Accounting Standards (AS)
vis-à-vis
Income Computation & Disclosure Standards (ICDS)

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AS I & AS II → TAS → ICDS

1995
Section 145(2)

1996
AS-I & AS-II

2010
- Committee formulated

2012
- Tax Accounting Standards [TAS]

2014
- TAS to ICDS

Jan 2015
- Draft of 12 ICDS

March, 2015
Notified 10 ICDS by CBDT

Prologue

- The Finance Act, 1995 empowered the Central Government to notify, the Accounting Standards for computing the income under the head **“Profits and Gains of Business or Profession”** or **“Income from Other Sources”** vide Section 145(2) of Income Tax Act,1961.
- The Section 145(1) and 145(2) of the Act can be read as under :
- *(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.*
- *(2) The Central Government may notify in the Official Gazette from time to time* ***[income computation and disclosure standards]*** *to be followed by any class of assessees or in respect of any class of income.*
- *Substituted for "accounting standards" by the Finance (No. 2) Act, 2014, w.e.f. **1-4-2015**.

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- Accounting standard 1 on 'disclosure of accounting policies', and as 2 on 'disclosure of prior period and extraordinary items and changes in accounting policies' notified vide notification dated 25th January, 1996.

- In December 2010, CBDT constituted a Committee to, inter alia, give suggestions to harmonize the ICAI's AS with provision of Income Tax Act for notification under the Act .

- In August 2012, the Committee submitted its report with draft of 14 Tax Accounting Standards (TAS) out of 31 AS issued by ICAI.

Contd...

- In October, 2012, 14 draft TAS issued inviting stakeholders comments/ suggestions.

- In August, 2014, the words 'Accounting Standards' in section 145(2) substituted with "Income Computation and Disclosure Standards" [ICDS] w.e.f 1st April 2015.

- In January, 2015, after examining the comments received from stakeholders, Committee issued new draft of 12 ICDS inviting stakeholders' comments.

Contd...

- Sec 145 confers the power for notifying Accounting Standards and not Income computation standards, there is dichotomy here.

- After prolonged discussions, dialogues and debates, finally, on March 31st 2015, **10 Income Computation & Disclosure Standards ('ICDS')** were notified.

- It is beyond doubt that these Standards will change the way Income will be computed and will materially impact the assessee

- These ICDS are applicable to **all the assessees (resident or Non-resident) following Mercantile System of accounting** for computation of income chargeable under the head "Profits and Gains of Business or Profession" or "Income from Other Sources", and **not for the purpose of maintenance of books of accounts complying with ICDS**, w.e.f. 01/04/2015 i.e. for the Financial Year 2015-16 or Assessment Year 2016-17.

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- **In the case of conflict between the provisions of the Act and the ICDS, the provisions of the Act shall prevail to that extent.**

- The need for ICDS is to resolve the disputes and gaps between the provisions of the Act and the Accounting Standards so as to calculate and disclose income in accordance of some specific guidelines to avoid litigations and provide an ease in doing the business.

ICDS vis -a- vis AS

ICDS		AS	
I	Accounting Policies	1	Disclosure of Accounting Policies
II	Valuation of Inventories	2	Valuation of Inventories
III	Construction Contracts	7	Construction Contracts
IV	Revenue Recognition	9	Revenue Recognition
V	Tangible Fixed Assets	10	Accounting for Fixed Assets
VI	The effects of changes in foreign exchange rates	11	The effects of changes in foreign exchange rates
VII	Government Grants	12	Government Grants
VIII	Securities	13	Accounting for Investments
IX	Borrowing Costs	16	Accounting for Borrowing Cost
X	Provisions, Contingent liabilities and Contingent assets	29	Provisions, Contingent liabilities and Contingent assets

Standards not yet issued by CBDT

Tax Accounting Standards Committee had recommended four more standards to be notified on the following subjects:

- Events occurring after the Balance Sheet Date
- Prior Period Items
- Leases
- Intangible Assets

CBDT has not yet notified the standards on the above subjects.

ICDS has not yet adequately addressed certain areas such as financial instruments, share-based payments, etc which are quite prevalent in today's business environment.

ICDS I
Accounting Policies

AS-1
Disclosure of Accounting Policies

AS-1: Disclosure of Accounting Policies

- This Standard deals with the disclosure of significant accounting policies **followed in preparing and presenting Financial Statements (FS)** so as to represent a true and fair view of the business.
- Accounting policies are **specified accounting principles and the methods of applying those principles** for the preparation of the FS of an enterprise.
- Aspects to be kept in mind while selecting accounting policies:

  1. Prudence: Account for all expected losses/expenses but never account for expected gains/incomes.

  2. Substance Over Form: Whenever there is a dispute, facts should prevail over Law.

  3. Materiality: Only 'material' information be presented whose knowledge might influence the decision of the user of FS.`

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- Examples of the areas where different accounting policies may be adopted by different enterprises are: Methods of depreciation, depletion & amortization, valuation of inventories, treatment of goodwill, etc.

- Certain fundamental accounting assumptions are assumed to be used in the preparation and presentation of financial statements. These are:
  1. Going concern
  2. Consistency
  3. Accrual

- **Read with AS 5- An Accounting policy should be changed if:**
  - Required by any statute, OR
  - Required for compliance with another accounting standard, OR
  - It will result in more appropriate presentation of financial statements.

DISCLOSURE REQUIREMENT:

- All significant policies adopted in preparation of Financial Statements should be disclosed.
- Any change in accounting policies should be disclosed.
- If a fundamental accounting assumption is not followed, the fact should be disclosed

Judicial pronouncements on concept of 'Prudence'

- **Dy. CIT (IT) v. Bank of Bahrain & Kuwait [2010] 41 SOT 290 (ITAT-Mum.)**

  When outflow of economic resources in settlement of present obligation can be anticipated with reasonable accuracy, then it is to be recognized as crystallised liability. This is in consonance with the principle of prudence as considered by the ***Supreme Court*** in the case of ***CIT v. Woodward Governor of India (P.) Ltd. [2009] 312 ITR 254***

- **Western Maharashtra Development Corpn. Ltd. v. Dy CIT [2008] 22 SOT 13 (ITAT-Pune)**

  The concept of 'prudence' as one of the basic considerations in deciding accounting policies is not of a recent origin. It is one of the fundamental principles of accounting that, as a measure of prudence and following the principle of conservatism, the incomes are not taken into account till the point of time that there is a reasonable degree of certainty of its realization, while all anticipated losses are taken into account as soon as there is a possibility, howsoever uncertain, of such losses being incurred

- ***Also refer: Kerala State Industrial Products Trading Corpn. Ltd. v. Asst. CIT [2012] 22 taxmann.com 78 (ITAT- Coch.), Western Coalfields Ltd. v. ACIT 124 TTJ 659 (Nagpur), H M Constructions v. JCIT 84 ITD 429 (Bangalore), & Western Maharashtra Development Corpn. Ltd. v. DCIT [2008] 22 SOT 13 (Pune)***

Comparison b/w ICDS I & AS 1

- According to AS-1, **the concept of prudence** is followed in accounting practices wherein **provision for 'expected losses' is created** **but**;

  As per ICDS such 'expected loss' or 'Mark to Market losses' shall not be recognized unless it is in accordance with the provisions of any other ICDS. **[Presently not required by any other ICDS]**
- Elimination of Concept of **Materiality and Prudence**.
- Unlike AS 1, under ICDS an accounting policy shall not be changed without reasonable cause.

Change in 'Accounting policy' as per judicial pronouncements..

A change in the method of accounting need not have the approval of the Income-tax authorities and need not be supported by cogent reasons showing the assessee's bone fides. If the method of accounting followed by the assessee does not reflect the correct income, the ITO can always compute the income on a different basis under section 144.

- **Snow White Food Products Co. Ltd. v. CIT[1983] 141 ITR 847 (CAL.)**

  Change in accounting policy followed by the aseessee is not acceptable if there is nothing on record to indicate that the change is intended to be followed regularly in future by the assessee.

- **CIT v. Mopeds (India) [1988] 38 TAXMANN 123 (AP)**

  Change adopted by the assessee was for bona fide purpose and was not actuated by consideration to reduce income for the income-tax purpose, the revenue had no right to interfere with the change in the method of valuation of the closing stock.

- Also see: **CIT *v.* Dalmia Cement (Bharat) Ltd. [1995] 82Taxman 255 (Delhi)**

Reasonable cause as per judicial pronouncements..

