD 100 and the receivable and payable will be eliminated. However, an exchange loss equivalent to EURO 50 for the year ending March 31, 2017 will remain on consolidation. This is appropriate because S will need to obtain USD in order to repay the liability; therefore, the group as a whole has a foreign currency exposure. It is not appropriate to transfer the exchange loss to equity on consolidation unless the loan forms part of P’s net investment in S.

### 2.11 GOODWILL AND FAIR VALUE ADJUSTMENTS ARISING FROM A BUSINESS COMBINATION

- Goodwill and fair value acquisition accounting adjustments arising from a business combination are treated as assets and liabilities of the foreign operation.
- Hence they are expressed in the functional currency of the foreign operation and should be translated at the closing exchange rate as is the case for other assets and liabilities.

### 2.12 DISPOSAL OR PARTIAL DISPOSAL OF FOREIGN OPERATIONS

#### 2.12.1 Full Disposal

- A disposal may arise, for example, through sale, liquidation or repayment of share capital. On disposal of the foreign operation, the cumulative exchange differences relating to that foreign operation recognised in other comprehensive income and accumulated separately in equity are reclassified to profit or loss (reclassification adjustment) when the gain or loss on disposal is recognised.
- On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences related to that foreign operation that have been attributed to the non-controlling interests forms part of the non-controlling interests that is derecognised and is included in the calculation of the gain or loss on disposal, but it is not reclassified to profit or loss.
- In addition to the disposal of an entity’s entire interest in a foreign operation, the following
are accounted for as disposals even if the entity retains an interest in the former subsidiary, associate or jointly controlled entity:

♦ the loss of control of a subsidiary that includes a foreign operation;
♦ the loss of significant influence over an associate that includes a foreign operation; and
♦ the loss of joint arrangement over a jointly controlled entity that includes a foreign operation.

Example:
Parent P owns 100 percent of subsidiary S. P sells 70 percent of its investment and loses control of S. The entire balance in the foreign currency translation reserve in respect of S is reclassified to profit or loss.

2.12.2 Partial Disposal

A partial disposal of an entity’s interest in a foreign operation is any reduction in an entity’s ownership interest in a foreign operation, except for those reductions that are accounted for as disposals.

In the case of the partial disposal of a subsidiary that includes a foreign operation, the entity reattributes the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the NCI in that foreign operation.

In any other partial disposal of a foreign operation, the entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

Example:
Parent P owns 100 percent of subsidiary S. P sells 10 percent of its investment and retains control over S. Therefore, 10 percent of the balance in the foreign currency translation reserve is reclassified to NCI.

Example:
Parent P owns 35 percent of Associate B. P sells a 5 percent stake and retains significant influence over B. Therefore, one-seventh (5/35) of the balance in the foreign currency translation reserve is reclassified to profit or loss.

A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal.
Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

### 2.13 TAX EFFECT OF ALL EXCHANGE DIFFERENCES

Ind AS 12 applies to tax effects of gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency.

### 2.14 DISCLOSURES

Ind AS 21 requires the following disclosures:

(a) amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with Ind AS 109;

(b) net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity, along with the reconciliation of the amount at the beginning and end of the period;

(c) if the presentation currency is different from the functional currency - that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency;

(d) in case of change in functional currency of either the reporting entity or a significant foreign operation:
   (i) fact of such change;
   (ii) reason for the change and;
   (iii) date of change in functional currency;

(e) if presentation currency is different from functional currency, the financial statements can be described as complying with Ind AS only if all Ind AS including the translation method of this Standard is complied with.

However, if an entity presents its financial statements or supplementary financial information in a currency other than its functional or presentation currency:

(i) the information should be clearly identified as supplementary information to distinguish it from the information that complies with Ind AS;

(ii) the currency in which the supplementary information is displayed should be disclosed; and
(iii) the entity’s functional currency and the method of translation used to determine the supplementary information should be disclosed.

