

INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

Frequently Asked Questions (FAQ)

By CA. Manohara Gupta

FAQ'S GENERAL:

1. Can the assessee maintain two sets of books of accounts one for AS and the other for ICDS?

Ans: As brought out in the Preamble of every ICDS, these standards do not require to make entries in books of account as per ICDS but only to make adjustments in computation of income. Hence there is no requirement to maintain two sets of books of account; however necessary workings will have to be maintained for adjustments carried to books profits in terms of ICDS.

2. Can a non corporate entity follow only ICDS in preference to the Accounting Standards issued by ICAI? If the entity is under Tax Audit what is the obligation of Tax Auditor in such situation?

The assessee is bound to follow ICDS while computing his return of income. He is not bound to follow the standards issued by the ICAI.

Ans: In case of the tax auditor while issuing audit reports on the books of account he is required to ensure compliance with accounting standards issued by the ICAI. Any non-compliance with AS issued by ICAI will have to be considered by the auditor while drafting his report. However while commenting on adjustments and disclosures as per ICDS in Form 3CD in clause 13; the tax auditor will have to check compliance with ICDS.

3. What if disclosures not made but adjustments contemplated in clause 13 (e) of Form 3 CD are made? Will it amount to non compliance attracting provisions of sec 144 ?

Ans: Yes, it would amount non-compliance with ICDS as disclosure requirements also forms part of the standard. Non-compliance could give power to Assessing Officer to powers under Sec 144.

4. What is the significance of ICDS I? Is it the mother of remaining ICDS?

Ans: ICDS-I is similar to AS 1 and only mandates the disclosure of significant accounting policies. Apart from that, it also prohibits recognition of MTM Losses and expected losses unless permitted by any other ICDS. Since ICDS specified fundamental accounting assumptions and governing principles, it has a special status.

5. When there is a change in the method of valuation of inventory and the impact due to such change is nil in that year but it may impact in future years. AS per ICDS one needs to disclose such impact in the future year when such impact occurs. How long this exercise should be carried out? Is there any disclosure requirement in the intervening years?

Ans: As brought in ICDS I, change in accounting policy is to be disclosed in two years – one in the year when the change is adopted and second in the year in which such change has a material effect for the first time.

6. Should incremental value of employee retirement benefits accrued in actuarial valuation basis form part of construction cost, but allowable u/s 43B only on payment?

Ans: As per ICDS III costs shall comprise costs that relate directly to the specific contract and ICDS X states that a provision shall be recognised when a person has a present obligation as a result of past event. It is nowhere stated that provision as per ICDS X should be considered as cost for ICDS III nor there is any bar on considering provision as per Income Tax Act as contract cost.

7. What is the status of ITAS - I & II notified u/s 145?

Ans: ICDS replaces 2 Income Tax Accounting Standards (ITAS) - I & II notified u/s 145 in 1996. Though *ITAS-I: 'Disclosure of accounting policies'*, continues in the form of ICDS-I; *ITAS-II relating to 'Disclosure of prior period & extra ordinary items and changes in accounting policies'* is missing in new ICDS.

Perhaps keeping IND AS in mind, where concept of prior period does not exist this standard is not prescribed. It is important to take note that though ICDS does not require Assessee to disclose prior period expenses, Form 3 CD specifically requires disclosure of prior period expenses vide clause No. 27 (b).

8. *In case of assesses covered by Sec 44AD and opting for presumptive tax based on turnover or gross receipts, though not covered by ICDS whether determination of such turnover or gross receipts should be on the principles of ICDS?*

Ans: In case of Individuals and HUFs covered by Sec 44AD and opted for presumptive tax, ICDS are not applicable and hence turnover or gross revenue should be based on generally accepted accounting principles and pronouncements of ICAI.

However in respect of other category of assesses though covered by Sec 44AD and opted presumptive tax, they should follow ICDS principles for determination of turnover or gross receipts. (Also refer to FAQ no 3 issued by CBDT).

9. *Whether these standards apply to all corporate assesses?*

Ans: No, not necessarily. If a company has income from house property (rentals), ICDS would not apply.

