Income Computation and Disclosure Standards

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Brief History of ICDS

- Earlier Vide Notification No. 9949 **DATED 25-1-1996, two accounting standards were issued:**
- Accounting Standard I relating to disclosure of accounting policies
- Accounting standard II relating to disclosure of prior period and extraordinary items and changes in accounting policies

History of ICDS

- 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.
- In October, 2012, 14 draft TAS issued inviting stakeholders comments/ suggestions. [These included Events Occurring After the Previous Year, Prior Period Items, Leases, Intangible Assets which do not find place in list of final 10]
- In January, 2015, after examining the comments received from stakeholders, Committee issued new draft of 12 ICDS inviting stakeholders' comments. [These Included Leases, Intangible Assets and ICDS on Events Occurring After the Previous Year and Prior Period Items were dropped out.]
- After prolonged discussions, dialogues and debates, finally, on March 31st 2015, **10 Income Computation & Disclosure Standards ('ICDS') were** notified. [In List of final 10, ICDS on Leases and Intangible Assets was also dropped Out]

Section 145(1) of Income Tax Act 1961 :Method of Accounting

- **145.** (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**.

145(2): Income Computation and Disclosure Standards

- (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**.

Consequences of Non Compliance [Section 145(3)]

- (3) Where the Assessing Officer is **not satisfied about the correctness or completeness of the accounts of the assessee**, or where the **method of accounting provided in sub-section (1) *has not been regularly followed by the assessee***, or ***income has not been computed in accordance with the standards notified under sub-section (2)***, the Assessing Officer may make an assessment in the manner provided in section 144

Analysis of Amendment in 145(3)

- **Note: Before Amendmend by Finance Act 2014 If accounting standards as notified under sub-section (2), have not been regularly followed by the assessee,** AO could make assessment under 144.
- Thus books of accounts by implication were required to be maintained as per Accounting standards to be notified by Central Government.

Circular 1/2015 [Explanatory Notes to Provisions of Finance Act 2014] Para 44

44.1 The Finance Act, 1995 empowered the Central Government to notify Accounting Standards (AS) for any class of assessee or for any class of income. Since the introduction of these provisions, only two Accounting Standards relating to disclosure of accounting policies and disclosure of prior period and extraordinary items and changes in accounting policies have been notified.

Circular 1/2015 [Explanatory Notes to Provisions of Finance Act 2014] Para 44

- 44.2 The Central Board of Direct Taxes **(CBDT) had constituted an Accounting Standard Committee in 2010**. The Committee has submitted its **Final Report in August, 2012**. The Committee recommended that the **AS notified under the Income-tax Act should be made applicable only to the computation of taxable income** and a taxpayer should not be required to maintain books of account on the basis of AS notified under the Income-tax Act.

Circular 1/2015 [Explanatory Notes to Provisions of Finance Act 2014] Para 44

- The Final Report of the Committee was placed in public domain for inviting comments from stakeholders and general public. After examining the comments/suggestions, the Committee, *inter alia*, **recommended that the provisions of section 145 of the Income-tax Act may be suitably amended to clarify that the notified AS are not meant for maintenance of books of account but are to be followed for computation of income**

Circular 1/2015 [Explanatory Notes to Provisions of Finance Act 2014] Para 44

44.3 In order to clarify that the standards notified under subsection (2) of section 145 of the Income-tax Act are to be followed for computation of income and disclosure of information by any class of assessees or for any class of income, section 145(2) has been amended to provide that 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.

Circular 1/2015 [Explanatory Notes to Provisions of Finance Act 2014] Para 44

- 44.3.1 Section 145(2) has been further amended to provide that the Assessing Officer may make an assessment in the manner provided in section 144 of the Income-tax Act, if the income has not been computed in accordance with the standards notified under subsection (2) of section 145 of the Income-tax Act.

Circular 1/2015 [Explanatory Notes to Provisions of Finance Act 2014] Para 44

- *44.4 Applicability:*—<u>These amendments take effect from 1st April, 2015 and will, accordingly, apply in relation to the assessment year 2015-16 and subsequent assessment years</u>

NOTIFICATION NO.32/2015 [F. NO. 134/48/2010-TPL]/SO 892(E), DATED 31-3-2015

- In supersession of the notification of the Government of India in the Ministry of Finance, Department of Revenue, published in the Gazette of India, Part II, Section 3, Sub-section (ii), vide number S.O 69(E) dated the 25th January, 1996, except as respects things done or omitted to be done before such supersession, the Central Government hereby notifies the income computation and disclosure standards as specified in the Annexure **to be followed by all assessees, following the mercantile system of accounting for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or " Income from other sources"** **[Hence ICDS are not applicable to Cash System of accounting]**
- **This notification shall come into force with effect from 1st day of April, 2015, and shall accordingly apply to the assessment year 2016-17 and subsequent assessment years.**

Preamble to all the 10 ICDS promulgates following postulates

- This Income Computation and Disclosure Standard is applicable 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**.
- In Income Tax Return for AY 2016-17, a New Schedule ICDS has been incorporated in ITRs to reflect the effect of Income Computation and Disclosure Standards on Profit

Schedule on ICDS Incorporated in ITRs

Schedule ICDS	Effect of Income Computation Disclosure Standards on profit	
Sl. No.	ICDS	Amount
(i)	(ii)	(iii)
I	Accounting Policies	
II	Valuation of Inventories	
III	Construction Contracts	
IV	Revenue Recognition	
V	Tangible Fixed Assets	
VI	Changes in Foreign Exchange Rates	
VII	Government Grants	
VIII	Securities	
IX	Borrowing Costs	
X	Provisions, Contingent Liabilities and Contingent Assets	
11.	**Total Net effect (I+II+III+IV+V+VI+VII+VIII+IX+X)**	

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Schedule 10A **Deduction under section 10A**

A **Deduction in respect of units located in Special Economic Zone**

Deemed treatment in accounts when ICDS are followed

- As per S.36(1)(vii) deduction is allowed for the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year:

- **Following second proviso inserted after the first proviso to clause (*vii*) of sub-section (1) of section 36 by the Finance Act, 2015, w.e.f. 1-4-2016 : Provided further** *that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under sub-section (2) of section 145 without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause.*

Preamble- Conflict between ICDS and Provisions of Act

- In the case of **conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard**, the provisions of the Act shall prevail to that extent.
- Also Held by Supreme Court in U.P. State Industrial Development Corporation 225 ITR 703:It is a well accepted proposition that "for the purposes of ascertaining profits and gains the ordinary principles of commercial accounting should be applied, so long as they do not conflict with any express provision of the relevant statute."

Words and Expressions not defined in ICDS

- Except for ICDS-I regarding Disclosure of Significant Accounting Policies, it is mentioned in all the ICDS
- Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meanings assigned to them in that Act

Whether ICDS shall prevail over Court Judgments under General Provisions of the law

- Since the provisions of law shall prevail over the ICDS.
- There may be a view point that since the Court pronouncements only interpret the provisions of law and do not enact law, the ICDS can not prevail over court Judgments.
- If such a view is adopted, it shall dilute the very existence the ICDS.

Income Computation and Disclosure Standard I relating to accounting policies

Scope

- This Income Computation and Disclosure Standard deals with significant accounting policies

Fundamental Accounting Assumptions

- The following are fundamental accounting assumptions, namely: -
- (*a*) **Going Concern**
- "Going concern" refers to the assumption that the person has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the **business, profession or vocation** and intends to continue his business, profession or vocation for the foreseeable future.

  Comments: In accounting standard the word operation is mentioned.
- (*b*) **Consistency**
- "Consistency" refers to the assumption that accounting policies are consistent from one period to another;
- (*c*) **Accrual**
- "Accrual" refers to the assumption that revenues and costs are accrued, that is, recognized as they are earned or incurred (and not as money is received or paid) **and recorded in the previous year to which they relate.**

Accounting Policies

- The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by a person.

Considerations in the Selection and Change of Accounting Policies

Accounting policies adopted by a person shall be such so as to represent a true and fair view of the state of affairs and income of the business, profession or vocation.

For this purpose,

(i) the treatment and presentation of transactions and events shall be governed by their substance and not merely by the legal form; and

(ii) **marked to market loss or an expected loss shall not be recognised unless the recognition of such loss is in accordance with the provisions of any other Income Computation and Disclosure Standard.**

[Mum Trib. in kotak Mahindra had held that on MTM derivatives held as SIT
loss is allowable]

Comments: Whether Provision for warranty, leave encashment, gratuity to be disallowed being expected losses

a) Supreme Court Judgment in Rotork Controls India P. Ltd. v. Commissioner of Income Tax [2009] 314 ITR 62 (SC) where in it was held that provision for warranty expenses is allowable if the warranty provisions are based on experience and historical trends.

b) Supreme Court Judgment in Bharat Earth Movers held that provision for leave encashment being proportionate with the entitlement earned by employees of the company subject to the ceiling on accumulation as applicable on the relevant date, is entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability. The liability is not a contingent liability.

c) In Metal Box Company case 73 ITR 53, SC allowed deduction for provision for gratuity calculated on acturial valuation basis.

Supreme Court on Estimated Accrued Liability

- Calcutta Co. Ltd. Vs. Commissioner of Income-Tax, West Bengal (1959) 37 ITR 1 wherein Supreme court has held that the liability on the assessee having been imported, **the liability would be an accrued liability and would not convert into a conditional one merely because the liability was to be discharged at a future date. There may be some difficulty in the estimation thereof but that would not convert the accrued liability into a conditional one**; it was always open to the tax authorities concerned to arrive at a proper estimate of the liability having regard to all the circumstances of the case.

