CA FINAL

FINANCIAL REPORTING

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Based on Revised Syllabus announced by ICAI

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BOOK 1

CA FINAL

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FINANCIAL REPORTING – BOOK 1

CHAPTER

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INTRODUCTION TO ACCOUNTING STANDARDS (AS) AND INDIAN ACCOUNTING STANDARDS (IND AS)

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1. ACCOUNTING STANDARDS :

1.1 INTRODUCTION :

Accounting as a "language of business" communicates the financial results of the enterprise to various stakeholders by means of financial statements.

If the financial accounting process is not properly regulated, there is possibility of financial statements being misleading, tendentious and providing a distorted picture of the business rather than the true.

To ensure transparency, consistency, comparability, adequacy and reliability of financial reporting, it is essential to standardize the accounting principles and policies.

Accounting Standards (Ass) provide framework and standard accounting polices for treatment of transactions and events so that the financial statements of different enterprise become comparable

1.2 WHAT ARE ACCOUNTING STANDARDS? :

Accounting Standards (Ass) provide framework and standard accounting polices for treatment of transactions and events so that the financial statements of different enterprise become comparable.

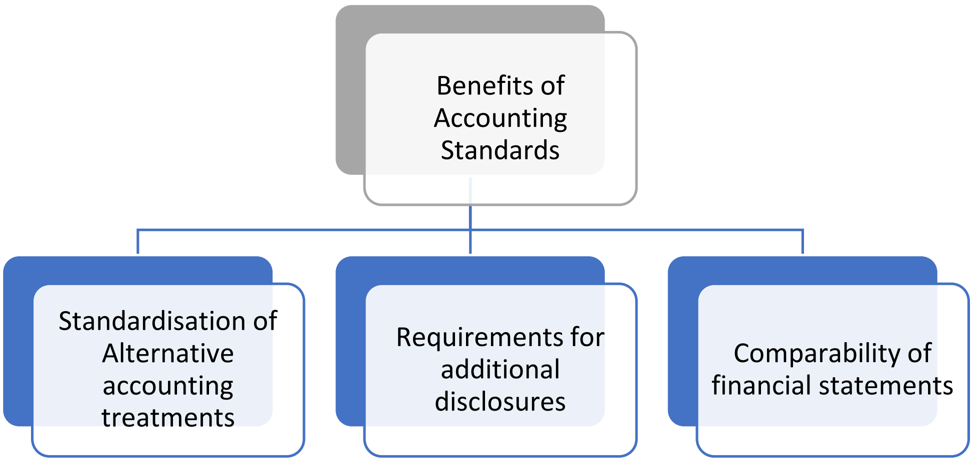
Accounting Standards are written policy documents issued by the expert accounting body or by government or other regulatory body, to harmonies the accounting process to that financial statement presents true and fair picture of business.

1.3 ACCOUNTING STANDARDS DEALS WITH :

Accounting Standards Deal with			
Recognition of events and transactions	Measurement of trasaction and Events	Presentation of transactions and Events	Disclosure requirements

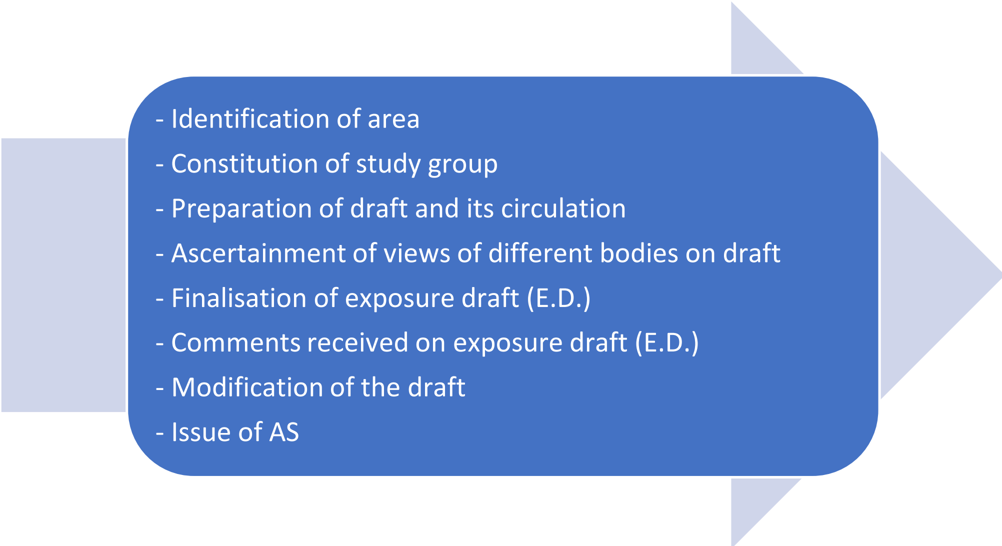
1.4 BENEFITS OF ACCOUNTING STANDARDS :

Accounting standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. By setting the accounting standards, the accountant has following benefits:



1.5 ACCOUNTING STANDARDS SETTING PROCESS :

The Institute of Chartered Accountants of India (ICAI), being a premier accounting body in the country, took upon itself the leadership role by constituting the Accounting Standards Board (ASB) in 1977.

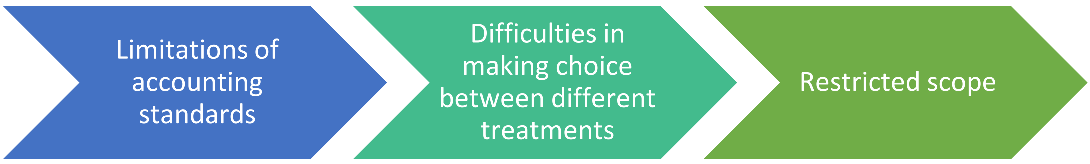


1.6 LIMITATIONS OF ACCOUNTNG STANDARDS :

However, there are some limitations of accounting standards:

(i) **Difficulties in making choice between different treatments:** Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

(ii) **Restricted scope:** Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.



2. INDIAN ACCOUNTING STANDARDS :

2.1 WHY IND AS? :

In the present era of globalization and liberalization, the world has become an economic village.

More and more Indian companies are being listed on overseas stock exchanges. The use of different accounting frameworks in different countries, which require inconsistent treatment and presentation of the same underlying economic transactions, creates confusion for users of financial statements. This confusion leads to inefficiency in capital markets across the world. Therefore, increasing complexity of business transactions and globalization of capital markets call for a single set of high quality accounting standards. Thus, the case for a single set of globally accepted accounting standards has prompted many countries to pursue convergence of national accounting standards with IFRS.

2.2 WHAT ARE IND AS? :

Indian Accounting Standards (Ind-AS) are the International Financial Reporting Standards (IFRS) converged standards issued by the Central Government of India under the supervision and control of Accounting Standards Board (ASB) of ICAI and in consultation with National Advisory Committee on Accounting Standards (NACAS).

ASB is a committee under Institute of Chartered Accountants of India (ICAI) which consists of representatives from government department, academicians, other professional bodies viz. icsi, icai, representatives from ASSOCHAM, CII, FICCI, etc. National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India.

The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS).

2.3 INTERNATIONAL ACCOUNTING STANDARDS :

IFRS – Collectively includes

International Accounting Standard Committee (IASC) – formed in 1973 issued

International Accounting Standards (IAS)

Standard interpretation committee (SIC)

International Accounting Standard Board (IASB) – from 2000 issued

International Financial Reporting Standards (IFRS)

International Financial Reporting Interpretation Committee (IFRIC)

In short IFRS means IAS/SIC/IFRS/IFRIC

2.4. KEY FEATURES OF IND AS :

Key Features

- Principle Based Standard – they establish broad rules rather than dictating specific treatments
- Applicable to CFS and SFS
- Substance over form
- Rely more on Fair Valuation Approach and measurements based on Time Value of Money
- Requires more disclosure of all the relevant information and assumption used.
- Requires higher degree of judgement and estimates.

2.5 NEED FOR CONVERGENSE :

Need for Convergense

- Standardization
- International capital Flow
- Beneficial to regulators

1. **Standardization :** A single set of accounting standard would enable standardization. In fact, they establish broad rules rather than dictating specific treatments. Standardization would ensure better quality of financial statements.
2. **International capital Flow :** It would also permit international capital to flow more freely, enabling companies to develop consistent global practices on accounting problems.
3. **Beneficial to regulators :** It would be beneficial to the regulators too, as complexity associated with understanding various reporting regimes would be reduced.

2.6 WHAT ARE CARVE IN / CARVE OUT :

The Government of India in consultation with the ICAI decided to converge and not to adopt IFRS issued by the IASB. The decision of convergence rather than adoption was taken after the detailed analysis of IFRS requirements and extensive discussion with various stakeholders.

Accordingly, while formulating IFRS converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential.

2.7 GOI COMMITMENT TO IND AS :

Consistent, comparable and understandable financial reporting is essential to develop a robust economy. With a view to achieve international benchmarks of financial reporting, the Institute of Chartered Accountants of India (ICAI), as a proactive role in accounting, set out to introduce Indian Accounting Standards (Ind AS) converged with the International Financial Reporting Standards (IFRS). This endeavour of the ICAI is supported by the Government of India.

Initially Ind AS were expected to be implemented from the year 2011. However, keeping in view the fact that certain issues including tax issues were still to be addressed, the Ministry of Corporate Affairs decided to postpone the date of implementation of Ind AS.

ROAD MAP TO IMPLEMENTATION OF IND AS

PHASE 1	PHASE 2	PHASE 3
• VOLUNTARY • 1/4/2015	• MANDATORY • 1/4/2016	• MANDATORY • 1/4/2017

PHASE 1	1st April 2015 or thereafter: Voluntary Basis for all companies	
PHASE 2	1st April 2016: Mandatory Basis	
	A	Companies listed / in process of listing on Stock Exchanges in India or Outside India having net worth =/> 500 crore
	B	Unlisted Companies having net worth =/> 500 crore
	C	Parent, Subsidiary, Associate and Joint venture of above
PHASE 3	1st April 2017: Mandatory Basis	
	A	All companies which are listed/or in process of listing inside or outside India on Stock Exchanges not covered in Phase I (other than companies listed on SME Exchanges)
	B	Unlisted companies having net worth =/> 250 crore
	C	Parent, Subsidiary, Associate and Joint venture of above

Thanks ....

CHAPTER

2

IND AS 1 – PRESENTATION OF FINANCIAL STATEMENTS

CONCEPTS COVERED

1. DIVISION II OF THE SCHEDULE III TO THE COMPANIES ACT, 2013
2. INTRODUCTION – IND AS 1
3. OBJECTIVE
4. SCOPE
5. DEFINITIONS
6. GENERAL FEATURES OF FINANCIAL STATEMENT
7. STRUCTURE AND CONTENT
8. SELF PRACTICE QUSTIONS

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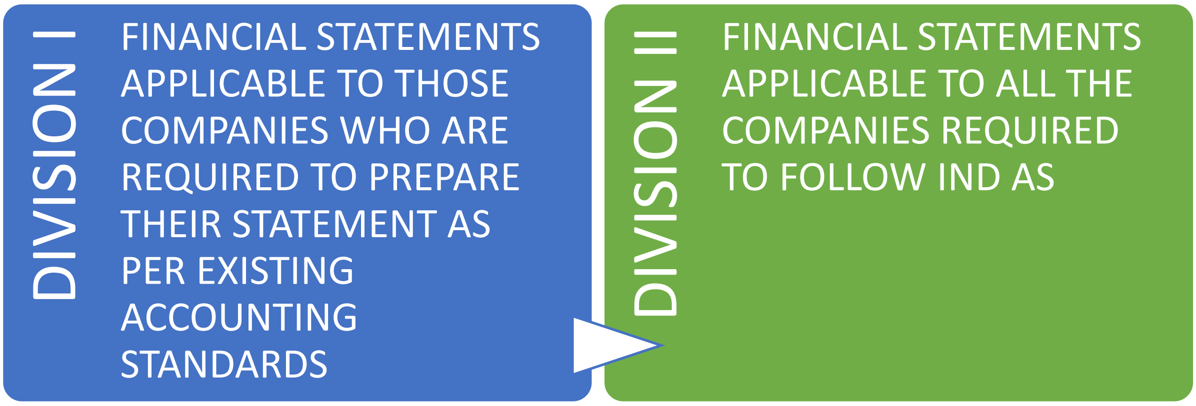
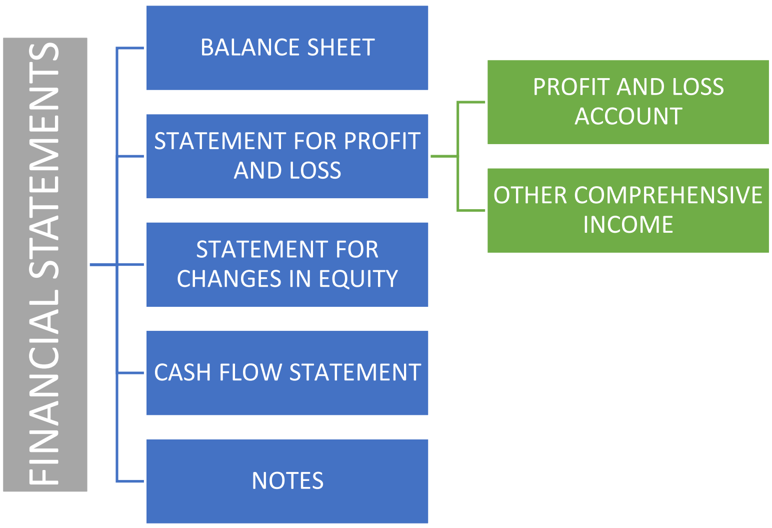
1. DIVISION II OF THE SCHEDULE III TO THE COMPANIES ACT, 2013 :

The Ministry of Corporate Affairs vide its notification dated 6th April, 2016 notified amendments to Schedule III to the Companies Act, 2013 thereby inserting Division II to Schedule III for preparation of financial statements by those entities who have to comply with Indian Accounting Standards (Ind AS). Now

1. Division I is applicable to a company whose financial statements are required to comply with the current accounting standards
2. Division II is applicable to a company whose financial statements are drawn up in compliance with Ind AS.



FINANCIAL STATEMENTS – DIV II :



PART 1 – BALANCE SHEET :

	Particulars	Note No	Current Year	Previous Year
	Assets			
1.	Non Current Assets			
	a. Property, Plant and Equipment		XX	XX
	b. Capital Work in Progress		XX	XX
	c. Investment property		XX	XX
	d. Goodwill		XX	XX

	e. Other Intangible Assets		XX	XX
	f. Intangible Assets Under Development		XX	XX
	g. Biological Assets other than bearer plants		XX	XX
	h. Financial Assets			
	i) Investments		XX	XX
	II) Trade Receivables		XX	XX
	III) Loans		XX	XX
	iv) Others (to be specified)		XX	XX
	i) Deferred Tax Assets (Net)		XX	XX
	j) Other Non-Current Assets		XX	XX
2.	Current Asset			
	a) Inventories		XX	XX
	b) Financial Assets			
	i) Investments		XX	XX
	II) Trade Receivables		XX	XX
	III) Cash and Cash Equivalents		XX	XX
	iv) Bank Balance		XX	XX
	v) Others (to be Specified)		XX	XX
	c) Current Tax Assets (Net)		XX	XX
	d) Other Current Assets		XX	XX
	TOTAL		XX	XX

	Particulars	Note No	Current Year	Previous Year
	Equity and Liabilities			
	Equity			
	a. Equity Share Capital		XX	XX
	b. Other Equity		XX	XX
	Liabilities			
1.	Non-current Liability			
	a. Financial Liabilities			
	(i) Borrowings		XX	XX
	(ii) Trade Payable		XX	XX
	(iii) Other financial Liabilities (to be specified)		XX	XX
	b. Provisions		XX	XX
	c. Deferred tax Liabilities		XX	XX
	d. Other non – current liabilities		XX	XX
2.	Current Liabilities			
	a. Financial Liabilities			
	(i) Borrowings		XX	XX
	(ii) Trade Payable		XX	XX

	(iii) Other financial Liabilities (to be specified)		XX	XX
	b. Provisions		XX	XX
	c. Current tax Liabilities		XX	XX
	d. Other non – current liabilities		XX	XX
	TOTAL		XX	XX

PART 2 – STATEMENT FOR CHANGES IN EQUITY :

The Statement of Changes in Equity has been introduced on the lines of IFRS. An SOCE is prepared in order to reconcile the various components of equity in the balance sheet for any period.

A. Equity share capital

B. Other Equity
   - a. Share Application money pending Allotment
   - b. Equity Component of Compound Financial Instrument
   - c. Reserves and Surplus
     - i. Capital Reserve
     - ii. Security Premium Reserve
     - iii. Other Reserve (to be Specified)
     - iv. Retained Earnings
   - d. Debt instrument through other comprehensive income
   - e. Equity instrument through other comprehensive income
   - f. Effective portion of cash flow hedges
   - g. Revaluation Reserve
   - h. Exchange difference on translating the financial statements of a foreign operations
   - i. Other items of other comprehensive income
   - j. Money received against share warrant

PART 3 – STATEMENT OF PROFIT AND LOSS ACCOUNT :

	Particulars	Note No	Current Year	Previous Year
I	Revenue from operations		XX	XX
II	Other income		XX	XX
III	Total Income (I + II)		XX	XX
IV	Expenses			
	Cost of Material Consumed		XX	XX
	Purchase of Stock in Trade		XX	XX
	Changes in inventory of Finished goods, Stock in trade and work in progress		XX	XX
	Employee benefit Expense		XX	XX
	Finance Cost		XX	XX
	Depreciation and Amortisation Expense		XX	XX
	Other Expense		XX	XX

	TOTAL EXPENSES (IV)		XX	XX
V	Profit / Loss before exceptional Items and Tax		XX	XX
VI	Exceptional Items		XX	XX
VII	Profit Before Tax		XX	XX
VIII	Tax Expense			
	1. Current Tax		XX	XX
	2. Deferred Tax		XX	XX
IX	Profit / Loss for the period from continuing operations		XX	XX
X	Profit / Loss from discontinued operations		XX	XX
XI	Tax expense from discontinued operations		XX	XX
XII	Profit / Loss from discontinued operations (After Tax)		XX	XX
XIII	Profit / Loss for the period (IX + XII)		XX	XX
XIV	Other comprehensive Income			
	A (I) Items that will not be reclassified to profit and loss Account		XX	XX
	(II) Income tax relating to above items		XX	XX
	B (I) Items that will be reclassified to profit and loss Account		XX	XX
	(II) Income tax relating to the above items		XX	XX
XV	Total comprehensive income for period (XIII + XIV)		XX	XX
XVI	Earnings per share (for continuing operations)			
	1. Basic		XX	XX
	2. Diluted		XX	XX
XVII	Earnings per share (for discontinuing operations)			
	1. Basic		XX	XX
	2. Diluted		XX	XX
XVIII	Earnings per share (for continuing and discontinuing operations)			
	1. Basic		XX	XX
	2. Diluted		XX	XX

OTHER COMPREHENSIVE INCOME :

1. It contains generally unrealised gains and losses arising from re-measurements of Assets and Liabilities
2. On Realisation, with few exceptions, gains and losses are recognised in profit or loss section
3. Exceptions
   a. Sale of revalued assets

b. Equity instruments opted to be measured at fair value through OCI

At outset, it is worthwhile to note that Total Comprehensive Income is different from Other Comprehensive Income and can be better understood as follows:

PART 4 – CASH FLOW STATEMENT :

Alike under the IGAAP, Schedule III for Ind AS does not provide for a format of the Cash Flow Statement and requires that the statement be prepared in accordance with the relevant Ind AS. However, in a sharp contrast to the AS 3 on Cash Flow Statements, Ind AS 7 on Cash Flow Statements Statements "encourages" the use of Direct Method instead of the Indirect Method for preparing the Cash Flow Statements but provides no format for the preparation of the same.

PART 5 – NOTES :

Notes containing information in addition to that which is presented in the financial statements would be provided, including, where required, narrative descriptions or disaggregation of items recognised in the financial statements and information about items that do not qualify for such recognition.

Disclosure under Ind AS (for e.g., fair value measurement reconciliation, fair value hierarchy, risk management and capital management, disclosure of interests in other entities, components of other comprehensive income, reconciliations on first-time adoption of Ind AS, etc.) shall be made in the Notes or by way of additional statement(s) unless required to be disclosed on the face of the Financial Statements.

2. INTRODUCTION – IND AS 1 :

Ind AS 1 is a basic Standard, which prescribes the overall requirements for the presentation of financial statements and guidelines for their structure, i.e., components of financial statements, viz., balance sheet, statement of profit and loss, statement of cash flows and notes comprising significant accounting policies, etc. Further, the Standard prescribes the minimum disclosures that are to be made in the financial statements and explains the general features of the financial statements. The presentation requirements prescribed in the Standard are supplemented by the recognition, measurement and disclosure requirements set out in other Ind AS for specific transactions and other events.

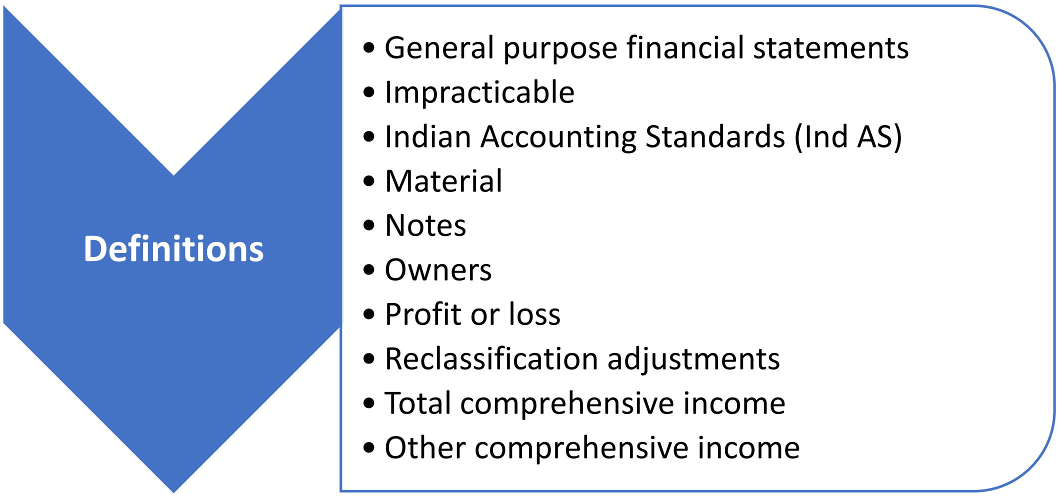
3. OBJECTIVE :

This standard prescribes the basis for presentation of general purpose financial statements to ensure comparability a) with the entity's financial statements of previous periods and b) with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

4. SCOPE :

- This standard applies to all types of entities including
  (a) those that present consolidated financial statements in accordance with Ind AS 110 'Consolidated Financial Statements'
  (b) those that present separate financial statements in accordance with Ind AS 27 'Separate Financial Statements'.
- This standard does not apply to Interim Financial statements prepared in accordance with Ind AS 34 except for para 15 to 35 of Ind AS 1.

5. DEFINITIONS :



1. **General purpose financial statements :**

   General purpose financial statements (referred to as 'financial statements') are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs

2. **Impracticable :**

   Impracticable Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

3. **Indian Accounting Standards (Ind AS) :**

   Indian Accounting Standards (Ind AS) are Standards prescribed under Section 133 of the Companies Act, 2013.

4. **Material :**

   Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

5. **Notes :**

Notes contain information in addition to that presented in the balance sheet (including statement of changes in equity which is a part of the balance sheet), statement of profit and loss and statement of cash flows.

Notes provide narrative descriptions or disaggregation of items presented in those statements and information about items that do not qualify for recognition in those statements.

6. **Owners :**

Owners are holders of instruments classified as equity

7. **Profit or loss :**

Profit or loss is the total of income less expenses, excluding the components of other comprehensive income

8. **Reclassification adjustments :**

Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.

9. **Total comprehensive income :**

Total comprehensive income is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

Total comprehensive income comprises all components of 'profit or loss' and of 'other comprehensive income'

10. **Other comprehensive income :**

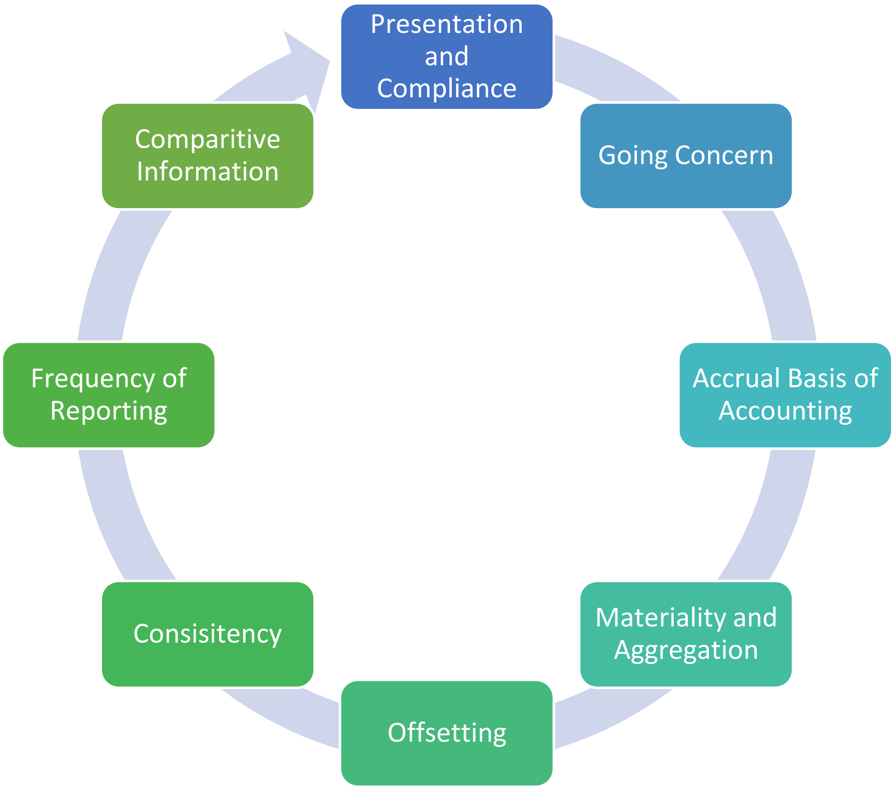
Other comprehensive income comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other Ind AS.

The components of Other Comprehensive Income include the following:

No.	Components	Reference
1	Changes in revaluation surplus	Ind AS 16
2	Remeasurements of defined benefit plans	Ind AS 19
3	Gains and losses arising from translating the financial statements of a foreign operation	Ind AS 21
4	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	Ind AS 109
5	Gains and losses on financial assets measured at fair value through other comprehensive income	Ind AS 109

6	The effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through other comprehensive income	Ind AS 109
7	For particular liabilities designated as at fair value through profit or loss, the amount of the change in fair value that is attributable to changes in the liability's credit risk	Ind AS 109
8	Changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value	Ind AS 109
9	Changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument	IND AS 109

6. GENERAL FEATURES OF FINANCIAL STATEMENT :



6.1 Presentation of True and Fair View and compliance with Ind AS :

Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework.

An explicit and unreserved statement :

An entity whose financial statements comply with Ind AS shall make an explicit and unreserved statement of such compliance in the notes.

Presentation of a true and fair view also requires an entity:

(a) to select and apply accounting policies in accordance with Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Ind AS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an Ind AS that specifically applies to an item.

(b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.

(c) to provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

6.2 Departure from the Requirements of an Ind AS — Whether Permissible? :

In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that requirement if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

When an entity departs from a requirement of an Ind AS, it shall disclose:

(a) that management has concluded that the financial statements present a true and fair view of the entity's financial position, financial performance and cash flows;

(b) that it has complied with applicable Ind AS, except that it has departed from a particular requirement to present a true and fair view;

(c) the title of the Ind AS from which the entity has departed, the nature of the departure, including the treatment that the Ind AS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Framework, and the treatment adopted; and

(d) for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.