10. *Whether these standards apply to a charitable trust?*

Ans: If the trust has income only from house property, or the trust is following cash system of accounting, then ICDS would not apply.

11. *Can a non-corporate assessee maintaining books of account on mercantile basis switch over to cash basis of accounting in order to escape from the applicability of ICDS?*

Ans: An assessee cannot change the method of accounting without a reasonable cause. Objective of avoiding ICDS would not be a reasonable cause. (Also refer FAQ No 9 issued by CBDT for reasonable cause).

12. In case of corporate assesses, whose turnover or gross receipts are lower than threshold limits prescribed u/s 44AB and are not required to get tax audit done, these standards still apply. In such case, where should such companies make disclosures required under ICDS?

Ans: Such assesses though required to follow ICDS are not required to make disclosures as clarified by CBDT. (Also, refer FAQ No25 issued by CBDT)

13. . Whether disclosures under ICDS are required to be made even though there are no such transactions? What happens if disclosures are not made though ICDS are followed?

Ans: Disclosures may be confined to the transactions. If required disclosures are not made, it would tantamount to non compliance and provisions of Sec 145 (3) would attract.

14. . These ICDS are applicable for the AY 2017-18. Are these applicable retrospectively?

Ans: Yes, partially since these standards were notified on 29th September, 2016, by which half of the financial was over, but still these standards apply effective from 1st April, 2016.

15. . In the preamble of each ICDS it is stated that “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.”

There are several litigations settled by judicial pronouncements by the Supreme Court. Whether ICDS prevail over these judicial pronouncements?

Ans: Please refer to FAQ No 2 issued by CBDT, wherein it is clarified that ICDS would apply for such transactional issues prospectively from AY 2017-18.

16. . Whether assesses should change the method of accounting to align with ICDS?

Ans: It would be convenient to the assessee if the accounting policies are aligned with ICDS. However it is not mandatory.

FAQ's relating to ICDS - III

17. ICDS III is effective from 1st April, 2016. What would be the position of contracts in pipe line as on that date, particularly when the contractor has followed CCM for these contracts?

Ans: As per transitional provisions contained in para 22.2 of ICDS III, an assessee can continue to follow the method regularly adopted even if such method is not in line with ICDS III.

18. What is the method to be followed for valuation of WIP under ICDS III?

During early stages of contract say not exceeding 25% value of the contract, WIP can be stated at cost. If the stage of contract exceeds 25%, proportionate profit to be loaded to WIP under POCM provided revenue can be measured reliably and there is no uncertainty of ultimate realisation.

19. A construction company accounts for depreciation based on useful life determined on technical evaluation. For the Financial year 2016-17 depreciation on equipments used in construction projects amount to Rs 50 lakhs, whereas depreciation on such items of plant & machinery as per Sec 32 of IT Act works out to Rs 10 lakhs only. Can Depreciation charged in statement of Profit & Loss on such equipments used for construction activity be considered as cost of construction? Should the company carry adjustments to cost of contract and consequential WIP valuation? What would be status of depreciation claim u/s 32?

Ans: As per ICDS III costs shall comprise costs that relate directly to the specific contract and ICDS V states that depreciation will be governed by ICDS V. It is nowhere stated that depreciation as per ICDS V should be considered as cost for ICDS III nor there is any bar on considering depreciation as per Income Tax Act as contract cost. However the amount considered for contract cost only would be considered for valuation of WIP before loading profit element as per POCM. Though this would neutralise

book profit, impact on total income would remain since depreciation charged in the books of account would get added back in the computation and depreciation as per ICDS V read with sec 32 only is eligible.

Adjustment of impact due to ICDS should have another step of adjusting contract cost by deducting book depreciation and adding IT depreciation and consequential adjustment to WIP also.

