

Income Computation and Disclosure Standard- Income Tax Act.

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Income Computation and Disclosure Standard

- Central Govt. in exercise of power conferred u/s 145(2), notifies **Income Computation and Disclosure Standard** vide S.O.3079(E), Dt. 29-09-2016.
- This is applicable from **A.Y. 2017-18**.
- This standard shall be applied for the computation of income chargeable under the head, '**Profit and gains of business or profession**' and '**Income from other sources**'.
- This standard shall be followed by the all **assesseees**
- This standard shall not be followed by an Individual or a HUF, who is not required to get his accounts audited u/s 44AB of IT Act, 1961 in the previous year.

Income Computation and Disclosure Standard

- This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head, 'Profit and gains of business or profession' and 'Income from other sources' and **not for the purpose of maintenance of books of account.**
- In the case of conflict between the provisions of the Income Tax Act, 1961 and this Income Computation and Disclosure Standard, **the provisions of the Income Tax Act shall prevail to that extent.**
- Words and expressions used and **not** defined in this Income Computation and Disclosure Standard but defined in Income Tax Act, **shall have the meaning assigned to them in that Act.**

Income Computation and Disclosure Standard

- Standard I Accounting Policies
- Standard II Valuation of Inventories
- Standard III Construction Contracts
- Standard IV Revenue Recognition
- Standard V Tangible Fixed Assets
- Standard VI The effects of changes in Foreign exchange rates
- Standard VII Government grants
- Standard VIII Securities

Income Computation and Disclosure Standard

- Standard IX Borrowing Cost
- Standard X Provisions, Contingent Liabilities and Contingent Assets.

Income Computation and Disclosure

Standard I- Accounting Policies

- **Scope** – Deals with significant accounting policies.
 1. Fundamental Accounting Assumption, i.e **Going Concern, Consistency, Accrual**
 2. Accounting policies adopted shall be such as to represent **true and fair view** of the state of affairs and income of the business, profession or vocation.
 3. Any Accounting policy shall not be changed without reasonable cause.

Income Computation and Disclosure

Standard I- Accounting Policies

- **Disclosure of Accounting Policies**
 1. All significant accounting policies adopted shall be disclosed
 2. Any **change** in an accounting policy which has a **material effect** shall be disclosed
 3. The **amount** by which any item is affected by such change shall also be disclosed to the **extent ascertainable**.
- **Transitional Provisions:-** All contract or transaction existing on 1st April, 2016 or entered on or after the 1st April, 2016 shall be dealt with in accordance with the provision of this standard after taking into account the income, expense or loss , if any recognized in respect of the said contract or transaction for the previous year ending on or before the 31st March, 2016.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- **Scope:-** This standard shall be applied for valuation of inventories, **excepts**
 - i. W.I.P, arising under 'construction contract' including directly related service contract
 - ii. W.I.P, which is dealt with by other Income Computation and Disclosure Standard.
 - iii. Shares, debentures and other financial instruments held in stock-in-trade.
 - iv. Producers' inventories of livestock, agriculture and forest products, mineral oils, ores and gases **to the extent** that they are measured at **net realisable value**.
 - v. Machinery spares , which can be used only in **connection with a tangible fixed asset** and their use is expected to be regular.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- Definitions

