Income Computation and Disclosure Standards (ICDS)

28th April, 2017
Gandhidham
CA Virat Bhavsar

Approaching ICDS

K C Mehta & Co.
Chartered Accountants

Evolution of ICDS

1996

- In 1996, two accounting standards were notified under Section145 of the Act, primarily related to disclosure.

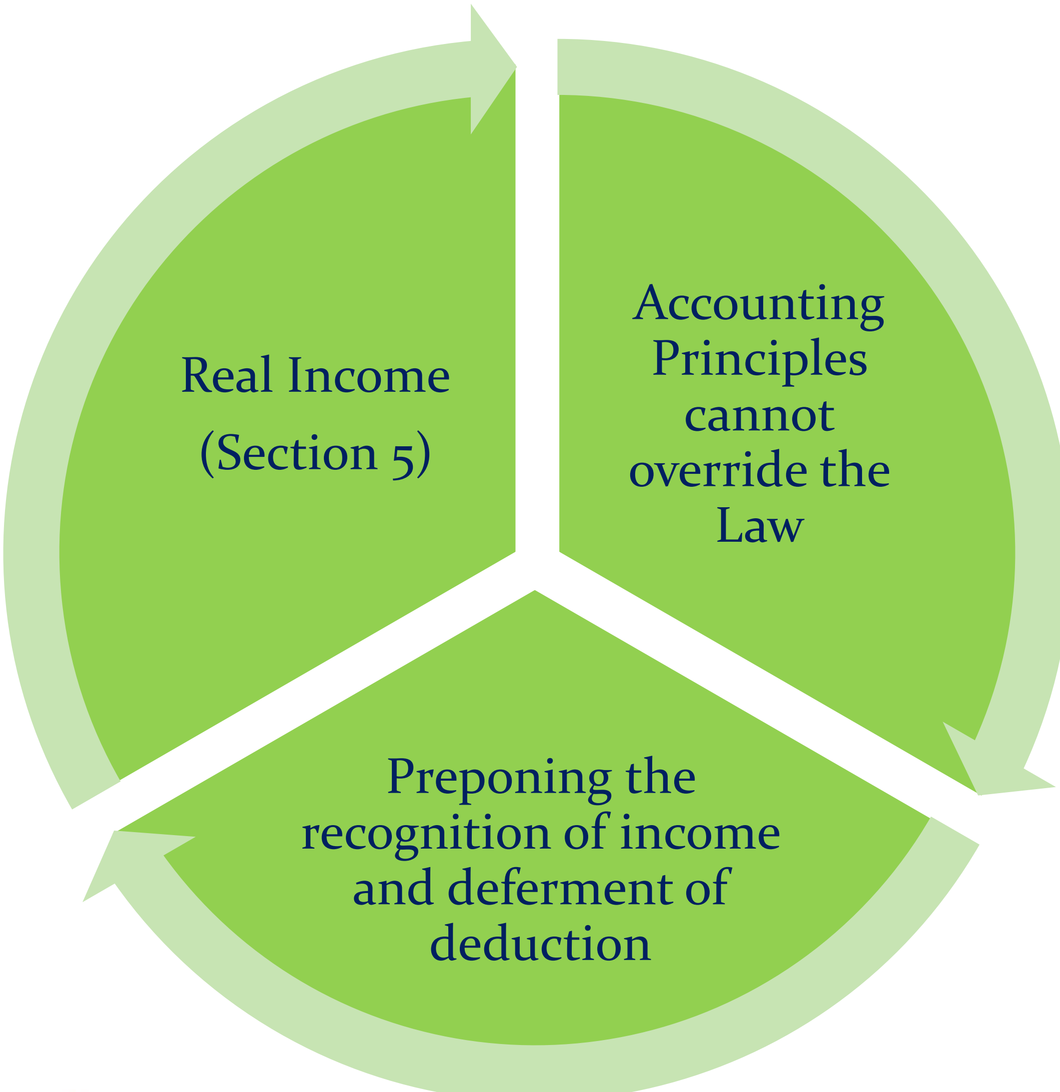
2002-2011

- First committee formed in July 2002 for formulation of TAS. The committee recommended for notification of AS issued by ICAI without any modification along with suitable amendments in Act.
- First report submitted in August 2011
- Final draft of TAS issued in 2012 for public comments

2015

- ICDS notified and later on modified in 2016

Genesis of ICDS



K C Mehta & Co.
Chartered Accountants

Preamble

1. The ICDS to be followed by all the Assessee following the Mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or " Income from other sources".

2. It shall apply to all person whether Resident or Non resident.

3. The ICDS to be followed for the purpose of Computation of Income and not for the purpose of maintenance of Books of Accounts.

4. In case of conflicts between the provision of Act and ICDS, the provision of Act shall prevail to that extent.

Section 145- Method of Accounting

Book Profit u/s 115JB and ICDS

Specific Provisions like 43B/ 43CA/40a(ia)

Presumptive Taxation & ICDS

Assessment u/s 144

ICDS notified

u/s 145

ICDS position

Income Tax Act, 1961
(ICDS preamble)

Income Tax Rules, 1962
(FAQ-4)

ICDS

Decisions of SC
(FAQ-2)

Existing
Notifications/Circulars

K C Mehta & Co.
Chartered Accountants

FAQ 2

- Certain ICDS provisions are inconsistence with judicial pronouncements, whether these judicial pronouncements would prevail over ICDS?

The ICDS have been notified after due deliberation and after examining judicial views for bringing certainty on the issues covered by it. Certain judicial pronouncements were pronounced in the absence of authoritative guidance on these issues under the Act for computing Income under the head "Profits and gains of business or profession" or Income from other sources. Since certainty is now provided by notifying ICDS under section 145(2), the provisions of ICDS shall be applicable to the transactional issues dealt therein in relation to assessment year 2017-18 and subsequent assessment years.

