Income Computation and Disclosure Standards (ICDS)

Background and approach for formulation of ICDS

Income Computation & Disclosure Standards (ICDS) – journey towards adoption

1996

•The Central Government notified two accounting standards under section 145(2) of the Income Tax Act, 1961 (the IT Act).

December 2010

The CBDT constituted AS Committee to suggest the following :

- AS to be notified under the Act
- Amendments to the Act
- Method to determine book profit for MAT purposes on transition to Ind AS

October 2012

- Final report of the Committee and 14 ICDS published
- Comments invited from public on the Draft ICDS

July 2014

- Finance Bill 2014 amended section 145(2) of the IT Act. ICDS applicable from FY 1 April 2015
- ICDS to be notified separately
- Compliance required in 2015 1st quarter

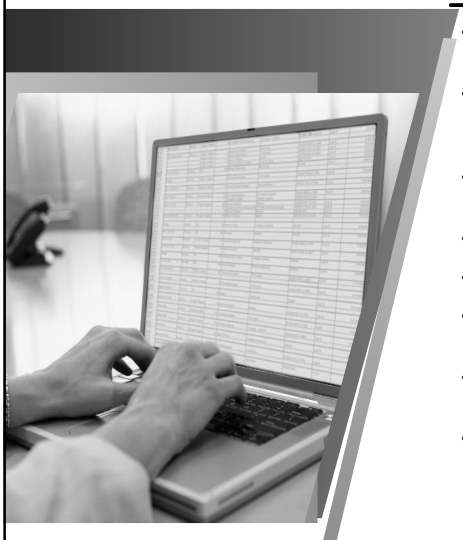
January 2015

- CBDT issued draft of 12 ICDS, after incorporating suggestions by stakeholders and providing transitional provisions for these ICDS
- The draft ICDS were open for comments and suggestions up to 8th February, 2015

March 2015

•10 ICDS notified by CBDT vide notification dated 31 March 2015

Recommendations in 2012 report



- To maintain harmony with the Act, ICDS to be notified under the Act may carry differences with AS
- ICDS to lay down specific rules that will enable computation of taxable income with certainty and clarity
- To ensure horizontal equity and uniformity, ICDS should eliminate alternatives, to the extent possible
- No separate books to be maintained for ICDS
- ICDS to apply to all taxpayers
- In case of conflict between ICDS and Act, the Act will prevail
- Amending form 3CD to include assertion on computation of taxable income as per ICDS
- Suitable amendments to the Act to provide clarity on certain issues, e.g., goodwill amortisation, leases

Final ICDS issued

- Accounting policies
- Inventory valuation
- Construction contracts
- Revenue recognition
- Tangible fixed assets
- Foreign exchange accounting
- Government grants
- Borrowing costs
- Provisions, contingent liabilities and contingent assets
- Securities

Implementation matters

- No concept of materiality – unrecorded audit adjustments
- No concept of prudence
- No mention of matching concept
- Significant differences may require multiple record keeping – system implications
- Status of Guidance notes/ ASI's
- Incremental differences – Ind AS
- Judicial proceedings and interpretations
- Disclosures

Significant impact areas

Significant impact areas

Accounting Policies

Accounting Impact:

- No recognition to the concept of 'Materiality'
- Eliminates the concept of 'Prudence' - disallows recognition of expected losses or mark to market losses unless specifically permitted by any other ICDS
- No changes in accounting policies without 'reasonable cause'
- No guidance on impact of change in policies on the computation of income.

Taxation Impact:

- Whether estimated losses (including onerous contracts) would be allowed as deduction ?
- Mark to market loss unless specifically covered in other ICDS allowed only on settlement

Transitional provision:

All contract or transaction existing on the 1st day of April, 2015 or entered into on or after the 1st day of April, 2015 shall be dealt with in accordance with the provisions of this standard after taking into account the income, expense or loss, if any, recognised in respect of the said contract or transaction for the previous year ending on or before the 31st March, 2015.

Significant impact areas

Inventories

Accounting Impact:

- Dispensation of standard cost method
- Opening value of inventory for current year = Closing value of inventory of immediately preceding year

Taxation Impact:

- Tax impact in year of change in inventory valuation

Transitional provision:

Transition provision only to the extent of borrowing cost. Prospective from Date of transition. The standard already has transition provision for inventory (Opening inventory to be closing of previous year)

Significant impact areas

Borrowing costs

Accounting Impact:

- No minimum period required for classification as a qualifying asset, except inventories
- Exchange differences not included as borrowing costs
- Specific borrowings - Income from temporary deployment of unutilised funds to be treated as income
- Capitalize even if active development is interrupted
- Borrowing costs to commence from

Particulars	Date
Specific Borrowing	Date of utilization of funds
General Borrowing	Date of borrowing

