

INCOME COMPUTATION & DISCLOSURE STANDARDS ICDS



BACK GROUND **(Section 145)**

- S. 145 – Method of Accounting:
- Subject to provisions of Sub S. (2)
- Applicable to Income chargeable under the head “Profits & Gains of Business or Profession” or “Income from other sources”.
- Cash or Mercantile system.
- Sub. S (2) provides for notification by Cent. Govt. in respect of “Income Computation & Disclosure Standards” (ICDS). For any class of assessee or in respect of any class of income.
- Sub. S. (3) provides if AO is not satisfied about correctness or completeness of the accounts or method of accounting under sub s. (1) not followed regularly or income has not been computed as per ICDS then the AO has right to make assessment u/s. 144 of the Act.

ICDS

- Notification No. SO 892(E) dt. March 31,2015 notified Ten ICDS.
- In super supersession of notification no. S.069 (E) dt. January 25,1996 had notified Two Accounting Standards viz. (i) Disclosure of Accounting Policies & (ii) Prior Period & Extra Ordinary Items and Changes in Accounting Policies. - now withdrawn.
- ICDS are in force from Asst. yr. 2016/17 i.e. from accounting year April 01,2015.
- Applicable to assessee who maintains books of account on mercantile basis for “Profits & Gains of Business or Profession” or “Income from other sources”.
- Applicable only for computation of total income and not for maintaining books of account.
- In case of conflict the Act will prevail over ICDS.
- Disclosure to be made.

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- Mat Vs. AMT
- Defer tax - on timing difference

ICDS – I: ACCOUNTING POLICIES

- Deals with significant Accounting Policies
- AS- I deals with selection and application of Accounting Policies viz. (a) prudence (b) substance over form and materiality.
- ICDS does not recognize the prudence e.g. retention money in the construction contracts (ICDS –III) chargeable even though receipt is not certain etc.,
- However ICDS recognizes fundamental assumptions: (a) Going concern, (b) Accrual and (c) Consistency.
- Accounting Policies refer to specific Accounting Principles and Methods.
- Purpose is to reflect true and fair view of the state of affairs and income of business, profession or vocation. For this purpose:
 - (i) the treatment and presentation of transactions be governed by substance and not by legal form and
 - (ii) marked to market loss or an expected loss is not to be recognized.
- Accounting Policy shall not be changed without reasonable cause.

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.DISCLOSURE OF ACCOUNTING POLICIES

- All significant Accounting Policies be disclosed.
- Any change of Accounting Policy having material effect be disclosed.
- Amount by which any item is affected by such change be disclosed to the extent ascertainable. If amount is unascertainable the fact be stated.
- Any change in Accounting Policy which has no material effect for current previous year but it is reasonably expected to have material effect in later year, the fact be disclosed in the previous year in which the change is adopted and also in the previous year in which such change has material effect.
- Disclosure of Accounting Policies or any change can not remedy a wrong or inappropriate treatment of the item.
- If fundamental assumptions are not followed – disclosure be made.

ICDS – II : VALUATION OF INVENTORIES

- This Standard does not apply to :
 - (i) Work-in-progress under “construction contract” including directly related service contract.
 - (ii) Work-in-progress dealt by other ICDS
 - (iii) Shares, Debentures & other Financial Instruments held as stock-in-trade and dealt by other ICDS i.e. ICDS VIII.
 - (iv) Producers’ inventories of livestock, agriculture and forest products, mineral oils ores and gases to the extent there are measured at NRV
 - (v) Machinery spares, which can be used only with tangible fixed asset and their use is expected to be irregular - dealt with ICDS V.

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DEFINATIONS & MEASUREMENT

- “Inventories” are assets
 - (i) held for sale in ordinary course of business.
 - (ii) in the process of production for sale
 - (iii) in the form of materials or supplies to be consumed in the production process or in rendering services.

- “Net realizable value” is estimated selling price in the ordinary course of business less the estimated costs of completion and estimated costs necessary to make the sale.

- Inventories shall be valued at cost or NRV whichever is lower .

