Presentation at

Seminar organized by SIRC of ICAI

Topic : ICDS – 2 : Valuation of Inventories

Date : 8th May 2017
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Introduction – Journey So far
ICDS will apply to
- An assess
- Following mercantile system of accounting
- Computing taxable income under the following heads of income (Preamble)
  - Profits and Gains from business or profession
  - Income from other sources

In case of conflict between the ICDS and the Income Tax Act, the Act shall prevail.

Applicable from AY 2017-18 onwards.
Not for the purpose of maintenance of books of accounts. (Preamble)

As per Sec 145(3), if the Assessing officer is not satisfied about the

- Correctness or completeness of the accounts of the assesse
- Where the method of accounting provided in sub-section (1) has not been regularly followed
- Income has not been computed in accordance with the ICDS,

the assessing officer may make an assessment in the manner provided in Sec 144.
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ICDS 2 – Valuation of Inventories
ICDS 2 – Definitions

Finished Goods or Stock in Trade

W.I.P

Raw Materials
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<td>Net Realisable Value</td>
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<td>Estimated Selling Price</td>
<td>Estimated Cost of Completion and estimated costs necessary for Sale</td>
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<td>Estimated Selling Price (in Ordinary course of business)</td>
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ICDS 2 – Valuation of Inventories

Cost of Inventory

Cost of Purchase
- a) Purchase Price
- b) Duties and Taxes
- c) Freight Inwards
- d) Other expenses directly attributable

Cost of Service
- a) Labour
- b) Other costs of personnel directly engaged in providing the service including supervisory staff and attributable overheads.

Cost of Conversion
- a) Fixed Overheads
- b) Variable Overheads

Other Costs
- a) Costs incurred in bringing the inventories to their present location and condition.
- b) Excludes Interest subject to ICDS 9
ICDS 2 – Valuation of Inventories

Methods of valuation of Inventory

Specific Identification
  a) Applicable only where items are not interchangeable or
  b) Used for specific projects.

FIFO & Weighted Average
  a) Most acceptable method if specific identification method fails.
  b) Reflects the most fairest possible approximation of the cost.
ICDS 2 – Valuation of Inventories

Techniques for measurement of Cost

Standard Cost Method

a) Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation.
b) They are regularly reviewed and, if necessary, revised in the light of the current conditions.

Retail Method

a) Where it is impracticable to use FIFO/Weighted Average cost, retail method could be used.
b) Cost = Sales – GP margin
Net Realisable Value

a) Must be done on an item to item basis. (CIT Vs Chari & Ram 17 ITR 1)

b) NRV to take events occurring after the PY end also (to the extent such events confirm the conditions prevailing on the last day of the previous year).

c) 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.
Opening Stock

No change in valuation needed for opening stock. Value as at the end of immediately preceding previous year can be adopted.

Change in the Method

The method of valuation of inventories once adopted by a person in any previous year shall not be changed without reasonable cause.

Transition Provisions: Interest and other borrowing Costs included in Opening Stock
Dissolution of firm

In case of dissolution of a Partnership firm or AOP or BOI, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the NRV.

Disclosures

- The accounting policies adopted including the cost formulae used
- Where Standard Costing has been used as a measurement of cost, details of such inventories and a confirmation of the fact that standard cost approximates the actual cost
- The total carrying amount of inventories and its classification appropriate to a person.
Judicial Precedents and Controversies
Notwithstanding anything to the contrary contained in Section 145 –

(a) The valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head “Profits and Gains of business or profession” shall be –

(i) In accordance with the method of accounting regularly employed by the assessee and

(ii) Further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

Explanation: For the purpose of this section, any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment.
ICDS 2 – Controversies

a) Whether ICDS 2 is applicable to assessees having inventory and adopting cash basis of accounting ??

Irrespective of method of accounting followed (ie either cash or mercantile), assesse has to take into account the value of stock/inventory at the beginning and end of the year.

CIT Vs Krishnaswami 53 ITR 122 (SC)

b) How to interpret the word “Reasonable Cause” ??

Judicial Guidance is available under Sec 273B – Whether the same holds ground.

Casual departure from the regular basis of valuation not permitted

CIT Vs Visweswardas, 14 ITR 110
c) In case a change is made to the method valuing inventory and the same is assumed to be reasonable, how should such change be effected??

It is not open to the assessee to adopt one method for valuing opening stock and a different method for valuing closing stock

CIT Vs Doom Dooma           200 ITR 496
CIT Vs Chengalvaraya Chetty  2 ITC 14
d) Does ICDS 2 erases the distinction between methods of valuing inventory in case of dissolution of firm/AOP/BOI and discontinued business ??

Dissolution of firm – Inventory at Market Value

ALA Firm Vs CIT 189 ITR 285 (SC)
CIT Vs Popular Automobiles 255 ITR 499 (SC)

Dissolution of firm and NOT Business – Inventory at Cost

Sakti Trading Vs CIT 250 ITR 871 (SC)
e) Which depreciation must be used in valuation of Inventories? (Income Tax Depreciation or Book depreciation)?

Book Depreciation only. Income Tax Depreciation is not an expenditure but a statutory allowance.

f) Can Impairment Loss (under AS 28) debited to the Statement of P&L be absorbed in the valuation of inventories??

Impairment Loss is an abnormal cost for AS 2 purpose and hence should not be absorbed in valuation of Inventories. Further Impairment is an adjustment to the fair value of the fixed assets and does not relate to the usage of those assets.
g) In case of sugar factories, sometimes the “Levy Price” is lesser than the NRV. But both Levy Price and NRV are lower than cost. In such cases, which price must be adopted for valuing Inventory?? Levy Price or NRV?

CIT Vs Bannari Amman Sugars Ltd – 349 ITR 708
Comparison between IFRS, Ind AS and ICDS
## ICDS 2 – Comparisons

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<th>Ind AS</th>
<th>ICDS</th>
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<td>Exclusions</td>
<td>WIP, Financial Instruments held has Stock in Trade, Producers inventory measured at NRV</td>
<td>Financial Instruments and Biological Assets. Makes a distinction between Exclusion from Scope and Measurement</td>
<td>WIP, Financial Instruments held as stock in trade, Producers inventory measured at NRV, Machinery Spares</td>
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<td>Measurement of Cost</td>
<td>Refundable Duties and Taxes must be excluded from the cost of Inventory</td>
<td>Refundable Duties and Taxes must be excluded from the cost of Inventory</td>
<td>All Duties and Taxes must be included in the cost of Inventory</td>
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<tr>
<td>Change in method of valuation of Inventory</td>
<td>Subject to 3 Conditions</td>
<td>Subject to 3 Conditions</td>
<td>Cannot be done without Reasonable Cause</td>
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<td>Valuation of Inventory in case of dissolution of firm/AOP/BOI</td>
<td>Not specifically dealt with by the AS</td>
<td>Not specifically dealt with by the Ind AS</td>
<td>Valuation must be carried out at NRV.</td>
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Thank you !!!

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