

Income Computation & Disclosure Standards ('ICDS')

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Background

- Section 145(2) of The Income Tax Act, 1961 empowers the Central Government to notify the Accounting Standards to be followed by the assesseees or in respect of any class of income.
- The CBDT Vide Notification no. 33/2015 dated 31-03-2015 notified 'ICDS' applicable from 1-04-2015 (i.e. A.Y. 2016-17).
- ICDS issued for the purpose of Computation of Income under “Profit and Gains of Business or Profession” and “Income from Other Sources” & not for the purpose of maintenance of books of accounts.
- ICDS to be followed by assesseees following mercantile system of accounting.
- In case of conflict between ICDS and Act, provisions of Act shall prevail

ICDS Coverage

- **ICDS V** : Tangible Fixed Assets
- **ICDS VI** : The Effects of changes in Foreign Exchange Rates
- **ICDS IX** : Borrowing Cost

ICDS V: Tangible Fixed Assets

- Contents of ICDS V:
 - Scope
 - Definition of Tangible Fixed Asset
 - Components of Actual Cost
 - Treatment of spare parts
 - Non-monetary consideration
 - Improvement & Repairs
 - Inspection Costs
 - Transitional Provision
 - Disclosure Requirements

Scope

- The standard deals with the treatment of Tangible Fixed Assets

Definitions

- Definition of Tangible Fixed Asset

- Assets being Land, Building, Machinery, Plant or Furniture held with the intention of being used for the purpose of producing goods and services and is not held for sale in the normal course of business.
- The definition gives criteria for determining classification of an item as an asset.

- Indian GAAP (AS 10) vis-a-vis ICDS

- The Definition of Tangible Fixed Assets is in line with AS 10
- Option of expensing off an expenditure which otherwise could have been included as fixed asset is available only under AS 10 and not under ICDS. This will result in onerous compliance and record keeping.

Actual Cost

▪ Components of Actual Cost

- Cost shall comprise of purchase price, import duties and other taxes excluding recoverable taxes & other directly attributable expenses.
- Expenditure incurred on test runs and experimental production to be capitalized.
- The expenses incurred during the interval between readiness of the project to commence its production and the commencement of actual production are allowed to be expensed out or deferred over the period of 3-5 years as per AS 10 but ICDS is silent on the treatment of these expenses.
- The above mentioned principles shall also apply in valuation of Self Constructed Tangible Fixed Assets.

▪ Treatment of Spare Parts as Per ICDS

- Spares which can be used 'only' in connection with the asset and their use is expected to be irregular are to be capitalized (insurance spares)
- Under AS 10, cost of the spares is allocated over the period of useful life of the principal items (insurance spares)

- Non Monetary Consideration

- Tangible fixed asset is acquired in exchange for another asset, shares or other securities, the fair value of the tangible fixed asset so acquired shall be its actual cost.
- The criteria's for determining fair value are different under AS 10.

- Improvements & Repairs

- An expenditure that increases the future benefits from existing assets beyond previously assessed standard of performance is added to actual cost.
- Similar treatment in AS 10.

- Inspection Costs

- No clarity under ICDS relating to capitalization of inspection cost.
- However, these costs do not increase future economic benefits. Hence, it can be inferred that such cost may not be added to cost of assets under ICDS

Transitional Provision

- The cost of asset, the acquisition or construction of which commenced before 31st March 2015 but not completed by the said date, shall be recognized in accordance with the provisions of this standard.

Disclosure Requirements

Following Disclosure Requirements are laid down under ICDS V

- Description of assets or block of assets
- Rate of depreciation
- Actual Cost or Written Down Value
- Additions and deductions during the year
 - Date of Put To Use (note required under AS 10),
 - Adjustments on account of indirect tax credit claimed and allowed,
 - Change in rate of currency,
 - Subsidy or grant or reimbursement received
- Depreciation allowable
- Written down value as at the end of the year

All the mentioned Disclosures are in Line with the disclosure requirements under Form 3CD

ICDS VI - The effects of changes in Foreign Exchange Rates

- Contents of ICDS VI:
 - Scope
 - Key Definitions
 - Initial Recognition
 - Conversion at Year End
 - Recognition of Exchange Differences
 - Foreign Operations – Classification & Translation of Accounts
 - Forward Exchange Contracts
 - Transitional Provision

