WIRC OF ICAI
SEMINAR ON TAX AUDIT
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IMPACT OF ICDS ON TAX AUDIT

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DISCLOSURE

- **CBDT Circular No. 10 of 2017 dated 23rd March 2017**

  Question 25: ICDS-I requires disclosure of significant accounting policies and other ICDS requires specific disclosures. Where is the taxpayer required to make such disclosures specified in ICDS?

  Answer: Net effect on the income due to application of ICDS is to be disclosed in the Return of income. The disclosures required under ICDS shall be made in the tax audit report in Form 3CD. However, there shall not be any separate disclosure requirements for persons who are not liable to tax audit.

ICDS Impact / Disclosures in ITR

ITR	Description	Yes / No
1	For Individuals having Income from Salaries, one house property, other sources (Interest, etc.) and having total income upto Rs. 50 lakh	No
2	For Individuals & HUFs not carrying out business or profession under any proprietorship	No
3	**For Individuals & HUFs having income from a proprietary business or profession**	**Yes**
4 (SUGAM)	For presumptive income from Business & Profession	No
5	**For persons other than (i) individual, (ii) HUF, (iii) company and (iv) person filing Form ITR - 7**	**Yes**
6	**For companies other than companies claiming exemption u/s 11**	**Yes**
7	For persons including companies required to furnish return u/s 139(4A) or 139(4B) or 139(4C) or 139(4D) or 139(4E) or 139(4F)	No

Disclosure Requirements in Form 3CD

Para 13(d)-Whether any adjustment is required to be made to the profits or loss for complying with the provisions of ICDS notified under s. 145(2)

Para 13(e)-*if answer to (d) above is affirmative, give details of such adjustment:*

		Increase in Profit	***Decrease in Profit***	***Net Effect (Rs)***
ICDS I	*Accounting Policies*			
ICDS II	*Valuation of Inventory*			
ICDS III	*Construction Contracts*			
ICDS IV	*Revenue Recognition*			
ICDS V	*Tangible Fixed Assets*			
ICDS VI	*Changes in Foreign Exchange Rates*			
ICDS VII	*Government Grants*			
ICDS VIII	*Securities*			
ICDS IX	*Borrowing Costs*			
ICDS X	*Provisions, CL & CA*			

Disclosure Requirements in Form 3CD

- Para 13(f)- Disclosure as per ICDS

		Disclosures as per ICDS
ICDS I	*Accounting Policies*	
ICDS II	*Valuation of Inventory*	
ICDS III	*Construction Contracts*	
ICDS IV	*Revenue Recognition*	
ICDS V	*Tangible Fixed Assets*	
ICDS VII	*Government Grants*	
ICDS IX	*Borrowing Costs*	
ICDS X	*Provisions, CL & CA*	

TAX AUDITOR

- To certify correctness of particulars in Form 3CD – including adjustments required by ICDS and disclosures under ICDS

- To identify the differences between the accounting standards / Ind AS followed in the books of accounts and the ICDS

- To maintain detailed working / memorandum of accounts on account of difference in the accounting standards and ICDS

ICDS I – ACCOUNTING POLICIES

ICDS 1 – ACCOUNTING POLICIES

- **FAQ 1 : What is the interplay between ICDS-I and maintenance of books of account?**
- *Answer : As stated in the Preamble, ICDS is not meant for maintenance of books of account or preparing financial statements. Persons are required to maintain books of account and prepare financial statements as per accounting policies applicable to them. For example, companies are required to maintain books of account and prepare financial statements as per requirements of Companies Act, 2013.* ***<u>The accounting policies mentioned in ICDS-I being fundamental in nature shall be applicable for computing income under the heads "Profits and gains of business or profession" or "Income from other sources".</u>***

- **What is the purpose and ambit of ICDS I?**
  - One view – Merely a disclosure standard and not computation standard
  - Another view – To be read down as ‘Computation policies’

ICDS 1 – ACCOUNTING POLICIES

❑ **Scope of ICDS I**

Fundamental Accounting Assumptions

- Going concern
- Consistency
- Accrual

Also Covers

- Accounting Policies
- Considerations in selecting Accounting Policy
- Disclosure of Accounting Policies

ICDS 1 – ACCOUNTING POLICIES

- **Case Study – Going Concern**
- ABC Limited has borrowed funds from various financial institutions, besides owes huge sums of money to the creditors.

  Since FY 2013-14, the Company has defaulted payments to the financial institutions and creditors. In FY 2014-15, the financial institutions have filed a case in Court for recovery of money.

  Sundry creditors, who have not been paid for last 3 years have also filed a petition in the court of recovery. ABC Limited was experiencing great financial difficulties and was ready to declare bankruptcy and close operations.

  Under the circumstances, being a Tax Auditor of ABC Limited, would any disclosure be required in relation to ICDS I?

