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Income Computation and Disclosure Standards
FAQs

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Frequently Asked Questions on Income Computation and Disclosure Standards ("ICDS")

General

1. **What is the relevance of ICDS for taxpayers?**
   ICDS applies to all taxpayers following accrual system of accounting for the purpose of computation of income under the heads "profits and gains from business/ profession" and "income from other sources".

2. **Which is the relevant year for applicability of ICDS?**
   ICDS has come into effect from 1 April 2015 and accordingly, applies from assessment year 2016-17 onwards.

3. **Would the implications under ICDS have to be considered for the purposes of the first advance tax installment due by 15 June 2015?**
   Yes, the implications under ICDS is required to be considered for the first advance tax installment as ICDS is applicable for assessment year 2016-17.

4. **Does ICDS impact the maintenance of books of accounts or preparation of financial statements?**

   ICDS applies only for computation of income and not for maintenance of books of accounts or preparation of financial statements. Accordingly, ICDS should not impact maintenance of books of accounts or preparation of financial statements. The financial statements would continue to be prepared based on Accounting Standards/ IndAS (as applicable).

5. **In case there is a conflict between the provisions of the Income-tax Act, 1961 ("the Act") and ICDS, how is the same to be dealt with?**

   In case of conflict between the provisions of the Act and ICDS, the Act shall prevail. This has been specifically provided in the ICDS.

6. **Under what powers have the ICDS been notified by the Central Board of Direct Taxes ("CBDT")?**

   The ICDS have been notified by the CBDT under Section 145(2) of the Act dealing with method of accounting to be followed by taxpayers.

7. **Which are the ICDS notified by the CBDT?**

The following ICDS have been notified by the CBDT on 31 March 2015:

- ICDS 1 Accounting Policies
- ICDS 2 Valuation of Inventories
- ICDS 3 Construction Contracts
- ICDS 4 Revenue Recognition
- ICDS 5 Tangible Fixed Assets
- ICDS 6 Changes in Foreign Exchange Rates
- ICDS 7 Government Grants
- ICDS 8 Securities
- ICDS 9 Borrowing Costs
- ICDS 10 Provisions, Contingent Liabilities and Contingent Assets

The key features of each of the ICDS are outlined below.

ICDS 1 - Accounting Policies

8. **Which fundamental accounting assumptions are recognized by ICDS 1 relating to accounting policies?**

The following three fundamental accounting assumptions are recognized by ICDS 1 relating to accounting policies:

- Going concern
- Consistency
- Accrual[1]

[1] Revenues and expenses

9. **Can a taxpayer change the accounting policy followed and if yes, under what circumstances can such change be made?**

   In principle, change in accounting policy is permissible. It should, however, be noted that an accounting policy should not be changed by a taxpayer "without reasonable cause".

ICDS 2 – Valuation of Inventories

10. **What are the methods for valuation of inventory recognized by ICDS 2?**

    The following are the three methods of valuation of inventory recognized by ICDS 2:

    - First-in first-out
    - Weighted average cost
    - Retail method

11. **Is it correct that even service providers are now required to record inventory?**

    Yes, this is correct. Even service providers are now mandatorily required to record inventory as per ICDS 2 relating to valuation of inventories.

ICDS 3 – Construction Contracts

12. **What is the manner of recognition of revenue and expenses from construction contracts under ICDS 3?**
    Revenue and costs from construction contracts are to be recognized by reference to the stage of completion of contract activity on the reporting date. This is referred to as "percentage of completion" method. Under this method, revenue, expenses and profit are reported based on the proportion of work completed.

13. **What is the manner of recognizing contract revenue during the early stages of a contract?**
    During the early stages of a contract, where the outcome of a contract cannot be estimated reliably, contract revenue is recognized only to the extent of costs incurred. It may be noted that an early stage of a contract should not extend beyond 25 percent of the stage of completion.

