An overview of Income Computation and Disclosure Standards (ICDS)

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Blue Consulting Pvt. Ltd.

A Finance & Accounts Outsourcing Company

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1. Introduction

- Income Computation & Disclosure Standards [ICDS] is a new framework for computation of taxable income by **all assesses** in relation to their income under the heads "**Profit and gains of business or profession**" and "**Income from Other Sources**".

- The Central Board of Direct Taxes (CBDT) has notified **10 ICDS** under Section 145(2) of the Income-tax Act, 1961.

- ICDS have been developed with a view to minimize tax related disputes by bringing greater consistency in the application of accounting principles governing the computation of income.

- In case of conflict between the provisions of the Income-Tax Act, 1961 and ICDS, the provisions of the Income-Tax Act would prevail.

- Before ICDS, only 2 accounting standards i.e., "Disclosure of Accounting Policies" & "Disclosure of Prior Period Items and Extraordinary Items and Changes in Accounting Policies" were notified for any class of assessees or in respect of any class of income.

2 . Applicability

- **All assesses** following the **Mercantile System of Accounting** will be required to adopt these standards for the purposes of computation of taxable income, **irrespective of:**
  - Turnover
  - Applicability of Tax Audit
  - Residential Status

- These standards have been made applicable from the previous year commencing from April 1, 2015, i.e., **Assessment Year 2016-17** onwards.

- ICDS does not mandate the preparation of Separate Books of Accounts as these Standards are only applicable for the computation of taxable income.

- These standards have been developed using the existing framework of Indian General Audit and Accounting Practices (GAAP), and suitable modified for tax purposes.

- ICDS will also lead to appropriate modification in Income Tax Return and Form 3CD.

3. Comparison of ICDS with Accounting Standards

Accounting Standards	Corresponding ICDS
AS-1: Disclosure of Accounting Policies	ICDS-1: Accounting Policies
AS-2: Valuation of Inventories	ICDS-2: Valuation Of Inventories
AS-7: Construction Contracts	ICDS-3: Construction Contracts
AS-9: Revenue Recognition	ICDS-4: Revenue Recognition
AS-10: Accounting for Fixed Assets & AS-6: Depreciation Accounting	ICDS-5: Tangible Fixed Assets
AS-11: : The Effects of Changes in Foreign Exchange Rates	ICDS-6: The Effects of Changes in Foreign Exchange Rates
AS-12: Accounting for Government Grants	ICDS-7: Government Rates
AS-13: Accounting for Investments	ICDS-8: Securities
AS-16: Accounting for Borrowing Costs	ICDS-9: Borrowing Costs
AS-29: Provisions,Contingent Liabilities & Contingent Assets	ICDS-10: Provisions,Contingent Liabilities & Contingent Assets

3.1 ICDS-1 : Accounting Policies

AS-1: Disclosure of Accounting Policies	ICDS-1: Accounting Policies
Accounting policy is changed: - in response to new or revised accounting standards or - if the adoption of a different accounting policy is required by statute or - on a voluntary basis if the new policy is more appropriate.	A change in accounting policy can't be made without having a reasonable cause.
Accounting Standards work on the principles of Materiality & Prudence.	No Concept of Materiality and Prudence in ICDS.
Expected losses or mark to market losses shall be recognized.	ICDS provides that expected losses or mark to market losses shall not be recognized
Entities meeting the conditions to qualify as Small and Medium Sized Company have certain exemption or relaxation in complying with the Accounting Standards.	ICDS does not provide any exemption or relaxation for Small and Medium Sized Company.

3.2 ICDS-2 : Value of Inventories

AS-2: Value of Inventories	ICDS-2: Value of inventories
- Standard Costing can be used to measure the cost of inventory.	- Use of Standard Costing method not permitted.
- When actual level of production approximates to normal capacity, fixed overheads may be allocated using either actual level of production or normal capacity.	- In such a scenario, fixed overheads can be allocated using actual level of production only.
- Change in method of valuation of inventories should be made only if - it is required by statute or for compliance with an AS or - if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.	- Method of valuation of inventories once adopted by a person in any previous year shall not be changed without reasonable cause.

