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On

*Income Computation and Disclosure
Standards (ICDS) – Accounting Policies,
Inventories & Government Grants*

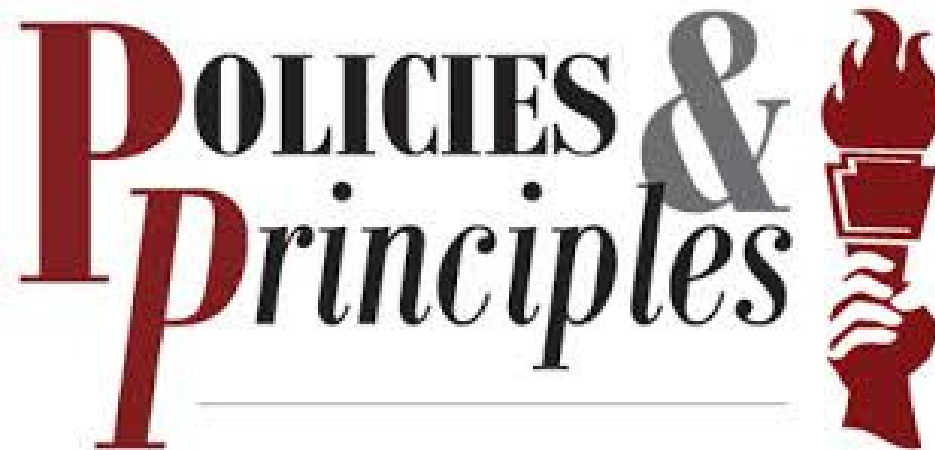
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ICDS I ACCOUNTING POLICIES





ICDS – Accounting Policies

Fundamental accounting assumptions:

■ **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.

■ **Consistency:**

- “Consistency” refers to the assumption that accounting policies are consistent from one period to another;

■ **Accrual:**

- “Accrual” refers to the assumption that revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the previous year to which they relate.
- The Notification dated 31/3/2015 states that the ICDS shall be followed by all assessees following mercantile system of accounting.
- The assessees following cash system of accounting are outside the purview of ICDS



ICDS – Accounting Policies

Accounting Policies:

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

Considerations in 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,
 - the treatment and presentation of transactions and events shall be governed by their substance and not merely by the legal form; and
 - 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 ICDS.

- An accounting policy shall not be changed without reasonable cause.



ICDS – Accounting Policies

Accounting Policies (Contd.):

- Accounting policies (AP) should be consistent
 - AS permits change in AP when
 - Required by the statute
 - Compliance with AS
 - More appropriate presentation of FS
 - As per ICDS, AP shall not be changed without a reasonable cause
 - Change in statute (other than ITA) reasonable cause?
 - Change in AS reasonable cause?
 - Meaning of reasonable cause
- Prudence as a consideration for selection of accounting policy
 - AS-1 includes Prudence as one of the consideration for selection of AP
 - The accounting standard u/s 145(2) notified vide 25.01.1996 notification included 'Prudence' as a consideration for selection of AP.
 - ICDS omits the Prudence - Implications ?



ICDS – Accounting Policies

■ Materiality

- AS -1 recognizes the concept of materiality for disclosure in financial statements.
(i.e items the knowledge of which might influence the decisions of the user of the financial statements.)
- ICDS is silent on materiality aspect because it does not deal with financial statements

■ Disclosure

- All significant accounting policies adopted by a person shall be disclosed (**where???**)
- 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
 - Where such amount is not ascertainable, wholly or in part, the fact shall be indicated
 - 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 and also
 - **in the previous year in which such change has material effect for the first time**



ICDS – Accounting Policies

- **Disclosure (Contd.)**

- Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item
- 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 01st April 2015 or entered into on or after 01st 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 31st March 2015

ICDS II

VALUATION OF INVENTORIES





ICDS – Inventories

■ Inventories defined as assets

- Held for sale in ordinary course of business
- In process of production for such sale
- In form of materials or supplies to be consumed in production process or rendering of services

■ Scope Exclusions

- Work in progress arising in construction contract including directly related service contract which is dealt with by ICDS on Construction Contracts
- Work in progress dealt by other ICDS (AS-2 refers to exclusion of WIP of service provider)
- Shares, debentures and other financial instruments held as stock in trade which are dealt with by ICDS on Securities
- Producers inventories of livestock, agriculture and forest products, mineral oils, ores and gases
- Machinery spares (specific to the tangible fixed asset and not expected to be used regularly) dealt with by ICDS on Tangible Fixed Assets

ICDS – Inventories

■ Measurement

- Valuation at cost , or net realisable value, whichever is lower

The Draft ICDS also read that “ in the case of service provider, the inventories of services shall be valued at cost”.

