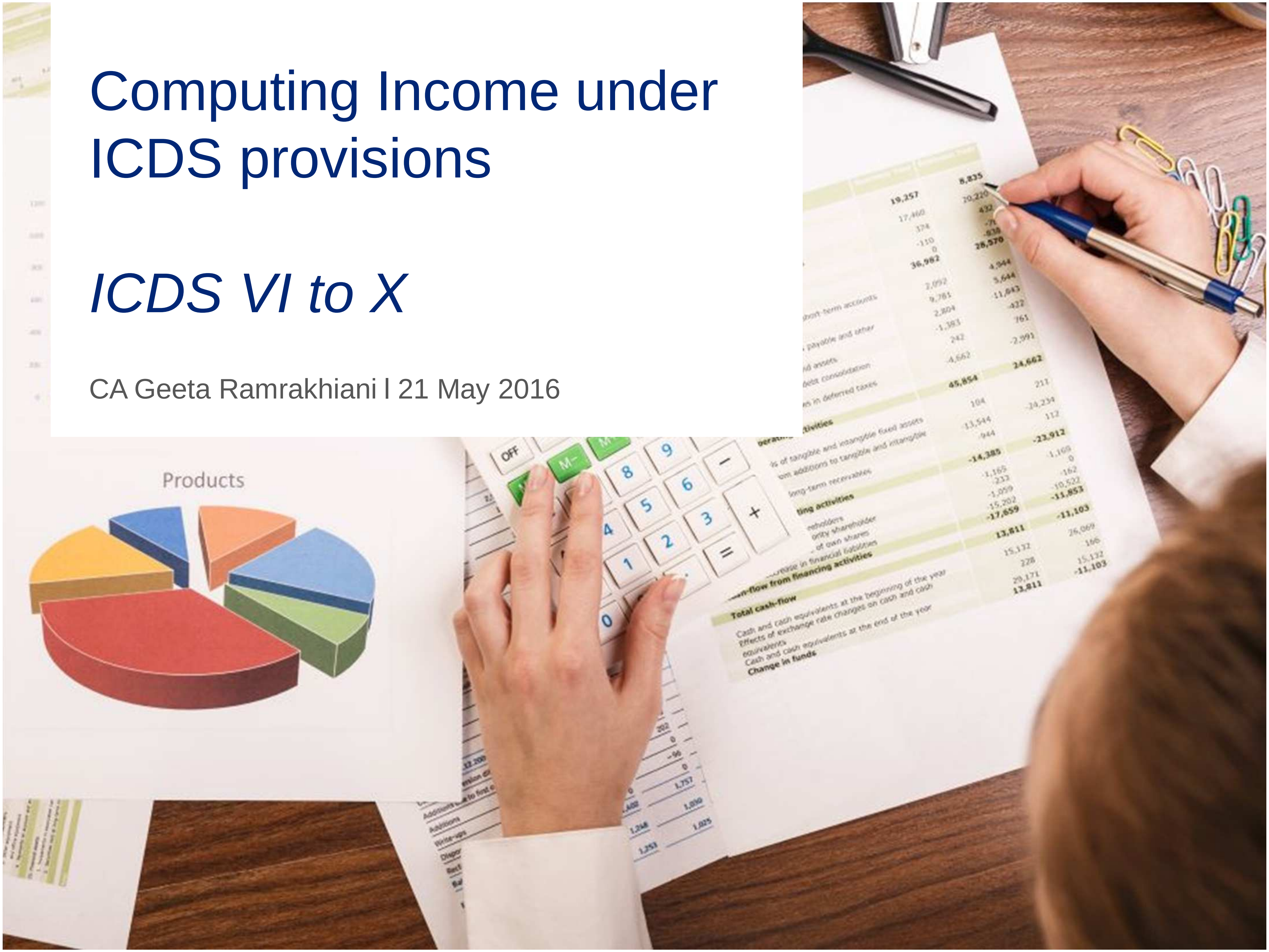
Computing Income under ICDS provisions

ICDS VI to X

CA Geeta Ramrakhiani I 21 May 2016

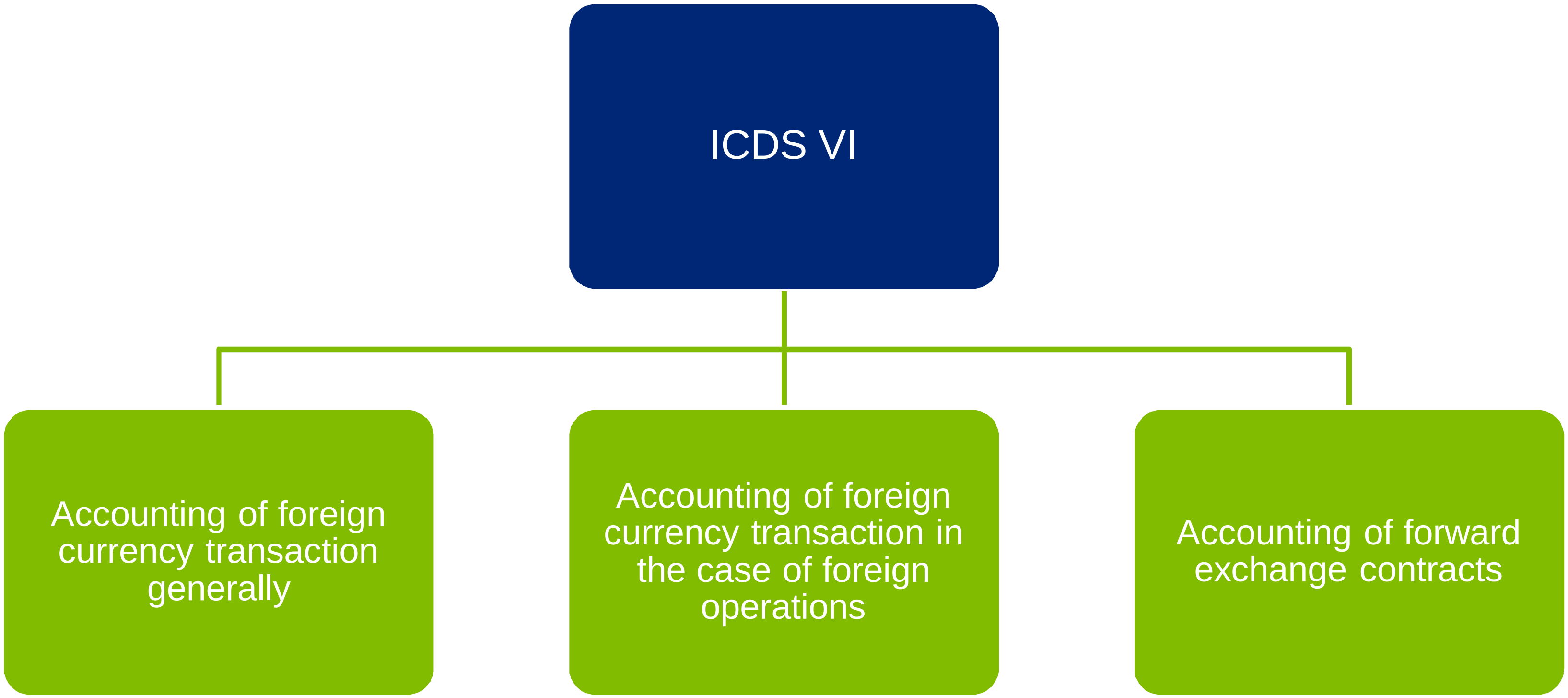


ICDS VI: Changes in Foreign Exchange Rates (AS 11)

Understanding of terms used in AS 11 and ICDS VI

- Foreign currency transaction
- Monetary vs. non-monetary items
- Integral operations vs. non-integral operations
- Foreign operations
  - AS 11 – Subsidiary, associate, joint venture or branch of reporting enterprise
  - ICDS VI – Branch of a person
- Forward exchange contract
  - AS 11 – Specified exchange rate for exchange of two currencies at a specified future date
  - ICDS VI – Same as above, and includes a foreign currency option contract or another financial instrument of similar nature

Layout of ICDS VI



Accounting of foreign currency transaction generally

	AS 11	ICDS VI
Initial recognition of transaction	Average rate of a week or month	
Conversion at the year end • Monetary item	Rate on the last date of the previous year provided such rate is not unrealistic. If unrealistic, rate at which likely to be realised	
