The CBDT notifies revised ICDS

5 October 2016

First Notes on

Financial Reporting

Corporate law updates

Regulatory and other information

Disclosures

Sector

All

Banking and Insurance

Information, Communication, Entertainment

Consumer and Industrial Markets

Infrastructure and Government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next 3 months

Post 3 months but within 6 months

Post 6 months

Background

On 31 March 2015, the Ministry of Finance (MoF) issued 10 Income Computation and Disclosure Standards (ICDS), operationalising a new framework for computation of taxable income by all assessees in relation to their income under the heads ‘Profit and gains of business or profession’ and ‘Income from other sources’. The notification specified that these standards were to be applicable for Previous Year (PY) commencing from 1 April 2015, i.e., Assessment Year (AY) 2016-17 onwards.

Subsequent to notification of ICDS, a number of representations were made by many stakeholders which were examined by an Expert Committee (the Committee) comprising departmental officers and professionals. The Committee has recommended amendments to the notified ICDS as well as issuance of clarifications in respect of certain points raised by the stakeholders.

In light of the above, the MoF, on 6 July 2016, announced that the revision of ICDS and the Tax Audit Report (Form No. 3CD) to ensure compliance with the provisions of ICDS and to capture the disclosures mandated by ICDS. Additionally, MoF announced deferment of ICDS by one year and to be applicable from 1 April 2016 i.e. PY 2016-17 (AY 2017-18), instead of 1 April 2015.

New developments

The Central Board of Direct Taxes (CBDT) through its notification No. 87/2016 dated 29 September 2016 notified revised ICDS and repealed its earlier Notification No. 32/2015, dated 31 March 2015. The revised ICDS is applicable to all assessees **other than an individual or a Hindu undivided family who is not required to get his/her accounts of the PY audited in accordance with the provisions of Section 44AB of the Income-tax Act, 1961 (IT Act).** Such assessees need to follow the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head ‘Profits and gains of business or profession’ or ‘Income from other sources’. The notification shall apply to AY 2017-18 and subsequent AYs. (Emphasis added to changes)

Further, CBDT through its notification No. 88/2016, dated 29 September 2016 has also amended Tax Audit Report Form No. 3CD in the Income-tax Rules, 1962 by inserting a new sub-clause in the Form No. 3CD to provide details of adjustments with respect to ICDS and disclosures as per ICDS.

There are no amendments to three ICDSs relating to accounting policies, government grants and provisions, contingent liabilities and contingent assets. All other ICDS have amendments.

This issue of First Notes aims to highlight the key amendments to those ICDS.

Overview of the key amendments

ICDS II: Valuation of inventories

Standard cost method

The revised ICDS now allows standard cost method for measuring inventory. Additionally, it prescribes that where standard costing would be used as a measurement of cost, the following disclosures should be provided:

– Details of inventories measured at standard cost, and

– A confirmation that standard cost approximates the actual cost.

Cost of services in the case of service provider

The previously issued ICDS included the requirement of determining the cost of services in the case of a service provider. The revised ICDS removes the reference to the service provider.

ICDS IV: Revenue recognition

Revenue from service transactions

The previously issued ICDS required revenue from service transactions to be recognised by the percentage-of-completion method in all cases. The revised ICDS introduces following exceptions:

– When services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on a straight line basis over the specific period, and

– Revenue from service contracts with duration of not more than 90 days may be recognised when the rendering of services under that contract is completed or substantially completed.

Use of resources by others yielding interest, royalties or dividends

The previously issued ICDS required interest revenue to be accrued on time basis determined by the amount outstanding and the rate applicable. The previously issued ICDS did not provide any exception to accrual of interest on time basis on tax, duty or cess. The revised ICDS exempts accrual of interest on refund of any outstanding tax, duty or cess.

The revised ICDS provides that interest on tax, duty or cess would be recognised in the PY in which it is received. Therefore, accrual is not required.

ICDS V: Tangible fixed assets

The previously issued ICDS required an entity holding jointly owned tangible fixed assets to indicate separately such assets in the tangible fixed assets' register.

The revised ICDS have removed this requirement.