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DETERMINATION OF COST

- Cost of Inventories:

Comprises of all cost of purchase, cost of service, cost of conversion and other costs incurred in bringing inventories to their present location and condition.

- Cost of Purchase:

Consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebate and other similar items be deducted in determining the cost.

While as per AS-2 cost of purchase is shown at net. i.e. exclusive method

- Cost of Services:

Consist of labour and other costs of personnel directly engaged in providing service including supervisory personnel and attributable overheads.

While AS 2 does not deal with costs of services.

Defer tax to be calculated

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- Cost of Conversion:

Include cost directly related to units of production and systematic allocation of fixed & variable production overheads that are incurred in converting material to finished goods.

Fixed production overheads - indirect cost remain constant regardless of volume of production like factory depreciation etc.

Variable production overheads - indirect cost vary directly or indirectly with volume of production.

- Therefore fixed production overheads shall be allocated on the basis of normal capacity of the production. Which is determined on the basis of average over a number of periods or seasons, after considering loss capacity resulting from planned maintenance. Thus fixed production overheads allocated to each production unit shall not be increased as consequence of low production or idle plant. In such case unallocated overheads shall be recognized as an expense in the period in which they are incurred.

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- In abnormally high production the amount of fixed production of overheads allocated to each unit of production is decreased so that inventories are not measured above the cost.
- Variable production overheads shall be assigned to each unit of production on the basis of actual use of production facility.
- Production process result in more than one product produce simultaneously and cost of conversion of each product are not separately identifiable, the cost shall be allocated between the products on rational and consistent basis i.e. sale price or cost of production.
- By- products, scrap, or waste material are immaterial they shall be measured at NRV and their value be deducted from the cost of main product.

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- Other costs:

Included in the cost of inventory only to the extent that they are incurred in bringing the inventories to their present location and condition.

- Interest:

Interest and other borrowing cost shall not be included in the cost of inventories unless they meet criteria for recognition of interest as component of cost.

- Exclusion from the cost of inventories:

- (i) Abnormal amount of wasted materials, labour or other production cost.
- (ii) Storage costs unless those cost necessary in production process prior of further production stage.
- (iii) Administrative overheads
- (iv) Selling costs

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- Cost formula

Specific project - inventories are not inter changeable in respect of goods and service produce and specific identified cost are allotted to specific project.

- FIFO & Weighted Average Cost

FIFO = First in First Out – items remaining in inventory are those most recently purchased or produced.

WAC = cost of similar items at the beginning and cost of similar items purchased or produced during the period. The average shall be calculated on periodic basis on the basis of shipment arrived etc.

Retails Method

The cost of inventory is determined by reducing from the sale value of inventory, the appropriate percentage of gross margin.

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- Net Realizable Value:
- Inventories written down to NRV item by item.
- Inventories relating to the same product line having similar purposes or end users and are produced and marketed separately from other items of product line, shall be grouped together and written down to NRV an aggregate basis .
- NRV should be on most reliable evidence at time of valuation . Take purpose for valuation.
- RM and supplies held for use in production of inventories shall not be written below the cost of FG in which they are incorporated are expected to be sold at or above cost. Where decline in price of RM and estimated that cost of FG will exceed NRV the value of RM be written down to NRV which shall be replacement cost of RM

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- Value of Opening Inventory:
The cost of inventory on day of commencement of business.
Value of inventory on close of immediate preceding previous year.
[Chainrup Sampatram Vs. CIT 24 ITR 285 (SC)]
- Change of method of valuation of inventory:
Shall not be changed without reasonable causes.
- Valuation of inventory in case of dissolution:
Shall be valued at NRV – Real Value
[ALA firm Vs. CIT - 189 ITR 285 (SC)]
- Transitional Provisions
Interest & other borrowings costs, which do not meet criteria for recognition of interest as a component of cost be included if it was inventory as on April 01,2015 and shall be included as cost of inventory till it is disposed off.
- Disclosure:
Accounting policies adopted in measuring
Total carrying amount of inventories.

