UPDATES
ON
Income Computation and Disclosure Standard

CA Haridas Bhat

GMJ & Co.

Transitional Provisions

- The ITR had a special clause for disclosing the transitional provisions
- Same is continued for the A. Y. 2018-19 also in the new ITR

Amendments in the Act

Finance Act 2018 (Budget)

- This amendment will take effect retrospectively from 1st April, 2017 (A. Y. 2017-2018)

MTM

Section 36(1) - Other deductions

- deduction in respect of any marked to market loss or other expected loss shall be allowed, if computed in accordance with the income computation and disclosure standards notified

Section 40A - Expenses or payments not deductible in certain circumstances

- no deduction or allowance shall be allowed in respect of any marked to market (MTM) loss or other expected loss except as allowable under the new clause 36(1)(xviii)

Taxation of Foreign Exchange Fluctuation

New section 43AA -

- subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, and such gain or loss shall be computed in accordance with the income computation and disclosure standards
- gain or loss arising on account of the change in foreign exchange rates shall be in respect of all foreign currency transactions including those relating to monetary items and non-monetary items or translation of financial statements of foreign operations or forward exchange contracts or foreign currency translation reserves.

Computation of Income from Construction and Service Contracts

New section 43CB -

- profits and gains of a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method in accordance with the income computation and disclosure standards
- in the case of a contract for providing services with duration less than ninety days, the profits and gains shall be determined on the basis of project completion method
- in the case of a contract for provision of services involving indeterminate number of acts over a specific period of time, the profits and gains arising from such contract shall be determined on the basis of a straight line method
- for this purpose the contract revenue shall include retention money and the contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains

Valuation of Inventory

New section 145A –

- the valuation of inventory shall be made at lower of actual cost or net realisable value in accordance with the ICDS;
- the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation;
- the valuation of inventory being securities not listed on a 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 in accordance with the ICDS.
- inventory being securities other than those referred to in clause (iii), shall be valued at lower of actual cost or net realisable value in accordance with the ICDS and for this purpose the comparison of actual cost and net realisable value shall be done category-wise.
- any tax, duty, cess or fee, by whatever name called, under any law for the time being in force, shall include al l su ch p ay me nt n ot wi th st and in g an y ri ght ar is in g as a consequence to such payment for the purposes of the said section.

Interest on compensation

- **New section 145B –**
- that notwithstanding anything to the contrary contained in section 145, the interest received by an assessee on any compensation or on enhanced compensation, as the case may be, shall be deemed to be the income of the year in which it is received.
- the claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.
- i n c o m e (**Subsidy)** r e f e r r e d t o i n sub-clause (xviii) of clause (24) of section 2 shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year.

Income Computation and Disclosure Standard I
Accounting Policies

This ICDS is not applicable for -

- Cash Method of Accounting
- Individual and HUF not subject to Tax Audit

Accounting Policies

- true and fair view
- substance over the form
- marked to market loss
- Shall not be changed without reasonable cause

Disclosure Requirements of Accounting Policies

- All significant accounting policies adopted by a person
- Any change in an accounting policy which has a material effect
- The amount by which any item is affected by such change to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact shall be indicated
- If a change is made in the accounting policies which has no material effect for the current previous year but which is reasonably expected to have a material effect in later previous years, the fact of such change shall be appropriately disclosed in the previous year in which the change is adopted and also in the previous year in which such change has material effect for the first time
- Non Compliance of Fundamental Accounting Assumptions of -
  - Going Concern
  - Consistency
  - Accrual

Income Computation and Disclosure Standard II

Valuation of Inventories

Scope

Applied for valuation of inventories, **except** :

- Work-in-progress arising under '**Construction Contract**'
- Work-in-progress which is dealt with by **other ICDS**
- **Shares, debentures and other financial instruments** held as stock-in-trade (dealt under ICDS VIII)
- Producers' inventories of **livestock, agriculture and forest products, mineral oils, ores and gases** to the extent that they are measured at net realizable value
- **Machinery spares**, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular (dealt under ICDS V)

Inventories are assets:

- 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.

Measurement

Inventories shall be valued at

- **Cost** or
- **Net Realisable Value**, whichever is lower.

Net Realisable Value

- estimated selling price in the ordinary course of business less
- the estimated costs of completion and the estimated costs necessary to make the sale.

Determination of Cost

Cost of Inventories comprises of all

A. Costs of Purchase
B. Costs of Services
C. Costs of conversion
D. Other costs incurred in bringing the inventories to their present location and condition

A. <u>Costs of Purchase</u>

purchase price including

- duties and taxes
- freight inwards
- other expenditure directly attributable to the acquisition

Trade discounts, rebates and other similar items shall be deducted in determining the costs of purchase

B. <u>Costs of Services</u>

- **labour** and
- **other costs of personnel** directly engaged in providing the service including supervisory personnel and attributable overheads.