ICDS VI: The Effects of Changes in Foreign Exchange Rates

Conversion of non-monetary item (inventory)

The revised ICDS have added a new paragraph relating to non-monetary item that is a foreign currency inventory. The revised ICDS require that such inventory, if carried at net realisable value, should be reported using the exchange rate that existed when such value was determined.

Change in foreign operation accounting

The revised ICDS removes the classification requirement of a foreign operation into integral and non-integral operations. The financial statements of such foreign operation should be translated using the principles and procedures specified for foreign currency transactions considering as if the transaction of the foreign operation had been those of the person himself.

ICDS VIII: Securities

The revised ICDS introduce two parts in this standard. They are as follows:

– Part A deals with the securities held as stock-in trade

– Part B deals with the 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 (1956 Act) or the Companies Act, 2013 (2013 Act).

ICDS VIII: Securities (cont.)

Part A

Part A of the revised ICDS is similar to previously issued ICDS on 31 March 2015. However, revised ICDS modifies the definition of securities. The revised ICDS defines securities as 'that 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)'.

Additionally, under the revised ICDS subsequent measurement of securities would be allowed using weighted average cost method.

Part B

Part B of the revised ICDS is a new addition to the standard and introduces requirements for securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the 1956 Act or the 2013 Act.

Securities covered under this part should be classified, recognised and measured in accordance with the guidelines issued by the Reserve Bank of India (RBI) and any claim for deduction in excess of such guidelines should not be taken into account. Further, Part B prescribes that in relation to such securities, the provisions of ICDS VI on the effect of changes in foreign exchange rates relating to forward exchange contracts should not apply.

ICDS IX: Borrowing Costs

The previously issued ICDS did not define a qualifying asset. Therefore, borrowing cost, may need to be capitalised even if an asset may not take substantial period of time to contact.

The revised ICDS introduces the definition of qualifying asset. It specifies that qualifying asset should be such an asset that necessarily requires a period of 12 months or more for its acquisition, construction or production.

Transitional provisions

The overarching principles of the transitional provisions are that no income would escape taxation nor would it suffer double taxation as a result of the transition to this new framework.

ICDS on construction contracts and services

With respect to construction contracts commenced prior to the applicability of ICDS, but not completed by 31 March 2016, the revised ICDS requires that the contract revenue and contract costs associated with such contracts to be recognised based on the method followed by an entity prior to the applicability of the ICDS i.e. 1 April 2016. Similar transition guidance is also available to service contracts.

Other ICDS

The revised ICDS has incorporated transitional provisions for most of the ICDSs. As per the transitional provisions the impacted assessees would have to do a retrospective catch up at the date of transition in certain cases, whereas in certain other cases, the provisions apply only on prospective basis. With the deferment of the ICDS, the transition date for this assessment is 1 April 2016 for all the ICDSs.

Our comments

The revised ICDSs are applicable to the AY 2017-18 and subsequent AYs. The adoption of ICDS is expected to bring with it a significant change and is expected to alter the way companies compute their taxable income. Therefore, companies should spend time to fully understand and evaluate the potential impact of ICDS on their tax liability for a smooth and effective transition to ICDS.

Also the amendments issued to existing Form No. 3CD will also facilitate tax payers to analyse the effort required for preparing the information for reporting purpose. Following are our detailed comments:

- **Applicability of the ICDSs**: The previously issued ICDSs were applicable to all assessees, following the mercantile system of accounting, for the purpose of computation of income chargeable to income-tax under the head 'Profit and gains of business or profession' or 'Income from other sources'. The revised ICDS clarifies that an individual or a Hindu undivided family who are not required to get their accounts of the PY audited in accordance with the provisions of Section 44AB of the IT Act would not be required to apply ICDS.

Our comments (cont.)

- **Valuation of inventories**: Existing AS 2, *Valuation of Inventories*, allows the use of the standard costing method for convenience, if the results approximate to the actual cost. However, the previously issued ICDS II did not permit use of the standard cost method. The revised ICDS permits standard cost method for valuation of inventories in addition to the retail method of valuation. This will help those assessees who are consistently following the standard cost method for valuation of inventories. Consequent disclosures relating to standard costing have also been introduced.

