ICMAI
The Institute of
Cost Accountants of India
(Statutory Body under an Act of Parliament)
www.icmai.in

iCMA

PRACTICAL GUIDE ON

Compliance of Income Computaion and Disclosure Standards (ICDS) under Income Tax Act

THE INSTITUTE OF
COST ACCOUNTANTS OF INDIA

Headquarters:
CMA Bhawan, 3, Institutional Area, Lodhi Road, New Delhi - 110003

Kolkata Office:
CMA Bhawan, 12, Sudder Street, Kolkata - 700016

Direct Tax

Behind Every Successful Business Decision, there is always a CMA

About the Institute

The Institute of Cost Accountants of India (ICMAI) is a statutory body set up under an Act of Parliament in the year 1959. The Institute as a part of its obligation, regulates the profession of Cost and Management Accountancy, enrols students for its courses, provides coaching facilities to the students, organizes professional development programmes for the members and undertakes research programmes in the field of Cost and Management Accountancy. The Institute pursues the vision of cost competitiveness, cost management, efficient use of resources and structured approach to cost accounting as the key drivers of the profession. In today's world, the profession of conventional accounting and auditing has taken a back seat and cost and management accountants increasingly contributing towards the management of scarce resources like funds, land and apply strategic decisions. This has opened up further scope and tremendous opportunities for cost accountants in India and abroad.

The Institute is headquartered in New Delhi having four Regional Councils at Kolkata, Delhi, Mumbai and Chennai, 117 Chapters in India and 11 Overseas Centres. The Institute is the largest Cost & Management Accounting body in the world with about 1,00,000 qualified CMAs and over 5,00,000 students pursuing the CMA Course. The Institute is a founder member of International Federation of Accountants (IFAC), Confederation of Asian and Pacific Accountants (CAPA) and South Asian Federation of Accountants (SAFA). The Institute is also an Associate Member of ASEAN Federation of Accountants (AFA) and member in the Council of International Integrated Reporting Council (IIRC), UK.

Vision Statement

"The Institute of Cost Accountants of India would be the preferred source of resources and professionals for the financial leadership of enterprises globally."

Mission Statement

"The CMA Professionals would ethically drive enterprises globally by creating value to stakeholders in the socio-economic context through competencies drawn from the integration of strategy, management and accounting."

Institute Motto

असतोमा सद्गमय तमसोमा ज्योतिर् गमय मृत्योर्मामृतं गमय ॐ शान्ति शान्ति शान्तिः	From ignorance, lead me to truth From darkness, lead me to light From death, lead me to immortality Peace, Peace, Peace

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Statutory Background

Section 145(1) required to follow either cash or mercantile system of accounting by the assessee to derive income chargeable under the head "Profits or gains from business or profession" and "Income from other sources". Also effective from 1st April, 2015 ICDS as notified under section 145(2) by the government is mandatory to follow while computing taxable income under the above two heads of income.

The Central Government in order to exercise the power conferred by section 145(2) of the Income tax Act, 1961 has notified ICDS on 29th September, 2016 vide S.O. 3078(E) applicable w.e.f. A.Y 2017-18.

- These ICDS have to be followed by all assessees except an Individual or HUF who is not required to get his accounts of the previous year audited in accordance to the provision under section 44AB, following the mercantile system of accounting for the purpose of computation of income chargeable under the head "Profits or gains of business or profession" or "Income from the other sources".
- The preamble of ICDS prescribes the usage only to compute income under the head "Profits or gains from business or profession" and "Income from other sources". The provision of ICDS is not applicable for the maintenance of books of accounts. Assesee shall maintain books of accounts based on the prevailing Generally Accepted Accounting Principle, Accounting standards, Ind AS, Generally Accepted Cost Accounting Principle, Cost Accounting Standards etc. as the case may be.
- In the case of conflict between the provisions of the Income-tax Act, 1961 and this ICDS, the provisions of the Act shall prevail to that extent.

The Central Government has issued a total of 10 ICDS.

ICDS-I Relating to Accounting Policies

The assessee is required to maintain books of accounts based on the fundamental accounting assumption.

- "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" refers to the assumption that accounting policies are consistent from one period to another
- "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 Accounting policies adopted by the assessee shall be such as to represent a true and fair view of the state of affairs and income of the business, profession or vocation. The accounting policies shall not be changed without reasonable cause.

ICDS-II Relating to Valuation of Inventories

Preamble

- 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 <u>not for the purpose of maintenance of books of accounts.</u>
- In the case of conflict between the provisions of Income Tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Preamble clearly mentions to adhere to the guidelines prescribed under this standard to compute the value of inventory for being a part of computing income under the head "Profits and gains of Business or profession" or "Income from other sources".

Company and non-company assessee is required to follow AS, Ind AS to maintain financial accounts. In the case of companies to which provisions of section 148 of Companies Act, 2013 is applicable, it is required to follow CCRA Rules, 2014, read with Cost Accounting Standards to maintain cost records. While doing inventory valuation it must not deviate from ICDS-II.

Explanation

As per the definition in ICDS-II inventories may be

- in the form of Finished goods (Manufactured or produced)
- Stock in trade
- Semi- finished goods/Intermediate products
- W.I.P
- Raw Materials, process materials, packing materials
- Stores and Consumables, chemicals, fuels
- Jigs, tools& tackle
- Joint products
- By-products
- Others(Specify if any)

Use of Cost Accounting standards and CCRA Rules, 2014

While determining the valuation of inventory as per provisions of ICDS and other provisions of Income Tax Act, 1961 which may have impact on the inventory valuation needs to be taken care of. Apart from this, practising Cost Accountant may use the costing techniques, methods and his cost expertise with reference to CRA-1 as prescribed in Companies (Cost records and Audit) Rules, 2014, Cost Accounting standards, Generally Accepted Cost Accounting Principle which is in conformity with the relevant provisions of the Income tax Act and ICDS notified there under.

Net Realisable Value: -

It is the estimated selling price in the ordinary course of business less estimated costs of completion and the estimated costs necessary to make the sale. Inventories shall be written down to net realisable value on an item-by-item 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 and also fluctuations of price or cost directly relating to events occurring after the end of the previous year.

The estimated price is further required to be adjusted for any estimated cost incurred during the sales process. The word estimated is an important factor. Since actual sale is not going to happen in this case, it has to be presumed that if the assessee sells or disposes off the inventory what amount he could get and what amount he would require to spend to complete the sale of inventory. A reference may give to the authenticated evidence and economical feasible base in order to derive estimated price and estimated costs to find out NRV of inventory.

The current price of inventory is required to discount with certain percentage to estimate the price of the inventory at the end of the relevant previous year with reference to price index or cost index released by the government or statistical information available with statistics department of government or market factors may be considered to estimate the price at the end of previous year. Also some other factors may have to be considered like market demand, price fetching capacity, condition of inventory i.e. obsolete, damaged etc.; similarly estimated costs related to presumed sale is required to be determined. Selling and distribution costs and S&D overheads have to be considered to estimate the costs related to sale. It may be packing cost, transportation cost, employees cost, warehouse cost, storing cost, commission, advertising cost etc.; Cost Accounting Standard 15 on Selling & Distributing Overheads issued by the Institute of Cost Accountants of India may refer.