• Non-monetary item (carried at fair value)	• Exchange rate on the date when fair value was determined	• No fair value concept exists (Definition of "fair value" in AS 11 has been eliminated in ICDS VI)
• Non-monetary item (others)	Exchange rate on the date of transaction	
Exchange difference on restatement on monetary item	Income or expenses	

Accounting of foreign operations

	AS 11	ICDS VI
Integral operations		
• Monetary item	Rate on the last date of the previous year provided such rate is not unrealistic. If unrealistic, rate at which likely to be realised	
• Non-monetary item (carried at fair value)	• Exchange rate on the date when fair value was determined	• No fair value concept exists (Definition of "fair value" in AS 11 has been eliminated in ICDS VI)
• Non-monetary item (others)	Exchange rate on the date of transaction	
• Exchange difference (restatement on monetary item)	Income or expenses	
Non-integral operations		
• Assets and liabilities (monetary & non-monetary)	Rate on the last date of the previous year	
• Income and expenses	Exchange rate on the date of transaction	
• Exchange difference (on assets & liabilities)	Taken to reserve	Income or expenses

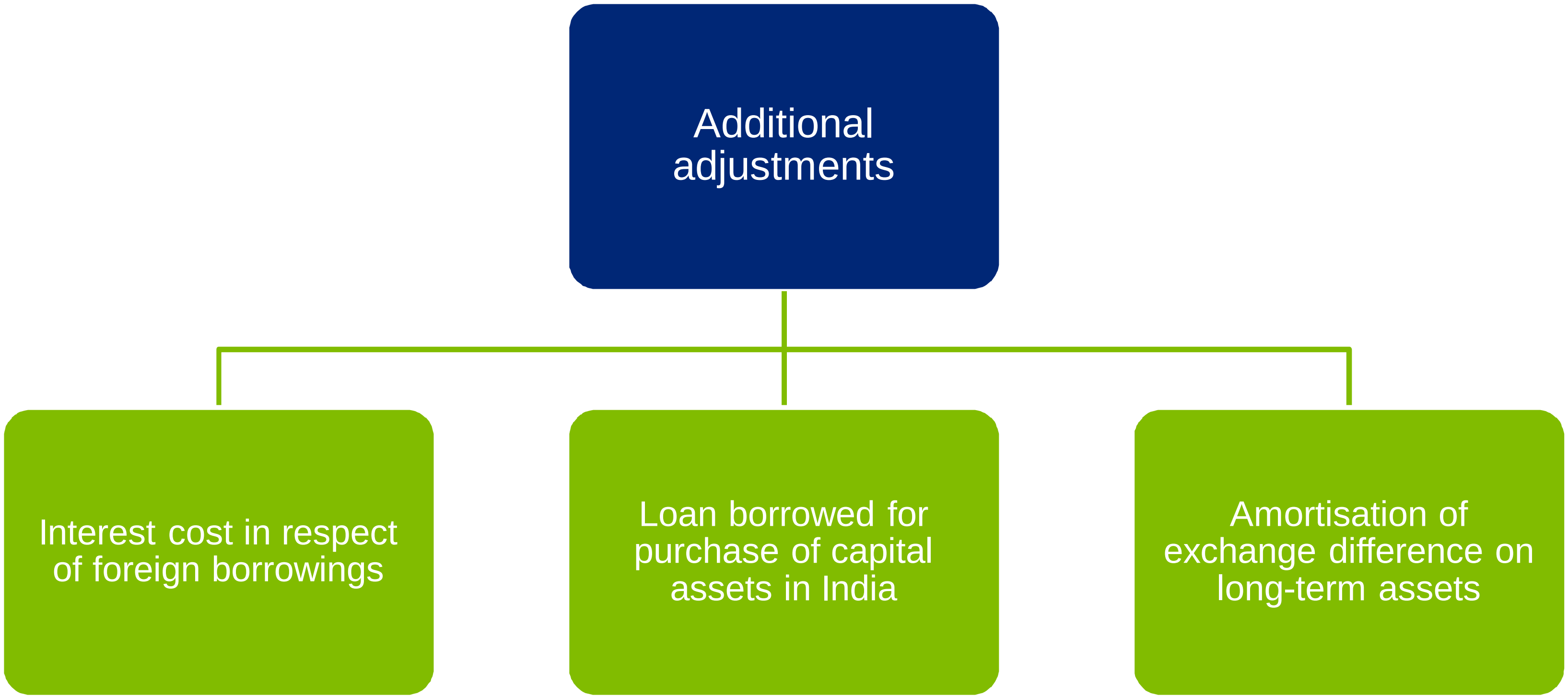
Accounting of forward exchange contracts