  Under the previously issued ICDS, there were concerns with respect to the manner in which cost of services of a service provider should be valued as there was substantial subjectivity on estimation of inventory for professional firms, particularly in case of a fixed price project. Additionally, there was a contradiction between the principles specified in the ICDS for revenue recognition and inventory valuation. Further, there could be a service tax implication on the inventory of a service provider for incomplete work. It appears that to remove this anomaly, the revised ICDS has omitted words 'in the case of a service provider' appearing in ICDS II for determining the cost of services. This alignes inventory and revenue accounting for service providers between accounting records and tax computations.

- **Revenue recognition**: The previously issued ICDS did not allow use of completed contract method for accounting of revenue for services contracts. It only required the use of percentage-of-completion method for revenue recognition. The revised ICDS provides a pragmatic solution for short-term services contract that are less than 90 days by allowing completed contract method for revenue recognition. Additionally, the revised ICDS allows use of straight-lining method for revenue recognition when services are provided by an indeterminate number of acts.

  Further, MoF took notice of the practice followed by assessees in accounting for interest of advances paid as tax, duty or cess. Under the revised ICDS, interest would be recognised on such deposits when received.

  This seems to provide a practical solution for short duration contracts as well as avoid the implication on tax payments due to interest on tax refunds, etc.

- **The effect of changes in foreign exchange rates**: The classification of foreign operations as integral and non-integral has been removed from ICDS. This is expected to simplify the translation of the financial statements of the foreign operations specifically for banks. Further, in case of a non-monetary item being inventory, which is carried at net realisable value denominated in a foreign currency, the previously issued ICDS did not provide clarity on the translation principles. This issue has been resolved in the revised ICDS, where the exchange rate that existed on the date of determination of such realisable value shall be used for the translation. The companies, however, need to prepare computation for foreign operations which may require more efforts.

- **Securities**: The previously issued ICDS relating to securities was applicable only to taxpayers who held securities as stock-in-trade. The revised ICDS now also includes scheduled bank and public financial institutions formed under a central or a state Act or so declared under the 1956 Act/2013 Act within its ambit. However, the revised ICDS does not deal with securities held by mutual funds, venture capital funds, etc. Further, the definition of securities now includes 'share of a company in which the public are not substantially interested'. Accordingly, the revised ICDS will now apply to shares of a company in which the public are not substantially interested.

  Under the previously issued ICDS, securities were valued at lower of cost or net realisable value on the category wise basis as against each individual security-wise basis. By following the category wise valuation, anticipated profits would be indirectly recognised and brought to tax since appreciation in the value of certain securities will be set off against diminution in the value of other securities. This aspect has not been considered in the revised ICDS.

  There would have been significant implications on banking and financial institution entities under the previously issued ICDS. The revision aligns their record keeping and tax implications largely based on the method that they follow for their books of accounts.

- **Companies that have already adopted ICDS**: As the ICDSs were earlier applicable from AY 2016-17, the notification for deferment came at a time when several companies might have already assessed the ICDS impact and planned their tax payments. The revised ICDS may require them to perform the assessment of ICDS impact again. However, majority of these changes seem to benefit the assessees and therefore, a welcome change.

- **Brought consistency with accounting standards**: The revised ICDS have brought consistency with the existing accounting practices prescribed under Ind AS and accounting standards.

  - ICDS II - The revised ICDS II on valuation of inventories brought standard cost model for measurement of inventory which is consistent with Ind AS and existing Accounting Standards.

  - ICDS IX – The revised ICDS brought definition of qualifying assets consistent with existing Accounting Standards.

- **Diversity still exists between accounting standards and ICDS**: ICDS have been drafted keeping the existing Accounting Standards as a base. There are significant differences between Ind AS and existing accounting standard. With Indian companies transitioning to Ind AS in phases beginning 1 April 2016, there would be additional adjustment required to be made to the accounting profit calculated using Ind AS to arrive at taxable income as per the IT Act.

  Additionally for accounting purposes companies have also been relying upon numerous other pieces of literature issued by the Institute of Chartered Accountants of India such as Guidance Notes, interpretations etc. These areas need to be carefully evaluated as they may have significant impact on reporting of numbers for companies. This may impact computation of taxable income also.