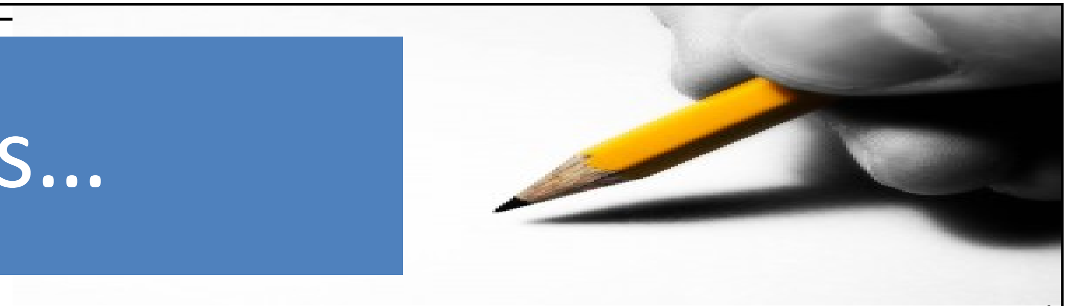
- **Woodward Governors India (P.) Ltd. v.CIT[2001] 118 Taxman 433 (Delhi)**

  Reasonable cause: an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do.

- **Fuji Bank Ltd. V. Asst. Cit [2002] 121 Taxman 25 (ITAT-Delhi)(Mag.) & Azadi Bachao Andolan v. Union of India [2001] 116 TAXMAN 249 (DELHI)**

  What would constitute reasonable cause cannot be laid down with precision. It would depend upon factual background and scope for interference in a reference application. The reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of bona fides.

Observations…



- Any provision for expected loss outstanding as on 31st March 2016 shall be added back in the P&L account being disallowed as per ICDS. The loss will be allowed in the year of its occurrence.

  However, any loss occurred during FY 2015-16, whose provision was allowed in preceding years would not be allowed in the year of occurrence according to ICDS.

  - **Current year** :As per ICDS, income will increase in current year.
  - **Next Year:** As per ICDS, Income will decrease in the subsequent year when loss has occurred.
- The point of 'Provision for expected loss' also considered in ICDS III, ICDS IV and ICDS X which will be treated in the same manner and will be discussed in detail with the relevant AS.
- The **immaterial items** may also become the grounds of additions by the way of the **levy of penalty** by the AO in case of non disclosure of the immaterial items because ICDS doesn't recognize concept of materiality.

Points needs Clarification:

- **PLACE OF DISCLOSURE OF ACCOUNTING POLICY UNDER ICDS:**
  - ICDS provides to disclose the accounting policies and/or any change in that policy. But it does not clarify the place of disclosure i.e. Income tax return OR Audit report OR elsewhere.
- **REASONABLE CAUSE:**
  - While ICDS prohibits any change in an accounting policy without reasonable cause, it is not clear as to what would constitute **'reasonable cause'** and in the absence of such a clarification, it is likely to lead to **litigation**. ICDS has not yet provided any definition of the **reasonable cause**.
- **ADJUSTMENTS IN COMPUTATION OF INCOME:**
  - It is to be clarified how to show the adjustments in the return of income, because no computation sheet gets enclosed with the return of income.

Note: Most likely the return Forms for A.Y. 2016-17 will have the adjustment column for AS vis-à-vis-ICDS

Disclosure requirements under ICDS I

- All significant policies adopted in preparation of Financial Statements should be disclosed.
- Any change in accounting policies which has a material effect should be disclosed.
- Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item.
- If a fundamental accounting assumption is not followed, the fact should be disclosed.

ICDS II	AS-2
Valuation of Inventories	Valuation of Inventories

AS-2 Valuation of Inventories

- This Standard deals with the **determination of the value** at which inventories are carried in the Financial Statements, including the ascertainment of cost of inventories and any write-down thereof to net realisable value.

- This Standard **does not deal** with:
  a) WIP arising under construction contracts.
  b) WIP arising in the ordinary course of business of service providers
  c) Shares, debentures and other financial instruments held as stock-in-trade.
  d) Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases.

- **Inventories** are assets:
  a) held for sale in the ordinary course of business;
  b) used in the process of production for such sale; or
  c) used in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Contd.......

- Value **Inventories** at the **'lower' of Cost OR Net Realisable Value.**

- **Cost of Inventories includes**:
  - Cost of Purchase,
  - Cost of conversion, and
  - Other costs incurred
    - In bringing the inventories to their present location and condition.

- While calculating the cost of Inventories, **exclude** certain costs and recognise them as **expenses** in the period in which they are incurred. Examples of such costs are:
  a) abnormal amounts of wasted materials, labour, or other production costs;
  b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
  c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
  d) selling and distribution costs.

- **Techniques used for measurement of cost of inventories are:**
  a) **Standard Cost method** = Cost of material (+) Cost of labour (+) Overheads; or
  b) **Retail method**= Sale value of inventory (-) % of gross profit.

Note:

These techniques need regular review and, where necessary, revised in the light of related conditions.

DISCLOSURE REQUIREMENTS:

- All accounting policies adopted in measuring inventories.
- Cost formula used in measuring inventories.
- Total carrying amount of inventories and its classification.

Comparison b/w ICDS II & AS 2

1) **Calculation of cost:**

Unlike AS-2, Standard Costing method has not been prescribed to measure cost under ICDS.

2) **Inclusion of inventory for service providers:**

ICDS provides for valuation of inventories in the case of service provider. WIP arising in ordinary course of business of service providers will included under ICDS.

Note: Inventories in the case of service providers are materials or supplies to be consumed in rendering of services & Cost of inventory includes cost of services which consist of labour and other costs of personnel directly engaged in providing service including supervisory personnel and attributable overheads. But, the identification of overheads attributable to service is a subject matter of judgment.

3) **Value of Opening Inventory:**

Unlike AS-2 , ICDS specifically provides for valuation of opening inventory which shall be the cost of inventory as on the close of the immediately preceding financial year.

If business commenced during the previous year, it shall be the cost of inventory available on the day of commencement of business. This will ensure that no permanent gain/loss should result from an adjustment to closing inventory valuation.

Comparison b/w ICDS II & AS 2

4) **Value Of Inventory In Case Of Dissolution Of A Firm OR AOP OR BOI:**
ICDS specifically provides that notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the **NRV (Net Realizable Value).**

5) **Change In Method**:
Unlike AS 2 (read with AS 5), under ICDS the method of valuation of inventory once adopted shall not be changed without a reasonable cause which is same as requirements in ICDS 1.

6) **Recoverable Duties And Taxes**:
For the purpose of calculation of cost of purchase, AS 2 excludes the amount of duties and taxes those are subsequently recoverable by enterprise from the taxing authorities, whereas ICDS includes all the duties and taxes (on the lines of adjustment of **Section 145A** of Income Tax Act).

Judicial Pronouncement on value of Inventory In Case of Dissolution of Firm/ AOP/ BOI.....

- Once the position was accepted that the business continued, the ratio enunciated by **A.L.A. Firm's** case (supra) and reiterated by **Sakthi Trading Co. v. CIT [2001] 250 ITR 871 (SC)** would apply with full force and the closing stock had to be valued at the **<u>cost or market price, whichever was lower</u>**, on the basis of established principles of commerce and accountancy.
- Where, a Partnership firm was dissolved, 1 individual of the erstwhile firm continued to make a living out of a business, which by sheer coincidence happened to be again jewellery business, in which, distributed capital was introduced in the form of stock. The stock on introduction in the business, stood converted into stock-in-trade and value **<u>would have to be the market value on the date of introduction</u>**. [**Madhu Rani Mehra v. CIT[2011] 10 taxmann.com 126 (Delhi)]**

- Where dissolution of firm is accompanied by discontinuance of business and not otherwise, Market Price should be adopted [**Kwality Steel Suppliers v. CIT [2004] 141 Taxman 177 (GUJ.)]**
- If business of the firm didn't cease to continue as one unit on dissolution, the closing stock could not be valued at Market price (irrespective of value shown) [**Asst. CIT v. Kuldip Chand & Sons [2005] 93 ITD 253 (Amritsar)]**

Observations…

1) Since ICDS does not prescribe standard costing method, inventory needs to be calculated separately for income tax purpose, which profits during the **current year** may increase or decrease.

2) Service provider also have to value their inventory as per ICDS. It means cost of services also needs to be added in the cost of inventory which will increase the cost of inventory and decrease the profits of **current year**.