This is further explained with adjustment Note to be stated in clause 13 € of Form 3 CD:

| | | |
|---|-------------|---|
| Facts: | | |
| A construction company has undertaken a long term project valuing Rs 5 Crores | | |
| No other activities in the company other than this project work | | |
| 40% Project was completed as on 31.3.2017 | | |
| Contract costs incurred till 31.3.2017 excluding depreciation is Rs 1.50 crores | | |
| Estimated profit determined on POCM is Rs 20 lakhs | | |
| Depreciatin as per books (Technical evaluation under Scheduloe II of Co Act is 50 lakhs | | |
| Depreciation u/s 32 is Rs 10 lakhs | | |
| Equipment is exclusively used for the project | | |
| | | |
| Adjustment for depreciation on account of ICDS III | | |
| Contract cost debited in books (1.50+ Depn .50) | 2,00,00,000 | |
| | | |
| Less: Cost of contract, for depreciation as per books | 50,00,000 | - |
| Add: Depreciation as per It (ICDS V) | 10,00,000 | |
| Adjusted contract cost as per ICDS III | 1,60,00,000 | |
| | | |
| Contract Revenue: | | |
| WIP as per books (Before loading profit element) | 2,00,00,000 | |
| | | |
| Less: Cost of contract, for depreciation as per books | 50,00,000 | - |
| Add: Depreciation as per It (ICDS V) | 10,00,000 | |
| | 1,60,00,000 | |
| Add: Profit element as per POCM | 20,00,000 | |

| | | |
|--|-------------|---|
| Adjusted contract Revenue | 1,80,00,000 | |
| | | |
| Less: Depreciation as per IT | 10,00,000 | |
| Total Income after considering adjustments under ICDS | | |
| Adjusted contract Revenue | 1,80,00,000 | |
| Less: Adjusted contract cost | 1,60,00,000 | - |
| Less: Depreciation u/s 32 | 10,00,000 | - |
| Total Income | 10,00,000 | |
| | | |
| Total Income with out ICDS adjustments: | | |
| | | |
| Contract Revenue: | | |
| WIP as per books (Before loading profit element) | 2,00,00,000 | |
| Less: Contract Cost | 2,00,00,000 | - |
| Add: Prifit element | 20,00,000 | |
| Add: Depreciation charged in books | 50,00,000 | |
| Less: Depreciation u/s 32 | 10,00,000 | - |
| Total Income | 60,00,000 | |
| | | |

20.As a business strategy, while quoting for a single tender for construction of structure, unit wise prices required to be quoted, certain items are quoted below estimated cost and certain items are quoted at exorbitant margins. When progress is achieved at 40% of the contract, which comprises only the items resulting in loss, should the exorbitant margins in the items not commenced be considered to estimate revenue under POCM?

Ans: Though artificial lower rates may be quoted for certain items but once service is treated as part of a single contract, the break up into individual components is not permitted and recognition of contract revenue and costs is to be made after considering contract as a whole.

21. X contractor receives Rs 10 lakhs on signing a fixed price long term contract worth Rs 100 lakhs on 1st January, 2017 and till the year ended 31st March, 2017 he has executed the contract to the extent of Rs 3 lakhs. He raised a running bill for Rs 4 lakhs. What should be the treatment under ICDS III?

Since the progress of contract is in early stages and the outcome of the contract cannot be estimated reliably, the contractor need not recognise revenue though payment is received and running bill is raised, considering the principle of substance over form.

22. What in the above contract, if the costs incurred for the contract is to the tune of Rs 60 lakhs as at 31st March, 2017 but neither any running bills submitted nor payment received.

As progress of the contract is 60 % of the contract value, the contractor by adopting POCM should recognise proportionate revenue subject to the condition that the outcome of the contract can reliably be estimated and there is no uncertainty for ultimate collection.

23. What constitutes contract revenue? Retention money is not recognised till the right to receive the same is established? Should such retention money form part of contract revenue?

As per para 10 of ICDS III contract revenue is

- a) the initial amount of revenue agreed in the contract including retention money
- b) Variations in contract work
- c) Claims
- d) Incentive Payments

Retention money is to be recognised as revenue to the extent that it is probable that they will result in revenue and they are capable of being reliably measured.

24. Whether foreseeable losses can be recognised under ICDS III?

As per para 4(ii) of ICDS I expected losses shall not be recognised unless the recognition is in accordance with any other ICDS. Under ICDS III expected loss should be recognised in proportion of work completed.