Summary

Accounting Principles ICDS 1	Revenue Recognition ICDS 3,4,7
Recognition of Cost ICDS 5, 9	Measurement standards ICDS 2,6,8,10

Notified ICDS

ICDS	Corresponding AS
ICDS I - Accounting Policies	AS 1
ICDS II - Valuation of Inventory	AS 2
ICDS III - Construction Contract	AS 7
ICDS IV - Revenue Recognition	AS 9
ICDS V – Tangible Fixed Asset	AS 6 &10
ICDS VI – Effect of change in exchange rates	AS 11
ICDS VII – Government Grant	AS 12
ICDS VIII – Securities	AS 13
ICDS IX – Borrowing Cost	AS 16
ICDS X – Provisions, Contingent liabilities & Contingent Assets	AS 29

ICDS 1
Accounting Policies

K C Mehta & Co.
Chartered Accountants

Fundamental Accounting Policies

- Scope:
  - This ICDS deals with the significant accounting policies. (FAQ-1)
- Fundamental Accounting Assumptions:
  - Going Concern
    - Liquidation , Amalgamation or Slump Sale – separate disclosure is warranted.
  - Consistency
    - Uniformity
  - Accrual
    - Accrual refers to assumption that revenue and cost are accrued, that is, recognized as thy are earned or incurred (and not as money is received or paid) and recorded in the previous year to which it relate..

Selection of Accounting Policy (Para 4)

- While considering the **selection and change in policies**, it is stated as under:
  - Treatment or presentation of transaction or event shall be governed by their 'substance and not merely by the legal form'
  - Marked to market loss or an expected loss shall not be recognized unless the recognition of such loss is in accordance with the provision of other ICDS. (FAQ-8)
    - ICDS II (Valuation of Inventory)
    - ICDS VI (Change in Exchange Rates)
    - ICDS III (Construction Contract)
- Accounting policies cannot be changed without **reasonable cause**. (FAQ-9)

Prudence

- Each year is self contained and future profit /losses are not relevant – Sir Kikabhai Premchand v CIT (1953) 24 ITR 506 (SC)
- Jacobs Engineering India P Ltd v ACIT (2011) 14 taxmann.com 186 (Mum)
- Mazagon Dock Ltd v JCIT (2009) 29 SOT 536 (mum)
- Metal Box Co. of India Ltd v their workmen (1969) 73 ITR 53 (SC)

Transitional Provisions

All the contracts existing on 1st day of April, 2016 or entered into on or after the 1st day of April, 2016 shall be dealt with in accordance with the provision of this ICDS after taking into account the income, expenses, or loss, if any, recombined in respect of the said contract or transaction for the previous year ending on or before 31st day of March, 2016.

Disclosure

- All Significant Accounting policy adopted by a person shall be disclosed.
- Any change in the policy which has **material effect** shall be disclosed. (Amount by which an item is affected that change shall also be disclosed.)
- Any change in policy made in an accounting period and has effect in another year may also be disclosed both in the year of change made and the year in which it will have impact for the first time. **Dual disclosure**
- Disclosure of accounting policies and change therein cannot remedy a wrong or inappropriate treatment of an item **_ consequence of penalty**

ICDS 1	AS 1
Mark to Market loss shall not be recognized.	Since 'Prudence' is one of the major consideration for selection of policy, loss to be recognized.
Change in Policy – Only when there is a 'Reasonable Cause'.	Changes in accounting policies should be made only if it is required by statute, for compliance with an Accounting Standard or for a more appropriate presentation of the financial statements
Prior Period items – Not specifically governed here.	Prior period items are included in determination of net profit or loss of the period in which the error pertaining to a prior period is discovered and are separately Disclosed.

ICDS 2

Valuation of Inventory

Scope

- Inventory (Para 2(1)(a)):
  - Held for sale in the ordinary course of business;
  - In the process of production for such sale
  - In the form of materials or supplies to be consumed in the production process or **in the rendering of services**.
- This ICDS shall apply for the valuation of inventories **except**:
  - WIP arising in **construction contracts** (ICDS III)
  - Shares, debentures and **other financial instruments** dealt by ICDS VIII
  - Producer's inventory of livestock, agriculture and forest products, mineral oils, ores and gases to the extent they are measured at NRV
  - **Machinery spares**, which can be used only in connection with a tangible fixed assets and their use is expected to be irregular. (ICDS V)

Cost of Inventory

- Cost of inventory shall consist of;
  - cost of purchase including the **duties, taxes,** freight inwards and other direct expenditure, (excluding rebate, trade discount, and other similar items),
    - Section 145A : ICDS 2 is in line with section 145A directing to follow 'Inclusive Method' for valuation.
  - **cost of services** (consisting of labour and personnel cost involved in the service),
  - **cost of conversion** (systematic allocation of overheads directly related to units of production),
  - **other cost** (interest and other cost shall not be included in the cost of inventories unless it meets the criteria specified by ICDS IX Borrowing Cost)

Measurement of Inventory

- 'Inventories' shall be valued at cost or net realizable value, whichever is lower.

- Valuation of opening inventory
  - **Cost of inventory** available , if any, on the day of commencement of business when the business is commenced during the year, and
  - The **value of inventory**, as on the close of the immediately preceding previous year, in any other cases.

- The method of valuation of inventory once adopted by a person in any previous year shall not be changed without **REASONABLE CAUSE**.

K C Mehta & Co.
Chartered Accountants

Method already accepted by the Department in past which is now not in conformity with ICDS?