ICDS 1 – ACCOUNTING POLICIES

- **Concept of Prudence**
- As per AS 1 –'**Prudence**' means
  - income to be recognized on realization and not anticipation
  - All known liabilities and losses to be recognized on estimation even though the amount cannot be determined with certainty

Accounting Standard	Recognises the concept of prudence hence, expected losses are provided
ICDS	Mark to market and expected loss should not be provided unless permitted by other ICDS (eg.- Inventory valuation)

ICDS 1 – ACCOUNTING POLICIES

❑ Disclosure Requirements of ICDS I in Tax Audit Report

All significant accounting policies adopted by a person.	• Mercantile method of accounting employed • Expenses and Income are accounted for on accrual basis as per generally accepted accounting principles
• Any change in an accounting policy which has a material effect • Amount by which any item is affected by any change • Whether such amount is not ascertainable, wholly or in part • Any change in an accounting policy of an earlier year which has material effect for the first time during the year	Applicable only if there is some change
Whether any fundamental accounting assumption is not followed	

ICDS II – VALUATION OF INVENTORIES

ICDS II – VALUATION OF INVENTORIES

- **Includes 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
- **Valuation at lower of cost or NRV**
- **Akin to ICAI AS-2, ICDS permits FIFO, Weighted average, specific identification, standard cost or retail method**

ICDS II – VALUATION OF INVENTORIES

❑ General Machinery spares

- As per Revised AS 2 read with Revised AS 10, general machinery spares whose
  - useful life is greater than 12 months and
  - if they fulfil other criteria of definition of 'PPE'
  - are to be treated as Property, Plant and Equipment (PPE).
  - If these conditions are not met, they are to be treated as inventory.

- ICDS II read with ICDS V - all general machinery spares, irrespective of their useful life, are to be treated as inventory. These spares will be charged to profit and loss statement as and when they are consumed.

ICDS II – VALUATION OF INVENTORIES

- **Cost of Purchase**

AS 2	ICDS II
The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition	The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition
Exclusive Method	Inclusive Method

- ICDS in line with section 145A
  - S. 145A(a)(ii) – inventory to include any tax, duty, cess or fee paid or incurred

ICDS II – VALUATION OF INVENTORIES

❑ Applicability of ICDS II to Service Provider

- <u>Accounting Standard</u>
  - Scope excludes WIP of service provider

- Committee Report
  - Incorporate the method of valuation of inventories of a service provider based on the international best practices

- **Cost of Services – para 6**
  The costs of services ~~in case of a service provider~~ shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads

ICDS II – VALUATION OF INVENTORIES

- **Definition of Inventories-**
  - Inventories are assets-
    a) held for sale in the ordinary course of business;
    b) in the process of production for such sale;
    c) in the form of materials or supplies to be consumed in the production process or in the rendering of services

- ICDS III / IV – revenue recognition on POCM basis

- Possible view - Inventories does not include WIP of a service provider but includes only materials or supplies to be consumed in the rendering of services

ICDS II – VALUATION OF INVENTORIES

- **Value of Opening Inventory – paragraph 22**

If business has commenced during the year	Opening Inventory = Cost of Inventory as on the day of commencement of business
In any other case	Opening Inventory = the value of the inventory as on the close of the immediately preceding previous year

- Issue arises where an assessee converts his capital asset into stock-in-trade and commences his business during the year.

ICDS II – VALUATION OF INVENTORIES

❑ Illustration - Value of Opening Inventory

Mr A had acquired a plot of land on 01.04.2005 for Rs 50 Lakhs. He converts this land into stock in trade for dealing in plots on 01.07.2016. FMV as on 01.07.2016 of the plot of land is 2 Crore.

What will be the value of the opening inventory?

ICDS II – VALUATION OF INVENTORIES

- **In case of dissolution of a partnership firm / AOP / BOI, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at NRV**

- **Illustration– Valuation of inventory in case of dissolution**
  AP & Co, a partnership firm consisting of 2 partners, is in the business of manufacturing electric bulbs. On 01.07.2016, Mr A died due to a heart attack. Since the Firm was reduced to one partner, the partnership firm was dissolved with effect from 01.07.2016. Mr P, the other partner, decided to continue the business under his proprietor capacity.
  As on 30.06.2016, the cost of the inventory was Rs 1 Crore and NRV of the inventory was Rs 1.25 Crore
  What will be the value of inventory as on the date of dissolution ?

ICDS II – VALUATION OF INVENTORIES

❑ Disclosure Requirements in Tax Audit Report

The accounting policies adopted in measuring inventories including the cost formulae used.	Inventory is valued at lower of cost or NRV
Where Standard Costing has been used as a measurement of cost, details of such inventories and **a confirmation of the fact that standard cost approximates the actual cost; and**	Not Applicable
The total carrying amount of inventories and its classification appropriate to a person.	• Total Carrying amount of inventories is Rs …… • Classification – raw materials / components / finished goods / stock / spares etc (Clause of financial statement may also be referred)

ICDS III – CONSTRUCTION CONTRACT

ICDS III – CONSTRUCTION CONTRACT

- Applicable only to contracts commenced on or after 1.4.2016

	AS	ICDS
Contract Revenue comprises of	• Initial amount of revenue agreed • Variations in the contract work, claims and incentive payments only if : ✓ it is probable that they will result in revenue; and ✓ they are capable of being reliably measured	• Initial amount of revenue agreed & **retention money** • Variations in the contract work, claims and incentive payments only if : ✓ it is probable that they will result in revenue; and ✓ they are capable of being reliably measured

