(For Private Circulation Only)

INCOME COMPUTATION

AND

DISCLOSURE STANDARD - (ICDS)

NOTIFICATION NO. 33_2015

DATED 31/03/2015

The readers are advised that this is a note only for different method to be used for the purpose of computation of income for year ended 31st March 2016 and onwards. There is no change in the standard method of preparation of accounts. So by this note only the differences that may arise on case to case basis between the computation of income and financial statements are addressed. The financial statements have to be continued to be prepared using the same accounting standards.

I. INTRODUCTION:

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- In exercise of the powers conferred by Sec. 145(2), CBDT, vide Notification No. 33/2015 dated 31-03-2015 has notified 10 Income Computation and Disclosure Standards (ICDS).

- This notification shall come into force with effect from 1st day of April, 2015 and shall apply from A.Y2016-17 and there on.

II. SCOPE :

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- The ICDS notified is to be followed by all assessees following Mercantile System of Accounting for the purpose of computation of income chargeable to income tax under the head

  - "Profit & Gain of business or profession" or

  - "Income from Other Sources"

- As per the notification the following Income Computation & Disclosures Standards are notified:
  - Standards relating to Accounting policies (In place of AS 1)
  - Standards relating to Valuation of inventories (In place of AS 2)
  - Standards relating to Construction contracts (In place of AS 7)
  - Standards relating to Revenue Recognition (In place of AS 9)
  - Standards relating to Tangible fixed assets (In place of AS 10)
  - Standards relating to the effects of changes in foreign exchange rates (In place of AS 11)
  - Standards relating to Government Grants (In place of AS 12)
  - Standards relating to Securities
  - Standards relating to Borrowing Costs (In place of AS 16)
  - Standards relating to Provisions, contingent liabilities & contingent assets (In place of AS 29)
- Transition provisions have been prescribed that all contract or transactions existing on the 1st day of April, 2015 or entered into on or after the first day of April, 2015 shall be dealt with in accordance with the provisions of the standard after taking into account the income, expense or loss, if any recognized in respect of the said contract or transaction for the previous year ending on or before 31st March, 2015.
- Words and expression used and not defined in this ICDS but defined in the Income Tax Act, 1961, shall have the same meaning assigned to them in the Act.

III. SYNOPSIS OF THE ICDS NOTIFIED BY THE CBDT:

1. <u>ICDS I relating to Accounting Policies (In place of AS 1):</u>

1.1 (a) Accounting policies adopted by a person shall be such so as to represent a true & fair view of the state of affairs & income of the business, or vocation.

(b) Accounting policy shall not be changed without reasonable cause.

(c) Disclosure of all significant policies adopted shall be disclosed.

(d) Any change in accounting policy which has material effect shall be disclosed, where such amount is not ascertainable wholly or in part the fact shall be indicated.

1.2 This ICDS differs from present AS 1 in terms of the following:

It doesn't recognize the under mentioned concepts laid down in AS 1:

- Concept of Prudence
- Concept of Materiality

2. ICDS II relating to Valuation of Inventories (In place of AS 2):

2.1 **(a) The standard does not apply to:**

- Work in progress and items which are dealt by other standards, eg.

i) Construction Contracts

ii) Shares, Debentures & Other financial instruments held as stock in trade

iii) Machinery parts which can be used only in connection with a tangible fixed assets

iv) Producers inventories of livestock, agriculture & forest products, mineral oils, ores & gases to the extent they are measured at net realizable value

(b) **Inventories can be valued at Cost or Net Realisable Value (NRV) whichever is lower :**

1) FIFO or weighted average cost
2) Retail Method
3) Net Realizable Value

(c) The method of valuation of inventories once adopted cannot be changed without a reasonable cause.

(d) In case of dissolution, whether the business is discontinued or not, the inventory on date of dissolution shall be valued at NRV.

2.2 **This ICDS differs from present AS 2 in terms of the following:**

- It does not recognize the Standard Costing as a method for valuation of inventory which is one of the methods allowed as per AS 2.

2.3 **Disclosure**

i) The accounting policies adopted in measuring inventories including the cost formulae used.

ii) The total carrying amount of inventories and its classification appropriate to a person.

3. ICDS III relating to construction contracts (In place of AS 7) :

3.1 (a) Applicable in determination of income for a construction contract of a contractor.