- a) “ Inventories” are assets: (a) held for sale, (b) in the process of production for such sale and, (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- b) “ Net Realisable Value” is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- **Measurement**
- Inventories shall be valued at cost, or net realisable value, whichever is lower.
- **Cost of Inventories**
- Cost of inventories shall comprise of all costs of purchase, costs of services, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- **Costs of Purchase** : The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates and other similar items shall be deducted in determining the costs of purchase.
- **Costs of Services**: The costs of services in the case of a service provider shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and **attributable overheads**.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- **Costs of Conversion** : The costs of conversion of inventories shall include costs directly related to the units of production and a systematic **allocation of fixed and variable production overheads** that are incurred in converting materials into finished goods.
- The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion shall be based on the **normal capacity** of the **production facilities**.
- The amount of fixed production overheads allocated to each unit of production **shall not be increased as a consequence of low production or idle plant**.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- Unallocated overheads shall be recognised as an **expense** in the period in which they are incurred.
- In periods of **abnormally high production**, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above the cost.
- **Variable production overheads** shall be assigned to each unit of production on the basis of the actual use of the production facilities.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- Where a production process results in more than one product being produced simultaneously and the costs of conversion of each product are not separately identifiable, the costs shall be allocated between the products on a rational and consistent basis. Where by-products, scrap or waste material are immaterial, they shall be measured at net realisable value and this value shall be deducted from the cost of the main product.
- Other costs shall be included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.
- Interest and other borrowing costs shall not be included in the costs of inventories, unless they meet the criteria for recognition of interest as a component of the cost as specified in the Income Computation and Disclosure Standard on borrowing costs.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- Exclusions from the Cost of Inventories
- the following costs shall be excluded and recognised 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;
 - **Administrative overheads** that do not contribute to bringing the inventories to their present location and condition ;
 - **Selling costs**.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- Cost Formulae
- The Cost of inventories of items
 - a. that are not ordinarily interchangeable; and
 - b. goods or services produced and segregated for specific projects shall be assigned by specific identification of their individual costs.
- 'Specific identification of cost' means specific costs are attributed to identified items of inventory.
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- Where there are a large numbers of items of inventory which are ordinarily interchangeable, specific identification of costs shall not be made.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- **First-in First-out and Weighted Average Cost Formula**
- Cost of inventories, other than that are not ordinarily interchangeable and Specific identification of cost, shall be assigned by using the First-in First-out (FIFO), or weighted average cost formula.
- **Retail Method**
- Where it is impracticable to use the costing methods as per FIFO or weighted average cost formula, the retail method can be used in the retail trade for measuring inventories of large number of rapidly changing items that have similar margins.
- The cost of the inventory is determined by reducing from the sales value of the inventory, the appropriate percentage gross margin. The percentage used takes into consideration inventory, which has been marked down to below its original selling price.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- **Net Realisable Value**
- Inventories shall be written down to net realisable value on an item-by-item basis.
- Net realisable value shall be based on the most reliable evidence available at the time of valuation.
- Materials and other supplies held for use in the production of inventories shall not be written down below the cost, where the finished products in which they shall be incorporated are expected to be sold at or above the cost. Where there has been a decline in the price of materials and it is estimated that the cost of finished products will exceed the net realisable value, the value of materials shall be written down to net realisable value which shall be the replacement cost of such materials.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- The value of the inventory as on the beginning of the previous year shall be
 1. the cost of inventory available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and
 2. the value of the inventory as on the close of the immediately preceding previous year, in any other case.

Income Computation and Disclosure Standard, II- Valuation of Inventories

- The method of valuation of inventories once adopted by a person in any previous year shall not be changed without reasonable cause.
- In case of dissolution of a partnership firm or association of person or body of individuals, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value.

Income Computation and Disclosure Standard, II- Valuation of Inventories

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

Income Computation and Disclosure Standard, III- Construction Contracts

- **Scope** : This Standard should be applied in determination of income for a construction contract of a contractor.
- **Definitions**
- **“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 :
 - contract for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects;
 - contract for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

Income Computation and Disclosure Standard, III- Construction Contracts

- **“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.
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- **“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.
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- **“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 have been rectified.
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- **“Progress billings”** are amounts billed for work performed on a contract whether or not they have been paid by the customer.
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- **“Advances”** are amounts received by the contractor before the related work is performed.

Income Computation and Disclosure Standard, III- Construction Contracts

- Combining and Segmenting Construction Contracts
- Where a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:
 - separate proposals have been submitted for each asset;
 - 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
 - the costs and revenues of each asset can be identified.

Income Computation and Disclosure Standard, III- Construction Contracts

- A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:
 - the group of contracts is negotiated as a single package;
 - the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and
 - the contracts are performed concurrently or in a continuous sequence.

Income Computation and Disclosure Standard, III- Construction Contracts

- 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:
 - the asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or
 - the price of the asset is negotiated without having regard to the original contract price.