3) ICDS specifically provides for opening value of inventory, which means opening value of inventory could not be changed even if there is change in formula of valuation of inventory during the year such as from FIFO to weighted average or vice versa.

   In current year, profit may increase or decrease depending upon the value of closing inventory only.

Observations...

Contd.......

4) Due to specific provision for Dissolution of Partnership firm, the assets and liabilities now to be valued on NRV i.e. to be written off to the value of its realisation, which will **decrease** profit of current year.

5) ICDS provides that method once adopted shall not be changed without a reasonable cause. It will **not impact** profitability of enterprise, it just provides a check over change of accounting policies.

6) Due to inclusion of all duties and taxes (including recoverable from tax authorities) in the value of inventory, the value of inventory will increase which will result in **decrease** in profits during current year.

Points needs Clarification:

- **VALUE OF OPENING INVENTORY:**
  - ICDS only provides to take the value of closing inventory of preceding year as opening value of inventory. But it does not clarify that which value should be taken i.e. value as per books of accounts OR value as per Income Tax Act.

- **REASONABLE CAUSE:**
  - ICDS prohibits change in a method of valuation of inventory without a reasonable cause. It is not clarified as to what would constitute 'reasonable cause'. The absence of such a clarification may lead to litigation

Transitional Provisions

- Interest and other borrowing costs, which do not meet the criteria for recognition of interest as a component of the cost as per Para 11, but included in the cost of the opening inventory as on the 1st day of April, 2015, shall be taken into account for determining cost of such inventory for valuation as on the close of the previous year beginning on or after 1st day of April, 2015 if such inventory continue to remain part of inventory as on the close of the previous year beginning on or after 1st day of April, 2015.

Disclosure requirement under ICDS

- The following aspects shall be disclosed :

(a)**Change in Policy** : The accounting policies adopted in measuring inventories including the cost of formulae used.

(b)**Carrying Amount**: The total carrying amount of inventories and its classification appropriate to a person

ICDS III Construction Contracts	AS-7 Construction Contracts

AS-7 Construction Contracts

- The Standard prescribes the **accounting treatment of revenue and costs associated with construction contracts.**

- **Construction Contracts includes**:
  a) Contracts for the rendering of services which are directly related to the construction of the asset
  b) Contracts for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

- **Contract revenue comprises**:
  a) the **initial amount** of revenue agreed in the contract &
  b) variations in contract work, **claims** and **incentive** payments:
    i. to the extent that it is probable that they will result in revenue;
    ii. they are capable of being reliably measured.

Contd…….

- **Contract costs comprise** :

a) costs that relate directly to the specific contract;

b) costs that are attributable to contract activity in general and can be allocated to the contract; &

c) other costs that are specifically chargeable to the customer under the terms of the contract.

  - **Any incidental income needs to be reduced from the cost such as sale of extra material, sale of plant & machinery at the end of contract, etc.**

- **Recognition of contract Revenue & Expense:**

1. When outcome of a contract can be estimated reliably :
   a) revenue & expense be recognized with reference to the **stage of completion** of the contract activity at the reporting date.
2. When the outcome of a contract cannot be estimated reliably:
   a) Revenue be recognised **only to the extent** of contract costs incurred of which recovery is probable; and
   b) contract costs should be recognised as an expense in the period in which they are incurred.

Contd…….

- An **expected loss** on the construction contract **should be recognized** as an expense immediately.

- **DISCLOSURE REQUIREMENTS:**
  - the amount of contract revenue recognised as revenue in the period;
  - the methods used to determine the contract revenue recognised in the period; and
  - the methods used to determine the stage of completion of contracts in progress.
  - For contracts in progress at the reporting date:
    1. the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;
    2. the amount of advances received; and
    3. the amount of retentions.

Comparison b/w ICDS III & AS 7

Presently, <u>Retention money</u> is excluded in computing taxable income on the premise that the <u>right to receive the retention money accrues only after the obligations under the contract are fulfilled</u>. Under ICDS regime, retention money is specifically included as part of contract revenue.

Contract Revenue and contract costs are to be recognized on POCM basis. During the early stages of a contract, where the outcome of the contract c annot be estimated reliably contract revenue is recognised only to th e extent of costs incurred. This requirement is contained both in AS 7 and ICDS III. However, in case of ICDS III the early stage of a contract shall not extend beyond 25 % of the stage of completion.

AS 7 requires a provision to be made for the expected losses on onerous construction contract immediately on signing the contract. Under ICDS, losses incurred on a contract shall be allowed only in proportion to the stage of completion. Future or anticipated losses shall not be allowed, unless such losses are actually incurred.

Observations…

- Inclusion of **retention money** increases the profit during current year. The profit will not be recognised in the year in which conditions to receive retention money (as per AS) will complete ,i.e. recognized on the basis of POCM basis.
- Pre-Construction Income in the nature of interest, dividend and capital gains is specifically not allowed to be reduced from the cost of construction.
- When stage of completion of contract exceeds 25%, it should be recognized in the P&L account - irrespective of whether the revenue is reliably estimated or not - which will increase profit of current year.

Observations…

- The **provision for expected losses** be added back in the current year and such losses will be allowed in the year of their occurrence. The losses are allowed to be recognized only in proportion to the stage of completion while the entire loss is considered in books of accounts. Therefore, increase current year's profit.
- No Minimum threshold or exemption granted in this ICDS.
- Mandatory computation of income on the POCM basis even for the partnerships, LLP, proprietors, etc. Even the service providers such as architects, project managers, etc. rendering services directly attributable to construction contracts needs to follow POCM basis overriding earlier judicial pronouncements. Also covers contracts for destruction or restoration of assets.

Deduction of anticipatory losses as per Judicial Pronouncement on

- Deduction for foreseeable losses is allowed by hon'ble Delhi High Court in **CIT v. Triveni Engg. & Industries Ltd. [2010] 8 taxmann.com 146**

- Losses provided by assessee in its books of account accourding to AS-7, had to be allowed. **[Asst. CIT v. ITD Cementation India Ltd. [2013] 36 taxmann.com 74 (Mumbai - Trib.)]**

- Where construction project has long gestation period and POCM is adopted for income-tax purpose, losses only proportionate to work completed during year can be allowed and not entire anticipated losses. **[Shivshahi Punarvasan Prakalp Ltd. v. ITO [2011] 15 taxmann.com 352 (Mum.)]**

Transitional Provisions

- Contract revenue and contract costs associated with the construction contract, which commenced on or before the 31st day of March, 2015 but not completed by the said date, shall be recognized as revenue and costs respectively in accordance with the provisions of this standard. The amount of contract revenue, contract costs or expected loss, if any, recognized for the said contract for any previous year commencing on or before the 1st day of April, 2014 shall be taken into account for recognizing revenue and costs of the said contract for the previous year commencing on the 1st day of April, 2015 and subsequent previous years.

ICDS III overruling the Judicial Pronouncement ……

CIT *v.* Simplex Concrete Piles India (P.) Ltd, [1989] 45 TAXMAN 370 (CAL.)

- Assessee was carrying on construction business on mercantile system of accounting. Assessee was entitled to get 90% of payment in first instance when work was done and remaining 10 or 5%, as case may be, was to be paid later on after submitting certificates from architects/engineers, removal of defects, etc.. Assessee was crediting 100 % of job value in past years but from A.y. 1965-66, it had started practice of crediting only 90% value for work done after deducting retention money It was held that on date of submission of bills assessee had no right to receive entire amount on completion of work and retention money did not accrue to it on such date but on later date in accordance with terms of contracts and ITO would be unjustified in making any addition by treating entire contract amount as accrued on submission of bills on completion of work. But Under ICDS regime, retention money is specifically included as part of contract revenue.

ICDS III overruling the Judicial Pronouncement ……

CIT v. Associated Cables Ltd [2006] 286 ITR 596 (BOM.)

- Assessee entered into a contract with certain parties. As per contract, certain amount was to be retained by buyers and same was to be paid to assessee on satisfactory completion of contract It was held that retention money did not accrue to assessee and could not be considered to be income of assessee in year in which amount was retained

- **Also see: CIT v. P & C Constructions (P.) Ltd. [2009] 318 ITR 113 (Mad.) Asst. CIT v. B.G.R. Energy Systems Ltd. [2014] 47 taxmann.com 266 (Hyderabad - Trib.) DIT (IT) v. Ballast Nedam International [2013] 33 taxmann.com 139 (Gujarat).**

Contd….

CIT v. Ignifluid Boilers (I) Ltd [2006] 283 ITR 295 (MAD.)