C. <u>Costs of Conversion</u>

- **costs directly related to the units of production** and
- systematic allocation of **fixed and variable production overheads** that are incurred in converting materials into finished goods

- ✓ The **allocation of fixed production overheads** to be based on the **normal capacity** of the production facilities

- ✓ The amount of fixed production overheads allocated to each unit of production **not to be increased** as a consequence of low production or idle plant

- ✓ **Unallocated overheads** to be **recognised as an expense** in the period in which they are incurred

- ✓ In periods of **abnormally high production**, the amount of fixed production overheads allocated to each unit of production is to be **decreased** so that inventories are not measured above the cost

- ✓ **Variable production overheads** shall be assigned to each unit of production on the basis of the **actual use** of the production facilities

✓ **<u>Where a production process results in more than one product being produced</u>**:

Costs of Conversion of each product are **not separately identifiable**

↓

costs to be allocated on a **rational and consistent basis**

<u>By-products, scrap or waste material are **immaterial**</u>:
Measured at NRV and deducted from the cost of the main product

D. <u>Other Costs</u>

To be included only to the extent that they are incurred **in bringing the inventories to their present location and condition**

Interest and other borrowing costs shall **not** be included unless they meet the criteria for recognition of interest as a component of the cost as specified in the Income Computation and Disclosure Standard on borrowing costs

Exclusions from the Cost of Inventories

- **Abnormal** amounts of wasted materials, labour, or other production costs
- **Storage costs**, unless those costs are necessary in the production process prior to a further production stage
- Administrative overheads that do not contribute to bringing the inventories to their present location and condition
- **Selling costs**

Cost Formulae

Specific Identification of Cost Method

- Specific costs are attributed to identified items of inventory
- Suitable for Cost of inventories of items that are **not ordinarily interchangeable**
- Where there are a **large numbers of items** of inventory which are **ordinarily interchangeable**, specific identification of costs not to be made

First-in First-out and Weighted Average Cost Formula

- Cost of inventories, other than those for which Specific Identification of Cost Method can be used, shall be assigned by using the First-in First-out FIFO, or weighted average cost formula
- Formula used shall reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition

Retail Method

- To be used where it is **impracticable to use other costing methods**
- Can be used in the retail trade for measuring **inventories of large number** of rapidly changing items that have **similar margins**
- Cost of the inventory determined by reducing from the sales value of the inventory, the appropriate percentage gross margin
- The percentage used takes into consideration inventory, which has been marked down to below its original selling price

Points to be Noted:

Net Realisable Value

Inventories shall be written down to net realisable value on an item-by-item basis. Where ‘items of inventory' relating to the same product line having similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line, such inventories shall be grouped together and written down to net realisable value on an aggregate basis.

Net realisable value shall be based on the most reliable evidence available at the time of valuation.
The estimates of net realisable value shall also take into consideration the purpose for which the inventory is held.
The estimates shall take into consideration fluctuations of price or cost directly relating to events occurring after the end of previous year to the extent that such events confirm the conditions existing on the last day of the previous year.

Materials and other supplies held for use in the production of inventories shall not be written down below the cost, where the finished products in which they shall be incorporated are expected to be sold at or above the cost. Where there has been a decline in the price of materials and it is estimated that the cost of finished products will exceed the net realisable value, the value of materials shall be written down to net realisable value which shall be the replacement cost of such materials.

Value of Opening Inventory

The value of the inventory as on the beginning of the previous year shall be the cost of inventory available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and the value of the inventory as on the close of the immediately preceding previous year, in any other case.

Change of Method of Valuation of Inventory

The method of valuation of inventories once adopted by a person in any previous
year shall not be changed without reasonable cause.

Valuation of Inventory in Case of Certain Dissolutions

In case of dissolution of a partnership firm or association of person or body of individuals, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value.

Disclosure

The following aspects shall be disclosed—

- the accounting policies adopted in measuring inventories including the cost formulae used
- the total carrying amount of inventories and its classification appropriate to a person

Income Computation and Disclosure Standard III

Construction Contracts

Definitions

Construction Contract

Contract specifically negotiated for the construction of -

- **an asset** or
- a **combination of assets** that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use and **includes** :
  - **contract for the rendering of services** which are directly related to the construction of the asset e.g. those for the services of project managers and architects;
  - **contract for destruction or restoration of assets**, and the restoration of the environment following the demolition of assets

Fixed Price Contract

Construction contract in which the contractor agrees to a

- **fixed contract price** or
- **a fixed rate per unit of output**, which may be subject to cost escalation clauses

Cost Plus Contract

Construction contract in which the contractor is **reimbursed** for allowable or otherwise defined costs, **plus a mark up on these costs or a fixed fee**

