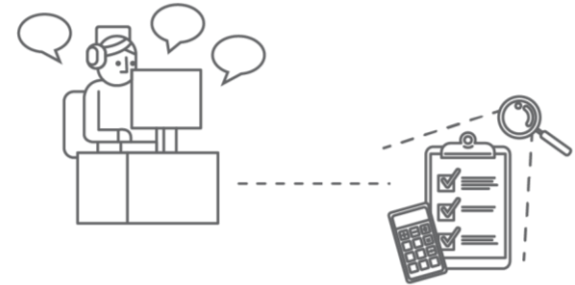


# INCOME COMPUTATION AND DISCLOSURE STANDARDS ('ICDS')

**NEWSFLASH : REVISED ICDS NOTIFIED ON 29 SEPTEMBER 2016**

**A COMPARISON FOR UNDERSTANDING**



7 October 2016

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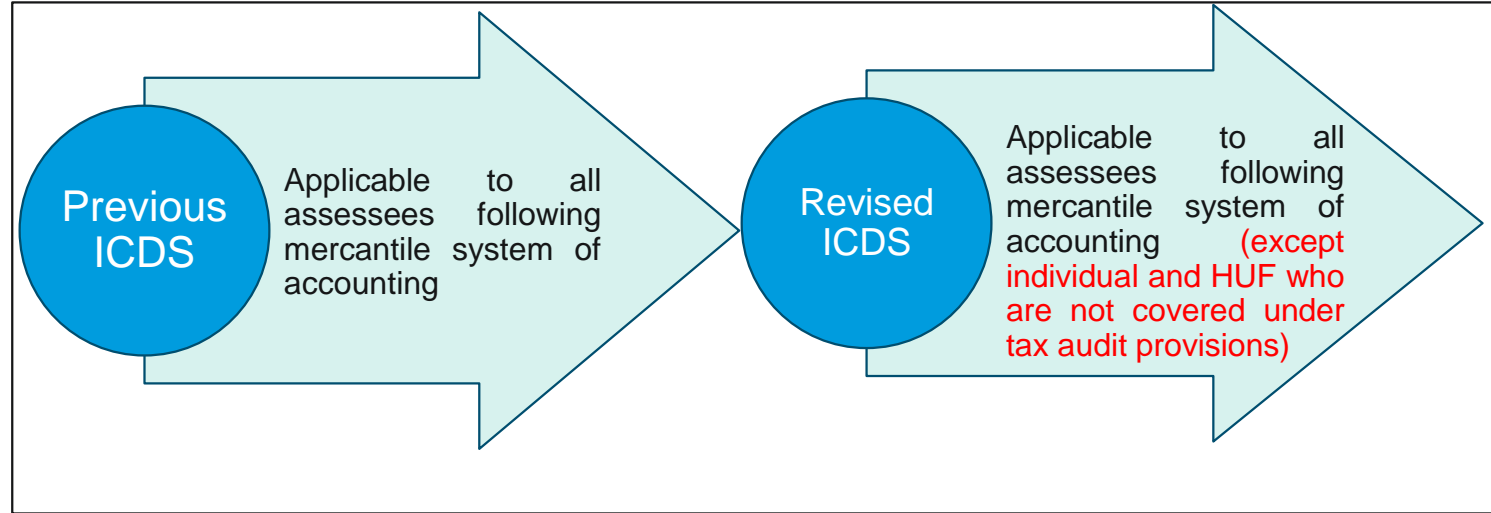
- The Central Government had notified 10 Income Computation and Disclosure Standards ('ICDS') vide Notification No. 32 of 2015 dated 31 March 2015
- The notified ICDS were applicable to all assesseees following mercantile system of accounting for computation of income chargeable under the head 'profits and gains from business or profession' and 'income from other sources' from AY 2016-17 onwards
- Subsequent to notification of the ICDS, owing to various implementation issues, a number of representations were received which were examined by an Expert Committee. In response to the same, the Committee had recommended amendments to the notified ICDS and also issuance of clarification in respect of certain points raised by the stakeholders
- The Ministry of Finance deferred the applicability of ICDS by one year (Press Release dated 6 July 2016) for considering the recommendations of Expert Committee and making suitable changes to tax audit forms. As such, the ICDS is now applicable from AY 2017-18 onwards.
- **The CBDT, through its Notification no. 86/2016 rescinded the ICDS issued vide notification no. 32 /2015 on 29 September 2016.**
- **It further issued revised ICDS (after making certain significant changes) vide Notification no. 87/2016 and also made suitable changes to tax audit forms vide Notification no. 88/2016.**