- **Modification to Form No. 3CD**: The recently issued notification also brought changes to Form No. 3CD, the amendments provides time to the tax payers who are required to file Tax Audit Report to analyse the requirement and prepare accordingly.

  The new notification changes Form No. 3CD as follows:

  – In place of disclosure of the deviations in the method of accounting employed, it is now required to provide the adjustments made to profit and loss for complying with the ICDS, in the given format.

  – Disclosures need to made as per the provisions of the ICDS except for ICDS VI relating to 'the effects of changes in foreign exchange rates' and ICDS VIII relating to 'securities'.

  It however, appears that while only a limited number of disclosures are made in the Form No. 3CD, companies need to also prepare and retain other disclosures which are mandated by the ICDS. These may be part of the records that may be required at the time of assessments.

- **Approach for changes**: Overall, it seems that many of the changes incorporated in the ICDS are facilitating more alignment with accounting records, simplifying some of the computational requirements and also addressing the concerns expressed by many of the stakeholders. Hence, most of these changes seem to have been welcomed by the stakeholders.

The bottom line

The revised ICDS are applicable from AY 2017-18 and issue of this notification is quite timely as it is expected to help India Inc. to transition to ICDS.

KPMG in India

Ahmedabad
Commerce House V, 9th Floor
902 & 903, Near Vodafone House
Corporate Road, Prahaladnagar
Ahmedabad 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bengaluru 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Centre
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604, 6th Floor, Tower -
1, Godrej Waterside, Sector – V,
Salt Lake, Kolkata - 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3058 5764/65
Fax: +91 20 3058 5775

KPMG in India's IFRS institute

KPMG in India is pleased to re-launch its IFRS institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework..

IFRS Notes

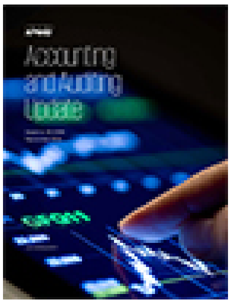
SEBI issues clarification on revenue recognition inclusive of excise duty

22 September 2016

The Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) issued a notification on behalf of SEBI, on 20 September 2016, which clarifies that companies should follow a uniform approach in their revenue disclosures. Accordingly, 'income from operations' may be disclosed inclusive of excise duty, instead of net of excise duty, as specified in the 2013 Act.

Our IFRS Notes provide an overview of the notifications issued by the BSE and NSE.

Missed an issue of Accounting and Auditing Update or First Notes?



Issue no. 2 | September 2016

- Data analytics and technology
- Foreign currency embedded derivatives
- Share-based payment accounting – new concepts
- Unconsolidated structured entities
- Classification of investments in preference shares
- Non-GAAP financial measures – IOSCO's final statement
- Regulatory updates.

The central government amends limits of managerial remuneration

20 September 2016

Section 197 of the Companies Act, 2013 (2013 Act) prescribes the conditions for overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits. The Schedule V to the 2013 Act provides certain conditions to be fulfilled by a company to pay managerial remuneration.

On 12 September 2016, the central government notified amendments to Section II of Part II of the Schedule V of the 2013 Act. The notification is effective from the date of its publication in the Gazette i.e. 12 September 2016.

Our issue of First Notes provide an overview of the key amendments in Schedule V relating to remuneration payable by companies having no profit or inadequate profit without central government approval.

KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

In our recent call, on 28 September 2016, we covered we covered key financial reporting and regulatory matters that are expected to be relevant for stakeholders as they approach the quarter ending 30 September 2016:

1. SEBI's relaxations for Ind AS results published by companies that have listed debt securities
2. Amendments for consolidated financial statements of wholly-owned and partially-owned subsidiaries issued by MCA
3. Amendments introduced in Schedule V to the 2013 Act relating to managerial remuneration
4. Issuance of clarifications - Bulletin 4 by Ind AS Transition Facilitation Group of the ICAI

Feedback/queries can be sent to aaupdate@kpmg.com

Previous editions are available to download from: www.kpmg.com/in