NRV of W.I.P-

W.I.P stands for work in progress. In the manufacturing process W.I.P is a stage of completion at which material is under process and is in semi-finished goods state. It includes costs of direct and indirect materials consumed, employees, utilities, production overheads.

To determine NRV, QTV (Quantity, Time and Value) factors may be considered. Raw material put into the manufacturing process passes through different stages. There is a time interval between each stage and quantity produced at each stage. To authenticate the cost and net realisable value, the quantity of W.I.P produced or manufactured is required to be cross checked with the finished goods manufactured records.

Cost plus margin formula may be followed for determination of NRV of W.I.P. In some industries there is a market demand for semi-finished goods which the company sells it to the other company to use as input inventory to make finished goods. In such cases the current selling price discounted may be considered as NRV of W.I.P for the purpose of the valuation of inventory of WIP. For example in Steel industry Ingot, in bread industry flour, in automobile industry chips, engine, in textile industry yarn, in sugar industry molasses etc.; which the company uses to manufacture the finished goods and also sell it to other companies as semi-finished goods.

Costs of Inventories:

It shall comprise of all costs of purchase, costs of services, cost of conversion and other costs incurred in bringing the inventories to their present state. The description is exhaustive. It shall include all the direct and indirect costs and overheads allocated and apportioned relevant to the procurement, manufacturing, producing, and storing the inventories (in certain cases)

Costs of Purchase:

It shall consist of purchase price including duties and taxes. Such duties and taxes on which a tax credit is available shall not be the part of purchase cost, like ITC under GST Act, Duty drawback under Custom Act etc.; Other duties and taxes on which ITC or duty drawback or scheme framed under EOU, SEZ, DFAI, Advance authorization, Manufacture under bond etc.; is not available shall be the part of purchase cost. It may be custom duty, CVD, royalty, entry tax, cess, environmental tax, pollution control tax etc.; imposed under any law being in force. For example on purchase of wine, state excise duty paid, on purchase of coal royalty, cess, duty to NMET(National Mineral Exploration Trust), DMF(District Mineral Foundation Trust) paid etc.;

Freight inward shall be included in the cost of purchase. Due consideration should be given to the agreement of purchase in respect to inward freight with respect to FOB (freight on board), CIF (Cost, Insurance and freight) in the course of import/export. Other direct costs like loading and unloading charges, material/goods handling cost, cost of container, parcel cost, cartage cost, storage and issuing losses, custom clearing agent commission and others which are directly attributed to the purchase of products shall be included to the cost of purchase. Any trade discount, rebates and other similar items like bulk quantity discounts cash discounts etc.; shall be deducted from the purchase cost. The cost of non-returnable containers shall be added in the cost of purchase and any disposable amount shall be deducted from the factory overheads like sale of cement bags, empty drums etc.; Adjustment of cost of returnable containers shall be made for example if oxygen cylinder is not returned in good condition supplier may charge cost of new cylinder as per agreement of supply.

Cost of services like direct and indirect employee cost attributed to the procurement process and storing of goods (in certain cases) shall be included in the cost of purchase. For example, employee cost of purchase department, store, warehouse, weighbridge and other costs incurred in this department shall be included in the cost of purchase.

CAS 6 on material cost, CAS 7 on employee cost, CAS 9 on packing materials, CAS 20 on royalty and technical knowhow may be referred for guidance for ensuring accurate computation of cost of purchase.

Costs of Conversion:

Conversion of materials into finished goods shall consist of material cost, labour cost, utilities cost, other production costs and production overheads costs. Direct and Indirect costs attributed to production cost centres shall be included in the conversion cost. It shall include direct and indirect material costs, direct and indirect employees cost, cost of utilities, repair and maintenance cost, cost of tools, jigs and fixtures, machines, depreciation and amortization costs, fixed and variable production overheads, quality control cost, research and development cost, other manufacturing or producing costs.

Appropriate references may be drawn for arriving at true and correct conversion cost from CAS 2 on capacity determination, CAS 3 on production and operation overheads, CAS 5 on transportation cost, CAS 6 on material cost, CAS 7 on employee cost, CAS 8 on utilities, CAS 10 on direct expenses, CAS 12 on repairs and maintenance, CAS 16 on depreciation and amortization, CAS 18 on research and development, CAS 19 on joint cost, CAS 21 on Quality control, CAS 22 on manufacturing cost, so long as these are not in contrast with the provisions of ICDS or where the ICDS is silent, as for the purpose of valuation of inventories, ICDS provisions shall prevail.

Sales realization from by-products, scrap or waste materials shall be deducted from the cost of finished goods.

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 locations and condition. There should be a clear and explainable linkage between such costs to the inventory being valued. Other costs may be quality control cost, laboratories cost, research and development cost, warehouse cost, goods handling costs, transportation cost etc;

Exclusion from the Cost of Inventories

The following costs shall be excluded and recognized as expenses of the period in which they are incurred.

- 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; for example the refrigeration cost in the making of ice cream, pharmaceutical active ingredients/inputs for manufacturing of Drugs, which are to be stored at an ambient temperature to avoid their deterioration, etc.;
- Administrative overheads that do not contribute to bring the inventories to their present location and conditions;
- Selling costs.

The above cost shall not be included in the cost of inventory. These costs shall be shown separately in the profit and loss accounts as expenditure.

There may be loss of materials during transportation, loading and unloading, due to pilferage, evaporation, spoilage, shrinkage etc.; there is no specific quantification prescribed for indicating the percentage of loss to be treated as abnormal. As per general accounting principles loss or gain due any reason within the range of (+/-) 5percent is treated as normal. Loss of more than 5percent may be treated as abnormal loss of material due to wastage.

Abnormal labour costs may arise due to strike, accident, lockout, fire, flood, climatic disaster, etc.

Cost Formula

Specific Identification of cost:-

It means specific costs are attributed to the identified items of inventory. For the items of inventories which are not ordinarily interchangeable and goods or services produced and segregated for specific projects, the cost shall be assigned by specific identification of their individual costs. Under this method, purchases made for particular jobs are kept physically separate in the store rooms and store cards are made out for the individual purchases. When materials are issued for jobs, requisitions are priced at the exact cost as recorded on the appropriate stores card. For example, high value items, hazardous chemicals, a job order for fabrication of a structure with particular design and dimension to be used for special purposes like in power plant, defence project, space industry, transportation cost for CKD (Completely knocked down) or sub assembly parts of the boiler manufacturing company etc.;

The FIFO or weighted average method shall be used to deal with the cost of inventory of items which are ordinarily interchangeable.

FIFO (First in First Out) method assumes that items first received are the first to be issued and that the requisitions are priced at the cost at which these items were placed in stock. In the FIFO method it doesn't mean that oldest materials are necessarily used first. It simply means that oldest costs are used first for cost booking.