Question 1 – An entity

An entity prepares its financial statements that contain an explicit and unreserved statement of compliance with Ind AS. However, the auditor's report on those financial statements contains a qualification because of disagreement on application of one Accounting Standard. In such case, is it acceptable for the entity to make an explicit and unreserved statement of compliance with Ind AS?

6.3 Going Concern :

Financial statements prepared under Ind AS should be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

If management has significant doubt of the entity's ability to continue as a going concern, the uncertainties should be disclosed.

In case the financial statements are not prepared on a going concern basis, the entity should disclose the basis of preparation of financial statements and also the reason why the entity is not regarded as a going concern. Illustration

Question 2 – Entity XYZ

Entity XYZ is a large manufacturer of plastic products for the local market. On 1 April 2016 the newly elected government unexpectedly abolished all import tariffs, including the 40 per cent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency (CU(2)) appreciating significantly against most other currencies. The currency appreciation severely reduced the competitiveness of the entity's products.

Before 2016 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ reported a loss of CU 4,000 for the year ended 31 March 2017. At 31st March 2017, entity XYZ's equity was CU 1,000. Management restructured entity B's operations in the second quarter of 2017. That restructuring helped reduce losses for the third and fourth quarters to CU 400 and CU 380, respectively.

In January 2017 the local plastic industry and labour union lobbied government to reinstate tariffs on plastic. On 15 March 2017, the government announced that it would reintroduce limited plastic import tariffs in 2018. However, it emphasised that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the government predicts a stable currency exchange rate in the short term with a gradual weakening of the jurisdiction's currency in the longer term. Management of entity XYZ undertook a going concern assessment at 31 March 2017. Management projects/forecasts that imposition of a 10 per cent tariff on the import of plastic products would, at current exchange rates, result in entity XYZ returning to profitability. How should the management of entity XYZ disclose the information about the going concern assessment in entity XYZ's 31 March 2017 annual financial statements?

6.4 Accrual basis of accounting :

- An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.
- When the accrual basis of accounting is used, an entity recognises items as assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the Framework.

6.5 Materiality and aggregation :

- An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law.
- Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items in the financial statements. If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.
- An entity need not provide a specific disclosure required by an Ind AS if the information is not material except when required by law.

Example :

1. Entity A has done a misclassification of assets between 2 categories of plant and machinery. Such a misclassification would not be material in amount if it affected two categories of plant or equipment however it might be material if it changed the classification between a noncurrent and a current asset category.
2. Losses from bad debts or pilferage that could be shrugged off as routine by a large business may threaten the continued existence of a small one.
3. An error in inventory valuation may be material in a small enterprise for which it cut earnings in half but immaterial in an enterprise for which it might make a barely perceptible ripple in the earnings.

6.6 Offsetting :

- An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an Ind AS.
- An entity reports separately both assets and liabilities, and income and expenses. Measuring assets net of valuation allowances — for example, obsolescence allowances on inventories and doubtful debts allowances on receivables — is not offsetting.

Question 3 –

Is offsetting of revenue against expenses, permissible in case of a company acting as an agent and having sub-agents, where commission is paid to sub-agents from the commission received as an agent?

6.7 Frequency of reporting :

- An entity shall present a complete set of financial statements (including comparative information) at least annually.

- When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:
  - the reason for using a longer or shorter period, and
  - the fact that amounts presented in the financial statements are not entirely comparable.

6.8 <u>Comparative information :</u>

- An entity should present comparative information in respect of the preceeding period for all amounts reported in the current period's financial statements except when Ind AS permit or require otherwise.
- Comparative information for narrative and descriptive information should be included if it is relevant to understand the current period's financial statements.
- An entity shall present, as a minimum:
  - 2 Balance Sheets
  - 2 Statement of Profit and Loss
  - 2 Statement of Cash Flows
  - 2 Statement of Changes in Equity and
  - Related Notes.
- When an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements or when it reclassifies items in its financial statements, it shall present, as a minimum, three balance sheets, two of each of the other statements, and related notes. An entity presents balance sheets as at
  - the end of the current period,
  - the end of the previous period (which is the same as the beginning of the current period), and
  - the beginning of the earliest comparative period.

Question 4 – A retail chain

A retail chain acquired a competitor in March, 20X1 and accounted for the business combination under Ind AS 103 on a provisional basis in its 31st March, 20X1 annual financial statements. The business combination accounting was finalised in 20X1-20X2 and the provisional fair values were updated. As a result, the 20X0-20X1 comparatives were adjusted in the 20X1-20X2 annual financial statements. Does the restatement require an opening statement of financial position (that is, an additional statement of financial position) as of 1st April, 20X0?

6.9 <u>Consistency of presentation :</u>

- An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:
  - it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation

or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Ind AS 8; or
    - an Ind AS requires a change in presentation.
- When making such changes in presentation, an entity reclassifies its comparative information in accordance.

7. STRUCTURE AND CONTENT :

Ind AS 1 requires particular disclosures in the balance sheet (including statement of changes in equity which is a part of the balance sheet) or in the statement of profit and loss and requires disclosure of other line items either in those statements or in the notes.

- An entity shall display the following information prominently:
    - the name of the reporting entity
    - whether the financial statements are of an individual entity or a group of entities;
    - Reporting date or the reporting period
    - the presentation currency
    - the level of rounding used in presenting amounts in the financial statements.

Balance Sheet

"Format as per last chapter"

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet except when a presentation based on liquidity provides information that is reliable and more relevant.

Current and Non-Current Assets

An entity shall classify an asset as current when:

(a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;

(b) it holds the asset primarily for the purpose of trading;

(c) it expects to realise the asset within twelve months after the reporting period; or

(d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

An entity shall classify all other assets as non-current.

Current and Non-current Liabilities :

An entity shall classify a liability as current when:

(a) it expects to settle the liability in its normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after the reporting period; or

(d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

Operating Cycle :

The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading (examples include some financial assets classified as held for trading in accordance with Ind AS 109) and the current portion of non-current financial assets.

Question 5 – X Ltd.

X Ltd provides you the following information:

Raw material stock holding period	: 3 months
Work-in-progress holding period	: 1 month
Finished goods holding period	: 5 months
Debtors collection period	: 5 months

You are requested to compute the operating cycle of X Ltd.

Question 6 – Inventory or trade

Inventory or trade receivables of X Ltd. are normally realised in 15 months. How should X Ltd. classify such inventory/trade receivables: current or non-current if these are expected to be realised within 15 months?

Question 7 – B Ltd.

B Ltd. produces aircrafts. The length of time between first purchasing raw materials to make the aircrafts and the date the company completes the production and delivery is 9 months. The company receives payment for the aircrafts 7 months after the delivery. (a) What is the length of operating cycle? (b) How should it treat its inventory and debtors?

Question 8 – Charming Ltd.

On 1st April, 20X3, Charming Ltd issued 100,000 Rs. 10 bonds for Rs. 1,000,000. On 1st April, each year interest at the fixed rate of 8 percent per year is payable on outstanding capital amount of the bonds (ie the first payment will be made on 1st April, 20X4). On 1st April each year (i.e from 1st April, 20X4), Charming Ltd has a contractual obligation to redeem 10,000 of the bonds at Rs. 10 per bond. In its statement of financial position at 31st March, 20X4. How should this be presented in the financial statements?

Question 9 – X Ltd.

X Ltd provides you the following information:

Raw material stock holding period	: 3 months
Work-in-progress holding period	: 1 month
Finished goods holding period	: 5 months
Debtors collection period	: 5 months

The trade payables of the Company are paid in 12.5 months. Should these be classified as current or non-current?

Question 10 – Entity A

Entity A has two different businesses, real estate and manufacture of passenger vehicles. With respect to the real estate business, the entity constructs residential apartments for customers and the normal operating cycle is three to four years. With respect to the business of manufacture of passenger vehicles, normal operating cycle is 15 months. Under such circumstance where an entity has different operating cycles for different types of businesses, how classification into current and non-current be made?

Question 11 – An entity

An entity has placed certain deposits with various parties. How the following deposits should be classified, i.e., current or non-current?

(a) Electricity Deposit

(b) Tender Deposit/Earnest Money Deposit [EMD]

(c) GST Deposit paid under dispute or GST payment under dispute

Question 12 – Ind AS 1

Ind AS 1 states "An entity shall classify a liability as current when it expects to settle the liability in its normal operating cycle". An entity develops tools for customers and this normally takes a period of around 2 years for completion. The material is supplied by the customer and hence the entity only renders a service. For this, the entity receives payments upfront and credits the amount so received to "Income Received in Advance". How should this "Income Received in Advance" be classified, i.e., current or non- current?

Question 13 – An entity

An entity has taken a loan facility from a bank that is to be repaid within a period of 9 months from the end of the reporting period. Prior to the end of the reporting period, the entity and the bank enter into an arrangement, whereby the existing outstanding loan will, unconditionally, roll into the new facility which expires after a period of 5 years.

(a) How should such loan be classified in the balance sheet of the entity?

(b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?

(c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?

(d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation?

Question 14 – In December 2001

In December 2001 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 2005. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 2002, failing which the loan becomes payable on demand. As on March 24, 2002, the entity has not been able to get the promoter's contribution. On March 25, 2002, the entity approached the bank and obtained a grace period up to June 30, 2002 to get the promoter's contribution. The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 2002.

(a) As on March 31, 2002, how should the entity classify the loan?

(b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 2002, the entity approached the bank and got the compliance date extended up to June 30, 2002 for getting promoter's contribution. In this case will the loan classification as on March 31, 2002 be different from (a) above?

Profit and Loss :

- The statement of profit and loss shall present, in addition to the profit or loss and other comprehensive income sections:
  - (a) profit or loss;
  - (b) total other comprehensive income;
  - (c) comprehensive income for the period, being the total of profit or loss and other comprehensive income.
- An entity shall present the following items as allocation of profit or loss and other comprehensive income for the period:
  - (a) profit or loss for the period attributable to:
    - (i) non-controlling interests, and
    - (ii) owners of the parent.

(b) comprehensive income for the period attributable to:
    (i) non-controlling interests, and
    (ii) owners of the parent.

Information to be presented in the profit or loss section of the Statement of Profit and Loss :

In addition to items required by other Ind AS, the profit or loss section of the statement of profit and loss should include line items that present the following amounts for the period:

(a) revenue, presenting separately interest revenue calculated using the effective interest method;
(b) gains and losses arising from the derecognition of financial assets measured at amortised cost
(c) finance costs;
(d) impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of Ind AS 109
(e) share of the profit or loss of associates and joint ventures accounted for using the equity method;
(f) if financial asset is reclassified out of the amortised cost measurement category so that it is measured at fair value through profit or loss, any gain or loss arising from a difference between the previous amortised cost of the financial asset and its fair value at the reclassification date;
(g) if a financial asset is reclassified out of the fair value through other comprehensive income measurement category so that it is measured at fair value through profit or loss, any cumulative gain or loss previously recognized in other comprehensive income that is reclassified to profit or loss
(h) tax expense;
(i) a single amount for the total discontinued operations

Statement of Changes in Equity :

An entity shall present a statement of changes in equity as a part of balance sheet. The statement of changes in equity includes the following information:

a. total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests;
b. for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with Ind AS 8;
c. for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing each changes resulting from:
    - profit or loss;
    - each item of other comprehensive income;
    - transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control; and
    - any item recognised directly in equity such as amount recognised directly in equity as capital reserve with Ind AS 103.

Notes :

The notes shall:

a. present information about the basis of preparation of the financial statements and the specific accounting policies used;

b. disclose the information required by Ind AS that is not presented elsewhere in the financial statements; and

c. provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.

An entity shall present notes in a systematic manner. In determining a systematic manner, the entity shall consider the effect on the understandability and comparability of its financial statements.

An entity shall cross-reference each item in the balance sheet, in the statement of changes in equity which is a part of the balance sheet and in the statement of profit and loss, and statement of cash flows to any related information in the notes.

Examples of systematic ordering or grouping of the notes include following the order of the line items in the statement of profit and loss and the balance sheet, such as:

(i) statement of compliance with Ind AS;

(ii) significant accounting policies applied;

(iii) supporting information for items presented in the balance sheet and in the statement of profit and loss, and in the statements of changes in equity and of cash flows, in the order in which each statement and each line item is presented; and

(iv) other disclosures,

An entity may present notes providing information about the basis of preparation of the financial statements and specific accounting policies as a separate section of the financial statements.

8. SELF PRACTICE QUESTIONS :

Question 15 – Entity A

Entity A has undertaken various transactions in the financial year ended March 31, 20X1. Identify and present the transactions in the financial statements as per Ind AS 1.

	Rs.
Remeasurement of defined benefit plans	2,57,000
Current service cost	1,75,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000
Income tax expense	35,000
Share based payments cost	3,35,000

Question 16 – XYZ Limited

XYZ Limited (the 'Company') is into the manufacturing of tractor parts and mainly supplying components to the Original Equipment Manufacturers (OEMs). The Company does not have any subsidiary, joint venture or associate company. During the preparation of financial statements for the year ended March 31, 20X1, the accounts department is not sure about the treatment/presentation of below mentioned matters. Accounts department approached you to advice on the following matters.

S. No.	Matters
(i)	There are qualifications in the audit report of the Company with reference to two Ind AS.
(ii)	Is it mandatory to add the word "standalone" before each of the components of financial statements?
(iii)	The Company is Indian Company and preparing and presenting its financial statements in Rs. Is it necessary to write in the financial statements that the financial statements has been presented in Rs.
(iv)	The Company had sales transactions with 10 related party parties during previous year. However, during current year, there are no transactions with 4 related parties out of aforesaid 10 related parties. Hence, Company is of the view that it need not disclose sales transactions with these 4 parties in related party disclosures because with these parties there are no transactions during current year.

Evaluate the above matters with respect to preparation and presentation of general purpose financial statement

Question 17 – A Company

A Company presents financial results for three years (i.e one for current year and two comparative years) internally for the purpose of management information every year in addition to the general purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purpose. During current year, management thought why not they should present third year statement of profit and loss also in the general purpose financial statements. I t will save time and will be available easily whenever management needs this in future.

With reference to above background, answer the following:

(i) Can management present the third statement of profit and loss as additional comparative in the general purpose financial statements?

(ii) If management present third statement of profit and loss in the general purpose financial statement as comparative, is it necessary that this statement should be compliant of Ind AS?

(iii) Can management present third statement of profit and loss only as additional comparative in the general purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?

Question 18 – A Company

A Company while preparing the financial statements for Financial Year (FY) 20X1-20X2, erroneously booked excess revenue of Rs. 10 Crore. The total revenue reported in FY 20X1-20X2 was Rs. 80 Crore. However, while preparing the financial statements for 20X2-20X3, it discovered that excess revenue was booked in FY 20X1-20X2 which it now wants to correct in the financial statements. However, management of the Company is not sure whether it need to present the third balance sheet as additional comparative.

With regard to the above background, answer the following:

(i) Is it necessary to provide the third balance sheet at the beginning of the preceding period in this case?

(ii) The Company wants to correct the error during FY 20X2-20X3 by giving impact in the figures of current year only. Is the contention of management correct?

Question 19 – XYZ Limited

XYZ Limited (the 'Company') is into construction of turnkey projects and has assessed its operating cycle to be 18 months. The Company has certain trade receivables and payables which are receivable and payable within a period of twelve months from the reporting date, i.e, March 31, 20X2.

In addition to above there are following items/transactions which took place during financial year 20X1-20X2.

S. No.	Items/transactions
(1)	The Company has some trade receivables which are due after 15 months from the date of balance sheet. So the Company expects that the payment will be received within the period of operating cycle.
(2)	The Company has some trade payables which are due for payment after 14 months from the date of balance sheet. These payables fall due within the period of operating cycle. Though the Company does not expect that it will be able to pay these payable within the operating cycle because the nature of business is such that generally projects gets delayed and payments from customers also gets delayed.
(3)	The Company was awarded a contract of Rs. 100 Crore on March 31, 20X2. As per the terms of the contract, the Company made a security deposit of 5% of the contract value with the customer, of Rs. 5 crore on March 31, 20X2. The contract is expected to be completed in 18 months' time. The aforesaid deposit will be refunded back after 6 months from the date of the completion of the contract.

(4)	The Company has also given certain contracts to third parties and have received security deposits from them of Rs. 2 Crore on March 31, 20X2 which are repayable on completion of the contract but if contract is cancelled before the contract term of 18 months, then it becomes payable immediately. However, the Company does not expect the cancellation of the contract.

Considering the above items/transactions answer the following:

(i) The Company wants to present the trade receivable as current despite the fact that these are receivables in 15 months' time. Does the decision of presenting the same as current is correct?

(ii) The Company wants to present the trade payables as non-current despite the fact that these are due within the operating cycle of the Company. Does the decision of presenting the same as non-current is correct?

(iii) Can the security deposit of Rs. 5 Crore made by the Company with the customers be presented as current?

(iv) Can the security deposit of Rs. 2 Crore taken by the Company from contractors be presented as non-current?

Thanks ....

CHAPTER

3

IND AS 2 – INVENTORIES

CONCEPTS COVERED

1. INTRODUCTION
2. SCOPE
3. DEFINITIONS
4. MEASUREMENT OF INVENTORIES
5. RECOGNITION AS AN EXPENSE
6. DICLOSURE
7. SELF PRACTICE QUSTIONS

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1. INTRODUCTION :

The objective of this Standard is to prescribe the accounting treatment for inventories. This Standard provides the guidance for determining the cost of inventories and for subsequent recognition as an expense, including any write-down to net realisable value.

2. SCOPE :

- **This Standard is applicable to all inventories, except:**
  - a) financial instruments (to be accounted under Ind AS 32, Financial Instruments: Presentation and Ind AS 109, Financial Instruments);
  - b) biological assets (i.e. living animals or plants) related to agricultural activity and agricultural produce at the point of harvest (to be accounted under Ind AS 41, Agriculture);
- **This Standard does not apply to the measurement of inventories held by:**
  - a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change
  - b) Commodity broker-traders who measure their inventories at fair value less costs to sell.
    When such inventories are measured at net realisable value/ fair value less costs to sell, changes in those values are to be recognised in profit or loss in the period of the change.

3. DEFINITIONS :

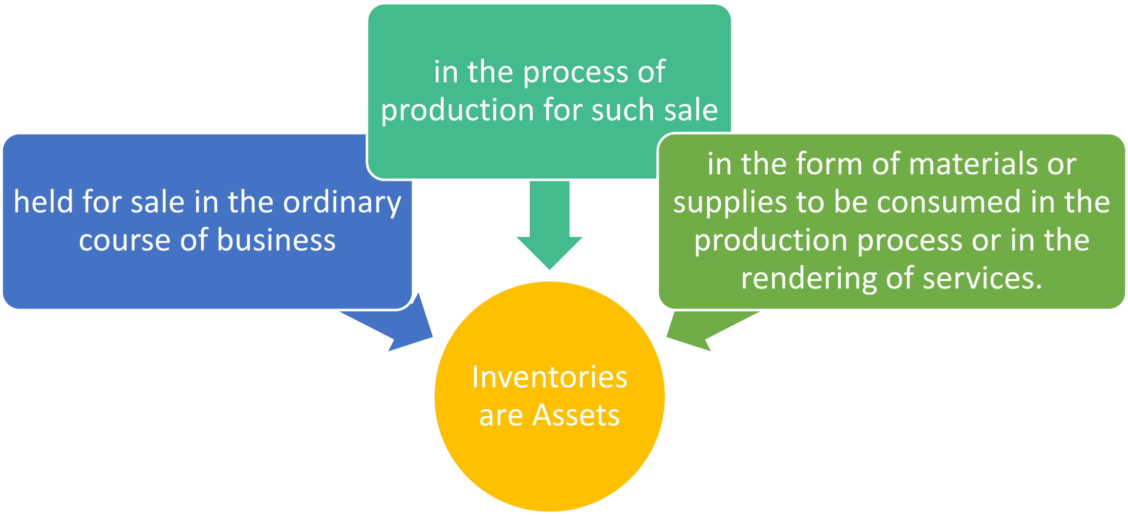
1. Inventories :

Inventories are Assets

a) held for sale in the ordinary course of business; (Finished Goods)

b) in the process of production for such sale; or (Work in progress)

c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. (Raw material)



2. Inventories encompass of :

a) goods purchased and held for resale (e.g. merchandise purchased by a retailer and held for resale, or land and other property held for resale);

b) finished goods produced, or work in progress being produced, by the entity; and includes

c) Materials and supplies awaiting use in the production process.

Costs incurred to fulfill a contract with a customer that do not give rise to inventories are accounted as per Ind AS 115.

Question 1 –

As per Ind AS 2, inventories include 'materials and supplies awaiting use in the production process'. Whether packing material and publicity material are covered by the term 'materials and supplies awaiting use in the production process'.

3. Net realisable value :

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. Net realisable value refers to the net amount that an entity expects to realize from the sale of inventory in the ordinary course of business. Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

4. Fair Value :

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (Ind AS 113, *Fair Value Measurement.*)

Difference between Net Realisable Value (NRV) and Fair Value (FV)

Basis	NRV	FV
Meaning	NRV refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business.	FV reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date
Measurement base	Entity-specific value i.e. the amount that the entity actually expects to make from selling the particular inventory	Market based measurement

4. MEASUREMENT OF INVENTORIES :

Measurement of Inventories

- Cost of Inventories
- Cost of Purchase
- Cost of Conversion
- Other costs
- Allocation of cost to joint products and by-products
- Cost Formulas
- Net realisable value

"Inventories shall be measured at the lower of cost and net realisable value."

At lower of → COST → Net Realisable Value

1) Cost of Inventories :

COST

- Cost of Purchase
- Conversion Cost
- Other costs incurred in bringing the inventories to their present location and condition

2) Cost of Purchase :

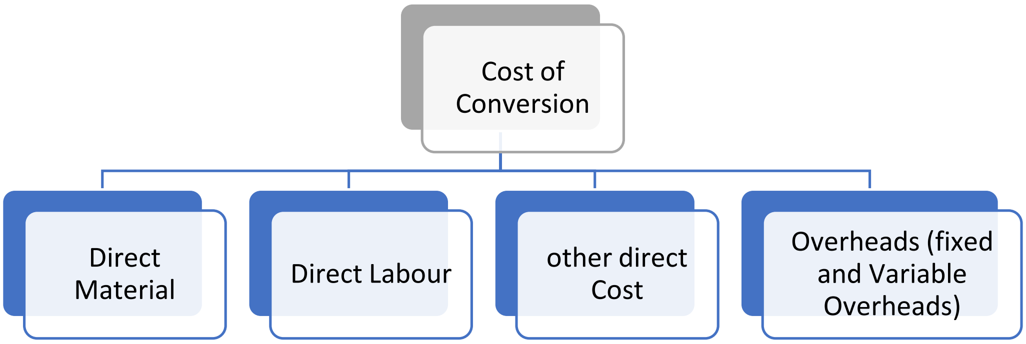
Cost of Purchase

- Purchase Price
- Import Duties and Other Taxes
- Transport, handling and
- other costs directly attributable to the acquisition of finished goods, materials and services.
- Trade discounts, rebates and other similar items

Question 2 – ABC Ltd

ABC Ltd. buys goods from an overseas supplier. It has recently taken delivery of 1,000 units of component X. The quoted price of component X was Rs. 1,200 per unit but ABC Ltd. has negotiated a trade discount of 5% due to the size of the order.
The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this.
Import duties (basic custom duties) of Rs. 60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost of Rs. 5,000 to have the components taken to its warehouse.
Calculate the cost of inventory.

3) Cost of Conversion :



- Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration.
- Allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity.
- When production levels are abnormally low, unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost.
- Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

Question 3 – Pluto Ltd

Pluto Ltd. has a plant with the normal capacity to produce 5,00,000 unit of a product per annum and the expected fixed overhead is Rs.15,00,000. Fixed overhead on the basis of normal capacity is Rs.3 per unit (15,00,000/5,00,000). How shall u treat Fixed overheads under following circumstances

a. Actual production is 5,00,000 units

b. Actual production is 3,75,000 units

c. Actual production is 7,50,000 units.

Question 4 – A business

A business plans for production overheads of Rs. 10,00,000 per annum.
The normal level of production is 1,00,000 units per annum.
Due to supply difficulties the business was only able to make 75,000 units in the current year. Other costs per unit were Rs. 126.
Calculate the per unit cost and amount of overhead to be expensed during the year.

Question 5 – ABC Ltd

ABC Ltd. manufactures control units for air conditioning systems.
Each control unit requires the following:
1 component X at a cost of Rs. 1,205 each
1 component Y at a cost of Rs. 800 each
Sundry raw materials at a cost of Rs. 150 each
The company faces the following monthly expenses:
Factory rent Rs. 16,500
Energy cost Rs. 7,500
Selling and administrative costs Rs. 10,000
Each unit takes two hours to assemble. Production workers are paid Rs. 300 per hour.
Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours.
Determine the cost of inventory.

4) <u>Other costs :</u>

- Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. Cost to be excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:
  a) abnormal amounts of wasted materials, labour or other production costs;
  b) storage costs, unless those costs are necessary in the production process before a further production stage;
  c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and
  d) selling costs.

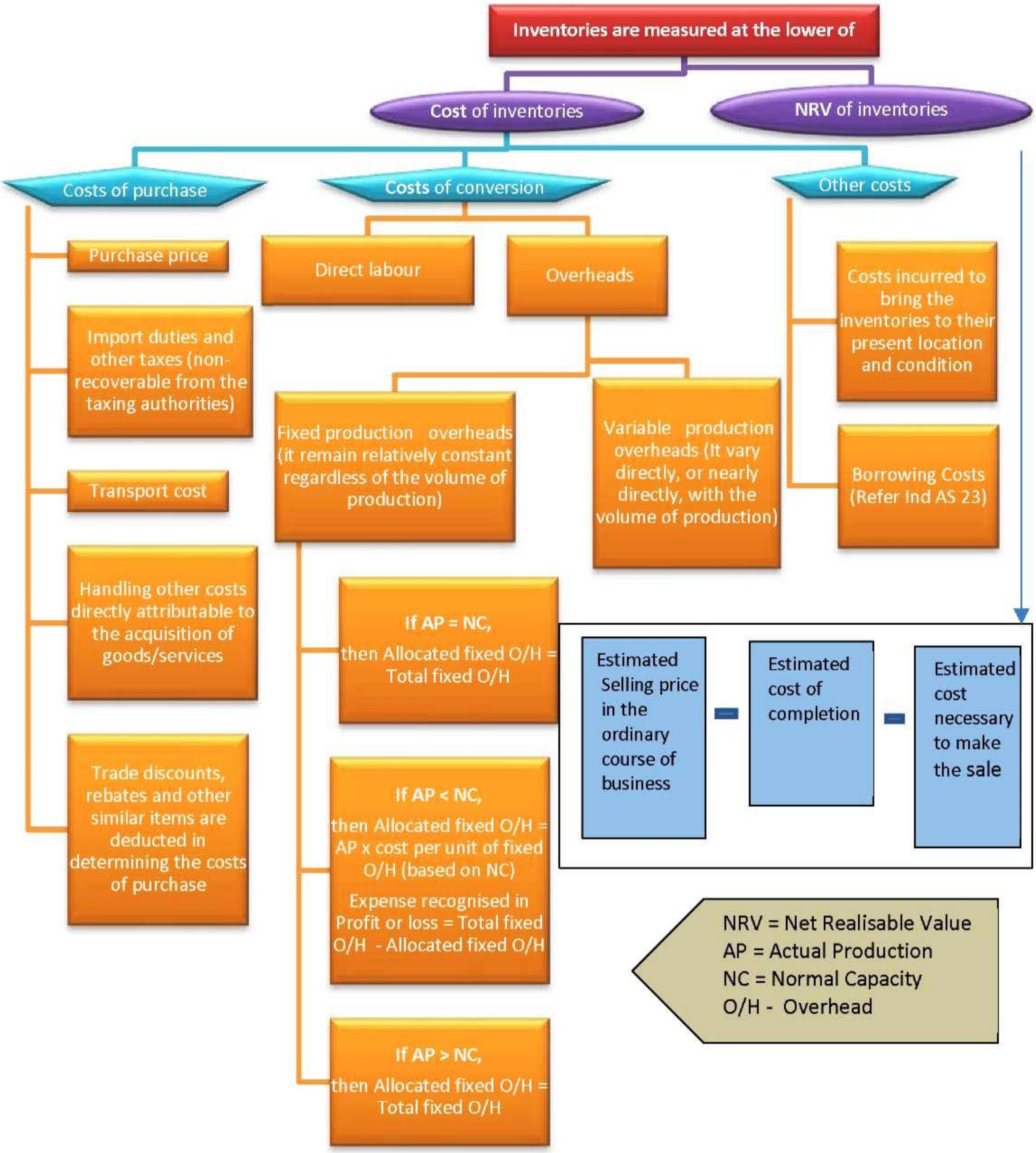
- The extent to which borrowing cost is included in the cost of inventories is determined on the basis of the requirement of Ind AS 23 Borrowing Costs.
- An entity may acquire inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase prices for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

Question 6 – A dealer

A dealer has purchased 1,000 cars costing Rs. 2,80,000 each on deferred payment basis as Rs. 25,000 per month per car to be paid in 12 equal instalments.