- Assessee who was maintaining mercantile system of accounting entered into a contract with 'S' for erection of boilers wherein there was a specific clause that 10% contract price would be retained by principal contractor and it would be paid after 1month subject to satisfactory performance of boiler. The AO brought into account 10% of contract amount and levied tax on accrual basis – CIT(A) as well as ITAT deleted inclusion made by the AO. It was held that since assessee was entitled to receive amount in question only after successful completion of work, it could not be said that 10% retention money retained by principal contractor accrued to assessee during relevant assessment year. Therefore, Tribunal rightly set aside order of AO.

Disclosure requirements under ICDS - III

- the amount of contract revenue recognised as revenue in the period;
- the methods used to determine the stage of completion of contracts in progress.
- For contracts in progress at the reporting date:
  i. the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;
  ii. the amount of advances received; and
  iii. the amount of retentions.

ICDS IV Revenue Recognition	AS-9 Revenue Recognition

AS-9: Revenue Recognition

This Standard deals with the bases for recognition of revenue in the statement of profit and loss of an enterprise. Revenue recognition is mainly concerned with the timing of recognition of revenue.

Revenue is the gross inflow of cash, receivables or other consideration arising in the *course of the ordinary activities* of an enterprise from

a) the sale of goods,

b) the rendering of services, and

c) other resources yielding interest, royalties and dividends.

- **Revenue from sale of goods** be recognised when significant risks and rewards of ownership related to goods are transferred to the buyer and no significant uncertainty exists regarding the amount of the consideration that will be derived.

Contd…….

- **Revenue from service transactions:** is usually recognised as the service is performed, either by using the :
    a) proportionate completion method or
    b) completed service contract method.

- **The 'other resources' of enterprise used by others gives rise to**:

a) **Interest**—charges for the use of cash resources or amounts due to the enterprise;

b) **Royalties**—charges for the use of such assets as know-how, patents, trade marks and copyrights;

c) **Dividends**—rewards from the holding of investments in shares.

Contd.......

- **Interest accrued** is recognised on the time proportion basis taking into account the amount outstanding and the rate applicable. Usually, **discount or premium on debt securities** held is treated as though it were accruing over the period to maturity.

- **Royalties** are recognised on an accrual basis in accordance with the terms of the relevant agreement.

- **Dividends from investments** in shares are recognised in the statement of profit and loss when the right to receive payment is established.

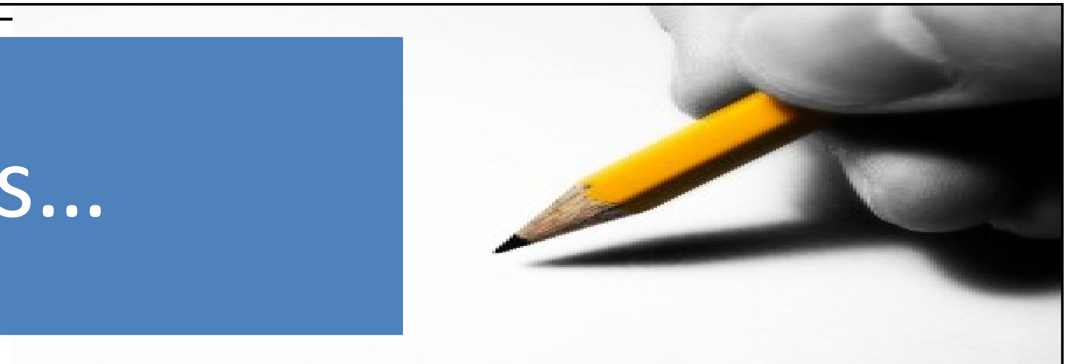
DISCLOSURE REQUIREMENTS:

- Disclosure required by AS-1.
- the circumstances in which revenue recognition has been postponed till the resolution of significant uncertainties.

Comparison b/w ICDS IV & AS 9

- As per ICDS, revenue from service contract is to be recognized only on percentage completion method as against AS-9 where both 'completed service contract method' and 'percentage completion method' are permitted for recognition of revenue from service contract. This is done to avoid the litigations contesting the method to be followed to recognize the revenue and costs such as: *Champion Construcion Co. vs ITO (5 ITD 495) (Mum Tribunal), CIT vs. V.S. Dempo and Co. P Ltd. (131 CTR 203) (Bombay HC).*
- As per ICDS, recognition cannot be postponed due to uncertainty of ultimate collection of revenue and inability to measure it reliably.
- Unlike AS 9, ICDS provides that the dividend income should be recognized in accordance with the provisions of the Act.

Observations…



- As per ICDS, only percentage completion method is allowed, therefore the persons using completion service method till 31st March 2015 are required to recognize the revenue in the current year accordingly.
  - **<u>Current Year:</u>**

    Profit for current year increases due to recognition of revenue.
- Recognition of dividend income according to the provisions of the Act provides that dividend income should be recognized in previous year in which it is so declared, distributed or paid, as the case may be and 'Dividend' also includes Deemed Dividend. Inclusion of Deemed Dividend will increase the profit of current year.
- The gross turnover under section 44AB or 44AD needs to be calculated in accordance to the provisions of this ICDS.
- The ICDS provides that the amount that could not be recognized due to lack of reasonable certainty of its ultimate collection should be disclosed with the nature of uncertainty.

Transitional Provisions

- Revenue for a transaction undertaken on or before the 31st day of March, 2015 but not completed by the said date shall be recognised in accordance with the provisions of this standard for the previous year commencing on the 1st day of April, 2015 and subsequent previous year. The amount of revenue, if any, recognised for the said transaction for any previous year commencing on or before the 1st day of April,2014 shall be taken into account for recognizing revenue for the said transaction for the previous year commencing on the 1st day of April, 2015 and subsequent previous years.

Disclosure requirement under ICDS

- Following disclosures shall be made in respect of revenue recognition:
  a) In a transaction involving sale of good, total amount of claim raised for escalation of price and export incentives but not recognized as revenue during the previous year along with nature of uncertainty about such claims.
  b) the amount of revenue from service transactions recognized as revenue during the previous year ; and
  c) the methods used to determine the stage of completion of service transactions in progress.
  d) For service transactions in progress at the end of previous year:
     (i) amount of costs incurred and recognized profits (less recognized losses) upto end of previous year;
     (ii) the amount of advances received; and
     (iii) the amount of retentions.

ICDS V
Tangible Fixed Assets

AS-10
Accounting for Fixed Assets

AS-10 : Accounting For Fixed Assets

- FS disclose certain information relating to fixed assets such as land, buildings, plant and machinery, vehicles, furniture and fittings, goodwill, patents, trade marks and designs.

- This Standard **does not deal** with accounting for the following items to which **special considerations apply**:
  a) forests, plantations and similar regenerative natural resources;
  b) wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources;
  c) expenditure on real estate development; and
  d) livestock

- The cost of fixed asset comprises
  - Purchase price, **including** import duties and other non-refundable taxes or levies and
  - **Any directly attributable cost** of bringing the asset to its working condition for its intended use.

- **<u>Examples of directly attributable costs are</u>:** (i) site preparation; (ii) initial delivery and handling costs; (iii) installation cost, such as special foundations for plant; and (iv) professional fees, for example fees of architects and engineers.

- Administration and other general overheads are usually excluded from the cost of fixed assets

- **Cost of assets acquired in exchange:**

  Fair market value or the net book value adjusted for any balancing payment or receipt of cash or other consideration of

  - asset given

    OR

  - asset acquired,

  which is more clearly evident.

Contd…….

- **Cost of Self Generated Fixed Assets:**
  - Costs that relate directly or are attributable to the construction activity of specific asset in general and can be allocated to the specific asset.

- **Cost of Fixed assets acquired on hire purchase:**
  - Cash value, which, if not readily available, should be calculated by assuming an appropriate rate of interest.
  - A narration should be shown in balance sheet to indicate that there is no full ownership on asset.

- **Cost of Jointly owned Fixed Assets:**
  - Proportionate cost to the extent of ownership.

- **Improvements or Repairs:**
  - Repair expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance must be **capitalized**.
  - Other expenditures must be charged to P&L account.

- **Revaluation of Assets:**
  - If revaluation is made, entire class of assets should be revalued, or the selection of assets for revaluation should be made on a systematic basis.
  - After revaluation, the net book value should not exceed the recoverable value of asset.
  - When a fixed asset is revalued upwards, any accumulated depreciation existing at the date of the revaluation should not be credited to the profit and loss statement.
  - Revaluation reserve should be made for increase in value of asset on revaluation.
  - Any loss on disposal of revalued asset should be first charged from the balance of revaluation reserve then from P&L account.

