

### **Query No. 33**

**Subject: Accounting treatment of foreign exchange gain/loss arising out of payables for capital goods/services under Ind AS framework.<sup>1</sup>**

#### **A. Facts of the Case**

1. A Company (hereinafter referred to as ‘the Company’) is a 50:50 joint venture between the Government of India (GOI) and a State Government with its main object to provide a ‘Rail based Mass Rapid Transit Facility’ to people residing in areas presently not connected by the State suburban rail system and to bring the metro system within reach of 500 meters to 1 km. The metro project is in the construction phase and is expected to be operational by the end of December 2023 and June 2024 for Phase I and Phase II respectively. By virtue of government company, its audited financial statements for a financial year (F.Y.) are subjected to supplementary audit under section 143(6) of the Companies Act, 2013 by the Comptroller and Auditor General of India (C&AG).

2. During supplementary audit for the financial year 2021-22, C&AG has commented on the accounting treatment followed by the Company with respect to foreign exchange gain/loss on the transaction and translation of payables for capital goods/services. Accordingly, it is now proposed to seek an opinion in this context.

3. The Company is in the construction phase and commercial operations of the Company have not yet started. The foreign exchange fluctuations on transactions and translations of payables for capital goods/services, being directly attributable cost for the Company, *is transferred to Capital Work in Progress*. (Emphasis supplied by the querist.)

4. The Company will start charging off the foreign exchange fluctuations on transactions and translations of payables for capital goods/services, as and when its project/construction will be completed and the asset is ready for its intended use.

5. An analogy can be drawn from the accounting treatment prescribed by paragraph 6(e) of Indian Accounting Standard (Ind AS) 23, ‘Borrowing Costs’, which allows the capitalisation of exchange fluctuation to the extent it is regarded as an adjustment to the interest cost.

6. Another analogy can also be drawn from paragraph D13AA of Ind AS 101, ‘First-time Adoption of Indian Accounting Standards’, which provides an option to the entities to continue the policy adopted for exchange differences arising from translation of long term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.

The policy referred above relates to paragraph 46A of the erstwhile Accounting Standard (AS) 11, ‘The Effects of Changes in Foreign Exchange Rates’, which states that in respect of accounting periods commencing on or after the 1<sup>st</sup> April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 and at the option of any other enterprise (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences insofar as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset.

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<sup>1</sup> Opinion finalised by the Committee on 16.10.2023.

As contracts entered into by the Company with vendors/suppliers/contractors towards acquisition of depreciable assets are before the date of convergence to Ind AS, the Company continued to capitalise the exchange variation on these contracts.

7. In this regard, the relevant extracts of accounting policy of the Corporation are as follows:

#### **“1.11. FOREIGN CURRENCY**

##### **Initial recognition**

Foreign currency transactions are recorded in the functional currency (Indian Rupee) by applying to the foreign currency amount, the exchange rate between the functional currency and the foreign currency on the date of the transaction.

##### **Conversion**

All monetary items outstanding at year end denominated in foreign currency are converted into Indian Rupees at the reporting date's exchange rate. Non-monetary items, which are measured in items of historical cost denominated in a foreign currency, are reported using the exchange rate at the date of the transaction and non-monetary items which are carried at fair value or other similar valuation denominated in a foreign currency are reported using the exchange rates that existed when the values were determined.

##### **Exchange differences**

Exchange difference arising on such conversion and on settlement of the transaction are capitalised till the assets are ready for intended use and thereafter recognised in the Statement of Profit and Loss”

8. C&AG of India during their supplementary audit for the financial year 2021-22, have issued comments that:

“the accounting policy/treatment followed by the company in respect of transaction and translation of Foreign Currency Payables for Capital Goods/Services are not as per the provisions of paragraphs 28 and 29 of Ind AS 21 titled ‘The Effects of Changes in Foreign Exchange Rates’ which stipulate that when monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. Such exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be *recognised in profit or loss* in the period in which they arise.”

(Emphasis supplied by the querist.)

9. The querist has stated that the Hon’ble C&AG has not considered paragraph 16(b) of Ind AS 16, ‘Property, Plant and Equipment’, which requires that till such time the asset is brought to the location and condition necessary for it to be capable of operating in the manner intended by management, all incidental expenses which are considered as directly attributable

expenses form part of cost of an item of Property, Plant and Equipment and therefore, the exchange fluctuation loss/gain must be capitalised.

As per the querist, foreign exchange loss/gain on translation of monetary items (to be precise translation of payables in foreign exchange), being inextricably related to acquisition cost of assets and directly attributable cost must be capitalised as per aforesaid paragraph 16(b) of Ind AS 16.

## **B. Query**

10. In view of the above submission, the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) is sought on the following issues:

- (i) Whether in view of accounting treatment prescribed by paragraph 16(b) of Ind AS 16, the accounting treatment for capitalisation of foreign exchange fluctuation loss/gain by the Corporation till such time the assets are not ready for intended use is correct.
- (ii) Any other connected issues that EAC wishes to add to the query and answer the same for better clarification.

## **C. Points considered by the Committee**

11. The Committee notes that the basic issue raised by the querist relates to the accounting treatment of foreign exchange fluctuations loss/gain on translation of foreign currency payables for capital goods/services, incurred by the Corporation till such time the assets are not ready for intended use under Ind AS framework. The Committee has, therefore, considered only this issue and has not examined any other issues that may arise from the Facts of the Case, such as, accounting for other foreign currency transactions, accounting for any other expense incurred by the Company in relation to the metro project, accounting for the borrowing costs, translation of non-monetary items, accounting treatment of contracts entered into between the Company and vendor/suppliers/contractors towards acquisition of depreciable assets, etc. Further, the opinion hereinafter has been expressed in the context of Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time and is purely from accounting perspective and not from any other perspective.

