

Query No. 21

Subject: Foreign Exchange fluctuation applicability in the books of the Company.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a government company within the meaning of section 2(45) of the Companies Act, 2013. The Company was incorporated with equal equity participation from the Government of India (GoI) and the State Government under a Special Purpose Vehicle (SPV) for implementation and operation of metro rail project in a state.

2. With regard to the project funding of phase I and phase I extension of metro rail project, the querist has informed that the Government of India (GoI), in addition to the provision of equity capital and sub-ordinate debt, funds the project by means of borrowed funds from multilateral/bilateral funding agencies as Overseas Development Assistance (ODA). The said ODA loan agreement is signed between the GoI and the multilateral/bilateral funding agency in foreign currency. The loan along with interest is to be repaid by the GoI in foreign currency. The loan is for a tenor of 30 years which includes a moratorium period of 10 years and the interest on the loan is around 1.2% - 1.4% p.a.

3. With respect to the procedure for flow of funds, the querist has stated that the Company received the amount from the GoI in terms of Indian Rupee (INR) as ‘Pass Through Assistance’ (PTA). Subsequently, the Company on utilisation of the said PTA amount, submits its claim to the multilateral/bilateral funding agency and the multilateral/bilateral funding agency releases the payment to Controller of Aid Accounts and Audit (CAAA). Based on information from CAAA, the Company used to adjust the PTA amount received from the GoI to loan (Non-Current – Long-term borrowings) from the multilateral/bilateral funding agency.

4. The Company has adopted Indian Accounting Standards (Ind ASs) with effect from 1st April 2016. As per the provisions of section 129(1) of the Companies Act, 2013, the financial statements of a company shall comply with the Accounting Standards notified under section 133 of the Act. The Companies (Indian Accounting Standards) Rules, 2015 notified on 1st April, 2015 by the Central Government in exercise of the powers conferred by section 133 read with section 469 of the Companies Act, 2013 mandated companies with net worth of Rs. 500 crores or more to comply with the Ind AS. The Company, being a government company carrying on the infrastructure projects, has adopted the Ind ASs in compliance of the law.

As per paragraph 23 of Ind AS 21 ‘The Effects of Changes in Foreign Exchange Rates’,

“At the end of each reporting period:

- (a) foreign currency monetary items shall be translated using the closing rate;**
- (b) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and**

¹ Opinion finalised by the Committee on 11.7.2023.

- (c) **non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was measured.”**

As per paragraph 29A of Ind AS 21²,

“An entity may exercise the option in respect of recognition of exchange differences arising on translation of long-term monetary items from foreign currency to functional currency as follows:

- (i) Unrealised exchange differences arising on long-term monetary assets and long-term-term monetary liabilities denominated in a foreign currency shall be recognised directly in equity and accumulated in a separate component of equity. The amount so accumulated shall be transferred to profit or loss over the period of maturity of such long-term monetary items in an appropriate manner. The separate component of equity shall be distinguished from any other component of equity representing any other exchange difference recognised in other comprehensive income and accumulated in equity”.

5. *Present Accounting practice of the Company:*

The Company does not follow the above Accounting Standard as it accounts for its liability only in Indian Rupee as it receives funds from the GoI in INR as Pass Through Assistance (PTA). So, the Company is of the view that as the loan agreement is between the GoI and the multilateral/bilateral funding agency and all amount received in INR from GoI, foreign exchange (forex) fluctuation is not required to be accounted for in the books of the Company. Also, the Company takes reference to clause 14.16 and 14.17 of Memorandum of Understanding (MoU) for Phase-I and Phase-I Extension respectively and Rule 273 of the General Financial Rules which are reproduced below. The MoU for Phase-I was signed in 2011 when the forex computation and accounting was different as per the applicable accounting standard at that point of time.

6. The querist has referred to the following clauses as per Memorandum of Understanding (MoU) between the GoI, State Government and the Company:

As per Clause 14.16 of Phase I MoU signed in February, 2011 –

“The debt servicing liability of the Company with regard to the Multilateral/Bilateral funding agency loan portion shall be reckoned based on the Multilateral/Bilateral funding agency’s repayment schedule received from the Multilateral/Bilateral funding agency in rupee terms along with exchange rate fluctuation of loan currency.”