Comments

Following Two Considerations for selection of accounting policy do not find place in ICDS

- **Prudence** In view of the uncertainty attached to future events, profits are not anticipated but recognized only when realized though not necessarily in cash. **Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.**
- Forsaking the concept of Prudence and mandating not to claim expected losses shall whether result in not making a provision for gratuity, leave encashment , warranty etc.
- **Materiality** Financial statements should disclose all "material" items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements.
- While ICDS-I requires deals with significant accounting policies it can not be equated with material items. Hence immaterial items also to be disclosed ?
- The Concept of Materiality and Prudence existed in IT-AS-1 dated 25-01-1996

Change in Accounting Policy

- An accounting policy shall not be changed without reasonable cause.
- Comments: What is reasonable cause ?
- As per Para 29 of AS-5, a change in accounting policy can be made:
- a) If adoption of different accounting policy is required by statute.
- b) For compliance with accounting standard or
- C) If it is considered that change would result in more appropriate presentation of financial statements of enterprise
- Further as per Para 30 of AS-5, more appropriate presentation of financial statements of enterprise occurs when the new accounting policy results in more relevant or reliable information about the financial position, performance or cash flows of the enterprise.
- Change in method of accounting in view of mandatory requirements of AS-7 is a *bona fide* reason for change, particularly in view of qualification made in this regard by statutory auditors as well as by Comptroller & Auditor General of India - *Mazagon Dock Ltd.* v. *Jt. CIT* [2009] 29 SOT 356 (Mum.)

Comments on Change in Accounting Policy

- Following, however, are not change in accounting policy as per Para 31 of AS-5:
- (a) the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, e.g., introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement; and

  (b) the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

Disclosure of Accounting Policies

- **All significant accounting policies adopted by a person shall be disclosed**
- Comments :Not mentioned whether it should form part of financial statements. Also not mentioned that they should be disclosed at one place instead of being scattered over several statements, schedules and notes

Disclosure of Change in Accounting Policy

- Any change in an accounting policy which has a material effect shall be disclosed.
- The amount by which any item is affected by such change shall also be disclosed to the extent ascertainable. **<u>Where such amount is not ascertainable, wholly or in part, the fact shall be indicated</u>**.
- If a change is made in the accounting policies which has no material effect for the current previous year but which is reasonably expected to have a material effect in later previous years, the fact of such change shall be appropriately disclosed in the previous year in which the change is adopted **<u>and also in the previous year in which such change has material effect for the first time.</u>**
- **<u>Comments:"and also in the previous year in which such change has material effect for the first time"</u>** This requirement did not prevail in Accounting Standard -1 AND Para 32 of AS-5

Wrong treatment not remedied by Disclosure

- Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item

Disclosure Requirements regarding Fundamental Accounting Assumptions

- If the fundamental accounting assumptions of Going Concern, Consistency and Accrual are followed, specific disclosure is not required.
- If a fundamental accounting assumption is not followed, the fact shall be disclosed

Transitional Provisions

- All contract or transaction existing on the 1st day of April, 2015 or entered into on or after the 1st day of April, 2015 shall be dealt with in accordance with the provisions of this standard after taking into account the income, expense or loss, if any, recognized in respect of the said contract or transaction for the previous year ending on or before the 31st March, 2015
- Comments: For example if deduction for provision for gratuity, warranty already allowed in earlier year, then expense for financial 2015-16 and subsequent years to be allowed after reducing loss already allowed.

Income Computation and Disclosure Standard II relating to valuation of inventories

Scope

- This Income Computation and Disclosure Standard shall be applied for valuation of inventories, except :
- (*a*) Work-in-progress arising under 'construction contract' **<u>including directly related service contract</u>** which is dealt with by the Income Computation and Disclosure Standard on construction contracts; [Dealt by ICDS III]
- (*b*) Work-in-progress which is dealt with by other Income Computation and Disclosure Standard; [As per AS-2, WIP of service providers not dealt. However since ICDS-II deals with inventory of service providers also, their WIP has not been excluded unlike AS-2]
- (*c*) Shares, debentures and other financial instruments held as stock-in-trade which are dealt with by the Income Computation and Disclosure Standard on securities; [Dealt in ICDS-VIII]
- (*d*) Producers' inventories of livestock, agriculture and forest products, mineral oils, ores and gases to the extent that they are measured at net realizable value;
- The inventories referred to in paragraph (d) are measured at net realizable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or mineral oils, ores and gases have been extracted and sale is assured under a forward contract or a government guarantee, or when a homogenous market exists and there is a negligible risk of failure to sell. These inventories are excluded from the scope of this Standard Dealt by ICDS-V

Scope of ICDS-II Contd…

(*e*) Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular, shall be dealt with in accordance with the Income Computation and Disclosure Standard on tangible fixed assets.

Definitions

- "**Inventories**" are <u>**assets**</u>:
- held for sale in the ordinary course of business
- in the process of production for such sale
- in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- [Inventory does not refer to goods only. Hence land and property held for resale shall also be covered by ICDS-II]
- "**Net realisable value**" is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale

Measurement

- Inventories shall be valued at cost, or net realizable value, whichever is lower

Cost of Inventories

- Cost of inventories shall comprise of all costs of purchase, **costs of services**, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
- Cost of service is not there in AS-2

Costs of Purchase

- The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates and other similar items shall be deducted in determining the costs of purchase.
- As per AS-2, duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) are part of Cost of Inventories. ICDS-II is silent. **So, Section 145A to be complied with**. **As per Punjab and Haryana High Court in M/s. Avery Cycles [on 07-01-2015] and Supreme Court in Indo Nippon Chemical Industries 261 ITR 275, computation of opening, closing stock, purchases and sales as per S.145A does not adversely impact the computation of Income.**
- **Further as per ICDS-V on tangible assets subsequently recoverable taxes and duties have been excluded.**

Costs of Services

- The costs of services in the case of a service provider shall consist of labor and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads.
- **Hence unbilled amount also brought to tax from perspective of service provider.**

Costs of Conversion

- The costs of conversion of inventories shall include costs directly related to the units of production **<u>and a systematic allocation of fixed and variable production overheads</u>** that are incurred in converting materials into finished goods.
- Fixed production overheads shall be those indirect costs of production that remain relatively constant regardless of the volume of production.
- Variable production overheads shall be those indirect costs of production that vary directly or nearly directly, with the volume of production.

Allocation of Fixed Production Overheads

- The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion shall be based on the normal capacity of the production facilities. Normal capacity shall be the production expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. **<u>The actual level of production shall be used when it approximates to normal capacity</u>**.
- **<u>The amount of fixed production overheads allocated to each unit of production shall not be increased as a consequence of low production or idle plant</u>. Unallocated overheads shall be recognized as an expense in the period in which they are incurred**.
- In periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above the cost.
- **<u>Variable production overheads</u>** shall be assigned to each unit of production on the basis of the actual use of the production facilities

Example on Allocation of Fixed Overheads

- **E.g. Fixed OH= 100000**
- **Normal Capacity= 10,000 units**
- **Actual Prod= 9500 units. Cost per Unit = 100000/9500**
- **Low Production = 5000 units. Cost per Unit = 100000/9500**
- **Very High Production= 20,000 units. Cost per Unit = 100000/20000**
- **This will result in undervaluation of inventory in period of low production. Hence method of allocating Fixed overheads is taxpayer friendly.**

- **How to determine normal capacity in first year?**
- **What if first year was abnormally high production year and next year it fell down heavily.**

Joint Products

- Where a production process results in more than one product being produced simultaneously and the costs of conversion of each product are not separately identifiable, the costs shall be allocated between the products on a **rational and consistent basis**.
- **What is rational and consistent ? Units of Production or Sale Value ? Allocation disputes shall arise where net realizable value of one of products is lesser than value so allocated. Method of allocation not required to be disclosed**

By Products

- Where by products, scrap or waste material are **immaterial**, they shall be measured at net realizable value and this value shall be deducted from the cost of the main product.
- Whether this implies that difference in joint product and bye product is comparison of their net realizable value and allocated value

Other Costs

- Other costs shall be included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

Interest and other borrowing costs

- Interest and other borrowing costs shall not be included in the costs of inventories, unless they meet the criteria for recognition of interest as a component of the cost as specified in the Income Computation and Disclosure Standard on borrowing costs.

Exclusions from the Cost of Inventories

- In determining the cost of inventories in accordance with paragraphs 4 to paragraphs 11, the following costs shall be excluded and recognized as expenses of the period in which they are incurred, namely: -
- (*a*)Abnormal amounts of wasted materials, labour, or other production costs;
- (*b*)Storage costs, <u>unless those costs are necessary in the production process prior to a further production stage</u>;
- **E.g. Paddy kept in sileo**
- (*c*)Administrative overheads that do not contribute to bringing the inventories to their present location and condition ;
- (*d*) Selling costs.

Cost Formulae- Specific Identification

- The Cost of inventories of items
- (*i*) that are not ordinarily interchangeable; and
- (*ii*) goods or services produced and segregated for specific projects shall be assigned by specific identification of their individual costs.
- 'Specific identification of cost' means specific costs are attributed to identified items of inventory
- Where there are a large numbers of items of inventory which are ordinarily interchangeable, specific identification of costs shall not be made

First-in First-out and Weighted Average Cost Formula

- 16. Cost of inventories, other than the inventory dealt with in paragraph 13, shall be assigned by using the First-in First-out (FIFO), or weighted average cost formula. The formula used shall reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.
- 17. The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the **weighted average of the cost of similar items at the beginning of a period** and the cost of similar items purchased or produced during the period. The average shall be calculated on a **periodic basis, or as each additional shipment is received, depending upon the circumstances.**

Retail Method

- Where it is impracticable to use the costing methods referred to in paragraph 16, 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**. The percentage used takes into consideration inventory, which has been marked down to below its original selling price.
- **As per AS-2,** An average percentage for each retail department is often used. Whether as per ICDS-II, separate percentage for each class of product with in each retail department to be used.

Net Realizable Value

- Inventories shall be written down to net realizable value on an **item-by-item basis**.
- Where 'items of inventory' relating to the same product line having similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line, such inventories shall be **grouped together** and written down to net realizable value on an aggregate basis.

Net Realizable Value

- Net realizable value shall be based on the most reliable evidence available **at the time of valuation.**
- The estimates of net realisable value shall also take into consideration the **purpose** for which the inventory is held.
- The estimates shall take into consideration fluctuations of price or cost directly relating to **events occurring after the end of previous year** to the extent that such events confirm the conditions existing on the last day of the previous year.