Specific formula for capitalisation of general borrowing cost

A X B / C

Where,

A = borrowing costs incurred during the previous year except on borrowings directly relatable to specific purposes;

B = (i) the average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year;
(ii) in case the qualifying asset does not appear in the balance sheet of a person on the first day or both on the first day and the last day of previous year, half of the cost of qualifying asset;
(iii) in case the qualifying asset does not appear in the balance sheet of a person on the last day of previous year, the average of the costs of qualifying asset as appearing in the balance sheet of a person on the first day of the previous year and on the date of completion,
other than those qualifying assets which are directly funded out of specific borrowings; or

C = the average of the amount of total assets as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than those assets which are directly funded out of specific borrowings;

Taxation Impact:

- Tax impact in line with provisions of the IT Act

Transitional provision:

Prospective from Date of transition.

Case Study– General borrowing costs eligible for capitalization

Particulars	Opening balance	Assets acquired during the year	Closing balance
Plant & machinery	50	10	60
Furniture	20	-	20
Capital work-in-progress	10	5	15
Investments	100	-	100
Current Assets	20	5	25
Current Liabilities	15	3	18

Amount to be capitalized (A x B*) / C*

A = 10

B = (80+95) / 2 = 87.5

C = (200+220)/2 = 210

General borrowing cost incurred during the year = 10

Borrowing cost to be capitalized = (A x B) / C
= (10 x 87.5) / 210
= 4.17

* Other than those assets which are directly funded out of specific borrowings

Significant impact areas

Construction Contracts and Revenue recognition

Accounting Impact:

- Completed contract method not permitted
- Non-recognition of margins permitted up to stage of completion of 25%
- Does not permit recognition of expected losses on onerous contracts
- Precludes reduction of certain incidental income (interest, dividend, capital gains) from contract cost
- No guidance on principal vs agent; claims and variations
- Straight lining for certain contracts
- Risk and reward basis of revenue recognition vs IFRS 15/ Ind AS 115

Taxation Impact:

- Deduction for future / anticipated / estimated losses (including onerous contract) not allowed unless actually incurred
- Taxability of service contracts on percentage completion method

Transitional provision:
Cumulative catch up of revenue after the date of transition for all open contracts

Point to ponder …..

Sales of goods

- Revenue to be recognized when:
  - transfer of property or all significant risk and reward of ownership to buyer
  - no effective control of goods retained
  - there is **reasonable certainty of its ultimate collection**

Rendering of services

- Revenue to be recognized:
  - by percentage completion method
  - proportionately by reference to the portion of work completed (profit not to be recognized if stage of completion < 25%)
  - there is **reasonable certainty of its ultimate collection**

Interest, Royalties or Dividends

- Interest to be recognized on time basis
- Dividend as per the provisions of the Act
- Royalties to be recognized as income based on terms of contract and not on actual payment basis

Will reasonable certainty of ultimate collection apply to interest and royalty income?

Significant impact areas

Effects of changes in foreign exchange rates

Accounting Impact:

- Premium, discount or exchange differences on all foreign currency derivatives that are intended for trading or speculation purposes or that are entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction are to be recognized only at the time of settlement of the contract
- For foreign currency derivatives entered into to establish the amount of the reporting currency required or available at the settlement date of the transaction, premium or discount arising at inception shall be amortised over the life of the contract. This shall also be accompanied by revaluation at spot rates at every reporting date to offset the impact of the hedged item
- Exchange difference on translation of non-integral foreign operation to be recognised as income / expense

(Continued)

Significant impact areas

Effects of changes in foreign exchange rates

Accounting Impact: (Continued)

- All foreign exchange losses on borrowings to be allowed, except borrowing used to import fixed assets
- An average rate for a week or a month that approximates the actual rate at the date of the transaction may be used (updated vis a vis old TAS)

Taxation Impact:

- Currently discount / premium is recorded in Profit and Loss Account and offered / claimed in tax return
- Losses / gains to be deferred in case of contracts overlapping two years

Transitional provision:

Prospective from Date of transition.

Significant impact areas

Derivatives treatment

Derivatives

Forward Exchange Contracts – For trading/ speculation	Forward Exchange Contracts – To hedge foreign currency risk of a firm commitment or a forecast transaction	Other Forward Exchange Contracts	Other Derivative contracts
• Covered in ICDS on Changes in Foreign exchange rates • Premium or discount on contracts shall be recognized at the time of settlement	• Covered in ICDS on Changes in Foreign exchange rates • Premium or discount on contracts shall be recognized at the time of settlement	• Covered in ICDS on Changes in Foreign exchange rates • Premium or discount arising at inception shall be amortised over the life of the contract.	• Covered in ICDS on Accounting policies • MTM shall not be recognized unless permitted by other ICDS. MTM deferred till settlement

"forward exchange contract" means an agreement to exchange different currencies at a forward rate, and includes a foreign currency option contract or another financial instrument of a similar nature;

Significant impact areas

Tangible fixed assets

Accounting Impact:

- Capitalization of exchange differences relating to fixed assets shall be in accordance with Section 43A and other similar provisions of the Act, which could be materially different from the provisions of AS 10, AS 16 and AS 11
- Assets acquired in exchange - value *(as per IT Act)* of the tangible fixed asset so acquired shall be its actual cost

Taxation Impact:

- Mostly in line with the current provisions of the Income-tax Act, 1961

Transitional provision:
Prospective from Date of transition. Transition provision clarifies new Standard would only apply to Capital Work in Progress on transition date and subsequent acquisitions/ capitalization.