Forward contracts other than those discussed below	**AS 11**	**ICDS VI**
Inception of contract	Premium or discount at the inception of a contract to be amortised as expense or income over life of contract	
Conversion at the year end	Income or expenses	
Cancellation or renewal of contract	Income or expenses	
Trading or speculations contracts		
Inception of contract	Premium or discount at the inception to be ignored	
Conversion at the year end	Not applicable	Not applicable
Settlement of contract	Income or expenses	Income or expenses

Accounting of forward exchange contracts

Forward contracts to hedge the foreign currency risk	AS 11	ICDS VI
Of existing assets and liabilities	Same as applicable to other forward contracts	
Of firm commitment	Same as applicable to trading or speculations contracts	
Highly probable forecast transaction	Same as applicable to trading or speculations contracts	

Additional adjustments

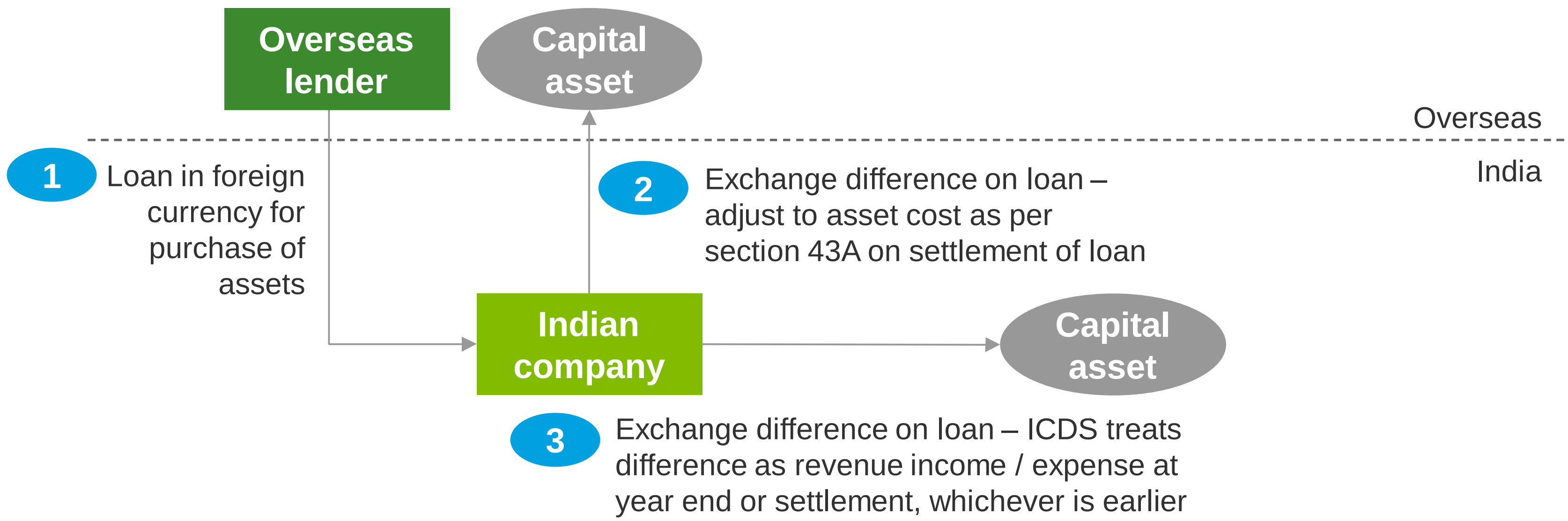


Interest cost in respect of foreign borrowings

Illustration as contained in the AS 16	
Loan taken on 1 April 2013 (exchange rate on 1 April 2013 = Rs. 45)	USD 10,000
Interest rate	5% p.a.
Exchange rate on 31 March 2014	48
Interest rate in local currency on the date when foreign currency loan was obtained	11%
Interest for FY 13-14 (USD 500 * 48)	24,000
Interest for FY 13-14 had loan was borrowed in local currency (10,000*45*11%)	49,500
Interest adjustment (49,500 - 24,000)	25,500
Exchange difference [(10,000*3)-25,500]	4,500

As per ICDS, interest 24,000 and exchange difference 30,000

Loan borrowed for purchase of capital assets in India



Can foreign exchange gain / loss on loan for purchase of capital assets in India be treated as revenue income / expense?

- ICDS only refers to section 43A
- As per section 43A, exchange difference relating to acquisition of a **foreign asset** is adjusted to the cost of the asset at the time of payment
- Section 43A is **silent on Indian assets**

Amortisation of exchange difference on long-term assets

- **Option provided under para 46A of AS 11 invoked – exchange gain or loss on long-term assets amortised**

"46A. (1) In respect of accounting periods commencing on or after the 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 and at the option of any other enterprise (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital assets, can be added to or deducted from the cost of the assets and shall be depreciated over the balance life of the assets, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long term assets or liability, by recognition as income or expense in each of such periods, with the exception of exchange differences dealt with in accordance with the provisions of paragraph 15 of the said rules.

Amortisation of exchange difference on long-term assets

- **Option provided under para 46A of AS 11 invoked – exchange gain or loss on long-term assets amortised**

IOC Annual Report FY 2014-15

(b) Exchange differences on long-term foreign currency monetary items relating to acquisition of depreciable assets are adjusted to the carrying cost of the assets and depreciated over the balance life of the assets in line with Para 46A of Accounting Standard -11. In other cases, exchange differences are accumulated in a "Foreign Currency Monetary Item Translation Difference Account" and amortized over the balance period of such long-term foreign currency monetary item by recognition as income or expense in each of such periods.

