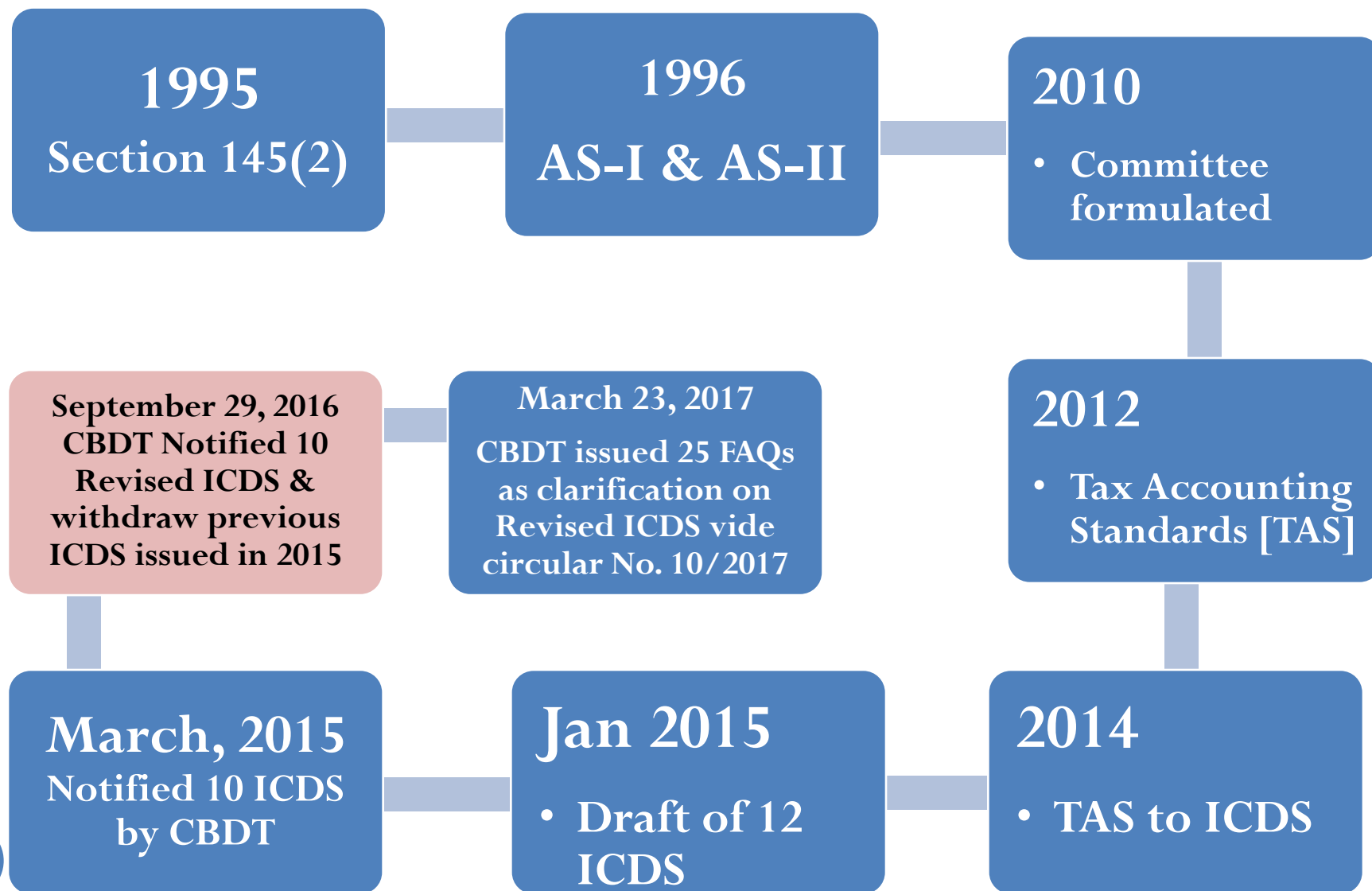


An Overview of Income Computation & Disclosure Standards (ICDS) and its Impact



Presented by: CA. Sanjay Agarwal
Assisted by: CA. Apoorva Bhardwaj & CA. Sonia Rani
Email id: agarwal.s.ca@gmail.com

AS I & AS II → TAS → ICDS



Prologue



- ❖ The Finance Act, 1995 empowered the Central Government to notify, the Accounting Standards for computing the income under the head **“Profits and Gains of Business or Profession”** or **“Income from Other Sources”** vide Section 145(2) of Income Tax Act, 1961.
- ❖ Section 145 of the Act after amendment by Finance Act (No.2), 2014 reads as under :
[w.e.f. 1-4-2015]
(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

- (2) *The Central Government may notify in the Official Gazette from time to time **[income computation and disclosure standards]** to be followed by any class of assesseees or in respect of any class of income.*
- (3) *Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) **[has not been regularly followed by the assessee, or income has not been computed in accordance with the standards notified under sub-section (2)]**, the Assessing Officer may make an assessment in the manner provided in section 144.*

- ❖ Accounting Standard I on 'disclosure of accounting policies', and Accounting Standard II on 'disclosure of Prior period and Extraordinary items and changes in accounting policies' notified vide notification dated 25th January, 1996.
- ❖ In December 2010, CBDT constituted a Committee to, inter alia, suggest Accounting Standards for the purposes of notification u/s 145 (2) of the Act.
- ❖ The Committee has submitted its Final Report in August, 2012. The Committee, inter alia, recommended that the provisions of Sec. 145 of the Act may be suitably amended to clarify that the notified AS are not meant for maintenance of books of account but are to be followed for computation of income.

- ❖ In August, 2012, the Committee recommended 14 Tax Accounting Standards (TAS) after examination of 31 AS issued by the ICAI.
- ❖ In August, 2014, the words 'Accounting Standards' in section 145(2) of the Act substituted with "Income Computation and Disclosure Standards" [ICDS] by the Finance Act (No.2), 2014 w.e.f 1st April 2015.
- ❖ In January, 2015, after examining the comments received from stakeholders, Committee issued Draft of 12 ICDS inviting stakeholders' comments.
- ❖ After prolonged discussions, dialogues and debates, finally, on March 31st, 2015, **10 Income Computation & Disclosure Standards ('ICDS')** were notified vide Notification No. 32/2015 and shall accordingly apply to the A.Y. 2016-17 and subsequent assessment years.

- ❖ Subsequent to various representations from taxpayers seeking guidance and clarifications for implementation of ICDS, the Finance Ministry, vide a Press Release dated July 06, 2016 , deferred the implementation of ICDS by one year to AY 2017-18 [FY 2016-17].
- ❖ On September 29, 2016, the Finance Ministry rescinded the earlier notified ICDS vide Notification No. 86/2016.
- ❖ Subsequent to that, on September 29, 2016, **The CBDT issued New ICDS applicable from AY 2017-18 [FY - 2016-17] by making certain changes to the old ICDS vide Notification No. 87/2016.**
- ❖ For proper implementation of ICDS, on March 23, 2017, The CBDT has issued 25 FAQs vide circular No. 10/2017 as **Clarification on Income Computation and Disclosure Standards (ICDS) notified under section 145(2) of the Income Tax Act, 1961.**

- ❖ On May 11, 2017, on the suggestions of the committee formed by the Hon'ble Finance Minister in respect of ICDS, The CBDT issued **Draft Income Computation and Disclosure Standards on Real Estate Transactions** by press release and asking for till 26th May, 2017.
- ❖ It is beyond doubt that these Standards will change the way Income will be computed and will materially impact the assessee. The need for ICDS is to resolve the disputes and gaps between the provisions of the Act and the Accounting Standards so as to compute and disclose income in accordance with some specific guidelines to avoid litigations and provide an ease in doing business.
- ❖ **In the case of conflict between the provisions of the Act and the ICDS, the provisions of the Act shall prevail to that extent.**

However, for the situations of conflict between ICDS & the Income-tax Rules and ICDS & judicial pronouncements, there is no explicit provision yet. The Board seems to be of view that ICDS shall prevail over the contrary judicial pronouncements but, the ICDS should be subordinate to the Income-tax Rules.

- ❖ These ICDS are applicable to all the assesseees (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB of the said Act)* following Mercantile System of accounting for computation of income chargeable under the head “Profits and Gains of Business or Profession” or “Income from Other Sources”, and not for the purpose of maintenance of books of accounts complying with ICDS, w.e.f. 01/04/2016 i.e. for the Financial Year 2016-17 or Assessment Year 2017-18.