Retentions

Amounts of progress billings which are **not** paid until

- the satisfaction of conditions specified in the contract for the payment of such amounts or
- defects have been rectified

Progress Billings

Amounts billed for work performed on a contract whether or not they have been paid by the customer

Advances

Amounts received by the contractor before the related work is performed

Combining and Segmenting Construction Contracts

✓ Where a contract covers a number of assets, the construction of each asset should be treated as a **separate construction contract** when -
• **separate proposals** have been submitted for each asset
• each asset has been subject to **separate negotiation** and the contractor and customer have been able to accept or reject that part of the contract relating to each asset and
• the **costs and revenues** of each asset can be **identified**

✓ A group of contracts, whether with a single customer or with several customers, should be treated as a **single construction contract** when -
• the group of contracts is **negotiated as a single package**
• the contracts are **so closely interrelated** that they are, in effect, part of a single project with an **overall profit margin** and
• the contracts are **performed concurrently** or in a **continuous sequence**

✓ Where a contract provides for or is amended to include **construction of an additional asset at the option of the customer**, the construction of the additional asset should be **treated as a separate construction contract** when -
• the asset differs significantly in **design, technology or function** from the asset or assets covered by the original contract or
• the **price of the asset is negotiated** without having regard to the original contract price

Contract Revenue

- To be recognised when there is reasonable certainty of its ultimate collection

- Comprises of -
  - the **initial amount of revenue agreed** in the contract, including retentions; and
  - **variations in contract work, claims and incentive payments**
    - to the extent that it is probable that they will result in revenue and
    - they are capable of being reliably measured

- Recognition as expense and not as adjustment of amount of contract revenue where contract revenue already recognised as income subsequently written off in the books of accounts as uncollectible

Contract Costs

Contract Costs shall comprise of :

- costs that **relate directly to the specific contract**
- costs that are attributable to contract activity in general and can be allocated to the contract
- such other costs as are specifically chargeable to the customer under the terms of the contract and
- **allocated borrowing costs** in accordance with the ICDS on Borrowing Costs

➢ These costs to be **reduced** by any **incidental income**, not being in the nature of interest, dividends or capital gains, that is **not included in contract revenue**

- Contract Cost shall **not** include cost :
  ✓ that cannot be attributed to any contract activity or cannot be allocated to a contract
  ✓ incurred in securing a contract recognised as an expense in the period in which they are incurred

- Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract

- Costs that are incurred in securing the contract are included as part of the contract costs provided -
  ✓they can be separately identified and
  ✓it is probable that the contract shall be obtained

- Contract costs that relate to future activity on the contract to be recognised as an asset.

- Such costs represent an **amount due from the customer** and are classified as **contract work in progress**

Recognition of Contract Revenue and Expenses

- Contract cost and revenue to be recognised by reference to the stage of completion of the contract activity at the reporting date

- Percentage of completion method used to compute the stage of completion

- Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed

- Progress payments and advances received from customers not determinative of the stage of completion of a contract

- Only those contract costs that reflect work performed are included in costs incurred upto the reporting date and thus following are excluded -
  ✓contract costs that relate to future activity on the contract
  ✓payments made to subcontractors in advance

- During the early stages of a contract ⟶ outcome of the contract cannot be estimated reliably ⟶ contract revenue to be recognised only to the extent of costs incurred

Progress payments and advances received from customers are not determinative of the stage of completion of a contract.

When the stage of completion is determined by reference to the contract costs incurred upto the reporting date, only those contract costs that reflect work performed are included in costs incurred upto the reporting date. Contract costs which are excluded are:
contract costs that relate to future activity on the contract; and
payments made to subcontractors in advance of work performed under the subcontract.

During the early stages of a contract, where the outcome of the contract cannot be estimated reliably contract revenue is recognised only to the extent of costs incurred. The early stage of a contract shall not extend beyond 25 % of the stage of completion.

<u>Changes in Estimates</u>
The percentage of completion method is applied on a cumulative basis in each previous year to the current estimates of contract revenue and contract costs. Where there is change in estimates, the changed estimates shall be used in determination of the amount of revenue and expenses in the period in which the change is made and in subsequent periods.