At year end 31 March 20X1, twenty cars are in stock. What would be the cost of goods sold, finance cost and inventory carrying amount?

Summary :



Question 7 – Venus Trading Company

Venus Trading Company purchases cars from several countries and sells them to Asian countries. During the current year, this company has incurred following expenses:

1. Trade discounts on purchase
2. Handling costs relating to imports
3. Salaries of accounting department
4. Sales commission paid to sales agents
5. After sales warranty costs
6. Import duties
7. Costs of purchases (based on supplier's invoices)
8. Freight expense
9. Insurance of purchases
10. Brokerage commission paid to indenting agents

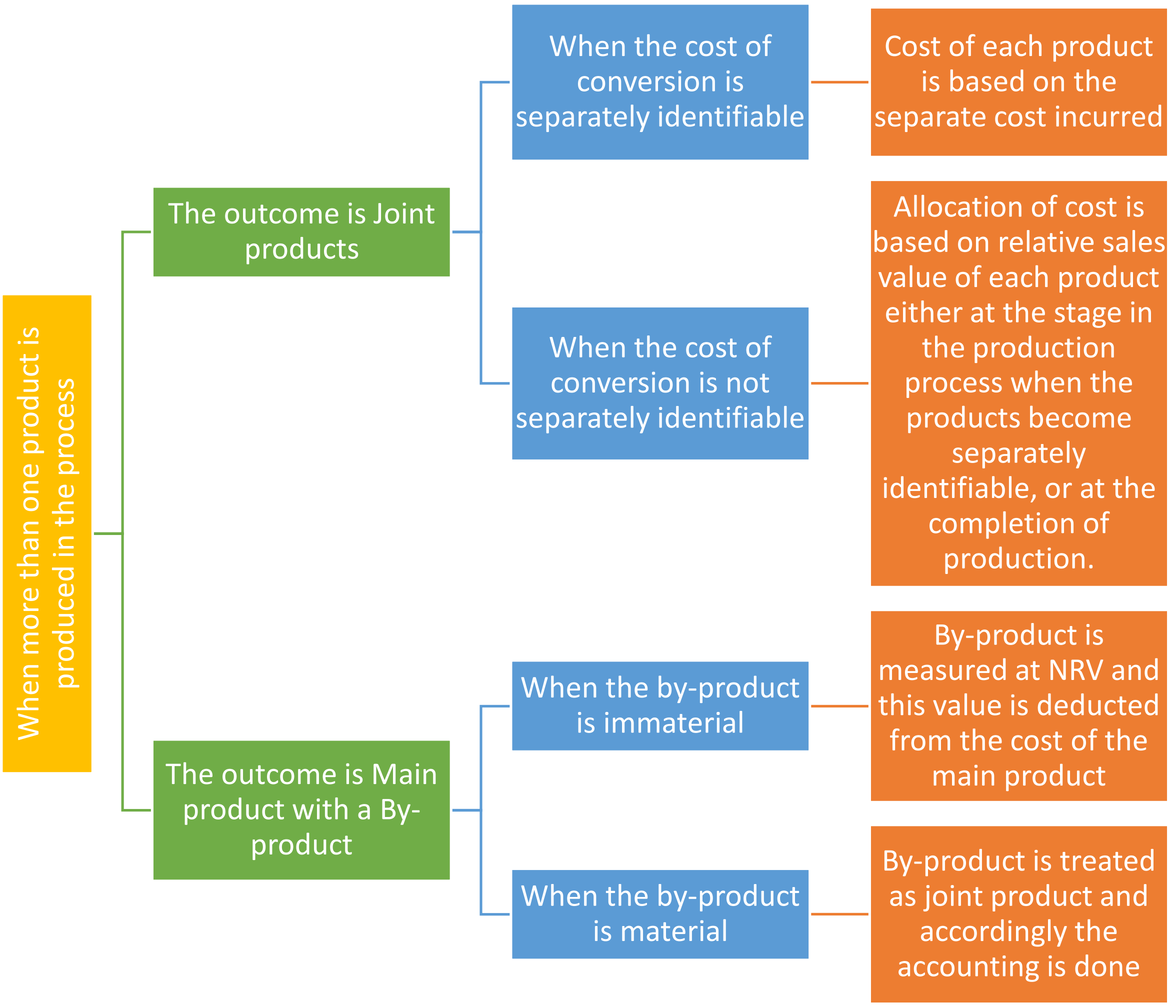
Evaluate which costs are allowed by Ind AS 2 for inclusion in the cost of inventory in the books of Venus.

Question 8 – As per IND AS 2

As per Ind AS 2, selling costs are excluded from the cost of inventories and are required to be recognised as an expense in the period in which these are incurred. Whether the distribution costs would now be included in the cost of inventories under Ind AS 2.

5) Allocation of cost to joint products and by-products :

- A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product.
- When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.
- Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost. cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.



Question 9 – In a manufacturing

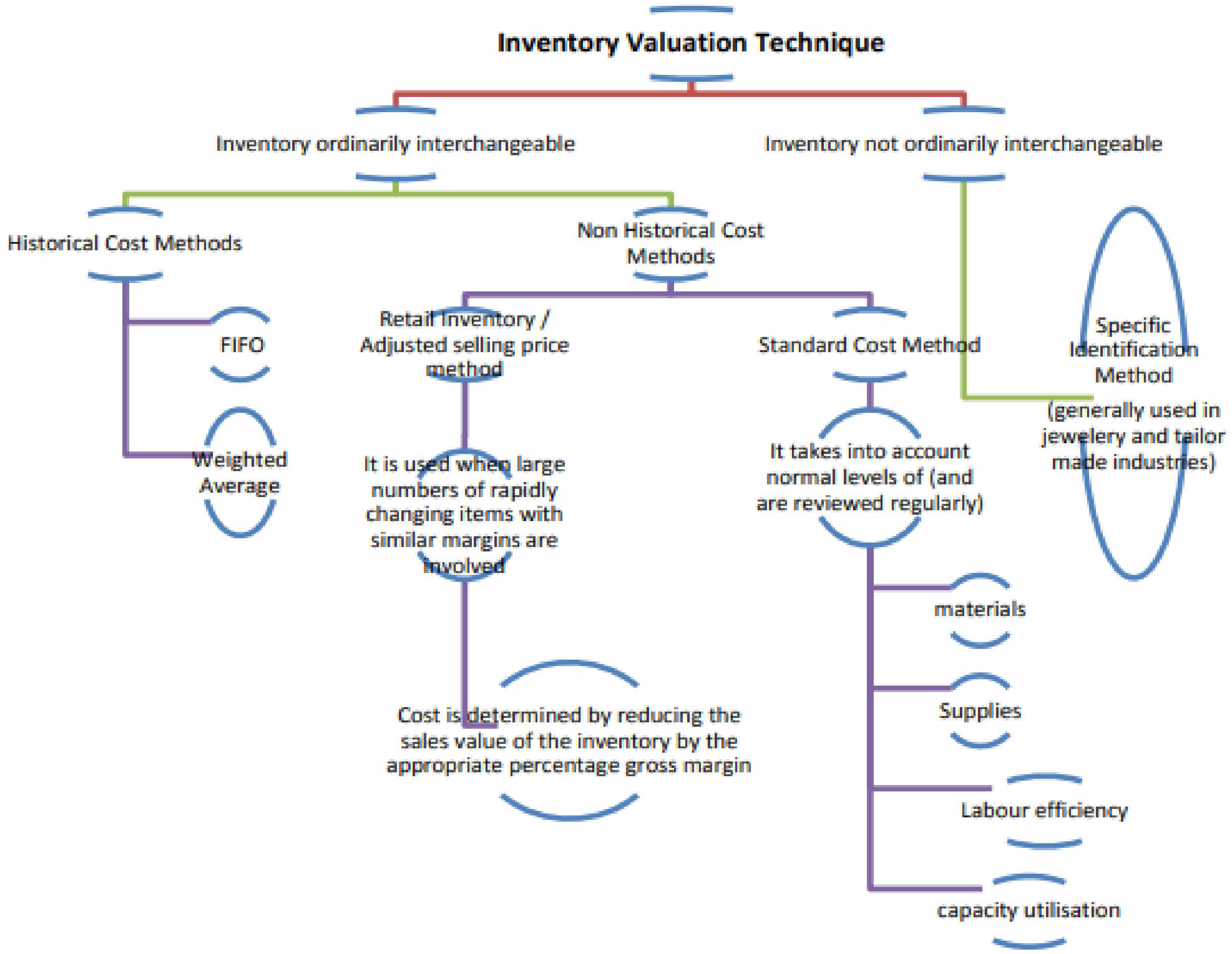
In a manufacturing process of Mars ltd, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount	Output	Closing Stock 31/3/2011
Raw Material	14500	150000	MP I-5,000 units	250
Wages	-	90000	MP II-4,000 units	100
Fixed Overhead	-	65000	BP- 2,000 units	
Variable Overhead	-	50000		

Average market price of MP1 and MP2 is Rs 60 per unit and Rs 50 per unit respectively, by- product is sold @ Rs 20 per unit. There is a profit of Rs 5,000 on sale of by-product after incurring separate processing charges of Rs. 8,000 and packing charges of Rs 2,000, Rs 5,000 was realised from sale of scrap.

Required: Calculate the value of closing stock of MP1 and MP2 as on 31-03-2011.

6) Cost Formulas :



Question 10 – Mars Fashions

Mars Fashions is a new luxury retail company located in Lajpat Nagar, New Delhi. Kindly advise the accountant of the company on the necessary accounting treatment for the following items:

(a) One of Company's product lines is beauty products, particularly cosmetics such as lipsticks, moisturizers and compact make-up kits. The company sells hundreds of different brands of these products. Each product is quite similar, is purchased at similar prices and has a short lifecycle before a new similar product is introduced. The point of sale and inventory system is not yet fully functioning in this department. The sales manager of the cosmetic department is unsure of the cost of each product but is confident of the selling price and has reliably informed you that the Company, on average, make a gross margin of 65% on each line.

(b) Mars Fashions also sells handbags. The Company manufactures their own handbags as they wish to be assured of the quality and craftsmanship which goes into each handbag. The handbags are manufactured in India in the head office factory which has made handbags for the last fifty years. Normally, Mars manufactures 100,000 handbags a year in their handbag division which uses

15% of the space and overheads of the head office factory. The division employs ten people and is seen as being an efficient division within the overall company.

In accordance with Ind AS 2, explain how the items referred to in a) and b) should be measured.

Question 11 – FIFO and Weighted Average Method

Particulars	Units available	Units sold	Actual Cost/unit (Rs.)	Actual Total Cost (Rs.)
Opening inventory	100	-	2.1	210
Sale	-	75	-	-
Purchases	150	-	2.8	420
Sale	-	100	-	-
Purchase	50	-	3	150
Total	300	175	-	780

Solution:

FIFO Method:

Cost of Goods Sold: 100 units x Rs. 2.10 + 75 units x Rs. 2.80 = Rs. 420

Closing Inventory: 50 units x Rs. 3.00 + 75 units x Rs. 2.80 = Rs. 360

Weighted Average Method:

Weighted average cost / unit: 780 units / Rs. 300 = Rs. 2.60

Cost of Goods Sold: 175 units x Rs. 2.60 = Rs. 455

Closing Inventory: 125 units x Rs. 2.60 = Rs. 325

Note: Weighted average method in practice is a moving average so computed after each purchase made and so sales are costed at most recent averages.

Cost of Goods Sold:

75 units @ Rs. 2.10 and 100 units @ Rs. 2.70 i.e. total cost = Rs. 427.50

Closing Inventory: 125 units x Rs. 2.82 = Rs. 352.50

Question 12 –

Whether an entity can use different cost formulae for inventories held at different geographical locations having similar nature and use to it.

Question 13 – Mercury Ltd.

Mercury Ltd. uses a periodic inventory system. The following information relates to 2011 -2012

Date	Particulars	Unit	Cost P.U	Total Cost
April	Inventory	200	10	2000

May Sept Feb	Purchase Purchase Purchase	50 400 350	11 12 14	550 4800 4900
	Total	**1000**		**12250**

Physical inventory at 31.03.2012 400 units. Calculate ending inventory value and cost of sales using: (a) FIFO (b) Weighted Average.

7) Net realisable value :

- **Measurement of net realisable value :**
  - o 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. The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined.
  - o Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.
  - o Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices.
  - o Inventories are usually written down to net realisable value item by item. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular operating segment.

- **Writing inventories down to net realisable value :**

  Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

- **Reversals of write-downs :**
  - o A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed (ie the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of the cost and the revised net realisable value.

- o This occurs, for example, when an item of inventory that is carried at net realisable value, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

Question 14 –

Whether the following costs should be considered while determining the Net Realisable Value (NRV) of the inventories?

(a) Costs of completion of work-in-progress;

(b) Trade discounts expected to be allowed on sale; and

(c) Cash discounts expected to be allowed for prompt payment

Question 15 – ABC Ltd.

ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost of Rs. 50 per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, was Rs. 40 per pack. Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total of Rs. 15 per pack for repairing and reapplying glue to the envelopes.

Calculate the net realizable value and inventory write-down (loss) amount.

Question 16 – Company P

At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of Rs. 10 per unit. The current market price is Rs. 8 per unit at which these units can be sold. Company P has a firm sales contract with Company Q to sell 60 units at Rs. 11 per unit, which cannot be settled net. Estimated incremental selling cost is Rs. 1 per unit.

Determine Net Realisable Value (NRV) of the inventory of Company P.

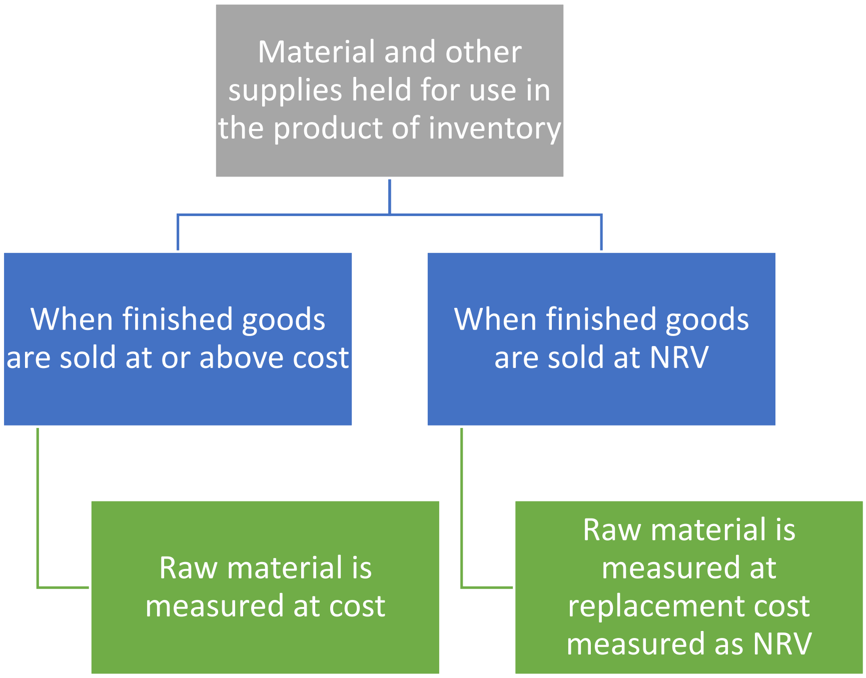
Question 17 – A business

A business has four items of inventory. A count of the inventory has established that the amounts of inventory currently held, at cost, are as follows:

			Rs.
	Cost	Estimated Sales price	Selling costs
Inventory item A1	8,000	7,800	500
Inventory item A2	14,000	18,000	200
Inventory item B1	16,000	17,000	200
Inventory item C1	6,000	7,500	150

Determine the value of closing inventory in the financial statements of a business.

Net realisable value for raw material



Question 18 –

Particulars		Kg.	Rs.
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was Rs. 20 per kg and the replacement cost for the raw material was Rs. 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date.

Question 19 – Sun Pharma Limited

Sun Pharma Limited, a renowned company in the field of pharmaceuticals has the following four items in inventory: The Cost and Net realizable value is given as follows:

Item	Cost	Net Realisable Value
A	2,000	1,900
B	5,000	5,100
C	4,400	4,550
D	3,200	2,990

Total	14,600	14,540

Determine the value of Inventories:

a. On an item by item basis

b. On a group basis

5. RECOGNITION AS AN EXPENSE :

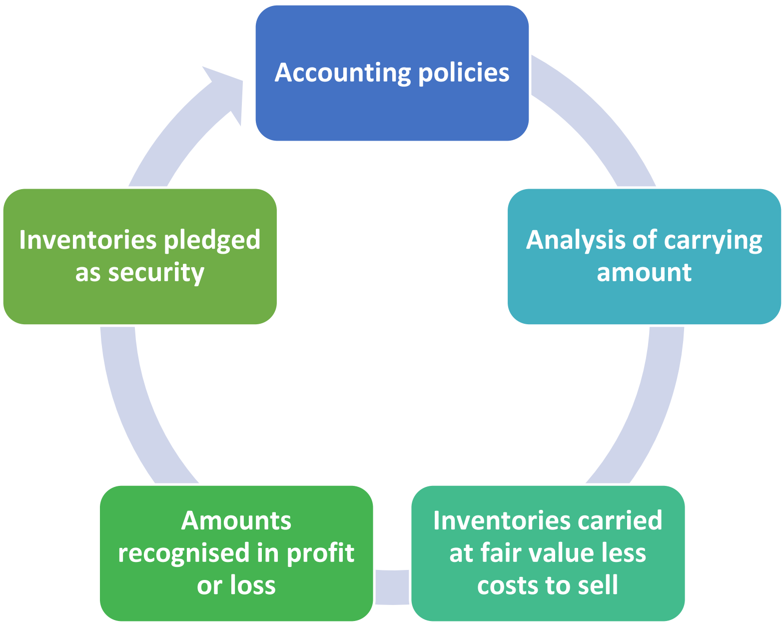
1) The amount of inventories recognised as an expense in the period will generally be:
   a) carrying amount of the inventories sold in the period in which related revenue is recognised; and
   b) the amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs; reduced by the amount of any reversal in the period of any write-down of inventories, arising from an increase in net realisable value shall be recognized as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.
2) Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset through charging of depreciation on that asset.

Example:

An item of inventory costing Rs.20,000 as covered under Ind AS 2 is consumed in the construction of self-constructed property to be accounted as Property, plant and equipment under Ind AS 16. The cost of such property, plant and equipment other than inventories is Rs.80,000. Such Inventory needs to be capitalized in the cost of Property, plant and equipment. The useful life of the property is 5 years. The depreciation on such property charged to profit and loss account is Rs.20,000 per annum (i.e. 1,00,000/ 5)

6. DISCLOSURE :

The financial statements shall disclose:



7. SELF PRACTICE QUESTIONS :

Question 20 – UA Ltd.

UA Ltd. purchased raw material @ Rs. 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is Rs. 300 per kg. How will you value the inventory of raw material?

Question 21 – Sun Ltd.

Sun Ltd. has fabricated special equipment (solar power panel) during 20X1-20X2 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31.3.20X3 are as follows:

Solar power panel (WIP)	Rs. 85 lakhs
Solar power panel (finished products)	Rs. 55 lakhs
Sundry Debtor (solar power panel)	Rs. 65 lakhs

The petition for winding up against the customer has been filed during 20X2-20X3 by Sun Ltd. Comment with explanation on provision to be made of Rs. 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 20X2-20X3.

Question 22 – ABC

On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was Rs. 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is Rs. 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to Rs. 8 million. The estimated selling expense required to make the sales would Rs. 0.5 million. Financial statements were approved by the Board of Directors on 20th April 20X1.

As at 31st March 20X2, Directors noted that such inventory is still unsold and lying in the warehouse of the company. Directors believe that inventory is in a saleable condition and active marketing would result in an immediate sale. Since the market

conditions have improved, estimated selling price of inventory is Rs. 11 million and estimated selling expenses are same Rs. 0.5 million.
What will be the value inventory at the following dates:
(a) 31st March 20X1
(b) 31st March 20X2

Question 23 –

The following is relevant information for an entity:

- Full capacity is 10,000 labour hours in a year.
- Normal capacity is 7,500 labour hours in a year.
- Actual labour hours for current period are 6,500 hours.
- Total fixed production overhead is Rs. 1,500.
- Total variable production overhead is Rs. 2,600.
- Total opening inventory is 2,500 units.
- Total units produced in a year are 6,500 units.
- Total units sold in a year are 6,700 units.
- The cost of inventories is assigned by using FIFO cost formula.

How overhead costs are to be allocated to cost of goods sold and closing inventory?

Question 24 – Sharp Trading Inc.

Sharp Trading Inc. purchases motorcycles from various countries and exports them to Europe. Sharp Trading has incurred these expenses during 20X1:
(a) Cost of purchases (based on vendors' invoices) 5,00,000
(b) Trade discounts on purchases 10,000
(c) Import duties 200
(d) Freight and insurance on purchases 250
(e) Other handling costs relating to imports 100
(f) Salaries of accounting department 15,000
(g) Brokerage commission payable to indenting agents for arranging imports 300
(h) Sales commission payable to sales agents 150
(i) After-sales warranty costs 600
Sharp Trading Inc. is seeking your advice as if which of the above item is to be included in the cost of inventory and wants you to calculate cost of inventory as per Ind AS 2.

Question 25 –

On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts. On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for Rs. 5,50,000, including Rs. 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of Rs. 5,55,000 (including Rs. 5,000 loan-raising fees). The loan is secured by the inventories.

During January 20X1 the entity designed the corporate gifts for the customer.
Design costs included:

- cost of external designer = Rs. 7,000; and
- labour = Rs. 3,000.

During February 20X1 the entity's production team developed the manufacturing technique and made further modifications necessary to bring the inventories to the conditions specified in the agreement. The following costs were incurred in the testing phase:

- materials, net of Rs.. 3,000 recovered from the sale of the scrapped output = Rs. 21,000;
- labour = Rs. 11,000; and
- depreciation of plant used to perform the modifications = Rs. 5,000.

During February 20X1 the entity incurred the following additional costs in manufacturing the customised corporate gifts:

- consumable stores = Rs. 55,000;
- labour = Rs. 65,000; and
- depreciation of plant used to manufacture the customised corporate gifts = Rs. 15,000.

The customised corporate gifts were ready for sale on 1 March 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.
Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required.

Thanks ....

CHAPTER

4

IND AS 16 – PROPERTY, PLANT & EQUIPMENT

CONCEPTS COVERED

1. OBJECTIVE
2. SCOPE
3. DEFINITIONS
4. RECOGNITION
5. MEASUREMENT
   - INITIAL MEASUREMENT
   - SUBSEQUENT MEASUREMENT
6. DEPRECIATION
7. IMPAIRMENT
8. DERECOGNITION
9. SELF PRACTICE QUESTIONS

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1. OBJECTIVE :

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Under Ind AS 16, property, plant and equipment is initially measured at its cost, subsequently measured using either a cost or a revaluation model and depreciated so that its depreciable amount is allocated on a systematic basis over its useful life.

2. SCOPE :

- This Standard shall be applied in accounting for property, plant and equipment except when another Standard requires or permits a different accounting treatment.
- This Standard does not apply to:

(a) PPE classified as held for sale (as per Ind AS 105)

(b) Biological assets related to agricultural activity other than bearer plants (Ind AS 41)

(c) Recognition and measurement of exploration and evaluation assets (Ind AS 106)

(d) Mineral rights and mineral reserves such as oil, natural gas and similar nonregenerative resources

- However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (b)–(d).
- An entity accounting for investment property in accordance with Ind AS 40, *Investment Property,* shall use the cost model in this Standard for owned investment property.

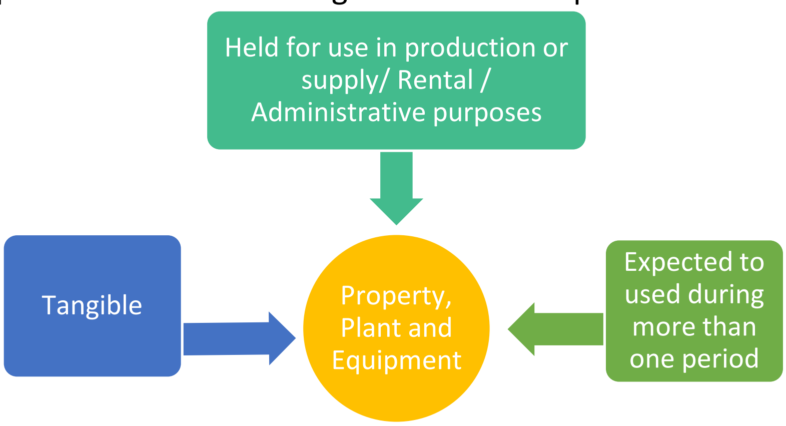
3. DEFINITIONS :

1. Property, Plant and Equipment :

    (b) are the tangible items that

    (b) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

    (c) are expected to be used during more than one period



2. A **bearer plant** is a living plant that:
   (a) is used in the production or supply of agricultural produce;
   (b) is expected to bear produce for more than one period; and
   (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.
3. **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.
4. **Cost** is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Indian Accounting Standards, e.g. Ind AS 102, Share based Payment.
5. **Depreciable amount** is the cost of an asset, or other amount substituted for cost, less its residual value.
6. **Depreciation** is the systematic allocation of the depreciable amount of an asset over its useful life.
7. **Entity-specific value** is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.
8. **Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113, Fair Value Measurement.)
9. An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.
10. **Recoverable amount** is the higher of an asset's fair value less costs to sell and its value in use.
11. The **residual value** of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.
12. **Useful life** is:
    (a) the period over which an asset is expected to be available for use by an entity; or
    (b) the number of production or similar units expected to be obtained from the asset by an entity.

4. RECOGNITION :

The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

A. it is probable that future economic benefits associated with the item will flow to the entity; and

B. the cost of the item can be measured reliably.

it is probable that future economic benefits associated with the item will flow to the entity;

the cost of the item can be measured reliably.

Spare parts, stand-by equipment and servicing equipment :

Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

Aggregation of individually insignificant items :

This Standard does not prescribe the unit of measure for recognition, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value.

Initial Cost :

Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets.

Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.

For example: A chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the entity is unable to manufacture and sell chemicals. However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with Ind AS 36 Impairment of Assets.