*Added vide Notification No. 87/2016, Previously ICDS were applicable to all assesseees irrespective of any exemption and threshold.

Impact of ICDS on ITR Forms for AY 2017-18

Income Tax Return Forms	Requirement under ICDS
Form No.: ITR-1 SAHAJ For Individuals having Income from Salaries, one house property, other sources (Interest etc.) and having total income upto Rs.50 lakh	Not contained ICDS schedule , as not individual is not required to get his account audited u/s 44AB of the Act. Hence, not covered under ICDS.
Form No.: ITR-2 For Individuals and HUFs not carrying out business or profession under any proprietorship	Not contained ICDS schedule , as individual and HUFs not having Business Income. Hence, not covered under ICDS.
Form No.: ITR-3 For individuals and HUFs having income from a proprietary business or profession	ICDS schedule incorporates as individual and HUFs having Business Income. Hence, covered under ICDS.

Income Tax Return Forms	Requirement under ICDS
<p>Form No.: ITR-4 SUGAM</p> <p>For Presumptive Income from Business & Profession (i.e. individual, HUF & partnership firms covered under presumptive scheme of taxation like 44AD, 44AE, AAADA of the Act)</p>	<p>Not contained ICDS schedule</p> <p>* However, clarifications issued by CBDT on ICDS vide circular 10/2017 (Question 3) states that relevant provision of ICDS shall also apply to the persons computing income under the relevant presumptive taxation scheme. For example, for computing presumptive income of a partnership firm under section 44AD of the Act, the provisions of ICDS on Construction Contract or Revenue recognition shall apply for determining the receipts or turnover, as the case may be.</p>

Note:- Though, ICDS is applicable on such taxpayers to compute presumptive income, however, there is no such requirement to disclose the effect of the same in ITR form.

Income Tax Return Forms

Requirement under ICDS

Form No.: ITR-5

For persons other than,- (i) individual, (ii) HUF, (iii) company and (iv) person filing Form ITR-7

(i.e. A person being a firm, LLPs, AOP, BOI, artificial judicial person, person referred to in section 160(1)(iii) or (iv) i.e. representative assessee, cooperative society, registered societies and local authority)

ICDS schedule incorporates as persons required to file ITR Form – 5 are specifically covered under ICDS.*

Form No.: ITR-6

For Companies other than companies claiming exemption under section 11]

ICDS schedule incorporates as persons required to file ITR Form – 5 are specifically covered under ICDS.*

* ICDS would apply only to those sources of income, where mercantile system of accounting is followed and would not apply to those sources of income, where cash method of accounting is followed.

Income Tax Return Forms

Requirement under ICDS

Form No.: ITR-7

For persons including companies required to furnish return under sections 139(4A) or 139(4B) or 139(4C) or 139(4D) or 139(4E) or 139(4F)

Not contained ICDS schedule

Note:- ICDS would also not apply for the purposes of computing exemption under sections 11 to 13, where, as clarified by the CBDT vide its Circular no. 5-P (LXX-6) dated 19th June 1968, the computation of exemption is based on the commercial concept of income. However, where such income loses exemption, the computation would be under the various heads of income, and to the extent of such income falling under the heads “Income from Business or Profession” and “Income from Other Sources”, the provisions of ICDS would apply if the books of account are maintained on mercantile system.

Note:- ICDS is applicable as there is no specific exclusion for such taxpayers, but there is no such requirement to disclose the effect of the same in ITR form. The absence of such a clarification may lead to litigation.

Disclosures required under ICDS

- ❖ Vide Amendment by Finance Act (No.2), 2014 in Section 145, the Assessing Officer is empowered to make Best Judgement assessment u/s 144 where the assessee has not computed income in accordance with notified ICDS.
- ❖ New ITR Form No. 3, 5 & 6 for AY 2017-18 incorporates the ICDS as under:
 - ❖ Information under Part A-OI [Other Information] for 'Effect on profit on account of deviation, if any, as per ICDS, not mandatory to be filled by assessee not liable for audit u/s 44AB.

Part A- OI		Other Information <i>(optional in a case not liable for audit under section 44AB)</i>		
1	Method of accounting employed in the previous year	(Tick) <input checked="" type="checkbox"/> <input type="checkbox"/> mercantile	<input type="checkbox"/> cash	
2	Is there any change in method of accounting	(Tick) <input checked="" type="checkbox"/> <input type="checkbox"/> Yes	<input type="checkbox"/> No	
3	Effect on the profit because of deviation, if any, as per Income Computation Disclosure Standards notified under section 145(2) [column 11(iii) of Schedule ICDS]		3	

❖ Separate Schedule- ICDS

Schedule ICDS		Effect of Income Computation Disclosure Standards on profit
Sl. No.	ICDS	Amount
(i)	(ii)	(iii)
I	Accounting Policies	
II	Valuation of Inventories	
III	Construction Contracts	
IV	Revenue Recognition	
V	Tangible Fixed Assets	
VI	Changes in Foreign Exchange Rates	
VII	Government Grants	
VIII	Securities	
IX	Borrowing Costs	
X	Provisions, Contingent Liabilities and Contingent Assets	
11.	Total Net effect (I+II+III+IV+V+VI+VII+VIII+IX+X)	

Note:- Only the amount of net effect under each ICDS is required to be disclosed. There is no place in the returns of income for the various disclosures required to be made under each ICDS

❖ The tax audit report in Form 3CD has now been amended, to incorporate the disclosure as required by ICDS **in clause 13** , as under:

(d) Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2)

(e) if answer to (d) above is in the affirmative, give details of such adjustments:

		<i>Increase in profit (Rs.)</i>	<i>Decrease in profit (Rs.)</i>	<i>Net Effect (Rs.)</i>
<i>ICDS I</i>	<i>Accounting Policies</i>			
<i>ICDS II</i>	<i>Valuation of Inventories</i>			
<i>ICDS III</i>	<i>Construction Contracts</i>			
<i>ICDS IV</i>	<i>Revenue Recognition</i>			
<i>ICDS V</i>	<i>Tangible Fixed Assets</i>			
<i>ICDS VI</i>	<i>Changes in Foreign Exchange Rates</i>			
<i>ICDS VII</i>	<i>Governments Grants</i>			
<i>ICDS VIII</i>	<i>Securities</i>			
<i>ICDS IX</i>	<i>Borrowing Costs</i>			
<i>ICDS X</i>	<i>Provisions, Contingent Liabilities and Contingent Assets</i>			
	<i>Total</i>			

(f) Disclosure as per ICDS :

<i>(i) ICDS I</i>	<i>- Accounting Policies</i>
<i>(ii) ICDS II</i>	<i>- Valuation of Inventories</i>
<i>(iii) ICDS III</i>	<i>- Construction Contracts</i>
<i>(iv) ICDS IV</i>	<i>- Revenue Recognition</i>
<i>(v) ICDS V</i>	<i>- Tangible Fixed Assets</i>
<i>(vi) ICDS VII</i>	<i>- Governments Grants</i>
<i>(vii) ICDS IX</i>	<i>- Borrowing Costs</i>
<i>(viii) ICDS X</i>	<i>- Provisions, Contingent Liabilities and Contingent Assets.</i>

Note:- The disclosures as required by the various ICDS will have to be made under this sub-clause.

ICDS vis -a- vis AS / IND -AS

ICDS	AS	Equivalent IND-AS
I Accounting Policies	1 Disclosure of Accounting Policies 5 Net Profit or Loss for the period, prior year period and changes in accounting policies	1 Presentation of Financial Statements 8 Accounting Policies, Changes in Accounting Estimates and Errors
II Valuation of Inventories	2 Valuation of Inventories	2 Inventories
III Construction Contracts	7 Construction Contracts	115 Revenue from Contracts with customers

ICDS		AS		Equivalent IND-AS	
IV	Revenue Recognition	9	Revenue Recognition	115	Revenue from Contracts with customers
V	Tangible Fixed Assets	10	Property, Plant & Equipment	16	Property, Plant & Equipment
VI	The effects of changes in foreign exchange rates	11	The effects of changes in foreign exchange rates	21	The Effects of Changes in Foreign Exchange Rates
VII	Government Grants	12	Government Grants	20	Accounting for Govt. Grants and Disclosure of Govt. Assistance

ICDS		AS		Equivalent IND-AS	
VIII	Securities	13	Accounting for Investments	109	Financial Instruments
IX	Borrowing Costs	16	Accounting for Borrowing Cost	23	Borrowing Costs
X	Provisions, Contingent liabilities and Contingent assets	29	Provisions, Contingent liabilities and Contingent assets	37	Provisions, Contingent Liabilities and Contingent Assets

Standards not yet issued by CBDT

Tax Accounting Standards Committee had recommended four more standards to be notified on the following subjects:

- Events occurring after the Balance Sheet Date
- Prior Period Items
- Leases
- Intangible Assets

The revised drafts issued in January 2015 were only for 12 ICDSs (including Leases & Intangible Assets) . **CBDT has not yet notified the standards on Leases & Intangible Assets. However, The CBDT issued Draft Income Computation and Disclosure Standards on Real Estate Transactions by press release on 11th May, 2017 and asking for comments from stakeholders.**

ICDS has not yet adequately addressed certain areas such as financial instruments, share-based payments, etc which are quite prevalent in today's business environment.