Contd…….

- **Retirements and Disposal of Assets:**
  - Items of fixed assets that have been retired from active use and are held for disposal are stated at the **lower of their Net Book Value OR Net Realizable Value.**
  - These items are shown separately in the FS.
  - Any expected loss is recognized immediately in the P&L account.

- **DISCLOSURE REQUIREMENTS:**
  - Opening & Closing Gross and Net book value.
  - Addition, disposals, acquisition & other movements.
  - Revaluation amount & basis for revaluation.

Comparison b/w ICDS V & AS 10

- **Tangible Fixed Assets:**

  Unlike AS, ICDS only deals with tangible fixed assets. It does not include goodwill, patents, trade marks and designs. It covers land, building, plant, machinery & furniture held for production of goods or services.

- **Exchange of a tangible asset for another asset:**

  In case of acquisition of a tangible fixed asset in exchange for another asset, shares or other securities, **the Fair Value of the tangible fixed asset so acquired is to be its Actual cost**, whereas **in AS-10 Fair Value OR Net Book Value** of asset acquired or given, **which is most clearly evident is taken**.

- **Revaluation of Fixed Assets:**

  There is no concept of revaluation of asset in the ICDS. The same is in conformity with the provision of the Act wherein also the concept of revaluation of assets is not recognized.

Comparison b/w ICDS V & AS 10

- **Retirement and Disposal of Fixed Asset:**

  Para 14, of AS-10 provides for retirement of fixed asset from active use & disposal of such asset to state them at lower of Net Book Value or NRV and separately show them in FS, **but ICDS does not provide for any such provision.**

- ICDS specifically provides for 'Depreciation' and 'Income from transfer of a tangible asset' that it should be computed in accordance with the provisions of the Act. This will not impact profit because depreciation is already calculated according to the Act while computing Income.
- **ICDS doesn't provide any guidance with regards to valuation of assets under the hire purchase system.**

Observations…

- Non inclusion of Intangible assets under ICDS will not impact the profit of current year because Income Tax Act separately allows depreciation for Intangible assets and disallows any amortisation of Intangible asset taken as per AS 26.

- Due to change in cost of acquired asset, taken on the basis of fair value of asset acquired, amount of depreciation will be changed in current year which will **increase or decrease** the profit.

- Revaluation will **not affect** the P&L account, because it is also not allowed under the Act.

- ICDS does not provide for the disposal of tangible fixed assets, so it should be treated as per the AS or Act, therefore, will not impact the P&L account.

Points that need Clarification:

- ICDS does not clarify the treatment of an expenditure made for improvement or repair of the tangible fixed asset which does not meet the criteria for capitalization of amount.
- ICDS does not clarify the treatment of expenses , whether to be capitalized or debited in P&L account, incurred between the completion of asset and its utilization for commercial production.
- ICDS is silent on the treatment of expenses incurred during the period post completion of test runs and pending commencement of commercial production. It doesn’t provide the classification of expenses during such period due to which there is an ambiguity about if such expenses are revenue or capital.
- Deferred taxes may arise w.r.t. machinery spares in case they are capitalized as per AS and charged to revenue as and when consumed as per the ICDS. This it would decrease profits as compared to the Act.

Transitional Provisions

- The actual cost of tangible fixed assets, acquisition or construction of which commenced on or before the 31st day of March, 2015 but not completed by the said date, shall be recognized in accordance with the provisions of this standard. The amount of actual cost, if any, recognized for the said assets for any previous year commencing on or before the 1st day of April, 2014 shall be taken into account for recognizing actual cost of the said assets for the previous year commencing on the 1st day of April, 2015 and subsequent previous years

Disclosure requirement under ICDS

Following disclosure shall be made in respect of tangible fixed assets:

- Description of asset/block of assets.
- Rate of depreciation.
- Actual cost or written down value, as the case may be.
- Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of:
  - Central Value Added Tax credit claimed and allowed under the Central Excise Rules, 1944, in respect of assets acquired on or after 1st March, 1994,
  - change in rate of exchange of currency, and
  - subsidy or grant or reimbursement, by whatever name called.
  - Depreciation Allowable.
  - Written down value at the end of year.

ICDS VI

The effects of changes in foreign exchange rates

AS-11

The effects of changes in foreign exchange rates

AS-11: The Effects Of Changes in Foreign Exchange Rates

- An enterprise may carry on activities involving foreign exchange in following ways: **(a)It may have transactions in foreign currencies or;(b)it may have foreign operations or (c)forward exchange contracts.** Thus to incorporate such foreign transactions, they must be expressed in the Financial Statements at the enterprise's reporting currency.

- **A foreign currency transaction** is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:
  a) buys or sells goods or services; or
  b) borrows or lends funds; or
  c) becomes a party to an unperformed forward exchange contract; or
  d) otherwise acquires or disposes of assets, or incurs or settles liabilities.

- **<u>Some Definitions:</u>**
  - Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money
  - Non-monetary items are assets and liabilities other than monetary items.
  - Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.
  - Non-integral foreign operation is a foreign operation that is not an integral foreign operation

- **<u>Recognition of Foreign Currency Transaction:</u>**
  - **Initial Recognition:**
    - A foreign currency transaction should be recorded, on initial recognition in the reporting currency, **at the date of the transaction** **at the prevailing rate on that date.**
  - **Subsequent Recognition at each Balance Sheet date:**
    - foreign currency **monetary items** should be reported using the closing rate.
    - foreign currency **non-monetary items** which are carried:
      - in terms of **historical cost** should be reported using the exchange rate at the date of the transaction.
      - at **fair value** or other similar valuation should be reported using the exchange rates on the date of determination of value.

- **Exchange differences** arising **<u>on monetary items</u>** should be
  - recognised as **income or expense** in the period in which they were recognised
  - **accumulated** in a **Foreign Currency Translation Reserve** for net investment in a **Non-Integral Foreign Operation** until the disposal of the net investment.

Contd…….

- **Forward Exchange Contracts:**
  - Forward exchange contract means an agreement to exchange different currencies at a forward rate.
  - An enterprise may enter into forward contract to establish the amount of the reporting currency required or available on the date of settlement.
  - Premium or discount at the inception of contract should be amortised as income or expense over the life of contract.
  - Exchange difference should be recognised in the period in which they occurred.
  - Any profit or loss on cancellation or renewal of such contract should be recognised as income or expense.
  - The value of forward exchange contract for trading or speculation purposes should be marked to market value at each balance sheet date and the exchange difference on the contract is recognised in P&L account.

Contd…….

Contd…….

- As per **Para 46A**, an enterprise on or after 1st April 2011 may opt for capitalisation of amount of exchange difference on **Long term Foreign Currency Monetary Items**:
  - In case of **depreciable asset** amount could be added or reduced from the cost of asset and shall be depreciated over the life of asset.
  - In **other cases** amount could be accumulated in "Foreign Currency Monetary Item Translation Difference Account" and amortised over the balance period of life of the asset or liability.

- **DISCLOSURE REQUIREMENTS:**
  - Amount of exchange difference.
  - Accumulated amount in Foreign currency translation reserve account.
  - Change in the classification of significant operations.

Comparison b/w ICDS VI & AS 11

Under AS 11, exchange differences on a Non-integral foreign operation are not recognized in the P&L account, but accumulated in a **Foreign Currency Translation Reserve**. Such a foreign currency translation reserve is recycled to the P&L account when the non-integral operation is disposed. Under **ICDS** exchange differences on Non-integral foreign operations shall be recognized as **income or expense** in that previous year.

AS-11 provides an option to **capitalize** the amount of exchange difference on Long Term Foreign Currency Monetary Items in the cost of Depreciable asset (in case of acquisition of depreciable asset) or in Foreign Currency Monetary Item Translation Difference Account (in other cases) which can be amortized over the life of such long term asset. **Under ICDS**, exchange difference on all monetary items should be recognized as **income or expense**.

Comparison b/w ICDS VI & AS 11

Unlike AS, ICDS recognise the profit or loss on Forward Contracts entered into for speculation or trading purpose on the settlement date rather than on each balance sheet date because these gains or losses are unrealised in nature.

Observations…

- As per ICDS, any amount outstanding as on 31st March 2016 in the "Foreign Currency Translation Reserve", should be credited to P&L account, which will increase profit of current year.