Scope

- The standard deals with
 - Treatment of transactions in foreign currencies
 - Translating the financial statements of foreign operations
 - Treatment of foreign currency transactions in the nature of forward exchange contracts

Key Definitions

Definitions

- Various terms used in the standard with the meanings specified are similar to definition given in AS 11, except foreign operations

Key Definitions

- “Foreign currency transactions” is a transaction denominated in or requires settlement in a foreign currency, including transactions arising when a person
 - buys or sells goods or services
 - borrows or lends funds
 - becomes party to unperformed forward exchange contract
 - Acquires or disposes off assets or incurs or settles liabilities
- “Foreign operations 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.

Key Definitions.....contd.

- “Monetary items” are money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money. Cash, receivables, and payables are examples of monetary items
- “Non-monetary items” are assets and liabilities other than monetary items. Fixed assets, inventories, and investments in equity shares are examples of non-monetary items.
- “Forward exchange contract” means an agreement to exchange different currencies at a forward rate, and includes a foreign currency option contract or another financial instrument of a similar nature .

Initial Recognition

- Initial Recognition of foreign currency transaction shall be as per the exchange rate on the date of transaction
- If the exchange rate does not fluctuate significantly, average rate for week or month can be considered for conversion
- However, if rate fluctuates significantly, rate on the date of transaction to be considered

Conversion at Year End

■ Monetary Items

- Foreign currency monetary items are converted into reporting currency by applying closing rate.
- To factor in currency restrictions volatility, it allows recognition at below closing rate where the restriction etc. is likely to get reduced net realization value of the monetary item for the assessee e.g. Receivables in Russian Roubles

■ Non-Monetary Items

- Such items are converted into reporting currency as on the date of transaction. These items are not restated as per the prevailing closing rate

■ Provisions of Indian GAAP (AS 11)

- The provisions of As 11 are in Line with the above mentioned provisions

Recognition of Exchange Differences

- Monetary Items
 - Differences arising on settlement or last day of previous year to be recorded as income or expenses.

- Non-Monetary Items
 - These items are recorded at the exchange rate as on the date of transactions and hence, no income or expense shall be recognised as at the end of previous year.

 - The provisions of AS 11 are in line with ICDS

 - Recognition of exchange difference shall be subject to provisions of section 43A of the Act or Rule 115 of the Rules, as the case may be.

Classification of Foreign Operations

- Foreign Operations are divided into two parts
 - Integral Foreign Operations.
 - Non-Integral Foreign Operations.

- The Classification as Non-integral Foreign Operations is based on following factors
 - Significant degree of autonomy
 - Proportion of Transactions out of total foreign transactions
 - Financing of foreign operations or activities
 - Payment or settlement for Labour, material or other components
 - Cash flows of the foreign operations
 - Presence of Active Local Sales Market

- The criterias for classification of foreign operations are in line with AS 11

Translations of Foreign Operations

■ Integral Foreign Operations

- The financial statements shall be translated using the principles and procedures as if the transactions of the foreign operation had been those of the entity itself.
 - Monetary Assets: Translated at closing rate
 - Non Monetary Assets: Translated at transaction rate

■ Non Integral Foreign Operations

- Assets & Liabilities : Monetary and non monetary assets will be translated at closing rate
 - Income & Expense items shall be translated at the rate of on the date of transactions
 - Resulting Exchange differences shall be recognised as income or expenses. However as per AS 11 the resulting exchange difference is accumulated in foreign currency translation reserve until the disposal of investment
- Provisions of ICDS are in line with AS 11 except as referred above.

