International Journal of Humanities Social Science and Management (IJHSSM)
Volume 5, Issue 3, May-June, 2025, pp: 40-44 ISSN: 3048-6874
www.ijhssm.org

Recognizing and Preventing Financial Market Fraud Via the Implementation of Income Computation and Disclosure Standards (ICDS)

[1]CA (Dr.) Laxmi Narayan,
Chartered Accountant, Department of Accounting, Jai Narain Vyas University, Jodhpur
[2]Divya Soni
(Corresponding Author), Research Scholar, Department of Business Finance & Economics, Jai Narain Vyas University, Jodhpur

Date of Submission: 28-04-2025 Date of Acceptance: 07-05-2025

Abstract
Deliberately falsifying a company's financial statements by omitting information or inflating figures to portray a more favourable picture of the company's financial situation is recognized as financial statement fraud. For many present and prospective investors and shareholders, financial statement fraud is a problem. Serious penalties from regulators as well as significant harm to one's reputation can arise. In general management of the company is primarily in charge of spotting financial statement fraud.

The Income Computation and Disclosure Standards (ICDS) are an innovative approach that was established in India to address financial fraud-related issues. Income Computation and Disclosure Standards (ICDS) provide a standard framework for the preparation and presentation of financial statements, which has become essential in the detection of financial fraud. This paper's framework aims to present a thorough understanding of ICDS's role in Indian fraud detection. The paper also covers how the audit committees examine fraud prevention and use the ICDS legislation for future implementation.

Keywords: Accounting, Forensic Accounting, Income Computation andDisclosure Standards (ICDS), Financial Market,Accounting Standards (AS)

I. Introduction

India, being a developing economy with quickly growing financial sectors, has particular difficulties in preventing financial fraud considering the corporate governance and regulatory enforcement are not as strong as in more developed nations (Leuz, Nanda, & Wysocki, 2003).Financial fraud affects the company's entire set of financial statements, and investors are the company's primary focus for potential future profits. Indian accounting rules primarily apply to various sections of various corporate books of accounts statements. The Income Computation and Disclosure Standards (ICDS) were established in order to stop these scams and identify any type of contradicting circumstances. The ICDS tackles a number of important problems, like income manipulation and inventive accounting techniques, that have historically made financial misreporting and fraud possible. By offering a more stringent structure for calculating income, it reduces the likelihood of disparities between taxable and book income, which are frequently used fraudulently (Joshi, 2017).The primary objective of this study of research is to investigate the manner ICDS could prove an effective tool for identifying and stopping financial fraud in the financial markets of India. It will examine how ICDS affects company financial reporting and evaluate how well it works to stop fraud. Furthermore, the research will explore the obstacles linked to the execution of ICDS, specifically for smaller enterprises and multinational corporations, while offering perspectives on the possibility of worldwide standardization of these guidelines.

II. Literature Review

The term "financial fraud" describes deliberate deception through practices like insider trading, market manipulation, accounting manipulation, or financial statement fabrication. The "Fraud Triangle," which identifies pressure, opportunity, and rationalization as the three main elements influencing financial fraud, has been the subject of several studies(Cressey, 1950).Financial fraud imposes significant financial losses, destabilizes markets, and destroys investor confidence. For instance, tighter laws like the Sarbanes-Oxley Act (SOX) in the US were enacted in response to Enron's collapse in 2001, which

destroyed billions of dollars' worth of investor capital and improved corporate governance and financial transparency(Healy & Palepu, 2003).

Considering the goal of improving transparency and comparability across businesses, accounting standards like Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) set the foundation for financial reporting. Empirical evidence indicates that strict adherence to these guidelines mitigates the risk of financial fraud and misrepresentation(Ball, 2006).In India, ICDS was put into place to close the gaps between accounting and taxable income and to unify tax reporting. A total of twelve criteria in the framework that include things like revenue recognition, inventory valuation, and building contracts(Gupta, 2016). ICDS limits the opportunity for creative accounting and inconsistencies between financial and tax reporting by ensuring uniform reporting standards. One preventive measure to reduce financial misreporting and tax evasion is the implementation of ICDS. Through closer alignment of tax and financial accounting, ICDS reduces organizations' ability to manipulate earnings and underreport income for taxation(Joshi, 2017). Research from empirical studies has demonstrated that nations with more stringent tax reporting laws—such as the ICDS—generally have lower rates of financial fraud (Hanlon & Heitzman, 2010).