Net Realizable Value

- Materials and other supplies held for use in the production of inventories shall not be written down below the cost, where the finished products in which they shall be incorporated are expected to be sold at or above the cost.
- **Where there has been a decline in the price of materials and it is estimated that the cost of finished products will exceed the net realisable value, the value of materials shall be written down to net realisable value which shall be the replacement cost of such materials.**

Value of Opening Inventory

- The value of the inventory as on the beginning of the previous year shall be
- (*i*) the cost of inventory available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and
- (*ii*) the value of the inventory as on the close of the immediately preceding previous year, in any other case.
- It 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.

Change of Method of Valuation of Inventory

- The method of valuation of inventories once adopted by a person in any previous year shall not be changed without reasonable cause

Valuation of Inventory in Case of Certain Dissolutions

- In case of dissolution of a partnership firm or association of person or body of individuals, <u>**notwithstanding whether business is discontinued or not,**</u> the inventory on the date of dissolution shall be valued at the net realizable value

Case Laws on Valuation in case of Dissolution

- "The Apex Court has held in the case of A.L.A. Firm v. CIT, (1991) 189 ITR 285, that with a view to arrive at the correct picture of trade of the partnership on the date when it ceases to function, the valuation of stock-in-trade should be made on the basis of the prevailing market price, affirming the view taken in the case of G. R. Ramachari and Co. v. CIT, (1961) 41 ITR 142 (Mad.)
- Where firm got dissolved due to death of a partner and business was reconstituted with the remaining partners, and business continued without any interruption, the closing stock was to be valued at the cost or market price, whichever was lower, and not at market value - *Sakthi Trading Co. v. CIT* [2001] 118 Taxman 301 (SC)

Case Laws on Valuation in case of Dissolution

- b) 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 disregarding value shown by assessee at an average cost price, which had been consistently followed by assessee in past - *Asst. CIT v. Kuldip Chand & Sons* [2005] 93 ITD 253 (Amritsar)
- c) Market value has to be adopted where dissolution of firm is accompanied by discontinuance of business and not otherwise - *Kwality Steel Suppliers v. CIT* [2004] 141 Taxman 177 (Guj.)
- d) Partnership firm stood converted into proprietorship firm after retirement of one out of only two partners of the firm, closing stock to be valued at market price instead of book value shown in books of dissolved firm - *Madhu Rani Mehra v. CIT* [2011] 10 taxmann.com 126 (Delhi)
- e) As per Bombay High Cour in A.N. Naik Associates 265 ITR 346 , 45(4) applicable to the cases of retirement also.

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

The following aspects shall be disclosed, namely:

(*a*) the accounting policies adopted in measuring inventories including the cost formulae used; and

(*b*) the total carrying amount of inventories and its classification appropriate to a person.

Income Computation and Disclosure Standard III relating to construction contracts

Scope

- This Income Computation and Disclosure Standard should be applied in determination of income for a construction contract of a contractor

Definitions

- (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:
- **Construction contract**" is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use and includes :

Construction contract [Contd..]

- (i) contract for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects;
- (ii) contract for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

"Fixed price contract

- is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which may be subject to cost escalation clauses.

"Cost plus contract"

- is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a mark up on these costs or a fixed fee

"Retentions"

- are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified.
- **Defined in AS-7 Para 40**

"Progress billings"

- are amounts billed for work performed on a contract whether or not they have been paid by the customer
- **Defined in AS-7 Para 40**

"Advances"

- are amounts received by the contractor before the related work is performed
- **Defined in AS-7 Para 40**

- A construction contract may be negotiated for the construction of a single asset.
- A construction contract may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.
- **Example of Single Contracts**- bridge, building, dam, pipeline, road, ship or tunnel .Example of closely interrelated assets- construction of refineries and other complex pieces of plant or equipment.

Classification of Construction Contracts

- Construction contracts are formulated in a number of ways which, for the purposes of this Income Computation and Disclosure Standard, are classified as fixed price contracts and cost plus contracts. Some construction contracts may contain characteristics of both a fixed price contract and a cost plus contract, for example, in the case of a cost plus contract with an agreed maximum price.

Combining and Segmenting Construction Contracts

- 5. The requirements of this Income Computation and Disclosure Standard shall be applied separately to each construction contract **except as provided for in paragraphs 6, 7 and 8 herein**. For reflecting the substance of a contract or a group of contracts, where it is necessary, the Income Computation and Disclosure Standard should be applied to the separately identifiable components of a single contract or to a group of contracts together.

Multiple Assets in Single Contract

- 6. Where **a contract covers a number of assets**, **the construction of each asset should be treated as a separate construction contract when**:
- (*a*)separate proposals have been submitted for each asset;
- (*b*) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
- (*c*) the costs and revenues of each asset can be identified.

Multiple Contracts to be grouped

7. **A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when**:

(*a*) the group of contracts is negotiated as a single package;

(*b*) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

(*c*) the contracts are performed concurrently or in a continuous sequence.

Construction of Additional Asset

8. Where a contract provides for the **construction of an additional asset** at the option of the customer or is amended to include the construction of an additional asset, the construction of the additional asset should be treated as a separate construction contract when:

(*a*) the asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or

(*b*) the price of the asset is negotiated without having regard to the original contract price.

Contract Revenue

Contract revenue shall be recognized when there is reasonable certainty of its ultimate collection.

Contract revenue shall comprise of:

(*a*) the initial amount of revenue agreed in the contract, **<u>including retentions</u>**; and

(*b*) variations in contract work, claims and incentive payments:

(*i*) to the extent that it is probable that they will result in revenue; and

(*ii*) they are capable of being reliably measured.

Comments on Inclusion of Retention Money in Contract Revenue

Including Retentions not mentioned in AS-7

<u>Explanation in AS-7 regarding contract revenue, variations, claims , incentive payments (para 11-14)</u>

- a) Where retention money and security deposit were repayable to the assessee after completion of the contract to the satisfaction of the contractee, it could not be said that said amount had accrued to assessee and, therefore, could not be taxed in assessee's hand - *CIT v. P & C Constructions (P.) Ltd.* [2009] 318 ITR 113 (Mad.)
- b) 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. The AO was not justified in treating entire contract amount as accrued on submission of bills - *CIT v. Simplex Concrete Piles India (P.) Ltd.* [1989] 45 Taxman 370 (Cal.)]

Comments on Inclusion of Retention Money in Contract Revenue

- c) Retention money could not be said to be accrued to assessee till completion of work - *DIT (International Taxation) v. Ballast Nedam International* [2013] 33 taxmann.com 139 (Gujarat)
- d) Retention money was to be taxed in assessment year relevant to 'previous year' in which it became payable to assessee as per terms of contract - *Amarshiv Construction (P.) Ltd. v. Dy. CIT* [2014] 45 taxmann.com 429 (Gujarat)
- e) Retention money to be brought to tax in the year in which contract was successfully completed irrespective of the fact that assessee had adopted mercantile system of accounting - *Asst. CIT v. B.G.R. Energy Systems Ltd.* [2014] 47 taxmann.com 266 (Hyderabad - Trib.)

Comments on Inclusion of Retention Money in Contract Revenue

f) **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

g) **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 nclusion 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.

Treatment of Uncollectible Contract Revenue

- Where contract revenue already recognized as income is subsequently written off in the books of accounts as uncollectible, the same **shall be recognised as an expense and not as an adjustment of the amount of contract revenue**

Contract Costs

- Contract costs shall comprise of :
- (*a*) costs that <u>relate directly to the specific contract</u>;
- (*b*) costs that are attributable to contract activity in general and can be allocated to the contract;
- (*c*) such other costs as are specifically chargeable to the customer under the terms of the contract; and
- (*d*) allocated borrowing costs in accordance with the Income Computation and Disclosure Standard on Borrowing Costs.
- These costs shall be reduced by any incidental income, not being in the nature of interest, dividends or capital gains, that is not included in contract revenue.

Comments on Contract Costs

Comments

What is directly relatable cost and what is cost attributable to contract activity in general not defined in this ICDS but In AS-7 for directly relatable cost Para 16 and for General Cost Para 17 and for

Cost specifically chargeable to customer in Para 18 may be referred

Costs that relate directly to a specific contract include:[Para 16 of AS-7]

- (a) site labour costs, including site supervision; (b) costs of materials used in construction;
- (c) depreciation of plant and equipment used on the contract;
- (d) costs of moving plant, equipment and materials to and from the contract site;
- (e) costs of hiring plant and equipment;
- (f) costs of design and technical assistance that is directly related to the contract;
- (g) the estimated costs of rectification and guarantee work, including expected warranty costs; and
- (h) claims from third parties.

  These costs may be reduced by any incidental income that is not included in contract revenue, for example income from the sale of surplus materials and the disposal of plant and equipment at the end of the contract

Costs that may be attributable to contract activity in general and can be allocated to specific contracts include [Para 17]

- (a) insurance;
- (b) costs of design and technical assistance that is not directly related to a specific contract; and
- (c) construction overheads.

  Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity.
- Construction overheads include costs such as the preparation and processing of construction personnel payroll.
- Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs as per Accounting Standard (AS) 16, Borrowing Costs.

Costs that are specifically chargeable to the customer [Para 18 of AS-7]

- Costs that are specifically chargeable to the customer under the terms of the contract may include some general administration costs and development costs for which reimbursement is specified in the terms of the contract.

Exclusion from Contract Cost

- Costs that cannot be attributed to any contract activity or cannot be allocated to a contract shall be excluded from the costs of a construction contract.
- As per AS-7 Such costs include:

  (a) general administration costs for which reimbursement is not specified in the contract;

  (b) selling costs;

  (c) research and development costs for which reimbursement is not specified in the contract; and

  (d) depreciation of idle plant and equipment that is not used on a particular contract

Cost of Securing Contract

- Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract.
- Costs that are incurred in securing the contract are also included as part of the contract costs, provided

  (*a*) they can be separately identified; and

  (*b*) it is probable that the contract shall be obtained.
- When costs incurred in securing a contract are recognized as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

Future Activity Cost

- Contract costs that relate to future activity on the contract are recognized as an asset.
- Such costs represent **an amount due from the customer** and are classified as contract work in progress.