ICDS I
Accounting Policies

AS-I
Disclosure of Accounting
Policies

AS-1: Disclosure of Accounting Policies

- This Standard deals with the disclosure of significant accounting policies **followed in preparing and presenting Financial Statements (FS)** so as to represent a true and fair view of the enterprise.
- Accounting policies are **specified accounting principles and the methods of applying those principles** for the preparation of the FS of an enterprise.
- Aspects to be kept in mind while selecting accounting policies:
 1. **Prudence:** Account for all expected losses/expenses but never account for expected gains/incomes.
 2. **Substance Over Form:** Whenever there is a dispute, facts should prevail over law.
 3. **Materiality:** Only 'material' information be presented whose knowledge might influence the decision of the users of FS.

- ▶ Examples of the areas where different accounting policies may be adopted by different enterprises are: Methods of depreciation, depletion & amortization, valuation of inventories, treatment of goodwill, etc.
- ▶ Certain fundamental accounting assumptions are assumed to be used in the preparation and presentation of financial statements. These are:
 1. Going concern
 2. Consistency
 3. Accrual
- ▶ **Read with AS 5- An Accounting policy should be changed if:**
 - Required by any statute, OR
 - Required for compliance with another Accounting Standard, OR
 - It will result in more appropriate presentation of Financial Statements.

➤ **DISCLOSURE REQUIREMENT:**

- All significant policies adopted in preparation of Financial Statements should be disclosed.
- Any change in accounting policies should be disclosed in the period in which the change is adopted.
- If a fundamental accounting assumption is not followed, the fact should be disclosed

Comparison b/w ICDS I & AS 1

- ▶ Elimination of Concept of **Prudence**. According to AS-1, the concept of prudence is followed in accounting practices wherein provision for 'expected losses' is created **but**;

As per ICDS such 'expected loss' or 'Mark to Market losses' shall not be recognized unless it is in accordance with the provisions of any other ICDS.
[Presently not required by any other ICDS]

- ▶ There is no specific provision in the ICDS I for Mark to Market gains. However, the Board has clarified that same principles as contained in ICDS-I relating to MTM losses or expected losses shall apply mutatis mutandis to MTM gains or an expected profit. (**FAQ No. 8, Circular – 10/2017 dated 23/03/2017**).

- ▶ Elimination of Concept of **Materiality**.

However, the Income Tax Act, 1961 itself provides for thresholds under various provisions.

Comparison b/w ICDS I & AS 1

- ▶ Unlike AS 1, under ICDS an accounting policy shall not be changed without **reasonable cause**.
- ▶ Where the changes made has no material effect for the current previous year but which is reasonably expected to have a material effect in later previous years, the ICDS I requires additional disclosure in the previous year in which such change has material effect for the first time apart from the previous year in which the change is adopted.

Judicial pronouncements on concept of 'Prudence'

- **Dy. CIT (IT) v. Bank of Bahrain & Kuwait [2010] 41 SOT 290 (ITAT-Mum.)**

When outflow of economic resources in settlement of present obligation can be anticipated with reasonable accuracy, then it is to be recognized as crystallised liability. This is in consonance with the principle of prudence as considered by the *Supreme Court* in the case of *CIT v. Woodward Governor of India (P.) Ltd. [2009] 312 ITR 254*

- **Western Maharashtra Development Corpn. Ltd. v. Dy CIT [2008] 22 SOT 13 (ITAT- Pune)**

The concept of 'prudence' as one of the basic considerations in deciding accounting policies is not of a recent origin. It is one of the fundamental principles of accounting that, as a measure of prudence and following the principle of conservatism, the incomes are not taken into account till the point of time that there is a reasonable degree of certainty of its realization, while all anticipated losses are taken into account as soon as there is a possibility, howsoever uncertain, of such losses being incurred

- **Also refer: Kerala State Industrial Products Trading Corpn. Ltd. v. Asst. CIT [2012] 22 taxmann.com 78 (ITAT- Coch.), Western Coalfields Ltd. v. ACIT 124 TTJ 659 (Nagpur), H M Constructions v. JCIT 84 ITD 429 (Bangalore), & Western Maharashtra Development Corpn. Ltd. v. DCIT [2008] 22 SOT 13 (Pune)**

Change in 'Accounting policy' as per judicial pronouncements..

A change in the method of accounting need not have the approval of the Income-tax authorities and need not be supported by cogent reasons showing the assessee's bone fides. If the method of accounting followed by the assessee does not reflect the correct income, the ITO can always compute the income on a different basis under section 144.

▶ **Snow White Food Products Co. Ltd. v. CIT[1983] 141 ITR 847 (CAL.)**

Change in accounting policy followed by the assessee is not acceptable if there is nothing on record to indicate that the change is intended to be followed regularly in future by the assessee.

➤ **CIT v. Mopeds (India) [1988] 38 Taxman 123 (AP)**

Change adopted by the assessee was for bona fide purpose and was not actuated by consideration to reduce income for the income-tax purpose, the revenue had no right to interfere with the change in the method of valuation of the closing stock.

• Also see: **CIT v. Dalmia Cement (Bharat) Ltd. [1995] 82 Taxman 255 (Delhi)**

Reasonable cause as per judicial pronouncements..

- ▶ **Woodward Governors India (P.) Ltd. v.CIT[2001] 118 Taxman 433 (Delhi)**

Reasonable cause: an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do.

- ▶ **Fuji Bank Ltd. V. Asst. Cit [2002] 121 Taxman 25 (ITAT-Delhi)(Mag.) & Azadi Bachao Andolan v. Union of India [2001] 116 Taxman 249 (Delhi)**

What would constitute reasonable cause cannot be laid down with precision. It would depend upon factual background and scope for interference in a reference application. The reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of bona fides.

Observations...



- ❖ Any provision for expected loss outstanding as on 31st March 2016 shall be added back in the P&L account being disallowable as per ICDS. The loss will be allowed in the year of its occurrence.

However, any loss occurred during FY 2016-17, whose provision was allowed in preceding years would not be allowed in the year of occurrence according to ICDS.

- ❖ **Current year** : As per ICDS, income will **increase** in current year.
- ❖ **Next Year** : As per ICDS, Income will **decrease** in the subsequent year when loss has occurred.
- ❖ The point of 'Provision for expected loss' also considered in ICDS III, ICDS IV and ICDS X which will be treated in the same manner and will be discussed in detail with the relevant AS.
- ❖ The **immaterial items** may also become the grounds of **additions** and **levy of penalty** by the AO in case of non disclosure of the immaterial items because ICDS doesn't recognize concept of materiality.

Observations...



- ❖ **Reasonable Cause:** ICDS prohibits any change in an accounting policy without reasonable cause, it is not clear as to what would constitute ‘reasonable cause’ and the Board has clarified that “Reasonable Cause” is an existing concept under the Act and has evolved over a period of time conferring desired flexibility to the tax payer in deserving cases. (FAQ No. 9, Circular – 10/2017 dated 23/03/2017).
- ❖ The scope of the ICDS is limited to significant accounting policies applied while computing income under the head “Profits and gains of business or profession” or “Income from other sources”, but the term ‘significant’ has not been defined in the ICDS.

Transitional Provisions

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

Disclosure requirements under ICDS I

- All significant policies adopted in preparation of Financial Statements should be disclosed.
- Any change in accounting policies which has a material effect should be disclosed in the previous year in which the change is adopted. The amount by which any item is affected by such change shall also be disclosed to the extent ascertainable.

If a change 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.

- Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item.
- If a fundamental accounting assumption is not followed, the fact should be disclosed.