As opposed to IFRS, which could be globally uniform, ICDS is intended to improve compliance and minimize tax-related disparities, which present difficulties for global corporations. Still, there is growing recognition of its contribution to lower income misreporting in India, particularly when it comes to preventing financial fraud(KPMG, 2018).India and other emerging markets face particular regulatory difficulties. Such markets have lower levels of market development and regulatory enforcement, which makes financial fraud more prevalent(Leuz, Nanda, & Wysocki, 2003).

Strong accounting and disclosure requirements, such as ICDS, are crucial for preventing financial market fraud, as per the body of current literature. ICDS contributes to a decrease in the possibility of financial fraud and tax evasion by establishing a standardized method for calculating income. But issues with interpretation, global alignment, and compliance still exist—particularly for multinational corporations and smaller businesses.

III. Methodology:

3.1 The Overview of Financial Market Fraud

Financial market fraud pertains to illicit activities intended to misguide investors, manipulate markets, or fabricate financial data in order to obtain unjust financial benefit. Both individual and institutional investors frequently suffer large financial losses as a result of fraud, especially when stock prices plummet or businesses fail as a result of poor management or fraudulent practices. Fraudulent actions damage the integrity of the financial system, cost investors money, and sometimes have far-reaching effects on the economy. Common financial statement manipulation techniques used by businesses to present a more favorable financial position than they actually have include inflating earnings and misreporting liabilities. These actions often result in inflated stock prices or easier access to financing by misleading creditors, investors, and regulators(Rezaee, 2005).

- **Several prominent forms of fraud in the financial markets are:**
- Insider trading: The unlawful act of purchasing or selling securities using material, non-public information.
- • Market misrepresentation: Efforts to manipulate the price of securities in order to create deceptive market conditions.
- Accounting fraud: Accounting fraud is the falsification of financial statements to give a business a more favourable financial position than is actually the case, misleading investors.

3.2 The Provision of Strict Disclosure Standards:

Fraud is still a major threat to investor confidence and the integrity of the financial sector. The evolution of fraud techniques, particularly in the digital age, means constant vigilance and further reforms are needed, even though regulatory bodies and governments have introduced stricter financial reporting and auditing standards, such as ICDS in India. To protect market integrity and stop fraud in the future, preventive measures are essential. One such measure is the adoption of standardized income disclosure frameworks like ICDS.

3.3 Introduction to Income Computation and Disclosure Standards (ICDS)

The Tax Administration Reforms Commission (TARC), that promoted harmonizing tax laws with contemporary accounting practices and was chaired by Parthasarathi Shome, provided

the foundation for ICDS. As a result, the Indian government started developing a set of guidelines to align tax reporting with the ideas of commercial accounting. The method of constructing of such standards was started in 2009 by the Central Board of Direct Taxes (CBDT), and following multiple rounds of consultation, the first draft of the ICDS was made available for public comment in 2012. The primary objective of ICDS was to ensure that specific income-related elements, such as inventory valuation, foreign exchange gains or losses, and revenue recognition, had been handled uniformly for taxation purposes, regardless of the accounting methodologies employed by businesses. According to Section 145(2) of the Income Tax Act, 1961, ICDS was formally notified by the CBDT and went into effect on April 1, 2015(Shome,2014). In the beginning, ten ICDS standards were released, addressing a variety of subjects such as:

- ICDS I: Accounting Policies
- ICDS II: Valuation of Inventories
- ICDS III: Construction Contracts
- ICDS IV: Revenue Recognition
- ICDS V: Tangible Fixed Assets
- ICDS VI: Effects of Changes in Foreign Exchange Rates
- ICDS VII: Government Grants
- ICDS VIII: Securities
- ICDS IX: Borrowing Costs
- ICDS X: Provisions, Contingent Liabilities, and Contingent Assets

The purpose of ICDS standards is to reduce tax evasion through accounting discrepancies and to establish a more structured approach to income computation. ICDS improves compliance and supports the effective administration of tax laws in India by filling in the gaps between financial reporting and tax accounting, lowering opportunities for tax avoidance, and giving taxpayers clarity.

3.4 An Actual Case Study on How ICDS Encourages Transparency and Reduces Fraud

To reduce financial fraud and increase transparency in the Indian corporate sector, the Income Computation and Disclosure Standards (ICDS) are essential. DLF Limited, one of the largest real estate companies in India, offers an example of how ICDS does this.

Case Study: DLF Limited and the Role of ICDS

Prominent in the real estate industry, DLF Limited was renowned for its sophisticated financial dealings and idealistic undertakings. The business has previously been embroiled in disputes over its financial reporting, mainly pertaining to the timing of expenses and the recognition of revenue, which raised questions about openness and possible tax evasion. These disparities grew more noticeable because there were no precise guidelines for calculating income in such a complicated sector(*Case Study:DLF India's Leading Real Estate Company in Trouble*, 2010).