Weighted average method: Under this method the weighted average price is used for valuation of stock at a particular date. Formula is

$$\text{Weighted average price} = \frac{\text{Total cost of purchase}}{\text{Total quantity}}$$

For Example

Date	Receipt (Units)	Rate/Unit	Issue (Unit)
02.04.2022	1000	Rs. 5000	----
15.4.2022	2500	Rs. 5150	----
20.4.2022	------	-------	850
30.42022	-----	-------	1580

Store Ledger under FIFO method

Date	Receipts			Issue			Balance		
	Qty.	Rate Rs.	Cost Rs.	Qty.	Rate Rs.	Cost Rs.	Qty.	Rate Rs.	Cost Rs.
02.04.2022	1000	5000	50,00,000	-	-	-	1000	5000	50,00,000
15.04.2022	2500	5150	1,28,75,000	-	-	-	1000	5000	50,00,000
							2500	5150	1,28,75,000
20.04.2022	-	-	-	850	5000	42,50,000	150	5000	7,50,000
							2500	5150	1,28,75,000
30.04.2022	-	-	-	150	5000	750000			
				1430	5150	73,64,500	1070	5150	55,10,500

* Pricing of issues shall be done at the rate of Rs. 5000/-(rate of the first lot received) each till the first lot of 1000 Nos. exhausts, followed by the rate of 5150/-(rate of the second lot received) till it exhausts , and so on.

Value of Inventory as on 30.04.2022 as per FIFO method shall be Rs. 55,10,500/-

Store Ledger under weighted average method

Date	Receipts			Issue			Balance		
	Qty.	Rate Rs.	Cost Rs.	Qty.	Rate Rs.	Cost Rs.	Qty.	Rate Rs.	Cost Rs.
02.04.2022	1000	5000	50,00,000	-	-	-	1000	5000	50,00,000
15.04.2022	2500	5150	1,28,75,000	-	-	-	3500	5107	1,78,74,500
20.04.2022	-	-	-	850	5107	43,40,950	2650	5107	1,35,33,550
30.04.2022	-	-	-	1580	5107	80,69,060	1070	5107	54,64,490

* Pricing of issues shall be done at the rate of Rs. 5107/-((50000+12875000)/(1000+2500) = 5107) each till the first consolidated lot of 3500 Nos. exhausts, new rate will be applicable when new input batch comes in and the weighted average rate shall be recalculated and applied accordingly, and so on.

Note: The weighted average rate quoted in the above example is not calculated accurately to decimal places, to keep the explanation simple, however in practice, it is to be done accordingly to ensure accuracy.

Value of Inventory as on 30.04.2022 as per weighted average method shall be Rs. 54,64,490/-

ICDS-III Relating to Construction Contracts

This ICDS deals with the computation of income from construction contract business. A contract agreement is created between the contractee and a contractor or group of contractors for construction of buildings, bridge, road, industry building, plant & machinery, ship, market complex etc.; A contract may be negotiated or created for the construction of a single asset or multiple assets which may or may not be interrelated subject to the design, dimension, technology etc.;

The construction contract may be a Fixed Price Cost or a Cost Plus Contract. In a fixed price contract, contractee agrees to pay a fixed price in lump sum for completion of the construction project. Whereas in cost plus contract, contractee agrees to pay a certain percentage over and above the actual costs incurred to the contractor as profit margin. Cost plus contract is generally undertaken when the cost of executing a contract cannot be estimated in advance accurately due to absence of a precedent or complete details of work to be done. Sometimes unsuitable conditions also necessitate cost plus contact. Generally, cost plus contract is entered into a special type of work like construction work in war, manufacture of a special design of ship or aircraft etc.

Retention money: During the period of construction work to complete the assets or contract works, contractor raises running bills to the contractee based on the work completion certificate or measurement book issued by the surveyor or architect or site in-charge. The contractee does not pay the whole amount of the running bill. Contractee retains a certain percentage of the bill as retention money and pays after the completion of the contract as per the agreement of the contract. The retention money is kept back as security to ensure the completion of contract work within the time and guarantee or warranty for the quality of assets built.

"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:

(i) contract for the rendering of services which are directly related to the construction of the asse for example, those for the services of project managers and architects;

(ii) contract for destruction or restoration of assets, and the restoration of the environ 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, if any, have been rectified.*

"Progress billings" *are amounts billed for the part of work performed on a contract whether or not they have been paid by the customer.*

Combining and Segmenting Construction Contracts:

Each construction contract shall be treated as a separate cost centre and revenue and cost shall be derived as per this ICDS. There may be a single asset contact or a group of assets contract. In the case of numbers of contracts, if a separate agreement is created for each asset, then each asset contract shall be treated as a separate contract. Where a group contract is negotiated with one or more customers through a single negotiation contract then this shall be treated as a single separate construction contract. For example, a turnkey project. Where a customer wants additional work apart from the awarded construction contract, it shall be treated as a single construction contract if it is significantly different in terms of design, technology or functions from the assets covered under the original contract and a separate contract negotiation takes place.

- The requirements of this ICDS shall be applied separately to each construction contract. 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.

- 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.

- 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.

- 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 cost:

- Contract costs shall comprise of:

(*a*) costs that relate directly to the specific contract;

(*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.

- 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.

- 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 recognised 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.

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

Contract costing or Job costing method may be followed to determine the construction contract cost. A separate contract number is assigned to each contract. Each contract shall be treated as a separate profit/cost centre. All direct and indirect costs which are attributed to that particular contract cost centre are required to be debited. In contract costing most of the expenses incurred are of the nature of direct expenses like material cost, labour cost, cost of special plant and equipment, tools and tackles, architect's fees, cost of designs, hiring cost of plants and equipment, sub contract cost etc.;. The value of plant and machinery transferred to other sites are credited to the contract cost centre. Plant and equipment purchased exclusively for the particular contract is debited to the cost of that contract cost centre. The abnormal loss or gain are not debited or credited to the contract account. The total depreciation during the period is debited to the contract account on an hourly rate basis of use of plant and machinery for that particular contract cost centre.

Overheads: A contractor may have more than one contract to execute at the same time and thus expenditures common to more than one contract become indirect expenses or overhead for that particular contract. The indirect expenses mainly consist of office and administration cost, expenses relating to repair workshops and expenses of storeroom and store yards, salary of supervisor and storekeeper, salary of chief engineer etc.;. The indirect expenses are apportioned to different contracts on some reasonable basis such as labour hour basis or machine hour basis or on the basis of actual expenditure incurred on material, labour and expenses.

Work- in-progress: W.I.P in contract consists of:

a) The cost of work complete. This may include work certified and work uncertified.

b) The cost of work not completed.

c) The amount of profit taken as credit.

Generally in the balance sheet W.I.P is shown under two heads- certified and uncertified. Work certified means the work of contract approved by architect engineer or surveyor or site-in-charge etc.; of the contractee. It is possible that a part of the work done which has not been approved by the surveyor or contractee is referred to as work uncertified. It is valued at cost and debited to WIP.

Materials and stores at site: - At the end of the accounting period if any materials and stores remain unutilized; the amount should be debited to "Material or Stores at site Account" and credited to Contract Account. In the balance sheet "Material or Stores at site Account" is shown under the head inventory.