As per ICDS, the entire gain or loss on account of restatement to be recognized as profit or loss (subject to section 43A)

Illustration (1) – Non-monetary items (carried at fair value)

Current tax practice – P&L statement	
Purchase of P+M on 1 April 2014	USD 100
Exchange rate on 1 April 2014	1 USD = INR 50
Fair value of P+M on 31 December 2015	USD 30
Exchange rate on 31 December 2015	1 USD = INR 60

P&L statement (As per AS)	
FY 2015-16	Expense / (Income)
Loss on account of revalue of P+M	3500
Gain on account of restatement	(300)

STI (before ICDS)	
AY 2016-17	Amt.
Add: Loss on account of revaluation of P+M	3500
To be added back to book income	**3500**

STI (after ICDS)	
AY 2016-17	Amt.
Add: Loss on account of revaluation of P+M	3500
Less: Gain on account of restatement	(300)
To be added back to book income	**3200**

Illustration (2): Restatement of trading or speculative derivative contracts

ICICI Bank Annual Report FY 2014-15

7. Accounting for derivative contracts

The Bank enters into derivative contracts such as foreign currency options, interest rate and currency swaps, credit default swaps and cross currency interest rate swaps.

The swap contracts entered to hedge on-balance sheet assets and liabilities are structured such that they bear an opposite and offsetting impact with the underlying on-balance sheet items. The impact of such derivative instruments is correlated with the movement of underlying assets and liabilities and accounted pursuant to the principles of hedge accounting. Hedge swaps are accounted for on an accrual basis and are not marked to market unless their underlying transaction is marked to market.

Foreign currency and rupee derivative contracts entered into for trading purposes are marked to market and the resulting gain or loss (net of provisions, if any) is accounted for in the profit and loss account. Pursuant to RBI guidelines, any receivables under derivative contracts which remain overdue for more than 90 days and mark-to-market gains on other derivative contracts with the same counter-parties are reversed through profit and loss account.

MTM gain or loss on derivative contracts entered for trading purposes to be ignored from ICDS perspective

Illustration (3): Definition of non-integral operations

IOC Annual Report FY 2014-15

Financial statements of Indian Oil (Mauritius) Ltd, Lanka IOC PLC, IOC Middle East FZE, IOC Sweden AB, IndOil Global B.V., IOCL (USA) INC. and Suntera Nigeria are drawn in Mauritius Rupees, Sri Lankan Rupees, UAE Dirhams, Euro, CAD and USD, respectively. The transactions with these foreign subsidiaries/Joint Ventures are considered as non integral operation as per Accounting Standard-11 on "The Effects of Changes in Foreign Exchange Rates" and accordingly, the Financial Statements have been translated in Indian Rupees for the purpose of Consolidated Financial Statements.

Illustration (4): Exchange difference on non-integral operations

ICICI Bank Annual Report FY 2014-15

6. Transactions involving foreign exchange

Foreign currency income and expenditure items of domestic operations are translated at the exchange rates prevailing on the date of the transaction. Income and expenditure items of integral foreign operations (representative offices) are translated at daily closing rates, and income and expenditure items of non-integral foreign operations (foreign branches and offshore banking units) are translated at quarterly average closing rates.

Monetary foreign currency assets and liabilities of domestic and integral foreign operations are translated at closing exchange rates notified by Foreign Exchange Dealers' Association of India (FEDAI) relevant to the balance sheet date and the resulting gains/losses are included in the profit and loss account.

Both monetary and non-monetary foreign currency assets and liabilities of non-integral foreign operations are translated relevant to closing exchange rates notified by FEDAI at the balance sheet date and the resulting gains/losses from exchange differences are accumulated in the foreign currency translation reserve until the disposal of the net investment in the non-integral foreign operations. On the disposal/partial disposal of a non-integral foreign operation, the cumulative/proportionate amount of the exchange differences which has been accumulated in the foreign currency translation reserve and which relates to that operation are recognised as income or expenses in the same period in which the gain or loss on disposal is recognised.

MTM gain or loss on restatement of monetary and non-monetary assets of non-integral operations to be considered as Income or expense as per ICDS

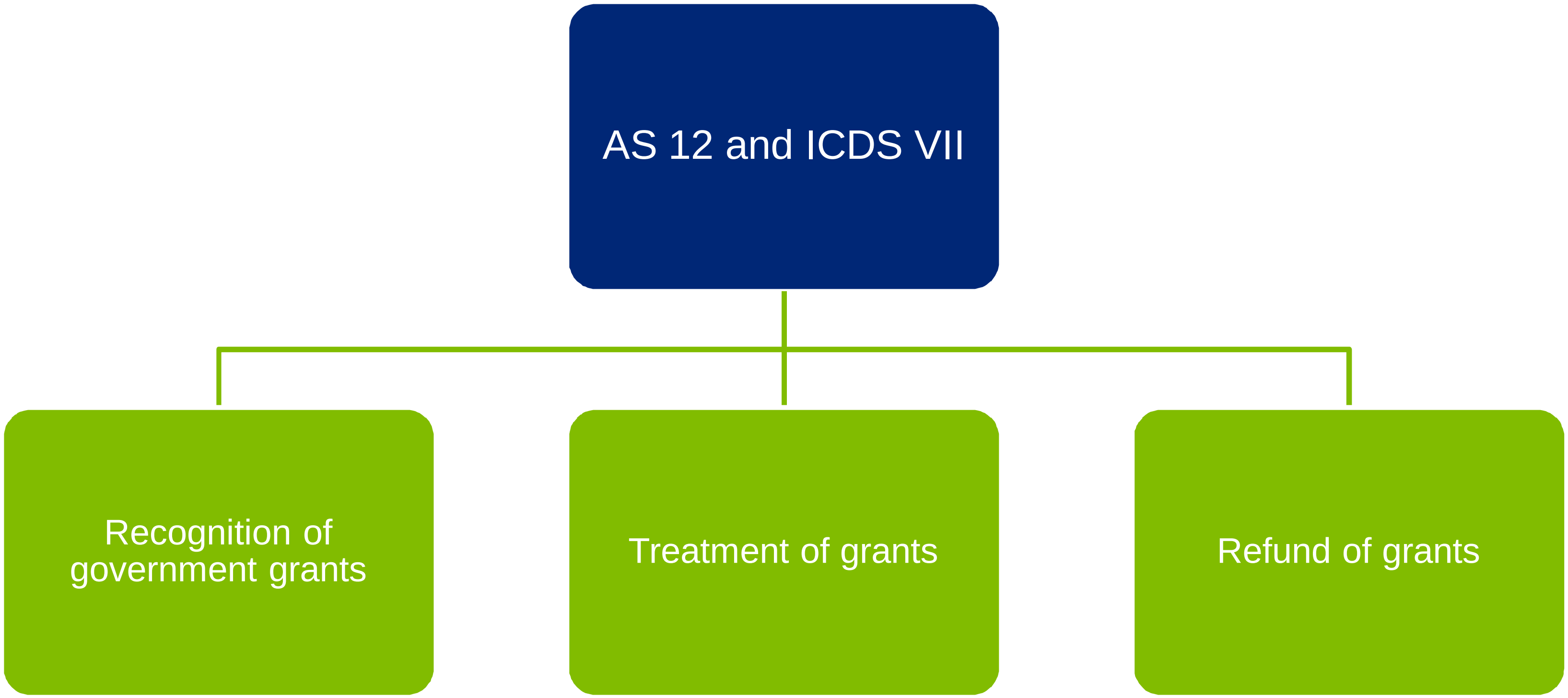
ICDS VI – effects of changes in foreign exchange rates