- As per ICDS III, Contract revenue should be **recognized only when there is reasonable certainty of its ultimate collection**
    - Reasonable certainty would mean there is hardly any doubt about collection of revenue

ICDS III – CONSTRUCTION CONTRACT

Case Study – Retention Money

Entered into construction contract

I Co. → **Customer**

Customer pays consideration	
During construction period	90 %
Retention money payable after 2 years	10 %
Total	**100%**
Stage of completion of contract of year 1	40%

Facts

- I Co executes a construction contract for customer for consideration of Rs 100 Cr
- As per the contractual terms, 90% of payment is released while construction is in progress
- Balance 10% will be released after 2 years (Yr 3) post completion of contract subject to satisfactory performance without defects

Issue

- What is the amount of contract revenue to be offered in Year 1, Rs 40 Cr or Rs 36 Cr ?
- Will it make any difference if separate bill for retention money is raised after 2 years?

ICDS III – CONSTRUCTION CONTRACT

❑ **Retention Money**

- ICDS - retentions constitutes contract revenue.
- This proposition was never in doubt.
- Issue - the year in which such revenue satisfied the test of accrual.
- Judicial decisions - contractor cannot be said to have earned the retentions in terms of section 5 unless the conditions stipulated in the contract are satisfied or defects are rectified.
- No enforceable right arises till the conditions are satisfied or defects are rectified. Till such time the right to receive vis-àvis retentions is contingent in nature [*CIT v Simplex Concrete Piles (India) (P) Ltd [1989] 179 ITR 8 (Cal), CIT v P&C Constructions (P) Ltd [2009] 318 ITR 113 (Mad), Amarshiv Construction (P) Ltd v DCIT [2014] 367 ITR 659 (Guj)*].
- Contract revenue – satisfaction of test of accrual

ICDS III – CONSTRUCTION CONTRACT

- As per ICDS III, Contract revenue should be recognized only when there is reasonable certainty of its ultimate collection

- Is there reasonable certainty of ultimate collection of retention money?

- **Q.11 of CBDT Circular No. 10 of 2017 dated 23rd March 2017**
  Question 11: Whether the recognition of retention money, receipt of which is contingent on the satisfaction of certain performance criterion is to be recognized as revenue on billing?
  Answer: Retention money, being part of overall contract revenue, shall be recognised as revenue <u>subject to reasonable certainty of its ultimate collection condition</u> contained in para 9 of ICDS-III on Construction contracts

ICDS III – CONSTRUCTION CONTRACT

- Contract revenue written off from books as uncollectible:

Accounting Standard 7	ICDS III
Revenue already recognized **can be reversed** on account of uncertainty on realization of contract revenue	Reversal of revenue which is written off in the books of accounts, needs **to be claimed separately as an expense** and no adjustment should be made to the contract revenue

- Possible Impact-
- Assessee following presumptive taxation u/s 44AD
- Applicability of audit u/s 44AB

ICDS III – CONSTRUCTION CONTRACT

- Incidental Income

Accounting Standard 7	ICDS III
Incidental income allowed to be set off against contract cost subject to certain conditions.	Incidental income in the nature of interest, dividends or capital gains not allowed to be set off against contract cost

- **Tuticorin Alkali Chemicals and Fertilizers Limited v CIT (227 ITR 172) (SC):**
  Interest income earned by the assessee from surplus funds available during the construction of a factory should not be reduced from the costs incurred in constructing the factory but would constitute taxable income

- **CIT v Bokaro Steel Ltd (236 ITR 315) (SC) :**
  Ratio of Tuticorin cannot be applied in cases where these receipts were directly connected or were incidental to the work of construction

ICDS III – CONSTRUCTION CONTRACT

- Expected / foreseeable losses

Accounting Standard 7	ICDS III
Expected losses from contract to be recognised in full	Expected loss allowed only to the extent of proportion of work completed by year end
No definition of what % of completion up to which a contract can be considered as at early stage	The early stage of a contract shall not extend beyond 25% of the stage of completion

- Judicial precedents permit recognition of foreseeable loss aligned to AS 7.
  - CIT vs Triveni Engineering & Industries Ltd [336 ITR 374 (Del)]
  - CIT vs Advance Construction Co. (P) Ltd [275 ITR 30 (Guj)]
  - Jacobs Engineering India (P) Ltd vs ACIT [30 DTR 614 (Mum Trib)]

ICDS III – CONSTRUCTION CONTRACT

- Expected / foreseeable losses

Year	Contract	Interest Income	Total Income computation		Remarks
			Taxable Income (ICDS)	Book Profit	
1 (<25% work)	Foreseeable loss of Rs. 50,000	40,000	40,000	(10,000)	Foreseeable loss of Contract is not allowed as deduction in Year 1
2	Contract concludes on Loss of Rs.50,000	40,000	(10,000)	40,000	Actual Loss of Rs. 50,000 of contract will be allowed as deduction in normal computation whereas MAT will apply