Valuation of inventory as per **Standard Costing** method and ICDS II

Para 18 as amended in ICDS-2

K C Mehta & Co.
Chartered Accountants

Valuation of Inventory in case of Dissolution of firm

- As per para 24, in case of Dissolution of firm or AOP or BOI, **notwithstanding whether the business is continued or not**, the inventory on the date of dissolution shall be valued at the Net Realizable Value. (NRV defined in Para 2(1)(b))
  - The Supreme Court in the case of **A.L.A. Firm v. CIT [1991] 189 ITR 285** held that in order to arrive at the correct picture of the trading results of the partnership on the date when it ceases to function, valuation of the stock in hand should be made on the basis of prevailing market price.
  - SC in the case of **Shakti Trading Co. V CIT (2001) 250 ITR 871** has held that where there is no cessation of business on dissolution of the firm , the closing stock could not be valued at market value.

K C Mehta & Co.
Chartered Accountants

Disclosure

- **Transitional Provisions**
  - Interest and other borrowing cost which do not meet the criteria for recognition of interest as a component of cost as per para 11, but included in the cost of opening inventory as on 01.04.2016, shall be taken into account for determination of cost of such inventory for valuation if such inventory continues to remain part of inventory as on close of the year.
- **Disclosure**
  - Accounting policy adopted for measuring the inventory including the cost formula used (Standard Costing and confirmation of fact that it approximates actual cost)
  - Total carrying amount of the inventory and its classification

ICDS 2	AS 2
ICDS II post amendment recognizes standard cost method.	**Standard cost** method is allowed if results approximates the actual cost.
Method of valuation shall not be changed without reasonable cause.	Change from one cost formula to another constitutes a change in an accounting policy. Such change is subject to requirements of AS 5.
Purchase price includes duties and taxes. It mandates 145A	The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities).
On Dissolution of firm/AOI/BOI : Inventory needs to be valued at NRV	Since it is going concern, the valuation is governed by AS 2

ICDS 3

Construction Contracts

K C Mehta & Co.
Chartered Accountants

Scope of ICDS 3

- Scope:
  - This ICDS should applied in determination of income for a <u>construction contract</u> of a contractor.
  - Real estate Developer – ICDS III or IV (FAQ-12)
  - *FAQ-12 Since there is no specific scope exclusion for real estate developers and Build-Operate-Transfer (BOT) projects from ICDS IV on Revenue Recognition, please clarify whether ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.*
  - *Answer: At present there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, relevant provisions of the Act and ICDS shall apply to these transactions as any be applicable.*

- Construction Contract means;
  - Contract specifically negotiated for the construction of asset or combination of asset that are closely interrelated in terms of their design, technology and functions or their ultimate purpose and include;
    - Contract for rendering of services directly related to construction of Assets (Architects)
    - Contract for destruction of assets or restoration of assets and environment following the demolition of asset

Contract Cost and Revenue

- **Contract Revenue**:
  - Contract Revenue shall be recognised when there is reasonable certainty of its ultimate collections. (Para 9)
  - Contract Revenue shall comprised of;
    - Initial amount of contract revenue agreed including retentions
    - Variation in contract work, claim and incentives payments (subject to they are capable of reliably measured and it is probable that they will result into revenue)
  - Contract revenue initially recognised as income subsequently written off in the books, shall be recognised as expense and not as adjustment of revenue. **(Section 36(1)(vii))**

- **Contract cost**:
  - Contract cost shall comprised of;
    - Cost directly related to contract
    - Cost that are attributable to contract activity in general
    - Cost specifically charged to the customer as per the contract
    - Adjustment as per ICDS IX (Borrowing Cost)
  - Cost shall be reduced by incidental income not being in the nature of interest, dividend or capital gain.
  - Contract cost relating to future activity on the contract are to be recognised as asset.

Recognition

- Contract revenue and cost associated with the contract should be recognised on POCM (Percentage of Completion Method).
  - During the early stage of a contract, where the outcome of the contract cannot be estimated reliably, contract revenue to be recognised only to the extent cost incurred.
  - **Completed contract method** (CCM)- not permitted
- Stage of recognition of revenue shall start once the project is 25% completed.

Transitional Provision (Para 22)

- Contract revenue and cost associated with the construction contract which commenced on or after the 1st day of April 2016 shall be recognised in accordance with this principles.

- Contract revenue and cost associated with the construction contract which commenced on or before the 31st day of March 2016 but not completed by the said date shall be recognised based on the method regularly followed by the person prior to the previous year beginning on the 1st day of April, 2016.

Disclosure

- A person shall disclose:
  - Amount of contract revenue recognized
  - Method used to determine the stage of completion
- A person shall disclose the following for contract in progress:
  - Amount of cost incurred and recognized profit till reporting date
  - amount of advances received
  - Amount of retention

ICDS 3	AS 7
completed service method to recognise revenue is not permitted under ICDS 3.	Revenue from service transactions can be recognized on completed service method for recognition of revenue.
Expected loss should be recognised in proportion of work completed.	When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.
Percentage of Completion 25%	Guidance Note

ICDS 4

Revenue Recognition

K C Mehta & Co.
Chartered Accountants

Scope

- This ICDS deals with the bases for recognition of revenue arising in the course of the ordinary activities of a person from:
  - The sale of goods
  - **The rendering of services**
  - The use by other person's resources yielding interest, royalties and dividends.
- This ICDS does not deal with the revenue recognition dealt by other ICDS
  - ICDS 3
  - ICDS 7

Revenue Recognition

- Sale of Goods
  - The revenue shall be recognised when the seller of the goods has transferred to the buyer the property in the goods for a price or significant risk and reward associated with the ownership of the goods have been transferred.
  - Revenue shall be recognised when there is reasonable certainty of ultimate collections.
  - When the ability to asses the ultimate collections with reasonable certainty is lacking at the time of raising claim for escalation of price or export incentives, recognition should be postponed to the extent uncertainty involve.

