INCOME COMPUTATION AND DISCLOSURE STANDARDS

- H SINGHVI & CO

SECTION 145 - METHOD OF ACCOUNTING

- 145(1) – Speaks for a system of accounting to be regularly followed by an assessee for income chargeable under head “Profits and gains of business or profession” or “Income from other sources” subject to provisions of section 145(2)

- 145(2) – gives power to the Central Government to notify from time to time income computation and disclosure standards to be followed by any class of assessee or in respect of any class of income

- 145(3) – gives power to an assessing officer unsatisfied with the i) correctness or completeness of the accounts; ii) method of accounting not been regularly followed u/s 145(1); iii) non compliance of ICDS u/s 145(2) to make best judgment

Why ICDS?

- Governance in terms of accounting and record keeping is different for each type of Entity – Accounting Standards could not cater to all forms of entity.

- Lack of uniformity as well as clarity.

- Vide Notification No. S.O. 3079(E) dated 29.09.2016 in total 10 ICDS were issued applicable from AY 2017-18. Clarifications were provided vide Circular No. 10/2017 dated 23.03.2017 after the decision of Delhi High Court in the case Chamber of Tax Consultants v UOI [2017].

FEATURES

- Applicable to all assessee following mercantile system of accounting except an individual or a HUF not required to get his accounts audited in the previous year.
- Applicable from AY 2017-18 – For computing “Profits and gains from business or profession” and “Income from other sources” – not for maintenance of books
- Only for the purpose of computation of income.
- In case of conflict between ICDS and the provisions of Act/Rules, the latter shall prevail
- Not applicable for computation of book profit i.e. Mat provisions u/s 115JB

ICDS I - ACCOUNTING POLICIES

- Deals with significant accounting policies. Accounting policies are the specific accounting principles and methods of applying those principles in preparation and presentation of financial statements

- Fundamental accounting assumptions
  - Going Concern
  - Consistency
  - Accrual

- Accounting Policy to reflect the true and fair view of the affairs of the assessee
  - Substance over form to be considered; and
  - Marked to market or expected loss shall not be recognised unless such recognition is in accordance to the provisions of ICDS

ICDS I - ACCOUNTING POLICIES

- **Disclosure:**
  - All significant accounting policies adopted by a person shall be disclosed under clause 13 (f) of 3CD
  - Any change in policy having material effect to be disclosed. Quantum, whether or not ascertainable to be indicated.
  - Change resulting in material impact in either previous or ensuing years to be disclosed appropriately
  - Fundamental accounting assumptions not followed then the fact to be disclosed

ICDS II - VALUATION OF INVENTORIES

- Deals with valuation of inventories except following:
- WIP – Construction Contracts
- Shares, debentures ad other financial instruments
- Producers inventories of livestock, agriculture and forest produce, mineral oil, ores and gases – if valued at NRV
- Machinery spares used only in tangible fixed assets

- Definition – Inventories are assets
  - Held for sale
  - In the process of production of such sale
  - In the form of materials to be consumed in production process or in the rendering of services

ICDS II - VALUATION OF INVENTORIES

- Measurement – cost of inventory or NRV, whichever is lower

Cost of Inventory
- Cost of Purchase
- Cost of Services
- Cost of conversion
- Other costs

- Interest and borrowing cost to be excluded unless they meet criteria of ICDS - borrowing cost
- Cost of Inventory to exclude:
  - Abnormal wastage
  - Storage cost unless necessary for production process
  - Administrative overheads
  - Selling costs

ICDS II - VALUATION OF INVENTORIES

- NRV = Estimated sale price less estimated cost of completion and estimated cost towards sale.
- Cost of inventory to be assigned using FIFO or Weighted average formula or standard cost method
- Retail method can be used in retail trade when its impractical to use other methods

- Valuation of Raw Material
  - Only at Cost. However, if decline in price of Finished Goods is less than NRV – then valuation at NRV (replacement cost)

- Valuation of Opening Inventory
- Valuation of inventory in case of certain dissolutions

ICDS II - VALUATION OF INVENTORIES

- **Disclosure**
  - Accounting Policies adopted including cost formula used
  - Total carrying amount of inventories and its classification

ICDS III – CONSTRUCTION CONTRACTS

- Deals with determination of income for a construction contract of a contractor
- Definitions:
  - Construction Contracts
  - Fixed Price Contract/Cost Plus Contract
  - Retentions
  - Progress Billings/Advances
- Implication of ICDS on Contracts (combined/segregated)
  - Covers number of assets – treated as separate construction
  - Group of contracts – single or multiple customers – single construction contract
  - Construction of additional asset – separate contract