Stage of Completion to determine Contract revenue and costs

- **Contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date.**

Expected Losses on Contract not to be recognized in ICDS

- ***[An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35] in Accounting Standard not adopted in ICDS***
- b) Deduction for foreseeable losses allowed by Delhi High Court in *CIT v. Triveni Engg. & Industries Ltd.* [2010] 8 taxmann.com 146
- c) Contentions of assessee regarding allowability of foreseeable losses were accepted principally - *Jacobs Engineering India (P.) Ltd. v. Asst. CIT* [2011] 14 taxmann.com 186 (Mum.)
- d) AS-7 allowed assessee to make provision for foreseeable losses and therefore, said losses provided by assessee in its books of account had to be allowed in year under consideration – *Asst. CIT v. ITD Cementation India Ltd.* [2013] 36 taxmann.com 74 (Mumbai - Trib.)

Expected Losses on Contract not to be recognized in ICDS

- Foreseeable Loss though allowed as per accounting standard is not allowable for Income Tax purpose . (Mahindra & Mahindra) 5 TTJ 567
- 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.)
- In the case of *Essar Oil Ltd.* 13 SOT 691 , the ITAT allowed 2/3 of provision made for foreseeable losses on the basis of percentage of completion of project

Stage of Completion=POCM

- The recognition of revenue and expenses by reference to the stage of completion of a contract is **referred to as the percentage of completion method.**
- Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.
- POCM method also to be used by architects, service providers and also for contracts for demolition and restoration

Determination of Stage of Completion

The stage of completion of a contract shall be determined with reference to:

(*a*) the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs; or

(*b*) surveys of work performed; or

(*c*) completion of a physical proportion of the contract work.

- **Corresponding to Para 30 of AS-7**

Stage of Completion

- Progress payments and advances received from customers are not determinative of the stage of completion of a contract.
- **Para 30 of AS-7**

Stage of Completion by reference to Contract Costs

When the stage of completion is determined by reference to the contract costs incurred upto the reporting date, **only those contract costs that reflect work performed** are included in costs incurred up to the reporting date. Contract costs which are excluded are:

(*a*) contract costs that relate to future activity on the contract; and

(*b*) payments made to subcontractors in advance of work performed under the subcontract.

Comments

- Such as costs of materials that have been delivered to a contract site or set aside for use in a contract but not yet installed, used or applied during contract performance, unless the materials have been made specially for the contract; and

Early Stages of Contract

- During the early stages of a contract, where the outcome of the contract cannot be estimated reliably contract revenue is recognized **only to the extent of costs incurred**. **The early stage of a contract shall not extend beyond 25 % of the stage of completion.**
- It means up to 25% of stage of completion, of outcome of contract can not be estimated reliably, contract revenue= contract cost, thus return with NIL income can be filed. However, when stage of completion exceeds 25%, profit has to be recognized by applying stage of completion to contract revenue also, even if outcome can not be estimated reliably.

Current Estimates to be used for POCM

- The percentage of completion method is applied on a cumulative basis in each previous year to the **current estimates** of contract revenue and contract costs.
- Where there is change in estimates, the changed estimates shall be used in determination of the amount of revenue and expenses in the period in which the change is made and in subsequent periods

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 recognised 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.

Disclosure

A person shall disclose:

(*a*) the amount of contract revenue recognized as revenue in the period; and

(*b*) the methods used to determine the stage of completion of contracts in progress.

24. A person shall disclose the following for contracts in progress at the reporting date, namely: -

(*a*) amount of costs incurred and recognized profits (less recognized losses) upto the reporting date;

(*b*) the amount of advances received; and

(*c*) the amount of retentions.

Income Computation and Disclosure Standard –IV on Revenue Recognition

Deals With

- This Income Computation and Disclosure Standard deals with the bases for recognition of **revenue** arising in the course of the ordinary activities of a person from

(*i*) the sale of goods;

(*ii*) the rendering of services;

(*iii*) the use by others of the person's resources yielding interest, royalties or dividends.

Does not deal with

- This Income Computation and Disclosure Standard does not deal with the aspects of revenue recognition which are dealt with by other Income Computation and Disclosure Standards

Definition of Revenue

- **Revenue**" is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of a person from the sale of goods, from the rendering of services, or from the use by others of the person's resources yielding interest, royalties or dividends.
- **In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.**

Cut off point for recognition of revenue-I

- In a transaction involving the sale of goods, the revenue shall be recognized when the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership

Where transfer of goods does not coincide with transfer of risks and rewards

- In a situation, where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership, revenue in such a situation shall be recognized at the time of transfer of significant risks and rewards of ownership to the buyer.

Cut off for Revenue Recognition-II

- 4. Revenue shall be recognized when there is reasonable certainty of its ultimate collection

Where ability to assess Ultimate collection is not certain

- 5. Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim for escalation of price and export incentives, revenue recognition in respect of such claim shall be postponed to the extent of uncertainty involved
- The assessee could not be said to be following wrong accounting policy if it didn't recognize the interest accrued on loan given to certain companies which eventually became sick - *Kerala State Industrial Products Trading Corpn. Ltd. v. Asstt. CIT* [2012] 22 taxmann.com 78/52 SOT 141 (Cochin)

Revenue from Services

- Revenue from service transactions shall be recognized by the **<u>percentage completion method</u>**.
- Under this method, **<u>revenue from service transactions is matched with the service transactions costs incurred in reaching the stage of completion</u>**, resulting in the determination of revenue, expenses and profit which can be attributed to the proportion of work completed.

- <u>Income Computation and Disclosure Standard on construction contract also requires the recognition of revenue on this basis. The requirements of that Standard shall *mutatis mutandis* apply to the recognition of revenue and the associated expenses for a service transaction</u>

Comments

- **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: *CIT vs. V.S. Dempo and Co. P Ltd. (131 CTR 203) (Bombay HC).***

The Use of Resources by Others Yielding Interest, Royalties or Dividends

- **Interest:** Interest shall accrue on the time basis determined by the amount outstanding and the rate applicable.
- **Discount:** Discount or premium on debt securities held is treated as though it were accruing over the period to maturity.
- **Royalties:** Royalties shall accrue in accordance with the terms of the relevant agreement and shall be recognized on that basis unless, having regard to the substance of the transaction, it is more appropriate to recognize revenue on some other systematic and rational basis
- **Dividends:** Dividends are recognized in accordance with the provisions of the Act.
- **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.**

Transitional Provisions

- **Transitional Provisions for Service Contracts:** The transitional provisions of Income Computation and Disclosure Standard on construction contract 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, 2015 but not completed by the said date.

Transitional Provisions for other than service contracts

- Revenue for a transaction, other than a service transaction referred to in Para 10, 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

- In a transaction involving sale of good, total amount not recognized as revenue during the previous year due to lack of reasonably certainty of its ultimate collection along with nature of uncertainty;
- the amount of revenue from service transactions recognized as revenue during the previous year;
- the method used to determine the stage of completion of service transactions in progress; and
- for service transactions in progress at the end of previous year:
- amount of costs incurred and recognized profits (less recognised losses) upto end of previous year;
- the amount of advances received; and
- the amount of retentions.
- **Whether amount of retention is revenue for purpose of this standard ?**

Tangible Fixed Assets (ICDS-V)

Definitions

- "**Tangible fixed asset**" is an asset being land, building, machinery, plant or furniture held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.
- "**Fair value**" of an asset is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

Criteria for determining tangible fixed asset

- The definition in clause (a) of sub-paragraph (1) of paragraph 2 provides criteria for determining whether an item is to be classified as a tangible fixed asset.
- Stand-by equipment and servicing equipment are to be capitalised.
- Machinery spares shall be charged to the revenue as and when consumed.
- When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised.

Acquired Tangible fixed Asset

The actual cost of an **acquired tangible fixed asset** shall comprise **its purchase price**, **import duties and other taxes**, **excluding those subsequently recoverable**, **and any directly attributable expenditure on making the asset ready for its intended use**. **Any trade discounts and rebates shall be deducted in arriving at the actual cost**

Changes in Cost of Tangible Fixed Assets

- The cost of a tangible fixed asset may undergo changes subsequent to its acquisition or construction on account of
- -price adjustment, changes in duties or similar factors; or
- -**<u>exchange fluctuation as specified in Income Computation and Disclosure Standard on the effects of changes in foreign exchange rates</u>**

Admn., General Overheads

- Administration and other general overhead expenses are to be excluded from the cost of tangible fixed assets if they do not relate to a specific tangible fixed asset

Specifically Attributable expenses or Expenses incurred to bring asset to working condition

- **<u>Expenses which are specifically attributable to construction of a project or to the acquisition of a tangible fixed asset or bringing it to its working condition</u>**, shall be included as a part of the cost of the project or as a part of the cost of the tangible fixed asset.

Expenses Pre/Post Date of Commercial Production

- The **expenditure incurred on start-up and commissioning** of the project, **including the expenditure incurred on test runs and experimental production**, shall be capitalized

The **expenditure incurred after the plant has begun commercial production**, that is, production intended for sale or captive consumption, shall be treated as revenue expenditure.

- [No accounting treatment suggested for expenses between trial run and commencement of commercial production]

Self- constructed Tangible Fixed Assets

- In arriving at the actual cost of self-constructed tangible fixed assets, the same principles shall apply as those described in paragraphs 5 to 8.
- Cost of construction that relate directly to the specific tangible fixed asset and costs that are attributable to the construction activity in general and can be allocated to the specific tangible fixed asset shall be included in actual cost.
- Any internal profits shall be eliminated in arriving at such costs.

Exchange Assets

- When a tangible fixed asset is acquired in exchange for another asset, the **<u>fair value of the tangible fixed asset so acquired</u>** shall be its actual cost
- As per Para 11.1 of AS-10, When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may be appropriate to consider also the fair market value of the asset acquired if this is more clearly evident. An alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, is to record the asset acquired at the net book value of the asset given up; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration.

Exchange Assets

- When a tangible fixed asset is acquired in exchange for shares or other securities, **<u>the fair value of the tangible fixed asset so acquired shall be its actual cost.</u>**
- As per11.2 of AS-10, When a fixed asset is acquired in exchange for shares or other securities in the enterprise, it is usually recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident.