Disclosure Requirements

- Amount of contract revenue recognised as revenue in the period
- Methods used to determine the stage of completion of contracts in progress
- Amount of costs incurred and recognised profits less recognised losses upto the reporting date
- Amount of advances received
- Amount of retentions

Income Computation and Disclosure Standard IV

Revenue Recognition

Scope

Deals with the basis 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 others of the person’s resources yielding interest, royalties or dividends

Does **not** deal with -

Aspects of revenue recognition which are dealt with by other ICDS

Definitions

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of a person from

- the sale of goods
- the rendering of services, or
- from the use by others of the person’s resources yielding interest, royalties or dividends

In an agency relationship, the revenue is the **amount of commission** and **not** the gross inflow of cash, receivables or other consideration

Sale of Goods

- In a transaction involving the sale of goods, the revenue shall be recognised when –
  • the seller of goods has transferred to the buyer the property in the goods for a price or
  • all significant risks and rewards of ownership have been transferred to the buyer and
  • the seller retains no effective control of the goods transferred to a degree usually associated with ownership

- Revenue to be recognised when there is reasonable certainty of its ultimate collection

- Ability to assess the ultimate collection with reasonable certainty → lacking at the time of raising any claim → claim shall be postponed to the extent of uncertainty involved

Rendering of Services

- Percentage completion method to be used to recognise revenue from service transactions
- Revenue from service transactions to be matched with the service transactions costs incurred in reaching the stage of completion, resulting in the determination of revenue, expenses and profit which can be attributed to the proportion of work completed
- Income Computation and Disclosure Standard on construction contract also requires the recognition of revenue on this basis
- The requirements of that Standard shall mutatis mutandis apply to the recognition of revenue and the associated expenses for a service transaction.

The Use of Resources by Others Yielding Interest, Royalties or Dividends

- Interest shall accrue on the time basis determined by the **amount outstanding and the rate** applicable

- Discount or premium on debt securities held is treated as though it were accruing over the **period to maturity**

- Royalties shall accrue in accordance with the terms of the relevant agreement and shall be recognised on that basis **unless** having regard to the substance of the transaction, it is **more appropriate** to recognise revenue on some other systematic and rational basis.

- Dividends are recognised in accordance with the provisions of the Act

Disclosure Requirements

- In a transaction involving sale of good, total amount not recognised as revenue during the previous year due to lack of reasonably certainty of its ultimate collection along with nature of uncertainty
- Amount of revenue from service transactions recognised as revenue during the previous year
- Method used to determine the stage of completion of service transactions in progress and for service transactions in progress at the end of previous year
- Amount of costs incurred and recognised profits less recognized losses upto end of previous year
- Amount of advances received
- Amount of retentions

Income Computation and Disclosure Standard V

Tangible Fixed Assets

Definitions

Tangible Fixed Asset is an asset

- being land, building, machinery, plant or furniture
- held with the intention of being used for the purpose of producing or providing goods or services and
- is **not held for sale** in the normal course of business.

Fair value of an asset is the amount for which that asset could be exchanged between **knowledgeable**, **willing** parties in an **arm's length transaction**

Identification of Tangible Fixed Assets

- **Stand-by equipment** and **servicing equipment** are to be capitalised
- **Machinery spares** charged to the **revenue** as and when consumed
- When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised

Components of Actual Cost

- The actual cost of an acquired tangible fixed asset shall comprise its
  - ✓purchase price
  - ✓import duties and other taxes, excluding those subsequently recoverable
  - ✓and any directly attributable expenditure on making the asset ready for its intended use

- Any trade discounts and rebates shall be deducted in arriving at the actual cost

- The cost of a tangible fixed asset may undergo changes subsequent to its acquisition or construction on account of
  - ✓price adjustment
  - ✓changes in duties or similar factors or
  - ✓exchange fluctuation as specified in ICDS on the effects of changes in foreign exchange rates

- Administration and other general overhead expenses are to be **excluded** from the cost of tangible fixed assets if they **do not relate** to a specific tangible fixed asset

- Expenses which are specifically attributable to construction of a project or to the acquisition of a tangible fixed asset or bringing it to its working condition, shall be included as a part of the cost of the project or as a part of the cost of the tangible fixed asset

- Expenditure incurred on **start-up and commissioning** of the project, including the expenditure incurred on test runs and experimental production, shall be **capitalised**

- The expenditure incurred **after** the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as **revenue expenditure**

Self- constructed Tangible Fixed Assets

- In arriving at actual cost, the same principles described earlier shall apply
- The actual cost shall include

  ✓cost of construction that relate directly to the specific tangible fixed asset and

  ✓costs that are attributable to the construction activity in general
- Any internal profits shall be eliminated in arriving at such costs

Non- Monetary Consideration

Tangible fixed asset is acquired in exchange for another asset	Fair value of the tangible fixed asset so acquired shall be its actual cost
Tangible fixed asset is acquired in exchange for shares or other securities	Fair value of the shares or other securities so acquired shall be its actual cost

Improvements and Repairs

Expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance	Added to Actual Cost
Cost of an addition or extension to an existing tangible fixed asset which is of a capital nature and which becomes an integral part of the existing tangible fixed asset	Added to Actual Cost
Any addition or extension, which has a separate identity and is capable of being used after the existing tangible fixed asset is disposed of	Treated as Separate Asset