### 2.15 SIGNIFICANT DIFFERENCES IN IND AS 21 VIS-À-VIS AS 11

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>Ind AS 21</th>
<th>AS 11</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Forward Exchange Contracts and other similar Financial Instruments</td>
<td>Excludes from its scope forward exchange contracts and other similar financial instruments, which are treated in accordance with Ind AS 109.</td>
<td>Excludes accounting for such contracts.</td>
</tr>
<tr>
<td>2.</td>
<td>Exchange Differences arising on Translation of Certain Long-term Monetary Items from Foreign Currency to Functional Currency:</td>
<td>Ind AS 21 does not apply to long-term foreign currency monetary items recognised in the financial statements before the beginning of the first Ind AS financial reporting period as per the previous GAAP, i.e. AS 11.  However, as provided in Ind AS 101, such an entity may continue to apply the accounting policy so opted for such long-term foreign currency monetary items as per the previous GAAP.</td>
<td>AS 11, gives an option to recognise exchange differences arising on translation of certain long-term monetary items from foreign currency to functional currency directly in equity, to be transferred to profit or loss over the life of the relevant liability/asset if such items are not related to acquisition of fixed assets. Where such items are related to acquisition of fixed assets, the foreign exchange differences can be recognised as part of the cost of the asset.</td>
</tr>
<tr>
<td>3.</td>
<td>Approach for Translation:</td>
<td>Ind AS 21 is based on the functional currency approach. However, in Ind AS 21, the factors to be considered in determining an entity’s functional currency are similar to the indicators in existing AS 11 to determine the foreign operations as non-integral</td>
<td>AS 11 is based on integral foreign operations and non-integral foreign operations approach for accounting for a foreign operation</td>
</tr>
</tbody>
</table>

© The Institute of Chartered Accountants of India
<table>
<thead>
<tr>
<th></th>
<th></th>
<th>foreign operations. As a result, despite the difference in the term, there are no substantive differences in respect of accounting of a foreign operation.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>4.</td>
<td><strong>Presentation Currency:</strong></td>
<td>As per Ind AS 21, presentation currency can be different from local currency and it gives detailed guidance in this regard.</td>
<td>AS 11 is silent on it</td>
</tr>
</tbody>
</table>
Practical Questions

1. Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for ₹ 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is ₹ 100 lakhs. The cumulative exchange differences that have arisen during P’s ownership are gains of ₹ 200 lakhs, resulting in P’s foreign currency translation reserve in respect of S having a credit balance of ₹180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is ₹ 20 lakhs.

Calculate P’s gain on disposal.

2. Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$).

The following is the statement of financial position of Infotech Global Ltd. prior to translation:

<table>
<thead>
<tr>
<th>USD</th>
<th>L$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>50,000</td>
</tr>
<tr>
<td>Receivables</td>
<td>9,35,000</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>9,85,000</strong></td>
</tr>
<tr>
<td>Issued capital</td>
<td>50,000</td>
</tr>
<tr>
<td>Opening retained earnings</td>
<td>28,000</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>20,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>8,40,000</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>47,000</td>
</tr>
<tr>
<td><strong>Total equity and liabilities</strong></td>
<td><strong>9,85,000</strong></td>
</tr>
</tbody>
</table>

Required:

Translate the statement of financial position of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre-populated.)

Prepare a working of the cumulative balance of the foreign currency translation reserve.

**Additional information:**

Relevant exchange rates are:

- Rate at beginning of the year L$ 1 = USD 1.22
- Average rate for the year L$ 1 = USD 1.175
- Rate at end of the year L$ 1 = USD 1.13
Answers to Practical Questions

1. P’s gain on disposal would be calculated in the following manner:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₹ in Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds</td>
<td>1500</td>
</tr>
<tr>
<td>Net assets of S</td>
<td>(1000)</td>
</tr>
<tr>
<td>NCI derecognised</td>
<td>100</td>
</tr>
<tr>
<td>Foreign currency translation reserve</td>
<td>180</td>
</tr>
<tr>
<td>Gain on disposal</td>
<td>780</td>
</tr>
</tbody>
</table>

2. Translation of the financial statements

<table>
<thead>
<tr>
<th>Description</th>
<th>USD</th>
<th>Rate</th>
<th>L$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>50,000</td>
<td>1.13</td>
<td>44,248</td>
</tr>
<tr>
<td>Receivables</td>
<td>9,35,000</td>
<td>1.13</td>
<td>8,27,434</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>9,85,000</strong></td>
<td><strong>1.13</strong></td>
<td><strong>8,71,682</strong></td>
</tr>
<tr>
<td>Issued capital</td>
<td>50,000</td>
<td>—</td>
<td>30,055</td>
</tr>
<tr>
<td>Opening retained earnings</td>
<td>28,000</td>
<td>—</td>
<td>15,274</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>20,000</td>
<td>1.175</td>
<td>17,021</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>8,40,000</td>
<td>1.13</td>
<td>7,43,363</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>47,000</td>
<td>1.13</td>
<td>41,593</td>
</tr>
<tr>
<td><strong>Total equity and liabilities USD</strong></td>
<td><strong>9,85,000</strong></td>
<td><strong>—</strong></td>
<td><strong>8,47,306</strong></td>
</tr>
<tr>
<td>Foreign Currency</td>
<td></td>
<td></td>
<td>24,376</td>
</tr>
<tr>
<td>Translation Reserve (proof below)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total equity and liabilities L$</strong></td>
<td><strong>8,71,682</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Working of the cumulative balance of the FCTR

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