(b) Construction contracts are formulated in a number of ways for the purpose of this standard & can be classified as fixed price contracts & cost plus contract

(c) The contract can be treated as a separate construction contract (where contract covers number of assets, the construction of each asset should be treated as a separate contract) :

i) Separate proposals have been submitted for each asset
ii) Each asset has been subject to separate negotiation & the contractor & customer have been able to accept or reject that part of the contract relating to each asset
iii) The costs & revenues of each asset can be identified

(d) The contract can be treated as a single construction contract (group of contracts with single customer or with several customer should be treated as a single construction contract when :

i) The group of contracts is negotiated as single package
ii) The contracts are so closely interrelated that they are in effect part of a single project
iii) The contracts are performed concurrently or in continuous sequence

(e) Contract revenue & contract costs associated with the construction contract should be recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date.

(f) Where a contract provides for construction of an additional asset at the option of the customer, such additional asset shall be treated as a separate construction contract when :

i. The asset differs significantly in design, technology or function from that of the original contract, or
ii. The price of the asset is negotiated without having regard to the original contract price.

(g) Contract Revenue shall be recognized when there is reasonable certainty of ultimate collection.

3.2 This ICDS differs from present AS 7 in terms of the following:

- No provision for expected losses
- No recognition of foreseeable loss
- No downward revision in revenue when there is a downward variation in contract.

3.3 **Disclosure**

i) The amount of contract revenue recognized as revenue in the period

ii) The methods used to determine the stage of completion of contracts in progress

For contracts in work in progress

- Amount of costs incurred & recognized profits upto reporting date
- The amount of advances received
- The amount of retentions

4. ICDS IV relating to Revenue Recognition (In place of AS 9):

4.1 This standard deals with the bases for recognition of revenue arising in the ordinary activities of a person from

i) The sale of goods

ii) The rendering of services

iii) The use by others of the persons resources yielding interest, royalties or dividends

4.2 This ICDS differs from present AS 9 in terms of the following:

- It does not recognize Completed Project Method as against AS 9.

4.3 Disclosures

i) In a transaction involving sale of goods, total amount not recognized as revenue during the previous year due to lack of reasonably certainty of its ultimate collection along with nature of uncertainty

ii) The amount of revenue from service transactions recognized as revenue during the previous year

iii) The method used to determine the stage of completion of service transactions in progress

iv) For service transaction in progress at the end of the previous year

v) amount of costs incurred and recognized profits(less recognized losses) upto end of previous year

- The amount of advances received
- The amount of retentions

5. ICDS V relating to Tangible Fixed Assets (In place of AS 10):

5.1 (a) Tangible fixed asset is an asset being land, building, machinery, plant or furniture held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in normal course of business.

(b) Fair value of the Asset is the amount for which the asset could be exchanged between knowledgeable willing parties in an arm's length transaction.

(c) Identification of Tangible Fixed Asset :

i) An asset is identified as Tangible Fixed Asset as per the definition at para (a) above.

ii) Stand-by Equipment and servicing equipment are to be capitalized.

iii) When the 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 capitalized, else the same is to be charged to the revenue.

(d) Valuation of Tangible Assets in special cases:

i) Where a person owns tangible assets jointly with others, the proportion in the actual cost, accumulated depreciation & written down value is grouped together with similar fully owned tangible assets. Details of such jointly owned tangible fixed assets shall be indicated separately in the tangible fixed asset register

ii) Where several assets are purchased for a consolidated price, the consideration shall be apportioned to the various assets on a fair basis.

5.2 **Disclosures**

i) Description of the asset or block of asset

ii) Rate of depreciation

iii) Actual cost or written down value, as the case may be

iv) Additions or deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of –

- Cenvat credit claimed and allowed.
- Change of rate of exchange of currency
- Subsidy or grant or reimbursement, by whatever name called;

v) Depreciation allowable and

vi) Written down value at the end of the year.

6. ICDS VI relating to Effects of change in Foreign Exchange Rate (In place of AS 11):

6.1 (a) Scope

i) Treatment of transactions in foreign currencies

ii) Translating the financial statements of foreign operations

iii) Treatment of foreign currency transactions in the nature of forward exchange contracts.

(b)**. Initial Recognition**

i) At tie time of initial recognition, the transaction shall be recorded in the reporting currency, by applying to foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of transaction.

ii) An average rate for a week or month that approximates the actual rate at the date of transaction may be used for all transaction in each foreign currency occurring during that period.

(c). Conversion on last date of the previous year:

i) Foreign Currency Monetary Items shall be converted into reporting currency by applying the closing rate.

ii) Where the closing rate does not reflect with reasonable accuracy, the amount in reporting currency that is likely to be realized from or required to disburse, then the relevant monetary item shall be reported in the reporting currency at the amount which is likely be to realized from or required to be disbursed at the last date of the previous year.

iii) Non-monetary items in a foreign currency shall be converted into reporting currency by using the exchange rate at the date of the transaction.