As per Clause 14.17 of Phase-I Extension MoU signed in September, 2017 –

“The debt servicing liability of the Company with regard to the Multilateral/Bilateral funding agency loan portion shall be reckoned based on the multilateral/bilateral loan repayment schedule received from the Multilateral/Bilateral funding agency in terms of Rupees.”

² Paragraph 29A of Ind AS 21 was not notified under the Companies (Indian Accounting Standards) Rules, 2015.

From the above clauses of both the MoUs, it is quite evident that while signing MoU for Phase-I extension, the forex fluctuation impact was suitably excluded compared to MoU of Phase-I as mentioned above keeping in view the requirements under Ind AS.

7. The querist has also referred to the General Financial Rules wherein Rule 273 of General Financial Rules 2017 states that GoI will recognise the foreign exchange rate variations, once the loan is fully repaid and not during the loan tenure and such accounting of exchange rate variation shall be adjusted/written off to “8680 Miscellaneous Government Accounts” which gives a tacit reference that the forex fluctuation is to the GoI’s account.

8. *Statutory auditors’ qualifications:*

Ind AS 21, ‘The Effects of Changes in Foreign Exchange Rates’: Foreign currency assets and liabilities are to be valued on the balance sheet date by translating using the closing rate as per paragraph 23 of Ind AS which has not been carried out by the Company regarding the multilateral/bilateral funding agency loan. Under clause 14.16 of the Memorandum of Understanding between Government of India, State Government and the Company, the debt servicing liability of the Company with regard to the multilateral/bilateral funding agency loan portion shall be reckoned based on the multilateral/bilateral funding agency’s repayment schedule received from the multilateral/bilateral funding agency in rupee terms along with exchange rate fluctuation of loan currency.

Ind AS 23, ‘Borrowing Costs’: The exchange differences arising from foreign currency borrowings that have to be regarded as interest costs under Ind AS paragraph 6(e) were not determined. The borrowing costs eligible for capitalisation on qualifying assets have not been determined accordingly.

9. The querist has mentioned the following issues with application of Ind AS 21/23:

Annual report perspective:

- (i) The Company being an infrastructure company has huge loan amount outstanding from the multilateral/bilateral funding agency repayable for a long period of over 30 years.
- (ii) In accordance with Ind AS 21, if the monetary long-term loan is reinstated at the closing rate at the end of the reporting period, it will result in a significant exchange rate difference affecting the Profit and Loss Account.
- (iii) The fact is that the forex fluctuation is far higher than the turnover due to high amount of forex loan component.
- (iv) Incorporating the forex fluctuation shall not reflect the fair value of the monetary items as on the balance sheet date and, with the quantum of loan running to crores, the financials shall be distorted in a big way. In addition to the above, there is a significant impact in calculation of book profits for the purposes of income tax.

10. *Impact from Income-tax Act:*

As per section 115JB, every taxpayer being a company is liable to pay Minimum Alternate Tax (MAT), if the income tax (including surcharge and cess) payable on the total income, computed as per the provisions of the Income-tax Act in respect of any year is less than 15% of its book-profit + surcharge (SC) + health and education cess.

These exchange rate differences reflected in the books of account mandate the Company to pay the applicable taxes on the profits inflated by the unrealised foreign exchange rate differences.

11. The loan agreement is signed between the GoI and the multilateral/bilateral funding agency. The amount transferred to the Company is in form of INR through CAAA, GoI. The Company has, at no point of time, received loan in any foreign currency nor repaid interest / principal in foreign currency. As per information available to the Company, all the repayment of principal and interest is being made by GoI at first hand. As per the MoU signed between GoI, State Government and the Company, in case the Company is not able to repay interest / principal of the loan, the same will be borne by the State Government.

Further, the Company, like other entities undertaking metro rail projects, is also not able to meet the operational cashflow requirements. For the past 4 years since its inception of operation, it has continued to report huge losses. It is also estimated that the same trend may continue for the next couple of years. In these scenarios, the State Government has to make repayment of principal and interest including the exchange rate variation if any. Further, although the interest and principal has become due for payment since 2018, the same has been met by Government considering the financial position of the Company and the same is likely to continue for few more years.

For repayment of loan and interest, the Company is primarily looking for support from the Government. Hence, when the entire transaction of loan is happening outside the books of the Company, accounting for forex fluctuations on estimated basis will neither add any value to the Company nor seems technically proper and just. Further, considering the huge loan amount and lower turnover, the forex fluctuation impact itself will tilt the financials in a big way which will not reflect true and fair view at any point of time.