Summary

- Foreign currency transaction shall be recorded **initially at exchange rate as on the date of transaction or at a weekly / monthly average rate** (if rates do not fluctuate significantly from actual)
- Exchange difference on **monetary items** (and not non-monetary items) at each year-end shall be recognized as income / expense
- All exchange differences relating to **integral foreign operations** will be done as mentioned above and those **relating to non-integral foreign operations** will be treated as income / expense
- **The above is made subject to section 43A and rule 115 of the Act**
- Premium / discount on certain forward exchange contracts shall be **amortized over life of the contract** and exchange differences / differences on renewal or cancellation will be **recognized as income / expense**
- ICDS prescribes that premium / discount / 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 should be recognized **at the time of settlement. MTM adjustment on such contracts to be disallowed**

ICDS VII: Government Grants (AS 12)

Layout of ICDS VII



Recognition of government grants

	AS 12	ICDS VII
Actual receipt	To be recognised only if conditions attached to the grant have been or will be fulfilled	Once received, grant should be recognised
Other cases	Reasonable assurance that (i) person shall comply with conditions and (ii) the grants shall be received	

Treatment of government grants

Monetary grants	AS 12	ICDS VII
Relates to a depreciable asset	Either reduced from cost or WDV or shown as deferred income	To be reduced from cost or WDV of the asset
Relates to a non-depreciable asset	Capital reserve if no obligations to be fulfilled. If it requires fulfilment of obligation, grant should be credited to income over which cost of meeting the obligations is charged to income	Recognised as income over the same period over which cost of meeting the obligations is charged to income
Not directly relatable to the asset acquired	Not provided	$\frac{\text{Asset * Government grant}}{\text{Total assets}}$

Treatment of government grants

Monetary grants	AS 12	ICDS VII
Compensation for expenses or losses (expenses incurred in a year /no further related costs)	To be recognized in the year in which it is receivable	
Residuary category	Recognised as income over the period necessary to match with related costs	

Treatment of government grants

Non-monetary grants	AS 12	ICDS VII
Assets given at a concessional rate	Accounted on the basis of acquisition cost. Assets given free of cost to be recorded at nominal value	Accounted on the basis of acquisition cost
Refund of grant		
If there is unamortised deferred credit	Refund to be adjusted	
Others	Charged to P&L statement	
Depreciable asset	• Increasing actual cost of WDV • Depreciation on increased amount to be provided prospectively	

Cash subsidy, grant, cash incentive, etc.

Amendment to definition of income u/s 2(24) of Act as per Finance Act 2015 – assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assesse other than subsidy or grant or reimbursement which is taken into account for determination of the actual cost of asset in accordance with Explanation 10 to Section 43(1)

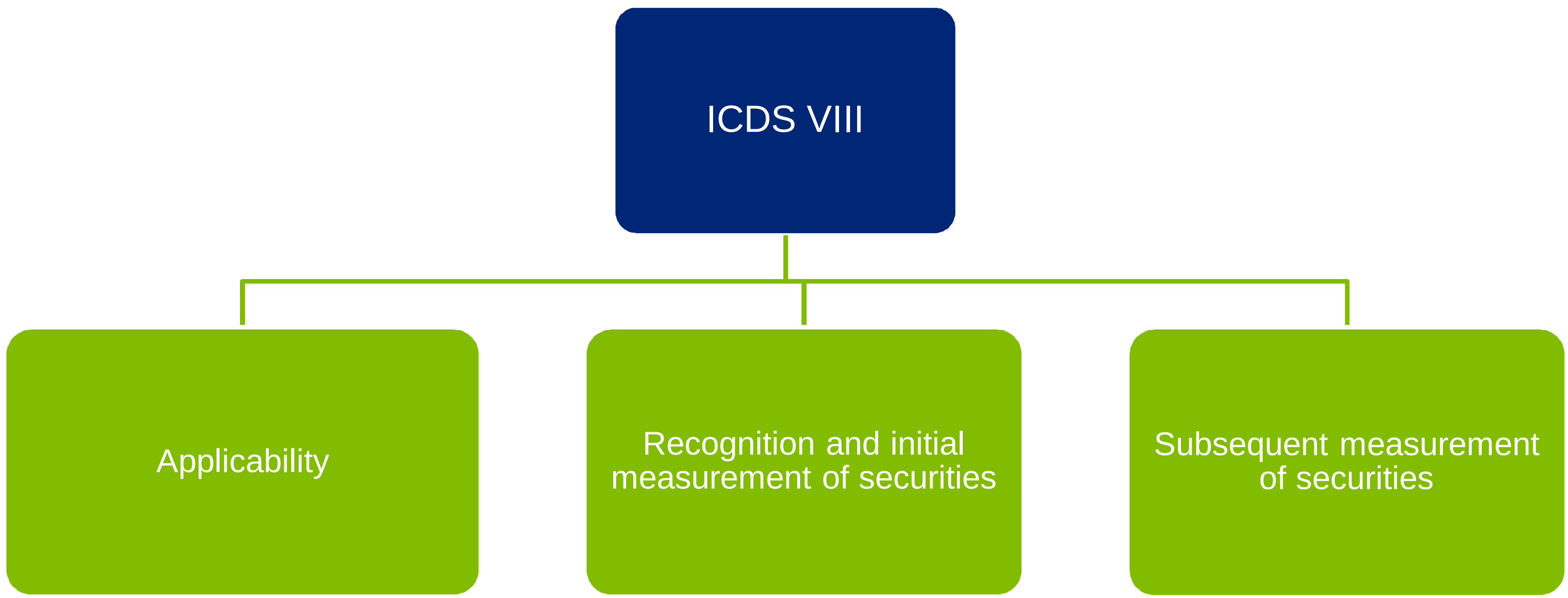
Grants are widely defined under the Act – ICDS now in line with Act