■ Cost of Inventories shall comprise of :

- costs of purchase,
- costs of services, [not mentioned in AS-2]
- costs of conversion, and
- other costs incurred in bringing the inventories to their present location and condition

■ Cost 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 [Duty drawbacks (AS-2) is omitted in view of Section 145A]



ICDS – Inventories

- **Cost of Services in the case of Service Provider shall consist of :**
 - labour and other costs of personnel directly engaged in providing the service
 - including supervisory personnel and attributable overheads.

- **Cost of conversion :**
 - Overheads to be included
 - Similar to AS -2 except that examples given in AS-2 are omitted in the ICDS
 - Implications of omission of the examples ?

- **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 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 ICDS on borrowing costs.



ICDS – Inventories

■ Exclusions from the Cost of Inventories

- Abnormal amounts of wasted materials, labour, or other production costs;
- Storage costs, unless those costs are necessary in the production process prior to a further production stage;
- Administrative overheads that do not contribute to bringing the inventories to their present location and condition ;
- Selling costs [(AS-2) also refers to distribution costs]

■ Cost formulae

- Specific identification of cost
- FIFO or weighted average cost
continues to be the prescribed formula as laid down in AS 2
- The option of standard cost method as a technique for the measurement of cost as per paragraph 18 of AS 2 has not been provided in the ICDS



ICDS – Inventories

- The option of Retail method as a technique for the measurement of cost as per paragraph 19 of AS 2 has been permitted subject to the conditions that:
 - It is to be used only when it is impracticable to use the other prescribed methods
 - the option of department-wise average percentage is not permitted

- **Net Realisable Value (NRV)**
 - Inventories shall be written down to NRV on an item-by-item basis.
 - 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 NRV on an aggregate basis.
 - NRV shall be based on the most reliable evidence available **at the time of valuation**.
 - The estimates of NRV shall also take into consideration the purpose for which the inventory is held.



ICDS – Inventories

■ **Net Realisable Value (NRV) (Cont..)**

- 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.
- 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.

Principles relating to NRV in the ICDS are similar to those prescribed in AS-2 subject to language modifications and omission of examples.



ICDS – Inventories

■ Value of Opening Inventory

As on the beginning of the previous year shall be :

- 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
- the value of the inventory as on the close of the immediately preceding previous year, in any other case

This is not prescribed in AS-2.

The purpose is to address the issues arising in a situation where the department may change the valuation principles for closing inventories without corresponding effect on the opening inventories.

■ 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



ICDS – Inventories

■ **Valuation of inventory in case of certain dissolutions**

- In case of partnership firm, AOP or BOI inventory on the date of dissolution shall be valued at the net realisable value, whether or not business is discontinued
 - The rule is intended to respond to the ratios laid down in various court judgements [e.g. Shakti Trading Co. 250 ITR 871 (SC); A.L.A Firm 189 ITR 285 (SC)]
 - The rule does not take companies within its sweep, whether on amalgamation or otherwise
 - Of course, AS 2 is silent on this rule

■ **Transitional Provisions**

- Interest and other borrowing costs, which don't meet criteria for its recognition as a component of cost, but included in the cost of opening inventory as on 01st April 2015, shall be taken into account for determining cost of such inventory for valuation as on close of previous year beginning on or after 01st April 2015 if such inventory continue to remain part of inventory as on close of the previous year beginning on or after 01st April 2015



ICDS – Inventories

■ **Disclosure**

- the accounting policies adopted in measuring inventories including the cost formulae used; and
- the total carrying amount of inventories and its classification appropriate to a person

■ **Significant Issues**

- Inventories valuation in the case of Service Providers contemplated ?
- Retail method of valuation cannot be applied in a routine manner
- Is inventory of Real Estate Developer (ready flats /units) covered by this ICDS?
If yes, the treatment of borrowing cost ?

ICDS VII GOVERNMENT GRANTS





ICDS – Government Grants

Scope of the Standard

- ❑ Deals with the treatment of Government Grants
- ❑ Subsidies, cash incentives, duty drawbacks, waiver, concessions, reimbursements etc

Exclusions from the Scope

- ❑ Government assistance which is not in the form of Government Grants
- ❑ Government participation in the ownership of the enterprise

Definitions

- ❑ “Government” refers to the Central Government, State Government, agencies and similar bodies, whether local, national or international
- ❑ “Government Grants” are assistance by government
 - ❑ In cash or kind
 - ❑ For past or future compliance with certain conditions

Excludes

- ❑ the assistance in a form which cannot be valued
- ❑ Normal trading transactions with government



ICDS – Government Grants

■ Recognition of Government Grants

- It is subject to reasonable assurance as to compliance with conditions attached to the grant and that the grants shall be received
- However, recognition shall not be postponed beyond the date of actual receipt

■ Treatment of Government Grants

- In the case of depreciable fixed assets (Para 5)
 - Deduct from the WDV of Block of Assets to which the asset belonged
 - Impliedly, recognized as income in the same pattern as depreciation claimed
- In the case of non depreciable fixed assets (subject to obligations to be fulfilled) (Para 6)
 - Recognized as income over the same period over which the cost of meeting such obligations is charged to income
 - The ICDS is silent in the case of non depreciable fixed asset which is not subject to obligations
- In the case of a grant which is not directly relatable to the asset acquired, proportionate adjustment prescribed (Para 7)



ICDS – Government Grants

■ Treatment of Government Grants (contd.)