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## Applicability



It may be noted that there are no revisions in ICDS I (Accounting Policies), ICDS VII (Government Grants) and ICDS X (Provisions, Contingent Liabilities and Contingent Assets)

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## 1. Definition of Cost of Services amended to exclude service providers

| Previous ICDS   | Revised ICDS   |
|---|--|
| <b>Cost of Services:</b><br><br>The costs of services in case of service provider shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads | <b>Cost of Services:</b><br><br>The costs of services <del>in case of service provider</del> shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads |

### Our Comments

As per Previous ICDS, it was contemplated that even service providers need to maintain inventory records for the work in progress as on 31 March of the financial year. However, there were various concerns about the valuation of inventory in case of service providers. Further, the principles set out for service providers in ICDS-IV (Revenue Recognition) were contradicting with that of ICDS-II. The revised ICDS has removed the reference to service provider to align ICDS-IV with ICDS-II.

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## 2. Standard Cost Method for valuing inventories allowed

### Previous ICDS

The Previous ICDS had de-recognized the concept of standard costing in valuation of inventories due to which the entities following standard costing needed to change the method to FIFO or weighted average

### Revised ICDS

As per revised ICDS, standard cost method allowed for convenience if the results approximates the actual cost. The same needs to be reviewed regularly

### Disclosure Requirements

Details of inventories for which standard costing is used and confirmation that standard cost approximates actual cost needs to be provided as a part of disclosure requirements

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## 3. Change in application of retail method

| Previous ICDS   | Revised ICDS  |
|---|---|
| <p>Where it is impracticable to use the costing methods, the retail method can be used in the retail trade for measuring inventories of large number of rapidly changing items that have similar margins. The cost of the inventory is determined by reducing from the sales value of the inventory, the appropriate percentage gross margin.</p> | <p>Where it is impracticable to use the costing methods, the retail method can be used in the retail trade for measuring inventories of large number of rapidly changing items that have similar margins. The cost of the inventory is determined by reducing from the sales value of the inventory, the appropriate percentage gross margin.</p> <p><b>An average percentage for each retail department is to be used.</b></p> |

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## Revision in Transition Provisions

| Previous ICDS   | Revised ICDS  |
|---|---|
| <p>Transition Provision –</p> <p>Contract Revenue and Contract Costs associated with the construction contract which commenced on or before 31 March 2015 shall be recognized as per provision of ICDS – III after taking into account the amount of revenue, cost or expected loss recognized in earlier years</p> | <p>Transition Provision –</p> <p>Contract Revenue and Contract Costs associated with the construction contract which commenced on or after 1 April 2016 shall be recognized as per provision of ICDS – III</p> <p>Contract Revenue and Contract Costs associated with the construction contract which commenced on or before 31 March 2016 but not completed by the said date, shall be recognized based on method regularly followed by the person prior to 1 April 2016</p> |

The revised ICDS provides relief to the persons engaged in construction contract as they shall be allowed to follow their regular accounting practice for the construction contracts which commenced before 1 April 2016

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## 1. Change in revenue recognition from service contracts

### Revenue Recognition as per revised ICDS

Revenue from service transactions shall be recognized on percentage completion method. The requirements of ICDS – III, shall mutatis mutandis apply to recognition of revenue from service contracts

Service including indeterminate number of acts

When service is provided by an indeterminate number of acts over a specific period of time, revenue may be recognized on straight line basis over the specific period

Revenue Recognition from service contracts

Duration ≤ 90 days

Revenue from service contracts with duration of not more than 90 days may be recognized under completed contract method

The specific provisions related to indeterminate no. of acts and service contracts with duration ≤ 90days have been inserted in revised ICDS.