Improvements and Repairs

- An Expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is added to the actual cost

Additions- Integral vs Separate Identity

- The cost of an addition or extension to an existing tangible fixed asset which is of a capital nature and which becomes an integral part of the existing tangible fixed asset is to be added to its actual cost.
- Any addition or extension, which has a separate identity and is capable of being used after the existing tangible fixed asset is disposed of, shall be treated as separate asset

Jointly Owned Assets

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. **<u>Details of such jointly owned tangible fixed assets shall be indicated separately in the tangible fixed assets register</u>**

Consolidated Price for Several Assets

- Where several assets are purchased for a consolidated price, the consideration shall be **apportioned to the various assets on a fair basis**

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 recognised in accordance with the provisions of this standard.
- The amount of actual cost, if any, recognised 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

Depreciation as per IT Act

- Depreciation on a tangible fixed asset shall be computed in accordance with the provisions of the Act.

Income from Transfer as per IT Act

- Income arising on transfer of a tangible fixed asset shall be computed in accordance with the provisions of the Act

Disclosures

- Description of asset or block of assets;
- Rate of depreciation;
- Actual cost or written down value, as the case may be;
- Additions or 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 CENVAT Credit Rules, 2004;

  -change in rate of exchange of currency;

  -subsidy or grant or reimbursement, by whatever name called;

  -Depreciation Allowable; and

  -written down value at the end of year.

Income Computation and Disclosure Standard VI relating to the effects of changes in foreign exchange rates

Scope

Deals With

- Treatment of transactions in foreign currencies;
- Translating the financial statements of foreign operations;
- Treatment of foreign currency transactions in the nature of forward exchange contracts.

  AS-11
- This Standard does not specify the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, this Standard requires disclosure of the reason for using that currency. This Standard also requires disclosure of the reason for any change in the reporting currency.
- This Standard does not deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purpose

DEFINITIONS

- "**Average rate**" is the mean of the exchange rates in force during a period.
- "**Closing rate**" is the exchange rate at the last day of the previous year.
- "**Exchange difference**" is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency of a person at different exchange rates.
- "**Exchange rate**" is the ratio for exchange of two currencies.
- "**Foreign currency**" is a currency other than the reporting currency of a person.
- "**Foreign operations of a person**" is a branch, by whatever name called, of that person, the activities of which are based or conducted in a country other than India.
- **Subsidiary, Associate and Joint Venture as mentioned in AS-11 Kept outside the purview because they are separate entities and no consolidation required. Only Branch to be included for this ICDS.**

- "**Foreign currency transaction**" is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when a person:
- buys or sells goods or services whose price is denominated in a foreign currency; or
- borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
- becomes a party to an unperformed forward exchange contract; or
- otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

- "**Foreign currency transaction**" is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when a person:
- buys or sells goods or services whose price is denominated in a foreign currency; or
- borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
- becomes a party to an unperformed forward exchange contract; or
- otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

- **Forward exchange contract**" means an agreement to exchange different currencies at a forward rate**, and includes a foreign currency option contract or another financial instrument of a similar nature**;
- **Extended definition of forward Contract as compared to AS-11 and includes a foreign currency option contract or another financial instrument of a similar nature**

- **Forward rate**" is the specified exchange rate for exchange of two Currencies at a specified future date;
- "**Indian currency**" shall have the meaning as assigned to it in section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999);
- "**Integral foreign operation**" is a foreign operation, the activities of which are an integral part of the operation of the person;
- "**Monetary items**" are money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money. Cash, receivables, and payables are examples of monetary items;
- "**Non-integral foreign operation**" is a foreign operation that is not an integral foreign operation;
- "**Non-monetary items**" are assets and liabilities other than monetary items. Fixed assets, inventories, and investments in equity shares are examples of non-monetary items;
- "**Reporting currency**" means Indian currency except for foreign operations where it shall mean currency of the country where the operations are carried out.

- "**Foreign currency transaction**" is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when a person: -
- buys or sells goods or services whose price is denominated in a foreign currency; or
- borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
- becomes a party to an unperformed forward exchange contract; or
- otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
- "**Forward exchange contract**" means an agreement to exchange different currencies at a forward rate<u>**, and includes a foreign currency option contract or another financial instrument of a similar nature**</u>

Initial Recognition of foreign currency transaction

- A foreign currency transaction shall be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency **at the date of the transaction**
- **An average rate** for a week or a month that approximates the actual rate at the date of the transaction may be used for all transaction in each foreign currency occurring during that period
- **If the exchange rate fluctuates significantly, the actual rate at the date of the transaction shall be used.**

Conversion at Last Date of Previous Year- Monetary Items

- Foreign currency **monetary items** shall be converted into reporting currency by applying the closing rate
- Where the closing rate does not reflect with reasonable accuracy, the amount in reporting currency that is likely to be realized from or required to disburse, a foreign currency monetary item owing to restriction on remittances or the closing rate being unrealistic and it is not possible to effect an exchange of currencies at that rate, then the relevant monetary item shall be reported in the reporting currency at the amount which is likely to be realized from or required to disburse such item at the last date of the previous year;

Reporting of Non Monetary Items

- Non-monetary items in a foreign currency shall be converted into reporting currency by using the exchange rate at the date of the transaction.
- **As per AS-11** non-monetary items which are carried at fair value or other similar valuation denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.

Recognition of Exchange Differences

- In respect of monetary items, exchange differences arising on the settlement thereof or on conversion thereof at last day of the previous year shall be recognized as income or as expense in that previous year.
- In respect of non-monetary items, exchange differences arising on conversion thereof at the last day of the previous year shall not be recognized as income or as expense in that previous year

As per AS-11

- The contingent liability denominated in foreign currency at the balance sheet date is disclosed by using the closing rate.

Section 43A and Rule 115 for conversion of foreign currency transactions to apply

- Notwithstanding anything contained in paragraph 3, 4 and 5; initial recognition, conversion and recognition of exchange difference shall be subject to provisions of section 43A of the Act or Rule 115 of Income-tax Rules, 1962, as the case may be.

Rule 115A

- The rate of exchange for the calculation of the value in rupees of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him or on his behalf in foreign currency shall be the **telegraphic transfer buying rate** of such currency as **on the specified date**.

Specified Date as per Explanation2 to Rule 115

- specified date" means—

(c)
in respect of income chargeable under the heads "Income from house property", "Profits and gains of business or profession" [not being income referred to in clause (*d*)] and "Income from other sources" (not being income by way of dividends [73][and "Interest on securities"]), **the last day of the previous year of the assessee;**

(*d*) in respect of income chargeable under the head "Profits and gains of business or profession" in the case of a non-resident engaged in the business of operation of ships, the last day of the month immediately preceding the month in which such income is deemed to accrue or arise in India ;

Specified Date as per Explanation2 to Rule 115

- (e) in respect of income by way of dividends, the last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company;
- (*f*) in respect of income chargeable under the head "Capital gains", the last day of the month immediately preceding the month in which the capital asset is transferred :]

- **Provided** that the specified date, in respect of income referred to in sub-clauses (*a*) to (*f*) payable in foreign currency **and from which tax has been deducted at source under rule 26**, shall be [75][the date on which the tax was required to be deducted] under the provisions of the Chapter XVII-B.

Rate of exchange for the purpose of deduction of tax at source on income payable in foreign currency.

- **26 .** For the purpose of deduction of tax at source on any income payable in foreign currency, the rate of exchange for the calculation of the value in rupees of such income payable to an assessee outside India shall be the **<u>telegraphic transfer buying rate of such currency as on the date on which the tax is required to be deducted at source under the provisions of Chapter XVIIB</u>** by the person responsible for paying such income.
- *Explanation* : For the purposes of this rule, "telegraphic transfer buying rate", in relation to a foreign currency, means [46][the rate or rates of exchange] **<u>adopted by the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), for buying such currency</u>** [47][, having regard to the guidelines specified from time to time by the Reserve Bank of India for buying such currency,] where such currency is made available to that bank through a telegraphic transfer.

Rule 115(2) where income received in India before specified date

- (2) Nothing contained in sub-rule (1) shall apply in respect of income referred to in clause (*c*) of the *Explanation* to sub-rule (1) where such income is received in, or brought into India by the assessee or on his behalf before the specified date in accordance with the provisions of the Foreign Exchange Regulation Act, 1973 (46 of 1973).

Section 43A of IT Act to apply

- **<u>Notwithstanding anything contained in any other provision of this Act,</u>** where an assessee has **<u>acquired any asset in any previous year from a country outside India</u>** for the purposes of his business or profession and, **<u>in consequence of a change in the rate of exchange during any previous year after the acquisition of such asset, there is an increase or reduction in the liability of the assessee as expressed in Indian currency</u>** (as compared to the liability existing at the time of acquisition of the asset) **<u>at the time of making payment—</u>**

- (*a*) towards the whole or a part of the cost of the asset; or
- (*b*)**towards repayment of the whole or a part of the moneys borrowed by him from any person, directly or indirectly, in any foreign currency specifically for the purpose of acquiring the asset along with interest, if any**,
- the amount by which the liability as aforesaid is so increased or reduced during such previous year and which is taken into account at the time of making the payment, **irrespective of the method of accounting adopted by the assessee**, shall be added to, or, as the case may be, deducted from—

(*i*) the actual cost of the asset as defined in clause (*1*) of section 43; or

(*ii*) the amount of expenditure of a capital nature referred to in clause (*iv*) of sub-section (1) of section 35; or

(*iii*) the amount of expenditure of a capital nature referred to in section 35A; or

(*iv*) the amount of expenditure of a capital nature referred to in clause (*ix*) of sub-section (1) of section 36; or

(*v*) the cost of acquisition of a capital asset (not being a capital asset referred to in section 50) for the purposes of section 48,

- and the amount arrived at after such addition or deduction shall be taken to be the actual cost of the asset or the amount of expenditure of a capital nature or, as the case may be, the cost of acquisition of the capital asset as aforesaid:

- **Provided** that where an addition to or deduction from the actual cost or expenditure or cost of acquisition has been made under this section, as it stood immediately before its substitution by the Finance Act, 2002, on account of an increase or reduction in the liability as aforesaid, the amount to be added to, or, as the case may be, deducted under this section from, the actual cost or expenditure or cost of acquisition at the time of making the payment shall be so adjusted that the total amount added to, or, as the case may be, deducted from, the actual cost or expenditure or cost of acquisition, is equal to the increase or reduction in the aforesaid liability taken into account at the time of making payment.