In the case of grant: (Para 8)

- received as compensation for expenses or losses incurred in Previous Financial Year or
- for giving immediate financial support to person with no further related costs

To be recognized as income of the period in which it is receivable

- The Government Grants not dealt with in Para 5-8 of the ICDS
 - Recognized as income over the period necessary to match them with related costs which they are intended to compensate
 - Impliedly, the ICDS suggest that a non depreciable asset (with no obligations attached) should be recognized as income in the year of recognition of the Grant
- In the case of non monetary assets given at a concessional rate
 - To be accounted for on the basis of acquisition cost
 - What if given at zero cost?



ICDS – Government Grants

■ Important Deviations from the AS 12

- Grants related to non depreciable assets (without requiring fulfillment of obligations) should be credited to capital reserve . The ICDS does not recognize this principle.
- Government Grants of the nature of promoters contribution to be credited to capital reserve and treated as part of shareholders fund. The ICDS is silent on this.

■ Significant Issues

- The Government Grants - the purpose test for treating as capital receipt is made redundant?
- A Grant given as an incentive for set up of new industries - merely because computed with reference to the value of investment in assets will considered as a grant related to the asset?
- Amendment by Finance Act 2015 – insertion of section 2(24)(xviii) in the IT Act



ICDS – Government Grants

■ Refund of Government Grants

- Refund of Government Grant referred in Para 6,8 and 9
 - First apply against any unamortized deferred credit
 - Refund in excess of the above to be charged to Profit & Loss A/c
- Refund of Government Grant related to a depreciable fixed asset
 - Increase the WDV of block of assets
 - Depreciation prospectively on the revised WDV of the block of assets

■ Transitional Provisions

- All the Government grants that meets with the recognition criteria of the ICDS on or after 1st day of April and relates to any period ending 31st March 2015 or before shall be recognized for the financial year commencing on or after 1st April 2015 after taking into account the said Government grant recognized for any period ending on or before 31st March 2015.



ICDS – Government Grants

Disclosures

- ❑ 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
- ❑ nature and extent of Government grants recognised during the previous year as income
- ❑ **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
- ❑ **nature and extent of Government grants not recognised** during the previous year as income and reasons thereof



Government Grants – Amendments by Finance Act 2015

The Definition of Income under section Section 2(24) of the Act has been amended by Finance Act 2015 to insert clause xviii which reads as:

"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 reimbursements 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."

- ❑ The purpose of this amendment seems to be to bring to tax even those Government Grants which are in the nature of non taxable capital receipts.
- ❑ Will this amendment pass through the test of legislative competence ?



ICDS – Government Grants

- **Some of the Important Judicial Precedents**

- **Ponni Sugars & Chemicals Ltd (306 ITR 0392) – SC**

- Test to be applied for determining the nature of subsidy is purpose test
- If the object of the subsidy scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account
- On the other hand, if the object of the assistance under the subsidy scheme was to enable the assessee to set up a new unit or to expand the existing unit then the receipt of the subsidy was on capital account
- Form or the mechanism through which the subsidy is given is irrelevant.
- As the assessee was obliged to utilize the subsidy only for repayment of term loans undertaken by the assessee for setting up new units/expansion of existing business, the same was capital in nature
- Fact that the subsidy was routed through the mechanism of price and duty differentials is immaterial



ICDS – Government Grants

- **Some of the Important Judicial Precedents (Cont..)**

- **Reliance Industries Ltd. (339 ITR 0632)- Bombay HC**

- Object of subsidy being to set up new units in backward area, the same is a capital receipt

- **Sahani Steels (228 ITR 253) - SC**

- Subsidy from public funds granted by Government by way of refund of sales-tax, etc. on purchase of machinery etc. after commencement of production to enable the assessee to run the business more profitably, and not for setting up of the industry, is operational subsidy and hence, a revenue receipt.
- What is material is the purpose for which it is granted and not the source of grant—If the purpose is to help the assessee to set up its business or complete a project, the monies must be treated as to have been received for capital purpose but if monies are given to the assessee for assisting him in carrying out the business operation and the money is given only after and conditional upon commencement of production, such subsidies must be treated as assistance for the purpose of the trade and revenue in nature