25. What is contract cost? Whether provision for liquidated damages, warranty costs form part of contract costs?

Contract Costs shall comprise of:

- (a) directly relatable costs to that specific contract;
- (b) allocated costs to the contract, that are attributable to contract activity in general; (incl. borrowing costs as per ICDS-IX)
- (c) such other costs as are specifically chargeable to the customer under the terms of the contract;

The costs shall be reduced by any incidental income other than in the nature of interest, dividends or capital gains, that is not included in contract revenue. (Para 12 of ICDS III).

There is no specific coverage of these items in ICDS III.

However as per AS 7:

- a) liquidated damages or penalties due to delay in execution of contract should be reduced from contract revenue (para 7) and
- b) while defining cost directly attributable to contract costs, estimated amount of warranty costs is included in cost of contract (para 16). Since ICDS III refers only to costs directly attributable to contract costs, warranty costs would form contract cost.

Para 11 of ICDS III states that where contract revenue is already recognised as income is subsequently written off in the books of account as uncollectable, the same would considered as contract expense. Alternately when there is uncertainty in ultimate collection of revenue to the extent of liquidated damages, revenue can be recognised net of liquidated damages.

26. What are the deviations of ICDS III from AS-7?

| ICDS III | AS 7 |
|--|--|
| Expected loss should be recognised in proportion of work completed | The expected loss should be recognised as an expense |

| | |
|--|--|
| | immediately |
| Limit of 25% is fixed for identifying early stages of the contract | No such % fixed for identifying early stages of the contract |
| Under ICDS III, contract revenue shall comprise of variations in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue and their capable of being reliably measured. | Under AS 7, incentive payments are included in contract revenue when the contract is sufficiently advanced that it is probable the specified performance standards will be met or exceeded and the amount of the incentive payments can be measured reliably |
| All types of contract costs should be reduced by any incidental income not being in the nature of interest, dividends and capital gains, that is not included in contract revenue. | Costs that relate directly to a specific contract may be reduced by any incidental income that is not included in contract revenue |

27. What is the treatment to be given for income generated during pre contract period like interest earned? What should be treatment given for income incidental to the contract like sale of debris, damages collected, claims received?

All types of contract costs should be reduced by any incidental income not being in the nature of interest, dividends and capital gains that is not included in contract revenue.

28. How are borrowing costs treated under ICDS III? Particularly interest paid on acquisition of general plant & equipment for the project? Costs during pre commissioning period and post commissioning period? What if such equipments are lying idle?

Borrowing costs in accordance with ICDS IX should be added to borrowing costs. In terms of para 8 of ICDS IX cessation of capitalisation of interest can be done only when the asset is first put to use and in case of inventory

when substantially all the activities necessary to prepare such inventory for its intended use is complete.

Hence interest will continue to be capitalised till such time the work is completed.

29. How contract costs to be determined when destruction of partial work performed like flood water?

Since such costs meet the definition of contract costs as per para 12 of ICDS III such costs must be considered as contract costs.

30. Whether ICDS III is applicable to Real Estate developers and builders who are engaged in developing properties, constructing flats/villas on their own and selling and transactions under BOT/ BOOT/ or under other terms in PPP mode? Would they apply to developers under JDA?

Ans: As clarified in Question No 12 of FAQ issued by the CBDT currently there is no specific ICDS applicable to real estate developers for transactions under BOT/BOOT. Presently Guidance Note for Real Estate Transactions as issued by the ICAI as well as provisions of the Income Tax Act will be required to follow in case of real estate transactions.

Since joint development agreements are covered in the scope of Guidance Note for Real Estate Transactions the accounting treatment will be governed by such Guidance Note.

31. How are contract costs for future activity considered?

Ans: Costs for future activity are classified as an asset under contract work in progress.

32. What are the implications of ICDS III on deferred tax?

Impact will arise in cases of difference in treatment as prescribed in AS-7 and ICDS III. *For example*, under AS 7 expected future losses are provided immediately whereas under ICDS III such losses are provided on a proportionate basis to the extent of work completed. The difference will give rise to a deferred tax asset.