- *Explanation 1.*—In this section, unless the context otherwise requires,—
- (*a*) "rate of exchange" means the rate of exchange determined or recognised by the Central Government for the conversion of Indian currency into foreign currency or foreign currency into Indian currency;
- (*b*) “foreign currency" and "Indian currency" have the meanings respectively assigned to them in section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999).

- *Explanation 2.*—Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section

Forward Contracts

- *Explanation 3*.—Where the assessee has entered into a contract with an authorized dealer[18] as defined in section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999), for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, to be added to, or deducted from, the actual cost of the asset or the amount of expenditure of a capital nature or, as the case may be, the cost of acquisition of the capital asset under this section shall, in respect of so much of the sum specified in the contract as is available for discharging the liability aforesaid, be computed with reference to the rate of exchange specified therein.]

AS-11 Para 46A

- In respect of accounting periods commencing on or after the 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 and at the option of any other enterprise (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, **in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset**, and **in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long term asset or liability, by recognition as income or expense in each of such periods**, with the exception of exchange differences dealt with in accordance with the provisions of paragraph 15 of the said rules

Financial Statements of Foreign Operations

- **Classification of Foreign Operations:** The method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to a person. For this purpose, foreign operations are classified as either "integral foreign operations" or "non-integral foreign operations

Indicators of Non Integral Foreign Operations

The following are indications that a foreign operation is a non-integral foreign operation rather than an integral foreign operation: -

(*a.a*) while the person may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from the activities of the person;

(*a.b*) transactions with the person are not a high proportion of the foreign operation's activities;

(*a.c*) the activities of the foreign operation are financed mainly from its own operations or local borrowings;

(*a.d*) costs of labor, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency;

(*a.e*) the foreign operation's sales are mainly in currencies other than Indian currency;

(*a.f*) cash flows of the person are insulated from the day-to-day activities of the foreign operation;

(*a.g*) sales prices for the foreign operation's products or services are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation;

(*a.h*) there is an active local sales market for the foreign operation's products or services, although there also might be significant amounts of exports.

Integral Foreign Operations

- The financial statements of an integral foreign operation shall be translated using the principles and procedures in paragraphs 3 to 6 as if the transactions of the foreign operation had been those of the person himself.

Non-integral Foreign Operations

(1) In translating the financial statements of a non-integral foreign operation for a previous year, the person shall apply the following, namely: -

(*a.h.1.a*) the assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation shall be translated at the closing rate;

(*a.h.1.b*) income and expense items of the non-integral foreign operation shall be translated at exchange rates at the dates of the transactions; and

(*a.h.1.c*) all resulting exchange differences shall be recognised as income or as expenses in that previous year.

[As per Para 24© of AS-11, all resulting exchange differences should be accumulated in a foreign currency translation reserve until the disposal of the net investment.]

(2) Notwithstanding anything stated in sub-paragraph 1, translation and recognition of exchange difference in cases referred to in section 43A of the Act or Rule 115 of Income-tax Rules, 1962 shall be carried out in accordance with the provisions contained in that section or that Rule, as the case may be

Change in the Classification of a Foreign Operation

- 10(1) When there is a change in the classification of a foreign operation, the translation procedures applicable to the revised classification should be applied from the date of the change in the classification.
- (2) The consistency principle requires that foreign operation once classified as integral or non-integral is continued to be so classified. However, a change in the way in which a foreign operation is financed and operates in relation to the person may lead to a change in the classification of that foreign operation.

Forward Exchange Contracts-Non Trade [Para 11(1)]

- (1) Any premium or discount arising at the inception of a forward exchange contract shall be amortised as expense or income **over the life of the contract.**
- Para 11(4) **The premium or discount** that arises on the contract is measured by the difference between the exchange rate at the date of the inception of the contract and the forward rate specified in the contract
- **Exchange differences** on such a contract shall be recognised as income or as expense in the previous year in which the exchange rates change.

  As per Para 11(4) Exchange difference on the contract is the difference between:
- (*a*) the foreign currency amount of the contract translated at the exchange rate at the last day of the previous year, or the settlement date where the transaction is settled during the previous year; and
- (*b*) the same foreign currency amount translated at the date of inception of the contract or the last day of the immediately preceding previous year, whichever is later.

- Any profit or loss arising on cancellation or renewal shall be recognised as income or as expense for the previous year.

(2) The provisions of sub-para (1) shall apply provided that the contract:

(*a*) is not intended for trading or speculation purposes; and

(*b*) is entered into to establish the amount of the reporting currency required or available at the settlement date of the transaction.

- (3) The provisions of sub-para (1) shall not apply to the contract that is entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction. For this purpose, firm commitment, shall not include assets and liabilities existing at the end of the previous year.

Forward Exchange Contract-Trade

- (5) Premium, discount or exchange difference on contracts that are intended for trading or speculation purposes, or that are entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction shall be recognised **<u>at the time of settlement.</u>**

Treatment of Forward Contracts for Trade purposes as per AS-11

- 38. A gain or loss on a forward exchange contract to which paragraph 36 does not apply [i,.e. Forward Contracts not for non trade purposes]should be computed by multiplying the foreign currency amount of the forward exchange contract by the difference between the forward rate available at the reporting date for the remaining maturity of the contract and the contracted forward rate (or the forward rate last used to measure a gain or loss on that contract for an earlier period).
- The gain or loss so computed should be recognised in the statement of profit and loss for the period. The premium or discount on the forward exchange contract is not recognised separately.
- 39. In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised

Transitional Provisions

- 12. (1) All foreign currency transactions undertaken on or after 1st day of April, 2015 shall be recognised in accordance with the provisions of this standard.
- (2) 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 recognised in accordance with the provisions of 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.
- (3) 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.
- (4) 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.

Income Computation and Disclosure Standard VII relating to government grants

Scope

- This Income Computation and Disclosure Standard deals with the treatment of Government grants
- The Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, **waiver, concessions, reimbursements**, etc.
- [As per AS-12, . Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, etc.Words Waiver, Concessions, re imbursements not mentioned in AS-12.]
- Waiver of Principal amount of loan granted by Government shall also get covered by this ICDS.

Does Not Deal With

- Government assistance other than in the form of Government grants; and
- Government participation in the ownership of the enterprise.

Definitions

- **Government**" refers to the Central Government, State Governments, **agencies and similar bodies**, whether local, national or international.

[Agencies and Similar Bodies not defined. Whether Govt Controlled Bodies Covered ?]

"Government grants"

- are assistance by Government in cash or kind to a person for past or future compliance with certain conditions.
- **<u>They exclude</u>** those forms of Government assistance **<u>which cannot have a value placed</u>** upon them and the transactions with Government **<u>which cannot be distinguished from the normal trading transactions</u>** of the person.

When to recognize Government Grant

- 4(1) Government grants should not be recognised **until there is reasonable assurance** that (*i*) the person shall comply with the conditions attached to them, and (*ii*) the grants shall be received.
- 4(2) Recognition of Government grant shall **not be postponed beyond the date of actual receipt.**
- **" Reasonable Assurance" not defined in ICDS**
- As per Para 6.1 of AS 12 Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.
- Further as per 6.3 A contingency related to a government grant, arising after the grant has been recognised, is treated in accordance with Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date.

Govt. Grant for Depreciable Assets

- 5. Where the Government grant relates to a depreciable fixed asset or assets of a person, the grant shall be deducted from the actual cost of the asset or assets concerned or from the written down value of block of assets to which concerned asset or assets belonged to
- As per Para 8.3 of AS-12 ,Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value

Alternative Accounting Treatment of Grant on Depreciable Assets not adopted in ICDS

- Para 8.4 permits alternate treatment of grant for depreciable assets as deferred Income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged.

Government Grant for Multiple Assets

7. Where the Government grant is of such a nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total Government grant, the same proportion as such asset bears to all the assets in respect of or with reference to which the Government grant is so received, shall be deducted from the actual cost of the asset or shall be reduced from the written down value of block of assets to which the asset or assets belonged to.

However, govt grant apportion able to non depreciable assets should be charged to Income as per Para 6 ? But para 7 is perhaps not applicable to non depreciable assets as emerges out from the discussion on refunds of government grants in Para 11, which excludes both Para 5 and Para 7 out of its purview.

Refund of Government Grant against depreciable fixed assets

- 12. The amount refundable in respect of a Government grant related to a depreciable fixed asset or assets shall be recorded by increasing the actual cost or written down value of block of assets by the amount refundable.
- Where the actual cost of the asset is increased, depreciation on the revised actual cost or written down value shall be provided **prospectively** at the prescribed rate.

Govt. Grant for Non Depreciable Assets

- 6. Where the Government grant relates to a non-depreciable asset or assets of a person **requiring fulfilment of certain obligations**, the grant shall be recognised as income over the same period over which the cost of meeting such obligations is charged to income
- As per Para 8.4 of AS-12 Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets.
- Further as per Para 8.4 of AS-12, However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account. For example, in the case of a company, it is shown after 'Reserves and Surplus' but before 'Secured Loans' with a suitable description, e.g., 'Deferred government grants'.

No Frills Grant

8. The Government grant that is receivable as **compensation for expenses or losses incurred in a previous financial year** or **for the purpose of giving immediate financial support to the person with no further related costs**, shall be recognised as income of the period in which it is receivable

   As per Para 6.4 and 6.5 of AS-12 These circumstances may warrant taking the grant to income in the period in which the enterprise qualifies to receive it, as an extraordinary item if appropriate (see Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies).

Matching Concept of Recognizing Income on Govt. Grants

- 9. The Government grants other than covered by paragraph 5, 6, 7, and 8 shall be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate.
- As per Para 9.1 of AS-12,Alternatively, they are deducted in reporting the related expense. However no such alternative permitted by ICDS

Refund of Government Grant against non depreciable assets or related expenses

- 11. The amount refundable in respect of a Government grant referred to in paragraphs 6, 8 and 9 shall 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 shall be charged to profit and loss statement
- [Same Treatment suggested in Para 11.2 of AS-12]
- As per Para 11.1 of AS-12, refund of Govt Grant is treated as Extra-ordinary Item

Grant in form of Non Monetary Assets

- The Government grants in the form of non-monetary assets, given at a concessional rate, shall be accounted for on the basis of their acquisition cost
- E.g. Land and Other resources [Para 7.1 of AS-12]
- As per Para 7.1 of AS-12 Non-monetary assets given free of cost are recorded at a nominal value

Transitional Provisions

- 13. 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.