ICDS III – CONSTRUCTION CONTRACTS

- **Revenue Recognition:**
  - Contract Revenue
  - Contract Cost
  - Based on percentage of completion method i.e. based on contract cost; or surveys; or completion of physical work
  - Progressive payments and advances received from customers are not determinative of stage of completion
  - In case of early stages of contract where outcome of contract cannot be reasonabily estimated contract revenue to be recognized to the extent of contract cost. Early stage cannot go beyond 25%
- **Change in estimates**

ICDS III – CONSTRUCTION CONTRACT

- **Disclosure**
  - contract revenue recognised as revenue in the period; and
  - the methods used to determine the stage of completion of contracts in progress.

- Further to disclose following details for contract in progress:
  - costs incurred and recognised profits (less recognised losses) upto the reporting date;
  - the amount of advances received; and
  - the amount of retentions.

ICDS IV – REVENUE RECOGNITION

- Deals with recognition of revenue – sale of goods, rendering of services and use by others of other persons resources yielding interest, royalties or dividends

Revenue	Time of Recognition
Sale of goods	- Significant risk and rewards transferred; AND - Reasonable certainty of collection of revenue
Revenue from service transactions	% completion method Or Straight line method Or Project completion method
Interest	Accrual
Refund of taxes, duty, etc. and interest thereon	Receipt basis
Royalties	Accrual as per relevant terms of contract, unless other rational and systematic basis is available
Dividend	As per Income Tax Act

ICDS IV – REVENUE RECOGNITION

- **Exception** – i) uncertainty in ultimate collect for escalation and incentives

  ii) Interest and royalty, booked on accrual basis, non-recovery be considered as bad debts

- **Disclosure:**
  - For sale of goods – amount not recognised as revenue due to lack of reasonable certainty of its ultimate collection along with nature of uncertainty.
  - Amount of revenue from service transaction
  - Method used for determination of stage of completion of transactions in progress
  - For services in progress:
    - Amount of costs incurred and recognised profits (less recognised losses) upto end of PY
    - Amount of advances received
    - Amount of retentions

ICDS V – TANGIBLE FIXED ASSETS

- Deals with treatment of tangible fixed assets

- Definitions:
  - Tangible Fixed Asset
  - Fair Value

- Note:
  - Standby equipment and service equipments
  - Machinery spares – charged to revenue as and when consumed. If for fixed asset than to be capitalised

ICDS V - TANGIBLE FIXED ASSETS

- Cost of Fixed Asset to comprise of Purchase Price + duties and taxes (excluding tax refundable) + directly attributable cost – discounts & rebates

- Note:

Expenses on startup and commissioning of project Test runs and experimental production	Capitalised
After test runs but before actual production begins	
Expenditure incurred after production begins	Treat as revenue expenditure

- FA in exchange of another FA → cost will be FMV of asset acquired
- Improvement and Repairs – added to actual cost, if it increases future benefits
- Depreciation
- Transfers

ICDS V - TANGIBLE FIXED ASSETS

- Disclosure
  - Description of asset or block of assets
  - Rate of depreciation
  - Actual cost or WDV
  - Additions/deletions during the year
  - Depreciation
  - WDV at the end of the year

ICDS VI – EFFECTS OF FOREIGN EXCHANGE RATES

- Deals with
  - Treatment of transactions in Foreign Currency
  - Translating the financial statements of foreign operations
  - Treatment of foreign currency transactions in the nature of Forward Exchange Contracts

- Initial recognition
  - At actual rates for one time transactions
  - Weekly or monthly average for all recurring transactions during the period. If exchange rates fluctuate significantly then actual rates to be used.