ICDS III – CONSTRUCTION CONTRACT

❑ Disclosure Requirements in Tax Audit Report

1. Amount of contract revenue recognised as revenue in the period	Total amount recognised
2. Method used to determine the stage of completion of contracts in progress	Proportion of contract cost method/surveys of work performed method/physical proportion method has been used for calculation of POCM
3. Disclosures for contracts in progress at the reporting date	
• Amount of costs incurred and recognised profits (less recognised losses) upto the reporting date	Amount to be shown
• Amount of advances received; and	
• Amount of retentions	

ICDS IV – REVENUE RECOGNITION

ICDS IV – REVENUE RECOGNITION

Revenue recognition criteria as per ICDS

- Construction contract (including services directly related to construction like architect)
  - POCM
- Sale of goods
  - Transfer of property or significant risks & rewards of ownership to buyer
- Rendering of services
  - Ordinarily, POCM
  - If contract duration ≤ 90 days, permits completed contract method
  - If services by indeterminate number of acts, permits straight line method
- Interest
  - Receipt basis for interest on tax refund
  - Time basis for other
- Royalty (as defined by ITA)
  - As per contractual terms, unless some other systematic / rational basis as per substance of transaction
- Dividend
  - As per ITA

ICDS IV – REVENUE RECOGNITION

- Revenue from sale of goods recognised upon transfer of property or upon transfer of significant risk/ rewards of ownership to buyer
  - ✓ In case of timing mismatch between transfer of property vs. significant risks/ rewards; revenue to be recognised on transfer of significant risks/ rewards
- Revenue to be recognised only if there is reasonable certainty of its ultimate collection
  - ✓ ICDS not materially different from AS-9

ICDS IV – REVENUE RECOGNITION

- <u>Reliable measurement</u>
  - AS 9 –Recognition of revenue to postponed where it cannot be reliably measured or determined
  - ICDS - no specific mention
- As per section 5 and as per ruling in CIT vs. A. Gajapathy Naidu 53 ITR 114 (SC):

  "income accrues or arises when the assessee acquires a right to receive the same"

  Where revenue cannot be measured, assessee has not acquired the right to receive the same
- May result in revenue recognition as per ICDS, though not as per accounts

ICDS IV – REVENUE RECOGNITION

- Revenue from service transactions

Features of service	Less than or equal to 90 days	More than 90 days
Service contract specifying indeterminate number of acts	Taxpayer can follow completed contract method	Taxpayer can follow Straight Line Method
Service contract with specified milestones	Taxpayer can follow completed contract method	Taxpayer shall follow Percentage of Completion Method

ICDS IV – REVENUE RECOGNITION

- <u>Recognition of Interest Income</u>
  - <u>AS</u> – Interest income to be recognized on time basis and recognition to be postponed where it is unreasonable to expect ultimate collection
  - <u>ICDS</u> - Interest income to be recognized on time basis irrespective of whether ultimate collection is certain or not
  - <u>FAQ 13 of CBDT Circular</u> - test of reasonable certainty of ultimate collection does not apply to interest and royalty income; subsequent non-recovery can be claimed as deduction u/s. 36(1)(vii)
  - <u>Specific provisions</u> of the ITA (e.g. s. 43D, 145A) override ICDS
- As per settled legal position, interest income not taxable (unless contractually due) in absence of real income
  - Credit Suisse First Boston 351 ITR 323 (Bom), City Union Bank Ltd 51 taxmann.com 542 (Mad)
- Interest on refund of any tax, duty or cess to be taxable on receipt basis

ICDS IV – REVENUE RECOGNITION

❑ Disclosure Requirements in Tax Audit Report

• In a transaction involving sale of good, total amount not recognised as revenue due to lack of reasonably certainty of its ultimate collection	Not Applicable OR Amount of Rs …. was not recognized
• Amount of revenue from service transactions recognised as revenue	Amount to be shown
• Method used to determine the stage of completion of service transactions in progress;	Name of the method to be shown
• For service transactions in progress at the end of previous year-	
✓ amount of costs incurred and recognised profits (less recognised losses) upto end of previous year	Amount to be shown
✓ the amount of advances received	
✓ amount of retentions	

ICDS V – TANGIBLE FIXED ASSETS

ICDS V – TANGIBLE FIXED ASSETS

- **Deals with treatment of Tangible Fixed Assets**
- **Components of actual cost**

- Actual Cost of acquired Fixed Asset to comprise of
  - Purchase prices
  - Import Duties and taxes (*excluding those subsequently recoverable)*
  - Directly attributable expenses on making asset ready for its intended use.
- Under AS 10, cost includes estimated **<u>cost of dismantling and removing the assets and site restoration</u>** – not to be treated as part of cost under ICDS
  - To be treated as revenue expenditure in year in which incurred for tax purposes

- Under AS, if payment beyond normal credit terms, **<u>difference between cash price and purchase price</u>** to be recognised as interest
- Under ICDS, no bifurcation of cost to account for such interest.

ICDS V – TANGIBLE FIXED ASSETS

Caption	ICDS	AS 10 (Revised)
Capitalisation	• Stand-by equipment and servicing equipment are to be capitalised. • Machinery spares shall be 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.	• Spare parts, stand-by equipment and servicing equipment are to be recognised as assets if they meet the definition of Property, Plant and Equipment. • Otherwise, they are classified as inventory.

