INCOME COMPUTATION & DISCLOSURE STANDARDS

BY PROF SIDDHARTH N SURANA (CA)
INTRODUCTION

• ICDS is applicable from AY 17-18 (PY 16-17).
• ICDS is applicable only for Computation of Income under the head **PGBP & IFOS** and not for maintenance of Books of Accounts, if Assessee follows *mercantile system* of accounting.
• ICDS is applicable to ALL Assessees (except individual and HUF who are not covered under the provision of Section 44AB i.e, Tax Audit in the immediately preceding FY).
• Students are expected to note the deviations of ICDS from the corresponding AS or any judicial pronouncements.
• If there is conflict between Income Tax Act and ICDS then provisions of Act shall prevail. However, in case of conflict between ICDS and AS / Case Law , the ICDS shall prevail on or after 1/4/2016.
ICDS I – ACCOUNTING POLICIES

• This ICDS deals with significant Accounting Policies.

• While it recognizes the principles of going concern, consistency and accrual it DOES NOT RECOGNISE the concepts of “PRUDENCE” & “MATERIALITY” due to which income will be recognized earlier and expenses / losses will be recognized later.

• Examples of such cases are-

1. Expected losses or costs with improbable recovery under construction contract SHALL NOT be recognized (ICDS -III) means recognize on ACTUAL BASIS.

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2. Governments Grants shall be recognized as Income immediately even if the conditions attached are not fulfilled (ICDS - VII).

3. Non recognition of provision for loss on onerous contracts.

• Accounting Polices can be changed if there is a “REASONABLE CAUSE” but reasonable cause has not been defined in ICDS.
ICDS II – VALUATION OF INVENTORIES

• “Inventories” are assets:
  – held for sale in the ordinary course of business;
  – in the process of production for such sale;
  – in the form of materials or supplies to be consumed in the production process or in the rendering of services.

• Inventory to be valued at COST or NRV whichever is Lower.

• As per ICDS - II in the case of DISSOLUTION of FIRM/AOP/BOI the stock should be valued at NRV, whether the business is continued or not.

  In view of this the SC ruling in the case of Shakti Trading Co. should be ignored for dissolution on or after 1/4/16.
ICDS III – CONSTRUCTION CONTRACTS

• Costs and Revenue associated with a Construction Contract are to be recognized only under POCM “% of Completion method”.

• However, Contract revenue and contract costs associated with the construction contract, which commenced on or before the 31/03/16 but not completed by the said date, shall be recognized based on the method regularly followed by the person prior to the PY 2016-17.

• Expected losses or costs with improbable recovery under construction contract SHALL NOT be recognized (ICDS -III) means recognize on ACTUAL BASIS, i.e, deviation from AS 7.

• Retention money is considered as part of contract revenue and hence shall be recognized under POCM under ICDS. As per AS 7 there is no treatment for retention money.

• Penalties arising from the delay of contract completion shall NOT be reduced from Contract Revenue.
ICDS IV – REVENUE RECOGNITION

• This ICDS deals with recognition of Revenue in the course of ordinary activity of a person from sale of goods, rendering of services or providing own resources yielding interest, royalty or dividend.

• Revenue from service transactions shall be recognized by the percentage completion method. However, Revenue can be recognized on a straight line basis over a specific period of time, when services are provided by an indeterminate number of acts over such period.

• Revenue from service contracts with duration of not more than 90 days may be recognized when the rendering of services under that contract is completed or substantially completed.

• Interest shall be recognized on the time basis determined by the amount outstanding and the rate applicable. Interest on refund of any tax, duty or cess shall be taxable on receipt basis.

• Divided income is to be recognized as per Income tax Act.
ICDS V – TANGIBLE FIXED ASSETS

• ICDS covered only TANGIBLE fixed assets.
• Revaluation of assets NOT PERMITTED in ICDS.
• In case of Exchange of assets – Cost of asset shall be FMV of asset received in return.
• Income arising on transfer of a tangible fixed asset shall be computed in accordance with the provisions of the Income Tax Act.
ICDS VI – THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

• This ICDS deals with treatment of transactions in Foreign Currencies, translating the financial statements of Foreign Operations and treatment of Foreign Currency transactions in the nature of forward exchange contracts.

• This ICDS requires exchange differences arising on settlement of monetary items or conversion thereof at last day of the previous year to be recognized as income or as expense in that previous year.

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

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ICDS VI – THE EFFECTS OF CHANGE
IN FOREIGN EXCHANGE RATES

• At the last day of each previous year, foreign currency monetary items shall be converted into reporting currency by applying the closing rate.

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

• Non-monetary item being inventory which is carried at net realisable value denominated in a foreign currency shall be reported using the exchange rate that existed when such value was determined.
ICDS VII – GOVERNMENT GRANTS

• All Govt Grants/subsidy/assistance shall be treated as income immediately except if grant is directly related to acquisition of any asset then it shall be reduced from Actual cost/WDV.

• Governments Grants shall be recognized as Income immediately even if the conditions attached are not fulfilled (ICDS - VII).

• This substantially deviates from past case laws which required to identify the purpose of the subsidy to decide whether the receipt is revenue or capital.
PART-A

• This ICDS covers only Securities held as STOCK in trade.
• ICDS Prescribes valuation of security “Category wise” and not “Security wise” as required by AS. Category means all Equity shares shall be counted as one category. Likewise preference shares shall be counted as one category. Thus valuation shall not be script wise.

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<th>Shares</th>
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<th>AS 13</th>
<th>ICDS</th>
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<td>-</td>
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<tr>
<td>B Ltd</td>
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<td>-</td>
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<tr>
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PART-A (continued…)

• Where a security is acquired in exchange for another asset, the fair value of the security so acquired shall be its actual cost

• Where the actual cost initially recognised cannot be ascertained by reference to specific identification, the cost of such security shall be determined on the basis of first-in-first-out method or weighted average cost formula.
PART-B

• This part of ICDS deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 or the Companies Act, 2013.

• Securities shall be classified, recognized and measured in accordance with the existing guidelines issued by the Reserve Bank of India in this regard and any claim for deduction in excess of the said guidelines shall not be taken into account.
Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalized as part of the cost of that asset. Other borrowing costs shall be recognized in accordance with the provisions of the Act.

For the purpose of computing the amount of Borrowing costs to be capitalized, in a case where the funds are not borrowed specifically for the purpose of acquisition, construction or production of qualifying asset, a qualifying asset would be such asset that require period of 12 months or more for its acquisition, construction or production.

AS 16 permits income earned on temporary investments of borrowed funds to be reduced from borrowing cost incurred, ICDS – IX doesn’t permit this.

AS 16 suspends capitalization of borrowed costs during the period in which active development is interrupted, ICDS – IX does not permit this.
The Criteria for recognition of Provision on the basis of the test of “PROBABLE” in AS-29 is replaced with the requirement of “REASONABLY CERTAIN” under ICDS.

However for Contingent Assets both AS 29 and ICDS – X disallow the recognition but require continuous assessment.