Recognition of Contract Revenue and Expenses

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

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

(*a*) the proportion of contract costs incurred for work performed up to the reporting date the estimated total contract costs; or

(*b*) surveys of work performed; or

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

Progress payments and advances received from customers are not determinative of the stage of completion of a contract.

- When the stage of completion is determined with reference to the contract costs incurred up to 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.

- During the early stages of a contract, where the outcome of the contract cannot be estimated reliably, contract revenue is recognised only to the extent of costs incurred. The early stage of a contract shall not extend beyond 25 % of the stage of completion.

Inventory valuation in the construction industry shall be computed as per the provisions of ICDS-III to compute income under the head "Profits & gains from business or profession" or "Income from other sources". So far maintenance of books of accounts is concerned the assessee shall follow the accounting policy, cost accounting policy, accounting standards and cost accounting standards as the case may be. It must be noted that for inventory valuation under section 142(2A) provisions of ICDS and Income tax Act is only required to be followed.

ICDS IV-Relating to revenue recognition

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.

"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.

Sale of Goods

(a) Amount received or receivable shall be considered as revenue only when ownership of goods is transferred to the purchaser by the seller either at the time of sale or later. If ownership is not transferred, the consideration received shall be treated as advance and will show in the balance sheet.

(b) Consideration receivable shall be recognised as revenue only when there is a certainty to receive. Any doubtful consideration shall not be recognised as revenue.

(c) Any escalation clause in price, export incentive etc; shall be considered as revenue if it is actually received or in the case of receivable, there is a written agreement or other promise note accepted as a terms and condition by the both seller and buyer.

Rendering of Services

In case of service provider revenue shall be recognised based on the completion stage of the service as mentioned under ICDS-III. Revenue shall be booked based on the completion certificate issued by the service receiver.

Where service period is less than 90 days and maximum part of service is completed, full amount of consideration shall be treated as revenue.

In case of trade activities and rendering the services some examples of revenue:-

(a) Instant cash received either in hand or in bank through upi or clearing of account payee cheque at the time of sale;

(b) Sale consideration receivable that is sundry debtors;

(c) Other consideration for example amount paid or payable for any alteration or modification in goods may be in respect to design, dimension, claim settlement etc; value addition in services like customisation of tally as per user's requirement etc;

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

Examples:-

(a) Interest received on loan and advances, letter of credit, letter of guarantee, bills discount, promise note etc;

(b) Royalty received or receivable for any property given on rent or lease for mining, extraction, royalty for any intellectual properties etc; and it shall be booked based on the terms and conditions of agreement;

(c) Dividend declared or distributed or paid by the company to its shareholder; Following shall be dividend income or deemed dividend income.

i. Distribution of dividend either in cash or in other mode may be by delivery of property or right having money value, increase in number of shares held in proportionate to the amount of dividend;

ii. Distribution of accumulated profits to the shareholders by the company

iii. Distribution of accumulated profits to the shareholders by the company in form of debentures or debenture-stock or deposit certificates with or without interest

iv. Distribution of accumulated profits to the preference shareholders by the company in form of bonus shares

v. Distribution of accumulated profits to the shareholders by the company on its liquidation

vi. Distribution of accumulated profits to the shareholders by the company in reduction of capital

vii. Distribution of accumulated profits to the beneficial shareholders by the company in form of advance or loan or any payment on behalf of or for the individual benefit

viii. Any payment by a company on purchase of its own shares from a shareholder as per section 68 of the Companies Act, 2013

ix. Any interim dividend

(d) Interest on refund of any tax, duty, cess shall be recognised as revenue on receipt basis;

(e) Interest accrued over the time of period shall be recognised as revenue based on mercantile accounting system;

(f) Discount on debt securities, infrastructure bonds, public sector bonds, debentures, Government securities, Debt instruments etc; shall be revenue at the time of purchase;

(g) Premium on debt securities, infrastructure bonds, public sector bonds, debentures, Government securities, Debt instruments etc; shall be revenue at the time of sale;

ICDS V-Relating to tangible fixed assets

This Income Computation and Disclosure Standard deals with the treatment of tangible fixed assets.

"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.

Identification of Tangible Fixed Assets

1. Stand by equipment shall be treated as tangible fixed assets and be capitalised.
2. Stand by equipment means ready to use but it is not in operation
3. Servicing equipment shall be capitalised. Examples are tools and tackles, computers, printers, security system, material handling plants, cranes, devices, instruments, lathes, drills, conveyors, welding machines, foundries etc;
4. General use of spares parts in repair and maintenance of the tangible fixed assets shall be treated as revenue expenditure.
5. Spares use specifically to a tangible fixed assets and without this the fixed assets cannot be usable and shall be capitalised. For example change of rope in crane, change of dala in truck, change of hard disk in computer etc;

Components of Actual Cost

1. The actual cost of tangible fixed assets shall include purchase price, freight, import duties, other taxes, instalment and commissioning cost and other direct cost attributes to make it operational.
2. Input tax credit and other recoverable taxes shall not be included in the cost of fixed assets.
3. Any trade discounts or rebates shall be excluded from the cost of fixed assets.
4. Administration and other general overhead expenses shall not be included in the cost of fixed assets.
5. Expenditures that are specifically attributable to the construction of a project or acquisition of fixed assets or bringing it to the stage of operation shall be included in the cost of fixed assets.

6. The expenditures incurred on start-up and commissioning of the project, incurred on test runs and experimental production before start of commercial production shall be included in the cost of tangible fixed assets.
7. Expenditures incurred on project on post commercial production shall be treated as revenue expenses.
8. Cost in case of self constructed tangible fixed assets shall include all direct expenses attributable to the specific tangible fixed assets.
9. Fair value of the tangible fixed assets shall be the actual cost in case where it is acquired in exchange for another asset or in exchange of shares or securities.

Improvements and Repairs

1. Expenditures which enhance the useful life of the tangible fixed assets shall be capitalised.
2. Any addition or extension to an existing tangible fixed asset and which an integral part of the existing tangible fixed asset shall be added to the actual cost of the fixed asset. For example construction of one or more rooms in office building, extension of parking shed etc;
3. Any addition or extension, which has a separate identity and is capable of being used even after the existing tangible fixed asset is disposed of, shall be treated as a separate asset. For example Dala of truck, battery used in power back-up system etc;

Valuation of Tangible Fixed Assets in Special Cases

Where the tangible fixed assets are under the joint ownership may be of two or more persons then in such case value of the tangible fixed assets shall be distributed in proportionate as agreed between the persons such as profit sharing ratio or investment of capital.

Depreciation

Depreciation on tangible fixed assets shall be computed based on a written down value method.

ICDS VI- Relating to the effects of changes in foreign exchange rates

This Income Computation and Disclosure Standard deals with:

(a) treatment of transactions in foreign currencies;

(b) translating the financial statements of foreign operations;

(c) treatment of foreign currency transactions in the nature of forward exchange contracts.