Scenario - Case where, under the tests laid down under AS 10, stand-by equipment or spares are classified as inventory, but as per this ICDS, these are required to be recognised as tangible assets, **Impact-** The amount expended on stand-by equipment or spares debited to the P&L account will have to be reduced from the expenditure and added to the appropriate block of assets, with corresponding depreciation claim.

ICDS V – TANGIBLE FIXED ASSETS

- **Differences between ICDS and AS 10 (Revised)**

Caption	ICDS	AS 10 (Revised)
Immaterial expenditure whether treated as fixed assets	No option of expensing off of immaterial assets resulting in onerous compliances and record keeping	Option to expense off an item if the amount of the expenditure is not Material
Asset acquired against non monetary consideration: Value of asset Acquired	Fair value of tangible fixed asset acquired	Its cost is usually determined by reference to the FMV of the consideration given. It may be appropriate to consider also the FMV of the asset acquired if this is more clearly evident

ICDS V – TANGIBLE FIXED ASSETS

❑ Treatment of Post trial run and pre-commercial production expenditure

Trial run expenditure → Expenditure between trial run and commercial production → Expenditure post commercial production

Trial run expenditure: Treated as capital expenditure in books as also for tax purposes

Expenditure between trial run and commercial production:

Old AS-10	Choice between revenue expenditure or deferred revenue expenditure
Revised AS-10	Mandates treatment as revenue expenditure
ICDS V	FAQ clarifies that it should be treated as capital expenditure

Expenditure post commercial production: Treated as revenue expenditure in books as also for tax purposes

ICDS V – TANGIBLE FIXED ASSETS

Disclosure Requirements in Tax Audit Report

• Description of asset or block of assets;	As per Clause 18 of Form 3CD
• 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, 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; and	
• Written down value at the end of year.	

ICDS VI – EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

ICDS VI – EFFECTS OF CHANGES IN FOREX

❑ **<u>Initial Recognition of foreign currency transaction –</u>**

✓ 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** or an **average rate** for a week or a month that approximates the actual rate –

  {If the exchange rate **fluctuates significantly**, the actual rate at the date of the transaction shall be used.}

ICDS VI – EFFECTS OF CHANGES IN FOREX

- **Rule 115**

  Exchange Rate – the exchange rate adopted by the SBI for buying that currency

- **Relevant date for determining applicable exchange rate –**
  - *income by way of **dividends or interest on securities**, the **last day** of the month immediately **preceding the month** in which, the dividend is declared or paid, or the interest is due.*
  - *income chargeable under the heads, "Profits and gains of **business** or profession" and "Income from **other sources**", the **last day of the previous year**; (other than income already brought in India during the year)*

- **Difference between ICDS v. Rule 115 –**
  - ✓ Dividend & Interest Income –
    - ICDS – exchange rate on the date of transaction
    - *Rule 115 – exchange rate of the last day of the preceding month*

ICDS VI – EFFECTS OF CHANGES IN FOREX

❑ **Conversion at last day of Previous Year**

Particulars	ICDS	AS 11	Adjustments to be considered
Non-monetary items –clause c			
Carried at historical cost	Exchange rate at the date of the transaction	Exchange rate at the date of the transaction	No difference
Carried at fair value or other similar valuation	Exchange rate at the date of the transaction	Exchange rates that existed when the fair value or other similar valuation was determined	Difference will arise due to respective exchange rates used
Non-monetary items –clause d			
Non-monetary items being inventory carried at NRV-clause d	Exchange rate that existed when NRV was determined	Exchange rate that existed when NRV was determined	No difference

ICDS VI – EFFECTS OF CHANGES IN FOREX

Item of Asset / Liability	Monetary / Non-Monetary	Exchange Rate on Transaction Date	Closing Rate on March 31	Conversion on Last Date of Previous Year	Remarks
Trade Receivables - Debtor XYZ	Monetary	63	65.5	65.5	Stated at closing rate - sub-para (a) Applied
Investment in Shares - Company A	Non-Monetary	64	65.5	64	Stated at Exchange rate on Transaction Date – see sub-para (c)
Inventory	Non-Monetary	65	60	60	Stated at Exchange rate on the date when NRV was determined - sub-para (d)

ICDS VI – EFFECTS OF CHANGES IN FOREX

❑ **Recognition of Exchange differences (Arising on settlement or conversion on last day)**

Particulars	ICDS	AS 11	Adjustments to be considered
Monetary Items	To be recognised as income or as expense	To be recognised as income or as expense	No Impact
Monetary Items of Non Integral foreign operation	No distinction between integral and non-integral foreign operations	To be accumulated in a foreign currency translation reserve in the enterprise's financial statements until the disposal of the net investment, at which time they should be recognised as income or as Expenses	Adjustment in computation of income required
Non Monetary Items	Not to be recognised as income or expense	Not to be recognised as income or expense	No Impact