Rendering of Services

- Rendering of Services
  - Revenue to be recognised based on POCM (Percentage of Completion Method)
    - When services are provided by an indeterminate number of acts over a specific period of time, revenue ay be recognised on **straight line basis** over the specific period.
    - Revenue from service contract with duration of not more than **90 days** may be recognised when the rendering of services under the contract is completed or substantially completed. (Para 7)
  - Principles of ICDS III shall apply.
  - Identification of different process (Stage involved in entire services)

- Interest
  - Interest shall accrue on the time basis
- Royalty
  - Shall accrue in accordance with the term of agreement or having regard to substance of transaction, it is more appropriate to recognise revenue on some systematic and rational basis.
- Dividend
  - In accordance with section 8

FAQ-13 and 14

FAQ-13	FAQ-14
Q. The conditions of reasonable certainty of ultimate collection is not laid down for taxation of interest, royalty and dividend. Whether the taxpayer is obliged to account for such income even the collection thereof is uncertain?	Q. Whether ICDS is applicable to revenues which are liable to tax on gross basis like interest, royalty and fees for technical services for non-residents u/s. 115A of the Act.
Answer: As a principle, interest accrues on time basis and royalty accrues on the basis of contractual terms. Subsequent non recovery in either cases can be claimed as deduction in view of amendment to S.36 (1) (vii). Further, the provision of the Act (e.g. Section 43D) shall prevail over the provisions of ICDS.	Answer: Yes, the provisions of ICDS shall also apply for computation of these incomes on gross basis for arriving at the amount chargeable to tax.

K C Mehta & Co.
Chartered Accountants

Transitional Provision & Disclosure

- Transitional Provision
  - The principles laid down in ICDS III shall apply.
- Disclosure:
  - In case of sale of goods, **total amount not recognized** as revenue during the year due to lack of reasonable certainty.
  - Amount of revenue from service transactions recognized as revenue during the year.
  - **Method used to determine the stage of completion of service transactions in progress**
  - For **service transition in process** at the end of the previous year
  - amount of cost incurred and recognized profit
  - amount of advance received and
  - the amount of retentions

ICDS 5

Tangible Asset

K C Mehta & Co.
Chartered Accountants

Overview of ICDS 5

- This ICDS deals with the treatment of tangible fixed asset.
- **Tangible asset** include land, building, machinery, plant or furniture held with an intention of being used for the purpose of business.
- **Fair value of the Asset** is the amount for which that asset could be exchanged between knowledgeable, willing parties at **'arm's length price'**.
- Component of Actual Cost (Para 5 ,6):
  - Purchase price
  - Import duties and other taxes , excluding those which are subsequently recoverable
  - Any direct attributable expenditure on making the asset ready for its intended use.
  - Exchange fluctuation as per ICDS 6
  - Borrowing cost adjustment as per ICDS 9

Overview

- Expenditures incurred on start-up and commissioning of the project, including the expenditure incurred in test runs and experimental production shall be capitalized.
  - FAQ-15:

    As clarified in para 8 of ICDS V, the expenditure incurred till the Plant has begun commercial production, that is, production intended for sale or captive commutation, shall be treated as capital expenditure.

- Stand by equipment and servicing equipment are to be capitalized. Machinery spares shall be charged to revenue as and when consumed except when their use is expected to be irregular.
  - ICDS II

Component of cost

- Self constructed fixed assets:
  - Same principles are to be followed. Internal profit should be eliminated.

- Improvement and Repairs:
  - Any expenditure that increase the future benefit(s) from the existing assets beyond its <u>previously assessed standard</u> of performance shall be capitalized.
  - Any addition or extension which has separate identity and is capable of being used after the tangible fixed asset is disposed of shall be treated as separate cost.

Valuation of Fixed Assets in Special cases

- **Non –monetary considerations:**
  - When a tangible fixed asset is acquired in exchange of another asset or shares or securities as the case may be, the fair value of the tangible fixed asset so acquired shall be its actual cost.
- **Consolidated consideration:**
  - The consolidated price shall be apportioned on the various assets on fair basis.
- **Joint Ownership:**
  - The proportionate ownership, depreciation and WDV shall be disclosed separately in Fixed Asset register.

- Depreciation:
  - Para 17, it shall be as per the provision of the Act.

- Capital Gain:
  - Para 18, income from transfer of tangible fixed asset shall be computed in accordance with the provision of the Act.

Disclosure requirements & 3CD

1. Description of asset or block of assets;
2. Rate of depreciation;
3. Actual cost or WDV at the beginning and end of the year;
4. Depreciation Allowable and
5. Additions or deductions during the year with dates, including adjustments of change in rate of exchange of currency, CENVAT credit, subsidy/grant.

Other points

- Section 43(6) and 43(1):
  - Whether the assets exchanged for another assets would qualify for adjustment to the block of assets?
  - Section 41 – “Money payable”.
- V Ltd. filed ITR for the FY 16-17. As per the ITR, the block of assets (P & M) as on 01.04.2016 is Rs.1.25 cr. During the FY 2016-17, V Ltd. exchanged its P & M for newly upgraded plant and paid balance consideration of Rs.2 Cr. The fair value of the new Plant is Rs.3.5 cr. Kindly ascertain the impact of this transaction in light of ICDS 5.

Section 43(6) and ICDS 5

Particulars	Option 1	Option 2
Opening WDV (Rs. in Cr)	1.25	1.25
Add: Assets purchased during the year	3.5	3.5
Less: Asset sold/exchanged during the year	-	1.5
Net Block of asset	4.75	3.25
Depreciation @ 15%	0.7125	0.4875

Section 43CA/50C and ICDS 5

- Mr. V is engaged in to Real Estate business. During the FY 2016-17, he entered into an agreement with T Ltd. whereby it is agreed that Mr. V will allot commercial units in upcoming projects (Stock in trade) in lieu of purchase of newly constructed corporate house (" New Asset") for its business purpose. The fair value of the new asset is Rs.50 cr. The book value of stock in trade is Rs.35 Cr. The SDV (Stamp duty value) of stock in trade is Rs.45 Cr whereas the SDV of new asset is Rs.60 Cr. Please assess the implication of this transaction in light of ICDS 5.