Income Computation and Disclosure Standard, III- Construction Contracts

- Contract Revenue
- Contract revenue shall be recognised when there is reasonable certainty of its ultimate collection.
- Contract revenue shall comprise of:
 - the initial amount of revenue agreed in the contract, including retentions; and
 - variations in contract work, claims and incentive payments:
 - to the extent that it is probable that they will result in revenue; and
 - they are capable of being reliably measured.
- Where contract revenue already recognised as income is subsequently written off in the books of accounts as uncollectible, the same shall be recognised as an expense and not as an adjustment of the amount of contract revenue.

Income Computation and Disclosure Standard, III- Construction Contracts

- **Contract Costs**

1. costs that relate directly to the specific contract;
2. costs that are attributable to contract activity in general and can be allocated to the contract;
3. such other costs as are specifically chargeable to the customer under the terms of the contract; and
4. 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.

Income Computation and Disclosure Standard, III- Construction Contracts

- 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, provided
 - they can be separately identified; and
 - it is probable that the contract shall be obtained.
- Contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date.
- 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.

Income Computation and Disclosure Standard, III- Construction Contracts

- Disclosure
- A person shall disclose:
 - the amount of contract revenue recognised as revenue in the period; and
 - the methods used to determine the stage of completion of contracts in progress.
- A person shall disclose the following for contracts in progress at the reporting date, namely:—
 - amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;
 - the amount of advances received; and
 - the amount of retentions.

Income Computation and Disclosure Standard, V- Tangible Fixed Assets

- **Definitions**

- **“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.

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“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.

- Stand-by equipment and servicing equipment are to be capitalised. Machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised.

Income Computation and Disclosure Standard, V- Tangible Fixed Assets

- **Components of Actual Cost**
- shall comprise its purchase price, import duties and other taxes, excluding those subsequently recoverable, and any directly attributable expenditure on making the asset ready for its intended use. Any trade discounts and rebates shall be deducted in arriving at the actual cost.
- The cost of a tangible fixed asset may undergo changes subsequent to its acquisition or construction on account of, price adjustment, changes in duties or similar factors; or exchange fluctuation in foreign exchange rates

Income Computation and Disclosure Standard, V- Tangible Fixed Assets

- Administration and other general overhead expenses are to be excluded from the cost of tangible fixed assets if they do not relate to a specific tangible fixed asset. Expenses which are specifically attributable to construction of a project or to the acquisition of a tangible fixed asset or bringing it to its working condition, shall be included as a part of the cost of the project or as a part of the cost of the tangible fixed asset.
- The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, shall be capitalised. The expenditure incurred after the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as revenue expenditure.
- **Self- constructed Tangible Fixed Assets**
- Cost of construction that relate directly to the specific tangible fixed asset and costs that are attributable to the construction activity in general and can be allocated to the specific tangible fixed asset shall be included in actual cost. Any internal profits shall be eliminated in arriving at such costs.

Income Computation and Disclosure Standard, V- Tangible Fixed Assets

- Non-monetary Consideration
- When a tangible fixed asset is acquired in exchange for another asset, the fair value of the tangible fixed asset so acquired shall be its actual cost.
- When a tangible fixed asset is acquired in exchange for shares or other securities, the fair value of the tangible fixed asset so acquired shall be its actual cost.
- Improvements and Repairs
- An Expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is added to the actual cost.

Income Computation and Disclosure Standard, V- Tangible Fixed Assets

- The cost of an addition or extension to an existing tangible fixed asset which is of a capital nature and which becomes an integral part of the existing tangible fixed asset is to be added to its actual cost. Any addition or extension, which has a separate identity and is capable of being used after the existing tangible fixed asset is disposed of, shall be treated as separate asset.
- Valuation of Tangible Fixed Assets in Special Cases
- Where a person owns tangible fixed assets jointly with others, the proportion in the actual cost, accumulated depreciation and written down value is grouped together with similar fully owned tangible fixed assets. Details of such jointly owned tangible fixed assets shall be indicated separately in the tangible fixed assets register.
- Where several assets are purchased for a consolidated price, the consideration shall be apportioned to the various assets on a fair basis.

