ACCOUNTING TREATMENT OF FORWARD CONTRACT IN DIFFERENT SCENARIOS:

SCENARIO-I: MATURITY

CASE-A :

- Entered into a USD 100 payable commitment to import raw materials on 1st Jan;
- Delivery of Raw Material is on 30th Jun and payment on 30th Jun;
- On 1st Jan , Entity enters into Fwd Contract to hedge the risk till 30th Jun ;

	1st Jan	31st Mar	30th Jun
Spot	62	63	**63.75**
Fwd Rate (30th Jun)	62.50	**63.50**	

Pass Journal Entries.

The forward contract is entered to hedge a firm commitment and hence AS 11 will not apply.

On 31st March

Forward Rate as at 31st March	63.50
Forward Rate 1st Jan	62.50
Difference	1.00
Total USD	100.00
Mark to Market (1*100)	100.00

The difference of Rs. 1 is a gain. Hence no accounting entries are required as at 31st March in terms of announcement of ICAI that gains should not be recognized.

Disclosure of the amount of Hedge is to be made in Notes to accounts with a mention that gain as on March 31st, is not recognized.

On 30th Jun

Inventory (100*63.75)	Dr.	6,375	
To Vendor	Cr.		6,375
(Being liability for inventory recognized)			
Vendor	Dr.	6,375	
To Bank	Cr.		6,375
(Being payment made to vendor)			
Bank	Dr.	125	
To Foreign Exchange Gain on Forward Contracts	Cr.		125

(Being amount credited by Bank on closure of contract (1.25 (63.75-62.50) *100)

CASE-B :

- Entered into a USD 100 payable commitment to import raw materials on 1st Jan;
- Delivery of Raw Material is on 1st Jun and payment on 30th Jun;
- On 1st Jan , Entity enters into Fwd Contract to hedge the risk for maturity till 30th Jun;

	1st Jan	31st Mar	30th Jun
Spot	62	63	**63.75**
Fwd Rate (30th Jun)	62.50	**63.50**	

As on 1st Jun, Spot Rate is Rs.63.30

Pass Journal Entries.

The forward contract is entered to hedge a firm commitment and hence AS 11 will not apply.

On 31st March

Forward Rate as at 31st March	63.50
Forward Rate 1st Jan	62.50
Difference	1.00
Total USD	100.00
Mark to Market (1*100)	100.00

The difference of Rs. 1 is a gain. Hence no accounting entries are required as at 31st March. Hence no accounting entries are required as at 31st March in terms of announcement of ICAI that gains should not be recognized.

Disclosure of the amount of Hedge is to be made in Notes to accounts with a mention that gain as on March 31st, is not recognized.

On 1st Jun

Inventory (100*63.30)	Dr.	6,330	
To Vendor	Cr.		6,330
(Being liability for inventory recognized)			

On 30th Jun

Vendor	Dr.	6,330	
Foreign Exchange Loss (Rs. 0.45 per USD)	Dr.	45	
To Bank	Cr.		6,375
(Being payment made to vendor)			

Bank Dr. 125
To Foreign Exchange Gain on Forward Contracts Cr. 125
(Being amount credited by Bank on closure of contract (1.25 (63.75-62.50) *100)

SCENARIO-II: ROLL OVER / EXTENSION

- Entered into a USD 100 payable commitment to import raw materials on 1st Jan;
- Delivery of Raw Material is on 30th June and payment on same date;
- On 1st Jan , Entity enters into Fwd Contract to hedge the risk;
- As part of Hedging Policy, the entity first enters for shorter period till 31st March; and
- Roll it over on 31st March to meet the Cash flow on 30th Jun.

	1st Jan	31st Mar	30th Jun
Spot	62	63	**63.75**
Fwd Rate (30th Jun)	62.50	**63.50**	

Pass Journal Entries.

Data about the Forward Rate on 1st Jan with reference to 31st March is required.

The documentation of the Roll Over / Extension is to be looked into.

If this is achieved by way, of closure of existing contract and entering into new contract.

Then the bank may debit or credit the exchange difference on closure. This requires to be recognized.

The new contract will also be in the nature of a contract to hedge firm commitment, since the contract is entered into prior to the actual occurrence of the transaction.

If this is achieved by way, of Roll over / extension of the existing contract.

Then the scheme of entries mentioned in Case A under Scenario 1 will be applicable.

SCENARIO-III: CANCELLATION

Case -A

- Entered into a USD 100 payable commitment to import raw materials on 1st Jan;
- Delivery of Raw Material is on 31st March and payment on same date;
- On 1st Jan , Entity enters into Fwd Contract to hedge the risk till 31st March (Spot as on 1st Jan @62 &Fwd Rate on 31st March @62.10);
- Earlier to Maturity, Forward Contract cancelled on 15th March due to short closure of import order(Spot on 15th March @ 63);

Pass Journal Entries.

On 15th March

The rate of exchange that will be considered by the Bank on 15th March, will have to be considered for ascertaining the profit or loss on cancellation.

If the Bank considers the rate as 62.10 then the entry would be:

Bank	Dr.	90	
To Foreign Exchange Gain on Forward Contracts	Cr.		90

(Being amount credited by Bank on cancellation of contract (0.90 (63.00-62.10) *100)

But it is quite possible that the bank may not consider 62.10 and they may insist to enter into a forward contract on 15th March to sell USD 100 to the bank on 31st March.

Then the bank will debit / credit the amount based on those rates.

Case -B

- Entered into a USD 100 payable commitment to import raw materials on 1st Jan;
- Delivery of Raw Material is on 31st March and payment on same date;
- On 1st Jan , Entity enters into Fwd Contract to hedge the risk for Maturity till31st March (Spot as on 1st Jan @62 &Fwd Rate on 31st March @62.10);
- On Maturity date, Forward Contract cancelled on 31st March due to short closure of import order (Spot on 31st March @ 63.15);

Pass Journal Entries.

Since, the maturity date and cancellation date is the same, the gain of Rs. 1.05 (63.15-62.10) per USD will be credited by Bank. This will be accounted as under:

Bank	Dr.	105	
To Foreign Exchange Gain on Forward Contracts	Cr.		105

(Being amount credited by Bank on maturity /cancellation of contract (1.05 (63.15-62.10) *100)

SCENARIO-IV: EARLY DELIVERY

- Entered into a USD 100 payable commitment to import raw materials on 1st Jan;
- Delivery of Raw Material is on 31st March and payment on same date against L/C;
- On 1st Jan , Entity enters into Fwd Contract to hedge the risk till31st March(Spot as on 1st Jan @62 &Fwd Rate on 31st March @62.10);
- Prior to Maturity date, Party made early delivery on 15th March and lodged for settlement against L/C for the payment on same date. (Spot on 15th March @ 63);

Pass Journal Entries.

On 15th March

Inventory (100*63)	Dr.	6,300	
To Vendor	Cr.		6,300
(Being liability for inventory recognized)			
Vendor	Dr.	6,300	
To Bank	Cr.		6,300
(Being payment made to vendor)			

The bank will debit / credit the amount on closure of the forward contract for settling the LC considering the spot rate on 15thMarch. Accordingly entries will have to be passed.

If the spot rate on 15th March is more than Rs. 62.10, then this results in foreign exchange gain.

If the spot rate on 15thMarch is less than Rs. 62.10, then this results in foreign exchange loss.