Apart from the above, as per the accounting requirements, the exchange impact has to be added / deducted from the value of the assets. As forex rates will undergo change in each accounting period, the asset value will also undergo changes at each reporting period, which will not reflect the actual cost of the asset and its depreciation.

12. The querist has also separately informed the following:

- i. Clause 11.1 of 2011 MoU refers to the obligation of State Government for overall foreign exchange fluctuation, whereas clause 14.7 specifically refers to the inclusion of forex fluctuations on JICA loan in debt servicing liability of the Company. With these, it can be inferred that clause 11.1 considers the forex fluctuations in project spend and not the JICA fluctuations.
- ii. The GFR (General Financial Rules) 2017 are applicable to all Central Government Ministries/Departments and its subordinate bodies. Since the Ministry of Finance to which the loan is sanctioned comes under the Central Government Ministry of India, the Rule 273 is very much applicable, which states, “the exchange variation in respect of foreign loans that have been fully repaid shall be adjusted written off to 8680-Miscellaneous Government accounts”, concludes that forex fluctuation is to the GoI’s account.
- iii. Phase-I MoU between GoI, State Government and the Company was signed in 2011 and Phase-I Extension in 2017. In both the phases of Project,

Multilateral/Bilateral funding agency is the only funding agency. As per schedule, the interest payment and loan repayment of Phase-I has already commenced and Phase-I Extension is yet to commence.

- iv. The entire loan was received in Rupee Terms from GoI as Pass Through Assistance (PTA) (clause 13.3 of both MoU), and repayment is also to be made in INR (clause 14.16 of both MoU). The details of reimbursement from Multilateral/Bilateral funding agency by GoI have not been advised specifically to the Company at any point of time.
- v. Further, although MoU is being largely focussed, the understanding of the Company is that the Loan agreement is a legally binding document as compared to MoU. However, in the MoU also, if the obligation of State Government is specifically examined in both the MoUs, it is clear that State Government will bear the exchange rate variation, if any.
- vi. Apart from the documents cited, in practice also, GoI/State Government is paying interest and repaying principal to Multilateral/Bilateral funding agency when it is due for payment and no claim has been made to the Company in this regard. It may be mentioned that the same practice is also being followed in other entities undertaking metro projects having similar arrangements.
- vii. Considering the exchange rates movements and the resultant changes in the Balance Sheet and Statement of Profit and Loss, the exchange rate variation clause is taken off in the Phase-I extension MoU. In the extension MoU, it is quite clear in clauses 14.16 and 14.17, and it is covered under obligation of State Government under clause 11.1 of both MoUs.

B. Query

13. In view of above, the querist has sought the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) on the issue of inclusion/exclusion the forex fluctuation impact in the books of the Company under the following two circumstances:

- (a) When the loan and interest are directly paid by the Government of India / State Government.
- (b) When the loan and interest are paid by the Company in rupee terms to Government for onward repayment to the funding agencies.

C. Points considered by the Committee

14. The Committee notes that the basic issue raised by the querist relates to the inclusion/exclusion of the forex fluctuation impact in the books of the Company in the situations when the loan and interest are directly paid by the Government of India/State Government and when the loan and interest are paid by the Company in rupee terms to the Government for onward repayment to the funding agencies. The Committee has, therefore, examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting treatment for loan received, accounting for repayments of loan or interest thereon, application of the requirements of Ind AS 23, 'Borrowing Costs', accounting to be followed in case the Company is not able to repay interest/principal of loans

and the same is borne by Government, accounting for accounting periods when the requirements of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates' were applicable including accounting on transition to Ind AS, etc. Further, the Standards referred to in the Opinion are Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time. Furthermore, the opinion expressed hereinafter is purely from accounting perspective and not from the perspective of legal interpretation of loan agreement between the GoI and the Multilateral/Bilateral funding agency, General Financial Rules and MoUs between GoI, State Government, and the Company, Income-tax Act, 1961 or Rules made thereunder.

At the outset, the Committee wishes to point out that paragraph 29A of Ind AS 21 as referred by the querist in the Facts of the Case was not notified under the Companies (Indian Accounting Standards) Rules, 2015 and hence, the same is not applicable in the extant case.