Repair and Maintenance :

An entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts.

Replacement Parts :

- Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe.

- Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement.
- Under the recognition principle, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard.

Major inspections and Overhauls :

- A condition of continuing to operate an item of property, plant and equipment may be performing regular major inspections for faults regardless of whether parts of the item are replaced
- When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied.
- Any remaining carrying amount of the cost of the previous inspection is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Question 1 – RM acquired

RM acquired an aircraft for Rs.1.5 crore on 1.4.2018. It has a life of 15 years. RM is required to get the aircraft inspected every 3 years to check its travel worthiness. On 1.4.2018, it carried out inspection at a cost of Rs.60,00,000. On 1.4.2021, its incurred Rs.75,00,000 as the cost of new inspection. Show treatment

Question 2 – A shipping company

A shipping company is required by law to bring all ships into dry dock every five years for a major inspection and overhaul.
A ship which cost Rs.15 million with a 20 year life must have major overhaul every five years. The estimated cost of the overhaul at the five-year point is Rs.5 million.
Explain how the asset shall be Capitalised and Depreciated for year 1 to 5.

Question 3 –

Assuming actual overhaul costs incurred at the end of year 5 are Rs 6 million. Explain the treatment for the cost incurred and depreciation for year 6 to 10.

5. MEASUREMENT :

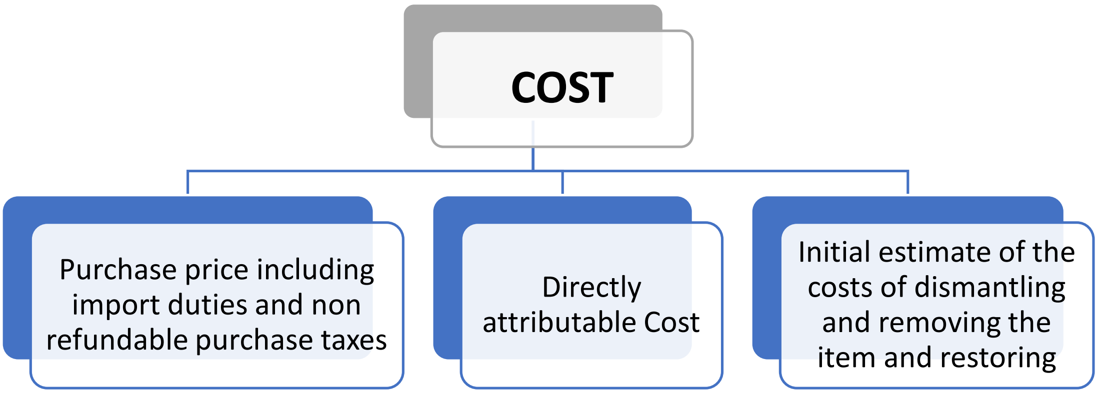
1. INITIAL MEASUREMENT :

An item of property, plant and equipment that qualifies for recognition as an asset should be initially measured at its cost.

COMPONENT OF COST :

The cost of an item of property, plant and equipment comprises:

- its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
- any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and
- the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.



Examples of Directly Attributable cost

- Employee benefits cost arising directly from construction or acquisition of PPE
- Cost of Site Preparation
- Initial delivery and handling costs
- Installation and assembly costs
- Professional Fees
- Costs of testing -whether the asset is working properly after deducting proceeds from sale of any product produced during the testing period

Examples of costs that are not costs of an item of property, plant and equipment are

- Costs of conducting business in a new location or with a new class of customer (including costs of staff training)
- Costs incurred in introducing a new product or service
- Cost of opening a new facility
- Administrative and other general overhead costs

Question 4 –

The purchase price of the machine is Rs.1,10,000. Other cost are as follows : Freight Rs.2000, Import duty Rs.5000. Installation Expenses Rs.1000. This are all initial cost. What will be the cost of the machinery.

Question 5 –

The purchase price of the machinery is Rs.110,000. The basic price is 1,00,000 + 10,000 Vat. The entity get the credit of VAT paid on the machinery, while calculating the tax payable on the finished goods sold. What will be the cost of machinery?

Cost of self-constructed asset :

The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale.

Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset.

Ind AS 23, Borrowing Costs, establishes criteria for the recognition of interest as a component of the carrying amount of a self constructed item of property, plant and equipment.

Bearer plants are accounted for in the same way as self-constructed items of property, plant and equipment before they are in the location and condition necessary to be capable of operating in the manner intended by management. Consequently, references to 'construction' in this Standard should be read as covering activities that are necessary to cultivate the bearer plants before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Question 6 – An entity

An entity constructs a building for its own use. It spends Rs.50 million for material (Rs.2 million of it was lost in a fire) and Rs.5 million on wages and other direct expenses for constructing the building, it uses borrowed cost of Rs.30 million on which it pays interest of Rs.3 million upto the date of completion of construction. What is the amount to be recognised as cost construction.

Question 7 – RM Ltd.

RM Ltd purchased a plant for Rs.200 million. The seller granted rebate of 0.5%. The gross price includes GST Rs.18 million for which the buyer will get tax refund. It has also incurred Rs.15 million for transport, Rs.5 million for installation and Rs.3 million for testing and professional fees.

It has earned Rs.0.2 million from selling goods produced out of testing. The company borrowed Rs.100 million for financing new plant at 10%. The entire process of purchase to make it operational took 15 months.

The company earned Rs.0.1 million from short term parking of money borrowed pending payment to supplier and meeting all costs.

What should be initial cost of the plant ?

Cost of dismantling, removal and site restoration :

Cost incurred by an entity in respect of obligation for dismantling, removing and restoring the site on which an item of property, plant and equipment is located are recognised and measured in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

If the obligations are incurred when the asset is acquired, or during a period when the item is used other than to produce inventories, they are included in the cost of the item property, plant and equipment.

An entity applies Ind AS 2, Inventories, to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period.

Decommissioning expenses are capitalised in cases of mining, oil exploration, nuclear plant, hydroelectricity plant etc. where are liability for site restoration.

Journal Entry at initial recognition for commissioning expenses

PPE A/c	Dr	XXX	
To Provision for Decommissioning Expenses			XXX

Question 8 – SK Ltd.

SK Ltd set up fire safety devices around its factory premises. The price paid for devices is Rs.1,10,000 (Including tax of Rs.10,000). The entity gets credit on VAT.

Additional cost are Freight Rs.2000, Import Duty Rs.5000 (No refund), installation expense of Rs.1000. The initial expense of dismantling and removing was Rs.3000. After the machinery was put to use Rs.1500 was spent for maintenance.

Calculate the initial cost of the asset.

Question 9 – RM Mining Ltd

RM Mining Ltd. has projected site restoration expenses of Rs.1,57,04,710 after 40 years. The rate of Discount is 11%. Pass journal entry at initial recognition.

Incidental operations :

Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management.

These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts.

Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.

Cessation of capitalisation :

Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item.

Question 10 – Entity A

Entity A has existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facility to another temporary site. The following incremental cost will be incurred.

1. Setup cost of Rs.5,00,000 to install machinery in new Location
2. Rent of Rs.15,00,000
3. Removal Cost of Rs.3,00,000 to transport machinery from old location to the temporary location.

Can this cost be capitalised in cost of new building.

Question 11 – SM Ltd.

SM Ltd. which operates a major chain of super markets has acquired a new store location.

The new location requires significant renovation expenditure. Management expects that the renovation will last for 3 months during which the super market will be closed.

Management has prepared the budget for this period including

Expenditure relating to construction and remodelling cost

Salaries of the staff who will be preparing the store before its opening and related utilities cost.

What will be treatment of such expenditure?

Question 12 – Moon Ltd.

Moon Ltd incurs the following costs in relation to the construction of a new factory and the introduction of its products to the local market.

Particulars	**Rs 000's (cost incurred)**
Site Preparation costs	150
Direct Material	2000
Direct Labour Cost, including 10,000 incurred during an industrial strike	1160
Testing of various processes in factory	200
Consultancy fees for installation of equipment	300
Relocation of staff to new factory	450
General overheads	550
Estimated Costs to dismantle (at present value)	200

Determine the cost that should be capitalised.

Deferred payment beyond normal credit terms :

The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with Ind AS 23.

Question 13 –

The purchase price of the machinery is Rs.40,000. The company did not have enough cash, and therefore agreed to pay a year later. However they will pay Rs.45,000. What shall be the treated with reference to the above arrangement.

Question 14 – On 1st April, 2011

On 1st April, 2011, an item of property is offered for sale at Rs.10 million, with payment terms being three equal instalments of Rs.33,33,333 over a two years period (payments are made on 1st April, 2011, 31st March, 2012 and 31st March, 2013). The property developer is offering a discount of 5 percent (i.e. Rs.0.5 million) if payment is made in full at the time of completion of sale. Implicit interest rate of 5.36 percent p.a. Show how the property will be recorded in accordance of Ind AS 16.

Exchange of Assets :

A. One or more items of property, plant and equipment may be acquired in exchange for a nonmonetary asset or assets, or a combination of monetary and nonmonetary assets. The cost of such an item of property, plant and equipment is measured at fair value (even if an entity cannot immediately derecognise the asset given up) unless:
   1. the exchange transaction lacks commercial substance; or
   2. the fair value of neither the asset received nor the asset given up is reliably measurable.

B. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

C. If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.

Question 15 – DM Ltd.

DM Ltd. purchases a Machinery in exchange of Motor Car B. Motor car B has a book Value of Rs.1,50,000. Fair Value of car given up is Rs.1,70,000. Fair value of Machine is Rs.1,80,000. Fair value of Machinery is more evidently known. Journalise.

Question 16 – VP Ltd.

VP Ltd purchases a Machinery by issuing 1000 shares of Rs.100 each. The fair value of Machine is Rs.1,50,000. Journalise.

Question 17 – Pluto Ltd.

Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of Rs 10 million. The fair value of such asset is Rs 15 million. It exchanges the land and building for a private jet, which has a fair value of Rs 18 million, and pays additional Rs 3 million in cash.

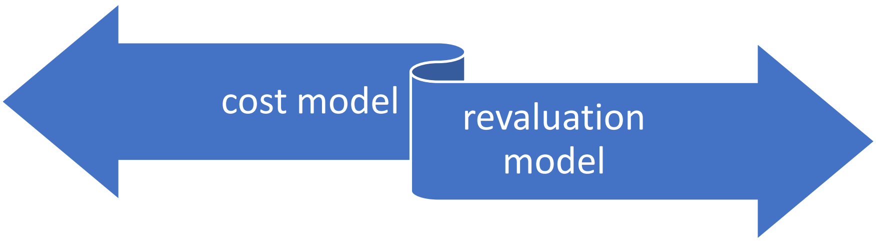
Show the necessary treatment as per Ind AS 16.

Question 18 – Fill in the blanks

Possible Situation	1	2	3	4
Fair Value of Asset acquired	12 (More evident)	Not evident	12	Not Measured at Fair Value
Fair Value of Asset Given up	10	10	Not Evident	Not Measured at Fair Value
Carrying Amount	8	8	8	8
Cost is Measured at	?	?	?	?
Profit / Loss	?	?	?	?

2 SUBSEQUENT MEASUREMENT :

An entity may choose either the cost model or the revaluation model as its accounting policy and should apply that policy to an entire class of property, plant and equipment.



COST MODEL :

After recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Cost – Accumulated Depreciation – Accumulated Impairment Loss	XXX XXX XXX
Carrying Amount	XXX

REVALUATION MODEL :

After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably is carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are required to be carried out with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

Fair Value at the date of revaluation – Accumulated Depreciation – Accumulated Impairment Loss	XXX XXX XXX
Carrying Amount	XXX

Method to Revalue :

When an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

A. the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses; or

B. the accumulated depreciation is eliminated against the gross carrying amount of the asset.

Question 19 – Jupiter Ltd.

Jupiter Ltd. has an item of plant with an initial cost of Rs.100,000. At the date of revaluation accumulated depreciation amounted to Rs.55,000. The fair value of asset, by reference to transactions in similar assets, is assessed to be Rs.65,000. Find out the entries to be passed?

Revaluation to be made for entire class of assets :

If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations.

The following are examples of separate classes:

Separate Classes								
Land	Land and Building	Machinery	Ships	Aircraft	Motor Vehicles	Furniture & Fixtures	Office Equipment	Bearer Plants

The items within a class of property, plant and equipment are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates.

However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.

Question 20 – XYZ Ltd.

XYZ Ltd. purchased a land at 50000. Professional valuer have at Rs.70,000. Journalise.

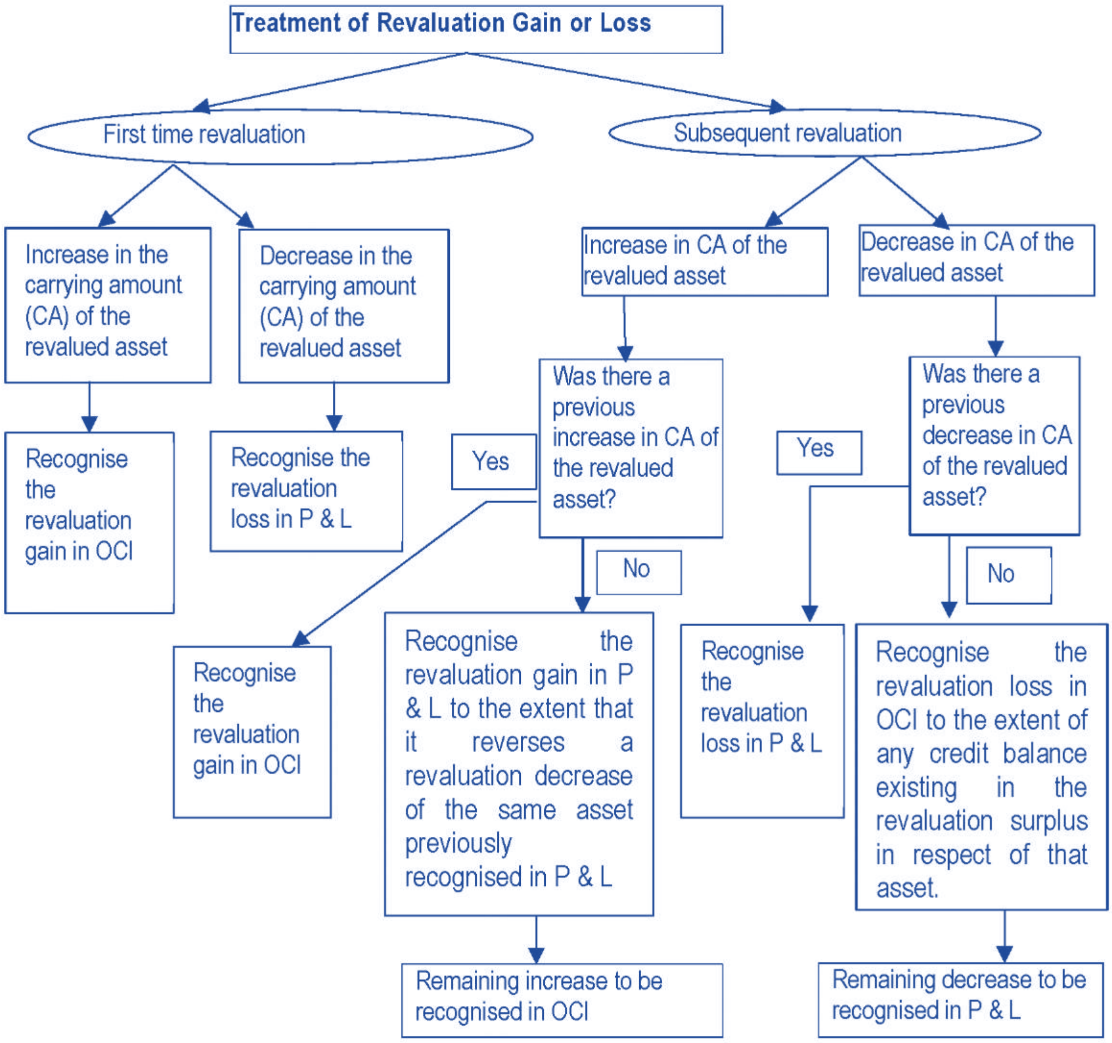
Question 21 – Venus Ltd.

Venus Ltd. is a large manufacturing group. It owns a considerable number of industrial buildings, such as factories and warehouses, and office buildings in several capital cities. The industrial buildings are located in industrial zones whereas the office buildings are in central business districts of the cities. Venus's Ltd. management wants to apply the Ind AS 16 revaluation model to subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings. Is this acceptable under Ind AS 16, Property, Plant and Equipment?

Treatment of surplus or deficit arising on revaluation :

- If an asset's carrying amount is increased as a result of a revaluation, the increase should be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase should be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.
- If an asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognised in profit or loss. However, the decrease should be recognised

in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.



The revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of.

However, some of the surplus may be transferred as the asset is used by an entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Transfers from revaluation surplus to retained earnings are not made through profit or loss.

The effects of taxes on income, if any, resulting from the revaluation of property, plant and equipment are recognised and disclosed in accordance with Ind AS 12, Income Taxes.

Question 22 – An item of PPE

An item of PPE was purchased for Rs.9,00,000 on 1st April, 2011. It is estimated to have a useful life of 10 years and is depreciated on a straight line basis. On 1st April,

2013, the asset is revalued to Rs.9,60,000. The useful life remains unchanged as ten years. Ignore impact of deferred taxes.
Show the necessary treatment as per Ind AS 16.

6. DEPRECIATION :

- The depreciable amount of an asset should be allocated on a systematic basis over its useful life. The depreciation charge for each period should be recognised in profit or loss unless it is included in the carrying amount of another asset.
- Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.
- An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part.
- A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.
- To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.
- Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.
- If the cost of land includes the costs of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

Question 23 – Nish Ltd.

Nish Ltd., a steel manufacturer industry commissioned a power plant at its steel plant at a cost of Rs.700 crore. The cost break up of Rs.700 crore is as follows

Component	**Cost (in Rs crore)**	**Useful life**
Erection, fabriation & construction of building structure	100	30
Electrical panels	50	10
Plant & Equipment (boiler, Turtine, generator, condenser etc)	500	40
Transformer grids	50	10

Calculate depreciation residual value may be assumed to be 5%.

RESIDUAL VALUE AND USEFULL LIFE :

The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

Question 24 – An asset

An asset which cost Rs.10,000 was estimated to have a useful life of 10 years and residual value Rs.2000. After two years, useful life was revised to 4 remaining years. Calculate the depreciation charge.

Commencement of Depreciation :

Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

Cessation of depreciation :

- Depreciation of an asset ceases at the earlier of:
    - a) the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105.
    - b) and the date that the asset is derecognised.
- Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

Factors affecting the useful life of an asset :

The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

a) expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output;

b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle;

c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset; and

d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Impact of an entity's asset management policy :

The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets.

Depreciation method :

The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include:

1. Straight-line depreciation method results in a constant charge over the useful life if the asset's residual value does not change.
2. Diminishing balance method results in a decreasing charge over the useful life.
3. Units of production method results in a charge based on the expected use or output.

The depreciation method applied to an asset is reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. **Such a change is accounted for as a change in an accounting estimate in accordance with Ind AS 8 i. change is accounted for prospectively**

Question 25 – An entity

An entity acquired an asset 3 years ago at a cost of Rs.5 million. The depreciation method adopted for the asset was 10 percent reducing balance method. At the end of Year 3, the entity estimates that the remaining useful life of the asset is 8 years and determines to adopt straight –line method from that date so as to reflect the revised estimated pattern of recovery of economic benefits. Show the necessary treatment in accordance of Ind AS 16.

7. IMPAIRMENT :

To determine whether an item of property, plant and equipment is impaired, an entity applies Ind AS 36, Impairment of Assets. Ind AS 36 explains how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss.

Compensation for impairment :

- Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable.

- Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:
  a) impairments of items of property, plant and equipment are recognised in accordance with Ind AS 36;
  b) derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
  c) compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and
  d) the cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with this Standard.

8. DERECOGNITION :

- The carrying amount of an item of property, plant and equipment should be derecognised:
  1. on disposal; or
  2. when no future economic benefits are expected from its use or disposal.
- The gain or loss arising from the derecognition of an item of property, plant and equipment is included in profit or loss when the item is derecognised (unless Ind AS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.

Question 26 – WDV

WDV of the item of PPE is 10,00,000. The asset is sold for Rs.12,00,000 during 2016. However the buyer will the proceeds after 1 year. The discounting rate is 10%. How should it be accounted as per IND AS 16.

9. SELF PRACTICE QUESTIONS :

Question 27 – MS Ltd.

MS Ltd. has acquired a heavy machinery at a cost of Rs.1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, one of the major components, the turbine requires replacement, as further maintenance is uneconomical. The remainder of the machine is perfect and is expected to last for the next four years. The cost of a new turbine is Rs.45,00,000. The discount rate assumed is 5%.
Can the cost of the new turbine be recognised as an asset, and, if so, what treatment should be used?

Question 28 – XYZ Ltd.

On April 1, 2018, XYZ Ltd. acquired a machine under the following terms:

	Rs.
List Price of the Asset	80,00,000

Import Duty	5,00,000
Delivery Fees	1,00,000
Electrical installation Costs	10,00,000
Pre-production costs	4,00,000
Purchase of a five year maintenance contract with vendor	7,00,000

In addition to the above information XYZ Ltd. was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5%, if payment for the machine was received within one month of purchase. XYZ Ltd. paid for the plant on April 20, 2018. At what cost the asset will be recognised?

Question 29 – KBC Ltd.

The term of an operating lease allows a tenant, KBC Ltd. to tailor the property to meet its specific needs by building an additional internal wall, but on condition that the tenant returns the property at the end of the lease in its original state. This will entail dismantling the internal wall. KBC Ltd. incurs a cost of Rs.25,00,000 on building the wall and present value of estimated cost to dismantle the wall is Rs.10,00,000. At what value should the leasehold improvements be capitalised in the books of KBC Ltd.

Question 30 – X Ltd.

X Limited started construction on a building for its own use on April 1, 2010. The following costs are incurred:

	Rs.
Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Materials	10,00,000
Direct labour cost	4,00,000
General overheads	1,00,000

Other relevant information: Material costing Rs.1,00,000 had been spoiled and therefore wasted and a further Rs.1,50,000 was spent on account of faulty design work. As a result of these problems, work on the building was stopped for two weeks during November, 2010 and it is estimated that Rs.22,000 of the labour cost relate to that period. The building was completed on January 1, 2011 and brought in use April 1, 2011. X Limited had taken a loan of Rs.40,00,000 on April 1, 2010 for construction of the building (which meets the definition of qualifying asset as per Ind AS 23). The loan carried an interest rate of 8% per annum and is repayable on April 1, 2012.
Calculate the cost of the building that will be included in tangible non-current asset as an addition?

Question 31 – XYZ Ltd.

XYZ Ltd. purchased an asset on January 1, 2010, for Rs.1,00,000 and the asset had an estimated useful life of ten years and a residual value of nil. The company has charged depreciation using the straight-line method at Rs.10,000 per annum. On January 1, 2014, the management of XYZ Ltd. Reviews the estimated life and decides that the asset will probably be useful for a further four years and, therefore, the total life is revised to eight years. How should the asset be accounted for remaining years?

Question 32 – Sun Ltd.

On 1st April, 2011, Sun Ltd purchased some land for Rs.10 million (including legal costs of Rs.1 million) in order to construct a new factory. Construction work commenced on 1st May, 2011.

Sun ltd incurred the following costs in relation with its construction:

– Preparation and levelling of the land – Rs.3,00,000.
– Purchase of materials for the construction – Rs.6·08 million in total.
– Employment costs of the construction workers – Rs.2,00,000 per month.
– Overhead costs incurred directly on the construction of the factory – Rs.1,00,000 per month.
– Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – Rs.50,000 per month.
– Income received during the temporary use of the factory premises as a car park during the construction period – Rs.50,000.
– Costs of relocating employees to work at the new factory – Rs.300,000.
– Costs of the opening ceremony on 31st January, 2011 – Rs.150,000.

The factory was completed on 30th November, 2011 and production began on 1st February, 2012. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building.

At the end of the 40-year period, Sun ltd has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The directors estimate that the cost of demolition in 40 years' time (based on prices prevailing at that time) will be Rs.20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of Rs.1 payable in 40 years' time at an annual discount rate of 8% is Rs.4.6.

The construction of the factory was partly financed by a loan of Rs.17·5 million taken out on 1st April, 2011. The loan was at an annual rate of interest of 6%. During the period 1st April, 2011 to 31st August, 2011 (when the loan proceeds had been fully utilised to finance the construction), Sun Ltd received investment income of Rs.100,000 on the temporary investment of the proceeds.

Required:

Compute the carrying amount of the factory in the Balance Sheet of Sun Ltd at 31st March, 2012. You should explain your treatment of all the amounts referred to in this part in your answer.

Question 33 – ABC Ltd.

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	Rs.25,00,000
2.	Initial delivery and handling costs	Rs.2,00,000
3.	Cost of site preparation	Rs.6,00,000
4.	Consultants used for advice on the acquisition of the plant	Rs.7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	Rs.2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	Rs.3,00,000
7.	Operating losses before commercial production	Rs.4,00,000

Please advise ABC Ltd. on the costs that can be capitalized in accordance with Ind AS 16.

Question 34 – A Ltd.

A Ltd. has an item of plant with an initial cost of Rs.2,00,000. At the date of revaluation, accumulated depreciation amounted to Rs.110,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be Rs.140,000.

Pass Journal Entries with regard to Revaluation?

Question 35 – B Ltd.

B Ltd. owns an asset with an original cost of Rs.2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be Rs.20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value.

At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to Rs.10,000. How would the above changes in estimates be made by B Ltd.?

Question 36 – X Ltd.

X Ltd. has a machine which got damaged due to fire as on January 31, 20X1. The carrying amount of machine was Rs.1,00,000 on that date. X Ltd. sold the damaged asset as scrap for Rs.10,000. X Ltd. has insured the same asset against damage. As on March 31, 2011, the compensation proceeds was still in process but the insurance company has confirmed the claim. Compensation of Rs.50,000 is receivable from the insurance company. How X Ltd. will account for the above transaction?

Question 37 – A Ltd.

A Ltd. purchased some Property, Plant and Equipment on 1st April, 20X1, and estimated their useful lives for the purpose of financial statements prepared on the basis of Ind AS: Following were the original cost, and useful life of the various components of property, plant, and equipment assessed on 1st April, 20X1:

Property, Plant and Equipment	Original Cost	Estimated useful life
Buildings	Rs. 15,000,000	15 years

Plant and machinery	Rs. 10,000,000	10 years
Furniture and fixtures	Rs. 3,500,000	7 years

A Ltd. uses the straight-line method of depreciation. On 1st April, 20X4, the entity reviewed the following useful lives of the property, plant, and equipment through an external valuation expert:

Buildings	10 years
Plant and machinery	7 years
Furniture and fixtures	5 years

There were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised.

Compute the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 20X5.

Question 38 – Mr. X

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:-

The notes to the financial statements state that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note states that property owned by ABC Ltd. but rent out to others is depreciated annually and not fair valued. Mr. Y is of the opinion that there is no consistent treatment of PPE items in the accounts. How should the finance controller respond to the query from the managing director?

Question 39 – Company X

Company X performed a revaluation of all of its plant and machinery at the beginning of 20X1. The following information relates to one of the machinery:

	Amount ('000)
Gross carrying amount	Rs. 200
Accumulated depreciation (straight-line method)	(Rs. 80)
Net carrying amount	Rs. 120
Fair value	Rs. 150

The useful life of the machinery is 10 years and the company uses Straight line method of depreciation. The revaluation was performed at the end of 4 years.

How should the Company account for revaluation of plant and machinery and depreciation subsequent to revaluation? Support your answer with journal entries.

