

Income Computation & Disclosure Standards (ICDS's)

ICDSs vis-à-vis AS and ICDSs vis-à-vis Judicial Rulings: There are significant deviations between the notified ICDSs, Accounting Standards & Judicial Rulings which are likely to have the effect of advancing the recognition of income or gains or postponing the recognition of expenditure or losses.

ICDS I : Accounting Policies:

(1) Non-consideration of the concepts of Prudence and Materiality:

ICDS I on Accounting Policies, while recognizing the fundamental accounting assumptions of going concern, consistency and accrual, does not recognize the concepts of “materiality” and “prudence” in selection and application of accounting policies.

The concept of prudence requires that provisions should be 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. Non consideration of prudence in selection and application of accounting policies may have the impact of earlier recognition of income and gains or later recognition of expenses or losses for tax computation.

(2) Requirement of “reasonable cause” for change in accounting policy:

AS 5 vis-à-vis ICDS I: AS 5 which deals with changes in accounting policies, permits change in accounting policies if adoption of different accounting policies is required by:

- (a) statute; or (b) for the purpose of compliance with an accounting standard; or
- (c) if such change results in a more appropriate presentation of financial statements.

ICDS I, however, states that an accounting policy should not be changed without any ‘reasonable cause’. The term “reasonable cause” has not been defined and would involve exercise of judgment by management and tax authorities.

ICDS II : Valuation of Inventories:

(1) Standard cost method not recognized for measurement of cost of inventories:

AS 2 vis-à-vis ICDS II: AS 2 permits standard cost method as one of the techniques for the measurement of the cost of inventories, for convenience if the results approximate the actual cost. However there is no enabling para in ICDS II permitting adoption of standard cost as a technique for measurement of the cost of inventories.

(2) Valuation of inventory on the date of dissolution of a firm, where the business is continued by a partner(s): ICDS II: In case of dissolution of a partnership firm requires the inventory on the date of dissolution to be valued at the **net realisable value, notwithstanding whether business is discontinued or not.**

This requirement in ICDS II is in deviation from the Supreme Court ruling where it was held that if the firm is dissolved due to death of a partner and the surviving partners reconstitute the firm and continue the business as before, **the firm is entitled to adopt cost or market price, whichever is lower.**

ICDS III: Construction Contracts:

(1) Point in time of recognition of expected loss on construction contracts

AS 7 vis-à-vis ICDS III: AS 7 permits recognition of expected loss on construction contract as well as contract costs, recovery of which is not probable, as an expense immediately.

It also permits recognition of expected loss immediately as an expense, when it is probable that total contract costs will exceed total contract revenue.

The absence of specific requirement in ICDS III to recognize such expected losses on construction contracts immediately as expense represents a significant deviation from AS 7.

By implication, such losses are also to be recognized on Percentage of Completion Method as per ICDS III. Consequently, recognition of losses for tax purposes is postponed.

(2) Treatment of penalties arising from delays caused by the contractor in completion of the contract: AS 7 vis-à-vis ICDS III: AS 7 permits decrease in contract revenue as a result of penalties arising from delays caused by the contractor in the completion of the contract. However, ICDS III does not permit such reduction in contract revenue. Non-recognition of decrease in contract revenue as a result of such penalties would have the effect of inflating the taxable income and consequent tax liability.

(3) Point in time of recognition of retention money:

AS 7 vis-à-vis ICDS III: As per ICDS III, "Contract Revenue" shall comprise of the initial amount of revenue agreed in the contract, **including retentions**.

However, as per AS 7, contract revenue should comprise the initial amount of revenue agreed in the contract.

While there is a specific requirement in ICDS III to include retentions, there is no such requirement in AS 7.

ICDS IV: Revenue Recognition:

(1) Revenue recognition in case of rendering of services and use by others of person's resources yielding interest, dividend or royalty, where there is significant uncertainty as to collectability: AS 9 vis-à-vis ICDS IV: AS 9 requires recognition of revenue only if no significant uncertainty exists regarding the amount of consideration that will be derived from sale of goods, rendering of services or use by others of enterprise resources yielding interest, royalties and dividends.

ICDS IV also requires revenue from sale of goods to be recognized when there is reasonable certainty of its ultimate collection.

However, "reasonable certainty for ultimate collection" is not a criterion for recognition of revenue from rendering of services or use by others of person's resources yielding interest, royalties or dividends. By implication, revenue recognition cannot be postponed in case of uncertainty regarding collectability of consideration to be derived from rendering of services or use by others of person's resources yielding interest, dividend or royalty.

(2) Recognition of revenue from service transactions:

AS 9 vis-à-vis ICDS IV: AS 9 permits revenue from service transactions to be recognised as the service is performed, either by the proportionate completion method or by the completed service contract method, whichever relates the revenue to the work accomplished. ICDS IV requires revenue from service transactions to be recognised only on the basis of percentage completion method.