15. In the context of the issue raised, the Committee notes the following requirements of Ind AS 21 'The Effects of Changes in Foreign Exchange Rates', as follows:

“3 This Standard shall be applied:

- (a) **in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of Ind AS 109, *Financial Instruments*;**
- (b) **in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation or the equity method; and**
- (c) **in translating an entity's results and financial position into a presentation currency.”**

From the above, the Committee notes that Ind AS 21 is applicable when there are transactions and balances in foreign currency. Further, paragraph 20 of Ind AS 21 states that “a foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity ... (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency ...”. Thus, the Committee is of the view that Ind AS 21 is applicable when amount *receivable/payable* is denominated in foreign currency and not necessarily when the receipt/payment is made in foreign currency.

16. In this context, the Committee further notes the following requirements of General Financial Rules 2017 (GFR) and clauses from the MoUs between Government of India (GoI), State Government and the Company in respect of Phase I and Phase I Extension of the metro project as follows:

General Financial Rules 2017 (GFR)

“Rule 265 Currency of external aid.

The external aid shall flow from the Funding Agency in foreign currency or Indian Rupees and shall be received by the Reserve Bank of India, Mumbai which shall remit the rupee equivalent to the account of Controller, Aid Accounts and Audit, Department of Economic Affairs at Reserve Bank of India, New Delhi.

The remittances shall be accounted as external loan/Grant receipts in the Consolidated Fund of India.”

“Rule 267 (1) Reimbursement procedure.

Under the reimbursement procedure the Project Implementing Agency shall initially spend or incur expenditure and subsequently claim the amount from the Funding Agency through the office of the Controller, Aid Accounts. The remittances shall be accounted as External Loan or Grant receipt in the Consolidated Fund of India. ...”

“Rule 271 Repayment of loans.

Office of Controller of Aid Accounts and Audit shall be responsible for prompt repayment of principal on the due date as per the agreements. The remittance of foreign currency is arranged through designated Public Sector Commercial Banks and Reserve Bank of India. The Rupee equivalent and the amount of foreign currency remitted shall be intimated by the Banks to Controller of Aid Accounts and Audit. The Rupee equivalent of the foreign currency remitted is credited to the respective Banks’ account maintained at Reserve Bank of India, New Delhi, by debit to Controller of Aid Accounts and Audit’s account as per standing arrangement. On the receipt of the advice from Reserve Bank of India, New Delhi, Controller of Aid Accounts and Audit shall debit the concerned loan account in the Consolidated Fund of India. The repayment of loans shall be classified as charged expenditure. In cases where the funds from externally aided Projects are further passed on as loans, the recovery of the loan along with interest shall be the responsibility of the respective administrative Ministry or Department.”

“Rule 273 Accounting of exchange variation.

The exchange variation in respect of foreign loans that have been fully repaid shall be adjusted written off to “8680- Miscellaneous Government Accounts - Write off in terms of Government Accounting Rules and the procedures prescribed by CGA in consultation with CAG.”

MoU between Government of India (GoI), State Government and the Company (2011) in respect of project funding of phase I of metro project:

“11.1 It is agreed between the parties that any cost escalation due to changes in the statutory levies and duties, *exchange rate variation* and price escalation within the approved project scope and approved time cycle will be shared equally between GoI and State Government.”

“12.0 OBLIGATIONS OF STATE GOVERNMENT

...

12.16 To finance cash losses, if any, and capital expenditure during the operational phase from its own resources in case the same cannot be provided by the Company.”

...

“13.0 OBLIGATIONS OF GOI

...

13.3 To make JICA ...loan funds of Rs. 8646 crore available directly and promptly to the Company through gross budgetary resources *in the form of Pass Through Assistance on back to back basis.*”

“14.15 *The entire loan amount* will be disbursed by JICA ... *in loan currency* under the Loan Agreement which *shall be the liability of the Company* for the purpose of repayment of loan through GOI. ...

14.16 *The debt servicing liability of the Company with regard to the JICA loan portion shall be reckoned based on JICA’s repayment schedule received from JICA in rupees terms along with exchange rate fluctuation of loan currency.*”

MoU between Government of India (GoI), State Government and the Company (2017) in respect of project funding of phase I extension of metro project:

“11.1 ... Any cost escalation due to price escalation, *exchange rate variation* and change in scope or avoidable delay within and beyond approved time cycles as well as inclusions of essential items not reflected in DPR shall be entirely borne by State Government.”