(d). **Recognition of Exchange Differences**

i) In respect of monetary items, exchange differences arising on the settlement there of at last day of the previous year shall be recognized as income or expense in that previous year

ii) In respect of non monetary items, exchange differences arising on conversion thereof at the last day of the previous year shall not be recognized as income or expenses in that previous year.

iii) Exception to the above:

- Initial recognition, conversion and recognition of exchange difference shall be subject to the provisions of Sec. 43A of the Act or Rule 115 of the Income Tax Rules, 1962.

(e) Financial Statement of Foreign Operations

i) The method used to translate financial statements of a foreign operation depends on the way in which it is financed and operates in relation to a person which may be classified as under:

- Integral Foreign Operation
- Non Integral Foreign Operation

ii) The Operation may be more of a non integral foreign operation in the following cases:-

- the activities are carried out with significant degree of autonomy
- transactions are not a high proportion of foreign operations activities
- operations are mainly financed by own operations or local borrowings
- labour and other cost in respect of the foreign operations are paid in local currency.
- Sales are mainly in currencies other than Indian currency.
- Sales prices of foreign operations are not affected by the short term changes in exchange rate but more by local competition or govt. regulation.

(f) Change in Classification of a Foreign Operation:

i) In case of change in classification, the transaction procedures applicable to the revised classification should be applied from the date of change.

ii) Though the consistency principle requires the classification of operation to be the same once classified as integral or non integral, however, a change in the finance and operation of the foreign operation may lead to a change in classification of foreign operation.

(g) Forward Exchange Contracts

i) Any premium or discount arising at the inception of forward exchange contract shall be amortised as income or expense or income over the life of the contract.
ii) Exchange difference shall be recognized as income or expense of the previous year in which exchange rate changes.
iii) Any loss or profit arising or renewal shall be recognized as income or as expense for the previous year

6.2 **This ICDS differs from the present AS 11 in terms of the following:**

- It does not capitalize the exchange difference by transferring the same in a special reserve called "Foreign Currency Translation Reserve" as that in AS 11.

6.3 The above said provisions shall not apply to a contract intended for trading or speculation purposes or hedging.

7. ICDS VII relating to Government Grants (In place of AS 12)

7.1 (a). This ICDS deals specifically with treatment of government grants.

(b). This ICDS does not deal with the following:

i) Government assistance other than in the form of Government Grants

ii) Government participation in the ownership of the enterprise

(c) Recognition of Government Grants

Government grants should not be recognized until there is reasonable assurance that the person shall comply with the conditions attached to them and the grants shall be received. Recognition of Govt. Grants should be postponed beyond the date of the actual receipt.

(d). **Treatment of Government Grants:**

i) Grant in respect of depreciable fixed assets is to be reduced from actual cost of such assets.

ii) In case of non depreciable asset or asset requiring fulfillment of certain obligations, grant shall be recognized as income over the same period.

iii)Grant received to compensate the expenses or losses incurred in the previous year, shall be recognized as income in the year ion which it is received.

iv)Grants in the form of non monetary assets, given at a concessional rate shall be accounted for on the basis of their acquisition cost.

7.2 Disclosure

i) Nature and extent of government grants recognized during the previous year by way of deduction from actual cost of asset or from WDV or which has being recognized as income

ii) Nature and extent of government grants which are not recognized by way of deduction from actual cost or WDV or not recognized as income.

8. ICDS VII relating to Securities [held as Stock in trade]

8.1 **(a).**This ICDS deals specifically with securities held as 'stock in trade'.

(b). The Standard does not deal with:

i) The bases for recognition of interest & dividends on securities which are covered by other standards

ii) Securities held by a person engaged in the business of insurance

iii) Securities held by mutual funds, venture capital funds, banks & public financial institutions formed under a Central or a state Act or so declared under companies Act

(c) Recognition & Initial Measurement of Securities

i) A security shall be recognized at actual cost including acquisition charges.

ii) Where a security is acquired in exchange for other securities or for other asset, the fair value of the security so acquired shall be its actual cost

iii) Where unpaid interest has accrued before the acquisition of an interest bearing security & is included in the price paid for the security, the subsequent receipt of interest is allocated between pre acquisition & post acquisition periods & the pre acquisition interest is to be deducted from actual cost

(d) Securities at the end of the previous year which are held as stock has to be valued at actual cost initially recognized or NRV whichever is lower.

(e) Comparison of actual cost and NRV shall be done category wise and not for each individual security.

(f) For the purpose of comparison, Securities have to be classified as:

i) Shares

ii) Debt securities

iii) Convertible securities

iv) Any other securities not mentioned above

(g) Where the securities are not listed on a recognized stock exchange or listed but not quoted shall be valued at actual cost initially recognized.