- Amount of exchange difference which was capitalized earlier should be reversed, which may increase or decrease profit of current year due to change in amount of depreciation.

- Non recognition of profit or loss on forward contracts on each balance sheet date will **increase or decrease** the profit of current year if these are not settled in the current year.

Transitional Provisions

- All foreign currency transactions undertaken on or after 1st day of April, 2015 shall be recognized in accordance with the provisions of this standard.
- Exchange differences arising in respect of monetary items or non-monetary items, on the settlement thereof during the previous year commencing on the 1st day of April,2015 or on conversion thereof at the last day of the previous year commencing on the 1st day of April, 2015,shall be recognized in accordance with the provisions of this standard after taking into account the amount recognized on the last day of the previous year ending on the 31st March,2015 for an item, if any, which is carried forward from said previous year.

Transitional Provisions

- The financial statements of foreign operations for the previous year commencing on the 1st day of April, 2015 shall be translated using the principles and procedures specified in this standard after taking into account the amount recognised on the last day of the previous year ending on the 31st March,2015 for an item, if any, which is carried forward from said previous year.
- All forward exchange contracts existing on the 1st day of April, 2015 or entered on or after 1st day of April, 2015 shall be dealt with in accordance with the provisions of this standard after taking into account the income or expenses, if any, recognised in respect of said contracts for the previous year ending on or before the 31st March, 2015.

ICDS VII	AS-12
Government Grants	Government Grants

AS-12: Government Grants

- This Standard deals with accounting for government grants.
- Government grants available to the enterprise are **recognised in the FS**:
  a) where there is reasonable assurance that the enterprise will comply with the conditions attached to them; and
  b) where such benefits have been earned by the enterprise and it is reasonably certain that the ultimate collection will be made.

- **Two broad approaches** may be followed for the accounting treatment of government grants: the **'capital approach'**, under which a grant is treated as part of shareholders' funds, and the **'income approach'**, under which a grant is taken to income over one or more periods.

- Mere **receipt of a grant is not** necessarily a **conclusive evidence** that **conditions attaching** to the grant have been or will be **fulfilled**.

- Government grants may take the form of **non-monetary assets**, such as land or other resources, given at concessional rates be recorded at a nominal value.
- **Grant for Fixed Assets:**
  - Grant may be recognised in two ways:
    - Deduct the amount of grant from cost of asset & charge depreciation on reduced balance.
    - Grant may be treated as deferred income which is recognised in the P&L account on a systematic and rational basis over the useful life of the asset.
- **Grant related to Revenue:**
  - be credited to P&L account.
- **Grant in the nature of Promoters' contribution:**
  - given with reference to the total investment be credited in capital reserve.

Contd…….

- **Refund of Government Grant:**

  Government grants sometimes become refundable because certain conditions attached to it are not fulfilled.

  Recognition of refund of Government Grant:

  - Grant Related to Revenue : First deducted from unamortized deferred amount then to P&L A/c.
  - Grant related to Fixed Asset : Increase value of Fixed asset OR Reduce Capital Reserve, as the case may be.
  - Grant in the nature of Promoters' Contribution : Reduce Capital Reserve.

- **DISCLOSURE REQUIREMENTS:**
  - The accounting policy adopted for government grants.
  - The nature and extent of government grants recognised.

Comparison b/w ICDS VII & AS 12

Under ICDS Government Grants are not treated by the "capital approach" (i.e. crediting grant to the shareholder's funds) and instead are recognized as:

a) Income, either immediately or over a period of time OR
b) Reduced from the cost of assets based on the nature of such grant.

Under AS 12 recognition of Government Grants may be postponed even beyond the actual date of receipt when it is probable that conditions attached to the grant may not be fulfilled and the grant may have to be refunded to the government. But Under ICDS, recognition of Government grants shall not be postponed beyond the date of actual receipt.

Note: Govt. grants which are not reduced from the cost of assets shall be treated as income u/s 2(24) of the I.T. Act. (Finance Act, 2015)

Is the government grant to be treated as per Capital Approach or Revenue Approach?

As per the old school, the government grants used to be treated as the capital receipt. But under the ICDS regime, the government grants should be **recognized as:**

a) Income, either immediately or over a period of time OR

b) Reduced from the cost of assets based on the nature of such grant.

CIT v. P.J. Chemicals Ltd. [1994] 76 TAXMAN 611 (SC)

- The central subsidy received by an assessee should not be deducted from actual cost of assets for purposes of computing depreciation

Shree Balaji Alloys* v.CIT [2011] 198 TAXMAN 122 (J&K)

- The amounts of excise refund and interest subsidy received by industrial units in pursuance of incentives announced in terms of new industrial policy for accelerated industrial development in State of J&K for creation of such industrial atmosphere and environment which would provide additional regular sources of employment to unemployed in State, were, in fact, in nature of creation of new assets of industrial environment, having potential of employment generation to achieve a social object and such incentives would be capital receipts in hands of such industrial units

Contd....

- Birla Corporation Ltd. *V.* DCIT [2015] 55 taxmann.com 33(Kol -Trib.)
- CIT v. Birla VXL Ltd [2013] 32 taxmann.com 330 (Gujarat)
- CIT*v.* Chaphalkar Brothers [2013] 33 taxmann.com 431 (Bombay)
- DCIT *v.* Gloster Jute Mills Ltd [2014] 51 taxmann.com 547 (Kol Trib.)
- CIT v. P*onni Sugars & Chemicals Ltd.* [2008] 174 TAXMAN 87 (SC)
- CIT*v.* Rasoi Ltd [2011] 11 taxmann.com 220 (Cal.)
- DCIT V.Reliance Industries Ltd. [2004] 88 ITD 273 (MUM.)(SB)

The above are the similar judicial decisions on a common paralance stating that the government grants are to be treated as **capital receipts** which are overruled by the ICDS on government grants.

Further, to find out nature of grant application of purpose test is not relevant under ICDS.

The Hon'ble Supreme Court has had in the case of CIT v. Ponni Sugars & Chemicals Ltd. [2008] 174 TAXMAN 87 that *"one has to apply the 'purpose test'. The point of time when the subsidy is paid is not relevant. The source is immaterial; the form of subsidy is also immaterial."*

Observations…

- Non capitalisation of grant received will increase profit of current year.

- Recognition of the amount of Government Grant in P&L A/c immediately on receipt will increase or decrease profit of current year.

Refund of Government Grants

- **Related to depreciable fixed asset or assets**
- To be recorded by increasing the actual cost of the asset or WDV of block of assets by the amount refundable
- Depreciation on the revised actual cost or WDV to be provided *prospectively* at the prescribed rate
- **Related to a non-depreciable fixed asset or compensation for expenses/losses or any other form**
- To be applied first against any unamortised deferred credit remaining in respect of the government grant
- To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement

Point needs consideration

- In ICDS "Reasonable Assurance" not defined
- Term Agencies and similar bodies' quite wide
- Measurement not prescribed for grants in kind
- "Purpose Test" Diluted
- Treatment of non-monetary assets given free of cost not prescribed.

Note: The above could lead to interpretation issues and possible litigations

Transitional Provisions……

- All the Government grants which meet 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, 2015..

Disclosure requirement under ICDS

- Nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost of the assets or from the WDV of block of assets during the previous year.
- Nature and extent of Government grants recognized during the previous year as income.
- Nature and extent of Government grants not recognized during the previous year by way of deduction from the actual cost of the asset or assets or from the WDV of block of assets and its reasons.
- Nature and extent of Government grants not recognized during the previous year as income and reasons thereof.

ICDS VIII	AS-13
Securities	Accounting for Investments

AS-13 Accounting For Investments

- This Standard deals with accounting for investments in the FS of enterprises and related disclosure requirements.

- Investments are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. **Assets held as stock-in-trade are not 'investments'**

- **However, this standard provides a note that** the manner in which shares, debentures and other securities (securities) held as stock-in-trade are accounted for and disclosed in the FS is quite similar to that applicable in respect of current investments. Accordingly, the provisions of this Standard, to the extent they relate to current investments, are also applicable to securities held as stock-in-trade, with suitable modifications.

- In respect of securities held as stock-in-trade, the cost of stocks disposed of is determined by applying an appropriate cost formula (e.g. FIFO, average cost, etc.) as specified in AS 2, in respect of Valuation of Inventories.

Contd.......

- An enterprise should disclose current investments and long term investments distinctly in its financial statements.