3.3 ICDS-3 : Construction Contracts

AS-7: Construction Contracts	ICDS-3: Construction Contracts
- Probable losses on a contract are recognized as an expense immediately.	- Does not allow recognition of foreseeable losses under a contract.
- AS 7 requires a provision to be made for the expected losses on onerous construction contract immediately on signing the contract. - (An onerous contract is defined as a contract where the unavoidable costs to meet the obligations exceeds the expected economic benefits).	- No such provision is required to be made for onerous contracts as per ICDS.
- Unlike ICDS, there is no bright line to conclude that the contract is no longer at an early stage.	- Early stage of a contract should not extend beyond 25% of the stage of completion, i.e., up to 25% of stage of completion if the outcome cannot be reliably measured, contract revenue is recognized only to extent of its cost.

3.4 ICDS-4 : Revenue Recognition

AS-9: Revenue Recognition	ICDS-4: Revenue Recognition
- Revenue from service transaction is recognized using either percentage of completion method or completed contract method whichever relates the revenue to the work accomplished.	- Revenue from service transaction is recognized using percentage of completion method only. Revenue recognition is not permitted as per Completed service contract method.
- Percentage of completion is determined either using cost expended method or output method.	- Percentage of completion is determined using cost expended method only.
- Dividends are not recognized until a right to receive payment is established.	- Dividends are recognized in accordance with the provision of the Act.

3.5 ICDS-5 : Tangible Fixed Asset

AS-10: Accounting for Fixed Assets AS-6 : Depreciation Accounting	ICDS-5: Tangible Fixed Asset
- An asset acquired in exchange for another asset, or for shares or securities can be recorded at - the Fair value of asset given or - asset acquired, whichever is more clearly evident	- Where an asset is acquired in for exchange for another asset or in exchange for shares or other securities, the fair value of the asset so acquired shall be recorded as actual cost.
- Gain arising on disposal is generally recognized in profit and loss statement unless permitted otherwise.	- Income arising on transfer of a tangible fixed asset is determined in accordance with the Income Tax Act.
- Depreciation is based on the 'component' approach; depreciation is charged over the estimated useful life of the asset.	- Depreciation on a tangible fixed asset is computed in accordance with the Income Tax Act.

3.6 ICDS-6 : Effects of changes in Foreign Exchange Rates

AS-11: Effects of changes in foreign exchange rates	ICDS-4: Effects of changes in foreign exchange rates
- Exchange differences on translation of non-integral foreign operations are accumulated in Foreign Currency Translation Reserve until the disposal of the net investment.	- ICDS provides that the exchange differences on translation of non-integral foreign operations to be recognized as an income or expense.
- Income and expenses in non-integral foreign operations are translated at actual rate or at an appropriate rate approximating the actual rate.	- Income and expenses in non-integral foreign operations are translated at actual rate only.
- In respect of forward contracts, premium or discount is ignored and at each balance sheet date, contract value is marked to its current market value and any gain or loss arising on such contract is then recognized.	- ICDS requires premium, discount or exchange difference on forward contracts that are intended for trading or speculation purposes to be recognized at the time of settlement.

3.7 ICDS-7 : Government Grants

AS-12: Government Grants	ICDS-7: Government Grants
- Both Capital approach as well as the Income approach are prescribed for the recording of the Government grants.	- ICDS does not permit the capital approach for recording of government grants.
- Government grants related to depreciable assets are either deducted from the actual cost of the asset or treated as deferred income and transferred to the statement of profit and loss in proportion to depreciation.	- Government grants related to depreciable assets are either deducted from the actual cost of the asset or from the written down value of block of assets to which concerned assets belongs to.
- Government grants related to non-depreciable assets are credited to capital reserve. If such grants require fulfillment of some obligation, such grants are credited to income over the period over which the cost of meeting the obligation is charged to income.	- Government grants related to non-depreciable assets, requiring fulfillment of some obligation, are credited to income over the period over which the cost of meeting the obligation is charged to income.
- Recognition may be postponed beyond the date of actual date of receipt.	- Recognition of government grant can not be postponed beyond the date of actual receipt.