ICDS VII – government grants
Summary

- Government grants will be **recognized when there is reasonable certainty that related conditions will be complied with and it is reasonably certain that ultimate collection will be made** – recognition **cannot be postponed beyond the date of actual receipt**
- **Grants relating to depreciable asset must be reduced from actual cost or written down value**. Grants received for a group of assets will be apportioned
- Grants for compensation of expense / loss or for giving immediate financial support with no further related costs will be **recognized as income in year in which it is receivable**
- Grants relating to non-depreciable assets and other grants will be **recognized as income over the period over which related cost is charged to income**
- The Government grants in the form of **non-monetary assets**, given at a concessional rate, shall be accounted for on the basis of their acquisition cost

ICDS VIII: Securities (AS 13)

Layout of ICDS VIII



Applicability

	AS 13	ICDS VIII
Applicability	Securities which are held as stock-in-trade will be governed by the treatment as applicable to current investment Current Investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made	Securities which are held as stock-in-trade

Recognition and initial measurement of securities

	AS 13	ICDS VIII
On acquisition	Actual cost	Actual cost
Composition of actual cost	Cost of investment includes acquisition charges such as brokerage, fees and duties	Purchase price plus acquisition charges such as brokerage, fees, tax, duty or cess
Acquired in exchange of other securities	Fair value of the security so acquired	Fair value of the security so acquired
Acquired in exchange of another asset	Fair value of asset given up or fair value of asset acquired if later is more clearly evident	Fair value of the security so acquired

Recognition and initial measurement of securities

	AS 13	ICDS VIII
Unpaid interest accrued before acquisition of interest bearing security (interest is included in the price)	• For interest same as ICDS VIII • Also for dividend and right shares	• Interest earned post acquisition to be split between pre-acquisition and post-acquisition periods • Pre-acquisition interest to be deducted from actual cost

Subsequent measurement

	AS 13	ICDS VIII

Held as stock-in-trade (securities listed and quoted)	• Lower of cost or fair value
	• Comparison of cost and NRV category wise is permissible though prudence demands comparison individually
	• Categories
	  • Equity shares
	  • Preference shares
	  • Convertible debentures
	  • Etc.
		• Lower of cost or net realisable value
		• Comparison of cost and NRV category wise and not for individual security
		• Categories
		  • Shares
		  • Debt securities
		  • Convertible securities
		  • Any other securities
		
		(Actual cost - specific identification basis else FIFO)

Subsequent measurement

	AS 13	ICDS VIII
Held as stock-in-trade (securities either not listed or listed but not quoted)	Same as above	Actual cost initially recognised (Actual cost - specific identification basis else FIFO)
Fair value definition	Amount for which asset could be exchanged between a knowledgeable, willing buyer and knowledgeable, willing seller in an arm’s length transaction. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value	Not applicable

Pre-acquisition interest to be reduced from cost…

- Unpaid interest accrued before the acquisition of an interest-bearing security included in the price paid for the security – deducted from actual cost to the extent it pertains to pre-acquisition period. Interesting to note following cases:
  - SC case of Vijaya bank [187 ITR 541] – Given that amounts claimed by the assesse as deduction were not shown to have been expended for the purpose of realizing the interest, interest were not allowable as deductible expenditure.
  - SC case of CitiBank N.A. [Appeal No. 1549 of 2006] – On the basis, that income of such broken period interest was taxed, therefore payment of such broken period interest could not be disallowed. This ruling will apply only in cases where the AO separately taxes the interest on sale.

Illustration: Pre-acquisition interest

Current tax practice – P&L statement	
Expense	Income
9 (pre-acquisition interest paid)	
	12 (interest received)

Current tax practice – Balance Sheet	
Liability	Asset
	100 (investment)

ICDS – P&L statement	
Expense	Income
	3 (interest received)

ICDS – Balance Sheet	
Liability	Asset
	100 (investment)
	+ 9 (pre-acquisition interest paid)
	- 9 (interest received)

- As per current practice, interest paid and received are treated as revenue income / expense
- Under ICDS, interest paid will form part of actual cost of securities and pre-acquisition interest will be reduced therefrom