<u>Valuation of Tangible Fixed Assets in Special Cases</u>

(1) Where a person owns tangible fixed assets jointly with others

↓

the proportion in the actual cost, accumulated depreciation and written down value is grouped together

↓

with similar fully owned tangible fixed assets

- Details of such **jointly owned tangible fixed assets** shall be indicated separately in the **Tangible Fixed Assets Register**

(2) Where several assets are purchased for a **consolidated price**

↓

the **consideration** shall be **apportioned** to the various assets on a fair basis

Depreciation

- Depreciation on a tangible fixed asset shall be computed in accordance with the provisions of the Act

Disclosures

Following disclosure shall be made in respect of tangible fixed assets -

- Description of asset or block of assets
- Rate of depreciation
- Actual cost or written down value, as the case may be
- Additions or deductions during the year with dates
- In the case of any addition of an asset, date put to use including adjustments on account of
  - Central Value Added Tax credit claimed and allowed under the CENVAT Credit Rules, 2004
  - change in rate of exchange of currency
  - subsidy or grant or reimbursement, by whatever name called
- Depreciation allowable
- Written down value at the end of year

Income Computation and Disclosure Standard VI

The Effects of Changes in Foreign Exchange Rates

SCOPE

This ICDS 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**

Definitions

- **“Average rate”** is the **mean** of the exchange rates in force during a period
- **“Closing rate”** is the exchange rate at the **last day** of the previous year
- **“Exchange difference”** is the **difference** resulting from reporting the same number of units of a foreign currency in the reporting currency of a person at different exchange rates
- **“Exchange rate”** is the ratio for exchange of two currencies
- **“Foreign currency”** is a currency **other than** the reporting currency of a person
- **“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**

- **“Foreign currency transaction”** is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when a person -
  - ✓ buys or sells goods or services whose price is denominated in a foreign currency; or
  - ✓ borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
  - ✓ becomes a party to an unperformed forward exchange contract; or
  - ✓ otherwise acquires or disposes of assets, or incurs or settles liabilities denominated in a foreign currency

- **“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

- **“Forward rate”** is the specified exchange rate for exchange of two Currencies at a specified future date

- **“Integral foreign operation”** is a foreign operation, the activities of which are an integral part of the operation of the person

- **“Monetary items”** are money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money
  e.g. Cash, receivables, and payables

- **“Non-integral foreign operation”** is a foreign operation that is not an integral foreign operation

- **“Non-monetary items”** are assets and liabilities other than monetary items
  e.g. Fixed Assets, inventories, and investments in equity shares

- **“Reporting currency”** means Indian currency except for foreign operations where it shall mean currency of the country where the operations are carried out

- **“Indian currency”** shall have the meaning as assigned to it in section 2 of the Foreign Exchange Management Act, 1999

Foreign Currency Transactions Initial Recognition

- A foreign currency transaction shall be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency **at the date of the transaction**.
- An **average rate for a week or a month** that approximates the actual rate at the date of the transaction may be used for all transaction in each foreign currency occurring during that period.
- If the exchange rate fluctuates significantly, the actual rate at the date of the transaction shall be used.

Conversion at Last Date of Previous Year

- foreign currency monetary items shall be converted into reporting currency by applying **the closing rate**;
- where the closing rate does not reflect with reasonable accuracy, the amount in reporting currency that is likely to be realised from or required to disburse, a foreign currency monetary item owing to restriction on remittances or the closing rate being unrealistic and it is not possible to effect an exchange of currencies at that rate, then the relevant monetary item shall be reported in the reporting currency **at the amount which is likely to be realised from or required to disburse such item at the last date of the previous year;** and
- **non-monetary items** in a foreign currency shall be converted into reporting currency by using the exchange rate at the **date of the transaction**.

Recognition of Exchange Differences

In respect of **monetary items**, exchange differences arising on the settlement thereof or on conversion thereof at **last day of the previous year** shall be recognised as income or as expense in that previous year.
In respect of **non-monetary items**, exchange differences arising on **conversion thereof at the last day** of the previous year shall not be recognised as income or as expense in that previous year.

Exceptions

initial recognition, conversion and recognition of exchange difference shall be subject to provisions of **section 43A** of the Act or Rule 115 of Income-tax Rules, 1962, as the case may be.

Financial Statements of Foreign Operations
Classification of Foreign Operations

- The method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to a person. For this purpose, foreign operations are classified as either “integral foreign operations” or “non-integral foreign operations”.

non-integral foreign operation

- while the person may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from the activities of the person;
- transactions with the person are not a high proportion of the foreign operation’s activities;
- the activities of the foreign operation are financed mainly from its own operations or local borrowings;
- costs of labour, material and other components of the foreign operation’s products or services are primarily paid or settled in the local currency;
- the foreign operation’s sales are mainly in currencies other than Indian currency;
- cash flows of the person are insulated from the day-to-day activities of the foreign operation;
- sales prices for the foreign operation’s products or services are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation;
- there is an active local sales market for the foreign operation’s products or services, although there also might be significant amounts of exports.