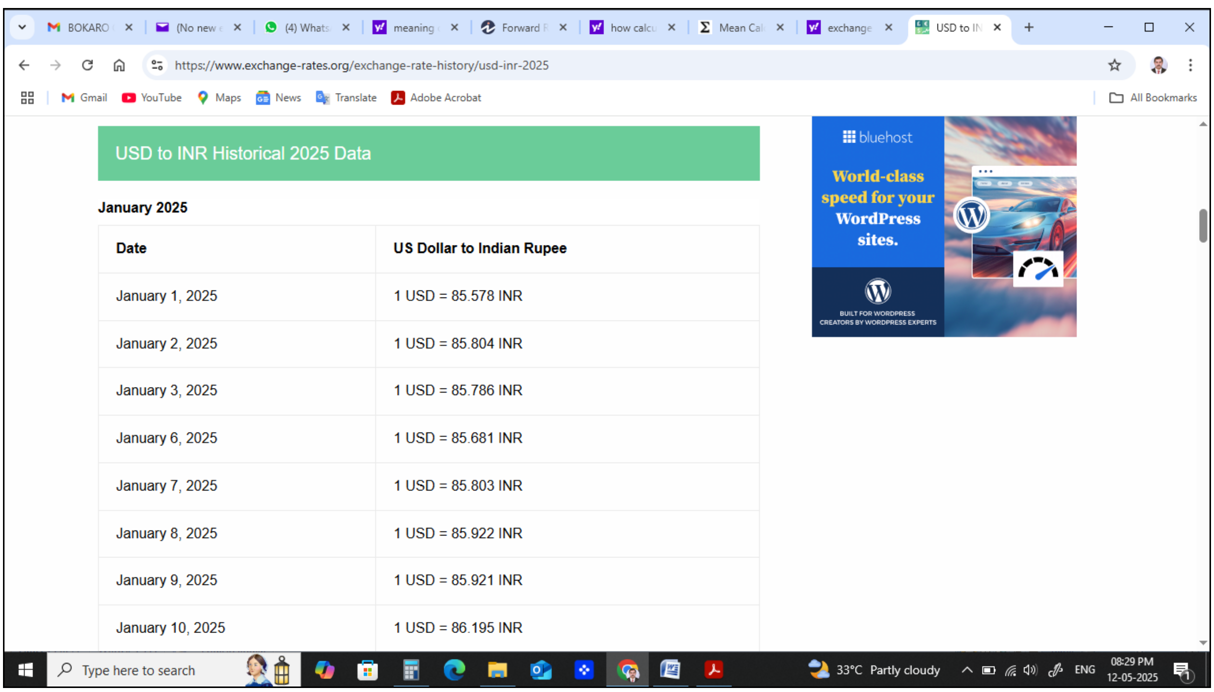
"Average rate" is the mean of the exchange rates in force during a period.

The exchange rates fluctuate frequently in international markets like the stock market. The exchange rate might be different in between the periods, say day to day. Average rate of exchange is derived by dividing the sum of data by the numbers of periods in the range of data collection. For example the exchange rate of 1 USD to 1 INR during the first 7 days in the month of January, 2025 is (85.578, 85.804, 85.786, 85.681, 85.803, 85.922, 85.921). Average rate shall be calculated as below:

Average rate = 85.578+85.804+85.786+85.681+85.803+85.922+85.921/7

= 600.495/7

= 85.785



Date	US Dollar to Indian Rupee
January 1, 2025	1 USD = 85.578 INR
January 2, 2025	1 USD = 85.804 INR
January 3, 2025	1 USD = 85.786 INR
January 6, 2025	1 USD = 85.681 INR
January 7, 2025	1 USD = 85.803 INR
January 8, 2025	1 USD = 85.922 INR
January 9, 2025	1 USD = 85.921 INR
January 10, 2025	1 USD = 86.195 INR

"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.

"Foreign currency transaction" is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when a person:—

(i) buys or sells goods or services whose price is denominated in a foreign currency; or

(ii) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(iii) becomes a party to an unperformed forward exchange contract; or

(iv) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

"Forward rate" is the specified exchange rate for exchange of two Currencies at a specified future date;

"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;

A forward exchange contract is a customised, private agreement between the two parties to exchange two currencies at a specific time in future, to buy or sell an asset such as a commodity, securities. This type of agreement is generally executed to protect from currency price fluctuations. A forward exchange contract protects both parties from unexpected or adverse movement of currencies in future. Typically it is an over-the-counter (OTC) instrument, meaning they are not traded on exchanges.

A forward exchange contract can specify the amount, the delivery date, and the price of the underlying asset, allowing for a high degree of flexibility.

In India RBI and SEBI is the regulatory authority to frame and monitor the forward contract.

The RBI is responsible for the regulation of foreign exchange (FX) forward contracts. It sets guidelines for the foreign exchange market in India, including permissible currency derivatives and forward contracts.

SEBI is responsible for regulating commodity derivatives markets, including forward contracts.

For Example suppose Mr. X wanted to purchase a property in the USA and get an agreement with Mr. Smith on 01-04-2025 and payment is required to make 5 lakhs US dollar within 45 days, say up to 15-05-2025. The exchange rate of 1 USD is 85.072 INR on 01-04-2025. Since payment has to be paid on 15-05-2025, the exchange rate in the future date might be changed. To mitigate the speculative risk from the significant change in exchange rate, Mr. X entered a forward contract agreement with an agent in OTC platform to settle the payment in the future date that is on 15-05-2025 at an exchange rate $1 to Rs. 85.072 . The exchange rate might be either more or less from the exchange rate as on 01-04-2025.

In the above example real time value of property would be Rs. 4.25 crore if payment made on 01-04-2025. But actual payment may vary. Suppose the exchange rate becomes $1 = 87 INR on 15-05-2025, then the value of property will be Rs. 4.35 crore, thus there is saving of Rs. 0.10 crore. On the other hand if the exchange rate on 15-05-2025 becomes $1= 84, then the value of property would be Rs. 4.20 crore, thus there is loss of Rs. 0.5 crore. So in this example, Mr. X has managed the gain or loss due to fluctuation in exchange rate by making a forward contract.

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. Exchange differences on such a contract shall be recognised as income or as expense in the previous year in which the exchange rates change. Any profit or loss arising on cancellation or renewal shall be recognised as income or as expense for the previous year.

Subject to

(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.

(c) It 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.

How to derive premium or discount in forward exchange agreement

1. It is the difference in between the exchange rate at the time of execution of the contract and exchange rate at the specified date in future that is forward rate.
2. Exchange rate difference in foreign currency shall be calculated at the last date of the previous year or In case where a transaction is settled during the previous year the date on which settlement took place.

   For example:

   Case-I, Suppose a forward exchange rate agreement is signed on 25-07-2024 and future date is 12-05-2025, then premium or discount for the previous year 2024-25 shall be the difference of exchange rate on 25-07-2024 and 31-03-2025.

   Case-II, Suppose a forward exchange rate agreement is signed on 25-07-2024 and future date is 12-02-2025, then premium or discount for the previous year 2024-25 shall be the difference of exchange rate on 25-07-2024 and 12-02-2025.