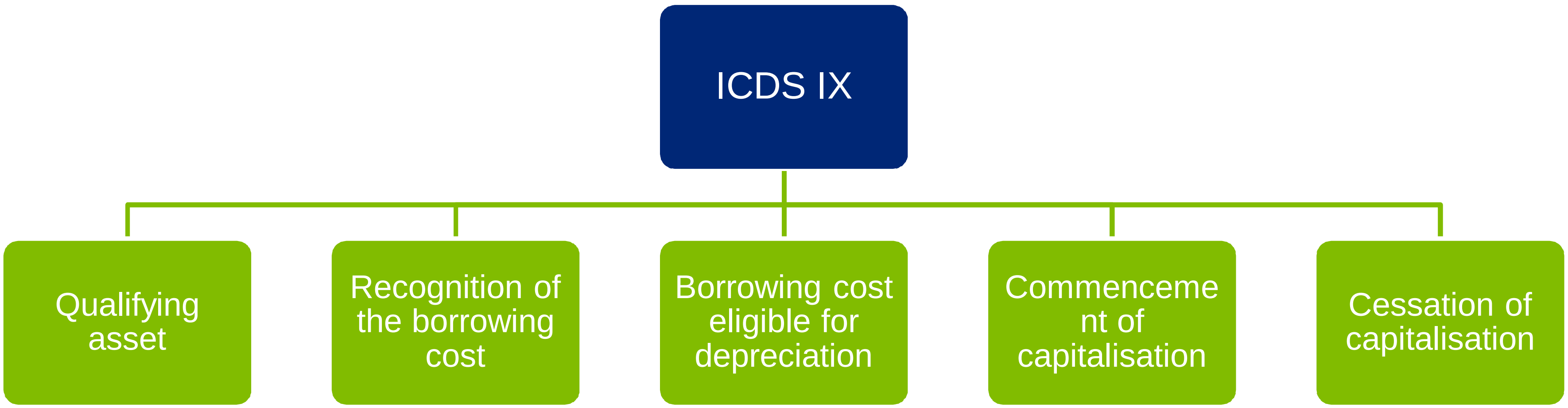
ICDS prevails – pre-acquisition interest must be adjusted to cost of securities

ICDS VIII – securities
Summary

- ICDS deals with securities held as stock-in-trade – shall be carried at **actual cost** (including purchase price, brokerage, cess, tax, etc.) **or net realizable value**, whichever is lower at year-end. **Comparison to be done category-wise and not on individual basis. For this purpose, securities shall be classified as: shares, debt securities, convertible securities and any other**
- Securities not listed or not quoted regularly will be recognized at **actual cost**
- Securities **do not include derivatives**
- **Pre-acquisition interest shall be reduced from the actual cost**

ICDS IX: Borrowing Costs (AS 16)

Layout of ICDS IX



Qualifying asset

AS 16	ICDS IX
• An asset that necessarily takes a substantial period of time to get ready for its intended use or sale. • Ordinarily, period of 12 months is considered as substantial period of time unless a shorter period is justified	• Land, building, machinery, plant or furniture, being tangible assets • 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

Borrowing costs

AS 16	ICDS IX
• Interest • Commitment charges on borrowings • Amortised amount of discounts or premium relating to borrowings • Amortised amount of ancillary cost incurred in connection with the arrangement of borrowings • Finance charges under finance lease • Exchange difference (adjustment to interest discussed earlier)	• Interest and other costs • Commitment charges on borrowings • Amortised amount of discounts or premium relating to borrowings • Amortised amount of ancillary cost incurred in connection with the arrangement of borrowings • Finance charges under finance lease

Recognition

AS 16	ICDS IX
• Borrowing costs directly attributable to acquisition, construction or production of qualifying asset shall be capitalised as part of cost of that asset	• Borrowing costs directly attributable to acquisition, construction or production of qualifying asset shall be capitalised as part of cost of that asset or added to cost of inventory

Borrowing costs eligible for capitalization/ addition

	AS 16	ICDS IX
Specific borrowings	Actual borrowing costs incurred less any income on temporary investment of these borrowings	Actual borrowing costs incurred
General borrowings	Applying weighted average rate of borrowing costs to the expenditure incurred on the qualifying asset	$\dfrac{\text{Borrowing cost * Average cost of qualifying assets}}{\text{Average cost of total assets}}$

Commencement of capitalisation

	AS 16	ICDS IX
Specific borrowings	Fulfilment of following conditions: • Expenditure for acquiring qualifying asset is being incurred, • Borrowing cost is being incurred, • Activities necessary to prepare the asset for its intended use or sale are in progress	Date on which funds were borrowed
General borrowings	Same as above	Date on which funds were utilised

Cessation of borrowing

	AS 16	ICDS IX
Qualifying assets is constructed in parts and a completed part is capable of being used while construction of other parts continues		
Inventory	Substantially all the activities necessary to prepare that part for its intended use or sale are complete.	Completion of activities necessary to prepare such part of inventory for intended sale
Others	Same as above	Date when such part of a qualifying asset is first put to use
Generally		
Inventory	Same as above	Completion of activities necessary to prepare inventory for intended sale
Others	Same as above	Date when asset is first put to use

Illustration: Interest on general borrowings

Particulars	Amount (Rs.)
Total assets appearing in balance sheet as on 31.3.16*	1,000
Total tangible assets acquired during year 2015-16	700
General borrowings	500
Interest on general borrowings	50
Specific borrowings	200
Interest on specific borrowings	20
Cost of assets constructed using general borrowings	450
Cost of assets constructed using specific borrowings	200

Particulars	ICDS	AS 16
Capitalization of general borrowing cost	= 22.73 Working: $\frac{50 \times [(700 - 200) / 2]}{[(300+1000-200) / 2]}$	= 45 (450 X 10%) Working: Weighted average borrowing cost is 10% i.e. (50/500)