Challenges Before ICDS

Prior to ICDS, businesses such as DLF could employ Indian GAAP accounting practices with greater latitude, which could be used to:

- By capitalizing costs that ought to have been expensed, reduce the financial costs and increase profits.
- Overestimate revenue and recognize it before realizing it. This is a common problem in long-term construction contracts.
- Understated liabilities that give an erroneous impression of financial health, particularly contingent liabilities.

Although there was considerable opportunity for manipulation, these practices were not inherently fraudulent and could have resulted in differences between reported financial income and actual taxable income. Regulatory agencies, such as SEBI (Securities and Exchange Board of India), began to look into DLF's accounting procedures and compliance with tax and financial disclosure laws as a result of this lack of transparency.

ICDS and Its Impact

With the introduction of ICDS in 2015, precise guidelines for calculating income were introduced. These guidelines specifically addressed the construction industry, which was known for revenue misreporting and tax evasion.

The following important ICDS standards had an effect on DLF's financial reporting:

1. ICDS III: Construction Contracts

Companies were more likely to postpone income recognition by using the project completion method, but ICDS III mandates that revenue from construction contracts be recognized using the percentage of completion method (PoCM). Delaying revenue recognition to later periods in order to manipulate earnings was less likely with PoCM in place to force DLF to recognize revenue as the project moved forward.

2. ICDS IV: Revenue Recognition

Revenue Recognition standard ensures that income is recognized when it is earned and realizable, further clarifying how revenue is treated for long-

term projects. As a result, there was less opportunity for businesses to overstate revenue by early recording of future income. DLF's earnings were more transparent as a result of having to abide by tighter rules when it came to recognizing revenue from its long-term real estate projects.

3. ICDS X: Provisions, Contingent Liabilities, and Contingent Assets

Businesses used to be able to artificially create a strong financial position by delaying the recognition of liabilities, especially contingent liabilities (like future payments or legal disputes). By requiring disclosure of provisions for such liabilities at the time of obligation, ICDS X mitigates the possibility of underreporting liabilities. Investors and regulators were given a clearer picture by DLF's financial statements, which became more transparent in displaying actual liabilities.

Outcome and Impact of ICDS on DLF

DLF had to update its income reporting in an attempt to comply with the new standards following the implementation of ICDS. This led to a number of significant changes:

- **More Transparent Financial Reporting:** DLF was required to reveal revenue in accordance with project advancement as opposed to holding off on income until long-term real estate projects were finished. This increased the company's earnings reports' transparency and gave investors a more realistic view of its financial situation.
- **Limited ability to manipulate earnings:** The ability of companies like DLF to manipulate earnings through accounting treatments was weakened by ICDS. ICDS reduced aggressive tax planning and earnings manipulation by standardizing the treatment of income and expenses for tax purposes.
- **Compliance with Tax Regulations**: To minimize tax liabilities and hide the company's true financial position, DLF reduced discrepancies between its tax filings and financial reporting.

Regulatory Scrutiny and Fraud Prevention

Regulations pertaining to financial misreporting were avoided in part because of DLF's increased transparency under ICDS. SEBI had been investigating DLF before ICDS for alleged financial disclosure frauds. By implementing more stringent and standardized reporting guidelines, ICDS tried to help reduce the possibility of these types of disputes. Furthermore, the risk of underreporting and tax evasion was decreased because DLF had less room to conceal possible obligations due to ICDS's requirement for the consistent disclosure of provisions and liabilities. In order to help regulators and auditors identify irregularities early on, transparent reporting is essential to the prevention of fraud.

Summery:

By standardizing the reporting of income and liabilities, ICDS was instrumental in promoting transparency in the DLF Limited case, especially in the real estate industry. Whereas the ICDS X required more transparent disclosure of contingent liabilities, the application of standards like ICDS III and IV ensured that revenue recognition was more accurate and reflective of actual progress. Because there were fewer opportunities for tax evasion and financial manipulation, investor confidence and regulatory compliance increased.

4.. Challenges in Implementing ICDS

One important step toward standardizing tax reporting procedures was the adoption of the Income Computation and Disclosure Standards (ICDS) in India. The adoption of these standards has not, however, been without its difficulties. The following are some of the main challenges that companies, accountants, and tax authorities encountered when implementing ICDS:

1. Divergence from Accounting Standards (Ind AS and IFRS)

The separation of ICDS from International Financial Reporting Standards (IFRS) and Indian Accounting Standards (Ind AS) is one of the main implementation challenges. Whereas ICDS is exclusively concerned with tax computation, Ind AS and IFRS are intended for use in financial reporting. For businesses, especially those with global operations or those obligated to adhere to IFRS for financial reporting, the distinctions between these standards pose challenges.