ICDS 4 – Revenue Recognition

14. **What is the manner in which revenue is to be recognized from sale of goods?**
    In the case of sale of goods, revenue is to be recognized when the property in the goods is transferred to the purchaser for a price or all significant risks and rewards of

ownership are transferred to the purchaser and no effective control (associated with ownership) of the goods is retained by the seller. Revenue should be recognized when there is a reasonable certainty of its ultimate collection.

15. **What is the manner in which revenue is to be recognized from service transactions?**

    In case of service transactions, revenue is to be recognized by "percentage of completion" method. Under this method, revenue, expenses and profit are reported based on the proportion of work completed as per ICDS 3 relating to construction contracts.

16. **What is the manner in which revenue is to be recognized from royalty transactions or similar transactions involving intellectual property?**

    Royalties should accrue in accordance with the terms of the relevant agreement, unless having regard to the "substance of the transaction", it is more appropriate to recognize revenue on some other "systematic and rational" basis.

ICDS 5 – Tangible Fixed Assets

17. **What is the value at which fixed assets are to be recorded as per ICDS 5 relating to tangible fixed assets?**
    Fixed asset are to be recorded at actual cost including purchase price, duties, taxes (excluding those that are recoverable) and other directly attributable expenditure for making such asset ready for its intended use.

18. **What is the treatment of expenditure incurred on test runs?**
    The expenditure incurred on start-up and commissioning of a project including expenditure on test runs and experimental production is to be capitalized while the expenditure incurred after the plant begins commercial production is to be treated as revenue expenditure.

ICDS 6 – Changes in Foreign Exchange Rates

19. **What is the manner in which foreign currency transactions are to be recorded?**
    A foreign currency transaction is to be recorded on initial recognition in the reporting currency by applying to the foreign currency amount, the exchange rate (between reporting currency and foreign currency) on the transaction date or weekly/ monthly average rate (if such rates do not fluctuate significantly from actuals).

20. **How are foreign exchange differences to be recognized?**
In case of monetary items (money held and assets receivable or liabilities payable in fixed/ determinate amounts of money), exchange differences arising on settlement/ on last day of the year are to be recognized as income or expense in that financial year. In case of non-monetary items, exchange differences arising on conversion on last day of the year is not to be recorded as income or expense of that financial year.

ICDS 7 – Government Grants

21. **How are Government grants to be recognized?**
Government grants are to be recognized when there is reasonable certainty that related conditions would be complied with and it is reasonably certain that the grants would be received. Government grant should not be postponed beyond actual receipt date.

ICDS 8 – Securities

22. **What is the manner in which securities held as stock-in-trade are required to be valued?**
Securities held as stock-in-trade are required to be valued at actual cost initially recognized or net realizable value at the end of that year, whichever is lower. Unlisted securities or unquoted securities are to be valued at actual cost initially recognized.

ICDS 9 – Borrowing Costs

23. Which are the borrowing costs covered by ICDS 9?

Borrowing costs are interest and other costs incurred in connection with the borrowing of funds which include the following:

- Commitment charges
- Amortized discount or premium
- Amortized ancillary costs in connection with arrangement of borrowings
- Finance charges for assets taken on finance lease.

24. What is the manner of recording the borrowing costs?

Borrowing costs directly attributable to acquisition, construction, production of tangible and intangible assets are required to be capitalized as part of that asset cost. With respect to inventory, the borrowing costs should be added to inventory cost, only if such inventory takes twelve months or more for being brought to saleable condition.

In respect of funds borrowed specifically for a qualifying asset, the actual borrowing costs during the period are required to be capitalized to that asset. In respect of general borrowings, a specific formula for capitalizing borrowing costs is provided based on the ratio of qualifying assets to total assets.

ICDS 10 – Provisions, Contingent Liabilities and Contingent Assets

25. **When can a provision be recognized as per ICDS 10?**

    Taxpayer can recognize a provision in the following situations:

    - Taxpayer has a present obligation as a result of a past event
    - It is reasonably certain that an outflow of resources embodying economic benefits would be required to settle such obligation and
    - A reliable estimate can be made of this obligation amount.

    A provision should not be recognized for costs that need to be incurred to operate in the future.

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