Particulars	**PGBP**	**PGBP (2)**	**PGBP(3)**
Sales (Stock in trade)	50.00	45.00	60.00
Less: Cost of Good sold /Indexed cost	35.00	35.00	35.00
Gross Profit	15.00	10.00	25.00
Less: Dep on Building (50 Cr @ 10%)	(5.00)	(5.00)	(5.00)
Addition u/s 56(2)(vii) (SDV) (60-50/45/60)	10.00	15.00	0.00
Total Income	**20.00**	**20.00**	**20.00**

ICDS 6

Effect of change in Foreign Exchange Rates

K C Mehta & Co.
Chartered Accountants

Overview of ICDS 6

- **Scope**:
  - Treatment of transactions in foreign currencies
  - Translating the financial statements of foreign operations
  - Treatment of foreign currency transactions in the nature of foreign exchange contracts

- **Definitions**:
  - Foreign Operation of a person is a **branch** , by whatever name called, of that person, the activities of which are based or conducted in a country other than India.
  - Forward exchange contract means an agreement to exchange different currencies at a forward rate and includes a foreign currency option contract or ***other similar financial instrument.***

Foreign Currency Transactions

Criteria	Monetary Items	Non-Monetary Items
	As per ICDS	As per ICDS
Initial Recognition	By applying the exchange rate at the date of transaction OR Average Rate for week which approximates the date of transaction.	By applying the exchange rate at the date of transaction
Conversion on last day of the year	By applying the closing rate	By applying the exchange rate on the date of transaction except inventory
Recognition of exchange difference	Exchange difference shall be recognized as income or expense in the previous year	Exchange difference shall not be recognized as income or expense.

K C Mehta & Co.
Chartered Accountants

Foreign Operation

- The financial statement of foreign operation shall be translated using the principles and procedures in para 3 to 6, as if the transaction is of the foreign operation had been those of the person himself.

Para 15 and 31 of AS 11

- Para 15 of AS 11: Exchange difference pertaining to monetary item that in substance part of the non-integral foreign operation shall be accumulated in foreign currency translation reserve until the disposal of net investment at which time they shall be recognized as income or expense in accordance with para 31.

- Para 31 of AS 11: On disposal of non-integral foreign operation the accumulated balance of exchange difference which has been deferred and which relates to operation should be recognized as income or expense in the same year in which gain or loss on disposal is recognized

FAQ-16

Q. What is the taxability of opening balance as on 1st day of April 2016 of Foreign Currency Translation Reserve (FCTR) relating to non-integral foreign operation, if any, recognized as per Accounting Standards (AS) 11?

Answer:

FCTR balance as on 1 April 2016 pertaining to exchange differences on monetary items for non-integral operations, shall be recognized in the previous year relevant for assessment year 2017-18 to the extent not recognized in the income computation in the past.

Transitional Provision (ICDS 6)- Foreign Operation

- VT Ltd. is engaged in the business of power generation. VT ltd is having an independent operating unit (Branch) located in USA which is non integral foreign operation as per AS 11 and as per ICDS 6. For the FY 2014-15 the financials of VT Ltd. shows debit balance of FCTR of Rs.5 Cr. The balance of FCTR as on 31.03.2016 as per the Audited Balance sheet comes to Rs.4 Cr. as under;

Particulars	Dr (In Cr)	Cr (In Cr)
Opening Balance of FCTR	5.00	
Adjustment during the Year		
Restatement of Monetary items		1.50
Restatement of Non-monetary items	0.50	
Closing Balance of FCTR	**4.00**	

- Out of the total restatement of monetary item represents the foreign borrowing, exchange fluctuation of Rs.1.00 Cr. Is attributable to exchange difference on foreign borrowing utilised for the purpose of acquisition of assets in USA.

K C Mehta & Co.
Chartered Accountants

Forward Exchange Contract

- Any **premium of discount** arising on forward exchange contract shall be amortized as expense or income over the life of the contract.
- **Exchange difference** on such contract shall be recognized as income or expense in the previous year in which the exchange rate changes.
- **Profit or loss arising on cancellation or renewal** shall be recognized as income or expense for the previous year.
- Exceptions:
  - Trading or Speculation purpose
  - Contract to hedge firm commitment or highly probable forecast transaction
  - Recognition - @ time of settlement of contracts

Transitional provision

1. All foreign currency transactions undertaken on or after 1st day of April, 2016 shall be recognized in accordance with the provision of tis standard.

2. Exchange difference arising in respect of monetary items or non-monetary items, on the settlement thereof during the previous year commencing on 1st day of April, 2016 or on conversion thereof on the last day of previous year commencing on the 1st day of April, 2016, shall be recognized in accordance with the provision of this standard **after taking into account the amount recognized on the last day of the previous year ending on the 31st Day of Mach 2016 for an item, which is carried forward from said year.**

3. The financial statement of FO for the previous year commencing on the 1st Day of April, 2016 shall be translated using the principles and procedure specified in the standard after taking into account the amount recognized on the last day of the previous year ending on the 31st day of March 2016 for an item, which is carried forward from that year.