3. In case of the same foreign currency settlement, the exchange rate difference shall be in between the exchange rate at the date of signing the agreement or the last day of the immediately preceding year, whichever is later.

   For example:

   Case-I, Suppose a forward exchange rate agreement is signed on 25-07-2024 and future date is 12-05-2025, then premium or discount shall be the difference of exchange rate on 31-03-2024 and 12-05-2025.

   Case-II, Suppose a forward exchange rate agreement is signed on 25-07-2024 and future date is 12-02-2025, then premium or discount shall be the difference of exchange rate on 25-07-2024 and 12-02-2025.

"Indian currency" shall have the meaning as assigned to it in section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999);

"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-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 Transactions

A Person in India may export goods or services to a person in an overseas business or professional transaction or may import goods or services from an overseas business or professional transaction, may lend or get loan or advance from overseas, sell or purchase asset in overseas and the term of payment is to be made in an overseas currency, this will be called a transaction in foreign currency. The person in India is required to book this transaction in account in reporting currency that is in rupees (INR). Transaction value shall be derived by converting the corresponding overseas currency to the reporting currency that is INR by multiplying with the foreign exchange rate at a particular date of the transaction. At the time of final settlement of accounts receivable or payable is required to adjust due to change in foreign exchange rate.

Initial Recognition

The transaction shall be recorded in books of account on the date of transaction by converting the foreign currency to the reporting currency applying the foreign exchange rate at that particular date.

For example XYZ company import a machine from USA on 12-05-2025. The value of machine is 10000 US dollar. Foreign exchange rate of 1 dollar to the Rs. 1 on 12-05-2025 is Rs. 85. In this case XYZ booked machine in its balance sheet of Rs. 8.50 lakhs (10000 USD * 85 INR).

Average rate of foreign exchange during the period of transaction may be used if there is no significant change in exchange rate. In case of significant change, the exchange rate at the particular date of transaction shall be used.

Conversion at Last Date of Previous Year

1. Monetary items shall be closed at the end of the year by converting foreign currency to the reporting currency at the closing rate of exchange at the last day of the previous year.
2. Non monetary items in foreign currency shall be converted into the reporting currency by using the exchange rate at the date of transaction.
3. Net realisable value of inventory in foreign currency shall be valued at the reporting currency by using the rate of exchange at the date of valuation.

Recognition of Exchange Differences

In respect to monetary items, there may be difference in value at the time of settlement thereof or conversion thereof due to change in exchange rate at the last date of previous year and consequently this shall be recognised as income or expense as the case may be for the previous year.

In respect to non-monetary items, there may be difference in value at the time of settlement thereof or conversion thereof due to change in exchange rate at the last date of previous year and consequently this shall be recognised as income or expense as the case may be for the previous year.

In case any person acquired an asset for use in his business or profession from foreign country during the previous year and after its acquisition, liability may increase or reduce due to change in exchange rate of currency at the end of the previous year. The amount by which liability increases or decreases at the time of making payment either whole or part, shall be adjusted from the actual cost of the asset.

For example, Mohan purchased a plant & machinery from the US on 31.12.2024 for 50000 USD. The exchange rate on 31.12.2024 was 85.637 INR. Thus, the actual cost of P&M on 31.12.2024 is Rs. 4281850/-. Mohan paid the amount on 31.03.2025. The exchange rate on 31.03.2025 was 85.429. So at the time of payment there is a decrease in the value of P&M due to change in exchange rate. The amount of change is Rs. 10400 [(85.637-85.429)*$50000]. Thus the actual cost of P&M shall be Rs. 4271450 at 31.03.2025 (Rs. 4281850-10400).

In case any income accruing or arising or deemed to accrue or arise to the assessee in a foreign currency or received or deemed to be received by him or on his behalf in foreign currency, the rate of exchange for the calculation of the value in rupees at any specified date shall be telegraphic transfer buying rate.

"telegraphic transfer buying rate", in relation to a foreign cvurrency, means the rate or rates of exchange adopted by the State Bank of India, for buying such currency under the guidelines specified from time to time by the Reserve Bank of India.

Specified date

1. In respect of income from "profits and gains from business or profession" and " Income from other sources" , the last day of the previous year.
2. In respect of income from "profits and gains from business or profession" to the 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.
3. 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.
4. In respect of income by way of interest on securities, the last day of the month immediately preceding the month in which the income is due.

ICDS VII- Relating to government grants

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.

This Income Computation and Disclosure Standard does not deal with:—

(a) Government assistance other than in the form of Government grants; and

(b) Government participation in the ownership of the enterprise.

> ***"Government"*** *refers to the Central* Government, State Governments, agencies and similar bodies, whether local, national or international.
>
> **"Government grants"** are assistance by Government in cash or kind to a person for past or future compliance with certain conditions. They exclude those forms of Government assistance which cannot have a value placed upon them and the transactions with Government which cannot be distinguished from the normal trading transactions of the person.

Recognition of Government Grants

1. The government grant shall be recognised only when beneficial person assured that he or she will fulfil the terms and conditions attached with the government grant
2. And the grant shall be received.
3. Recognition of government grant shall not be postponed beyond the date of actual receipt.

Treatment of Government Grants

1. Where the government grant is in respect to depreciable fixed assets or personal assets, the amount of grant shall be deducted from the actual cost of fixed assets or from the written down value of block of asset or from the value of personal assets. In case where the government grant is refundable over the period, the amount so refundable shall be added back to the actual cost of the depreciable fixed assets or written down value of the block of asset. Where the actual cost is increased due to refund of government grant, depreciation shall be provided.

   Example:

   Suppose XYZ Company purchased a Solar plant of Rs. 2 crore on 01-05-2022. Rate of depreciation is 15%. Written down value at the end of previous year 2022-23 is Rs. 1.70 crore. During the month of April, 2023, the company received Rs. 35 lakhs as a government grant. Thus the written down value as on 31-03-2024 shall be Rs. 1.15 crore. [WDV as on 01-04-2023 Rs. 1.701 crore. Less grant received Rs. 35 lakhs. Balance will be Rs. 1.35 crore. Less: depreciation Rs. 20.25 lakhs for the FY 2023-24. WDV as on 31-03-2024 Rs. 1.15 crore]

   Further in the above example suppose the company has to refund the grant amounting to Rs. 10 lakhs on 30-05-2024. Then the WDV as on 31-03-2025 shall be Rs. 1.06 crore

WDV as on 01-04-2024	Rs. 1.15 crore
Add: Refund of government grant	Rs. 10 lakhs
Less: Depreciation	Rs. 18.71 lakhs
WDV as on 31-03-2025	Rs. 1.06 crore

2. Where the government grant is in respect to non depreciable fixed assets or personal assets and the recipient has met the required obligation attached with the grant, the grant so received shall be recognised as income over the same period over which cost incurred in meeting obligation shall be amortised. In case where a government grant is refundable over the period then shall be first

adjusted from the unamortised deferred credit liability and in case where no unamortised deferred credit is available, it shall be charged to the profit and loss account.