ICDS – III: CONSTRUCTION CONTRACTS

Applicability – applicable to only contractor and not builder

Construction Contract

- For construction of an asset or combination of assets – interrelated or interdependent in terms of their design, technology and function or their ultimate use or purposes
- It includes rendering of services which are directly related to construction of asset e.g. project manager and architects – on percentage basis.
- Also include contract for destruction or restoration of assets.
- Fixed Price contract:
Either fixed price contract or fixed rate per unit of output
- Cost plus contract:
Contractor is reimbursed for allowable or defined cost plus mark up

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- Generally this Standard shall be applied separately to each construction contract.
 - a) Single asset – bridge, dam, ship or tunnel, building etc.
 - b) Number of assets (e.g. refineries & other complex Plant & Machinery - then, each asset should be treated as separate construction contract when:
 - i) separate proposals for each asset;
 - ii) each asset is subject to separate negotiation and the contract.
 - iii) Costs or revenues of each asset can be identified.
 - c) Group of contracts either with single or several customers - when
 - i) the group of contracts negotiated as single package
 - ii) contracts are closely inter - related
 - iii) contracts are performed concurrently or in continuous sequence.

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- d) Contracts provides for construction of additional asset at the option of the customer. The construction of additional asset be treated as separate construction contract, when
 - : i) the asset differs in design, technology or function
 - ii) price of asset is negotiated without regards to original contract price.

- Contract Revenue:
 - i) To be recognized when there is reasonable certainty of its ultimate collection
 - ii) Contract revenue shall comprise of:
 - initial amount of revenue agreed in contract including retention and
 - variations in contract work, claims and incentives if it is payable that they will result in revenue and are capable of being measured.

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iii) If contract revenue is already recognized as income & subsequently written off in the books as uncollectible shall recognized as an expense.

Contract cost comprises of

- a) cost relate directly to specific contract.
 - b) Cost attributable to contract
 - c) Other costs specifically chargeable to customers &
 - d) Allocated borrowing costs.
- These costs be reduced by incidental income,(sale of surplus materials and dispose off plant and equipment at the end of the contract), not being in the nature dividend or capital gains, that is not included in contract revenue.
[CIT Vs. Bokaro Steel Ltd 236 ITR 315 (SC)]

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- Pre construction income
[Tuticorian Alkali Chemicals & Fertilizers Ltd. Vs. CIT [227 ITR 172 (SC)]
- Recognition of contract cost
 - costs not attributed or allocable be excluded
 - costs attributable to contract from date of securing the contract to final competition of contact
 - costs incurred for securing contract are included if they can be identified and probable that the contract can be obtained.
 - Costs incurred in securing contract are recognized as an expense in the period of which they are incurred . They are not included in contract cost when contract is obtained in a subsequent period.
 - Contract cost recoverable from customer in future to be classified as work-in-progress

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- Recognition of Contract Revenue & Expense
 - By reference to the stage of completion of the contract i.e. percentage of completion method.
 - Stage of completion be determined with reference to
 - a) Proportion of costs bear to estimated total contract costs; or
 - b) Surveys of work performed; or
 - c) Completion of physical proportion of the contract work
 - In percentage of completion method, the following costs are excluded:
 - a) contract cost relate to future activity and
 - b) payments made to sub contractors in advance of work to be performed.
 - Where the outcome of contract cannot be estimated reliably contract revenue is recognized to the extend of costs incurred. The early stage of contract shall not be extended beyond 25% of the stage of completion.

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- Not applicable to presumptive basis – S. 44AD
- Change in estimate:
Percentage of completion method is applied on cumulative basis. So, when there is change in estimates, the changed estimates shall be used in determination of amount of revenue and expenses in the period of change and subsequent periods.
- No provision for expected loss
Para 35 of AS 7
- Disclosure:
 - i) Method used to determine the stage of completion
 - ii) The amount of advanced received
 - iii) The amount of retentions.
 - iv) The amount of contract revenue / cost incurred and profit recognized (less recognized loss) upto reporting date

ICDS – IV : REVENUE RECOGNITION:

- Scope

Revenue recognition in the course of ordinary activities:

- i) Sale of goods
- ii) Rendering of Services
- iii) Use by others of person's resources yielding interest, royalties or dividends.