Other points for considerations

- ICDS 5 and ICDS 6- Component of Actual cost
  - In ICDS 6, there is no mechanism such adjustment is prescribed
- Para 46A of AS 11
  - Reconciliation of P & L and Reserve Account is required to be made
- Foreign borrowings utilized for acquisition of indigenous Assets
  - Decisions of SC
  - Section 43A

ICDS 7
Government Grants

Scope of ICDS 7

- This ICDS deals with treatment of Government Grant. (Subsidies, cash incentives, Duty drawbacks, waiver, concession, reimbursement etc.)
  - *Government* as per para 3(1)(a) includes state government, central government, agencies and similar bodies whether local, national **or international**.
  - *Government Grant*: Government grant are government assistance in cash or kind to a person for past or future compliance with certain conditions.
  - Recognition of Government Grant
    - When there is reasonable assurance that person shall comply with the conditions and,
    - The grant shall be received
  - **<u>Recognition of government grant shall not be postponed beyond the date of actual receipt</u>.**

Treatment of Government Grant

Government grant relating to Depreciable Fixed Asset (Para 5)	Shall be reduced form the cost of asset or WDV as the case may be
Government grant relating to Non-Depreciable Fixed Asset or Assets, requiring fulfillment of certain conditions (Para 6)	Shall be recognized as income of the same period in which the cost of meeting such obligation is charged to income.
When the government grant is of such nature that it cannot directly relate to the asset acquired (Para 7)	Shall be apportioned in the ratio of such asset to total assets in respect of or with reference to which the government grant is so received and shall be reduced form the cost or WDV as the case may be.
For compensation of expenses or losses incurred in the previous financial year for the purpose of giving immediate financial support with no further related cost (Para 8)	Shall be recognized as income of the period in which it is receivable.

K C Mehta & Co.
Chartered Accountants

Treatment of Government Grant (Cont.)

Other than mentioned above (Para 9)	To be charged to P&L as income over the period necessary to match them with related cost which they are intended to compensate
The Government grant in the form of non-monetary assets, given at concessional rate (Para 10)	Assets shall be accounted for, on the basis of their acquisition cost.

Refund of Government Grant

Other than depreciable asset (Para 6,8,9)	Shall be applied first against any unamortized deferred credit remaining in respect of government grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount shall be charged to Profit and loss account.
Relating to Depreciable asset	By **<u>increasing the cost or WDV</u>** and depreciation on revised cost may be claimed prospectively.

Disclosure and 3CD

- Nature and extent of GG recognized during the year by way of deduction from the actual cost or WDV
- Nature and extent of GG recognized as income during the previous year
- Nature and extent of GG not recognized during the year by way of deduction from cost or WDV and reasons thereof
- Nature and extent of GG not recognized during the year as income and reasons thereof.

Other points for consideration

- In case block of asset ceases to exist then what would be the implication of refund of government grant referable to said asset?
  - Depreciation on notional block
- Scope of explanation 10 to 43(1) is much wider than ICDS 7.
  - Explanation 10 includes assistance from government or **any other person** whereas ICDS 7 only speaks about **'Government'.**

Transitional Provision

- All the GG which meet the recognition criteria as per para 4 on or after 1st Day of April, 2016 shall be recognised for the previous year commencing on or after 1st Day of April, 2016 in accordance with this ICDS after taking into account the amount, if any, of the said GG recognised for any previous year ending on or before 31st March 2016.

Scenario	Implication under ICDS
GG (Non-Depreciable Asset) sanctioned during the FY 2015-16 but payment was not disbursed by 31.03.2016. Under AS 12 it was not recognised.	FAQ-17
GG relating to depreciable asset was sanctioned in FY 15-16. Under AS 12 the same has been deducted from the cost and depreciation has been claimed on residual cost. In FY 16-17, due to contravention of conditions, the same is refunded.	To increase WDV
GG relating to non depreciable asset was received in FY 15-16. the same had been shown as capital Reserve. This GG is refunded in FY 16-17.	FAQ 17

ICDS 7	AS 12
Recognition of Government grant shall not be postponed beyond the date of actual receipt.	Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.
Government Grant other than grant for depreciable asset, shall be recognized as income over the period to match the cost intended to meet.	Grant related to Revenue – charged to Profit and Loss Account. Grant related to Depreciable Asset- either to reduce from the cost or treated as Deferred income. Other than Depreciable asset- Capital Receipt.

ICDS 8

Securities

K C Mehta & Co.
Chartered Accountants

ICDS 8

- Part A
  - Other than entities specified in part B
- Part B
  - Applicable to Scheduled Bank or Public Financial Institution formed under a Central or State Act or so declared under the Companies Act, 2013.
  - Recognition shall be in accordance with the guideline issued by RBI. Excess shall be ignored.

Part A

- This ICDS deals with the securities which are held as **stock in trade.**
- This ICDS does not deal with;
  - **Recognition of interest and dividend** on securities which is governed by ICDS 4
  - Securities held by person engaged **in Insurance business**
  - Securities held by **Mutual Funds, Venture Capital, Banks and Public Financial Institution** formed under State or Central Act or so declared by Companies Act 2013
- Securities: Excludes Derivatives
- Fair Value: at Arm's length price

Derivative

FAQ-8	FAQ-10
Q. Para 4(ii) of ICDS-I provides that Market to Market (MTM) loss or an expected loss shall not be recognized unless the recognition is in accordance with the provisions of any other ICDS. Whether similar consideration applies to recognition of MTM gain or expected incomes?	Q. Which ICDS would govern derivative instruments?
Answer: Same principle as contained in ICDS-I relating to MTM losses or an expected loss shall apply *mutatis mutandis* to MTM gains or an expected profit.	Answer: ICDS- VI (subject to para 3 of ICDS-VIII) provides guidance on accounting for derivative contracts such as forward contracts and other similar contracts. For derivates, not within the scope of ICDS-VI, provisions of ICDS-I would apply.

K C Mehta & Co.
Chartered Accountants

Recognition and measurement

<table>
<tr><th>Initial Recognition</th><th>Subsequent Measurement</th></tr>
<tr><td>Security on acquisition shall be recognized at actual cost.</td><td rowspan="4">Actual cost initially recognized or net realizable value whichever is lower.