3.8 ICDS-8 : Securities

AS-13: Accounting for Investments	ICDS-8: Securities
- AS deals with securities, both, held as stock-in-trade as well as held as securities.	- ICDS deals with securities held as stock-in-trade and not with the securities held as investment.
- The actual cost of a security acquired in exchange for another asset is fair value of the asset given up or investment acquired, whichever is more clearly evident.	- The actual cost of a security acquired in exchange for another asset is the fair value of the security so acquired.
- Comparison of actual cost or fair value is performed either on an individual investment basis or on category basis.	- Comparison of actual cost and net realizable value is done category wise and not for each individual security.

3.9 ICDS-9 : Borrowing Cost

AS-16: Accounting for Borrowing Costs	ICDS-9: Borrowing Costs
- As per AS, capitalization of borrowing cost is determined by applying the capitalization rate- - The capitalization rate is weighted average of borrowing costs that are outstanding during the period.	- ICDS has prescribed a new formula for capitalization of borrowing cost- - Total borrowing costs X (multiplied) Average of costs of qualifying asset as at the beginning and the end of the year /(divided) Average of total assets as at the beginning and the end of the year.
- As per AS, a minimum period of 12 months is defined for classification of an asset as a Qualifying Asset. - Borrowing cost is capitalized only if an asset takes a substantial period of time to construct, i.e., only in case of a Qualifying Asset.	- ICDS does not define any minimum period for classification of an asset as a Qualifying Asset. Borrowing cost , may need to be capitalized even if an asset does not take substantial period of time to construct.
- Capitalization of borrowing costs commences when expenditure for the asset is being incurred, borrowing costs are being incurred & all the activities that are necessary to prepare the asset for its intended use or sale are in progress.	- In case of special borrowing , capitalization of borrowing cost should commence from the date of the borrowing & in case of general borrowing, from the date of utilization of funds.

...contd. [3.9 ICDS-9 : Borrowing Costs]

AS-16: Accounting for Borrowing Costs	ICDS-9: Borrowing Costs
- Capitalization of borrowing cost is suspended during the extended periods in which active development is interrupted.	- ICDS requires capitalization even if active development of a qualifying asset is interrupted.
- Capitalization of borrowing costs to qualifying assets ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.	- In case of qualifying assets other than inventories, capitalization of borrowing cost should cease when the asset is put to use.
- Income earned on the temporary investments of the borrowings specific to a qualifying asset is reduced from the borrowing costs eligible for capitalization.	- Income earned on the temporary investments of the borrowings specific to a qualifying asset is not reduced from the borrowing costs eligible for capitalization.
- As per AS-16, Exchange differences arising from foreign currency borrowings to the extent they are regarded as interest cost are considered as borrowing cost.	- Exchange differences arising from foreign currency borrowings to the extent they are regarded as interest cost are not considered as borrowing cost under ICDS.

3.10 ICDS-10 : Provisions, Contingent Liabilities & Assets

AS-29: Provisions, Contingent Liabilities & Contingent Assets	ICDS-10: Provisions, Contingent Liabilities & Contingent Assets
- Similar to ICDS except that the liability should be probable.	- A Provision is recognized for a present obligation as a result of past event if the liability is considered reasonably certain and can be reliably estimated.
- Contingent asset is recognized when the realization is "virtually certain".	- A contingent asset is recognized when the realization is "reasonably certain".
- A reimbursement of expenditure required to settle a provision is recognized when its recovery is virtually certain.	- Such reimbursement of expenditure that is required to settle a provision is recognized when its recovery is reasonably certain.
- If an entity has an onerous contract, the present obligation shall be recognized and measured as a provision.	- Obligations for onerous contracts are not recognized. - (An onerous contract is defined as a contract where the unavoidable costs to meet the obligations exceeds the expected economic benefits).

4. Conclusion

- The introduction of ICDS may significantly alter the way the companies compute their taxable income, irrespective of whether the company reports its financial results as per Ind AS or existing AS.

- ICDS is expected to put an additional compliance burden on the tax payers.