Question 40 – An entity

An entity has the following items of property, plant and equipment:

- Property A — a vacant plot of land on which it intends to construct its new administration headquarters;
- Property B — a plot of land that it operates as a landfill site;
- Property C — a plot of land on which its existing administration headquarters are built;
- Property D — a plot of land on which its direct sales office is built;
- Properties E1–E10 — ten separate retail outlets and the land on which they are built;
- Equipment A — computer systems at its headquarters and direct sales office that are integrated with the point of sale computer systems in the retail outlets;
- Equipment B — point of sale computer systems in each of its retail outlets;
- Furniture and fittings in its administrative headquarters and its sales office;
- Shop fixtures and fittings in its retail outlets.

How many classes of property, plant and equipment must the entity disclose?

Question 41 – Heaven Ltd.

Heaven Ltd. had purchased a machinery on 1.4.2X01 for Rs. 30,00,000, which is reflected in its books at written down value of Rs. 17,50,000 on 1.4.2X06. The company has estimated an upward revaluation of 10% on 1.4.2X06 to arrive at the fair value of the asset. Heaven Ltd. availed the option given by Ind AS of transferring some of the surplus as the asset is used by an enterprise.

On 1.4.2X08, the machinery was revalued downward by 15% and the company also re-estimated the machinery's remaining life to be 8 years. On 31.3.2X10 the machinery was sold for Rs. 9,35,000. The company charges depreciation on straight line method. Prepare machinery account in the books of Heaven Ltd. over its useful life to record the above transactions.

Thanks ....

CHAPTER 5

IND AS 40 – INVESTMENT PROPERTY

CONCEPTS COVERED

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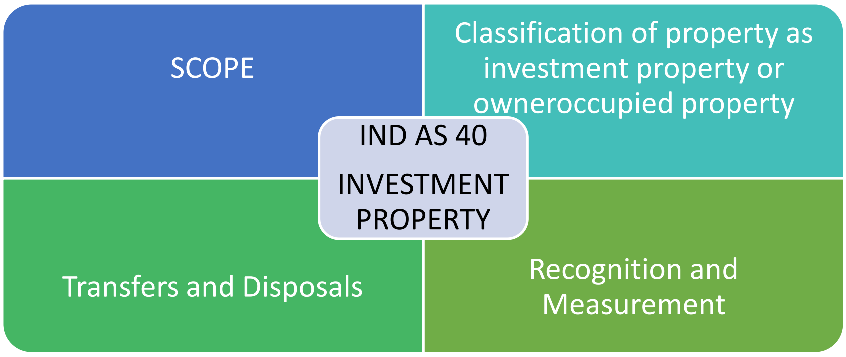
1. OBJECTIVE :

The objective of this standard is to prescribe the accounting treatment for property (land and/or buildings) held to earn rentals or for capital appreciation (or both). Ind AS 40 prescribes the cost model for accounting for investment property.



2. SCOPE :

1) Ind AS 40 should be applied in the recognition, measurement and disclosure of investment property.

2) This Standard does not apply to:

   a) biological assets related to agricultural activity (see Ind AS 41 '*Agriculture'* and Ind AS 16 '*Property, Plant and Equipment')*; and

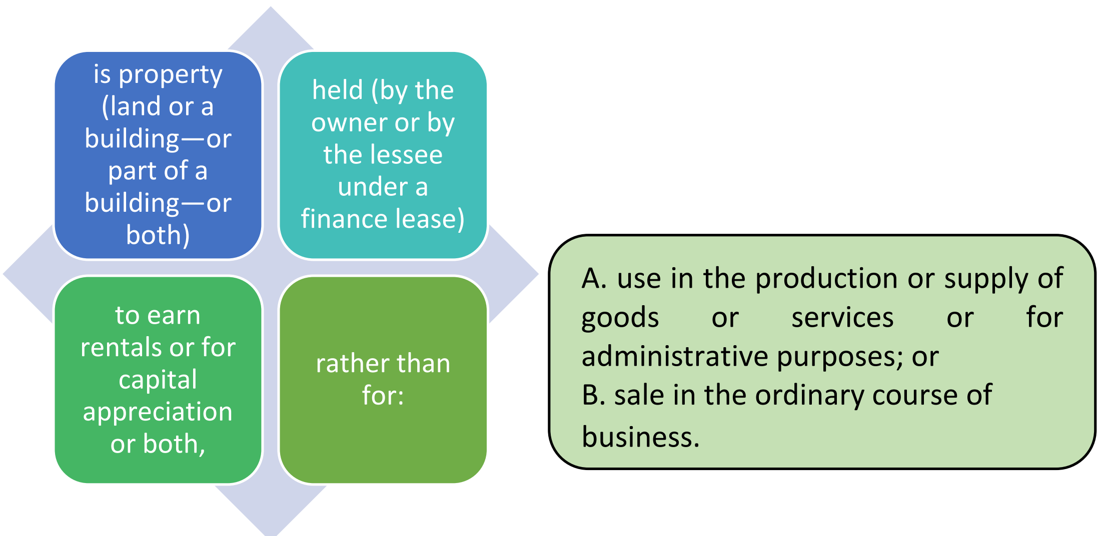
   b) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

3. DEFINITIONS :

1. INVESTMENT PROPERTY :

Investment property

- is property (land or a building—or part of a building—or both)
- held (by the owner or by the lessee under a finance lease)
- to earn rentals or for capital appreciation or both,
- rather than for:
  - a) use in the production or supply of goods or services or for administrative purposes; or
  - b) sale in the ordinary course of business.



2. **PROPERTY, PLANT AND EQUIPMENT :**

A. are the tangible items that

B. are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

C. are expected to be used during more than one period

3. **OWNER-OCCUPIED PROPERTY :**

Owner occupied property is property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.

4. **FAIR VALUE :**

Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (IND AS 113)

5. **COST :**

Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Ind ASs, eg Ind AS 102, Share Based Payment.

6. **CARRYING AMOUNT :**

Carrying amount is the amount at which an asset is recognised in the balance sheet.

4. CLASSIFICATION OF PROPERTY AS INVESTMENT PROPERTY & OWNER OCCUPIED PROPERTY :

4.1 NATURE OF INVESTMENT PROPERTY :

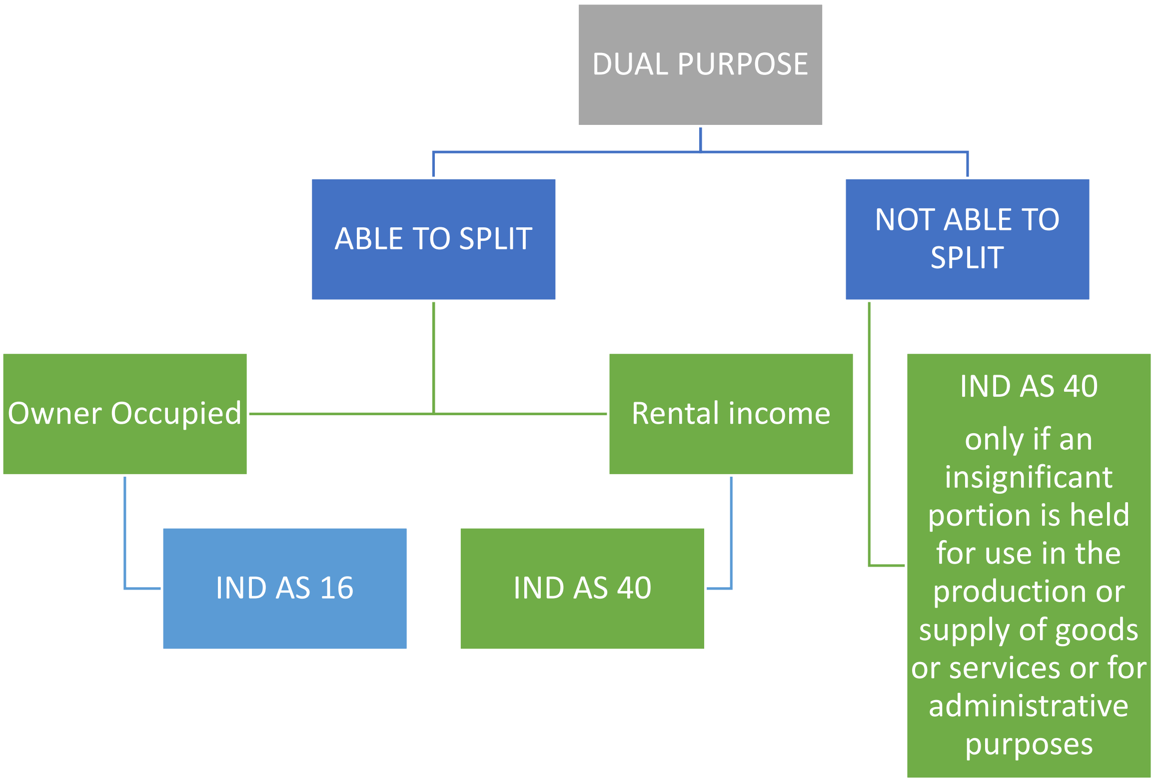
Investment property is held to earn rentals or for capital appreciation or both. Therefore, an investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that are attributable not only to property, but also to other assets used in the production or supply process. Ind AS 16 Property, Plant and Equipment applies to owner-occupied property.

4.2 EXAMPLES :

INVESTMENT PROPERTY	NOT AN INVESTMENT PROPERTY
Land held for long-term capital appreciation	Property intended for sale in the ordinary course of business (IND AS 2)
Land held for a currently undetermined future use.(if the entity is undecided it is assumed that its currently held for capital appreciation)	Property in the process of construction or development for sale in ordinary course of business (IND AS 2)
A building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.	Owner-occupied property, including property held for future use as owner occupied property. (IND AS 16)

A building that is vacant but is held to be leased out under one or more operating leases.	Property held for future development and subsequent use as owner occupied property (IND AS 16)
Property that is being constructed or developed for future use as investment property.	Property occupied by employees (whether or not the employees pay rent at market rates) (IND AS 16)
	Property leased to another entity under a finance lease (IND AS 17)

4.3 PROPERTY HELD FOR ONE OR MORE PURPOSE :



Question 1 – Sun Ltd.

Sun Ltd. owns a building having 15 floors of which it uses 5 floors for its office; the remaining 10 floors are leased out to tenants under operating leases. According to law company could sell legal title to the 10 floors while retaining legal title to the other 5 floors.

Explain how shall the property be classified?

Question 2 – Moon Ltd.

Moon Ltd. uses 35% of the office floor space of the building as its head office. It leases the remaining 65% to tenants, but it is unable to sell the tenant's space or to enter into finance leases related solely to it. Head office can't be shifted and is significant to the overall operation of the firm.

Can the above property be classified as Investment Property as per IND AS 40?

Question 3 – An entity

An entity owns a hotel, which includes a health and fitness centre, housed in a separate building that is part of the premises of the entire hotel. The owner operates the hotel and other facilities on the hotel with the exception of the health and fitness centre, which can be sold or leased out under a finance lease. The health and fitness centre will be leased to an independent operator. The entity has no further involvement in the health and fitness centre.

Explain how the above assets can be classified as per IND AS 40.

4.4 ANCILLARY SERVICES :

In some cases, an entity provides ancillary services to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole.

If the services provided are significant than the entity should treat the property as owner occupied property and account for it as per IND AS 16

Question 4 – The owner

The owner of an office building provides security and maintenance services to the lessees who occupy the building. Can this be treated as Investment property?

Question 5 –

If an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Can this be treated as Investment property?

It may be difficult to determine whether ancillary services are so significant that a property does not qualify as investment property. For example, the owner of a hotel sometimes transfers some responsibilities to third parties under a management contract. The terms of such contracts vary widely.

- At one end of the spectrum, the owner’s position may, in substance, be that of a passive investor.
- At the other end of the spectrum, the owner may simply have outsourced day-to-day functions while retaining significant exposure to variation in the cash flows generated by the operations of the hotel.

Judgement is needed to determine whether a property qualifies as investment property. Judgement is also required to determine whether the acquisition of Investment Property is the acquisition of an asset or a group of assets or a business combination within the scope of Ind AS 103, Business Combinations.

Question 6 –

No.	Property	Does it meet definition of Investment Property	Which Ind AS is Applicable
1	Owned by a Co and leased out under an Operating Lease		
2	Held Under Finance Lease and Leased out under an Operating Lease		
3	Held under Finance Lease and Leased out under Finance Lease		
4	Property acquired with a view for development and resale		
5	Property partly owner occupied and partly leased out under Operating Lease		
6	Land held for currently undetermined use		
7	Property occupied by Employees paying rent at less than market rate		
8	Investment Property held for sale		
9	Existing Investment Property that is being redeveloped for continued use as Investment Property		

5. RECOGNITION :

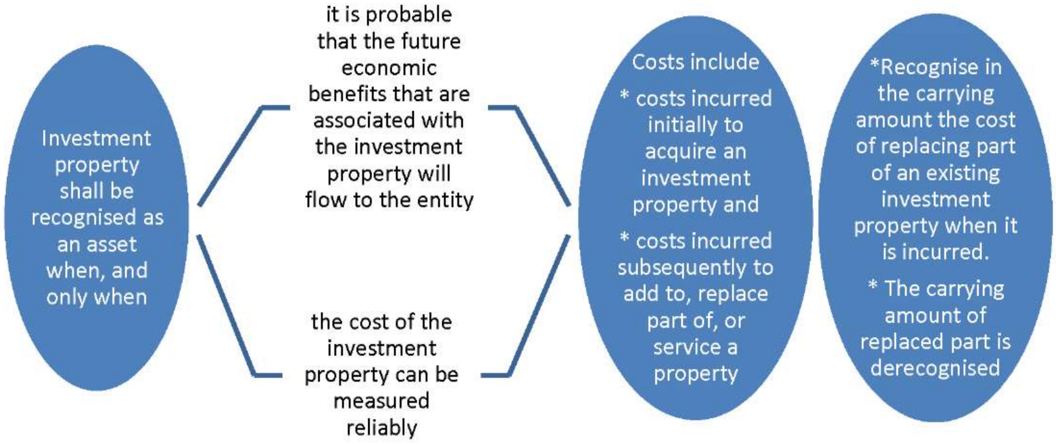
5.1 GENERAL RECOGNITION :

Investment property shall be recognised as an asset when, and only when:

a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and

b) the cost of the investment property can be measured reliably.

This general principle is used to consider whether capitalisation is appropriate both in respect of the cost incurred initially to acquire or construct an investment property and costs incurred subsequently to add to, replace part of, or service a property



5.2 SUBSEQUENT COSTS :

Under the recognition principle set out above, an entity does not recognise in the carrying amount of an investment property the costs of the day-to-day servicing of such a property and costs incurred to replace parts of the original property being recognised in the investment property if they meet the recognition criteria.

When the cost of replacement parts are capitalised, the carrying amounts of the replaced parts are derecognised.

Question 7 – X Limited

X Limited owns a building which is used to earn rentals. The building has a carrying amount of Rs.50,00,000. X Limited recently replaced interior walls of the building and the cost of new interior walls is Rs.5,00,000. The original walls have a carrying amount of Rs.1,00,000. How X Limited should account for the above costs?

6. MEASUREMENT :

6.1 MEASUREMENT AT RECOGNITION – GENERAL :

An investment property should be measured initially at its cost. Transaction costs are included in the initial measurement.

The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs). The cost of an investment property is not increased by:

a) start-up costs (unless they are necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management),

b) operating losses incurred before the investment property achieves the planned level of occupancy, or

c) abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.

Question 8 – Netravati Ltd.

Netravati Ltd. purchased a commercial office space as an Investment Property, in the Global Trade Centre Commercial Complex, for Rs. 5 crores. However, for purchasing the same, the Company had to obtain membership of the Global Trade Centre Commercial Complex Association by paying Rs. 6,25,000 as a one-time joining fee. Netravati Ltd. wants to write off the one-time joining fees paid as an expense under Membership and Subscription Charges and value the investment property at Rs. 5 crores. Advise.

Would you answer change if the office space was purchased with the intention of using it as an administrative centre of the company?

Question 9 – X Limited

X Limited purchased a building for Rs. 30,00,000 on 1st May, 20X1 with an intention to earn rentals. The purchase price was funded by a loan, interest on which is payable @ 5%. Property transfer taxes and direct legal costs of Rs. 1,00,000 and Rs. 20,000 respectively were incurred in acquiring the building. X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:

(a) Rs. 2,00,000 planning permission.

(b) Rs. 7,00,000 construction costs (including Rs. 40,000 refundable purchase taxes)

What is the cost of the Building as per Ind AS 40?

6.2 DEFERRED PAYMENTS :

If payment for an investment property is deferred, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit.

Question 10 – X Limited

X Limited purchased a land worth of Rs. 1,00,00,000. It has option either to pay full amount at the time of purchases or pay for it over two years for a total cost of Rs. 1,20,00,000. What should be the cost of the building under both the payment methods?

6.3 EXCHANGE OF ASSETS :

The cost of such an investment property is measured at fair value unless:

a) the exchange transaction lacks commercial substance or

b) the fair value of neither the asset received nor the asset given up is reliably measurable.

Question 11 – Sun Ltd.

Sun Ltd. acquired a building in exchange of a warehouse whose fair value is Rs.5,00,000 and payment of cash is Rs.2,00,000. The fair value of the building received by the

Company is Rs.8,00,000. The company decided to keep that building for rental purposes. Pass the journal Entry for the above transaction

Question 12 – Y Limited

Y Limited purchased a building for Rs.30,00,000 in May 1, 2011.The purchase price was funded by a loan. Property transfer taxes and direct legal costs of Rs.1,00,000 and Rs.20,000 respectively were incurred in acquiring the building. In 2011-2012, Y Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:
Rs.2,00,000 planning permission.
Rs.7,00,000 construction costs (including Rs.40,000 refundable purchases taxes).
The redevelopment was completed and the retail shops were ready for rental on September 2, 2011. What is the cost of building at initial recognition?

Question 13 – Z Limited

Z Limited purchased a land worth of Rs.1,00,00,000. It has option either to pay full amount at the time of purchases or pay for it over two years for a total cost of Rs.1,20,00,000. What should be the cost of the building under both the payment methods?

Question 14 – S Limited

S Limited (as the lessee) has taken a building under finance lease from the owner. It classifies its interest in the leasehold building as investment property and after initial recognition measures the property interest at fair value. The fair value is Rs.50,000. The present value of the minimum lease payment is Rs.40,000. At what value, S Limited will recognise its investment property?

7. MEASUREMENT AFTER RECOGNITION :

ACCOUNTING POLICY :

a. After initial recognition, an entity is required to measures all of its investment property in accordance with Ind AS 16's requirement for cost model

b. If it meets the criteria to be classified as held for sale or are included in a disposal group that is classified as held for sale in accordance with Ind AS 105

Entities are required to measure the fair value of investment property, for the purpose of disclosure even though they are required to follow the cost model.

8. TRANSFERS :

An entity shall transfer a property to, or from, investment property when, and only when, there is a change in use.

a) commencement of owner-occupation, or of development with a view to owner-occupation, for a transfer from investment property to owner-occupied property;

Ind AS 40 ⟶ Ind AS 16

b) commencement of development with a view to sale, for a transfer from investment property to inventories;

Ind AS 40 ⟶ Ind AS 2

c) end of owner-occupation, for a transfer from owner-occupied property to investment property; or

Ind AS 16 ⟶ Ind AS 40

d) inception of an operating lease to another party, for a transfer from inventories to investment property.

Ind AS 2 ⟶ Ind AS 40

Transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes.

Question 15 – Moon Ltd.

Moon Ltd. has purchased a building on 1st April, 2011 at a cost of Rs.10 million. The building was used as a factory by the Moon Ltd and was measured under cost model. The expected useful life of the building is estimated to be 10 years. Due to decline in demand of the product, the Company does not need the factory anymore and has rented out the building to a third party from 1st April, 2015. On this date the fair value of the building is Rs.8 million. Moon ltd uses cost model for accounting of its investment property.

9. DISPOSALS :

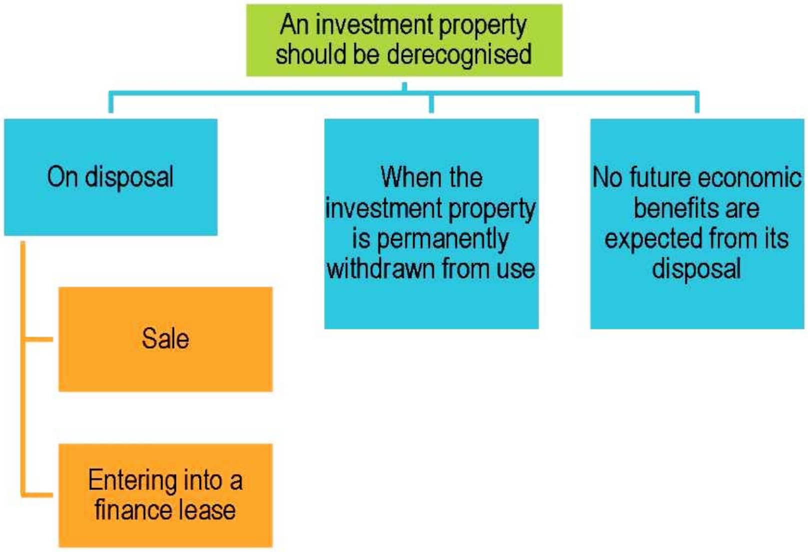
1) An investment property should be derecognised (eliminated from the balance sheet)
   a. on disposal or
   b. when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.
2) The disposal of an investment property may be achieved by:
   a. sale or
   b. entering into a finance lease.
3) Gains or losses arising from the retirement or disposal of investment property should be calculated as the difference between the net disposal proceeds and the carrying amount of the asset and is recognised in profit or loss (unless Ind AS 17 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.

Question 16 – Sun Ltd.

Sun Ltd., an aeronautics company is having a building which is given on an operating lease. The book value of such building in the books is Rs.2,00,000.

Case -A

Pluto Ltd. offers to buy the building at Rs.4,00,000.
Case – B
Pluto Ltd. offers to take the building on finance lease for 10 years at a lease rental of Rs.80,000 p.a. The present value of minimum lease payments is Rs.3,20,000.



10. DISCLOSURE :

An entity should disclose:

1) its accounting policy for measurement of investment property.
2) the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business.
3) the extent to which the fair value of investment property (as measured for disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.
4) the amounts recognised in profit or loss for:
   a) rental income from investment property;
   b) direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period; and
   c) direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period.
5) the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.
6) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.
7) In addition to the general disclosures required above, an entity is required to disclose:
   a) the depreciation methods used;
   b) the useful lives or the depreciation rates used;
   c) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period;

8) An entity is also required to disclose the fair value of investment property. In the exceptional cases when an entity cannot measure the fair value of the investment property reliably, it should disclose:

a) a description of the investment property;

b) an explanation of why fair value cannot be measured reliably; and

c) if possible, the range of estimates within which fair value is highly likely to lie.

11. SELF PRACTICE QUESTIONS :

Question 17 – On April 1, 2011

On April 1, 2011 an entity acquired an investment property (building) for Rs.40,00,000. Management estimates the useful life of the building as 20 years measured from the date of acquisition. The residual value of the building is Rs.2,00,000. Management believes that the straight-line depreciation method reflects the pattern in which it expects to consume the building's future economic benefits. What is the carrying amount of the building on March 31, 2012?

Question 18 – T Limited

T Limited has an investment property (building) which is carried in Balance Sheet on March 31, 2011 at Rs.15,00,000. During the year T Limited has stopped letting out the building and used it as its office premise. On March 31, 2011, management estimates the recoverable amount of the building as Rs.10,00,000 and its remaining useful life as 20 years and residual value is nil. How should T Limited account for the above investment property as on March 31, 2011?

Question 19 – X Limited

In financial year 2011-2012, X Limited incurred the following expenditure in acquiring property consisting of 6 identical houses each with separate legal title including the land on which it is built.

The expenditure incurred on various dates is given below:

On April 1, 2011 - Purchase cost of the property Rs.1,80,00,000.

On April 1, 2011 – Non-refundable transfer taxes Rs.20,00,000 (not included in the purchase cost).

On April 2, 2011- Legal cost related to property acquisition Rs.5,00,000.

On April 6, 2011- Advertisement campaign to attract tenants Rs.3,00,000.

On April 8, 2011 - Opening ceremony function for starting business Rs.1,50,000.

Throughout 2011-2012, incurred Rs.1,00,000 towards day-to-day repair maintenance and other administrative expenses.

X Limited uses one of the six houses for office and accommodation of its few staffs. The other five houses are rented to various independent third parties.

How X Limited will account for all the above mentioned expenses in the books of account?

Question 20 – X Ltd

X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 20X1, X Ltd. purchased a large property (consisting of land) for Rs. 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were Rs. 20,00,000. On 31st March, 20X5, the fair value of the property was Rs. 2,60,00,000. Under the terms of the lease, Y Ltd. was able to cancel the lease by giving six months' notice in writing to X Ltd. Y Ltd. gave this notice on 31st March, 20X5 and vacated the property on 30th September, 20X5. On 30th September, 20X5, the fair value of the property was Rs. 2,90,00,000. On 1st October, 20X5, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X Ltd. spent a total of Rs. 60,00,000 on this conversion project between 30th September, 20X5 to 31st March, 20X6. The project was incomplete at 31st March, 20X6 and the directors of X Ltd. estimate that they need to spend a further Rs. 40,00,000 to complete the project, after which each flat could be sold for Rs. 50,00,000.
Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 20X6 as per Ind AS.

Question 21 – Shaurya Limited

Shaurya Limited owns a Building A which is specifically used for the purpose of earning rentals. The Company has not been using the building A or any of its facilities for its own use for a long time. The company is also exploring the opportunities to sell the building if it gets the reasonable amount in consideration.
Following information is relevant for Building A for the year ending 31st March, 20X2:
Building A was initially purchased at the cost of Rs. 10 crores. At that time, the useful life of the building was estimated to be 20 years; out of which 5 years have been expired as on 1st April, 20X1. The company follows straight line method for depreciation.
During the year, the company has invested in another Building B with the purpose to hold it for capital appreciation. The property was purchased on 1st April, 20X1 at the cost of Rs. 2 crores. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation.
Further, during the year 20X1-20X2 the company earned/incurred following direct operating expenditure relating to Building A and Building B:

Rental income from Building A	= Rs. 75 lakhs
Rental income from Building B	= Rs. 25 lakhs
Sales promotion expenses	= Rs. 5 lakhs
Fees & Taxes	= Rs. 1 lakhs
Ground rent	= Rs. 2.5 lakhs
Repairs & Maintenance	= Rs. 1.5 lakhs
Legal & Professional	= Rs. 2 lakhs

Commission and brokerage = Rs. 1 lakhs

The company does not have any restrictions and contractual obligations against Property - A and B. For complying with the requirements of Ind AS, the management sought an independent report from the specialists so as to ascertain the fair value of buildings A and B. The independent valuer has valued the fair value of property as per the valuation model recommended by International valuation standards committee. Fair value has been computed by the method by streamlining present value of future cash flows namely, discounted cash flow method.

The other key inputs for valuation are as follows:

The estimated rent per month per square feet for the period is expected to be in the range of Rs. 50 - Rs. 60. And it is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.

Assume that the fair value of properties based on discounted cash flow method is measured at Rs. 10.50 crores. The treatment of fair value of properties is to be given in the financials as per the requirements of Indian accounting standards.

What would be the treatment of Building A and Building B in the balance sheet of Shaurya Limited? Provide detailed disclosures and computations in line with relevant Indian accounting standards. Treat it as if you are preparing a separate note or schedule, of the given assets in the balance sheet.

Question 22 – X Ltd.

X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1? During June 20X1, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 20X2

(a) How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?

(b) Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?

(c) Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?

(d) Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 20X2?

Thanks ....