Disclosures

14 Following disclosure shall be made in respect of Government grants, namely: -

- (*a*) nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets during the previous year;
- (*b*) nature and extent of Government grants recognised during the previous year as income;
- (*c*) nature and extent of Government grants **not recognised** during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets and reasons thereof; and
- (*d*) nature and extent of Government grants **not recognised** during the previous year as income and reasons thereof.

Capital Approach as per AS-12 not followed in ICDS on Government Grants

- As per AS-12, Para 10.1 Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income

Purpose Test for tax treatment of Subsidy

- Ponni Sugars & Chemicals Ltd. [2008] 174 TAXMAN 87 (SC)[16-09- 2008](Supreme Court)"........ If the object of the subsidy scheme was to enable the assessee to run the business more profitably, then the receipt was on revenue account. On the other hand, **<u>if the object assistance under the subsidy scheme was to enable the assessee to set up a new unit or to expand its existing units, then the receipt of the subsidy was on capital account</u>**. Therefore, it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy.

Section 2(24)(xvii) inserted by FA 2015 wef AY 2016-17

- As per clause (xviii) inserted in section 2(24) by Finance Act 2015 w.e.f. AY 2016-17, **definition of income includes**:

  assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee **other than the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43**;
- **Hence the Government Grant can not be treated as "capital receipt" both as per Section 2(24)(xvii) and ICDS on Government Grant.**

Income Computation and Disclosure Standard VIII relating to

Scope

- This Income Computation and Disclosure Standard deals with securities held as stock-in-trade.
- As per ICDS-II on Inventories, it does not deal with Shares, debentures and other financial instruments held as stock-in-trade which are dealt with by the Income Computation and Disclosure Standard on securities
- As per AS-13, Para 3.1 Assets held as stock-in-trade are not 'investments'.
- However AS-13 also says that Shares, debentures and other securities held as stock-in-trade (i.e., for sale in the ordinary course of business) are not 'investments' as defined in this Standard. However, the manner in which they are accounted for and disclosed in the financial statements is quite similar to that applicable in respect of current investments. Accordingly, the provisions of this Standard, to the extent that they relate to current investments, are also applicable to shares, debentures and other securities held as stock-in-trade, with suitable modifications as specified in this Standard.

Comments on Scope of ICDS on Securities vs. AS-13

- ICDS on Securities deal with securities held as Stock in Trade only, while AS-13 deals with with Current Investments and Long term Investments where in :
- A current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made
- A long term investment is an investment other than a current investment.
- Further AS-13 deals with Investment properties also, where ICDS-VIII does not deal with the same. An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise. As per Para 20 of AS-13, The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

Does not deal

- This Income Computation and Disclosure Standard does not deal with:
- the bases for recognition of interest and dividends on securities which are covered by the Income Computation and Disclosure Standard on revenue recognition;
- securities held by a person engaged in the business of insurance;
- securities held by mutual funds, venture capital funds, banks and public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013).

Definitions

The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(*a*) "**Fair value**" is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

(*b*) "**Securities**" shall have the meaning assigned to it in clause (*h*) of Section 2 of the Securities Contract (Regulation) Act, 1956 (42 of 1956), other than Derivatives referred to in sub-clause (1a) of that clause.

Initial Recognition and Subsequent Measurement of Securities

- As per Para 4, A security on acquisition shall be recognised at actual cost
- As per Para 9 At the end of any previous year, securities held as stock-in-trade shall be valued at actual cost initially recognised or net realisable value at the end of that previous year, whichever is lower.
- As per Para 10, For the purpose of para 9, **<u>the comparison of actual cost initially recognised and net realisable value shall be done categorywise and not for each individual security</u>**. For this purpose, securities shall be classified into the following categories, namely:-

  (*a*) shares;

  (*b*) debt securities;

  (*c*) convertible securities; and

  (*d*) any other securities not covered above.
- As per Para 12, Notwithstanding anything contained in para 9, 10 and 11, at the end of any previous year, **<u>securities not listed on a recognised stock exchange; or listed but not quoted on a recognised stock exchange with regularity from time to time</u>**, shall be valued at actual cost initially recognised.

AS-13 suggests to make comparison of Cost and NRV for each Individual security

- Valuation of current investments on overall (or global) basis is not considered appropriate. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not with each individual investment, and accordingly the investments may be carried at the lower of cost and fair value computed category wise (i.e. equity shares, preference shares, convertible debentures, etc.). However, the more prudent and appropriate method is to carry investments individually at the lower of cost and fair value.

FIFO Method where Specific Identification of Actual Cost can not be made

- 13. For the purposes of para 9, 10 and 11 where the actual cost initially recognised cannot be ascertained by reference to specific identification, the cost of such security shall be determined on the basis of first-in-first-out method.

Actual Cost to Comprise

- 5. The actual cost of a security shall comprise of its purchase price and include acquisition charges such as brokerage, fees, tax, duty or cess.

Exchanged for Other Security/Assets

- 6. Where a security is acquired in exchange for other securities, the **<u>fair value of the security so acquired</u>** shall be its actual cost.

  As per Para 10 of AS-13, If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the **<u>fair value of the securities issued</u>** (which, in appropriate cases, may be indicated by the issue price as determined by statutory authorities). The fair value may not necessarily be equal to the nominal or par value of the securities issued
- 7. Where a security is acquired in exchange for another asset, the **<u>fair value of the security so acquired</u>** shall be its actual cost
- As per Para 11 of AS-13, If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the **<u>fair value of the asset given up</u>**. **<u>It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.</u>**

Treatment of Broken Period Interest

- 8. Where unpaid interest has accrued before the acquisition of an interest-bearing security and is included in the price paid for the security, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion of the interest is deducted from the actual cost.
- As per Para 12 of AS-13, If it is difficult to make such an allocation except on an arbitrary basis, the cost of investment is normally reduced by dividends receivable only if they clearly represent a recovery of a part of the cost.

Opening Balance

- 11. The value of securities held as stock-in-trade of a business as on the beginning of the previous year shall be:
- (*a*) the cost of securities available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and
- (*b*) the value of the securities of the business as on the close of the immediately preceding previous year, in any other case.

Classification as per AS-13

- As per AS-13, Current investments are in the nature of current assets, although the common practice may be to include them in investments.
- 3 Shares, debentures and other securities held for sale in the ordinary course of business are disclosed as 'stock-in-trade' under the head 'current assets'.

Treatment of Rights shares as per AS-13 not suggested in ICDS

- As per Para 13 of ICDS on Securities, When right shares offered are subscribed for, the **cost of the right shares is added to the carrying amount of the original holding**.
- If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement.
- However, where the **investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired**, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.

Disposal of Securities also not dealt in ICDS-VIII

- Disposal of Securities also not dealt in ICDS.
- ICDS suggests that for comparison of actual cost and NRV , FIFO method to be adopted.
- This will logically lead to calculation of taxable income from disposal on FIFO method only.
- However, as per Para 22 of AS-13, When disposing of a part of the holding of an individual investment, the carrying amount to be allocated to that part is to be determined **on the basis of the average carrying amount of the total holding of the investment.**
- Further as per AS-13, In respect of shares, debentures and other securities held as stock-in-trade, the cost of stocks disposed of is determined by applying an appropriate cost formula (e.g. first-in, first-out; average cost, etc.). These cost formulae are the same as those specified in Accounting Standard (AS) 2, in respect of Valuation of Inventories.

Income Computation and Disclosure Standard IX relating to

Scope

1. (1) This Income Computation and Disclosure Standard deals with treatment of borrowing costs.

- (2) This Income Computation and Disclosure Standard does not deal with the actual or imputed cost of owners' equity and preference share capital.

Borrowing costs

- "**Borrowing costs**" are interest and other costs incurred by a person in connection with the borrowing of funds and include:
- commitment charges on borrowings;
- amortised amount of discounts or premiums relating to borrowings;
- amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;
- finance charges in respect of assets acquired under finance leases or under other similar arrangements.
- As per AS-16, Para 4©exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs are also borrowings costs, however, not included in ICDS.

Qualifying asset

- "**Qualifying asset**" means:
- land, building, machinery, plant or furniture, being tangible assets;
- know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- inventories **<u>that require a period of twelve months or more</u>** to bring them to a saleable condition.
- [There is no time limit for completion of assets other than Inventory, hence, borrowing cost to be capitalized for tangible and intangible assets even if period of completion is not substantial]

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset.
- The amount of borrowing costs eligible for capitalisation shall be determined in accordance with this Income Computation and Disclosure Standard.
- **Other borrowing costs shall be recognised in accordance with the provisions of the Act.**
- For the purposes of this Income Computation and Disclosure Standard, "capitalisation" in the context of inventory referred to in item (*iii*) of clause (*b*) of sub-paragraph (1) of paragraph 2means addition of borrowing cost to the cost of inventory.

When Funds Borrowed Specifically for Qualifying Asset

- To the extent the **funds are borrowed specifically for the purposes of acquisition, construction or production** of a qualifying asset, the amount of borrowing costs to be capitalised on that asset shall be **the actual borrowing costs** incurred during the period on the funds so borrowed

When Funds Borrowed Generally and Used for Qualifying Asset

- To the extent the funds are borrowed generally and utilised for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised shall be computed in accordance with the following formula namely :

capitalized where funds not specifically borrowed for qualifying asset

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

  (*i*) the average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year;

  (*ii*) in case the qualifying asset does not appear in the balance sheet of a person on the first day or both on the first day and the last day of previous year, half of the cost of qualifying asset;

  (*iii*) in case the qualifying asset does not appear in the balance sheet of a person on the last day of previous year, the average of the costs of qualifying asset as appearing in the balance sheet of a person on the first day of the previous year and on the date of put to use or completion, as the case may be ,

  other than those qualifying assets which are directly funded out of specific borrowings; or
- C = the average of the amount of total assets as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than those assets which are directly funded out of specific borrowings;
- [A x B/C]

Point of Commencement of Capitalization of Borrowing Cost

7. The capitalisation of borrowing costs shall commence:

(*a*) in a case referred to in paragraph 5, from the **date on which funds were borrowed** [Where funds specifically used for QA. Capitalization Commences even if construction is not started or borrowed funds are not utilized.];

(*b*) in a case referred to in paragraph 6, from the **date on which funds were utilised** [When Funds not Borrowed Specifically for Qualifying Asset.]