“12.27 In case of SPV i.e. the Company not being able to repay the loan (as and when it becomes due), the responsibility for the same shall be borne by the State Government, and not by the Government of India.”

“13.3 GoI will facilitate to make available JICA loan funds or any other multilateral loan fund equivalent to Rs. 2,141/- crore...or any such additional amount as sanctioned, directly to the Company through gross budgetary resources in the form of Pass Through Assistance on back to back basis.”

“14.16 The entire loan amount disbursed by JICA or any other multilateral agency under the Loan Agreement shall be the liability of the Company for the purpose of repayment of loan through GoI. The repayment of loan of GoI by the Company shall be through an Escrow Account.

14.17 The debt servicing liability of the Company with regard to JICA or any other multilateral/bilateral loan portion shall be reckoned based on JICA or any other multilateral/bilateral loan repayment schedule received from JICA or any other multilateral funding agency in terms of rupees.”

From the above, the Committee notes that 2011 MoU in respect of Phase I of the metro project clearly states that *the entire loan amount* will be disbursed by JICA *in loan currency* under the Loan Agreement which *shall be the liability of the Company* for the purpose of repayment of loan through GoI. Further, it also states that the debt servicing liability of the Company with regard to the JICA loan portion shall be reckoned based on JICA’s repayment schedule received from JICA in rupees terms *along with exchange rate fluctuation of loan currency*. Thus, as per the terms agreed, it appears that the loan amount in loan currency,

which is denominated in foreign currency, is the liability of the Company on which exchange rate fluctuation shall be borne by the Company. Therefore, the Committee is of the view that the same should be considered as a foreign currency transaction as per the requirements of Ind AS 21 and the requirements with regard to measurement, etc. as per the Standard should be followed by the Company on such loan liability. In this context, the Committee wishes to point out that the loan being a pass through assistance from CAAA/Government (and not a direct loan liability from the funding agency) and disbursement of loan and repayment of loan being made in Indian Rupee or through Government do not alter the fact that the initial liability is a foreign currency liability for the Company. Further, the contentions of the Company that all the repayment of principal and interest is being made by GoI at first hand and that as per the MoUs, in case the Company is not able to repay interest / principal of the loan, the same will be borne by State Government are also not relevant to determine that the liability is a foreign currency liability or not as the payments in the extant case may be made by the Government on behalf of the Company or because of its capacity as guarantor or due to its other commitments towards the loan funding agency, such as, timely payments etc.

However, the Committee notes that 2017 MoU in respect of Phase I extension of the metro project although states that the entire loan amount disbursed by JICA or any other multilateral agency under the Loan Agreement shall be the liability of the Company for the purpose of repayment of loan through GoI, it does not clearly state that the *loan amount* disbursed by JICA *in loan currency* shall be the liability of the Company. Further, unlike in 2011 MoU, clause 14.17 also does not explicitly state about the debt servicing liability of the Company in respect of foreign exchange fluctuations. Furthermore, clause 11.1 of the MoU specifically states that cost escalation due to foreign exchange fluctuation is to be borne by the State Government and as clarified by the querist, in practice also, no claim has been made by the Government to the Company in this regard. Therefore, it appears that in respect of Phase I extension of the metro project, the Company has no liability towards foreign exchange fluctuation and thus, it cannot be considered that the amount payable by the Company towards the loan is denominated in foreign currency. Accordingly, in this case, the loan liability cannot be considered as a foreign currency transaction as per the requirements of Ind AS 21 and the requirements of Ind AS 21 with regard to measurement, etc. shall not be applicable. However, the Committee also wishes to mention that in case, due to any subsequent development or due to differences in understanding of facts, the Company is required to bear foreign exchange fluctuations though paid or reimbursed by the Government, the Opinion expressed by the Committee may not be applicable.

D. Opinion

17. On the basis of the above, the Committee is of the opinion on the issues raised in paragraph 13 above that the question of inclusion/exclusion the forex fluctuation impact in the books of the Company depends upon whether the transaction can be considered as a foreign currency transaction or not as per the requirements of Ind AS 21 and not on whether the loan and interest are directly paid by the Company or the Government or in INR or foreign currency, as discussed in paragraphs 15 and 16 above.