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## 2. Exclusion granted for interest on refund of any tax, duty or cess

### Recognition of revenue from interest

#### Previous ICDS

Interest shall be accrued on the time basis determined by the amount outstanding and the rate applicable

#### Revised ICDS

Interest shall be accrued on the time basis determined by the amount outstanding and the rate applicable

**Interest on refund of any tax, duty or cess shall be taxable on receipt basis**

**Interest on Income-tax, Service Tax, etc. shall now be taxable on receipt basis instead of accrual basis as contemplated under Previous ICDS**

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## 3. Contradicting Transition Provisions ?

### Transition Provisions of ICDS IV

**Para 11** - The Transitional provisions of ICDS - III shall mutatis mutandis apply to the recognition of revenue and the associated costs for a service transaction undertaken on or before the 31st day of March, 2016 but not completed by the said date

#### **Transition provisions of ICDS III**

Contract Revenue and Contract Costs associated with the construction contract which commenced on or before 31 March 2016 but not completed by the said date, shall be recognized based on method regularly followed by the person prior to 1 April 2016

**Para 12** - Revenue for a service transaction undertaken on or before the 31st day of March, 2016 but not completed by the said date shall be recognised in accordance with the provisions of this standard after considering the amount recognized in earlier years.

**Revenue from service transactions undertaken on or before 31 March 2016 but not completed by the said date shall be recognized as per regular accounting practice or as per provisions of ICDS IV?**

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## Requirement of maintaining details of jointly owned tangible assets omitted

| Previous ICDS  | Revised ICDS  |
|--|---|
| <p>Where a person owns tangible fixed assets jointly with others, the proportion in the actual cost, accumulated depreciation and written down value is grouped together with similar fully owned tangible fixed assets.</p> <p>Details of such jointly owned tangible fixed assets shall be indicated separately in the tangible fixed assets register.</p> | <p>Where a person owns tangible fixed assets jointly with others, the proportion in the actual cost, accumulated depreciation and written down value is grouped together with similar fully owned tangible fixed assets.</p> <p><del>Details of such jointly owned tangible fixed assets shall be indicated separately in the tangible fixed assets register.</del></p> |

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## Concept of Integral / Non-Integral removed in foreign operations

### Previous ICDS

#### Translating the financial statements of foreign operations

##### **Integral**

The financial statements shall be translated using the principles and procedures as if the transactions of the foreign operation had been those of the person himself

##### **Non-Integral**

- The assets and liabilities shall be translated at closing rate
- Income and expense items shall be translated at exchange rate on the date of transactions
- The resulting exchange differences shall be transferred to profit and loss account.

### Revised ICDS

#### Translating the financial statements of foreign operations

The financial statements shall be translated using the principles and procedures as if the transactions of the foreign operation had been those of the person himself

**While there will be no change in translation of financial statements of integral operations, the translation in case of non-integral foreign operation shall undergo a change. Also, the transitioning aspect shall be looked into**

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## Translation of foreign currency transactions – Clarification inserted with regards inventory carried at fair value

### Previous ICDS

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

### Issue

Issue arose with regards non-monetary items being inventory carried at fair value as AS-II prescribed date of determining the NRV while the ICDS – VI prescribed exchange rate at the date of the transaction. The same led to difference in valuation on inventory as per AS-II and ICDS-VI r.w ICDS-II

### Revised ICDS

Clarification issued that non-monetary items being inventory carried at fair value shall be converted at rate prevailing on date when such NRV is determined which is as per provisions of AS-II.