Comparison at a Glance

	ICDS 1	AS 1
Materiality	Materiality concept is not there	Materiality is one of the key consideration for selection and adoption of accounting policies
Prudence	Marked to market loss basis or expected losses not to be recognized unless specifically mentioned in any other ICDS	All expected losses are to be recognized and profits to be recognized on actual realization
Change in Accounting Policy	An accounting policy shall not be changed without a reasonable cause.	A change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

ICDS II

Valuation of Inventories

AS-2

Valuation of Inventories

AS-2 Valuation of Inventories

- ▶ This Standard deals with the **determination of the value** at which inventories are carried in the Financial Statements, including the ascertainment of cost of inventories and any write-down thereof to net realisable value.

- ▶ This Standard **does not deal** with:
 - a) WIP arising under construction contracts.
 - b) WIP arising in the ordinary course of business of service providers
 - c) Shares, debentures and other financial instruments held as stock-in-trade.
 - d) Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases.
 - e) Machinery spares which can be used only in connection with an item of fixed asset & whose use is expected to be irregular (such machinery spares are accounted for in accordance with AS-10, Accounting for Fixed Assets)

- ▶ **Inventories** are assets:
 - a) held for sale in the ordinary course of business;
 - b) used in the process of production for such sale; or
 - c) used in the form of materials or supplies to be consumed in the production process or in the rendering of services
- ▶ **Inventories** Includes-
 - a) goods purchased & held for resale, computer software held for resale, or land and other property held for resale.
 - b) finished goods produced, or WIP being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools awaiting use in the production process.
- ▶ Value **Inventories** at the **'lower' of Cost OR Net Realisable Value.**
- ▶ **Cost of Inventories includes:**
 - a) Cost of Purchase,
 - b) Cost of conversion, and
 - c) Other costs incurred in bringing the inventories to their present location & condition.

▶ **Cost Formulas:**

- ▶ first-in, first-out (FIFO), or
- ▶ weighted average

▶ While calculating the cost of Inventories, **exclude** certain costs and recognise them as **expenses** in the period in which they are incurred. Examples of such costs are:

- a) abnormal amounts of wasted materials, labour, or other production costs;
- b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
- c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- d) selling and distribution costs.

► **Techniques used for measurement of cost of inventories are:**

- a) **Standard Cost method** = Cost of material (+) Cost of labour (+) Overheads; or
- b) **Retail method** = Sale value of inventory (-) % of gross profit.

Note:

These techniques need regular review and, where necessary, revision in the light of related conditions.

► **DISCLOSURE REQUIREMENTS:**

- All accounting policies adopted in measuring inventories.
- Cost formula used in measuring inventories.
- Total carrying amount of inventories and its classification.

Comparison b/w ICDS II & AS 2

1) Inclusion of costs of services for calculating cost of inventories:

ICDS also provides for inclusion of cost of services incurred in bringing the inventories to their present location and condition while valuation of inventories.

Note: Earlier Cost of inventories includes **cost of services in the case of service provider only**, which consist of labour and other costs of personnel directly engaged in providing service including provisory personnel and attributable overheads. However, the words **“in the case of service provider”** has removed in **New ICDS**. *(This amendment seems to liberate provisions for service providers from maintaining inventory for services.)*

But, the identification of overheads attributable to service is still a subject matter of judgment.

2) Value of Opening Inventory:

Unlike AS-2, ICDS specifically provides for valuation of opening inventory which shall be the cost of inventory as on the close of the immediately preceding F.Y.

If business commenced during the previous year, it shall be the cost of inventory available on the day of commencement of business.

3) Value of Inventory in Case Of Dissolution of a Firm OR AOP OR BOI:

ICDS specifically provides that notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at **NRV (Net Realizable Value)**.

4) Change In Method:

Unlike AS 2 (read with AS 5), under ICDS the method of valuation of inventory once adopted shall not be changed without a **reasonable cause** which is same as requirements in ICDS I.

5) Recoverable Duties and Taxes:

For the purpose of calculation of cost of purchase, AS 2 excludes the amount of duties and taxes those are subsequently recoverable by enterprise from the taxing authorities, whereas ICDS includes all the duties and taxes (on the lines of adjustment of **Section 145A** of Income Tax Act).

6) Standard cost method for measurement of cost of inventory

For the purpose of calculation of cost of Inventory, AS 2 prescribes techniques for measurement of cost. Identical to AS-2, **Standard cost method has been introduced in New ICDS*** as one of the methods for inventory valuation, if the results approximate the actual cost. Relevant changes have also been made in disclosure requirements as well.

*** Note: Earlier retail method was the only technique prescribed in ICDS for calculation of Cost of Inventories for Income Tax purpose.** Since ICDS does not prescribe standard costing method earlier and due to that inventory needs to be calculated separately for income tax purpose, as it may increase or decrease the profits during the current year, which causes hardship to many assesseees. To reduce this hardship, standard costing method is introduced in New ICDS.

Comparison b/w New ICDS II & Old ICDS II

ICDS II	ICDS as notified vide Notification No. 32/2015 dated 31.3.2015	ICDS as notified vide Notification No. 87/2016 dated 29.9.2016
Para 18	Retail Method	Retail Method <u>Techniques for the Measurement of Cost</u> <u>18(1) Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate the actual cost. Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of the current conditions.</u>

Comparison b/w New ICDS II & Old ICDS II

ICDS II	ICDS as notified vide Notification No. 32/2015 dated 31.3.2015	ICDS as notified vide Notification No. 87/2016 dated 29.9.2016
Para 18	<p>Retail Method</p> <p>18. Where it is impracticable to use the costing methods referred to in paragraph 16, the retail method can be used in the retail trade for measuring inventories of large number of rapidly changing items that have similar margins. The cost of the inventory is 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.</p>	<p>18(2) 18. Where it is impracticable to use the costing methods referred to in paragraph 16, The retail method can be used in the retail trade for measuring inventories of large number of rapidly changing items that have similar margins <u>and for which it is impracticable to use other costing methods.</u> The cost of the inventory is 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. <u>An average percentage for each retail department is to be used.</u></p>

Comparison b/w New ICDS II & Old ICDS II

ICDS II	ICDS as notified vide Notification No. 32/2015 dated 31.3.2015	ICDS as notified vide Notification No. 87/2016 dated 29.9.2016
Para 26	<p>Disclosure</p> <p>(a) the accounting policies adopted in measuring inventories including the cost formulae used; and</p>	<p>Disclosure</p> <p>(a) the accounting policies adopted in measuring inventories including the cost formulae used. <u>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;</u> and</p>

Comparison b/w New ICDS II & Old ICDS II

ICDS II	ICDS as notified vide Notification No. 32/2015 dated 31.3.2015	ICDS as notified vide Notification No. 87/2016 dated 29.9.2016
Para 6	<p>Costs of services</p> <p>6. The costs of services in the 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.</p>	<p>Costs of services</p> <p>6. The costs of services in the 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.</p>

Judicial Pronouncement on value of Inventory In Case of Dissolution of Firm/ AOP/ BOI.....

- Once the position was accepted that the business continued, the ratio enunciated by **A.L.A. Firm's** case (supra) and reiterated by **Sakthi Trading Co. v. CIT [2001] 250 ITR 871 (SC)** would apply with full force and the closing stock had to be valued at the **cost or market price, whichever was lower**, on the basis of established principles of commerce and accountancy.
- Where, a Partnership firm was dissolved, individual of the erstwhile firm continued to make a living out of a business, which by sheer coincidence happened to be again jewellery business, in which, distributed capital was introduced in the form of stock. The stock on introduction in the business, stood converted into stock-in-trade and value **would have to be the market value on the date of introduction**. [**Madhu Rani Mehra v. CIT[2011] 10 taxmann.com 126 (Delhi)**]
- Where dissolution of firm is accompanied by discontinuance of business and not otherwise, Market Price should be adopted [**Kwality Steel Suppliers v. CIT [2004] 141 Taxman 177 (GUJ.)**]
- If business of the firm didn't cease to continue as one unit on dissolution, the closing stock could not be valued at Market price (irrespective of value shown) [**Asst. CIT v. Kuldip Chand & Sons [2005] 93 ITD 253 (Amritsar)**]

Observations...