CHAPTER

6

IND AS 38 – INTANGIBLE ASSETS

CONCEPTS COVERED

1. OBJECTIVE
2. SCOPE
3. IDENTIFICATION OF INTANGIBLE ASSETS
   - MEANING OF INTANGIBLE ASSETS
   - IDENTIFICATION
   - TANGIBLE ASSETS
4. RECOGNITION OF INTANGIBLE ASSETS
5. MEASUREMENT OF INTANGIBLE ASSETS
6. RECOGNITION OF AN EXPENSE
7. SUBSEQUENT MEASUREMENT
8. USEFULL LIFE
9. INTANGIBLE ASSET WITH FINITE USEFULL LIVES
10. INTANGIBLE ASSET WITH INFINITE USEFUL LIVES
11. IMPAIRMENT
12. RETIREMENT AND DISPOSAL
13. SELF PRACTICE QUESTIONS

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1. OBJECTIVE :

The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognise an intangible asset if, and only if, specified criteria are met. This standard specifies the requirement of recognition, measurement and disclosures of Intangible Assets.

The Standard states that intangible assets are initially measured at cost, subsequently measured at cost or using the revaluation model, and amortised on a systematic basis over their useful lives unless the asset has an indefinite useful life, in which case it is not amortised.

2. SCOPE :

This standard is applied to all intangible assets. except

- Intangible Assets which are within the scope of other standard like
- Intangible assets held for sale in ordinary course of business (IND AS 2)
- Deferred tax Assets (IND AS 12)
- Leases (IND AS 17)
- Assets arising from employee benefits (IND AS 19)
- Financial Assets (IND AS 32)
- Goodwill arising from Business Combination (IND AS 103)
- Deferred acquisition costs and intangible assets arising from insurance cost (IND AS 104)
- Non current intangible assets held for sale (IND AS 105)
- Exploration for and Evaluation of Mineral Resources (IND AS 106)
- Assets arising from contracts with customers (IND AS 115)

Intangible assets contained in or on a physical substance :

Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a license or patent) or film. In determining whether an asset that incorporates both tangible and intangible elements should be treated under Ind AS 16, Property, Plant and Equipment, or as an intangible asset under this Standard, an entity uses judgement to assess which element is more significant.

For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

Intangible assets on leases :

In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard. Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are excluded from the scope of Ind AS 17, and are within the scope of this Standard

For example, Pluto Ltd acquired some 'rights' from Mercury Ltd on lease for a period of 15 years. Mercury Ltd has accounted for such rights as an Intangible Assets. Mercury Ltd has estimated that the future economic benefits will be received by the entity for 15 years. At the time of initial recognition, Pluto (the lessee) will recognise such finance lease in accordance with the provisions given in Ind AS 17, Leases. After Initial recognition, such lease for intangibles will be accounted for in the books of Pluto Ltd in accordance with Ind AS 38, Intangible Assets.

Intangible assets used in the extractive and insurance industries :

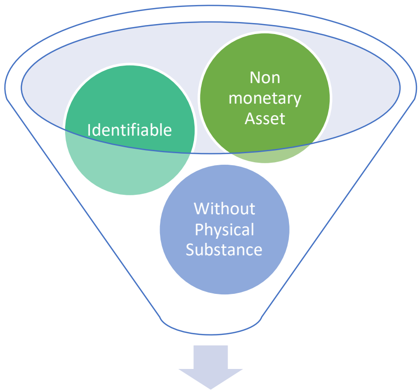
This Standard does not apply to expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of insurance contracts. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries or by insurers.

3. IDENTIFICATION OF INTANGIBLE ASSETS :

3.1. MEANING OF INTANGIBLE ASSETS :

An intangible asset is an

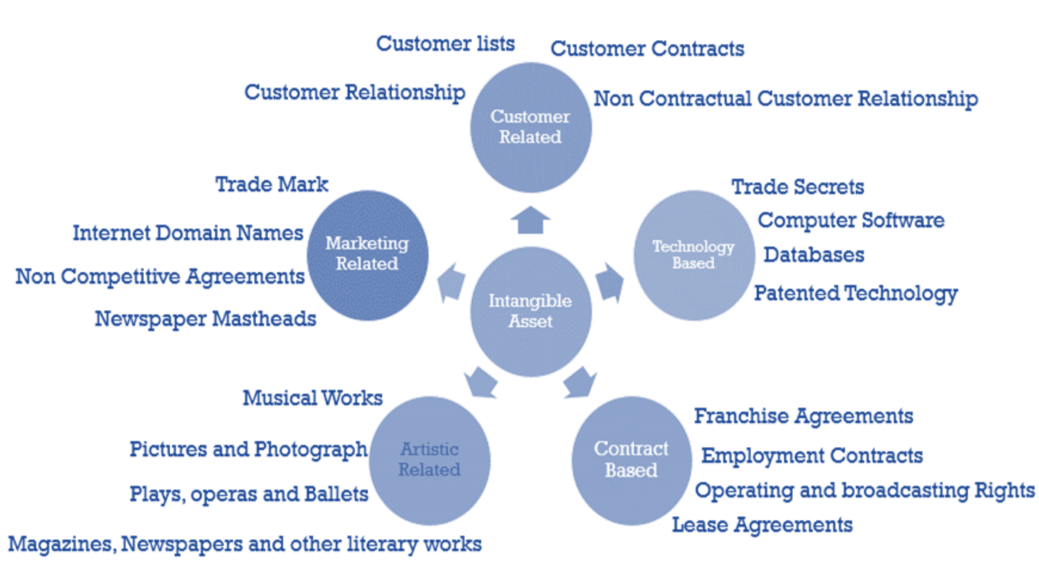
- identifiable
- non-monetary asset without physical substance



Intangible Asset

Common examples of items encompassed by these broad headings are:

- Computer software
- Patents
- Copyrights
- Motion picture films
- Customer lists
- Mortgage servicing rights
- Fishing licenses
- Import quotas
- Franchises
- Customer or supplier relationships
- Customer loyalty
- Market share and marketing rights.
- Intangible

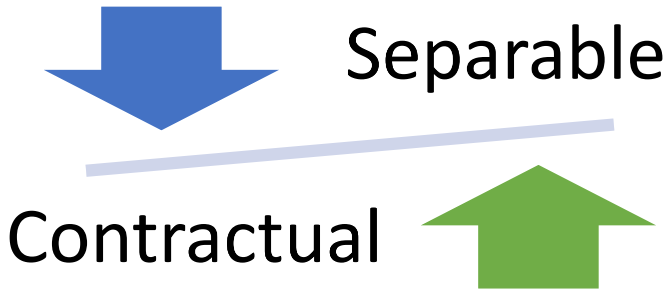


Not necessarily all of the above item meet the conditions of recognizing as an Intangible Assets within purview of this standard:

- Identifiability
- Control over a Resource (Asset) and
- Existence of Future Economic Benefits

Note: If an item within the scope of this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date.

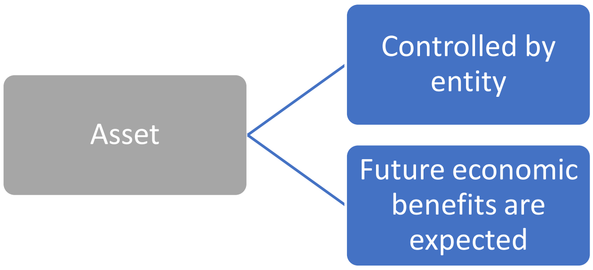
3.2 IDENTIFICATION :



Question 1 – Sun Ltd.

Sun Ltd has an expertise in consulting business. In past years, company has gained a market share for its services of 30 percent and considers recognizing it as an intangible asset. Is the action by company is justified?

3.2 TANGIBLE ASSETS :



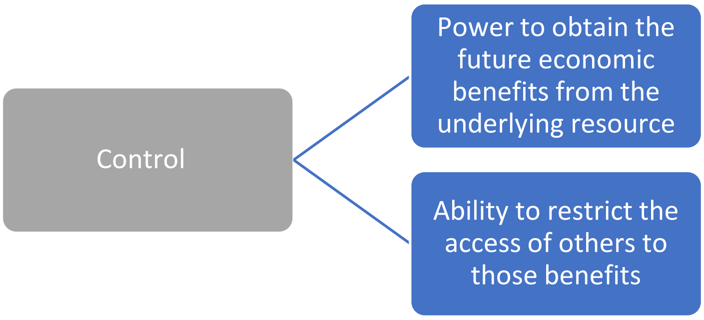
An asset is a

(a) resource:

(b) controlled by an entity

(c) as a result of past events; and

(d) from which future economic benefits are expected to flow to the entity.



An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law.

Example :

An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (e.g. portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets

Question 2 – Company XYZ Ltd.

Company XYZ Ltd. has provided training to its staff on various new topics like GST, Ind AS etc. to ensure the compliance as per the required law. Can the company recognise such cost of staff training as intangible asset?

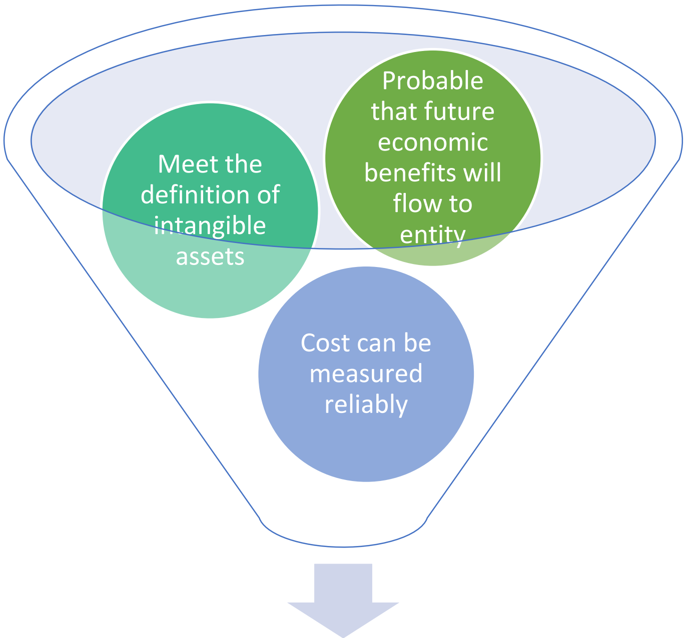
The future economic benefits flowing from an intangible asset may include:

(a) Revenue from the sale of products or services;

(b) Cost savings; or

Other benefits resulting from the use of the asset by the entity.

4. RECOGNITION OF INTANGIBLE ASSETS :



Intangible Asset - Recognition Criteria

Question 3 – Pluto Ltd.

Pluto Ltd. intends to open a new retail store in a new location in the next few weeks. Pluto Ltd has spent a substantial sum on a series of television advertisements to promote this new store. The Company has paid an amount of Rs.800,000 for advertisements before 31st March, 2011. Rs.700,000 of this sum relates to advertisements shown before 31st March, 2011 and Rs.100,000 to advertisements shown in April, 2011. Since 31st March, 2011. The Company has paid for further advertisements costing Rs.400,000. Pluto Ltd is of view that such costs can be carried forward as intangible assets. Since market research indicates that this new store is likely to be highly successful. Please explain and justify the treatment of the above costs in the financial statements for the year ended 31st March, 2011

Question 4 – Mercury Ltd.

Mercury Ltd. is preparing its accounts for the year ended 31st March, 2012 and is unsure about how to treat the following items.

(a) The company completed a grand marketing and advertising campaign costing Rs.4.8 lakh. The finance director had authorised this campaign on the basis that it would create Rs.8 lakh of additional profits over the next three years.

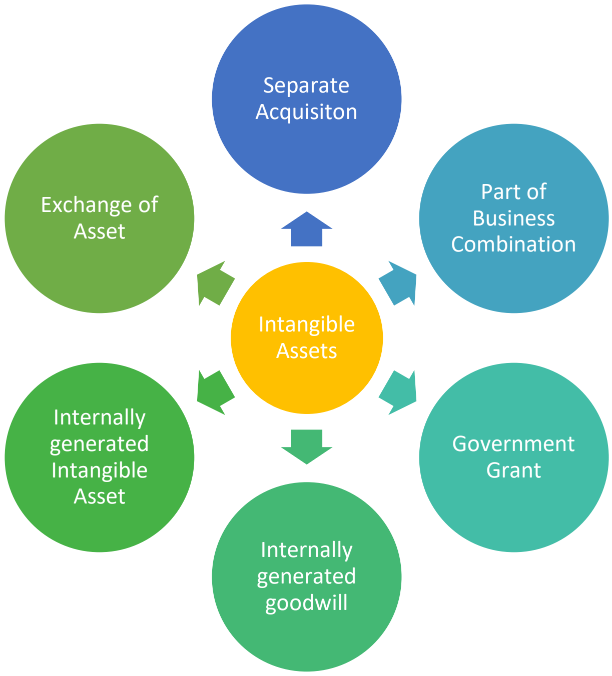
(b) A new product was developed during the year. The expenditure totaled Rs.3 lakh of which Rs.1.5 lakh was incurred prior to 30th September, 2011, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at Rs.1.4 lakh.

(c) Staff participated in a training programme which cost the company Rs.5 lakh. The training organisation had made a presentation to the directors of the company outlining that incremental profits to the business over the next twelve months would be Rs.7 lakh.

What amounts should appear as intangible assets in accordance with Ind AS 38 and Ind AS 36 in Mercury's balance sheet as on 31st March, 2012?

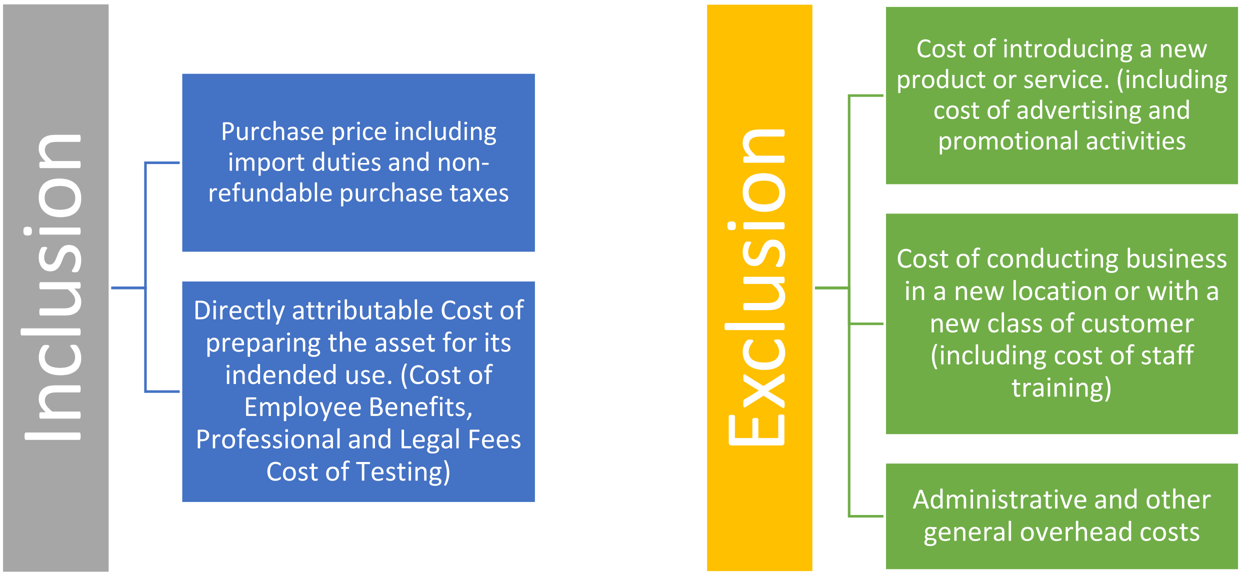
5. MEASUREMENT OF INTANGIBLE ASSETS :

An intangible asset should be measured initially at cost.



Generally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits associated with asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow.

SEPARATE ACQUISITION :



Question 5 – Jupiter Ltd.

Jupiter Ltd. Acquires new energy efficient technology that will significantly reduce its energy costs for manufacturing

1. Costs of new solar technology – 10,00,000
2. Trade discount provided – (1,00,000)
3. Training course for staff in new technology – 50,000
4. Initial testing of new technology – 35,000
5. Losses incurred while other parts of plant shut down during testing and training – 25,000

Calculate the amount of Intangible Asset.

Question 6 – Venus India Private Ltd.

Venus India Private Ltd acquired a software for its internal use costing Rs.10,00,000. The amount payable for the software was Rs.600,000 immediately and Rs.400,000 in one year time. The other expenditure incurred were:-

- Purchase tax : Rs.1,00,000
- Entry Tax : 10% (recoverable later from tax department)
- Legal fees: Rs.87,000
- Consultancy fees for implementation : Rs.1,20,000
- Cost of capital of the company is 10%.

Calculate the cost of the software on initial recognition using the principles of Ind AS 38 Intangible Assets.

PART OF BUSINESS COMBINATION :

An acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination

If an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset.

Question 7 – Business Combination

Business Combination On 31st March, 20X1, Earth India Ltd paid Rs.50,00,000 for a 100% interest in Sun India Ltd. At that date Sun Ltd's. net assets had a fair value of Rs.30,00,000.

In addition, Sun Ltd also held the following rights:

Trade Mark named "GRAND" – valued at Rs.180,000 using a discounted cash flow technique.

Sole distribution rights to an electronic product. Future cash flows from which are estimated to be Rs.150,000 per annum for the next 6 years.

10% is considered an appropriate discount rate.

The 6 year, 10% annuity factor is 4.36.

Calculate goodwill and other Intangible assets arising on acquisition.

GOVERNMENT GRANT :

In accordance with Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, an entity should recognise both the intangible asset and the grant initially at fair value.

EXCHANGE OF ASSETS :

One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets.

1. The cost of such an intangible asset is measured at fair value
2. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

No intangible asset can be recognised unless its cost can be measured reliably. If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost. However, if the fair value of the asset received is more clearly evident, then fair value of the asset received is taken up as cost.

Question 8 – Sun Ltd.

Sun Ltd. acquired a software from Earth Ltd. in exchange for a telecommunication license. The telecommunication license is carried at Rs.5,00,000 in the books of Sun Ltd. The Software is carried at Rs.10,000 in the books of the Earth Ltd which is not the fair value.

Advise journal entries in the following situations in the books of Sun Ltd and Earth Ltd:-

1) Fair value of software is Rs.5,20,000 and fair value of telecommunication license is Rs.5,00,000.

2) Fair Value of Software is not measureable. However similar Telecommunication license is transacted by another company at Rs.4,90,000.
3) Neither Fair Value of Software nor Telecommunication license could be reliably measured.

INTERNALLY GENERATED GOODWILL :

This standard prohibits the recognition of internally generated goodwill as an asset.

Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (i.e. it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.

INTERNALLY GENERATED INTANGIBLE ASSET :

It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

1. identifying whether and when there is an identifiable asset that will generate expected future economic benefits; and
2. determining the cost of the asset reliably.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, this standard includes additional recognition criteria for internally generated intangible assets which expand on the general recognition criteria.

To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:

1. a research phase; and
2. a development phase.

If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the entity treats the expenditure on that project as if it were incurred in the research phase only.

Research phase :

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

- No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.
- In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is recognised as an expense when it is incurred.

Examples of research activities are :

- activities aimed at obtaining new knowledge;

- the search for, evaluation and final selection of, applications of research findings or other knowledge;
- the search for alternatives for materials, devices, products, processes, systems or services; and
- the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development Phase :

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an entity can demonstrate all of the following:

1. Technical feasibility of completion of Intangible asset to make it available for use or sale
2. Intention to complete the intangible asset and use or sell it
3. Ability to use or sell the intangible asset.
4. How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
5. Adequate resources (like technical, financial or others) to complete the development.
6. Ability to measure reliably the expenditure attributable to the intangible asset during its development.

Inclusion

The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management.

- Costs of materials and services used or consumed in generating the intangible asset
- Costs of employee benefits (as defined in BAS 19) arising from the generation of the intangible asset
- Fees to register a legal right
- Amortisation of patents and licences that are used to generate the intangible asset

This standard prohibits reinstatement of expenditure previously recognised as an expense.

Exclusion

- selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;
- identified inefficiencies and initial operating losses incurred before the asset achieves planned performance; and
- expenditure on training staff to operate the asset.

Question 9 – Venus Ltd.

Venus Ltd. is preparing its accounts for the year ended 31st March, 2012 and is unsure how to treat the following items.

- Company has completed a big marketing and advertising campaign costing Rs.2,40,000. The finance director had authorized this campaign on the basis that it would create Rs.5,00,000 of additional profits over the next three years.
- A new product was developed during the year. The expenditure totaled Rs.1,50,000 of which Rs.1,00,000 was incurred prior to 30th September, 20X1, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at Rs.70,000.
- Staff participated in a training programme which cost the company Rs.300,000. The training organization had made a presentation to the directors of Baxter outlining that incremental profits to the business over the next twelve months would be Rs.500,000.

What amounts should appear as assets in Venus Ltd. Balance sheet as at 31st March, 2012?

Question 10 – Venus Ltd.

Development Phase Expenditure on a new production process in 2011-2012:

	Rs.
1st April to 31st December	2,700
1st January to 31st March	900
	3,600

The production process met the intangible asset recognition criteria for development on 1st January, 2012. The amount estimated to be recoverable from the process is Rs.1,000.

What is the carrying amount of the intangible asset at 31st March, 2012 and the charge to profit or loss for 2011-2012?
Expenditure incurred in FY 2012-2013 is Rs.6,000.
At 31st March, 2013, the amount estimated to be recoverable from the process (including future cash outflows to complete the process before it is available for use) is Rs.5,000.
What is the carrying amount of the intangible asset at 31st March, 2013 and the charge to profit or loss for 2012-2013?

6. RECOGNITION OF AN EXPENSE :

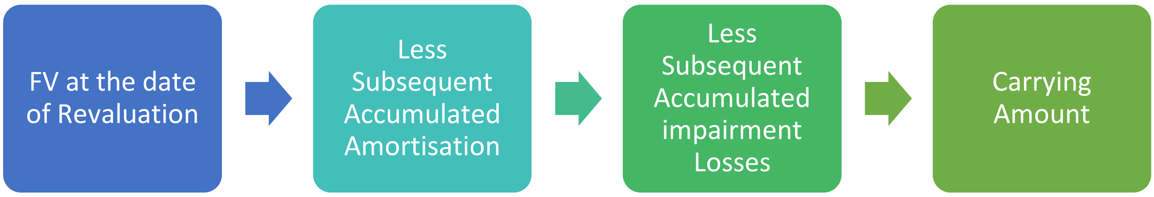
Expenditure on an intangible item should be recognised as an expense when it is incurred unless:
it forms part of the cost of an intangible asset that meets the recognition criteria; or
the item is acquired in a business combination and cannot be recognised as an intangible asset. In such case, it forms part of the amount recognised as goodwill at the acquisition date.
This standard states that the following types of expenditure should always be recognised as an expense:

1. expenditure on research (except when it is acquired as part of a business combination);
2. expenditure on start-up activities (i.e. start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment in accordance with Ind AS 16. Startup costs may consist of:
   a. establishment costs such as legal and secretarial costs incurred in establishing a legal entity;
   b. expenditure to open a new facility or business (i.e. pre-opening costs);
   c. expenditures for starting new operations or launching new products or processes (i.e. pre-operating costs);
3. expenditure on training activities;
4. expenditure on advertising and promotional activities (including mail order catalogues); and
5. expenditure on relocating or reorganising part or all of an entity

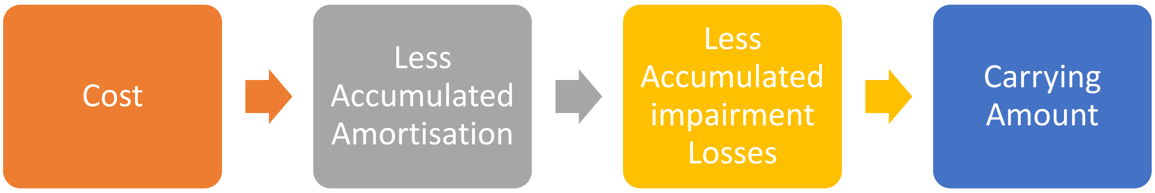
7. SUBSEQUENT MEASUREMENT :

An entity should choose either the **cost model** or the **revaluation model** as its accounting policy.

Revaluation Model : After initial recognition, an intangible asset is carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.



Cost Model : After initial recognition, an intangible asset is carried at its cost less any accumulated amortization and any accumulated impairment losses.



Frequency of revaluations :

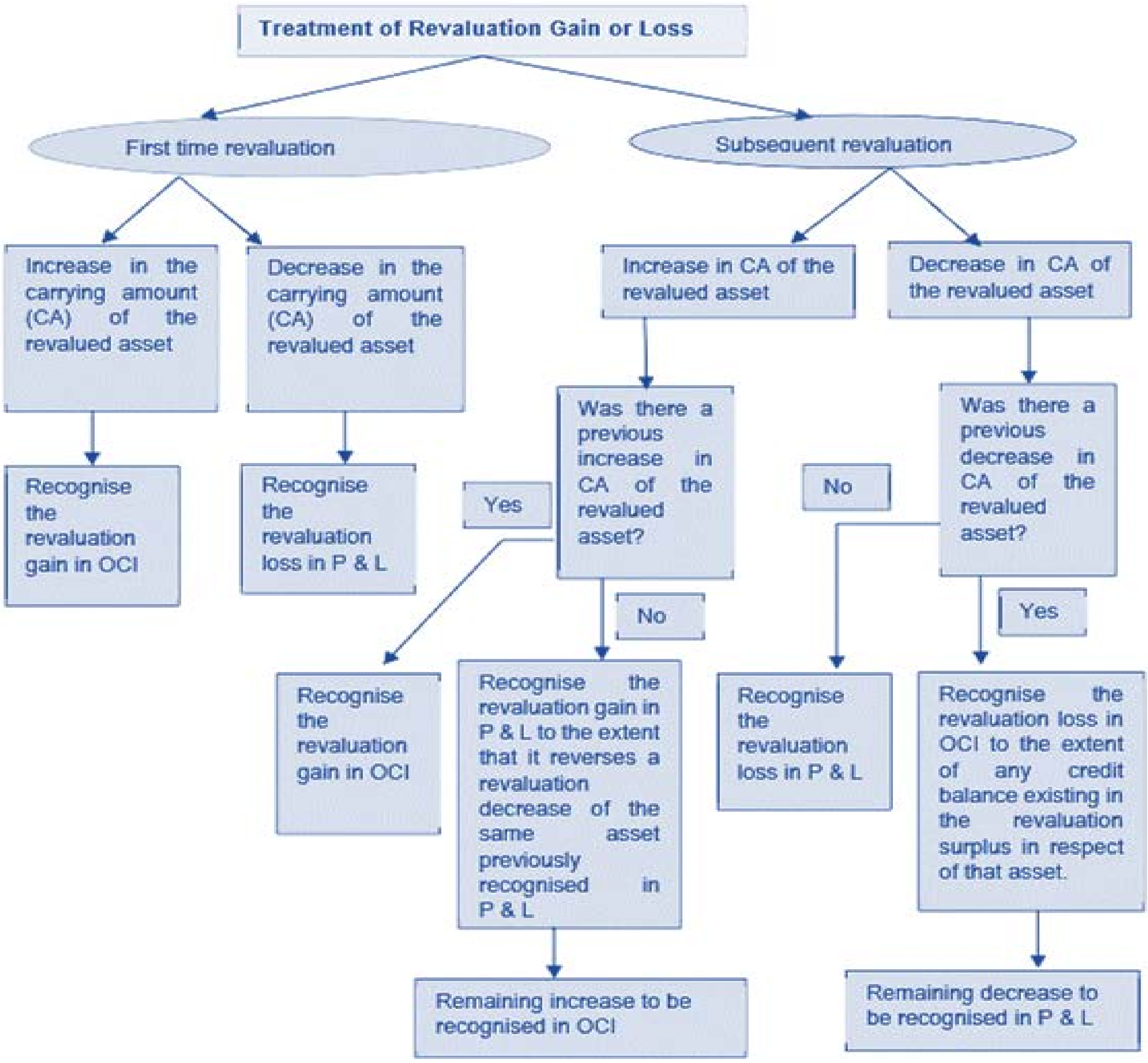
1. Revaluations should be made with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value.
2. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.