ICDS VI – EFFECTS OF CHANGES IN FOREX

- ❑ Inventory
- Valuation of Inventory Cost or NRV whichever is lower. Comparison of Cost & NRV in foreign currency or INR ?
- E.g. Cost & NRV of Inventory is 100$, but exchange rate reduced from 68 Rs./$ (date of acquisition) to 65 Rs./$ (on last day of year) - How should inventory be valued ?
- *Para 4(d) non-monetary item being inventory which is* ***carried at NRV denominated in a foreign currency*** *shall be reported using the exchange rate that existed when such value was determined.*
- *Para 5(ii) exchange differences arising on conversion of non-monetary items not be recognised as income or expense.*

ICDS VI – EFFECTS OF CHANGES IN FOREX

- <u>Financial Statements of Foreign Operations</u>

- Financial statements of a foreign operation shall be translated using the principles and procedures used for foreign currency transactions as if the transactions of the foreign operation had been those of the person himself.

  - Under AS 11, classification of foreign operation as integral or non-integral is made
  - The principles for translation of integral foreign operation are similar to ICDS.
  - AS – 11 - exchange differences arising on translation of <u>**non-integral foreign operation**</u> to be accumulated separately in foreign currency translation reserve till investment in foreign operation is disposed.
  - Difference between ICDS and AS

ICDS VI – EFFECTS OF CHANGES IN FOREX

- **<u>Q.16 of CBDT Circular No. 10 of 2017 dated 23rd March 2017</u>**

  Question 16: *What is the taxability of opening balance as on 1st day of April 2016 of Foreign Currency Translation Reserve (FCTR) relating to non-integral foreign operation, if any, recognised as per Accounting Standards (AS) 11?*

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

- Answer seems debatable as there is no real income that is really earned on the conversion

ICDS VI – EFFECTS OF CHANGES IN FOREX

❑ **Disclosure Requirements in Tax Audit Report**

✓ There are no disclosure requirements in relation to ICDS VIII

✓ Impact (increase/decrease in profit) due to ICDS VIII to be disclosed in Tax Audit Report and ITR

ICDS VII – GOVERNMENT GRANTS

ICDS VII – GOVERNMENT GRANTS

- **Recognition of Government Grants:**
  - ✓ Government grants should not be recognised until there is reasonable assurance that the person shall comply with the conditions attached to them, and the grants shall be received.
  - ✓ Recognition of Government grant shall not be postponed beyond the date of actual receipt

ICDS VII – GOVERNMENT GRANTS

- **Grants relating to depreciable fixed assets**
  - ICDS - Reduction of grants from the 'actual cost' or 'WDV' of the asset - in line with explanation 10 to section 43(1)
  - As per AS 12, two methods of presentation in financial statements of grants related to specific fixed assets-
    1. Deduction from the gross value of the asset in arriving at its book value, or
    2. Treat as deferred income and recognise in the profit and loss statement on a systematic and rational basis over the useful life of the asset.
  - ICDS recognises only one method - first method of AS 12
  - If second method followed in books, adjustment under ICDS required

ICDS VII – GOVERNMENT GRANTS

- **Grants relating to depreciable fixed assets**

  - Case Study

    ABC Limited receives grant in Year 1 from the Central Government but the asset is purchased in Year 2.
    The question is whether the grant has to be recognised in Year 1 or 2?

- Para 4 - mandatory not to postpone the recognition beyond ‘receipt’ of grant
- However, the recognition mechanism fails since the assessee is not aware of the cost of asset which is acquired in Year 2

ICDS VII – GOVERNMENT GRANTS

- **Grants relating to non - depreciable fixed assets**

  - *Where the Government grant relates to a non-depreciable asset or assets of a person requiring fulfillment of certain obligations, the grant shall be recognised as income over the same period over which the cost of meeting such obligations is charged to income*

  - Similar treatment is evident in AS 12.

ICDS VII – GOVERNMENT GRANTS

- **Grants which not directly relatable to asset acquired (whether depreciable or not)**

- Total grant has to be apportioned over the various assets to reduce their cost proportionately

- Amount to be reduced from the actual cost or written down value can be computed in the following manner:

- Amount to be reduced from actual cost/ written down value = (A * B)/C
  Where A = Value of the asset acquired;
  B = Total government grant received or receivable; and
  C = Sum of all assets in respect of which Government grant is received

  - Same treatment applicable in case of non-depreciable assets

ICDS VII – GOVERNMENT GRANTS

- **Grants in relation to non – depreciable assets**

- Grants directly relatable to non-depreciable assets - to be apportioned over the period of costs in the profit and loss account
- Grants not directly relatable to non-depreciable assets - proportionate reduction from the cost of the asset

- **Section 2(24)(xviii)** provides that government grant including all its variants (whether in cash or kind) are categorized as income save grants in relation to depreciable assets referred in expln. 10 to section 43(1). Therefore, grants in relation to non-depreciable assets would be categorized as 'income' or 'revenue item' for the purposes of the Act.