- 1) Due to specific provision for Dissolution of Partnership firm, the assets and liabilities are now to be valued on NRV i.e. to be written off to the value of its realisation, which will **decrease** profit of current year.
- 2) ICDS provides that method once adopted shall not be changed without a reasonable cause thereby providing a check over change of accounting policies.
- 3) Due to inclusion of all duties and taxes (including recoverable from tax authorities) in the value of inventory, the value of inventory will increase which will result in **Increase** in profits during current year i.e. FY 2016-17

Points needs Clarification:

➤ VALUE OF OPENING INVENTORY:

- ICDS only provides to take the value of closing inventory of preceding year as opening value of inventory. But it does not clarify that which value should be taken i.e. **value as per books of accounts OR value as per Income Tax Act.**

➤ REASONABLE CAUSE:

- ICDS prohibits change in a method of valuation of inventory without a reasonable cause. It is not clarified as to what would constitute 'reasonable cause'. The absence of such a clarification may lead to litigation.

Transitional Provisions

Interest and other borrowing costs, which do not meet the criteria for recognition of interest as a component of the cost as per para 11, but included in the cost of the opening inventory as on the 1st day of April, 2016, shall be taken into account for determining cost of such inventory for valuation as on the close of the previous year beginning on or after 1st day of April, 2016 if such inventory continue to remain part of inventory as on the close of the previous year beginning on or after 1st day of April, 2016.

Disclosure requirement under ICDS

- The following aspects shall be disclosed :
 - a) **Policy:** The accounting policies adopted in measuring inventories including the cost of formulae used. **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.**
 - b) **Carrying Amount:** The total carrying amount of inventories and its classification appropriate to a person.

Comparison at a Glance

	ICDS II	AS 2
Scope	<p>Not applicable for:</p> <ul style="list-style-type: none"> a. Construction contracts b. WIP dealt in other ICDS c. Financial instruments held as stock-in-trade d. Products relating to agriculture e. Machinery spares held as stock in trade 	<p>Not applicable for:</p> <ul style="list-style-type: none"> a. Construction contracts b. Financial instruments held as stock-in trade c. Products relating to Agriculture
Cost of Services	Inclusion of cost of services in cost of inventories to bring inventories to their present location and condition	Cost of Services were not included in cost of inventories as per AS 2 issued by ICAI

	ICDS II	AS 2
Methods of valuation	1. Specific Identification Method 2. FIFO 3. Weight Average Cost 4. Retail method 5. Standard Cost	1. Specific Identification Method 2. FIFO 3. Weight Average Cost 4. Retail method 5. Standard Cost
Change in the method	Not permitted without a “reasonable cause”	Change in method will amount to change in Accounting Policy

	ICDS II	AS 2
Interest Cost	Excluded unless they meet the criteria as specified in the ICDS on borrowing costs.	Usually excluded.
Valuation of inventory in case of dissolutions	In the case of dissolution of a partnership firm or association of persons or body of individuals irrespective of whether the business continues or not , the inventories on the date of dissolution shall be valued at net realizable value .	As 2 does not specifically mention the valuation of inventory in the case of dissolution.

	ICDS II	AS 2
Cost of Purchase	The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates and other similar items shall be deducted in determining the costs of purchase	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. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.

	ICDS II	AS 2
Value of Opening Inventory	<p>The value of the inventory as on the beginning of the previous year shall be:</p> <ul style="list-style-type: none"> • Value of inventory on the day of commencement in case of new business and • Value of the inventory as on the close of the preceding PY, in case of existing business. 	Value of opening inventory is not discussed in AS 2

ICDS III
Construction Contracts

AS-7
Construction Contracts

AS-7 Construction Contracts

- ▶ The Standard prescribes the accounting treatment of revenue and costs associated with construction contracts.
- ▶ **Construction Contracts includes:**
 - a) Contracts for the rendering of services which are directly related to the construction of the asset
 - b) Contracts for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.
- ▶ **Contract revenue comprises:**
 - a) the **initial amount** of revenue agreed in the contract &
 - b) **variations** in contract work, **claims** and **incentive** payments:
 - i. to the extent that it is probable that they will result in revenue;
 - ii. they are capable of being reliably measured.

▶ Contract costs comprise :

- a) costs that relate directly to the specific contract;
- b) costs that are attributable to contract activity in general and can be allocated to the contract; &
- c) other costs that are specifically chargeable to the customer under the terms of the contract.
 - **Any incidental income needs to be reduced from the cost such as sale of extra material, sale of plant & machinery at the end of contract, etc.**


▶ Recognition of contract Revenue & Expense:

1. When outcome of a contract can be estimated reliably :
 - a) revenue & expense be recognized with reference to the **stage of completion** of the contract activity at the reporting date.
2. When the outcome of a contract cannot be estimated reliably:
 - a) Revenue be recognised **only to the extent** of contract costs incurred of which recovery is probable; and
 - b) contract costs should be recognised as an expense in the period in which they are incurred.


- An **expected loss** on the construction contract **should be recognized** as an expense immediately.
- **DISCLOSURE REQUIREMENTS:**
 - the amount of contract revenue recognised as revenue in the period;
 - the methods used to determine the contract revenue recognised in the period; and
 - the methods used to determine the stage of completion of contracts in progress.
 - For contracts in progress at the reporting date:
 - i. the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;
 - ii. the amount of advances received; and
 - iii. the amount of retentions.

Comparison b/w ICDS III & AS 7

Presently, Retention money is excluded in computing taxable income on the premise that the right to receive the retention money accrues only after the obligations under the contract are fulfilled. Under ICDS regime, retention money is specifically included as part of contract revenue.



Contract Revenue and contract costs are to be recognized on POCM basis. 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. This requirement is contained both in AS 7 and ICDS III. However, in case of ICDS III the early stage of a contract shall not extend beyond 25 % of the stage of completion.



AS 7 requires a provision to be made for the expected losses on onerous construction contract immediately on signing the contract. Under ICDS, losses incurred on a contract shall be allowed only in proportion to the stage of completion. Future or anticipated losses shall not be allowed, unless such losses are actually incurred.

Comparison b/w ICDS III & AS 7

- Unlike As-7, the ICDS III does not enumerates the components of Contracts cost including,
 - costs that relate directly to the specific contract
 - Costs that may be attributable to contract activity in general and can be allocated to the contract
 - Costs specifically chargeable to customers under the terms of the contract

and the Costs that cannot be attributed to any contract activity or cannot be allocated to a contract which are to excluded from the costs of a construction contract

Observations...



- Contract revenue is to be recognized when there is reasonable certainty of its ultimate collection.

Where the ultimate collection is not reasonably certain at the time of raising any claim for escalation of price & export incentives, revenue recognition in respect of such claim **shall be postponed** to the extent of uncertainty involved.

The Board has also clarified this **FAQ No. 11, Circular 10/2017 dated 23/03/2017:**

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 subject to reasonable certainty of its ultimate collection condition contained in pars 9 of on Construction contracts.

Observations...



- **Inclusion of retention money will increase the profit during current year.** The profit will not be recognised in the year in which conditions to receive retention money (as per AS-7) will complete. The revenue will be recognized on POCM basis.
- Incidental Income in the nature of interest, dividend and capital gains is specifically not allowed to be reduced from the cost of construction.
- When stage of completion of contract exceeds 25%, revenue should be recognized in the P&L account irrespective of whether the same can be reliably estimated or not - **which will increase profit of current year.**

Observations...



- The provision for expected losses for the current year be added back and such losses will be allowed in the year of their occurrence. The losses are allowed to be recognized only in proportion to the stage of completion while the entire loss is considered in books of accounts. Therefore, increase current year's profit.
- Mandatory computation of income on the Percentage of Completion Method (POCM) basis even for the partnerships, LLP, proprietors, etc. Even the service providers such as architects, project managers, etc. rendering services directly attributable to construction contracts needs to follow POCM basis overriding earlier judicial pronouncements.

Deduction of anticipatory losses as per Judicial Pronouncements

- Deduction for foreseeable losses is allowed by Hon'ble Delhi High Court in **CIT v. Triveni Engg. & Industries Ltd. [2010] 8 taxmann.com 146**
- Losses provided by assessee in its books of account according to AS-7, had to be allowed. **[Asst. CIT v. ITD Cementation India Ltd. [2013] 36 taxmann.com 74 (Mumbai - Trib.)]**
- Where construction project has long gestation period and POCM is adopted for income-tax purpose, losses only proportionate to work completed during year can be allowed and not entire anticipated losses. **[Shivshahi Punarvasan Prakalp Ltd. v. ITO [2011] 15 taxmann.com 352 (Mum.)]**

Transitional Provisions

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

Brief:

Existing ongoing contracts are recognized as per existing accounting method followed by the taxpayer. Therefore, the revenue in relation to contracts commenced with effect from 01 April, 2016 shall only be recognised as per new ICDS.