Forward Exchange Contract

- The forward contract is entered into to establish the amount of the reporting currency required or available at the settlement date of the transaction.
- Premium or discount on arising at the inception of forward contract shall be amortized as expense or income over the life of contract.
- Exchange difference on contract shall be recognised in previous year in which the exchange rates change
- The above mentioned provisions are not applicable to Contracts for trading or speculative purpose.
- For other forward exchange contracts that are intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each Balance Sheet date the value of the contract is marked to its current market value and the gain or loss is recognized.
- The provisions of ICDS are in line with AS 11

Transitional Provision

- All foreign currency transactions undertaken on or after 1st day of April, 2015 shall be recognised in accordance with the provisions of the standard.
- Exchange differences arising in respect of monetary or non-monetary items, on the settlement thereof during the previous year commencing on 1st day of April, 2015 shall be recognised in accordance with the provisions of the standard.
- The financial statements of foreign operations for the previous year commencing on the 1st day of April, 2015 shall be translated using the principles and procedures specified in the standard.
- All forward exchange contracts existing on the 1st day of April, 2015 or entered on or after 1st day of April, 2015 shall be dealt with in accordance with the provisions the standard.
- There are no specific disclosure requirements laid down under ICDS VI

ICDS IX- Borrowing Costs

- Contents of ICDS IX:
 - Scope
 - Definition of Borrowing Cost & Qualifying Assets
 - Recognition
 - Eligibility of Borrowing Costs for Capitalization
 - Commencement & Cessation of Capitalization
 - Transitional Provision
 - Disclosure

Scope

- The standard deals with treatment of borrowing cost
- The standard does not deal with actual or imputed cost of owner's equity and preference share capital.

Definition

Borrowing Costs shall include

- Commitment charges on Borrowings
- Amortised amount of premium and Discounts
- Finance charges in respect of assets under finance lease
- Ancillary costs in connection with arrangements of borrowings.

Qualifying Asset means

- Land, Building, Machinery plant or furniture, being tangible asset
- Know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature being intangible assets
- Inventories that require a period of twelve months or more to bring them to a saleable condition.

Continued...

- Qualifying Asset as per Indian GAAP (AS 16)

Qualifying asset is one which takes substantial period of time to get ready for its intended use or sale.

Recognition of Borrowing Costs

- Borrowing costs that are directly attributable to acquisition , construction or production of a qualifying asset shall be capitalized.
- Similar provision under AS 16.
- Borrowing costs eligible for capitalization shall be determined in accordance with ICDS & other borrowing cost shall be dealt in accordance with provisions of The Act.
- Income on Temporary investments of those borrowings cost eligible for capitalization is not reduced by any income on temporary investment under ICDS. However, the same is reduced from Borrowing cost under AS 16.
- The provision of ICDS is in line with the settled judicial precedence.

Eligibility of Borrowing Cost for Capitalization

- Specific Borrowings

The funds borrowed specifically for the purpose of acquiring of a qualifying asset, the amount of borrowing cost to be capitalized on that asset shall be the actual borrowing cost incurred during the period of the funds so borrowed. This is in line with AS 16.

- General Borrowing

The funds are borrowed generally and utilized for the purpose of acquisition of a qualifying asset, the amount of borrowing cost to be capitalized shall be as per formulae.

For the purpose of AS 16, the borrowing cost is related to the actual period for which the borrowing was outstanding. Whereas the ICDs considers the borrowings only on the first day and last day of the year

This method is likely to give rise to huge litigation.

Commencement of Capitalization

ICDS

- In a case where there are specific borrowings for qualifying asset, from the date on which funds were borrowed;
- In a case where there are general borrowings, from the date on which funds were utilised.

AS 16

- Capitalization of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied:
 - (a) expenditure for the acquisition, construction or production of a qualifying asset is being incurred;
 - (b) borrowing costs are being incurred; and
 - (c) activities that are necessary to prepare the asset for its intended use or sale are in progress

However capitalization of borrowing cost is suspended during extended period in which active development is interrupted (In ICDS this is not considered)

Cessation of Capitalization

ICDS

- In case of inventory, when substantially all the activities necessary to prepare such inventory for its intended sale are complete;
- In case of other qualifying assets, when such asset is first put to use (explanation 8 to Section 43 (1))

AS 16

- Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete
- When the asset is ready to use but has not been put to use, borrowing cost shall not be capitalized under AS 16. However it is required to be capitalized under ICDS IX

Transitional Provision

- Transitional provision has been carved out to ensure that the borrowing cost capitalized in past is not required to be recomputed.

Disclosure

- Accounting policy adopted for borrowing costs
- Amount of borrowing costs capitalized during the year

Thank you!!!