For the above comparison, composition of actual cost or net realizable value shall be done <u>category wise</u> and not for each individual security.</td></tr>
<tr><td>Actual cost of the security shall comprise of its actual cost and includes acquisition charges such as brokerage, taxes, duty or cess.</td></tr>
<tr><td>In case security is acquired in exchange of other security, the fair value of the security so acquired shall be its actual cost</td></tr>
<tr><td>In case security is acquired in exchange of other asset, the fair value of the security so acquired shall be its actual cost</td></tr>
</table>

Categories:

- Shares
  - Listed
  - Listed but not quoted
  - Unlisted
- Debt Securities
- Convertible Securities
- Any other securities not covered above

Valuation Method

Scripts	Cost (Rs. In lacs)	NRV (Rs. In lacs)	Valuation as per ICDS	Valuation as per Book
ABB Ltd.	100.00	90.00		90.00
Bharat Forge	125.00	200.00		125.00
Castrol	75.00	80.00		75.00
SBI Ltd.	50.00	10.00		10.00
NTPC Ltd	50.00	10.00		10.00
Listed Shares	400.00	390.00	390.00	310.00
A Ltd.``	100.00	10.00		10.00
B Ltd.	100.00	10.00		10.00
Listed but not quoted	200.00	20.00	200.00	20.00
Total	600.00	410.00	590.00	330.00
(Loss)/Profit			(10.00)	(270.00)

K C Mehta & Co.
Chartered Accountants

Para 12 of ICDS 8

"Notwithstanding anything contained in para 9,10 and 11, at the end of previous year, **securities not listed on recognised stock exchange; or listed but not quoted on a recognised stock exchange with regularity from time to time, shall be valued at actual cost initially recognised.**"

Closing Inventories	31.03.2016 (Cost)	31.03.2016 (NRV)	31.03.2017 (ICDS)*
A Ltd. (Quoted _not Traded)	100.00	10.00	
B Ltd. (Quoted _not Traded)	100.00	10.00	
Total	200.00	20.00	20.00
Valuation (For computation)		20.00	200.00
Profits/(Loss) to be recognised		(180.00)	180.00

* Stock is unsold as on 31.03.2017. As per para 12, the said securities need to be valued at **cost. Thus, the incremental impact is on profit. (200 -20)**

K C Mehta & Co.
Chartered Accountants

Other points for considerations

- Explanation to Section 73 and ICDS 8
  - The provision will continue to apply.
- Capital Gain income is assessed as Business income u/s 143(3).
  - The provision of ICDS will apply once the income is assessed. Valuation benefit, if any, available should be pointed out.
- ICDS 2 and ICDS 8 (Dissolution of Firm)
  - Firm engaged in the business of dealing in securities. If the firm is dissolved, how to determine valuation of the securities under ICDS 8?

ICDS 9
Borrowing Cost

K C Mehta & Co.
Chartered Accountants

Overview of ICDS

- ICDS 9 deals with the treatment of borrowing cost.
  - Amount of borrowing cost eligible for capitalization shall be determined as per ICDS 9.
  - ICDS 9 however does not deal with the actual or imputed cost of owners equity and preference share capital.
- Borrowing costs are interest and **other costs** incurred by a person in connection with the borrowing of the funds and includes;
  - Commitment charges on borrowing
  - amortized amount of discount or premium relating to borrowing
  - Amortized amount of ancillary costs incurred in connection with the arrangement of borrowing
  - Finance charges in respect of assets acquired under the finance lease or under other similar arrangement

Qualifying Assets

Qualifying Assets (QA) includes:

- land, building machinery, plant or furniture being tangible assets
- Know-how, patents, trade marks, licenses, franchise or any other business or commercial rights of similar nature being intangible assets
- Inventories that require a period of 12 months or more to bring them to a saleable condition.

Recognition:

- The borrowing costs directly attributable to acquisition, construction, or production of a QA is to be capitalised as a part of actual cost.

Manner of capitalization

Specific Borrowing

- Actual amount of borrowing cost incurred during the period on the funds so borrowed shall be capitalised.
- Capitalisation shall *commence* from the **date of borrowing** of funds till the asset is first put to use.

General Borrowing

- A x B/C
- A = Borrowing cost (excluding specific borrowing cost)
- B= Average Assets (QA)- As per Table
- C= Average of Total Assets (other than those Assets acquired out of specific borrowing) as appearing on the first and last day of the PY
- Capitalization commences from date of **utilisation** till the asset is first put to use.

Average QA- how to determine

QA appears on first and last day	• The average of the QA as appearing on first and last day of the PY (A1)
QA does not appear on first day or both on first and last day	• ½ the cost of QA (A2)
QA does not appear on last day	• The average of the cost of QA as appearing on the first day and that on the date of put to use or completion as the case may be. (A3)

Calculation of Borrowing Cost eligible for ICDS IX

- Loan sanctioned for purchase of assets from ICICI Bank on 01.01.2016 of Rs.100 lacs at 10%.
- As per the term of the agreement, loan needs to be utilised within 6 months else commitment charges to be paid of 1%.
- The loan disbursed in August 2016. Stamping and commission on loan amounts to Rs.1.5 lacs. Loan processing fees paid at Rs.0.05 lacs. Interest paid is Rs.8 lacs.

Particulars	Borrowing Cost.
Interest Paid	8.00
Stamping and Commission paid	1.50
Commitment Charges	1.00
Loan Processing fees	0.05
Total	10.55

Cessation of capitalization in part

- Cessation in part
  - Tangible/Intangible Assets
    - When such part of asset is first put to use
  - Inventories
    - When substantially all activities necessary to prepare such part of inventory for its intended sale are complete

Disclosure

- Transitional Provision:
  - All borrowing cost incurred on or after 01.04.2016 shall be capitalized for the previous year in accordance with this standard after taking into account the borrowed cost already capitalized earlier
- Disclosure:
  - Accounting policy adopted for borrowing cost, and
  - Amount of borrowing costs capitalized during the year

Other points for consideration

- Netting off income arising from temporary investments against the borrowing costs under ICDS 9
  - The provision of ICDS is in line with the settled judicial precedent i.e., “Not be reduced from the cost.”
- Exchange fluctuation attributable to Interest under AS 16 and ICDS 9
  - Since the provision of ICDS 9 does not cover the exchange fluctuation on interest as a part of the borrowing cost, same needs to be recognized as per ICDS 6 on Exchange fluctuation.