ICDS III overruling the Judicial Pronouncement

CIT v. Simplex Concrete Piles India (P.) Ltd, [1989] 45 TAXMAN 370 (CAL.)

Assessee was carrying on construction business on mercantile system of accounting. Assessee was entitled to get 90% of payment in first instance when work was done and remaining 10 or 5%, as case may be, was to be paid later on after submitting certificates from architects/engineers, removal of defects, etc.

Assessee was crediting 100 % of job value in past years but from A.Y. 1965-66, it had started practice of crediting only 90% value for work done after deducting retention money.

It was held that on date of submission of bills assessee had no right to receive entire amount on completion of work and retention money did not accrue to it on such date but on later date in accordance with terms of contracts and ITO would be unjustified in making any addition by treating entire contract amount as accrued on submission of bills on completion of work.

But Under ICDS regime, retention money is specifically included as part of contract revenue.

ICDS III overruling the Judicial Pronouncement

CIT v. Associated Cables Ltd [2006] 286 ITR 596 (BOM.)

- Assessee entered into a contract with certain parties. As per contract, certain amount was to be retained by buyers and same was to be paid to assessee on satisfactory completion of contract.

It was held that retention money did not accrue to assessee and could not be considered to be income of assessee in year in which amount was retained.

- Also see: CIT v. P & C Constructions (P.) Ltd. [2009] 318 ITR 113 (Mad.)
Asst. CIT v. B.G.R. Energy Systems Ltd. [2014] 47 taxmann.com 266 (Hyderabad - Trib.)
DIT (IT) v. Ballast Nedam International [2013] 33 taxmann.com 139 (Gujarat).

ICDS III overruling the Judicial Pronouncement

Contd....

CIT v. Ignifluid Boilers (I) Ltd [2006] 283 ITR 295 (MAD.)

Assessee who was maintaining mercantile system of accounting entered into a contract with 'S' for erection of boilers wherein there was a specific clause that 10% contract price would be retained by principal contractor and it would be paid after 1 month subject to satisfactory performance of boiler.

The AO brought into account 10% of contract amount and levied tax on accrual basis – CIT(A) as well as ITAT deleted inclusion made by the AO.

It was held that since assessee was entitled to receive amount in question only after successful completion of work, it could not be said that 10% retention money retained by principal contractor accrued to assessee during relevant assessment year. Therefore, Tribunal rightly set aside order of AO.

Disclosure requirements under ICDS - III

- the amount of contract revenue recognised as revenue in the period;
- the methods used to determine the stage of completion of contracts in progress.
- For contracts in progress at the reporting date:
 - i. the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;
 - ii. the amount of advances received; and
 - iii. the amount of retentions.

Comparison at a Glance

	ICDS III	AS 7
Retention Money	Contract Revenue comprise of initial amount of revenue agreed including retentions	Retentions are not specifically mentioned in Contract Revenue as per AS 7
Borrowing costs	ICDS III specifically consider borrowing cost as a part of contract cost	AS 7 does not specifically mention borrowing costs as a part of contract cost. But AS 7 considers borrowing cost as a part of cost that are allocated to contract activity in general and can be allocated to the contract cost.

	ICDS III	AS 7
Interest, dividend and capital gain	Preconstruction income in the nature of interest, dividend and capital gain shall not be reduced from the cost of construction. They shall be treated and taxed as income.	AS 7 states that incidental income that is not included in contract revenue shall be reduced from contract costs, but it does not specifically mention about interest, dividend and capital gain.
Reversal of revenue	Provides for write-off in line with the provisions of Sec. 36(1)(vii) Sec. 36(1)(vii) - bad debts written off.	Provides for reversal of revenue on account of uncertainty arising on realizability of contract revenue which was already recognized as income.

	ICDS III	AS 7
Anticipated loss	Does not permit recognition of anticipated losses.	All expected losses shall be recognized fully and not in proportion to percentage of completion.
Incentives and claims	ICDS III does not mention about the specific performance standards to be met in case of incentives and claims.	Incentive payments are included in contract revenue only when the specific performance standards are met and amount of incentive payment can be measured reliably.
Attributing contract cost	The condition for attributing contract cost that such expenses should be capable of being measured reliably is removed.	For attributing contract costs to a construction contract, one condition is that such expenses should be capable of being measured reliably.

ICDS IV
Revenue Recognition

AS-9
Revenue Recognition

A close-up photograph of a financial document featuring a line graph with multiple peaks and troughs. Several gold coins are scattered on top of the document, partially obscuring the chart and text. The background is a solid blue color.

AS-9: Revenue Recognition

This Standard deals with the bases for recognition of revenue in the statement of profit and loss of an enterprise. Revenue recognition is mainly concerned with the timing of recognition of revenue.

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

- a) the sale of goods,
- b) the rendering of services, and
- c) other resources yielding interest, royalties and dividends.

➤ Revenue from sale of goods be recognised when significant risks and rewards of ownership related to goods are transferred to the buyer and no significant uncertainty exists regarding the amount of the consideration that will be derived.

- **Revenue from service transactions:** is usually recognised as the service is performed, either by using the :
 - a) proportionate completion method or
 - b) completed service contract method.

- **The 'other resources' of enterprise used by others gives rise to:**
 - a) **Interest**—charges for the use of cash resources or amounts due to the enterprise;
 - Interest accrued is recognised on the time proportion basis taking into account the amount outstanding & the rate applicable.
 - Usually, discount or premium on debt securities held is treated as though it were accruing over the period to maturity.

- b) **Royalties**—charges for the use of such assets as know-how, patents, trade marks and copyrights;

Royalties are recognised on an accrual basis in accordance with the terms of the relevant agreement.

- c) **Dividends**—rewards from the holding of investments in shares.

Dividends are recognised in accordance with the provisions of the Act. Thus, dividends from investments in shares are recognised in the statement of profit and loss when the right to receive payment is established. Dividend will also include deemed dividend u/s 2(22)(e).

DISCLOSURE REQUIREMENTS:

- ▶ Disclosure required by AS-1, 'Disclosure of Accounting Policies',
- ▶ The circumstances in which revenue recognition has been postponed till the resolution of significant uncertainties.

Comparison b/w ICDS IV & AS 9

- As per ICDS, revenue from service transactions shall be recognized **on percentage completion method (PCM)**. However, when services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on a straight line basis over the specific period.*
- Revenue from service contracts with duration not more than 90 days may be recognized by completed service method (i.e when rendering of services is complete or substantially complete)*

*** Note:** The old ICDS provided that revenue from service contracts would have to be recognised by using percentage completion method (without any exceptions). However, this could have led to many practical difficulties. The new ICDS has taken into consideration two such practical difficulties.

- As per AS-9, both 'completed service contract method' and 'percentage completion method' are permitted for recognition of revenue from service contract without any condition. This is done to facilitate flexibility of recognizing revenue.
- Use of Resources by Others Yielding Interest, Royalties or Dividends AS-9 is silent on the Interest on refund of any tax, duty or cess while New ICDS notifies that it shall be deemed to be the income of the previous year in which such interest is received.*

* **Note:** The old ICDS provided that interest shall accrue on the time basis determined by the amount outstanding and the rate applicable (without any exceptions). However, the new ICDS has taken into consideration practical difficulties and new clause is added that interest on refund of taxes, duties etc. shall be recorded as income in the year of receipt irrespective of the method of accounting followed by the taxpayer.

- The Board has also clarified in this matter vide circular 10/2017:

Question: The condition of reasonable certainty of ultimate collection is not laid down for taxation of interest, royalty and dividend. Whether the taxpayer is obliged to account for such income even when the collection thereof is uncertain?

Answer: As a principle, interest accrues on time basis and royalty accrues on the basis of contractual terms. Subsequent non recovery in either cases can be claimed as deduction in view of amendment to sec.36 (1) (vii). Further, the provision of the Act (e.g. Section 43D) shall prevail over the provisions of ICDS.

Comparison b/w ICDS IV & AS 9

- Unlike AS 9, ICDS provides that the dividend income should be recognized in accordance with the provisions of the Act.
- Recognition of dividend income according to the provisions of the Act provides that dividend income should be recognized in previous year in which it is so declared, distributed or paid, as the case may be and 'Dividend' also includes Deemed Dividend. Inclusion of Deemed Dividend will increase the profit of current year.
- The **gross turnover/ receipts** under section 44AB or 44AD of the Act needs to be calculated in accordance to the provisions of this ICDS.