- Revenue

Gross inflow of cash, receivables or other consideration.

In agency business the revenue is the amount of commission and not gross inflow of cash, receivable or other consideration.

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- Sale of goods:
 - When the seller of goods transfers to the buyer the property in goods for a price with significant risks and rewards.
 - Revenue shall be recognized when there is reasonable certainty of its ultimate collection.
 - Raising claim for escalation of price and export incentives, revenue recognition is postponed to the extent of uncertainty involved.

- Rendering Services:
 - On percentage of completion method i.e. on the basis of performance.
 - Early stage can not be extended beyond 25% of stage of completion as per para 6 of ICDS- IV as ICDS – III would apply.
 - Completed service contract method is not recognized in this ICDS

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- Use of resources by others:
 - i) Interest shall accrue on time basis on the amount outstanding and rate applicable. Discount or premium on debt securities held to maturity - accruing over the period
[Madras Industrial Investment Corp. Ltd. Vs. CIT 225 ITR 802 (SC)]
 - ii) Royalty shall accrue in accordance with terms of relevant agreement.
 - iii) Dividend is recognized as per S. 8 of Act – declared, distributed and paid. Dividend from foreign company?

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- Disclosure:
 - i) In case of sale of goods, amount not recognized due to lack of reasonable uncertainty of its ultimate collection alongwith nature of uncertainty
 - ii) The amount recognize as revenue from service transactions.
 - iii) Method used to determine stage of completion of service transaction in progress.
 - iv) Service transactions in progress at the end of previous year.
 - v) The amount of advance received and
 - vi) The amount of retention

ICDS - VII: GOVERNMENT GRANTS

- Definition:
- “Government” refers to Central, State, agencies and similar bodies, whether local, National or International.
- “Government grants” – assisted by Govt. in cash or Kind to a person for past or future compliance with certain conditions. They exclude those forms of Govt. assistance which can not have a value and transactions with Govt. in normal course of business.
- Government grants some time called as subsidies, cash incentives, duty draw backs, waiver, concession, reimbursement etc.
- Does not deal with
Govt. assistance other than in the form of Govt. grants and Govt. participation in the ownership of the enterprise.
- Recognition
Should not be recognized until there is reasonable assurance (i) the person shall comply with the conditions and (ii) grants shall be received
Shall not be postponed beyond the date of actual receipts

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- Does not deal

Government grants in the nature of promoters contribution (i.e. on the basis of total investment) – credited directly to shareholders fund.

Vs.

Certain grants are given for encouraging specific industries or starting in backward area – capital receipt.

[Sahney Steel & Press Works Ltd. & Others Vs. CIT [228 ITR 253(SC)]

[CIT Vs. Ponni Sugar & Chemicals Ltd. [306 ITR 392 (SC)]

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- Treatment:

Relates to depreciable asset shall be deducted from the actual cost or WDV.

Relates to non depreciable asset requiring fulfillment of certain obligations shall be recognized as income over the same period over which the cost of meeting such obligations is charged to income.

Relates to such nature that it cannot be directly relatable to the specific asset acquired, so much amount bears to the total Govt. grants the same proportion as such bears to all the assets in respect of which Govt. grant is so received, be deducted from the actual cost of the asset or WDV.

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Receivable as compensation for expenses or losses be recognized as income.
Other Govt. grants be recognized as income over the periods necessary to match them with related cost.

Govt. grants in the form of non-monetary assets given at concessional rate be accounted for on the basis of their acquisition cost. However IND AS-20 – at fair value.

- Refund of Govt. grants:

Relate to depreciable asset be recorded by increasing the actual cost or WDV. Where the actual cost of the asset is increased, depreciation on revised actual cost or WDV be provided prospectively

Relate to others, first against any unamortized deferred credit remaining and / or be charged to P & L statement

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- Disclosure:

Nature & extent recognized by way of deduction from the actual cost of the asset. If not recognized the reason.

Nature & extent recognized as income. If not recognized the reason.



THANK YOU