Example:

Suppose the government grants financial support to the ABC a start up of Rs. 2 crore to develop a non depreciable asset remote area, on 01-04-2020. The company has invested Rs. 5 crore on this start up project during the previous year 2019-20. As per the scheme the cost of the project shall be amortised in 5 years that is up to the previous year 2024-25.

Recognised income in respect to government grants for the previous year 2020-21 will be Rs. 40 lakhs, for 2021-22 Rs. 40 lakhs and so on. And amortised amount to be debited to the profit & loss account in each previous year will be Rs. 1 crore up to the previous year 2024-25.

Further suppose in the above example Rs. 50 lakhs of the government grant is refundable and due in the previous year 2024-25. In such a case the unamortised amount as on 01-04-2024 is Rs. 1 crore. At the time of payment of grant refund of Rs. 50 lakhs shall be first adjusted from the opening unamortised amount that is Rs. 1 crore and balance amount Rs. 50 lakhs shall be debited to the P&L account.

Further in the above example if the grant refundable amount is Rs. 1.50 crore in 2024-25, then in such scenario at first Rs. 1 crore grant refund shall be adjusted from the opening unamortised deferred liability and balance Rs. 50 lakhs shall be charged to the P&L account.

3. Where the government grant is not directly relatable to the asset acquired, the grant so received shall be adjusted from the actual cost of the asset or the written down value of the block of asset.

4. The government grant which is sanctioned to compensate any expenses or loss 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 in the year in which grant becomes receivable. In case where a government grant is refundable over the period then shall be first adjusted from the unamortised deferred credit liability and in case where no unamortised deferred credit is available, it shall be charged to the profit and loss account.

5. *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.*

ICDS VIII- Relating to Securities

This ICDS deals with the valuation of securities held as stock in trade. This standard is divided into two parts. Part A deals with the valuation of stock in trade. Whereas part B deals with valuation of the securities held by a scheduled bank or public financial institution formed under Central or State Act or as declared under the Companies Act, 1956 or Companies Act, 2013.

Part A

Securities means shares, scrip, stocks, bonds, debentures, debenture stock, derivatives or other marketable securities of a like nature in or of any incorporated company or other body corporate

Fair value means a fair market value of securities at which the securities may be sold or bought in the open market between the willing prospective buyer and seller at arm's length. FMV is a price at which a property would sell in an open market. Prospective buyers and sellers are reasonably having knowledge about the property, behaving in their own interest, free from undue pressure to trade and given a reasonable time period to complete the transaction.

Acquisition cost of security: It shall be recognized at actual cost. The actual cost shall include purchase price of security paid and include acquisition costs like brokerage, commission, security transaction tax, cess, fees, duty etc.;

In case where a security is acquired in exchange of another security, the fair value of the security acquired at the time of acquisition shall be the cost of acquisition of acquired security. For example, issue of sweat equity, alteration of share etc;

In cases where a security is acquired in exchange for another asset, the fair value of the security acquired at the time of acquisition shall be the cost of acquisition of acquired security. For example, conversion of debenture into equity shares or preference shares, share allotted to creditors, debt lenders etc;

In case 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. For example:- Central Govt. issued a bond carrying 9.15% payable on 15th May and 15th November in every year on 1st January 2022 of Rs. 40 lakhs. ABC Company purchased this bond on 1st June, 2022 at Rs. 42.33 lakhs. At the time of purchase the interest payable on 15th May, 2022 is accrued to the amount of Rs. 183000/-. The company will get next interest on 15th November, 2022 Rs. 183000/-. Here pre- acquisition period interest is Rs. 1.98 lakhs and post-acquisition period Rs. 1.83 lakhs. So the cost of acquisition in this case shall be Rs. 40.35 lakhs [Rs. 42.33-1.98].

The value of security held as stock-in-trade at the end of previous year shall be the lower of the Cost of Acquisition and Net realisable value.

- ***The comparison of actual cost initially recognised and net realisable value shall be done category wise and not for each individual security. 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.***

- ***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.***

Securities not listed on a recognised stock exchange; or listed but not quoted on a recognised stock exchange with regularity from time to time, shall be valued at actual cost initially recognized at the end of the previous year
Where the actual cost initially recognised cannot be ascertained with reference to specific identification, the cost of such security shall be determined on the basis of first-in-first-out method or weighted average cost formula.

(*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 Contracts (Regulation) Act, 1956 (42 of 1956) and shall include share of a company in which public are not substantially interested but shall not include derivatives referred to in sub-clause (*ia*) of that clause (*h*).

Security held as stock in trade shown in balance sheet
Stock exchange is a market place where trading of security takes place. In India two stock exchanges are in function. One is BSE (Bombay Stock Exchange) with Sensex index and another is NSE (National Stock Exchange) with Nifty index. SEBI is the regulatory body who regulate the functioning of stock exchange and depository. A company brought IPOs in the primary market and after the subscription of security offered to the public, it is listed in the secondary market in the stock exchange. In the secondary market trading of security takes place through a dematerialized account managed by the depositary. In India there are two main depository;

NSDL and CDSL. The depositary maintains the records related to buyer and seller and holds security in digital platforms. On execution of a trade, the depositary directly transfers the securities from the account of the seller to the buyer. Stock broker acts as an intermediary between the stock exchange and the investor. For this broker charges some amount to the investor.

Investors may show the value of securities at the end of previous year either as investment or stock in trade under current assets in his balance sheet. It is the choice of the investor. If investors purchase securities with intention to earn dividend on it and want to hold the security for a longer period then it will be treated as investment and consequent sale of securities shall be taxed as capital gain. On the other hand, if the intention of the investor is of trading and he frequently purchases and sells the securities with an intention to earn profit within a short period, it will be treated as business and securities at the end of the previous year shown as stock in trade should be taken under inventory. There is no specific guideline to describe when the securities are to be treated as investment or as stock in trade. There are many court decisions on this matter. The Honourable High court in one case given direction as below:

While deciding whether the sale of shares is income from business or income from capital gain, one has to go by the following criteria, as held by the jurisdictional High Court in the case of PVS Raju v. Addl. CIT [2012] 340 ITR 75 / 18 taxmann.com 3 (AP)—

a) The frequency of buying and selling of shares by the appellants were high;

b) The period of holding was less;

c) The quantum of turnover was on account of frequency of transactions, and not because of huge investment;

d) The intention of the assessee to make quick profits on a huge turnover;

e) No. of scrips shares held for fewer days;

f) Whether engaged in dealing in the same scrips frequently;

g) Intention of the assessee in buying shares is not to derive income by way of dividend on such shares, but to earn profits on the sale of the shares;

h) Whether the assessees had indulged in multiple transactions of large quantities with high periodicity. These periodic transactions selecting the time of entry and exit in each scrip, called for regular direction and management which would indicate that it was in the nature of trade;

i) Repeated transactions, coupled with the subsequent conduct of the assessee to re-enter the same scrip or some other scrips, in order to take advantage of market fluctuations lent the flavour of trade to such transactions;

j) The assessees were purchasing and selling the same scrips repeatedly, and were switching from one scrip to another;

k) Mere classification of these share transactions as investment in the assessee's books of accounts was not conclusive;

l) The intention of the assessees at the time of purchase was only to sell the shares immediately after purchase;

m) Frequency of purchase and sale of shares showed that the assessee never intended to keep these shares as investment; and

n) It is only for the purpose of claiming benefit of lower rate of tax, under Section 111A of the Act, that they had claimed certain shares to be investment, though these transactions were only in the nature of trade.