Income Computation and Disclosure Standard, V- Tangible Fixed Assets

- **Transitional Provisions**
- The actual cost of tangible fixed assets, acquisition or construction of which commenced on or before the 31st day of March, 2015 but not completed by the said date, shall be recognised in accordance with the provisions of this standard. The amount of
 - actual cost, if any, recognised for the said assets for any previous year commencing on or before the 1st day of April, 2014 shall be taken into account for recognising actual cost of the said assets for the previous year commencing on the 1st day of April, 2015 and subsequent previous years.
- **Depreciation**
- Depreciation on a tangible fixed asset shall be computed in accordance with the provisions of the Act.

Income Computation and Disclosure Standard, V- Tangible Fixed Assets

- **Transfers**
- Income arising on transfer of a tangible fixed asset shall be computed in accordance with the provisions of the Act.
- **Disclosures**
- description of asset or block of assets;
- rate of depreciation;
- actual cost or written down value, as the case may be;
- additions or deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of—

Income Computation and Disclosure Standard, V- Tangible Fixed Assets

- Central Value Added Tax credit claimed and allowed under the CENVAT Credit Rules, 2004;
 - change in rate of exchange of currency;
- subsidy or grant or reimbursement, by whatever name called;
- depreciation Allowable; and
- written down value at the end of year.

Income Computation and Disclosure Standard, IX- Borrowing Costs

- **Scope**
- deals with treatment of borrowing costs.
- does not deal with the actual or imputed cost of owners' equity and preference share capital.
- **Definitions**
 - “**Borrowing costs**” are interest and other costs incurred by a person in connection with the borrowing of funds and include:
 - commitment charges on borrowings;
 - amortised amount of discounts or premiums relating to borrowings;
 - amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;
 - finance charges in respect of assets acquired under finance leases or under other similar arrangements.

Income Computation and Disclosure Standard, IX- Borrowing Costs

– **“Qualifying asset”** means:

- land, building, machinery, plant or furniture, being tangible assets;
- know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- inventories that require a period of twelve months or more to bring them to a saleable condition.

- **Recognition**

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset.

Income Computation and Disclosure Standard, IX- Borrowing Costs

- **Borrowing Costs Eligible for Capitalisation**
- To the extent the funds are borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised on that asset shall be the actual borrowing costs incurred during the period on the funds so borrowed.
- To the extent the funds are borrowed generally and utilised for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised shall be computed in accordance with the following formula namely :—
$$\frac{A \times B}{C}$$
- Where A = borrowing costs incurred during the previous year except on borrowings directly relatable to specific purposes;

Income Computation and Disclosure Standard, IX- Borrowing Costs

- 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 or both on the first day and the last day of previous year, half of the cost of qualifying asset; (iii) in case the qualifying asset does not appear in the balance sheet of a person on the last day of 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 other than those qualifying assets which are directly funded out of specific borrowings; or

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 those assets which are directly funded out of specific borrowings;

Income Computation and Disclosure Standard, IX- Borrowing Costs

- **Commencement of Capitalisation**
- To the extent the funds are borrowed **specifically** for the purposes of acquisition, construction or production of a qualifying asset, **from the date on which funds were borrowed;**
- To the extent the funds are borrowed **generally** and utilised for the purposes of acquisition, construction or production of a qualifying asset, **from the date on which funds were utilised.**
- **Cessation of Capitalisation**
- **In case of qualifying assets i.e.** land, building, machinery, plant or furniture, being tangible assets; know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets; **when such asset is first put to use**

Income Computation and Disclosure Standard, IX- Borrowing Costs

- In case of inventories that require a period of 12 months or more to bring to a saleable condition, when substantially all the activities necessary to prepare such inventory for its intended sale are complete.
- **Transitional Provisions**
- All the borrowing costs incurred on or after 1st day of April, 2015 shall be capitalised for the previous year commencing on or after 1st day of April, 2015 in accordance with the provisions of this standard after taking into account the amount of borrowing costs capitalised, if any, for the same borrowing for any previous year ending on or before 31st day of March, 2015.

Income Computation and Disclosure Standard, IX- Borrowing Costs

- Disclosure
- The following disclosure shall be made in respect of borrowing costs, namely:—
 - the accounting policy adopted for borrowing costs;
and
 - the amount of borrowing costs capitalised during the previous year.

THANKS

Remaining standards shall discuss in next webinar as
part-II of Income Computation and Disclosure
Standard

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