ICDS VI - EFFECTS OF FOREIGN EXCHANGE RATES

- Conversions into reporting currency

Foreign currency Item	Exchange Rate
Monetary	Closing rate
Non- monetary	Transaction rate
Inventory valued at NRV	Rate on the date of valuation

- Exchange difference recognition

Items	On conversion (last date) MTM	On settlement
Monetary items	**Gain – Taxable** **Loss – Allowed**	**Gain – Taxable** **Losses – Allowed**
Non- monetary items	**Gain – Not taxable** **Losses – Not Allowed**	**Gain – Taxable** **Losses – Allowed**

ICDS VI – EFFECTS OF FOREIGN EXCHANGE RATES

- Note:
  - Forex loan
- a. For acquisition of assets – Adjusted to cost or WDV of asset (Sec- 43A)
- b. Others- Charged to P&L

  - Foreign operations - same as initial recognition

ICDS VI – EFFECTS OF FOREIGN EXCHANGE RATES

- Forward Contracts:

Speculation or trading or hedging of forex risk, firm commitment	Premium/Discount exchange differences shall be recognized only at the time of settlement
Other forward contracts	Premium/Discount amortised over life of contract MTM at the end of PY shall be recognized as income / expense in every year On renewal or cancellation, P/L shall be recognized in that PY
Premium/Discount→	Rate at inception (-) Forward rate

ICDS VII – GOVERNMENT GRANTS

- Deals with treatment of Government Grants.
- Grants in the form of subsidies, cash incentives, duty drawbacks, waiver, concessions, reimbursements, etc.
- Does not deal with
  - Assistance other than in form of Government Grants
  - Participation in the ownership of the enterprise
- Recognition
  - Only when reasonable assurance that conditions attached to grants would be complied and the grants shall be received
  - No later than the date of actual receipt

ICDS VII – GOVERNMENT GRANTS

- **Treatment of grants**

Directly related to asset	Depreciable asset → Reduce from cost of asset Non-depreciable asset → Recognise as income over the same period in which cost of meeting obligations is charged to income to income
Not directly related to acquisition of asset	Proportionate grant shall be reduced from cost or WDV of asset Cost/ WDV (-) grant X $\frac{\text{Cost of asset purchased}}{\text{Cost of all assets}}$ Eg: Govt. grant of Rs. 30 lacs received for a project costing 100 lacs. Asset acquired in previous year costing 10 lacs. Thus cost of asset =10 – (30 X 10/ 100)= 7 lacs
Grants received as compensation for expenses or losses incurred in PY for giving immediate financial support (with no further cost associated)	Recognise as income of the period in which it is receivable
Other Govt Grants	Recognise as income over the periods necessary to match with related costs which they are intended to compensate
Grant for non- monetary asset given at concessional rates	Recognise at acquisition cost

ICDS VII – GOVERNMENT GRANTS

- **Treatment of Refund**

- Related to depreciable asset	Amount refundable shall be added to actual cost or WDV	
- Other grants (related to non-depreciable, compensatory grants, grants at concessional rates, etc.)	If there is unamortised deferred credit	- Refundable amount is applied against unamortised deferred credit - Balance is charged to P&L
	When there is no deferred credit	Refundable amount to be charged to P&L

- **Disclosure**
  - Nature and extent of grants recognised or not recognised by way of deduction from actual cost or WDV
  - Nature and extent of grants recognised or not recognised as income

ICDS VIII - SECURITIES

- **Part A**
  - Deals with Securities held as Stock-in-trade
  - Specifically excludes following:
    - Recognitions of interest and dividend on securities
    - held by person engaged in insurance business
    - Held by MF, VC, banks and Public Financial Institutions (covered in Part B)
- **Part B**
  - Held by MF, VC, banks and Public Financial Institutions (covered in Part B) – to be governed by the guidelines of RBI

ICDS VIII - SECURITIES

- Initial Recognition:
  - At cost of acquisition i.e. Purchase Price + acquisition cost like brokerage, fees, tax, duty or cess)
  - Where one security is acquired in exchange of another security or asset, the FMV of the security acquired shall be its actual cost
  - If any interest is accrued before acquisition and is included in purchase price, on receipt of such interest, it shall be allocated to pre-acq and post-acq interest. Further, pre-acq interest to be deducted from actual cost.

ICDS VIII - SECURITIES

- Subsequent Measurements:
  - At the end of PY – to be valued at Cost or NRV, whichever is lower
  - Category wise comparison of cost or NRV – Shares, Debt Securities, Convertible Securities and other securities

In case actual cost cannot be ascertained by reference to a specific identification, “FIFO” or “Weighted Average Cost” formula can be adopted.

Security	Category	Cost	NRV	Security- wise	Category- wise (ICDS)
A	Share	500	420	420	
B	Share	550	600	550	
	Total	1,050	1020	970	1,020
C	Debentures	450	600	450	
D	Debentures	510	490	490	
	Total	960	1090	940	960
Grand Total		**2,010**	**2,110**	**1,910**	**1,980**

ICDS IX - BORROWING COSTS

- Deals with treatment of borrowing cost and costs incurred in relation to borrowing funds but excludes the actual or imputed cost of owners’ equity and preference share capital.