Comparison b/w ICDS IV & AS 9

- The ICDS provides that the amount that could not be recognized due to lack of reasonable certainty of its ultimate collection should be disclosed with the nature of uncertainty.
- ICDS does not provide for specific exclusion for revenue recognition in case of Leases. Till the notification of separate ICDS on Leases, the already available provisions under this ICDS will have to apply.

Transitional Provisions

- The transitional provisions of Income Computation and Disclosure Standard on construction contract shall *mutatis mutandis apply to the recognition of revenue and the associated costs for a service transaction undertaken on or before the 31st day of March, 2016* but not completed by the said date.
- Revenue for a transaction, other than a service transaction referred to in Para 10, undertaken on or before the 31st day of March, 2016 but not completed by the said date shall be recognised in accordance with the provisions of this standard for the previous year commencing on the 1st day of April, 2016 and subsequent previous year. The amount of revenue, if any, recognised for the said transaction for any previous year commencing on or before the 1st day of April, 2015 shall be taken into account for recognising revenue for the said transaction for the previous year commencing on the 1st day of April, 2016 and subsequent previous years.

Disclosure requirement under ICDS

- In a transaction involving sale of goods, total amount of claim raised for escalation of price and export incentives but not recognized as revenue during the previous year due to lack of reasonably certainty of its ultimate collection along with nature of uncertainty.
- The amount of revenue from service transactions recognized as revenue during the previous year ; and
- The methods used to determine the stage of completion of service transactions in progress.
- For service transactions in progress at the end of previous year:
 - (i) amount of costs incurred and recognized profits (less recognized losses) upto end of previous year;
 - (ii) the amount of advances received; and
 - (iii) the amount of retentions.

Comparison at a Glance

	ICDS IV	AS 9
Rendering of Services	Limits the scope of completed service contract method for recognition of revenue from service transactions ,only for the contracts with duration not more than 90 days.	AS 9 recognizes both completed service contract method and proportionate completion method for recognition of revenue from service transactions.
Recognition of Dividend	Dividend shall be recognised in accordance with the provisions of the Income Tax Act 1961.As per Sec 8 of Income Tax Act 1961, any dividend declared by a company or distributed or paid by it within the meaning of clause (22) of section 2 shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be	Dividend are recognised in the year when the right to receive payment is established.

ICDS V
Property, Plant &
Equipment

AS-10
Accounting for Fixed
Assets

AS-10 : Property, Plant & Equipment

- ❑ FS disclose certain information relating to fixed assets such as land, buildings, plant and machinery, vehicles, furniture and fittings, goodwill, patents, trade marks and designs.
- ❑ This Standard **does not deal** with accounting for the following items to which **special considerations apply**:
 - a) biological assets (living animal or plant) related to agricultural activity other than bearer plants. This Standard applies to bearer plants but it does not apply to the produce on bearer plants; and
 - b) wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources
- ❑ Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Standard when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

AS-10 : Property, Plant & Equipment

- ▶ The cost of fixed asset comprises:
 - Purchase price, **including** import duties and other non-refundable taxes or levies and
 - **Any directly attributable cost** of bringing the asset to its working condition for its intended use.
 - the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located

- ▶ **Examples of directly attributable costs are:**
 - (i) site preparation; (ii) initial delivery and handling costs; (iii) installation cost, such as special foundations for plant; and (iv) professional fees, (v) costs of employee benefits, arising directly from the construction or acquisition of PPE.

 - Administration and other general overheads are usually **excluded** from the cost of fixed assets. Inauguration costs, costs of advertising and promotional activities and costs of staff training, etc. are also not included in value of asset.

► **Cost of assets acquired in exchange:**

The cost of such an item of property, plant and equipment is measured at fair value unless

- (a) the exchange transaction lacks commercial substance or
- (b) the fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.

► **Cost of Self Generated Fixed Assets:**

Costs that relate directly or are attributable to the construction activity of specific asset in general and can be allocated to the specific asset.

► **Measurement of value of PPE after Recognition:**

An enterprise should choose either the cost model or the revaluation model as its accounting policy and should apply that policy to an entire class of PPE.

- ❑ **Cost Model** - cost less any accumulated depreciation and any accumulated impairment losses.
- ❑ **Revaluation Model** - fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued

► **Improvements or Repairs:**

- Repair expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance must be **capitalized**.
- Other expenditures must be charged to P&L account.

► **Depreciation:**

- ❑ Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately
- ❑ The depreciation charge for each period should be recognised in the statement of profit and loss unless it is included in the carrying amount of another asset.
- ❑ The depreciable amount of an asset should be allocated on a systematic basis over its useful life.
- ❑ The useful life of an asset is defined in terms of its expected utility to the enterprise.
- ❑ The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.

- **Retirements and Disposal of Assets:**
 - Items of fixed assets that have been retired from active use and are held for disposal are stated at the **lower of their carrying amount OR Net Realizable Value**. Any write-down in this regard should be recognised immediately in the statement of profit and loss.

- **Derecognition:**
 - The carrying amount of an item of PPE should be derecognised :
 - (a) on disposal; or
 - (b) when no future economic benefits are expected from its use or disposal.

And the gain or loss arising from the derecognition should be included in the statement of profit and loss when the item is derecognized.

- **DISCLOSURE REQUIREMENTS:**

- ❖ The financial statements should disclose, for each class of property, plant and equipment:
 - a) the measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;
 - b) the depreciation methods used;
 - c) the useful lives or the depreciation rates used. In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;
 - d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
 - e) a reconciliation of the carrying amount at the beginning and end of the period showing:
- ❖ In respect of Depreciation, it is necessary to disclose:
 - (a) depreciation, whether recognised in the statement of profit and loss or as a part of the cost of other assets, during a period; and
 - (b) accumulated depreciation at the end of the period

- **DISCLOSURE REQUIREMENTS:**

- ❖ The financial statements should also disclose:
 - (a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
 - (b) the amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
 - (c) the amount of contractual commitments for the acquisition of property, plant and equipment;
 - (d) if it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and
 - (e) the amount of assets retired from active use and held for disposal.
- ❖ In accordance with AS 5, an enterprise discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods.

- **DISCLOSURE REQUIREMENTS:**

- ❖ If items of **property, plant and equipment** are stated at **revalued amounts**, the following should be disclosed:
 - (a) the effective date of the revaluation;
 - (b) whether an independent valuer was involved;
 - (c) the methods and significant assumptions applied in estimating fair values of the items;
 - (d) the extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and
 - (e) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

Comparison b/w ICDS V & AS 10

► **Tangible Fixed assets:**

Unlike As, ICDS deals with tangible fixed assets i.e. land, building, machinery, plant or furniture. AS-10 applies to Property, plant and equipment i.e. tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and are expected to be used during more than a period of twelve months, but do not cover Bio-logical assets or Wasting assets.

As per As-10, Bearer Plants such as tea bushes, grape vines, oil palms and rubber trees, etc. are covered under the scope. However, the produce growing on bearer plants, for example, tea leaves, grapes, oil palm fruit and latex, are not with in the scope of AS-10. Conversely, ICDS does not provide any particular definition for plants (i.e. whether

Comparison b/w ICDS V & AS 10

▶ Recognition of spare parts, stand-by equipment and servicing equipment:

Unlike AS 10, ICDS states that 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. As per As-10, items should be capitalized only if they meet the definition of PPE.

▶ Revaluation of Fixed Assets:

There is no concept of revaluation of asset in the ICDS. The same is in conformity with the provision of the Act wherein also the concept of revaluation of assets is not recognized.

Comparison b/w ICDS V & AS 10

▶ Exchange of a tangible asset for another asset:

Same as in AS-10, ICDS also states that in case of acquisition of a tangible fixed asset in exchange for another assets, **the Fair Value of the tangible fixed asset so acquired is to be its Actual cost. However,** AS-10 also provides that if fair value of acquired assets is not measurable then carrying amount of asset given is to be recognized.