2. Increased Compliance Burden

Companies presently face a greater burden of compliance as a result of the implementation of ICDS, particularly small and medium-sized enterprises (SMEs). Companies will still have to to adhere to financial accounting principles in addition to a set of rules for tax computation. Many businesses might not have the resources or expertise necessary to fully comply with these standards due to their complexity.

3. Complexity in Interpretation and Application

Particularly in certain industries like real estate, finance, and construction, interpreting the complex rules of ICDS regarding the treatment of income, expenses, and provisions can be challenging. There can be uncertainty in the application of some ICDS components due to their ambiguity and

susceptibility to different interpretations, such as revenue recognition and the handling of foreign exchange gains and losses.

4. Conflict with Judicial Precedents

A set of tax computation guidelines, ICDS occasionally contradicts court rulings made by Indian courts regarding matters pertaining to taxes. ICDS may enforce regulations that are in conflict with various rulings that have been made, for instance, about how specific expenses should be treated or when revenue recognition should occur.

5. Treatment of Certain Items under ICDS

Many businesses have experienced difficulty with how the ICDS treats particular items like government grants, foreign exchange fluctuations, and borrowing costs. For example, the strict and ambiguous provisions of ICDS IX (borrowing costs) and ICDS VI (effects of changes in foreign exchange rates) have drawn criticism.

7. **Effects on Tax Liability and Profitability**

A company's profitability and tax liability may be impacted by the adoption of ICDS since the standards impose separate guidelines for the recognition of income and expenses. For instance, certain expenses that, in accordance with financial accounting standards, would have been recognized sooner may be deferred under ICDS, which would increase taxable income temporarily.

Conclusion and future study:

Financial fraud is largely prevented by the Income Computation and Disclosure Standards (ICDS), which offer an essential framework that improves financial reporting for tax purposes in terms of accountability, consistency, and transparency. In addition to bringing financial reporting into compliance with tax laws, ICDS enhances the overall integrity of financial disclosures, fostering a more reliable atmosphere for business. ICDS is an effective instrument in the fight against financial fraud because it closes loopholes and lessens the opportunity for manipulative practices. Future studies may combine artificial intelligence (AI)-driven technology with ICDS to detect fraud.

References:

[1]. Leuz, C., Nanda, D., & Wysocki, P. D. (2003). Earnings management and investor protection: An international comparison. *Journal of Financial Economics, 69*(3), 505–527. https://doi.org/10.1016/S0304-405X(03)00121-1

[2]. Joshi, M. (2017). Role of ICDS in tax compliance and financial reporting in India. *International Journal of Accounting*.

[3]. Cressey, D. R. (1950). The criminal violation of financial trust. *American Sociological Review*.

[4]. Healy, P. M., & Palepu, K. G. (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting and Economics*.

[5]. Ball, R. (2006). International Financial Reporting Standards (IFRS): Pros and cons for investors. *Accounting and Business Research*.

[6]. Gupta, R. (2016). ICDS in India: Impact and benefits for tax reporting. *Journal of Taxation*.

[7]. Hanlon, M., & Heitzman, S. (2010). A review of tax research. *Journal of Accounting and Economics, 50*(2–3), 127–178. https://doi.org/10.1016/j.jacceco.2010.09.002

[8]. KPMG. (2018). *Income Computation and Disclosure Standards (ICDS) – Impact analysis*. KPMG India. Retrieved from https://home.kpmg.com/xx/en/home/insights/2018/09/icds-impact.html

[9]. Leuz, C., Nanda, D., & Wysocki, P. D. (2003). Earnings management and investor protection: An international comparison. *Journal of Financial Economics, 69*(3), 505–527. https://doi.org/10.1016/S0304-405X(03)00121-1

[10]. Rezaee, Z. (2005). Causes, consequences, and deterrence of financial statement fraud. *Critical Perspectives on Accounting, 16*(3), 277-298. https://doi.org/10.1016/S1045-2354(03)00072-8

[11]. Shome, P. (2014). *Tax Administration Reform Commission (TARC) Report: First Report* (Vol. 1). Government of India, Ministry of Finance, Department of Revenue, Central Board of Direct Taxes.

[12]. *Case Study:DLF India's Leading Real Estate Company in Trouble*. (2010, December 16). MantrASmS Alert. https://mantrasmsalert.wordpress.com/case-studies/case-studydlf-indias-leading-real-estate-company-in-trouble/