- **Whether a grant not directly relatable to non-depreciable assets should be treated as an income (in accordance with section 2(24)(xviii) and offered to tax,**

OR

- **Whether such grant should be proportionately reduced from the cost of the asset in accordance with the ICDS VII?**

ICDS VII – GOVERNMENT GRANTS

Disclosure Requirements in Tax Audit Report

• Nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets during the previous year;	Amount to be shown
• Nature and extent of Government grants recognised during the previous year as income	Amount to be shown
• Nature and extent of Government grants not recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets and reasons thereof; and	Amount along with reasons thereof
• Nature and extent of Government grants not recognised during the previous year as income and reasons thereof	Amount along with reasons thereof

ICDS VIII – SECURITIES

ICDS VIII – SECURITIES

ICDS VIII

Part A

- Deals with Securities held as stock in trade

Part B

- Deals with Securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 / 2013

ICDS VIII – SECURITIES

- **Part A**
  - **Scope – ICDS VIII does not apply to-**
    - Recognition of Interest and dividends on securities - ICDS IV;
    - Securities held by-
      - person engaged in the business of insurance;
      - MFs, VCFs, banks & public financial institutions
        - NBFC not excluded from the scope. ICDS VIII shall apply

- **Definition of Securities – s. 2(h) of Securities Contracts (Regulation) Act, 1956**
- Specific inclusion - share of a company in which public are not substantially interested
- Specific exclusion – derivatives

ICDS VIII – SECURITIES

Subsequent Measurement (at the end of the year)	
Listed Securities	Lower of cost or NRV Bucket approach To be classified into 4 buckets – • shares • debt securities • convertible securities • any other security
Unlisted Securities or thinly traded Securities	At cost initially recognized

ICDS VIII – SECURITIES

- **FAQ 19**

Qs: Para 9 of ICDS-VIII on securities requires securities held as stock-in-trade shall be valued at actual cost initially recognised or net realisable value (NRV) at the end of that previous year, whichever is lower. Para 10 of Part-A of ICDS-VIII requires the said exercise to be carried out category wise. How the same shall be computed?

Answer: For subsequent measurement of securities held as stock-in-trade, the securities are first aggregated category wise. The aggregate cost and NRV of each category of security are compared and the lower of the two is to be taken as carrying value as per ICDS-VIII. This is illustrated below-

ICDS VIII – SECURITIES

- **FAQ 19 (contd)**

Security	Category	Cost	NRV	Lower of cost or NRV	ICDS Value
A	Share	100	75	75	
B	Share	120	150	120	
C	Share	140	120	120	
D	Share	200	190	190	
	Total	**560**	**535**	**505**	**535**
E	Debt Security	150	160	150	
F	Debt Security	105	90	90	
G	Debt Security	125	135	125	
H	Debt Security	220	230	220	
	Total	**600**	**615**	**585**	**600**
Securities Total		**1160**	**1150**	**1090**	**1135**

ICDS VIII – SECURITIES

- **Part B of ICDS VIII**
- ✓ **Scope**

  Deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 / 2013

- ✓ **Recognition**
  - Securities shall be classified, recognised & measured in accordance with the RBI Guidelines
  - Any claim for deduction in excess of the said guidelines shall not be taken into account
  - To this extent, the provisions of ICDS VI on the effect of changes in foreign exchange rates relating to forward exchange contracts shall not apply

ICDS VIII – SECURITIES

- ❑ **Disclosure Requirements in Tax Audit Report**
- ✓ There are no disclosure requirements in relation to ICDS VIII
- ✓ Impact (increase/decrease in profit) due to ICDS VIII to be disclosed in Tax Audit Report and ITR

ICDS IX – BORROWING COST

ICDS IX – BORROWING COST

- **Deals with capitalisation of borrowing cost**

- **ICDS – does not deal with allowability of borrowing costs as expenditure**
  - Allowability of expense governed by section 36(1)(iii), or by section 57(iii)

- **Conflict between section 36(1)(iii) and ICDS IX**
  - ICDS to include inventory which takes more than 12 months to be ready for sale
  - Proviso to S. 36(1)(iii) - prohibits deduction in respect of capital borrowed for acquisition of an **asset**
    - ✓ Term "asset" used in this proviso, has to be construed as "**capital asset**",
  - CIT v Lokhandwala Construction Industries (260 ITR 579) (Bom) confirmed - the term 'asset' used in proviso to S.36(1)(ii) to be construed as 'capital asset'.

ICDS IX – BORROWING COST

	ICDS IX	AS 16
Qualifying Asset	Specified tangible and intangible assets regardless of their time to get ready, are covered. Inventories requiring a period of 12 months or more to bring them to a saleable condition are covered. However, for the purpose of general borrowing, asset that necessarily require a period of 12 months or more for its acquisition, construction or production	It covers assets which take substantial period of time to get ready for its intended use or sale. Ordinarily, period of 12 months is usually considered as substantial period of time, however not mandatory.

ICDS IX – BORROWING COST

- **Q.20 of CBDT Circular No. 10 of 2017 dated 23rd March 2017**

  Question 20: There arc specific provisions in the Act read with Rules under which a portion of borrowing cost may get disallowed under sections like 14A, 438, 40(a)(i), 40(a)(ia), 40A(2)(b), etc of the Act. Whether borrowing costs to be capitalized under ICDS-IX should exclude portion of borrowing costs which gets disallowed under such specific provisions?