ICDS IX - BORROWING COSTS

- Definitions:
  - Borrowing Cost – interest and other costs and to include:
    - Commitment charges on borrowings
    - Amortised amounts of discounts or premiums related to borrowings
    - Amortised amount of ancillary costs incurred
  - Qualifying Asset –
    - Land, building, machinery, plant or furniture, being tangible assets;
    - Know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets
    - inventories that require a period of twelve months or more to bring them to a saleable condition

ICDS IX - BORROWING COSTS

- **Recognition:**
  - Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset.
  - Other borrowing costs shall be recognised in accordance with the provisions of the Act.
  - For the purposes of this Income Computation and Disclosure Standard, "capitalisation" in the context of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2 means addition of borrowing cost to the cost of inventory.

ICDS IX - BORROWING COSTS

- Calculation of Capitalisation, commencement and cessation of capitalisation

Type of borrowing	Amount eligible for Capitalisation	Commencement of Capitalisation	Cessation of Capitalisation
Specific Borrowing Cost	Actual borrowing cost incurred during the PY	Date of borrowing	First put to use (in case of inventory, when all activities necessary for its intended sale are completed)
General Borrowing Cost	General Borrowing Cost X $\frac{\text{Avg. cost of QA}}{\text{Avg. cost of total asset}}$	Date of utilization of borrowed funds	

QA - construction of asset	
Started in PY and not completed during the year	(Opening + Closing balance) / 2
Started during the year	Closing balance / 2
Completed in current year	(Opening + Value on the date of put to use) / 2

ICDS IX - BORROWING COSTS

- Disclosure:
  - Accounting policy adopted for borrowing cost; and
  - The amount of borrowing cost capitalised during the previous year
- **AS-16 vs ICDS IX**
  - Temporary income
  - Suspension of capitalisation

ICDS X - PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

- Deals with provisions, contingent liabilities and contingent assets, except:
  - Resulting from financial instruments
  - Resulting from executory contracts
  - Arising in insurance business from contracts with policy holders; and
  - Covered by other ICDS
  - Revenue recognition and provisions for carrying amounts i.e. depreciation, impairment of assets and doubtful assets

ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

- Definitions:
  - Provision
  - Liability
  - Obligating Event
  - Contingent Liability
  - Contingent Asset
  - Executory Contracts
  - Present Obligations

ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

- **Recognition - Provisions**
  - Present obligation as a result of past event
  - Reasonable certainty for outflow of resources required to settle obligations
  - Reliable estimate can be made of the amount of obligation
  - No provisions for cost to be incurred to operate in future
  - Only obligations arising out of past event
  - If an obligation arises of a proposed new law – it arises only when the legislation is enacted
- **Recognition – Contingent Liabilities/Assets**
  - No recognition
  - Contingent assets to be assessed continually and on reasonable certainness of inflow of economic benefit to arise, the asset and related income are recognized in the previous year in which the change occurs

ICDS X - PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

- **Measurement**
  - Provision to be recognized to the extent that its estimate is based on the expenditure required to settle the present obligation. No discounting to be done on present value.
  - Asset and related income shall be recognized to the extent that its estimate is based on the value of economic benefit arising from such asset. No discounting to be done on present value.
  - If any reimbursement is expected to be made by any third party in order to settle the provision, then such reimbursement will be recognized only when it is reasonably certain that the reimbursement amount will be received
  - No provision shall be made for those costs, which the entity is not liable for payment in case the third party fails to pay
- **Review**
  - Provisions - reviewed at the end of each previous year. Reversals to be made if it is reasonably certain that an outflow of will not be required to settle the provision
  - An asset and related income - reviewed at the end of each previous year. Reversals to be made if it is reasonably certain that an inflow of economic benefits will not arise.
- **Note:** A provision shall be used only for expenditures for which the provision was originally made.

ICDS X - PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

- Disclosures - Provisions:
  - Descriptions of obligation
  - Carrying amount at the beginning and end of the PY
  - Additional provision made recognized during the year
  - Amount used and charged against the provision
  - Amount of provision reversed during the year

- Disclosures – asset and related income:
  - Descriptions of obligation
  - Carrying amount at the beginning and end of the PY
  - Additional asset and related income recognized during the year
  - Amount used and charged against the provision
  - Amount of asset and related income reversed during the year

THANK YOU!