Scope of revaluations :

1. If an intangible asset is accounted for using the revaluation model, all the other assets in its class should also be accounted for using the same model, unless there is no active market for those assets.
2. If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset is carried at its cost less any accumulated amortisation and impairment losses.

Treatment of surplus or deficit arising on revaluation :

1. If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.
2. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.
3. If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss.
4. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.



Question 11 – Saturn Ltd.

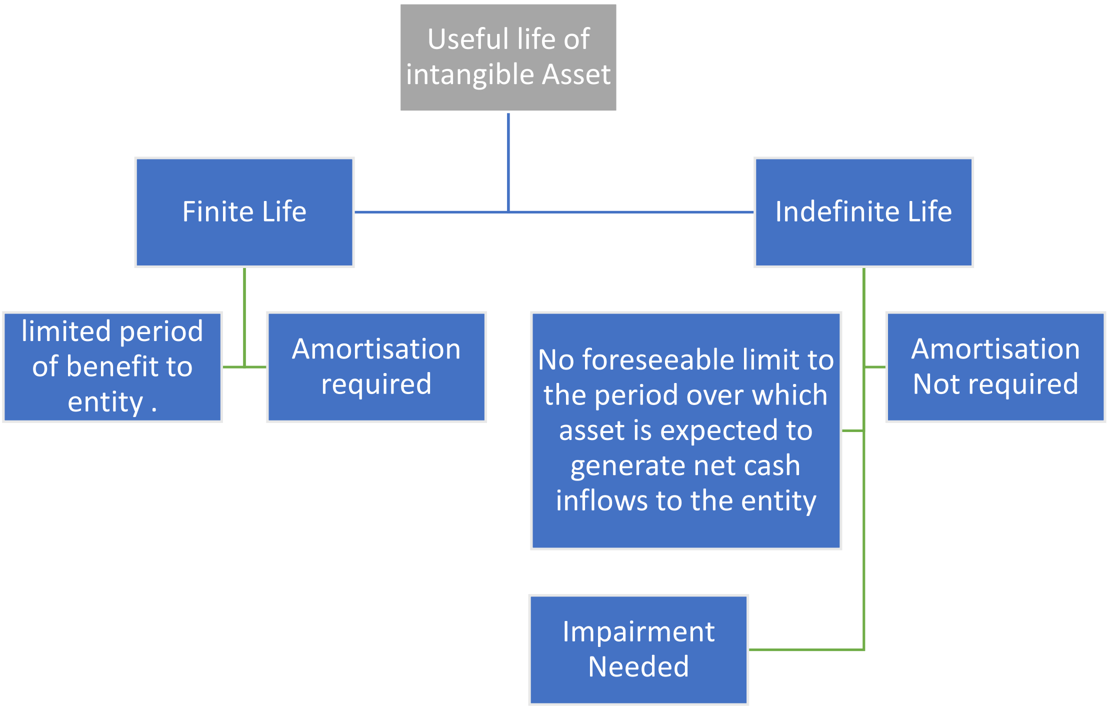
1. Saturn Ltd. acquired an intangible asset on 31st March, 2011 for Rs.1,00,000. The asset was revalued at Rs.1,20,000 on 31st March, 2012and Rs.85,000 on 31st March, 2013.
2. Jupiter Ltd. acquired an intangible asset on 31st March, 2011 for Rs.1,00,000. The asset was revalued at Rs.85,000 on 31st March, 2012 and at Rs.1,05,000 on 31st March, 2013.

Assuming that the year-end for both companies is 31st March, and that they both use the revaluation model, show how each of these transactions should be dealt with in the financial statements. Explain the treatment for revaluation of intangible asset. Ignore computation of amortization on them for ease of understanding.

At 31st March, 2013, the amount estimated to be recoverable from the process (including future cash outflows to complete the process before it is available for use) is Rs.5,000.

What is the carrying amount of the intangible asset at 31st March, 2013 and the charge to profit or loss for 2012-2013?

8. USEFULL LIFE :

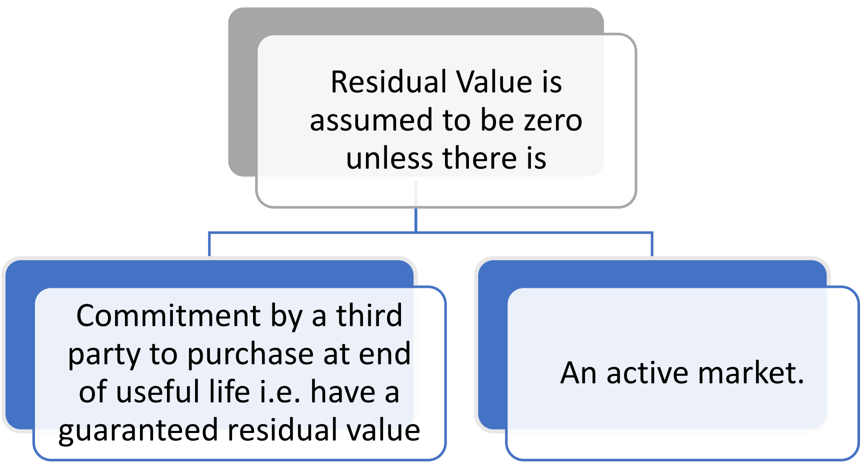


The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised, and an intangible asset with an indefinite useful life is not amortised and tested for impairment.

9. INTANGIBLE ASSET WITH FINITE USEFULL LIVES :

Depreciable amount :

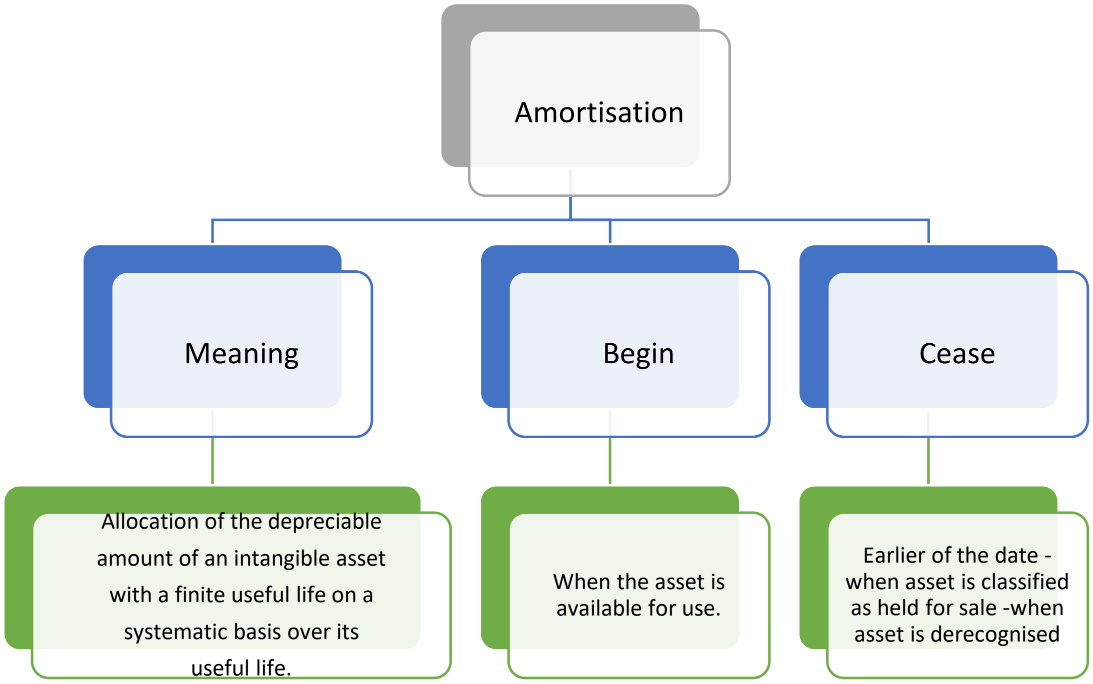
The depreciable amount of an intangible asset with a finite useful life is allocated on a systematic basis over its useful life. The depreciable amount of an asset is defined as the cost of an asset, or other amount substituted for cost, less its residual value.



Residual Value :

Review of amortisation period

The amortisation period for an intangible asset with a finite useful life should be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortization period should be changed accordingly. Such change is accounted for as a change in accounting estimates in accordance with Ind AS 8.



AMORTIZATION METHOD :

The amortisation method used should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method should be used.

A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method.

Example : An acquired customer list

A direct-mail marketing company acquires a customer list and expects that it will be able to derive benefit from the information on the list for at least one year, but no more than three years. The customer list would be amortised over management's best estimate of its useful life, say 18 months. Although the direct-mail marketing company may intend to add customer names and other information to the list in the future, the expected benefits of the acquired customer list relate only to the customers on that list at the date it was acquired. The customer list also would be reviewed for impairment in accordance with Ind AS 36, Impairment of Assets, by assessing at the end of each reporting period whether there is any indication that the customer list may be impaired.

Example : An acquired patent that expires in 15 years

The product protected by the patented technology is expected to be a source of net cash inflows for at least 15 years. The entity has a commitment from a third party to purchase that patent in five years for 60 per cent of the fair value of the patent at the date it was acquired, and the entity intends to sell the patent in five years.

The patent would be amortised over its five-year useful life to the entity, with a residual value equal to the present value of 60 per cent of the patent's fair value at the date it was acquired. It may be noted that the estimated useful life has to be considered with reference to the entity only though the total life of the patent is much higher i.e., 15 years. The patent would also be reviewed for impairment in accordance with Ind AS 36 by assessing at the end of each reporting period whether there is any indication that it may be impaired.

Example : An acquired copyright that has a remaining legal life of 50 years

An analysis of consumer habits and market trends provides evidence that the copyrighted material will generate net cash inflows for only 30 more years.

It needs to be noted that although the remaining legal life of the patent is 50 years, however the useful life from the entity's perspective is only 30 years. The copyright would be amortised over its 30-years estimated useful life. The copyright also would be reviewed for impairment in accordance with Ind AS 36 by assessing at the end of each reporting period whether there is any indication that it may be impaired.

Example A: An acquired broadcasting licence that expires in five years

The broadcasting licence is renewable every 10 years if the entity provides at least an average level of service to its customers and complies with the relevant legislative requirements. The licence may be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition. The acquiring entity intends to renew the licence indefinitely and evidence supports its ability to do so. Historically, there has been no compelling challenge to the licence renewal. The technology used in broadcasting is not expected to be replaced by another technology at any time in the foreseeable future. Therefore, the licence is expected to contribute to the entity's net cash inflows indefinitely.

The broadcasting licence would be treated as having an indefinite useful life because it is expected to contribute to the entity's net cash inflows indefinitely. Therefore, the licence would not be amortised until its useful life is determined to be finite. The licence would be tested for impairment in accordance with Ind AS 36 annually and whenever there is an indication that it may be impaired.

Example : The broadcasting licence in Example A

The licensing authority subsequently decides that it will no longer renew broadcasting licences, but rather will auction the licences. At the time the licensing authority's decision is made, the entity's broadcasting licence has three years until it expires. The entity expects that the licence will continue to contribute to net cash inflows until the licence expires.

Because the broadcasting licence can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired licence would be amortised over its remaining three-year useful life and immediately tested for impairment in accordance with Ind AS 36.

Example : An acquired airline route authority between two European cities that expires in three years

The route authority may be renewed every five years, and the acquiring entity intends to comply with the applicable rules and regulations surrounding renewal. Route authority renewals are routinely granted at a minimal cost and historically have been renewed when the airline has complied with the applicable rules and regulations. The acquiring entity expects to provide service indefinitely between the two cities from its hub airports and expects that the related supporting infrastructure (airport gates, slots, and terminal facility leases) will remain in place at those airports for as long as it has the route authority. An analysis of demand and cash flows supports those assumptions.

Because the facts and circumstances support the acquiring entity's ability to continue providing air service indefinitely between the two cities, the intangible asset related to the route authority is treated as having an indefinite useful life. Therefore, the route authority would not be amortised until its useful life is determined to be finite. It would be tested for impairment in accordance with Ind AS 36 annually and whenever there is an indication that it may be impaired.

Example : An acquired trademark used to identify and distinguish a leading consumer product that has been a market-share leader for the past eight years

The trademark has a remaining legal life of five years but is renewable every 10 years at little cost. The acquiring entity intends to renew the trademark continuously and evidence supports its ability to do so. An analysis of (1) product life cycle studies, (2) market, competitive and environmental trends, and (3) brand extension opportunities provides evidence that the trademarked product will generate net cash inflows for the acquiring entity for an indefinite period.

The trademark would be treated as having an indefinite useful life because it is expected to contribute to net cash inflows indefinitely. Though the remaining legal life is five years, the possibility that it can be renewed every ten years and the entity's intention to renew the same leads to the conclusion that the trademark has an indefinite useful life. Therefore, the trademark would not be amortised until its useful life is determined to be finite. It would be tested for impairment in accordance with Ind AS 36 annually and whenever there is an indication that it may be impaired.

Example : A trademark acquired 10 years ago that distinguishes a leading consumer product

The trademark was regarded as having an indefinite useful life when it was acquired because the trademarked product was expected to generate net cash inflows indefinitely. However,

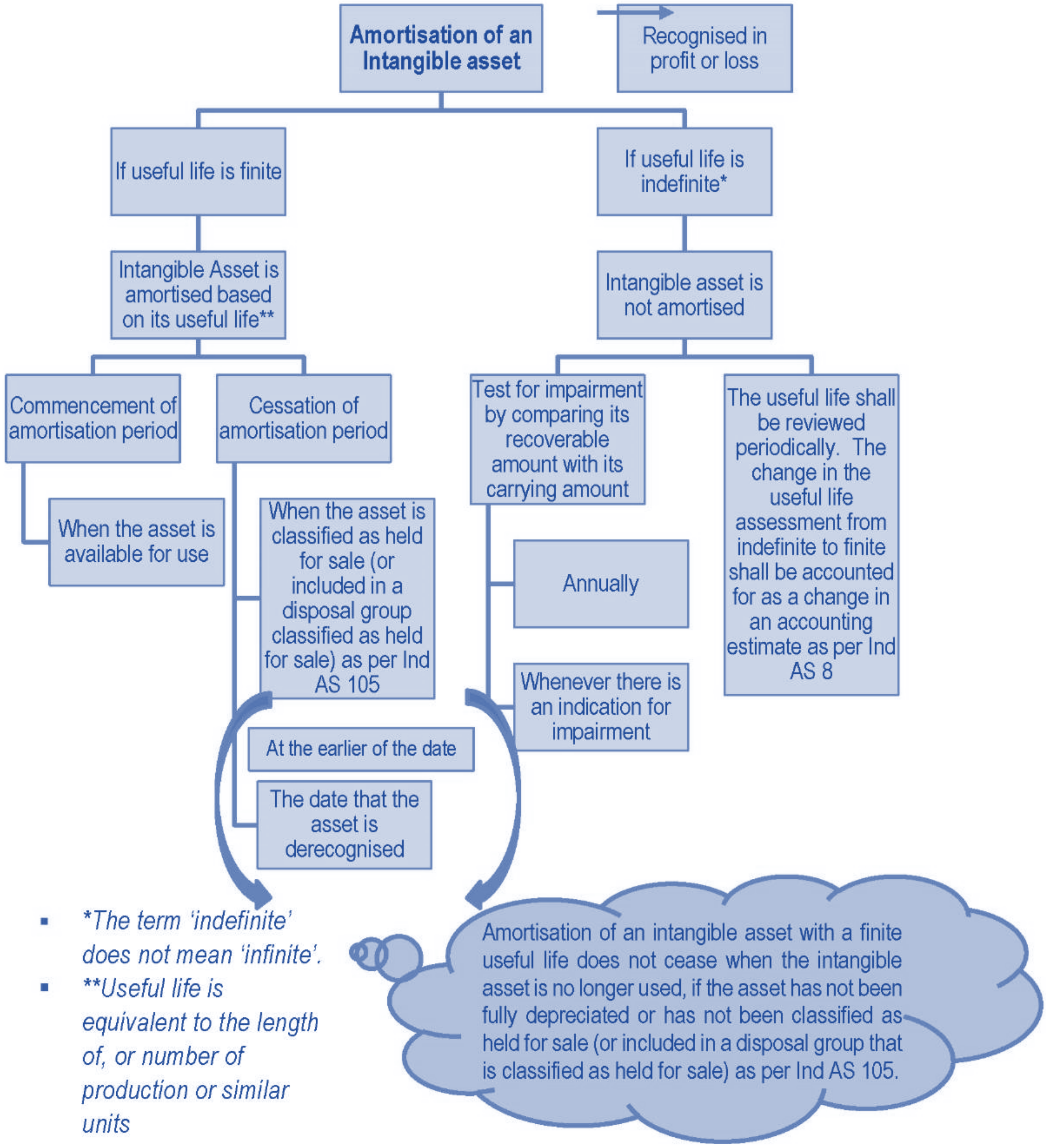
unexpected competition has recently entered the market and will reduce future sales of the product. Management estimates that net cash inflows generated by the product will be 20 per cent less for the foreseeable future. However, management expects that the product will continue to generate net cash inflows indefinitely at those reduced amounts.
As a result of the projected decrease in future net cash inflows, the entity determines that the estimated recoverable amount of the trademark is less than its carrying amount, and an impairment loss is recognised. Because it is still regarded as having an indefinite useful life, the trademark would continue not to be amortised but would be tested for impairment in accordance with Ind AS 36 annually and whenever there is an indication that it may be impaired.

Example : Trademark for a line of products that was acquired several years ago in a business combination
At the time of the business combination the acquiree had been producing the line of products for 35 years with many new models developed under the trademark. At the acquisition date the acquirer expected to continue producing the line, and an analysis of various economic factors indicated there was no limit to the period the trademark would contribute to net cash inflows. Consequently, the trademark was not amortised by the acquirer. However, management has recently decided that production of the product line will be discontinued over the next four years. Because the useful life of the acquired trademark is no longer regarded as indefinite, the carrying amount of the trademark would be tested for impairment in accordance with Ind AS 36 and amortised over its remaining four-year useful life.

10. INTANGIBLE ASSET WITH INFINITE USEFULL LIVES :

1. An intangible asset with an indefinite useful life should not be amortised.
2. In accordance with Ind AS 36, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount
   a. annually; and
   b. whenever there is an indication that the intangible asset may be impaired.
3. The useful life of an intangible asset that is not being amortised should be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate in accordance with Ind AS 8.

In accordance with Ind AS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with Ind AS 36, with its carrying amount, and recognising any excess of the carrying amount over the recoverable amount as an impairment loss.



11. IMPAIRMENT :

1. To determine whether an intangible asset is impaired, an entity applies Ind AS 36. That Standard explains when and how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.
2. For an intangible asset with indefinite useful lives, an impairment review is required at least annually.

12. RETIREMENTS AND DISPOSALS :

1. An intangible asset should be derecognised:
   a. on disposal; or
   b. when no future economic benefits are expected from its use or disposal The disposal of an intangible asset may occur in a variety of ways (e.g. by sale, by entering into a finance lease, or by donation)
2. The gain or loss arising from the derecognition of an intangible asset should be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It is to be recognised in profit or loss when the asset is derecognized (unless Ind AS 17 requires otherwise on a sale and leaseback). Gains should not be classified as revenue.

13. SELF PRACTICE QUESTIONS :

Question 12 – X Limited

X Limited engaged in the business of manufacturing fertilisers entered into a technical collaboration agreement with a foreign company Y Limited. As a result, Y Limited would provide the technical know-how enabling X Limited to manufacture fertiliser in a more efficient way. X Limited paid Rs.10,00,00,000 for the use of know-how for a period of 5 years. X Limted estimates the production of fertiliser as follows:

Year	**(In metric tons)**
1	50,000
2	70,000
3	1,00,000
4	1,20,000
5	1,10,000

At the end of the 1st year, it achieved its targeted production. At the end of 2nd year, 65,000 metric tons of fertiliser was being manufactured, and X Limited considered to revise the estimates for the next 3 years. The revised figures are 85,000, 1,05,000 and 1,15,000 metric tons for year 3, 4 & 5 respectively.
How will X Limited amortise the technical know-how fees as per Ind AS 38?

Question 13 – Y Ltd.

Y Ltd. purchased a patent right on April 1, 2011, for Rs.3,00,000; which has a legal life of 15 years. However, due to the competitive nature of the product, the management estimates a useful life of only 5 years. Straight-line amortisation is determined by the management to be the best method. As at April 1, 2012, management is uncertain that the process can actually be made economically feasible, and decides to write down the patent to an estimated market value of Rs.1,50,000 and decides to amortise over 2 years. As at April 1, 2013, having perfected the related production process, the asset is now appraised at a value of Rs.3,00,000. Furthermore, the estimated useful life is now believed to be 4 more years. Determine the value of intangible asset at the end of each financial year.

Question 14 – X Pharmaceutical Ltd.

X Pharmaceutical Ltd. seeks your opinion in respect of following accounting transactions:

1. Acquired a 4 year license to manufacture a specialised drug at a cost of Rs.1,00,00,000 at the start of the year. Production commenced immediately.
2. Also purchased another company at the start of year. As part of that acquisition the company acquired a brand with a FV of Rs.3,00,00,000 based on sales revenue. The life of the brand is estimated at 15 years.
3. Spent Rs.1,00,00,000 on an advertising campaign during the first six months. Subsequent sales have shown a significant improvement and it is expected this will continue for 3 years.
4. It has commenced developing a new drug 'Drug-A'. The project cost would be Rs.10,00,00,000. Clinical trial proved successful and such drug is expected to generate revenue over the next 5 years.
   Cost incurred (accumulated) till March 31, 2011 is Rs.5,00,00,000.
   Balance cost incurred during the financial year 2011-2012 is Rs.5,00,00,000.
5. It has also commenced developing another drug 'Drug B'. It has incurred Rs.50,00,000 towards research expenses till March 31, 2012. The technological feasibility has not yet been established. How the above transactions will be accounted for in the books of account of X Pharmaceutical Ltd?

Question 15 – X Ltd.

X Ltd. is engaged in the business of publishing Journals. They acquired 50% stake in Y Ltd., a company in the same industry. X Ltd. paid purchase consideration of Rs.10,00,00,000 and fair value of net asset acquired is Rs.8,50,00,000. The above purchase consideration includes:

A. Rs.30,00,000 for obtaining the skilled staff of Y Ltd.
B. Rs.50,00,000 by way of payment towards 'Non-compete Fee' so as to restrict Y Ltd. to compete in the same line of business for next 5 years.

How should the above transactions be accounted for by X Ltd?

Question 16 – Z Ltd.

Z Ltd. purchased a franchise from a restaurant chain at a cost of Rs.1,00,00,000 and the franchise has 10 years life. In addition, the franchise agreement mentions that the franchisee would also pay the franchisor royalty as a percentage of sales made. Can the franchise rights be treated as an intangible asset under Ind AS 38?

Question 17 – An entity

An entity regularly places advertisements in newspapers advertising its products and includes a reply slip that informs individuals replying to the advertisement that the entity may pass on the individual's details to other sellers of similar products, unless the individual ticks a box in the advertisement.

Over a period of time the entity has assembled a list of customers' names and addresses. The list is provided to other entities for a fee. The entity would like to recognise an asset in respect of the expected future economic benefits to be derived from the list. Can the customer list be treated as an intangible asset under Ind AS 38?

Question 18 – A software company X Ltd.

A software company X Ltd. is developing new software for the telecom industry. It employs 100 employs engineers trained in that particular discipline who are engaged in the development of the software. X Ltd. feels that it has an excellent HR policy and does not expect any of its employees to leave in the near future. It wants to recognise these set of engineers as a human resources asset in the form of an intangible asset. What would be your advice to X Ltd?

Question 19 – S Ltd.

S Ltd. has acquired a telecom license from Government to operate mobile telephony in two states of India. Can the cost of acquisition be capitalised as an intangible asset under Ind AS 38?

Question 20 – X Ltd.

X Ltd. purchased a standardised finance software at a list price of Rs.30,00,000 and paid Rs.50,000 towards purchase tax which is non refundable. In addition to this, the entity was granted a trade discount of 5% on the initial list price. X Ltd. incurred cost of Rs.7,00,000 towards customisation of the software for its intended use. X Ltd. purchased a 5 year maintenance contract with the vendor company of Rs.2,00,000. At what cost the intangible asset will be recognised?

Question 21 – P Ltd.

P Limited in a business combination, purchased the net assets of Q Limited for Rs.4,00,000 on March 31, 2011. The assets and liabilities position of Q Limited just before the acquisition is as follows:

Assets	Cost (in Rs)
Property, Plant & Equipment	1,00,000
Intangible asset 1	20,000
Intangible asset 2	50,000

Cash & Bank 1,30,000

Liabilities

Trade payable 50,000

The fair market value of the PPE, intangible asset 1 and intangible asset 2 is available and they are Rs.1,50,000, Rs.30,000 and Rs.70,000 respectively.

How would P Limited account for the net assets acquired from Q Limited?

Question 22 – R Ltd.

R Ltd. acquired S Ltd. on April 30, 2011. The purchase consideration is Rs.50,00,000. The fair value of the tangible assets is Rs.45,00,000. The company estimates the fair value of "in-process research projects" at Rs.10,00,000. No other Intangible asset is acquired by R Ltd. in the transaction. Further, cost incurred by R Ltd. in relation to that research project is as follows:

A. Rs.5,00,000 – as research expenses

B. Rs.2,00,000 – to establish technological feasibility

C. Rs.7,00,000 – for further development cost after technological feasibility is established.

At what amount the intangible asset should be measured under Ind AS 38?

Question 23 – X Ltd.

X Ltd. acquired a patent right of manufacturing drug from Y Ltd. In exchange X Ltd. gives its intellectual property right to Y Ltd. Current market value of the patent and intellectual property rights are Rs.20,00,000 and Rs.18,00,000 respectively. At what value patent right should be initially recognised in the books of X Ltd. in following two situations?

A. X Ltd. did not pay any cash to Y Ltd.

B. X Ltd. pays Rs.2,00,000 to Y Ltd.

Question 24 – X Garments Ltd.

X Garments Ltd. spent Rs.1,00,00,000 towards promotions for a fashion show by way of various on-road shows, contests etc.

After that event, it realised that the brand name of the entity got popular and resultantly, subsequent sales have shown a significant improvement. It is further expected that this hike will have an effect over the next 2-3 years.

How the entity should account for the above cost incurred on promoting such show?

Question 25 – An entity

An entity is developing a new production process. During 2011-2012, expenditure incurred was Rs.1,000, of which Rs.900 was incurred before March 1, 2012 and Rs.100

was incurred between March 1, 2012 and March 31, 2012. The entity is able to demonstrate that at March 1, 2012, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs.500.

During 2012-2013, expenditure incurred is Rs.2,000. At the end of 2013, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs.1,900.

Question 26 – T Ltd.

T Ltd. is engaged is developing computer software. The expenditures incurred by T Ltd. in pursuance of its development of software is given below:

A. Paid Rs.2,00,000 towards salaries of the program designers.

B. Incurred Rs.5,00,000 towards other cost of completion of program design.

C. Incurred Rs.2,00,000 towards cost of coding and establishing technical feasibility.

D. Paid Rs.7,00,000 for other direct cost after establishment of technical feasibility.

E. Incurred Rs.2,00,000 towards other testing costs.

F. A focus group of other software developers was invited to a conference for the introduction of this new software. Cost of the conference aggregated to Rs.70,000.