33. *What are the principles of contract revenue recognition under ICDS III?*

- a) Contract revenue is recognised with reference to the stage of completion of contract activity.
- b) Progress Payments and advances received are not determinative of the stage of completion.
- c) During early stages of the contract which cannot be beyond 25% of stage of completion contract revenue is recognised only to the extent of contract costs incurred.

34. *Whether ICD III applies to service contracts or to professionals rendering services on contract basis?*

As per the scope para ICDS III applies only to construction contracts. Since service contracts and services of professionals are not provided in relation to construction of an asset they will not be governed by ICDS III but by ICDS IV. However if the professional services are attached to a contract like architect, or project manager would constitute a contract and would be covered by ICDS III.

35. *What are the disclosures to be made under ICDS III?*

- a) Amount of contract revenue recognised during the period
- b) Method used to determine the stage of completion of contracts in progress.
- c) For contracts in progress:
 - i. Amount of costs incurred and recognised profits upto 31st March
 - ii. Amount of advance received
 - iii. Amount of retention money

36. *A company undertakes Turnkey project for fabrication / manufacture, supply and erection of equipment. Manufacture of basic units of the equipment is done at their factory and assembly (which involves fabrication) and erection takes place at customer's site. Whole transaction takes 3 years. Should this attract ICDS III or ICDS IV?*

The answer would depend upon the terms of the contract. If the equipment's to be supplied are unique and as per the specifications of the customer the contract would be a construction contract governed by ICDS III whereas if the equipments are as per the design of the vendor and supplied from shelf, then it would be governed by ICDS IV as a sale of goods.

FAQs relating to ICDS IV

37. What are the key differences between AS 9 and ICDS IV?

| AS 9 | ICDS IV |
|--|---|
| In case of services option to follow either percentage of completion method or completed service contract method | Only percentage of completion service method is allowed. Certain exceptions for short duration contracts and services including determinate number of acts. |
| Dividends are recognised when the owners right to receive the payment is established | Dividends are recognised in accordance with the provisions of the Act. |
| Interest accrues on time basis | Interest accrues on time basis except for interest on refund of any tax, duty or cess shall be on receipt basis. |

38. What are the implications of ICDS IV on deferred tax?

Implications may arise in case of difference in accounting treatment prescribed for services.

39. When services are provided by an indeterminate number acts over a specified period how revenue should be recognised?

In such cases service income is recognised on a straight line basis over the specified period.

40. When dividends should be recognised under ICDS IV?

Recognition of dividend will be governed by the provisions of Income tax Act.

41. A Service provider has undertaken 50 short duration jobs at a value of Rs 2 Crores each. All jobs were commenced between 1st and 10th February, 2017 and completed on 30th April, 2017. 60% to 70% of the

jobs are completed as on 31st March, 2017. Should the service provider follow POCM for recognition of profit on these jobs for computation of income for the AY 2017-18?

From the facts of the question it is noted that the duration of the job is for less than 90 days. As provided in para 7 of ICDS IV, the service provider need not recognise revenue by adopting POCM.

42. What are the transition provisions applicable to service contracts?

| Type of Service Income | Transitional Provisions |
|--|---|
| In case of services where revenue is recognised based on POCM | For contracts commenced before 01.04.2016 an assessee can continue to follow the method regularly adopted even such method is not in line with ICDS IV |
| In case of services where revenue is required to be recognised on straight line basis (indeterminate number of acts) | From 01.04.2016 revenue to be recognised as per provisions of ICDS IV after giving effect to revenue already recognised by using old method up to 31.03.2015. |

43. What are the disclosure requirements of ICDS IV?

- a) In a transaction involving sale of good, total amount not recognised as revenue during the previous year due to lack of reasonably certainty of its ultimate collection along with nature of uncertainty
- b) The amount of revenue from service transactions recognised as revenue during the previous year
- c) The method used to determine the stage of completion of service transactions in progress;
- d) For service transactions in progress at the end of previous year:
 - (i) amount of costs incurred and recognised profits (less recognised losses) upto end of previous year;
 - (ii) the amount of advances received; and
 - (iii) the amount of retentions.