ICDS VI: Effects of changes in Foreign Exchange Rates:

(1) Treatment of exchange differences in translation of financial statements of non integral foreign operations: AS 11 vis-à-vis ICDS VI: AS 11 requires the resulting exchange differences in translating the financial statements of a non-integral foreign operation to be accumulated in a foreign currency translation reserve until the disposal of the net investment. ICDS VI on the other hand requires such exchange differences to be recognized as income or as expenses in that previous year.

ICDS VII: Government Grants:

(1) Recognition of Government Grants:

AS 12 vis-à-vis ICDS VII: AS 12 provides that Government Grants should not be recognized until there is a reasonable assurance that the enterprise will comply with the conditions attached to them and the grants will be received.

ICDS VII also provides that Government Grants should not be recognized until there is a reasonable assurance that the enterprise will comply with the conditions attached to them and the grants will be received. However, ICDS VII goes on to provide that recognition of government grant shall not be postponed beyond the date of actual receipt.

(2) Treatment of Government Grants of capital nature and Government Grants in the nature of promoter's contribution:

AS 12 vis-à-vis ICDS VII: AS 12 permits government grants in the nature of promoters' contribution, to be treated as capital reserve which can neither be distributed as dividend nor considered as deferred income.

ICDS VII, however, does not contain specific requirement to capitalize government grants in the nature of promoter's contribution. Except in case of government grant relating to a depreciable fixed asset, which has to be reduced from written down value or actual cost, all other grants have to be recognized as upfront income or as income over the periods necessary to match them with the related costs which they are intended to compensate.

Accordingly, new sub-clause has been inserted in the definition of income under section 2(24) to provide that assistance in the form of a subsidy or grant etc., by the Central Government or a State Government or any authority in cash or kind to the assessee would be considered as income. It is only the subsidy or grant or reimbursement which has been reduced from the actual cost of the asset in accordance with section 43(1) which would not be considered as income.

ICDS VIII: Securities:

(1) Manner of comparison of cost and NRV for valuation of securities held as stock-in-trade: ICDS VIII requires securities held as stock-in-trade to be valued at lower of actual cost initially recognized or net realizable value at the end of the year, whichever is lower. Further, such comparison has to be done **category-wise** and not for each individual security. This requirement in the ICDS deviates from the judicial position that comparison should be done stock wise.

(2) Valuation of unlisted or irregularly traded securities at actual cost initially recognized.

ICDS VIII requires valuation of the following securities only at actual cost initially recognized:

- (i) Securities not listed on a recognized stock exchange; or
- (ii) Securities listed but not quoted on a recognized stock exchange with regularity from time to time.

ICDS IX: Borrowing Costs:

(1) Minimum period for classification of an asset as a qualifying asset:

AS 16 vis-à-vis ICDS IX: As per AS 16, “qualifying asset” has been defined to mean an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. AS 16 clarifies that ordinarily a period of 12 months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case.

ICDS IX, however, does not provide any minimum period for treating an asset as a qualifying asset (except in the case of inventories). Consequently, borrowing costs in respect of assets have to be capitalized even if the asset, say, land or building or plant or machinery, does not take a substantial period of time to get ready for intended use.

(2) Treatment of income earned from temporary investment of borrowed funds:

AS 16 vis-à-vis ICDS IX: AS 16 permits income earned on temporary investment of borrowed funds pending their expenditure on the qualifying asset to be deducted from borrowing costs incurred. ICDS IX however, does not permit such reduction from borrowing costs.

(3) Suspension of capitalization of borrowing costs:

AS 16 vis-à-vis ICDS IX: AS 16 permits suspension of capitalization of borrowing costs during extended periods in which active development is interrupted. ICDS IX does not permit suspension of capitalization of borrowing costs in such cases.

ICDS X: Provisions, Contingent Liabilities & Contingent Assets:

(1) Condition for recognition of Provision:

AS 29 vis-à-vis ICDS X: AS 29 requires recognition of a provision when it is **probable** that an outflow of resources embodying economic benefits will be required to settle the obligation. ICDS X requires recognition of a provision only when it is **reasonably certain** that an outflow of resources embodying economic benefits will be required to settle the obligation.

The requirement of “reasonable certainty” in ICDS X to recognize a provision is more stringent as compared to the requirement of “probability” in AS 29. This will have the effect of postponing the recognition of provision for tax purposes and consequently, result in earlier payment of taxes.

(2) Condition for recognition of Contingent Asset:

AS 29 vis-à-vis ICDS X: Both AS 29 and ICDS X provide that a contingent asset should not be recognized. Further, both AS 29 and ICDS X require contingent assets to be assessed continually.

Thereafter, recognition of contingent assets and related income is required in:

AS 29, if inflow of economic benefits is “**virtually certain**”;

ICDS X, if inflow of economic benefits is “**reasonably certain**”.

The requirement of “reasonable certainty” in ICDS X to recognize a contingent asset and the related income is more stringent as compared to the requirement of “virtual certainty” in AS 29. This deviation between AS 29 and ICDS X would have the effect of advancing recognition of income for tax purposes and consequently, result in earlier payment of taxes.