▶ Retirement and Disposal of Fixed Asset:

Para 73, of AS-10 provides for retirement of fixed asset from active use & disposal of such asset to state them at lower of carrying amount or NRV and separately show them in FS, **but ICDS does not provide for any such provision.**

▶ Derecognition of Fixed Asset:

Para 74, of AS-10 provides for derecognition of fixed asset on disposal and gain/loss arising from such assets should be included in statement of P&L, **but ICDS does not provide for any such provision.**

Comparison b/w ICDS V & AS 10

▶ Valuation of Tangible assets in special cases:

- ❖ Unlike As-10, ICDS deals with jointly owned fixed assets and states that the proportion in the actual cost, accumulated depreciation and written down value is grouped together with similar fully owned tangible fixed assets. However, there is no concept of jointly owned assets in AS-10.
 - ❖ Same as in AS-10, ICDS also states that if assets are purchased for a consolidated price, the consideration shall be apportioned to the various assets on a fair basis. However, AS-10 provides if fair value is not measured reliably, then values are estimated on a fair basis as determined by competent valuers.
- ▶ ICDS specifically provides for 'Depreciation' and 'Income from transfer of a tangible asset' that it should be computed in accordance with the provisions of the Act. This will not impact profit because depreciation is already calculated according to the Act while computing Income. As per AS-10, The depreciable amount of an asset should be allocated on a systematic basis over its useful life

Observations...



- ▶ Non inclusion of Intangible assets under ICDS will not impact the profit of current year because Income Tax Act separately allows depreciation for Intangible assets and disallows any amortisation of Intangible asset taken as per AS 26.
- ▶ Revaluation will **not affect** the P&L account, because it is also not allowed under the Act.
- ▶ ICDS does not provide for the disposal of tangible fixed assets, so it should be treated as per the AS or Act, therefore, will not impact the P&L account.
- ▶ Deferred taxes may arise w.r.t. machinery spares in case they are capitalized as per AS and charged to revenue as and when consumed as per the ICDS. Thus it would decrease profits as compared to the Act.

Observations...



- ICDS does not clarify the treatment of expenses, whether to be capitalized or considered as expense, incurred between the completion of asset and its utilization for commercial production. ICDS is also silent on the treatment of expenses incurred during the period post completion of test runs and pending commencement of commercial production. **However, the Board has clarified in this matter vide circular 10/2017 that:**

As per Para 8 of ICDS-V, the expenditure incurred till the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as capital expenditure.

Transitional Provisions

The actual cost of tangible fixed assets, acquisition or construction of which commenced on or before the 31st day of March, 2016 but not completed by the said date, shall be recognised in accordance with the provisions of this standard. The amount of actual cost, if any, recognised for the said assets for any previous year commencing on or before the 1st day of April, 2015 shall be taken into account for recognising actual cost of the said assets for the previous year commencing on the 1st day of April, 2016 and subsequent previous years.

Disclosure requirement under ICDS

- Description of asset/block of assets.
- Rate of depreciation.
- Actual cost or written down value, as the case may be.
- Additions/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 Central Excise Rules, 1944, in respect of assets acquired on or after 1st March, 1994,
 - change in rate of exchange of currency, and
 - subsidy or grant or reimbursement, by whatever name called.
- Depreciation Allowable
- Written down value at the end of year

The disclosure requirements are same as in Tax Audit Report in respect of 'Depreciation'

Other clarifications issued by CBDT on ICDSs vide circular 10/2017

Clarifications by CBDT on ICDS

Question: 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.

Question: Certain ICDS provisions are inconsistent with judicial precedents. Whether these judicial precedents would prevail over ICDS?

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

Question: Does ICDS apply to non-corporate taxpayers who are not required to maintain books of account and/or those who are covered by presumptive scheme of taxation like sections 44AD, 44AE, 44ADA, 44B, 44BB, 44BBA, etc. of the Act?

❑ **Answer:** ICDS is applicable to specified persons having income chargeable under the head Profits and gains of business or profession' or 'Income from other sources'. **Therefore, the relevant provisions of ICDS shall also apply to the persons computing income under the relevant presumptive taxation scheme.** For example, for computing presumptive income of a partnership firm under section 44AD of the Act, the provisions of ICDS on Construction Contract or Revenue recognition shall apply for determining the receipts or turnover, as the case may be.

Question: If the taxpayer sells a security on the 30th day of April 2017. The interest payment dates are December and June. The actual date of receipt of interest is on the 30th day of June 2017 but the interest on accrual basis has been accounted as income on the 31st day of March .2017. **Whether the taxpayer shall he permitted to claim deduction of such interest i.e. offered to tax but not received while computing the capital gain?**

❑ **Answer:** Yes, the amount already taxed as interest income on accrual basis shall be taken into account for computation of income arising from such sale.

Question: If there is conflict between ICDS and other specific provisions of the Income-tax rules, 1962 ('the Rules') governing taxation of income like rules 9A, 9B etc. of the Rules, which provisions shall prevail?

❑ **Answer:** ICDS provides general principles for computation of income. In case of conflict, if any, between the provisions of Rules and ICDS, **the provisions of Rules, which deal with specific circumstances, shall prevail.**

Question: ICDS is framed on the basis of accounting standards notified by Ministry of Corporate Affairs (MCA) vide Notification No. GSR 739(E) dated 7 December 2006 under section 211(3C) of erstwhile Companies Act 1956. However, MCA has notified in February 2015 a new set of standards called 'Indian Accounting Standards' (Ind-AS). **How will ICDS apply to companies which adopted Ind-AS?**

❑ **Answer:** ICDS shall apply for computation of taxable income under the head "Profit and gains of business or profession" or "Income from other sources" under the Income Tax Act. **This is irrespective of the accounting standards adopted by companies i.e. either Accounting Standards or Ind-AS.**

Question: Whether ICDS shall apply to computation of Minimum Alternate Tax (MAT) under section 115JB of the Act or Alternate Minimum Tax (AMT) under section 115JC of the Act?

- ❑ **Answer:** MAT under section 115.113 of the Act is computed on 'book profit' that is net profit as shown in the Profit and Loss Account prepared under the Companies Act subject to certain specified adjustments. Since, the provisions of ICDS are applicable for computation of income under the regular provisions of the Act, **the provisions of ICDS shall not apply for computation of MAT.**

AMT under section 115JC of the Act is computed on adjusted total income which is derived by making specified adjustments to total income computed as per the regular provisions of the Act. Hence, **the provisions of ICDS shall apply for computation of AMT.**

Question: Whether provision for employee benefit such as provident fund, gratuity, etc. are excluded from scope of ICDS X?

- ❑ **Answer:** It is clarified that provisioning for employee benefit which are otherwise covered by AS 15 shall continue to be governed by specific provisions of the Act and are not dealt with by ICDS-X.

Question: Whether the provisions of ICDS shall apply to Banks, Non-banking financial institutions, Insurance companies, Power sector, etc.?

- ❑ **Answer:** The general provisions of ICDS shall apply to all persons unless there are sector specific provisions contained in the ICDS or the Act. For example, ICDS VIII contains specific provisions for banks and certain financial institutions and Schedule 1 of the Act contains specific provisions for Insurance business.

Question: Which ICDS would govern derivative instruments?

- ❑ **Answer:** ICDS –VI (subject to para 3 of ICDS-VIII) provides guidance on accounting for derivative contracts such as forward contracts and other similar contracts. For derivatives, not within the scope of ICDS-VI, provisions of ICDS-1 would apply.

Question: Since there is no specific scope exclusion for real estate developers and Build -Operate- Transfer (BOT) projects from ICDS IV on Revenue Recognition, please clarify whether ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.

❑ **Answer:** At present there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable.

***However, The CBDT issued Draft Income Computation and Disclosure Standards on Real Estate Transactions by press release on 11th May, 2017 and asking for comments from stakeholders.**

Question: Whether ICDS is applicable to revenues which are liable to tax on gross basis like interest, royalty and fees for technical services for non-residents u/s. 115A of the Act.

Answer: Yes, the provisions of ICDS shall also apply for computation of these incomes on gross basis for arriving at the amount chargeable to tax.

General Impact of all ICDSs

General Impact of all ICDSs

- ❖ It will result in increase in administration cost.
- ❖ The difference in Accounting Income and Taxable Income will result in Increase in deferred tax assets/liabilities.
- ❖ It will reduce litigations because of standards providing the definite method of computation of income and also the proper disclosure required by the authorities.
- ❖ Non-compliance of ICDS may result into Assessment u/s 144 of the Income Tax act, 1961.
- ❖ ICDS are also considered for Tax Audit.

Note: No need to maintain separate set of books of account for the purpose of ICDS



Question

Answer

THANK YOU...!!

Presented by: CA. Sanjay Agarwal

Assisted by: CA. Apoorva Bhardwaj & CA. Sonia Rani

Email id: agarwal.s.ca@gmail.com