Integral Foreign Operations

The financial statements of an integral foreign operation shall be translated using the principles and procedures as if the transactions of the foreign operation had been those of the person himself.

Non-integral Foreign Operations

In translating the financial statements of a non-integral foreign operation for a previous year, the person shall apply the following, namely:—

the assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation shall be translated at the closing rate;
income and expense items of the non-integral foreign operation shall be translated at exchange rates at the dates of the transactions; and
all resulting exchange differences shall be recognised as income or as expenses in that previous year.

Notwithstanding anything stated translation and recognition of exchange difference in cases referred to in section 43A of the Act or Rule 115 of Income-tax Rules, 1962 shall be carried out in accordance with the provisions contained in that section or that Rule, as the case may be.

Change in the Classification of a Foreign Operation

- When there is a change in the classification of a foreign operation, the translation procedures applicable to the revised classification should be applied from the date of the change in the classification.
- The consistency principle requires that foreign operation once classified as integral or non-integral is continued to be so classified. However, a change in the way in which a foreign operation is financed and operates in relation to the person may lead to a change in the classification of that foreign operation.

<u>Forward Exchange Contracts</u>

Any **premium** or discount arising at the inception of a forward exchange contract shall be **amortised** as expense or income over the life of the contract.
Exchange differences on such a contract shall be recognised as income or as expense in the previous year in which the exchange rates change. Any profit or loss arising on **cancellation or renewal** shall be recognised as income or as expense for the **previous year**.

The provisions shall apply provided that the contract:
is not intended for trading or speculation purposes; and
is entered into to establish the amount of the reporting currency required or available at the settlement date of the transaction.

The provisions **shall not apply** to the contract that is entered into to **hedge** the foreign currency risk of a firm commitment or a highly probable forecast transaction. For this purpose, firm commitment, shall not include assets and liabilities existing at the end of the previous year.

The premium or discount that arises on the contract is measured by the difference between the exchange rate at the date of the inception of the contract and the forward rate specified in the contract. Exchange difference on the contract is the difference between:
the foreign currency amount of the contract translated at the exchange rate at the last day of the previous year, or the settlement date where thetransaction is settled during the previous year; and
the same foreign currency amount translated at the date of inception of the contract or the last day of the immediately preceding previous year, whichever is later.

Premium, discount or exchange difference on contracts that are intended for trading or speculation purposes, or that are entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction shall be recognised at the time of settlement.

Income Computation and Disclosure Standard VII

Government Grants

ICDS VII deals with accounting treatment of -
Government grants, subsidies, cash incentives, duty drawbacks, waiver, concessions, reimbursements, etc.

This ICDS does not deal with -

- ✓ Government assistance other than in the form of Government grants
- ✓ Government participation in the ownership of the enterprise

Definitions

- **“Government”** refers to the Central Government, State Governments, agencies and similar bodies, whether local, national or international
- **“Government grants”** are assistance by Government in cash or kind to a person for past or future compliance with certain conditions

Government grants exclude those forms of Government assistance which **cannot have a value placed upon them** and the transactions with Government which cannot be distinguished from the normal trading transactions of the person

Recognition of Government Grants

- **Not** recognised **until** there is **reasonable assurance** that the person shall comply with the conditions attached to them, and the grants shall be received
- **Recognition** not to be postponed beyond the date of actual receipt

TREATMENT OF GOVERNMENT GRANTS	
Relates to a Depreciable Fixed asset or assets of a person	Deducted from the actual cost of the asset or assets concerned or from the written down value of block of assets
Relates to a Non-depreciable asset or assets of a person requiring fulfillment of certain obligations	Recognised as income over the same period over which the cost of meeting such obligations is charged to income
Cannot be directly relatable to the asset acquired	Proportion such asset bears to all the assets in respect of or with reference to which the Government grant is so received, shall be deducted from the actual cost of the asset or shall be reduced from the written down value of block of assets
Receivable as compensation for expenses or losses incurred in a previous financial year or for the purpose of giving immediate financial support to the person with no further related costs	Recognised as income of the period in which it is receivable
Other Government Grants	Recognised as income over the periods necessary to match them with the related costs which they are intended to compensate
In the form of Non-monetary assets, given at a concessional rate	Accounted for on the basis of their acquisition cost

Refund of Government Grants

In respect of a Government Grant referred to in point 2, 4 and 5 above:

- ✓Unamortised deferred credit remaining in respect of the Government grant to be first applied
- ✓Balance amount to be charged to Profit and Loss Statement.