Part B

This part of Income Computation and Disclosure Standard deals with securities held by a scheduled bank or 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).

(*a*) "**Scheduled Bank**" shall have the meaning assigned to it in clause (*ii*) of the *Explanation* to clause (*viia*) of sub-section (1) of section 36 of the Act.

(*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) and shall include share of a company in which public are not substantially interested;

Securities shall be classified, recognised and measured in accordance with the extant guidelines issued by the Reserve Bank of India *(Master Circular – Prudential norms for Classification, Valuation and Operation of Investment Portfolio by Bank, issued on 1st July 2013 vide RBI/2013-14/109, DBOD No BP.BC. 8 /21.04.141/2013-14)* and any claim for deduction in excess of the said guidelines shall not be taken into account.

ICDS IX- Relating to borrowing cost

This Income Computation and Disclosure Standard deals with treatment of borrowing costs and does not deal with the actual or imputed cost of owners' equity and preference share capital.

"Borrowing costs" are interest and other costs incurred by a person in connection with the borrowing of funds and include:

(i) commitment charges on borrowings;

(ii) amortised amount of discounts or premiums relating to borrowings;

(iii) amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;

(iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements.

"Qualifying asset" means:

(i) land, building, machinery, plant or furniture, being tangible assets;

(ii) know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets;

(iii) inventories that require a period of twelve months or more to bring them to a saleable condition.

Recognition

1. Borrowing costs that directly attribute to the acquisition, construction, or production of a qualifying asset shall be capitalised as part of the cost of that asset.
2. The borrowing costs shall be capitalised only to the cost of those qualifying asset which require the period of 12 months or more to acquire or construct or produce as the case may be.

Borrowing Costs Eligible for Capitalisation

1. The funds are borrowed specifically for the purpose of acquisition, construction or production of a qualifying asset, and the actual borrowing cost incurred during the period on the funds so borrowed.
2. The capitalisation of borrowing cost shall be commenced from the date of borrowing.
3. In case where the borrowing cost is not attributable directly to any specific qualifying asset, then borrowing cost shall be capitalised by using the following formula.

   A X B/C

   Where

A = borrowing costs incurred during the previous year which is not directly attributable

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, half of the cost of qualifying asset; or

(iii) in case the qualifying asset does not appear in the balance sheet of a person on the last day of the 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,

Note: The cost of qualifying asset in the above formula shall not include the proportionate amount of cost for which specifically funds were borrowed.

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 assets to the extent they are directly funded out of specific borrowings;

Note: Capitalisation of borrowing funds in the above case shall be commenced from the date on which funds were utilized.

For Example

Case-I In the balance sheet of Mohan during the previous year 2024-25 the figures of qualifying assets and total assets are as below:

As on 01-04-2024

Building	Rs. 25 lakhs
Other assets	Rs. 50 lakhs

As on 31-03-2025

Building	Rs. 35 lakhs
Other assets	Rs. 85 lakhs

The borrowing cost which is not directly attributable Rs. 5 lakhs

The amount of borrowing cost to be capitalized shall be calculated as below

A= Rs. 5 lakhs

B = Opening qualifying assets Rs. 25 lakhs and Closing qualifying asset Rs. 35 lakhs, so average cost of qualifying asset is Rs. 30 lakhs

C= Opening total assets Rs. 75 lakhs and closing total assets Rs. 120 lakhs, so average cost of total assets Rs. 97.5 lakhs

Borrowing cost to be capitalized = AXB/C

5*30/97.5 = Rs. 1.54 lakhs

Case-II- In the balance sheet of Mohan during the previous year 2024-25 the figures of qualifying assets and total assets are as below:

As on 01-04-2024

Building	Nil
Other assets	Rs. 50 lakhs

As on 31-03-2025

Building	Rs. 35 lakhs
Other assets	Rs. 85 lakhs

The borrowing cost which is not directly attributable Rs. 5 lakhs

The amount of borrowing cost to be capitalized shall be calculated as below

A = Rs. 5 lakhs

B = half of the qualifying asset Rs. 35 lakhs, Rs. 17.5 lakhs

C = Opening total assets Rs. 50 lakhs and closing total assets Rs. 120 lakhs, so average cost of total assets Rs. 85 lakhs

Borrowing cost to be capitalized = AXB/C

5*17.5/85 = Rs. 1.03 lakhs

Case-III- In the balance sheet of Mohan during the previous year 2024-25 the figures of qualifying assets and total assets are as below:

As on 01-04-2024

Building	Rs. 0 lakhs
Other assets	Rs. 50 lakhs

As on 31-03-2025

Building	Rs. 0 lakhs
Other assets	Rs. 85 lakhs

Value of building competed as on 30-04-2025 Rs. 25 lakhs

The borrowing cost which is not directly attributable Rs. 5 lakhs

The amount of borrowing cost to be capitalized shall be calculated as below

A = Rs. 5 lakhs

B = Average cost of the qualifying asset Rs. 25/2= Rs. 12.5 lakhs

C = Opening total assets Rs. 50 lakhs and closing total assets Rs. 85 lakhs, so average cost of total assets Rs. 67.5 lakhs

Borrowing cost to be capitalized = AXB/C

5*12.5/67.5= Rs. 0.93 lakhs

Cessation of Capitalisation

1. In the case of qualifying asset (i) land, building, machinery, plant or furniture, being tangible assets; (ii) know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets; when asset is first put to use. The capitalization of borrowing cost shall be stopped and shall be charged to P&L account.

Further 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 when it is first put to use.

2. In the case of qualifying asset inventories that require a period of twelve months or more to bring them to a saleable condition, when substantially all the activities necessary to prepare such inventory for its intended sale are complete. The capitalization of borrowing cost shall be stopped and shall be charged to P&L account.

Further 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 when substantially all the activities necessary to prepare such inventory for its intended sale are complete.

ICDS X- Relating to provisions, contingent liabilities and contingent assets

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.

"Provision" is a liability which can be measured only by using a substantial degree of estimation.

"Liability" is a present obligation of the person arising from past events, the settlement of which is expected to result in an outflow from the person of resources embodying economic benefits.

"Obligating event" is an event that creates an obligation that results in a person having no realistic alternative to settling that obligation.

"Contingent liability" is:

(i) a possible obligation that arises from past events and 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; or

(ii) 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" is a possible asset that arises from past events 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.

"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.

"Present obligation" is an obligation if, based on the evidence available, its existence at the end of the previous year is considered reasonably certain.

Recognition

1. A provision shall be recognized 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.
2. No provision shall be recognised for costs that need to be incurred to operate in the future.
3. A person shall not recognise a contingent liability.

4. A person shall not recognise a contingent asset.

5. 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.

6. 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.

7. 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.

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

Notes

Behind Every Successful Business Decision, there is always a CMA

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