9. ICDS IX relating to Borrowing Costs (In place of AS 16):

9.1 (a) This standard deal with the treatment of Borrowing Cost

(b) This standard does not deal with the actual or imputed cost of owners equity & preference share capital

(c) **Recognition**

Borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets shall be capitalized as part of that asset.

(d) **Borrowing Cost Eligible for Capitalization:**

i) Where funds are borrowed specifically for the purpose of acquisition, construction or production of qualifying assets, the borrowing costs to be capitalized shall be the actual costs incurred during the period.

ii) Where only part of the borrowings is utilized for acquisition of the qualifying asset, the Borrowing Cost to be capitalized would be computed as under :

$$(A)*(B)/(C)$$

(A) Borrowing cost except directly relatable to specific purpose

(B) Average cost of qualifying asset at the first day and last day of the previous year and

(C) Average cost of asset at the first day and last day of the previous year.

(e) **Commencement of Capitalization:**

i) In case the fund borrowed refer to d (i) above, the cost shall be capitalized from the date on which funds were borrowed

ii) In case the fund borrowed refers to d (ii) above, the cost shall be capitalized from the date on which funds were utilized.

9.2 **This ICDS differs from present AS 16 in terms of the following:**

- It does not allow the income earned from temporary investments made out of the borrowings to be adjusted from the cost of borrowing.

9.3 Capitalization of borrowing costs shall cease :

i) In case of qualifying asset:

- When asset is first put to use
- When construction of a qualifying asset is completed in parts & a completed part is capable of being used, capitalization of borrowing costs to a part shall cease

ii) In case of Inventory:

- When substantially all the activities necessary to prepare such inventory for its intended sale are complete.

10 ICDS X relating to Provisions, Contingent Liabilities & Contingent Assets (In place of AS 29)

10.1 (a) Scope

This standard deals with the provisions, contingent liabilities and contingent assets, except:

i) Resulting from financial instruments

ii) Resulting from executor contracts

iii) Arising in insurance business from contracts with policyholders

iv) Covered by another standard

(b) Recognition of Provisions

i) a person has a present obligation as a result of past events

ii) it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation

iii) a reliable estimate can be made of the amount of the obligation

If these conditions are not met, no provision shall be recognized

(c) A person shall not recognize a contingent asset/liability

(d) Contingent assets are assessed continually & when it becomes reasonably certain that inflow of economic benefit will arise, the asset & related income are recognized in the previous in which the change occurs

(e) Review

Provisions shall be reviewed at the end of the previous year & adjusted to reflect the current best estimate. If it is no longer reasonably certain, the same should be reversed.

(f) A provision shall be used only for expenditure for which provision was originally recognized.

10.2 **This ICDS differs from present AS 29 in terms of the following:**

- As per AS 29, if the inflow of economic benefits is considered virtually certain, the same is to recognized as Contingent Asset, however in ICDS, the same is to be recognized if they meet the criteria of reasonably certain.

10.3 **Disclosure:**

Following disclosure shall be made in respect of each class of provisions

i) A brief description of the nature of the obligation

ii) The carrying amount at the beginning & end of the previous year

iii) Additional provisions made during the previous year, including increases to existing provisions
iv) Amounts unused reversed during the previous year
v) The amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement

Disclosures in respect of each class of asset & related income recognized as namely:

i) A brief description of the nature of asset & related income
ii) The carrying amount of asset at the beginning & end of the previous year
iii) Additional amount of asset & related income recognized during the year including increases to assets & related income already recognized
iv) Amount of asset & related income reversed during the previous year.

IV. CONCLUSIONS/OBSERVATIONS:

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- The method of computing the taxable income will change drastically with the introduction and implementation of the above ICDS.
- Since the provisions of the ICDS differ significantly from the present provisions, the companies will be have maintain separate records in order to comply with the requirements of the ICDS even though there is no specific requirement to maintain separate books of accounts.
- ICDS so notified are only supplementary to the present income Tax Act and do not over ride the provisions of the Act.
- The ICDS have been issued to reduce the uncertainty of alternative accounting treatment caused due to flexibility offered by AS & also to reduce litigation when the matter is treated differently by the I.T. Officials. The extent of application of the newly issued ICDS however depends on the attitude of the lower income tax authorities.
- Where Book Profit u/s 115JB of the Act, is to be computed, ICDS will not be applicable.
- Since the notification is silent as to where the disclosures as required by the ICDS are to be made, the said disclosures may be likely to be reported in the Tax Audit Report and Return of Income with appropriate changes in the same.
- Computation of Advance tax for the current financial year will have to be done considering the effects of ICDS.