Related to a Depreciable Fixed Asset or Assets:

- ✓**Increase** the actual cost or written down value of block of assets by the amount refundable
- ✓Depreciation to be provided **prospectively** at prescribed rate on the revised actual cost or written down value

Disclosures

Nature and Extent of Government grants recognised during the previous year -

- by way of **deduction from the actual cost** of the asset or from the written down value of block of assets during the previous year
- as **income**
- **not recognised** during the previous year by **way of deduction from the actual cost** of the asset or from the written down value of block of assets and reasons thereof
- **not recognised** during the previous year as **income** and reasons thereof

Income Computation and Disclosure Standard VIII

Securities

This ICDS deals with

↓

securities held as **stock-in- trade**

This ICDS does **not** deal with:

- basis for **recognition** of interest and dividends on securities (covered by ICDS on Revenue Recognition)
- securities held by a person engaged in the business of **insurance**
- securities held by **mutual funds, venture capital funds, banks and public financial institutions** formed under a Central or a State Act or so declared under the Companies Act, 1956 or the Companies Act, 2013

Definitions

- **“Fair value”** is the amount for which an asset could be exchanged between a **knowledgeable, willing buyer** and a **knowledgeable, willing seller** in an **arm’s length transaction**
- **“Securities”** shall have the meaning assigned to it in clause h of Section 2 of the Securities Contract Regulation Act, 1956, other than Derivatives referred to in sub-clause 1(a) of that clause

Recognition and Initial Measurement of Securities

Security on acquisition $\longrightarrow$ **recognised at Actual Cost**

Actual cost to comprise of its purchase price and acquisition charges such as brokerage, fees, tax, duty or cess

- For security acquired in exchange for other securities -

  Actual cost = Fair value of the security so **acquired**

- For security acquired in exchange for another asset –

  Actual cost = Fair value of the security so acquired

Accrual of **Unpaid Interest** before Acquisition of Interest Bearing Security:

- ✓ Unpaid interest included in the price of security
- ✓ Subsequent receipt of interest allocated between pre-acquisition and post-acquisition periods
- ✓ Pre-acquisition portion of the interest **deducted from the actual cost**

Subsequent Measurement of Securities

At the end of any previous year, **securities held as stock-in-trade** valued at

- Actual Cost initially recognised or
- Net Realisable Value at the end of that previous year, whichever is **lower**

➢ **Comparison** of actual cost and NRV to be done **category-wise** and not for each individual security

➢ Categories for classification -

- shares
- debt securities
- convertible securities
- any other securities not covered above

Income Computation and Disclosure Standard IX

<u>Borrowing Costs</u>

Definitions

"Borrowing costs" are interest and other costs incurred by a person in connection with the borrowing of funds and include:

- **commitment charges** on borrowings;
- amortised amount of discounts or **premiums** relating to borrowings;
- amortised amount of **ancillary costs** incurred in connection with the arrangement of borrowings;
- finance charges in respect of assets acquired under **finance leases** or under other similar arrangements.

"Qualifying asset" means:

  - land, building, machinery, plant or furniture, being tangible assets;
  - know-how, patents, copyrights, trade marks, licences, 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.

Recognition

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset.
- The amount of borrowing costs eligible for capitalisation shall be determined in accordance with this Income Computation and Disclosure Standard.
- Other borrowing costs shall be recognised in accordance with the provisions of the Act.

Borrowing Costs Eligible for Capitalisation

To the extent the funds are borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be

capitalised on that asset shall be the actual borrowing costs incurred during the period on the funds so borrowed.

To the extent the funds are borrowed generally and utilised for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised shall be computed in accordance with the formula

Commencement of Capitalisation
in a case Direct Loan, from the date on which funds were borrowed;
in a case indirrect borrowing as per formulae, from the date on which funds were utilised.

Cessation of Capitalisation

- in case of a qualifying asset is first put to use;
- in case of inventory referred, when substantially all the activities necessary to prepare such inventory for its intended sale are complete.

When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part shall cease:—
in case of part of a qualifying asset, when such part of a qualifying asset is first put to use;

- in case of part of inventory when substantially all the activities necessary to prepare such part of inventory for its intended sale are complete.

Income Computation and Disclosure Standard X

provisions, contingent liabilities and contingent assets

This Income Computation and Disclosure Standard deals with provisions, contingent liabilities and contingent assets, except those:

- resulting from financial instruments;
- resulting from executory contracts;
- arising in insurance business from contracts with policyholders; and
- covered by another Income Computation and Disclosure Standard.

The value of securities held as stock-in-trade of a business as on the beginning of the previous year shall be:

the cost of securities available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and

the value of the securities of the business as on the close of the immediately preceding previous year, in any other case.