** Does not consist of under-construction assets at beginning or end of the year*

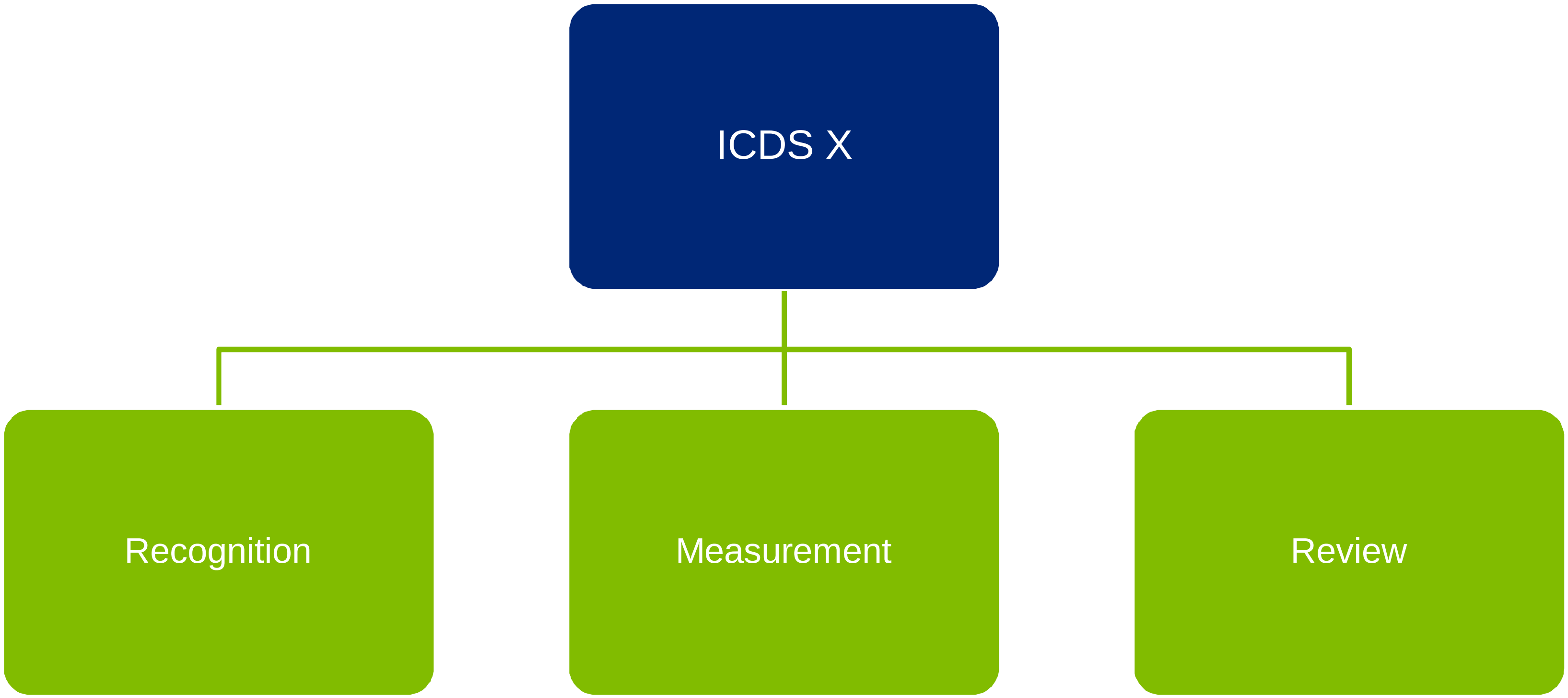
Capitalization of general borrowing cost under ICDS and AS differs

ICDS IX – borrowing costs
Summary

- Borrowing costs (including interest, commitment charges, premium, etc.) shall be capitalized in case of **tangible and intangible assets** to the extent provided in the standard. With respect to inventory, they shall be added to cost only if **inventory takes 12 months or more** for bringing to saleable condition.
- ICDS provides a **specific formula** for capitalizing borrowing costs relating to general borrowings based on the ratio of qualifying assets to total assets.
- **As per Finance Act 2015,** proviso to section 36(1)(iii) is amended to remove the word ‘extension’ and thereby now, ICDS is in line with Act

ICDS X: Provisions, Contingent Liabilities and Contingent Assets

Layout of ICDS X



Recognition

	AS 29	ICDS X
Provisions	• To be recognised if following conditions are satisfied • Present obligation as a result of past event • Probable that outflow of resources required to settle the obligation • Reliable estimate can be made of the obligation	• To be recognised if following conditions are satisfied • Present obligation as a result of past event • Reasonably certain that outflow of resources required to settle the obligation and • Reliable estimate can be made of the obligation
Contingent Liabilities	Contingent liability not be recognised	
Contingent Assets	Contingent asset not be recognised	

Measurement

	AS 29	ICDS X
Provisions	Expenditure required to settle the present obligation at the balance sheet date. Amount of provision should not be discounted to its present value.	• Amount recognised as provision is the best estimate of the expenditure required to settle the present obligation at the end of the previous year. • Amount of provision shall not be discounted to its present value • Amount recognised as asset and related income shall be best estimate of value of economic benefit arising at the end of the previous year.
Reimbursement	When expenditure required to settle a provision is reimbursed by another party, it shall be recognised when it is virtually certain that the reimbursement will be received on settlement of obligation.	When expenditure required to settle a provision is reimbursed by another party, it shall be recognised when it is reasonably certain that the reimbursement will be received on settlement of obligation.

Review

	AS 29	ICDS X
Provisions	• At each balance sheet date and adjusted to reflect the current best estimate. • Provision should be reversed if it is no longer probable that outflow of resources required to settle the obligation	• At the end of each previous year and adjusted to reflect the current best estimate. • Provision should be reversed if it is no longer reasonably certain that outflow of resources required to settle the obligation
Asset	Not applicable	• At the end of each previous year and adjusted to reflect the current best estimate. • Asset and related income should be reversed if it is no longer reasonably certain that inflow of economic benefits will arise

Illustration: Provisions as per books and ICDS

Year 1 – book profits	
Revenue	100
Less: Provision based on probability	(40)
Net profit	**60**

Year 2 – book profits	
Revenue	200
Less: Cost incurred and adjusted against provision	NIL
Net profit	**200**

Year 1 – taxable income (ICDS)	
Revenue	100
Less: Provision based on reasonable certainty	NIL
Net profit	**100**

Year 2 – taxable income (ICDS)	
Revenue	200
Less: Cost incurred as per provision	(40)
Net profit	**160**

As per income-tax, 160 would have got taxed but additional 40 gets taxed as per MAT

Mismatch of profits in books and income-tax could lead to double taxation in case book profits are taxed as per minimum alternate tax (MAT) provisions in year 2

ICDS X – provisions, contingent liabilities and contingent assets

Summary

- A provision should be recognized 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 obligation amount.
- However, as per AS-29, provision is recognized when outflow of resources is **“probable”** and not when it is ‘reasonably certain’.
- Contingent asset must be assessed continually and if it becomes **“reasonably certain”** that inflow of economic benefit will arise, the asset and the income are recognized in previous year in which the change occurs. However, as per AS-29, contingent asset is recognized when inflow of resources is **“virtually certain”** and not when it is ‘reasonably certain’
- Provisions and contingent assets will be reviewed at each year-end and reversed if they do not meet recognition criteria

Q&A

Thank you