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| Particulars   | Previous ICDS   | Revised ICDS   |
|---|---|--|
| <b>Definition of securities</b>   | “Securities” shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) other than derivatives referred to in sub-clause (ia) of that clause (h). | <p>“Securities” shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) <b>and shall include share of a company in which public are not substantially interested</b> but shall not include derivatives referred to in sub-clause (ia) of that clause (h).</p> <p><b>Comment :</b> The provisions of ICDS – VIII shall also be applicable to share of a company in which public are not substantially interested</p> |
| <b>Valuation of securities (when cost cannot be ascertained by specific identification)</b> | The cost of such security shall be determined on basis of FIFO method.  | The cost of such security shall be determined on basis of FIFO method <b>or weighted average formula.</b>  |

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| Particulars   | Previous ICDS | Revised ICDS  |
|---|---------------|---|
| <b>Part – B inserted<br/>(Securities held by<br/>scheduled bank or<br/>public financial<br/>institutions)</b> | No provisions | <p><b>Securities shall be classified, recognised and measured in accordance with the existing guidelines issued by the Reserve Bank of India in this regard and any claim for deduction in excess of the said guidelines shall not be taken into account.</b></p> <p><b>To this extent, the provisions of ICDS VI (Effect of changes in foreign exchange rates) relating to forward exchange contracts shall not apply.</b></p> |

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## 1. Clarification with regards capitalization in case of qualifying asset in the nature of inventory

In the revised ICDS, it has been clarified that capitalization in the context of inventory shall mean addition of the borrowing cost to the cost of inventory.

By implication, it shall mean that the borrowing cost in case of inventory will be added to inventory and shall be taken to the credit side of profit and loss account as inventory is a revenue item.

## 2. Definition of Qualifying asset amended for capitalization of borrowing costs in case of general borrowings

As per Previous ICDS, borrowing costs were needed to be capitalized in case of specific borrowings and general borrowings even if the assets (except inventory) took less than twelve months of time for its acquisition, construction or production.

**However, in case of capitalization of general borrowings cost, a qualifying asset has been defined to be an asset that necessarily require a period of twelve months or more for its acquisition, construction or production.**

By implication, it seems that there shall be no need to capitalize general borrowing costs in case of asset which require less than 12 months of time for its acquisition, construction or production



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## 3. Issue regarding time period for capitalization of borrowing costs

### Previous ICDS

#### Para 5 & 6 - Borrowing Costs eligible for capitalization

**Specific Borrowings** – The actual borrowing costs incurred during the period on the funds so borrowed

**General borrowings** – As per prescribed formula

### Issue

While Para 8 of Previous ICDS specified the cessation date of capitalization, the said reference was not made in para 5 and para 6 owing to mismatch between period of capitalization as per Para 5 & 6 and that of Para 8

### Revised ICDS

As per revised ICDS, the borrowing costs eligible for capitalization is made subject to Para 8 (cessation of capitalization) so as to rectify the mismatch of periods

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Tax Audit Forms have been suitably modified to include:

## 1. Adjustments pertaining to ICDS

The adjustments pertaining to the ICDS shall be mentioned in clause 13 of appendix-II in Form 3CD as under:

| ICDS No. | Name of the ICDS | Increase in profit (Rs.) | Decrease in profit (Rs.) | Net (Rs.) |
|----------|------------------|--------------------------|--------------------------|-----------|
|          |                  |                          |                          |           |

## 2. Disclosure

The disclosure requirements of each ICDS shall form part of Clause 13(f) of the Form 3CD.

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- The revised ICDS shall be applicable for AY 2017-18 onwards and the same are mandatory to be followed by all assesseees following mercantile system of accounting (except individual and HUF not covered under tax audit provisions)
- Non-compliance of the said ICDS may result into best judgement assessment as per provisions of section 144 of the IT Act, 1961 in addition to the interest and penalty exposure.
- The clarifications / amendments in the revised ICDS have settled some of the implementation issues, however, there are still many gaps which needs to be filled.
- As the ICDS are laid out keeping the accounting standards as base, the compliance of ICDS in Ind-AS regime will pose a challenge which needs to be dealt with.
- In such a scenario, it may be advisable to undertake an ICDS impact assessment to ascertain the impact of ICDS on advance tax installments which are impending and effectively comply with and adopt the revised ICDS.

## Impact Assessment of ICDS

- Analyzing the difference between current tax computation and requirements of revised ICDS
- Evaluating the impact of each ICDS on the Company
- Effective transition and adoption

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This newflash is general in nature. In this newflash, we have summarised the revised ICDS issued vide notification no. 87/2016. It may be noted that nothing contained in this newflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain applicability or otherwise of the said scheme and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this newflash.

8 October 2016

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