Land – Put to use

- How to determine the date of put to use in case of land?
  - "Intended Use"
  - Land is purchased out of the specific borrowing of Rs.10 Cr. Interest paid is Rs.1 cr. The land is acquired for construction of corporate house. The construction completed within 9 months.
    - ICDS 9 will be applicable. Interest attributable for 9 months needs to be capitalised.
    - (Capital Gain on sale of Land- can we claim BC capitalised as cost of Capital Asset?)
  - Land is acquired but there is no immediate intention of construction on it.
    - No capitalisation of Borrowing cost.
  - Land is held as Stock in trade and construction takes place around 11 months only.
    - ICDS 9 is not applicable.

Borrowing Cost disallowed under specific provision of the Act (FAQ-20)

Particulars	Scenario 1 (Lacs)	Scenario 2 (Lacs)	Scenario 3 (Lacs)
Total Interest paid (General Borrowing)	250.00	250.00	250.00
Disallowance (As per Rule 8D)	(15.00)	(15.00)	--
Excessive interest u/s 40A(2)(b)	(50.00)	(50.00)	--
Disallowance u/s 40a(ia) -Non deduction of TDS on Interest	(50.00)	--	--
Interest eligible for capitalisation (ICDS 9)	135.00	185.00	250.00

Scenario 1: All the disallowance under the specific provisions of the Act should be eliminated for working under ICDS 9.

Scenario 2: Only permeant disallowances like 14A, 40A(2)(b) need to be eliminated while working under ICDS 9.-Rational approach

Scenario 3: No effect of any disallowance. –not permissible.

K C Mehta & Co.
Chartered Accountants

1. Thin Capitalization u/s 94B

2. GAAR – Section 98 Consequences of IAA

ICDS 9	AS 16
exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest cost are not covered under this ICDS.	AS 16 include exchange difference arising from foreign currency borrowing attributable to interest .
Borrowing cost not eligible for capitalization – Shall be claimed as per the I T Act.	Shall be charged to profit and loss account.
the income from temporary investments of those borrowings is not reduced from the amount of borrowing costs incurred	The amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period **less any income on the temporary investment of those borrowing**

ICDS 9	AS 16
General Borrowing – Capitalization as per the Formula	Capitalization should be determined by applying a capitalisation rate to the expenditure on that asset. i.e weighted average rate of the borrowing cost
Commencement of Capitalization - Depends upon specific borrowing or general borrowing	Capitalisation commence when all the following conditions are satisfied: expenditure for the acquisition, construction or production of a qualifying asset is being incurred; borrowing costs are being incurred; and activities that are necessary to prepare the asset for its intended use or sale are in progress.

K C Mehta & Co.
Chartered Accountants

ICDS 9	AS 16
Cessation of capitalization – When Asset is put to use.	Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
Suspension of capitalization – Not covered in ICDS	Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.- Such expense to be charged to P & L.

ICDS 10

Provisions, contingent liabilities, and contingent assets

K C Mehta & Co.
Chartered Accountants

Scope

- Deals with the Provisions, Contingent Liability, Contingent Assets except:
  - Resulting from the Financial Instruments
  - Resulting from Executory contracts
  - Arising in Insurance business
  - Covered by other ICDS's
- This ICDS does not deal with the recognition of Revenue.
- The term 'provision' is also used in the context of Depreciation, impairment and doubtful debts which are adjusted to carrying amounts of assets and are not addressed in this ICDS

Recognition

- Provisions:
  - Person has present obligation as a result of past event
  - It is reasonably certain that an outflow of resources embodying economic benefit will be required to settle the obligation, and
  - Realistic estimates can be made of the amount of obligation.
  - Only those obligations arising from past events existing independently of person's future action that are recognized as provision.

Recognition

- Contingent Liability:
  - Not to be recognised

- Contingent Assets:
  - Not to be recognised
  - Contingent Assets are assessed continually and when it becomes reasonably certain that inflow of economic benefit will arise, **the asset and related income are recognized in the previous year in which the change occurs**

Reasonable certainty
Vs.
Virtual certainty

Disclosure

- Provision:
  - Description of nature of obligation
  - Carrying amount at beginning & end of P.Y.
  - Additional provisions made & unused amounts reversed during P.Y.
  - Amount of any expected reimbursement, stating the amount of any asset recognized for that reimbursement.
- Contingent Assets & related Income:
  - Brief description of the nature of asset & related income
  - Carrying amount of asset at beginning & end of P.Y.
  - Additional amount of asset & related income recognized during the year
  - Amount of asset & related income reversed during P.Y.

Thank You

K C Mehta & Co.
Chartered Accountants

Vadodara: Meghdhanush, Race Course, Vadodara 390 007, INDIA
Phone: +91 265 2341 626 / 3086 400 Fax: +91 265 3086 444/455/466

Mumbai: 101, Cosmos Court, Above Waman Hari Pethe, S.V. Road, Vile Parle (west),
Mumbai 400 056 INDIA Phone: +91 22 261 25 834

Ahmedabad: 308, Aaryan Workspaces, St. Xaviers' College Corner, Umashankar Joshi Marg,
Navrangpura, Ahmedabad - 380 009, INDIA Phone: +91 79 403 26 400

e-mail: office@kcmehta.com; **website:** www.kcmehta.com