- Further **classification of current and long-term investments** should be as specified in the statute governing the enterprise. In the absence of a statutory requirement, such further classification should disclose, where applicable, investments in:

  (a) Government or Trust securities

  (b) Shares, debentures or bonds

  (c) Investment properties

  (d) Others—specifying nature

- **Carrying Amount of Investments:**
  - **Current Investments** : lower of cost OR fair value
  - **Long-term investments** : at cost

Contd.......

- **Profit or loss on disposal** of an investment should be charged or credited to the P&L account.

- **DISCLOSURE REQUIREMENTS:**
  - The accounting policies for determination of carrying amount.
  - Classification of investments.
  - The amounts included in P&L account such as interest, dividend etc.
  - Significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal.

Comparison b/w ICDS VIII & AS 13

- **STOCK- IN-TRADE Vs. INVESTMENTS:**

  This ICDS deals with securities held as "stock-in-trade" and not securities held as "investment".

- **SECURITY ACCQUIRED IN EXCHANGE OF ANOTHER:**

  As per ICDS, where a security is acquired in exchange for another security, **cost shall be fair value** of the security **acquired**, whereas, the AS requires that the cost of security **acquired & held as investment may be equal** to the fair value of security **acquired/ given up** whichever is clearly evident.

- Securities namely:-

  A) Shares B)Debt C)Convertible/ Non- Convertible Securities

  are to be valued at **actual cost or net realizable value**, whichever is lower at the end of every previous year.

Comparison b/w ICDS VIII & AS 13

- The comparison of Cost or NRV should be made **category wise** under ICDS whereas under AS the comparison of value of current investments is taken on individual basis. This difference would result in deferred tax assets and liabilities.
- A security is to be recognized at the actual cost including brokerage, fees, tax, duty or cess paid in connection with the purchase/ acquisition.

- **Securities not listed on Stock Exchange:**

  ICDS specifically provides that securities not listed on a recognized stock exchange be valued at actual cost initially recognized.
- Opening value of securities is specifically provided in ICDS, which shall be equal to the closing value of preceding previous year. If preceding previous year is the year of commencement of business then the cost on the date of commencement should be taken.

Observations…

- ICDS deals with securities held fo
  as investments. Therefore, securi
  ambit of ICDS.

- When fair value of security acquired is taken as its cost of acquisition then it may **increase or decrease** profit of current year.

- Category wise comparison may **increase** the profit because appreciation of one security will not set off from the depreciation of another security.
- ICDS VIII will not apply to insurance companies, banks, mutual funds, public financial institutions and venture capital funds.
- Interest relating to a period prior to the acquisition of debt security must go to reduce the cum-interest cost of acquisition.

Anticipated or the MTM losses is allowed as deduction.......

Judicial Decisions overruled by ICDS VIII

Edelweiss Capital Ltd. *v.* ITO [2010] 8 TAXMANN.COM 157 (MUM)

- If the derivatives have been treated as stock-in-trade then there is nothing unusual in the assessee's valuing each derivative by applying the rule cost or market, whichever is lower, and, therefore, the provision for the anticipated loss arising on account of valuation of the closing stock (derivatives) has to be allowed

  [*Also Refer* ***United Commercial Bank v. CIT[1999] 106 TAXMAN 601 (SC), Urudavan Investment & Trading (P.) Ltd. V. ACIT [2013] 29 taxmann.com 312 (Mumbai - Trib.)]***

Issue-Broken Period Interest- To be deducted from the actual cost of security on receipt on interest

American Express International Banking Corpn. V. CIT [2002] 125 TAXMAN 488 (BOM.)

- Where adopting either of assessee's method of accounting or that of department's same amount was brought to tax and, further, department could not show as to how assessee's method ought to be rejected, assessee's method of treating income was to be accepted - Held, yes - Assessee-bank, like several other banks, was consistently following practice of valuing securities/interest held by it at end of each year and offer for taxation appreciation in their value by way of profit/interest earned due to efflux of time - Assessee used to pay interest for broken period to seller on purchase of dated Government securities while used to receive interest for broken period from purchaser on sale of such securities - Bank claimed difference of amount paid and amount received as revenue expenditure - Whether once an income falls under section 18, it cannot come under section 28, but if income from securities is treated as trading assets, it can come under section 28 - Held, yes - Whether having assessed assessee's income from securities under section 28, department ought to have taxed interest from broken period interest received and allow deduction for broken period interest paid.
- *[Also refer Indian Bank [2014] 213 Taxman 339 (Madras]*

ICDS IX	AS-16
Borrowing Costs	Accounting for Borrowing Cost

AS- 16: Borrowing Costs

- **Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset.**

Examples of Borrowing costs include:

a) interest on all bank borrowings;

b) amortisation of discounts or premiums relating to borrowings;

c) finance charges in respect of assets acquired under finance leases ;

d) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs, etc.

Qualifying Asset:

- A **Qualifying asset** is an asset that necessarily takes a **substantial period** of time to get ready for its intended use or sale.
  - **Substantial period** of time primarily depends upon facts and circumstances. However, normally a period of 12 months is considered as substantial period of time.
- Land, Building, Machinery, Plant or Furniture, being the tangible assets.
- Know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets
- Inventories that require a period of twelve months or more to bring them to saleable condition

- **Borrowing Costs Eligible for Capitalisation:**
  - **Funds specifically borrowed for obtaining qualifying asset: actual borrowing costs** incurred on that borrowing should be capitalised.
  - **Funds generally borrowed and used for obtaining qualifying asset:** amount to be capitalised should be determined by applying a **capitalisation rate** to the expenditure on that asset.

- The **capitalisation rate** is the weighted average of the borrowing costs applicable to the general borrowings outstanding during the period.

- **Commencement of Capitalisation:**

  Capitalisation should be commenced when **all** the following conditions are satisfied:
  - Expenditure for acquisition of capital asset is being incurred.
  - Borrowing costs are being incurred.
  - Activities necessary to prepare the asset are in progress.

Contd…….

Contd.......

- **Other borrowing costs** should be **recognised as an expense** in the period in which they are incurred.

- In determining the amount of borrowing costs eligible for capitalisation during a period, any **income earned on the temporary investment** of those borrowings is **deducted** from the borrowing costs incurred.

- Capitalisation of borrowing costs should be **suspended** during extended periods in which active development is interrupted.

- Capitalisation of borrowing costs should **cease** when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

- **DISCLOSURE REQUIREMENTS:**
  - The accounting policy adopted for borrowing costs; and
  - The amount of borrowing costs capitalised during the period.

Comparison b/w ICDS IX & AS 16

- As per ICDS, exchange differences arising from foreign currency borrowings to the extent that they are regarded as interest cost will not be considered as borrowing cost. The same will be treated in terms of ICDS VI on 'The Effect of Changes in Foreign Exchange Rate'.
- Unlike AS-16, ICDS doesn't define any minimum period for classification of an asset as qualifying asset (except for inventories). Borrowing cost may need to be capitalised even if the asset doesn't take substantial time to construct.
- Unlike AS -16, provision of suspension period of capitalization of borrowing cost is not covered in the ICDS.
- Under ICDS IX, capitalization of specific borrowing cost commences from the date of borrowing, even when the construction of asset has not been started.
- Unlike AS 16, income on temporary investments of borrowed funds cannot be reduced from borrowing costs eligible for capitalization in ICDS IX.

Comparison b/w ICDS IX & AS 16

Contd.......

Borrowing Cost in respect of general borrowings utilized for acquisition of the qualifying asset to be capitalized in accordance with the following formula:

(A) X B/C

Where ;

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

B = Average cost of Qualifying asset appearing in the balance sheet as on the first day and last day of the previous year,

OR

50% of cost of Qualifying asset (If Qualifying asset does not appear in balance sheet on first day or both on the first day & the last day of previous year)

Note: this is possible when the qualifying asset is not under capital-WIP and has been capitalized in the mid of the year directly.

OR

Average of cost of Qualifying asset on first day and on the date of put to use or completion, as the case may be (if Qualifying asset does not appear in the balance sheet on the last day of previous year)

&

C = Average cost of total assets at the first day and last day in balance sheet of the previous year other than those funded out of specific borrowings.

Observations…

- Due to non inclusion of Foreign exchange difference in borrowing cost, borrowing cost to be capitalised will be reduced resulting in lesser amount of depreciation and hence the profit for current year may increase.