Significant impact areas

Government grants

Accounting Impact:

- Capital approach for grants not permitted
  - *Extract from ICDS*
  - *Where the Government grant relates to a non-depreciable asset or assets of a person requiring fulfillment of certain obligations, the grant shall be recognized as income over the same period over which the cost of meeting such obligations is charged to income Initial recognition of grant cannot be postponed beyond the date of actual receipt*
- Initial recognition of grant cannot be postponed beyond the date of actual receipt (Para 4)
- Non monetary asset grant treatment

Taxation Impact:

- Whether purpose test - capital vs. revenue, held by judicial precedents would continue to apply?

Transitional provision:
Prospective from Date of transition - All the Government grants which meets the recognition criteria of para 4 on or after 1st day of April, 2015 shall be recognised for the previous year commencing on or after 1st day of April, 2015 in accordance with the provisions of this standard after taking into account the amount, if any, of the said Government grant recognised for any previous year ending on or before 31st day of March, 2014.

Significant impact areas

Provisions, contingent liabilities and contingent assets

Accounting Impact:

- Excludes all executory contracts and onerous contracts from its scope.
- ICDS requires recognition of provision only if it is 'reasonably certain'
- ICDS requires recognition of contingent assets when inflow of economic benefits is reasonably certain

Taxation Impact:

- Intention appears to bring tax treatment of losses and gains on par

Transitional provision:
Prospective from Date of transition.

Significant impact areas

Securities

Accounting Impact:

- Covers only securities held as stock–in-trade (Also excludes banks, PFIs and mutual funds)
- Comparison of cost and net realisable value for securities held as stock-in-trade to be assessed category wise and not for each individual security
- FIFO Method – cost of securities sold
- Unquoted / irregularly quoted securities carried at cost
- Securities acquired in exchange - value of the security so acquired shall be its actual cost
- Derivative held as stock in trade might be covered in this ICDS

Taxation Impact:

- As per AS-13, determination of cost where specific identification not possible shall be done through Weighted Average Method. As per ICDS, FIFO shall be followed

Transitional provision:
None

ICDS Disclosure Requirements

ICDS : Accounting Policies

- Significant Accounting Policies adopted
- Material changes in Accounting Policies
- If fundamental accounting assumptions not followed

ICDS : Valuation of Inventories

- Accounting policy and Cost formulae decision
- The total carrying amount of inventories and its classification

ICDS : Construction Contracts

- Amount of contract revenue recognised
- For contracts in progress:
  - methods used to determine the stage of completion
  - Amount of costs incurred and recognized profits
  - the amount of advances received
  - the amount of retentions

ICDS : Revenue Recognition

- For sale of goods transactions - total amount of claim raised for escalation of price and export incentives but not recognised as revenue
- For service revenue –
  - amount of revenue
  - methods used to determine the stage of completion of service transactions in progress
- For service transactions in progress –
  - amount of costs incurred and recognized profits
  - the amount of advances received
  - the amount of retentions

ICDS Disclosure Requirements

ICDS : Borrowing Cost

- Accounting policy adopted
- Amount of borrowing costs capitalised

ICDS : Government Grants

- Nature and extent of Government grants capitalised /recognised as income
- Nature and extent of Government grants not capitalised /recognised as income and reasons thereof

ICDS : Tangible Fixed Assets

- Description of asset/block of assets
- Rate of depreciation
- Actual cost/WDV
- Additions/deductions during the year with dates including adjustments for Cenvat, change in rate of exchange of currency, subsidy etc
- Depreciation Allowable
- Written down value at the end of year

ICDS : Provisions, Contingent Assets & Liabilities

- For each class of provision -
  - Description of the nature of the obligation
  - Carrying amount at the beginning and end of the previous year
  - Additional provisions made
  - Amounts used (i.e. incurred and charged against the provision)
  - Unused amounts reversed
  - The amount of any expected reimbursement
- For each class of asset and related income recognised –
  - Brief description of the nature of the asset and related income
  - Carrying amount of asset at the beginning and end of the previous year
  - Additional amount of asset and related income recognised
  - Amount of asset and related income reversed

Thank You