Point of Cessation of Borrowing Cost to be capitalized

- 8. Capitalisation of borrowing costs shall cease:

  (*a*) in case of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub-paragraph (1) of paragraph 2, **when such asset is first put to use**;

  (*b*) in case of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2, **when substantially all the activities necessary to prepare such inventory for its intended sale are complete.**

Point of Cessation of Borrowing Cost to be capitalized where QA completed in parts

- 9. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part shall cease: -

  (*a*) in case of part of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub-paragraph (1) of paragraph 2, when such part of a qualifying asset is first put to use;

  (*b*) in case of part of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2, when substantially all the activities necessary to prepare such part of inventory for its intended sale are complete.

Transitional Provisions

- 10. All the borrowing costs incurred on or after 1st day of April, 2015 shall be capitalised 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 capitalised, if any, for the same borrowing for any previous year ending on or before 31st day of March, 2015.

Disclosure

11. The following disclosure shall be made in respect of borrowing costs, namely: -

- (*a*) the accounting policy adopted for borrowing costs; and
- (*b*) the amount of borrowing costs capitalised during the previous year.

Explanation 8 to Section 43 of capitalization of borrowing cost

- [*Explanation 8.*—For the removal of doubts, it is hereby declared that where any amount is paid or is payable as interest in connection with the acquisition of an asset, so much of such amount as is relatable to **<u>any period after such asset is first put to use</u>** shall not be included, and shall be deemed never to have been included, in the actual cost of such asset.]

Proviso to Section 36(1)(iii) on capitalization of borrowing cost for acq. Of asset for extension of existing business

- **Provided** that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset ~~*for extension of existing business or profession*~~ (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.]
- This proviso inserted by FA 2003 w.e.f. AY 2004-05.
- The words "*for extension of existing business or profession*" *omitted by Finance Act 2015 wef AY 2016-17. Hence the proviso shall be applicable to capital borrowed for acquisition of an asset whether it is extension of existing business or new business.*
- This proviso is to operate prospectively as held by Hon'ble Supreme Court in the case of Deputy Commissioner of Income Tax. Vs. Core Health Care Ltd. (SC) 298 ITR 194
- This treatment is in connosance with provisions of ICDS

Para 18 of Supreme Court Judgment in Chalapali Sugar Mills 98 ITR 167

- Para 18 In case money is borrowed by **<u>a newly started company</u>** which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the fixed assets which have been created as a result of such expenditure. The above rule of accountancy should, in our view, be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary

Comments

- Unlike AS 16, income on temporary Investments of borrowed funds cannot be reduced from borrowing costs eligible for capitalization in ICDS IX.
- There is no provision for suspension of capitalization during extended periods in which active development is interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalisation.

Comments

- 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.**

Income Computation and Disclosure Standard X relating to provisions, contingent liabilities and contingent assets

Scope

1. This Income Computation and Disclosure Standard deals with provisions, contingent liabilities and contingent assets, except those:

   (*a*) resulting from financial instruments;

   (*b*) resulting from executory contracts;

   (*c*) arising in insurance business from contracts with policyholders; and

   (*d*) covered by another Income Computation and Disclosure Standard.

2. This Income Computation and Disclosure Standard does not deal with the recognition of revenue which is dealt with by Income Computation and Disclosure Standard - Revenue Recognition.

3. The term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts which are adjustments to the carrying amounts of assets and are not addressed in this Income Computation and Disclosure Standard.

Provision Definition

- "**Provision**" is **<u>a liability</u>** which can be measured only by using a substantial degree of estimation.
- "**Liability**" is **<u>a present obligation of the person arising from past events</u>**, the settlement of which is expected to result in an outflow from the person of resources embodying economic benefits.
- "**Present obligation**" is an obligation if, **<u>based on the evidence available, its existence at the end of the previous year is considered reasonably certain.</u>**

Contingent liability

- "**Contingent liability**" is:
- a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the person; or
- a present obligation that arises from past events but is not recognised because:
- A) it is not reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; or
- B) a reliable estimate of the amount of the obligation cannot be made.

Contingent asset

- "**Contingent asset**" is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person.

- **Obligating event**" is an event that creates an obligation that results in a person having no realistic alternative to settling that obligation
- **Executory contracts**" are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

Recognition of Provision

5. A provision shall be recognised when:
   (*a*) a person has a present obligation as a result of a past event;
   (*b*) it is **reasonably certain** that an outflow of resources embodying economic benefits will be required to settle the obligation; and
   (*c*) a reliable estimate can be made of the amount of the obligation.
   If these conditions are not met, no provision shall be recognised.
6. No provision shall be recognised for costs that need to be incurred to operate in the future.
7. It is only those obligations arising from past events existing independently of a person's future actions, that is the future conduct of its business, that are recognised as provisions
8. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is enacted

Following Provisions may get allowed under if "Reasonable Certainty" test is passed ICDS-X

a) Supreme Court Judgment in Rotork Controls India P. Ltd. v. Commissioner of Income Tax [2009] 314 ITR 62 (SC) where in it was held that provision for warranty expenses is allowable if the warranty provisions are based on experience and historical trends.

b) Supreme Court Judgment in Bharat Earth Movers held that provision for leave encashment being proportionate with the entitlement earned by employees of the company subject to the ceiling on accumulation as applicable on the relevant date, is entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability. The liability is not a contingent liability.

c) In Metal Box Company case 73 ITR 53, SC allowed deduction for provision for gratuity calculated on acturial valuation basis.

Measurement

- 12. The amount recognised as a provision shall be the **best estimate** of the expenditure required to settle the present obligation at the end of the previous year. The amount of a provision shall not be discounted to its present value.
- 13. The amount recognised as asset and related income shall be the best estimate of the value of economic benefit arising at the end of the previous year. The amount and related income shall not be discounted to its present value.

Reimbursements

- 14. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when it is reasonably certain that reimbursement will be received if the person settles the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision.
- 15. Where a person is not liable for payment of costs in case the third party fails to pay, no provision shall be made for those costs.
- 16. An obligation, for which a person is jointly and severally liable, is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties

Review

- 17. Provisions shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate. If it is no longer reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.
- 18. An asset and related income recognised as provided in para 11 shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate. If it is no longer reasonably certain that an inflow of economic benefits will arise, the asset and related income shall be reversed.

Use of Provisions

19. A provision shall be used only for expenditures for which the provision was originally recognised.

Transitional Provisions

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

Disclosure

21(1) Following disclosure shall be made in respect of each class of provision, namely:-

(*a*) a brief description of the nature of the obligation;

(*b*) the carrying amount at the beginning and end of the previous year;

(*c*) additional provisions made during the previous year, including increases to existing provisions;

(*d*) amounts used, that is incurred and charged against the provision, during the previous year;

(*e*) unused amounts reversed during the previous year; and

(*f*) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Disclosure

- 21(2) Following disclosure shall be made in respect of each class of asset and related income recognised as provided in para 11, namely: -
- (*a*) a brief description of the nature of the asset and related income;
- (*b*) the carrying amount of asset at the beginning and end of the previous year;
- (*c*) additional amount of asset and related income recognised during the year, including increases to assets and related income already recognised; and
- (*d*) amount of asset and related income reversed during the previous year.

Contingent Liabilities

- 9. A person shall not recognise a contingent liability.

Contingent Assets

- 10. A person shall not recognise a contingent asset.
- 11. Contingent assets are assessed continually and when it becomes reasonably certain that inflow of economic benefit will arise, the asset and related income are recognised in the previous year in which the change occurs

Judicial Pronouncements that may be followed on Issues where ICDS are silent

Prior-period expenses

- Expenses pertaining to earlier year were not allowable as they were not pertaining to year under consideration- *Dy. CIT v. Rediff.com India (P.) Ltd.* [2011] 12 taxmann.com 22 (Mumbai)
- If liability to pay an amount crystallized only in previous year on receipt of bills, travel claims, etc., the expenditure could not be disallowed as prior-period expenditure merely because same related to earlier years - *SRF Ltd. v. Dy. CIT* [2009] 34 SOT 1 (Delhi)

Prior-period expenses

- If assessee failed to discharge duty of providing for a known expenditure, it could not claim same expenditure in subsequent assessment year - *Delhi Tourism & T.D.C. Ltd. v. CIT* [2006] 155 Taxman 10 (Delhi)
- Expenses of earlier years allowable in current year if crystallized during that year - *SMCC Construction India Ltd. v. Asst. CIT* [2013] 38 taxmann.com 146 (Delhi)
- Prior period adjustment were not allowable as deductions as per provisions of law; claims in regard to same fell under category of false claims, hence, provisions of section 271(1) (c) were attracted - *Deraj Agrotech Ltd. v. ITO* [2014] 45 taxmann.com 69 (Mumbai - Trib.)
- Just because income and expenditure was classified as prior period, they need not be excluded or disallowed if same were crystallized during the relevant previous year - *E-City Entertainment (India) (P.) Ltd. v. Addl. CIT* [2013] 39 taxmann.com 120 (Mumbai - Trib.)

Finance Leases

- In case of finance lease, lessee is entitled to depreciation in respect of asset leased out - *IndusInd Bank Ltd. v. Addl. CIT* [2012] 19 taxmann.com 173 (Mumbai)(SB)
- Depreciation is not allowable to bank leasing out assets on finance lease - *State Bank of India v. Dy. CIT* [2014] 44 taxmann.com 99 (Mumbai - Trib.)
- In case of operating lease, it is lessor who can claim depreciation whereas in case of finance lease, lessee is entitled to depreciation in respect of asset leased out - *IndusInd Bank Ltd. v. Additional CIT* [2012] 19 taxmann.com 173 (Mum.)(SB)

Thank You