  Answer: Since specific provisions of the Act override the provisions of ICDS, it is clarified that borrowing costs to be considered for capitalization under ICDS IX shall exclude those borrowing costs which are disallowed under specific provisions of the Act. Capitalization of borrowing cost shall apply for that portion of the borrowing cost which is otherwise allowable as deduction under the Act.

- **<u>Amount of borrowing costs to be capitalized would be different under ICDS and AS</u>**

ICDS IX – BORROWING COST

Specific Borrowings	General Borrowings
• 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. • Capitalisation of such costs shall COMMENCE from the date on which funds were borrowed.	• Borrowing costs related to the funds utilised for acquisition, construction or production of a qualifying asset, amount to be capitalised shall be computed using the pro rata formula (A*B/C) • Capitalisation of such costs shall COMMENCE from the date on which funds were utilised.

- Capitalisation of such borrowing costs shall CEASE when:
  - a qualifying asset or a part of it is put to use;
  - all the substantial activities are completed to prepare Inventory or a part of inventory for its intended sale.

ICDS IX – BORROWING COST

	ICDS IX	AS 16
Commencement of capitalisation	Specific borrowings: • from the date on which funds were borrowed General borrowings: • from the date on which funds were utilized	When below conditions are met: • Expenditure on qualified asset • incurred. • Borrowings costs incurred • Activities to prepare asset for its intended use or sale is in progress.
Cessation of capitalisation	Capitalisation should cease when: • a qualifying asset or a part of it is put to use; • Substantial activities completed to prepare Inventory or a part of inventory for its intended sale	Capitalisation should cease when: • all the substantial activities are completed to prepare a qualifying asset for its intended sale or use.

ICDS IX – BORROWING COST

	ICDS IX	AS 16
Suspension of capitalisation	Not covered by ICDS	During extended periods in which active development is interrupted.
Income from temporary investment – specific borrowings	• ICDS silent • The income from temporary investments of those borrowings is not reduced from the amount of borrowing costs incurred.	Such income is reduced from borrowing costs eligible for capitalization.

ICDS IX – BORROWING COST

❑ Disclosure Requirements in Tax Audit Report

• The accounting policy adopted for borrowing costs;	• In case of specific borrowing, actual borrowing cost has been capitalized on that asset • In case of general borrowing, borrowing cost is being capitalized as per Para 6 of ICDS IX
• The amount of borrowing costs capitalised during the previous year	• Amount to be shown

ICDS X – PROVISIONS, CONTINGENT LIABILITES & CONTINGENT ASSETS

ICDS X - PROVISIONS, CONTINGENT LIABILITES & CONTINGENT ASSETS

Recognition of Provision

	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 • Reliable estimate can be made of the Obligation

"Probable vs Reasonably Certain"

CASE STUDY – Provision for warranty

ABC Mobile Ltd. is a manufacturer of a mobile phones and provides warranty of one year on all the mobile phones sold.

Can the provision for such warranty be made in accordance with ICDS-X?

CASE STUDY – Provision for onerous contracts

An enterprise operates profitably from a factory that it has leased under an operating lease. During December 2017 the enterprise relocates its operations to a new factory. The lease on the old factory continues for the next four years, it cannot be cancelled and the factory cannot be re-let to another user.

Onerous Contract

Can a provision be recognized for the best estimate of the unavoidable lease payments?

ICDS X - PROVISIONS, CONTINGENT LIABILITES & CONTINGENT ASSETS

❑ Contingent Assets

- Recognition of a contingent asset as an asset and its related income – requires lesser degree of certainty under ICDS X
- Under ICDS - **reasonable certainty** of inflow of economic benefits
- Under accounting standard, **virtual certainty** of inflow of economic benefits.

❑ Reimbursement

- Recognition on **reasonable certainty** under ICDS, as against **virtual certainty** under AS 29

ICDS X - PROVISIONS, CONTINGENT LIABILITES & CONTINGENT ASSETS

❑ Disclosure Requirements in Tax Audit Report

Disclosures in respect of each class of provision-		
	A brief description of the nature of the obligation	Nature of obligation
	Carrying amount at the beginning and end of the previous year	Opening Bal
	Additional provisions made during the previous year, including increases to existing provisions	Add- Amount provided
	Amounts used, that is incurred and charged against the provision, during the previous year	Less – Amount paid
	Unused amounts reversed during the previous year	Less – Amount reversed
	Amount of any expected reimbursement, stating the amt of any asset that has been recognized for that expected reimbursement	Amount

ICDS X - PROVISIONS, CONTINGENT LIABILITES & CONTINGENT ASSETS

❑ Disclosure Requirements in Tax Audit Report

Disclosure to be made in respect of each class of asset & related income recognised		
	Brief description of the nature of the asset & related income	Nature
	Carrying amount of asset at the beginning and end of the previous year	Amount
	Additional amount of asset & related income recognised during the year, including increases to assets & related income already recognized	Add- Amount added during the year
	amount of asset & related income reversed during the previous year	Less – Income reversed during the year

THANK YOU