- Due to non mentioning of minimum time for an asset to become qualifying asset, borrowing cost related to every asset (other than inventory) should be capitalised during the current year, resulting into lesser amount of borrowing cost to be charged to P&L account which will reduce the profit for current year and higher amount of depreciation in subsequent years.

- Due to non inclusion of suspension period, the borrowing cost for the current period will include suspension period borrowing cost, resulting in increase in the amount to be capitalised and depreciation on it. Therefore, the profit for current year will reduce.

Observations…

- The capitalisation of specific borrowing will start immediately on receipt of borrowing even when the construction of qualifying asset has not started. It will lead to increase in borrowing cost for current year and depreciation on it, which will reduce the profit of current year, if the asset installed during the same year.

- The non deduction of earning from temporary investment of borrowed funds from borrowing cost may have impact on profit for the current year because on the one hand our borrowing cost will increase thereby decreasing the profit, and, on the other hand, profit will increase due to earning.

- Due to change in formula of calculation of general borrowing cost, amount of borrowing cost capitalised to specific qualifying asset may change which in turn, may change the amount of depreciation resulting into **increase or decrease** in the profit.

Observations…

- The Fixed assets, which are acquired off the shelf, like books, laptops etc. would also be treated as qualifying assets and accordingly the proportionate borrowing cost thereof needs to be worked out and added to the cost of such asset. This would practically result into maintaining two sets of fixed assets registers i.e. one for financial accounts and another one for tax accounts.
- **ICDS IX emphasizes on purpose of borrowing rather than on utilization of funds. Therefore it may be interpreted that in cases where funds have been borrowed for the purpose of acquisition etc. of a qualifying assets but has been used (or partly used) for purpose other than acquisition etc. of qualifying asset, the borrowing cost may still have to be capitalized.**

Observations…

- If half of the cost of the qualifying assets or average of the cost of the qualifying assets is taken without any consideration of number of days for which is capitalization is eligible, it may result into litigations and disputes.
- Capitalisation for the borrowing starts from :
  - On the date on which funds were specifically borrowed for acquisition of qualifying asset
  - On the date on which funds were utilised, where funds were borrowed generally.

Transitional Provisions

- All the borrowing costs incurred on or after 1st day of April, 2015 shall be capitalized 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 of borrowing costs capitalized, if any, for the same borrowing for any Previous Year ending on or before 31st day of March, 2015.

Disclosure requirement under ICDS

The following disclosure shall be made in respect of borrowing costs:

- Accounting policy adopted for borrowing costs
- Amount of borrowing costs capitalised during the Previous Year

ICDS X Provisions, Contingent liabilities and Contingent Assets	AS-29 Provisions, Contingent liabilities & Contingent Assets

AS-29 : Provisions, Contingent Liabilities & Contingent Assets

- Accounting for Provisions, Contingent Liabilities & Contingent Assets, except:
  - those resulting from **financial instruments**
  - those resulting from **executory contracts**, except where the contract is **onerous**;
- 'Executory Contracts' are those contracts wherein neither parties to the contract have performed their obligations or both parties have partially performed their obligations equally.
- 'Onerous contracts' are those contracts where the costs involved with fulfilling the terms and conditions of the contract are higher than the amount of economic benefit received from the contract itself.
- The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the Financial Statements to enable users to understand their nature, timing and amount.

Contd….

Provision:

- A provision should be recognised when:
  - as a result of a past event;
  - there is a present obligation
  - that probably requires outflow of resources embodying economic benefits; and
  - a reliable estimate can be made of the amount.

- The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The amount of a provision should not be discounted to its present value.

- Gains from the expected disposal of assets should not be taken into account in measuring a provision.

- Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate

Contd....

- Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the **reimbursement** should be recognised when, and only when, it is **virtually certain** that reimbursement will be received.

- A provision should be used only for expenditures for which the provision was originally recognised.

CONTINGENT LIABILITY:

- A contingent liability should not be recognised. It should be disclosed when:
  - as a result of past events,
  - there is **present or possible obligation**
  - that may, but **probably will not** , require an outflow of resources.

- When as a result of past events, there is present or possible obligation, where the **chances of outflow of resources are remote**, then neither provision should be recognised nor contingent liability should be disclosed.

Contd....

CONTINGENT ASSET:

- Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits.
- For example: a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain.
- These are usually not disclosed in FS, rather disclosed in the report of approving authority when inflow of economic benefit is probable.
- A contingent asset should not be recognised since this may result in the recognition of income that may never be realised. It should be recognized when realization of income is virtually certain.

DISCLOSURE REQUIREMENTS:

- For each class of provision:
  - carrying amount at the beginning and end of the period
  - additional provisions made in the period
  - amounts used during the period
  - unused amounts reversed during the period

Comparison b/w ICDS X & AS 29

- Treatment of 'onerous contracts' is not covered under ICDS.
- For recognition of income from contingent asset, there should be a ***reasonable certainty*** that inflow of economic benefit will arise as per ICDS, whereas AS-29 requires ***virtual certainty*.**
- For recognition of Reimbursement of any expenditure, there should be a *reasonable certainty* that reimbursement will be received as per ICDS, whereas AS-29 requires *virtual certainty*.

Type of provisions & relevant provisions of the Act

- Depreciation: Section 32
- Gratuity: Section 40A(7)
- Liquidated damages
- Doubtful debts: Section 36(1)(vii)/ (viia)
- Leave Encashment: Section 43B
- and other provisions

Could the provision be allowed on the basis of probable conditions...........

- **Judicial Decisions overruled by ICDS X**
- **Himalaya Machinery (P.) Ltd. *v.* DCIT[2011] 16 taxmann.com 60 (Guj.) :** The assessee made provision for warranty obligation, in view of fact that actual expenditure incurred during relevant year was more than provision made, assessee's claim in respect of said provision was to be allowed
- **FL Smidth Minerals (P.) Ltd. *V.* DCIT [2013] 36 taxmann.com 72 (Madras) :** A company making reliable estimate of liquidated damages based on performance capacity and quality and materials relating to machinery, its claim for provision towards damages was fully allowable
- Refer: **Kone Elevator India (P.) Ltd. V. ACIT [2012] 21 taxmann.com 81 (Madras)**
- **Rotork Controls India (P.) Ltd. V. CIT [2009] 180 TAXMAN 422 (SC)**

Observations…

- Due to non-inclusion of onerous contract in ICDS, the expected loss cannot be recognised as provision in the current period. Therefore, the amount of profit during the current year will increase on reversal of any outstanding amount of provision made in the preceding year.

- There will be no impact on computation of income due to change in criteria of recognition of Contingent Asset.

- **Amendment to Finance Act, 2015 to "align ACT with ICDS"**

  Second proviso to section 36(1)(vii) inserted to provide for the deduction of bad debts, in regard to income recognised as per the ICDS without recording in books of accounts, in the year in which such debt '**becomes irrecoverable**'- deemed to be written off in accounts.

Transitional Provisions

- All the provisions or assets and related income shall be recognized 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 recognized, if any, for the same for any previous year ending on or before 31st day of March, 2015.

Note: It is not made clear whether transitional provision requires recognition of all past accumulated contingent assets in F.Y. 2015-16.

Disclosure requirements under ICDS X

- For each class of provision:
  - A brief description of the nature of the obligation
  - carrying amount at the beginning and end of the period
  - additional provisions made in the previous year and increase in existing provisions.
  - amounts used, that is incurred & charged against the provision, during the previous year
  - unused amounts reversed during the previous year
  - Amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.

- **For each class of asset:**
  - A brief description of the nature of the asset & related income;
  - The carrying amount of asset at the beginning and end of the previous year;
  - Additional amount of asset &related income recognized during the year, including increases to assets and related income already recognized; &
  - Amount of asset and related income reversed during the previous year.

General Impact of all ICDSs

General Impact of all ICDSs

- It will result in increase in administration cost.
- The difference in Accounting Income and Taxable Income will result in Increase in deferred tax assets/liabilities.
- It will reduce litigations because of standards providing the definite method of computation of income and also the proper disclosure require by the authorities.
- Non-compliance of ICDS result into Assessment u/s 144 of the Income Tax act, 1961.
- ICDS are applicable for computing advance tax for Quarter ending 30-06-2015.
- ICDS are also considered for Tax Audit.

Note: No need to maintain separate set of books of account for the purpose of ICDS

Issue required to be considered……

- The return form and Form 3CD should be modified according to ICDS issued.
- The clarity on the tax position in ICDS in alignment with the IND AS is required as from 1st April, 2016 the IND AS will be applicable.

THANK YOU…!!

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