Notwithstanding anything at the end of any previous year, securities not listed on a 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.

where the actual cost initially recognised cannot be ascertained by reference to specific identification, the cost of such security shall be determined on the basis of first-in-first-out method.

Definitions

- “Provision” is a liability which can be measured only by using a substantial degree of estimation.
- “Liability” is a present obligation of the person arising from past events, the settlement of which is expected to result in an outflow from the person of resources embodying economic benefits.
- “Obligating event” is an event that creates an obligation that results in a person having no realistic alternative to settling that obligation.
- “Contingent liability” is:
  - a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person; or
  - a present obligation that arises from past events but is not recognized because:
  - it is not reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; or
  - a reliable estimate of the amount of the obligation cannot be made.
- “Contingent asset” is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person.
- “Executory contracts” are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.
- “Present obligation” is an obligation if, based on the evidence available, its existence at the end of the previous year is considered reasonably certain.

Recognition
Provisions

A provision shall be recognised when:

- a person has a present obligation as a result of a past event;
- it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.
- If these conditions are not met, no provision shall be recognised.

- No provision shall be recognised for costs that need to be incurred to operate in the future.
- It is only those obligations arising from past events existing independently of a person's future actions, that is the future conduct of its business, that are recognised as provisions.

- Where details of a proposed new law have yet to be finalised, an obligation arises
- only when the legislation is enacted.

Contingent Liabilities

A person shall not recognise a contingent liability.

Contingent Assets

A person shall not recognise a contingent asset.

Contingent assets are assessed continually and when it becomes reasonably certain that inflow of economic benefit will arise, the asset and related income are recognised in the previous year in which the change occurs.

Measurement

Best Estimate

The amount recognised as a provision shall be the best estimate of the expenditure
required to settle the present obligation at the end of the previous year. The amount of a
provision shall not be discounted to its present value.

The amount recognised as asset and related income shall be the best estimate of the value of economic benefit arising at the end of the previous year. The amount and related income shall not be discounted to its present value.

Reimbursements

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when it is reasonably certain that reimbursement will be received if the person settles the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision.

Where a person is not liable for payment of costs in case the third party fails to pay, no provision shall be made for those costs.

An obligation, for which a person is jointly and severally liable, is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Review

- Provisions shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate. If it is no longer reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.
- An asset and related income recognised shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate. If it is no longer reasonably certain that an inflow of economic benefits will arise, the asset and related income shall be reversed.
- Use of Provisions
- A provision shall be used only for expenditures for which the provision was originally recognised.

Disclosure

Following disclosure shall be made in respect of each class of provision, namely:-

- a brief description of the nature of the obligation;
- the carrying amount at the beginning and end of the previous year;
- additional provisions made during the previous year, including increases to existing provisions;
- amounts used, that is incurred and charged against the provision, during the previous year;
- unused amounts reversed during the previous year; and
- the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Following disclosure shall be made in respect of each class of asset and related income recognised

- a brief description of the nature of the asset and related income;
- the carrying amount of asset at the beginning and end of the previous year;
- additional amount of asset and related income recognised during the year, including increases to assets and related income already recognised; and
- amount of asset and related income reversed during the previous year.

ICDS	AS (Indian GAAP)	Ind AS
ICDS I: Accounting policies	AS 1: Disclosure of Accounting Policies AS 5: Net profit or loss for the period, prior period items and changes in accounting policies	Ind AS 1: Presentation of financial statements Ind AS 8: Accounting policies, changes in accounting estimates and errors
ICDS II: Valuation of inventories	AS 2: Valuation of inventories	Ind AS 2: Inventories
ICDS III: Construction contracts	AS 7: Construction contracts	Ind AS 115: Revenue from contracts with customers
ICDS IV: Revenue recognition	AS 9: Revenue recognition	Ind AS 115: Revenue from contracts with customers
ICDS V: Tangible fixed assets	AS 10: Accounting for fixed assets AS 6: Depreciation accounting	Ind AS 16: Property, plant and equipment
ICDS VI: The effects of changes in foreign exchange rates	AS 11: The effects of changes in foreign exchange rates	Ind AS 21: The effects of changes in foreign exchange rates
ICDS VII: Government grants	AS 12: Accounting for government grants	Ind AS 20: Accounting for government grants and disclosure of government assistance
ICDS VIII: Securities	AS 13: Accounting for investments	Ind AS 109: Financial instruments
ICDS IX: Borrowing costs	AS 16: Borrowing costs	Ind AS 23: Borrowing costs
ICDS X: Provisions, contingent liabilities and contingent assets	AS 29: Provisions, contingent liabilities and contingent assets	Ind AS 37: Provisions, contingent liabilities