12. At the outset, the Committee notes from the Facts of Case that the Company in the extant case is in the construction phase and commercial operations of the Company have not yet started. As per the facts supplied, the contracts in the extant case are entered into by the Company with vendors/suppliers/contractors towards acquisition of depreciable assets before the date of convergence to Ind AS. In this context, the Committee notes paragraph D13AA of Ind AS 101, 'First-time Adoption of Indian Accounting Standards' as follows:

### **“Long Term Foreign Currency Monetary Items**

D13AA A first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.”

From the above, the Committee notes that Ind AS 101 gives an option to the entities to continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP (viz., AS 11). In this regard, the Committee notes that the Company in the extant case seems to have availed such an option on adoption of Ind AS. The Committee also notes the following requirements of Ind AS 21, ‘The Effects of Changes in Foreign Exchange Rates’:

“7AA This Standard does not also apply to long-term foreign currency monetary items for which an entity has opted for the exemption given in paragraph D13AA of Appendix D to Ind AS 101. Such an entity may continue to apply the accounting policy so opted for such long-term foreign currency monetary items.”

**“Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.”**

**“Recognition of exchange differences**

...

**28 Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognised in profit or loss in the period in which they arise, except as described in paragraph 32.**

29 When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each period up to the date of settlement is determined by the change in exchange rates during each period.”

From the above, the Committee is of the view that in respect of long-term foreign currency payables/monetary items that had been recognised under previous GAAP (AS 11) in respect of which, the Company has availed the option as per requirements of paragraph D13AA, the requirements of Ind AS 21 shall not be applicable. Thus, in the extant case, if the Company, under the previous GAAP, had applied the requirements of AS 11 appropriately, it can continue to capitalise the exchange differences arising from translation of *long-term foreign currency payables/monetary items* with the cost of *depreciable assets* as per the requirements of paragraphs D13AA of Ind AS 101. However, as stated above, it may be noted that the exemption under paragraph D13AA is available only for the exchange differences arising from translation of long-term foreign currency monetary items *recognised* in the financial statements immediately before the beginning of the first Ind AS financial reporting period and not in respect of other items, such as, those which were recognised after adoption of Ind AS and accordingly the said requirements of paragraph D13AA cannot be adopted by analogy in the latter case.

13. Further, in this context, the Committee notes the following requirements of Ind AS 23, 'Borrowing Costs':

“6 Borrowing costs may include:

(a) interest expense calculated using the effective interest method as described in Ind AS 109, *Financial Instruments*;

...

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

**6A With regard to exchange difference required to be treated as borrowing costs in accordance with paragraph 6(e), the manner of arriving at the adjustments stated therein shall be as follows:**

**(i) the adjustment should be of an amount which is equivalent to the extent to which the exchange loss does not exceed the difference between the cost of borrowing in functional currency when compared to the cost of borrowing in a foreign currency.**

**(ii) where there is an unrealised exchange loss which is treated as an adjustment to interest and subsequently there is a realised or unrealised gain in respect of the settlement or translation of the same borrowing, the gain to the extent of the loss previously recognised as an adjustment should also be recognised as an adjustment to interest.”**

Accordingly, in the given case, to the extent the requirements of paragraph 6(e) are applicable, the exchange differences will be considered as borrowing costs and since these borrowing costs are directly attributable to the acquisition or construction of a qualifying asset (viz., a metro project that necessarily takes a substantial period of time to get ready for its intended use), these should be capitalised as part of the cost of that asset, as per the requirements of Ind AS 23. However, the aforesaid requirements cannot be used by analogy to other foreign exchange differences, i.e. those that are not covered under paragraph 6(e) of Ind AS 23.

14. The Committee is further of the view that apart from the above exchange differences, any other exchange differences on translation of foreign currency monetary items/payables at the reporting date in the extant case are to be recognised in the Statement of Profit and Loss as per the above-reproduced requirements of Ind AS 21. Further, in this context, the Committee wishes to point out that since there are specific requirements of Ind AS 21 dealing with exchange differences, the general requirements of Ind AS 16, 'Property, Plant and Equipment' are not applicable in respect of such differences.

#### **D. Opinion**

15. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 9 above:

(i) In the extant case, the Company can continue to capitalise the foreign exchange fluctuations loss/gain in respect of long-term foreign currency payables/ monetary

items that had been recognised under previous GAAP (AS 11) in respect of contracts entered into by the Company with vendors/suppliers/ contractors towards acquisition of depreciable assets, as per the requirements of paragraph D13AA, as discussed in paragraph 12 above. Further, to the extent the requirements of paragraph 6 (e) of Ind AS 23 are applicable, the exchange differences will be considered as borrowing costs and since these borrowing costs are directly attributable to the acquisition or construction of a qualifying asset (viz., a metro project that necessarily takes a substantial period of time to get ready for its intended use), these should be capitalised as part of the cost of that asset, as discussed in paragraph 13 above. Apart from the above exchange differences, any other exchange differences, on translation of foreign currency monetary items/payables e.g., those recognised in the financial statements after the date mentioned in paragraph D13AA of Ind AS 101 are to be recognised in the Statement of Profit and Loss as per the above-reproduced requirements of Ind AS 21, since these requirements are specific to the treatment of foreign exchange fluctuations and the requirements of Ind AS 16 are therefore not applicable.

- (ii) This being general issue cannot be answered by the Committee.
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