- The rationale behind issuing ICDS is to **lessen the uncertainty** of alternative accounting treatment due to flexibility offered by AS.

- ICDS shall not be applicable to computation of book profit u/s 115 JB of the Act.

- Each ICDS requires **disclosures** in respect of various items dealt in the said standard. However, ICDS is silent about as to where such disclosure has to be given. Therefore, it is likely that appropriate changes will be made to include in the Tax Audit Report and Income Tax returns to capture such disclosures.

- Non-compliance of ICDS will result in best judgment assessment by tax authorities which may lead to prolonged litigation.

5. About us

Blue Consulting Pvt. Ltd.

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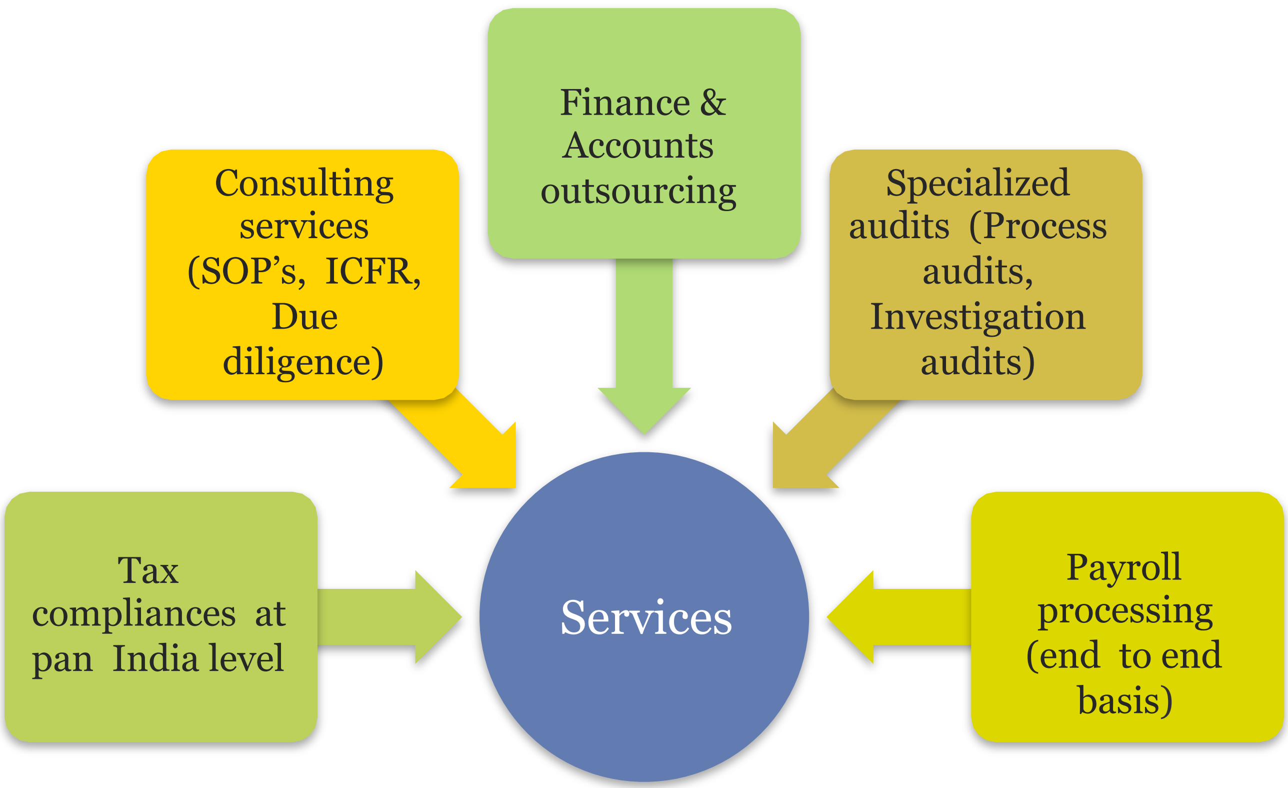

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"A dream is not that
which you see in sleep
A dream is that
which does not let you sleep"