G. On March 15, 20X1, the development phase was completed and a cash flow budget was prepared.

Net profit for the year was estimated to be equal Rs.40,00,000. How T Ltd. should account for the above mentioned cost?

Question 27 – A Ltd.

A Ltd. has started developing a new production process in financial year 2011-2012. Total expenditure incurred till September 30, 2013, was Rs.1,00,00,000 . The expenditure on the development of the production process meets the recognition criteria on July 1, 2011. The records of A Ltd. show that, out of total Rs.1,00,00,000, Rs.70,00,000 were incurred during July to September, 2011. A Ltd. publishes its financial results quarterly. How A Ltd. should account for the development expenditure?

Question 28 – X Ltd.

X Ltd. decides to revalue its intangible assets on April 1, 2011. On the date of revaluation, the intangible assets stand at a cost of Rs.1,00,00,000 and accumulated amortization is Rs.40,00,000. The intangible assets are revalued at Rs.1,50,00,000. How should X Ltd. account for the revalued intangible assets in its books of account?

Question 29 – XYZ

One of the senior engineers at XYZ has been working on a process to improve manufacturing efficiency and, consequently, reduce manufacturing costs. This is a major project and has the full support of XYZ's board of directors. The senior engineer believes that the cost reductions will exceed the project costs within twenty four months of their implementation. Regulatory testing and health and safety approval was obtained on 1 June 20X5. This removed uncertainties concerning the project, which was finally completed on 20 April 20X6. Costs of Rs. 18,00,000, incurred during the year till 31st March 20X6, have been recognized as an intangible asset. An offer of Rs. 7,80,000 for the new developed technology has been received by potential buyer but it has been rejected by XYZ. Utkarsh believes that the project will be a major success and has the potential to save the company Rs. 12,00,000 in perpetuity. Director of research at XYZ, Neha, who is a qualified electronic engineer, is seriously concerned about the long term prospects of the new process and she is of the opinion that competitors would have developed new technology at some time which would require to replace the new process within four years. She estimates that the present value of future cost savings will be Rs. 9,60,000 over this period. After that, she thinks that there is no certainty about its future. What would be the appropriate accounting treatment of aforesaid issue?'

Thanks ....

CHAPTER

7

IND AS 105 – NON CURRENT ASSETS HELD FOR SALE & DISCONTINUED OPERATIONS

CONCEPTS COVERED

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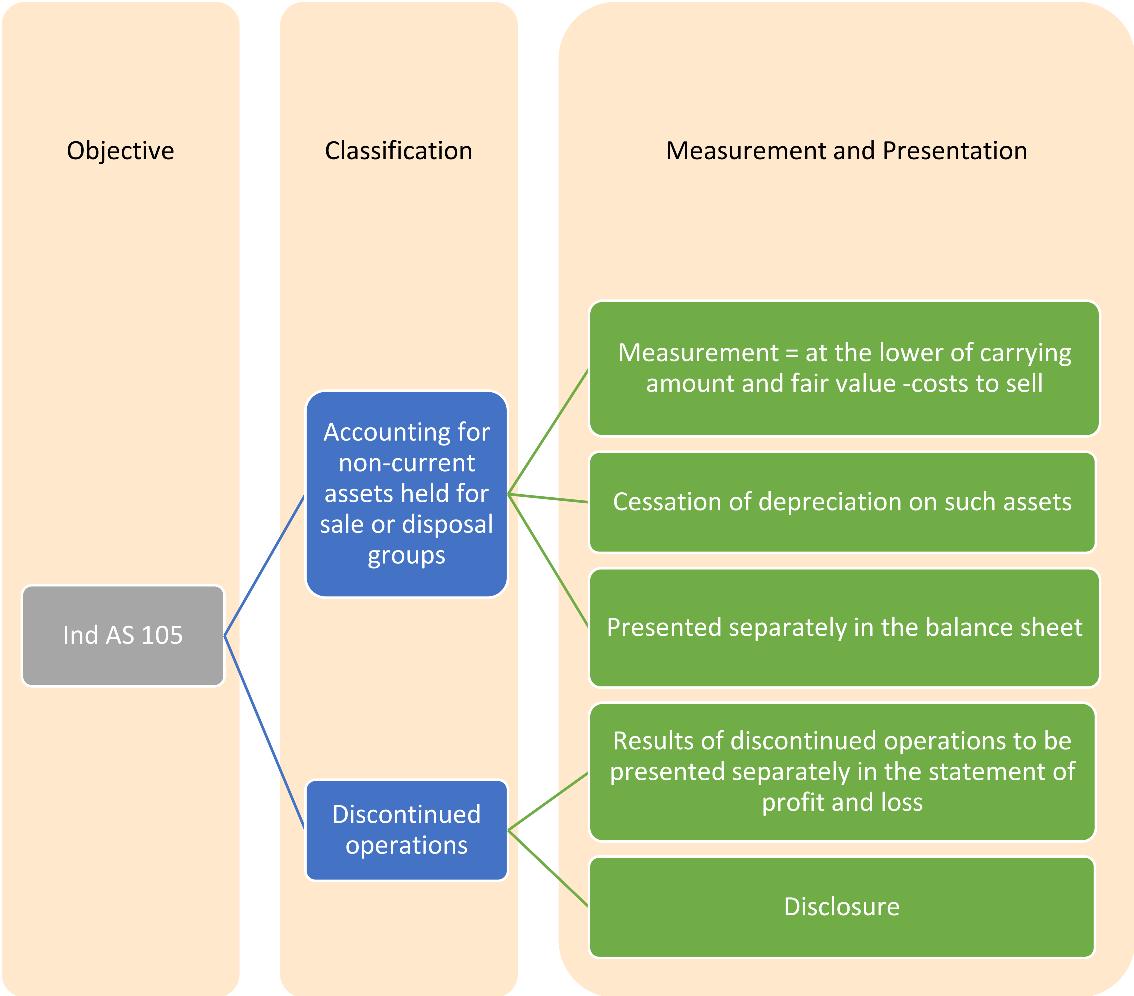
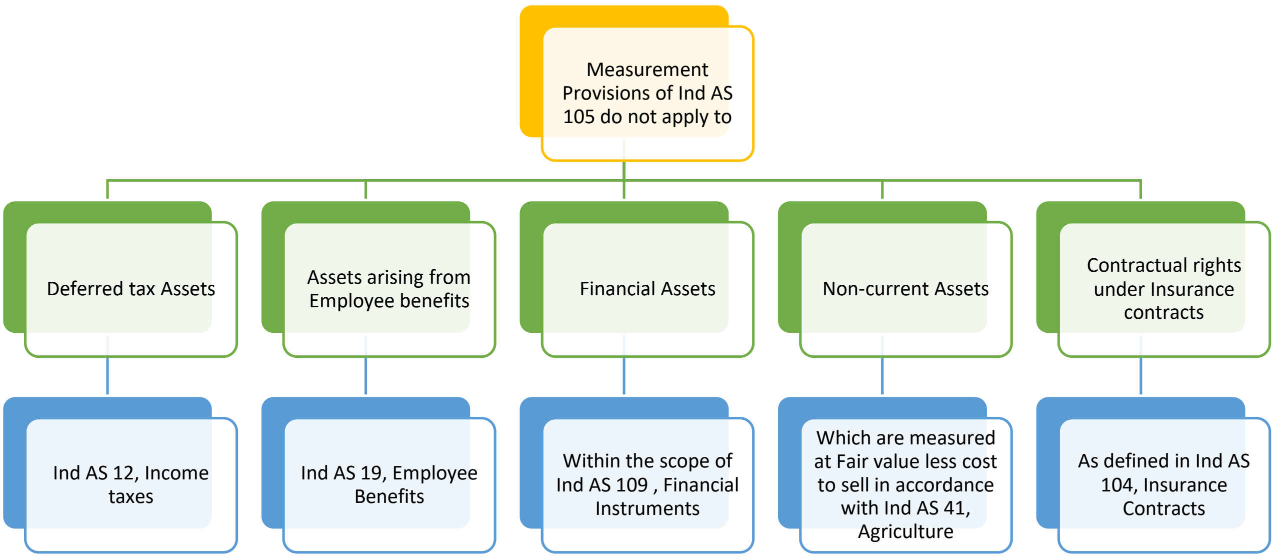
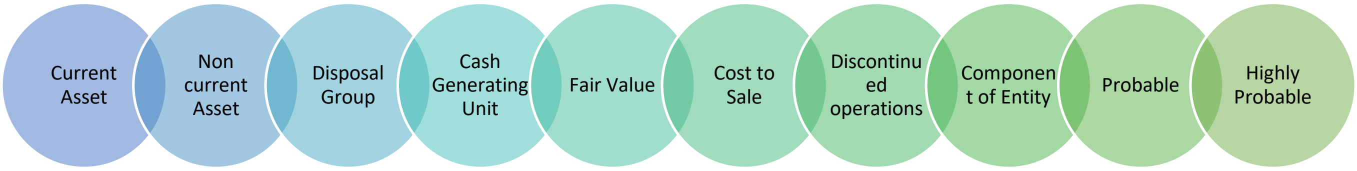
1. OBJECTIVE :



2. SCOPE :



3. DEFINITIONS :



1. Current Asset :

An entity classifies an asset as current when:

- it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;
- it holds the asset primarily for the purpose of trading;
- it expects to realise the asset within twelve months after the reporting period; or
- the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

2. Non current Asset :

Non-current assets are assets that do not meet the definition of current assets.

3. Disposal Group :

Disposal group is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. A disposal group may be a group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit.

4. Cash Generating Unit :

Cash-generating unit is a smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

5. Fair Value :

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (Ind AS 113)

6. Cost to Sale :

Costs to sell are the incremental costs directly attributable to the disposal of an asset (or disposal group), excluding finance costs and income tax expense.

7. Discontinued operations :

A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale and:

(a) represents a separate major line of business or geographical area of operations; or

(b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or

(c) is a subsidiary acquired exclusively with a view to resale.

8. **Component of Entity :**

A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

9. **Probable :**

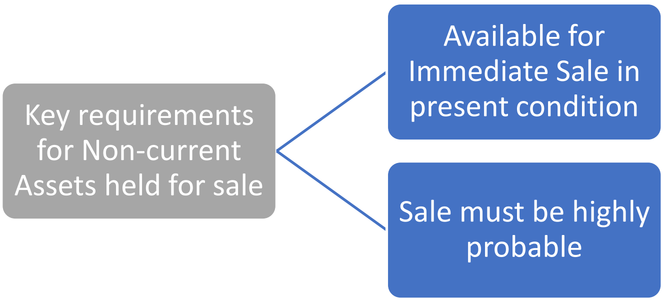
It means more likely than not.

10. **Highly Probable :**

Significantly more likely than probable.

4. CLASSIFICATION :

An entity is required to classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.



Available for Immediate Sale :

- The asset (or disposal group) must be available for immediate sale in its present condition. The terms that are usual and customary for sale of similar assets (or disposal group) doesn't disqualify to being classified as held for sale.
- An asset (or disposal group) cannot be classified as a non-current asset (or disposal group) held for sale, if the entity intends to sell it in a distant future.

Question 1 – Available for Immediate Sale

1. A property being used as a headquarters by the entity needs to be vacated before it can be sold. The time required to vacate the building is usual and customary for sale of such assets. Hence the criteria for classification as held for sale would be met.
2. In above example, if property can be vacated only after a replacement is available then this may indicate that the property is not available for immediate sale, but only after the replacement becomes available.
3. An entity can't classify a manufacturing facility as held for sale if prior to selling the facility it needs to clear a backlog of uncompleted order.
4. In above example, if entity intends to sell the manufacturing facility along with the uncompleted orders it can be classified as held for sale.
5. An entity plans to renovate some of its property to increase its value prior to selling it to a third party. The entity is already searching for a buyer at current

6. A company has put a property on the market and expects that all the conditions of classification as held for sale is meeting. Any buyer will undertake searches and valuations before making an offer and exchanging contracts : Such conditions are normal for properties and any delays that might arise from such legal processes do not preclude the property from being classified as held for sale.

market values. But due to the plans to renovate the property prior to sale, the property may not be meeting condition of available for immediate sale.

Sale must be highly probable :

This Standard defines 'highly probable' as 'significantly more likely than probable' where probable means more likely than not.

1.The appropriate level of management must be committed to a plan to sell the asset (or disposal group).

2. An active programme to trace a buyer and complete the selling plan must have been initiated.

3. The asset (or disposal group) must be marketed for sale at a price that is reasonable in relation to its current fair value.

4. The sale transaction is expected to be completed within one year from the date of classification.

5. Significant changes to or withdrawal from the plan to sell the asset are unlikely.

Loss of control in subsidiary :

An entity which has committed to a sale plan which involves loss of control of subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out above is met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale.

Exception to the period of one year :

An entity can still classify an asset (or disposal group) as held for sale, even if the timeframe of one year to conclude the sale transaction has lapsed.

For this:

(i) the delay must have been caused by the events or circumstances which are beyond the control of the entity; and

(ii) there must be sufficient evidences that the entity is still committed to it selling plan.

Question 2 – An entity

An entity is committed to its selling plan of a manufacturing facility in its present condition and so classifies it as held for sale. After a firm purchase commitment, the buyer's inspection identifies environmental damages not previously known to exist. The entity is required by the buyer to make good the damage, which will extend the timeframe of one year to complete the sale within one year. However, the entity has initiated actions to make good the damage and satisfactory rectification is highly probable. In this situation exception to one year requirement will met.

Sale includes Exchange :

Sale transaction includes exchange of non-current assets for other non-current assets when the exchange has commercial substance in accordance of Ind AS 16 Property, Plant and Equipment.

Sale includes assets held for distribution to its owner :

An entity shall classify a non-current asset (or disposal group) as held for distribution to its owner on a parallel line as discussed above required for classification as held for sale.

Assets Acquired exclusively with a view to subsequent disposal :

When an entity acquires a non-current asset (or disposal group) exclusively with a view to its subsequent disposal, the non-current asset (or disposal group) is classified as held for sale at the acquisition date. This standard provides a short period (usually three months) to meet the classification criteria that don't met at the acquisition except requirement of one year.

Question 3 – An entity

An entity has acquired a building exclusively with a view of its subsequent disposal. The management is highly confident that the property can be sold in one year. The property requires refurbishing it to enhance its value which is highly probable to be completed in less than a period of three months. The building will be classified as held for sale on the date of acquisition itself even though it is not immediately available for sale.

Criteria met after reporting period :

If the criteria of held for sale are met after the reporting period but before the date of authorisation the financial statements, a non-current asset should not classify as held for sale. However, when those criteria are met after the reporting period but before the approval of the financial statements for issue, the entity shall disclose the information.

Non Current Assets to be Abandoned :

Non-current assets (or disposal group) that need to be abandoned will not qualify to classify as held for sale because their carrying amount will be principally recovered through continuing use in the entity's operation rather through the sale. If however, the disposal group to be abandoned meets the criteria as prescribed in Ind AS 105 to be classified as a discontinued operation, then the disclosure regarding discontinued operation must be presented.

Non-current assets (or disposal groups) to be abandoned include non-current assets (or disposal groups) that are to be used to the end of their economic life and non-current assets (or disposal groups) that are to be closed rather than sold.

Question 4 – Entity

Entity ceases to use a manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it is expected to be brought back into use in future when demand picks up. It is neither to be treated as abandoned asset nor as held for sale because its carrying amount will be principally recovered through continuous use, therefore the entity will not stop charging depreciation or treat it as held for sale. This is because its carrying amount will be recovered principally through continuing use to the end of its economic life.

5. MEASUREMENT OF ASSETS CLASSIFIED AS HELD FOR SALE :

1. An entity should measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.
2. Depreciation and amortization shall be immediately stopped from the moment the asset has been classified as held for sale.
3. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale shall continue to be recognised.
4. When the sale is expected to occur beyond one year, the entity should measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in profit or loss as a financing cost.
5. Non-current asset (or disposal group) classified as held for distribution are also measured on same line as non-current asset (or disposal group) classified as held for sale.

Question 5 – An item of property

An item of property, plant and equipment that is measured on the cost basis should be measured in accordance with Ind AS 16.

Entity ABC owns an item of property and it was stated at the following amounts in its last financial statements:

31st December, 2011	**Rs.**
Cost	12,00,000
Depreciation	(6,00,000)
Net book value	6,00,000

The asset is depreciated at an annual rate of 10% ie. Rs.1,20,000 p.a.

During July, 2012, entity ABC decides to sell the asset and on 1st August it meets the conditions to be classified as held for sale. Analyse.

Question 6 – A Ltd.

A Ltd. acquired a property for Rs.2,00,000. After few years the cumulative depreciation on the property is of Rs.80,000 has been recognised and subsequently the property is classified as held for sale under Ind AS 105.

The Fair Value less cost of Sale = Rs.100,000
On the next reporting date, the Fair Value less cost of sale is Estimated at Rs 85,000
Subsequently the property was sold at Rs.90,000
Show the Asset shall be measured at various measurement dates.

Recognition of Impairment Losses and Reversals :

- An entity should recognise an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell, to the extent that it has not been recognised in accordance with above.
- An entity should recognise a gain for any subsequent increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognised either in accordance with this Ind AS or previously in accordance with Ind AS 36, Impairment of Assets.
- An entity should recognise a gain for any subsequent increase in fair value less costs to sell of a disposal group:
  1. to the extent that it has not been recognised in the remeasurement of scoped out noncurrent assets, current assets and liabilities; but
  2. not in excess of the cumulative impairment loss that has been recognised, either in accordance with this Ind AS or previously in accordance with Ind AS 36, on the noncurrent assets that are within the scope of the measurement requirements of this Ind AS.

Question 7 –

Disposal Group	Carrying Amount at the reporting Date before classification as held for Sale	Carrying Amount as remeasured immediately before classification as held for sale
Goodwill	1500	1500
PPE	4600	4000
Building	5700	5700
Inventory	2400	2200
Investment in Equity	1800	1500
Total	**16000**	**14900**

The entity estimated that fair value less costs to sell of the disposal group amounts to Rs 13,000 on the date the disposal group is classified as Held for Sale. On the subsequent measurement date the fair value less cost of sale is measured at 15,500. How would you account for the same.

Changes to Plan of Sale ;

- If an entity has classified an asset (or disposal group) as held for sale, but the held for sale criteria no longer met, the entity should cease to classify the asset (or disposal group) as held for sale.

- The entity shall measure a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of: (a) its carrying amount before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortization or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale; and (b) its recoverable amount at the date of the subsequent decision not to sell.
- The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale in profit or loss from continuing operations in the period in which the held for sale criteria no longer met.
- Financial statements for the periods since classification as held for sale shall be amended accordingly if the disposal group or non-current asset that ceases to be classified as held for sale is a subsidiary, joint operation, joint venture, associate, or a portion of an interest in a joint venture or an associate.
- If an entity removes an individual asset or liability from a disposal group classified as held for sale, the remaining assets and liabilities of the disposal group will continue to be measured as a group only if the group meets the criteria for classification as held for sale. Otherwise:
- the remaining non-current assets of the group that individually meet the criteria to be classified as held for sale shall be measured individually at the lower of their carrying amounts and fair values less costs to sell at that date; and
- any non-current assets that do not meet the criteria shall cease to be classified as held for sale.

Question 8 – S Ltd.

S Ltd purchased a property for Rs.6,00,000 on 1st April, 20X1. The useful life of the property is 15 years. On 31st March, 2013, S Ltd classified the property as held for sale. The impairment testing provides the estimated recoverable amount of Rs.4,70,000.

The fair value less cost to sell on 31st March, 2013 was Rs.4,60,000. On 31st March, 2014 management changed the plan, as property no longer met the criteria of held for sale. The recoverable amount as at 31st March, 2014 is Rs.5,00,000.

Value the property at the end of 2013 and 2014.

6. PRESENTATION AND DISCLOSURE OF A NON CURRENT ASSET (OR DISPOSAL GROUP) CLASSFIED AS HELD FOR SALE :

Presentation :

- An entity is required to present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the balance sheet.
- The liabilities of a disposal group classified as held for sale should be presented separately from other liabilities in the balance sheet. Those assets and liabilities should not be offset and presented as a single amount.

- An entity should present separately any cumulative income or expense recognised in other comprehensive income relating to a non-current asset (or disposal group) classified as held for sale.
- If the disposal group is a newly acquired subsidiary that meets the criteria to be classified as held for sale on acquisition, disclosure of the major classes of assets and liabilities is not required.
- Comparative amounts for non-current assets or for the assets and liabilities of disposal groups classified as held for sale in the balance sheets for prior periods are not reclassified or represented to reflect the classification in the balance sheet for the latest period presented.

Disclosure :

An entity should disclose the following information in the notes to the financial statements in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:

(a) Description of the non-current asset (or disposal group);

(b) Description of facts and circumstances of the sale, or leading to the expected disposal and the expected manner and timing of that disposal;

(c) Gain or loss recognised and if not presented separately on the face of the income statement, the caption in the income statement that includes that gain or loss.

(d) If applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance of Ind AS 108 Operating Segments.

(e) If there is a change of plan to sell, a description of facts and circumstances leading to the decision and its effect on results.

7. PRESENTATION AND DISCLOSURE OF DISCONTINUED OPERATIONS :

Ind AS 105 defines Discontinued Operation as: A component of an entity that either has been disposed of or is classified as held for sale and:

a) represents a separate major line of business or geographical area of operations; or

b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or

c) is a subsidiary acquired exclusively with a view to resale.

A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash generating units while being held for use.

Question 9 – Company XYZ

Company XYZ has 5 different operating segments, one of which solely produces consumer goods. All of the consumer goods production facilities are situated in Central Europe. XYZ also has other operations in Central Europe for other operating segments. In April 20X1, XYZ disposed of its consumer goods segment which meets the definition of a component of a business and represents a separate major line of business and would therefore be considered as a discontinued operation.

Question 10 – A group

A group has announced that it is closing an engineering contracting segment. Although no new contracts are being undertaken, all existing contracts will be completed and the business will be run down accordingly. In this situation, the operation will have ceased to be used when the contracting activity has been completed (that is, at the end of the last contract). In the period during which existing contracts are completed, the group is continuing to carry out a revenue-earning activity, albeit that the activity is being wound down, and so it does not qualify as a discontinued operation.

Question 11 – A Company

A company carried out a merchandise wholesaling business that it operated from several leasehold premises throughout the country. The business has been closed, all stocks have been disposed of, and employees have been made redundant before the end of three months into the next financial year. At that time, some debtors remain to be collected, and costs will continue to be incurred in respect of the vacated premises until the leases are disposed of. In this case, the former activity of merchandise wholesaling has ceased. The outstanding future transactions do not constitute the continuation of the activity and, consequently, the operation has been discontinued.

Question 12 – XYZ Company

XYZ Company has one business segment, and it operates in the UK, the US and Australia. Each of these operations represents a component of XYZ and a major geographical area of operations. Management has decided to sell the US operation, which met the criteria to be classified as held for sale during the year. The US operation should be disclosed in the XYZ's financial statements as a discontinued operation, despite the fact that there has been no change to the number of business segments.

Question 13 –

Identify whether each of the following scenarios gives rise to a discontinued operation and/or classification of assets as held for sale:

S. No	Particulars	Discontinued operation Yes/No	Assets held for sale Yes/No
1	MNO disposes of a component of the entity by selling the underlying assets. The sales transaction is incomplete at the reporting date.		
2	PQR has ceased activities that meet the definition of a discontinued operation without selling any assets.		
3	STU ceases activities and has already completed the sale of the underlying assets at the reporting date.		
4	VWX will sell or has sold assets that are within the scope of Ind AS 105, but does not discontinue any of its operations.		

Question 14 – Sun Ltd.

Sun Ltd is a retailer of takeaway food like burger and pizzas. It decides to sell one of its outlets located in chandni chowk in New Delhi. The company will continue to run 200 other outlets in New Delhi.

All Ind AS 105 criteria for held for sale classification were first met at 1st October, 2011. The outlet will be sold in June, 2012.

Management believes that outlet is a discontinued operation and wants to present the results of outlet as 'discontinued operations'. Analysis

8. SELF PRACTICE QUESTIONS :

Question 15 – Entity X

On November 30, 2011, Entity X becomes committed to a plan to sell a property. However, it plans certain renovations to increase its value prior to selling it. The renovations are expected to be completed within a short span of time i.e., 2 months. Can the property be classified as held for sale at the reporting date i.e. December 31, 2011?

Question 16 – Entity R

On March 1, 2011, entity R decides to sell one of its factories. An agent is appointed and the factory is actively marketed. As on March 31, 2011, it is expected that the factory will be sold by February 28, 2012. However, in May 2011, the market price of the factory deteriorated. Entity R believed that the market will recover and thus did not reduce the price of the factory. The company's accounts are authorised for issue on June 26, 2011. Should the factory be shown as held for sale as on March 31, 2011?

Question 17 – Entity X

On June 1, 2011, entity X plans to sell a group of assets and liabilities, which is classified as a disposal group. On July 31, 2011, the Board of Directors approves and becomes committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity Y. However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by November 30, 2011 and the sale is expected to be completed by March 31, 2012. Entity X follows December year end. The assets and liabilities attributable to this manufacturing unit are as under:

Disposal Group	Carrying Value as on December 31, 2010	Carrying value as on July 31, 2011
Goodwill	500	500
PPE	1000	900
Building	2000	1850
Debtors	850	1050
Inventory	700	400
Creditors	(300)	(250)
Loans	(2000)	(1850)
Total	2750	2600

The fair value of the manufacturing unit as on December 31, 2010 is Rs.2,000 and as on July 31, 2011 is Rs.1,850. The cost to sell is 100 on both these dates. The disposal group is not sold at the period end i.e., December 31, 2011. The fair value as on December 31, 2011 is lower than the carrying value of the disposal group as on that date.

Required:

1. Assess whether the manufacturing unit can be classified as held for sale and reasons there for. If yes, then at which date?
2. The measurement of the manufacturing unit as on the date of classification as held for sale.
3. The measurement of the manufacturing unit as at the end of the year.

Question 18 – A Ltd.

Following is the extract of the consolidated financial statements of A Ltd. for the year ended on:

Asset/ (liability)	Carrying amount as on 31st March, 20X1 (In Rs.'000)
Attributed goodwill	200
Intangible assets	950

Financial asset measured at fair value through other comprehensive income	300
Property, plant & equipment	1100
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	600
Current liabilities	(850)
Non-current liabilities – provisions	(300)
Total	**2,250**

On 15th September 20X1, Entity A decided to sell the business. It noted that the business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with that standard.

The disposal group is stated at the following amounts immediately prior to reclassification as held for sale.

Asset/ (liability)	Carry amount as on 15th September 20X1 (In Rs. '000)
Attributed goodwill	200
Intangible assets	930
Financial asset measured at fair value through other comprehensive income	360
Property, plant & equipment	1,020
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	520
Current liabilities	(870)
Non-current liabilities – provisions	(250)
Total	**2,160**

Entity A proposed to sell the disposal group at Rs.19,00,000. It estimates that the costs to sell will be Rs.70,000. This cost consists of professional fee to be paid to external lawyers and accountants.

As at 31st March 20X2, there has been no change to the plan to sell the disposal group and entity A still expects to sell it within one year of initial classification. Mr. X, an accountant of Entity A remeasured the following assets/ liabilities in accordance with respective standards as on 31st March 20X2:

Available for sale:	**(In Rs. '000)**
Financial assets	410
Deferred tax assets	230
Current assets- Inventory, receivables and cash balances	400
Current liabilities	900
Non- current liabilities- provisions	250

The disposal group has not been trading well and its fair value less costs to sell has fallen to Rs. 16,50,000.

Required:

What would be the value of all assets/ labilities within the disposal group as on the following dates in accordance with Ind AS 105?

(a) 15 September, 20X1 and

(b) 31st March, 20X2

Question 19 – CK Ltd.

CK Ltd. prepares the financial statement under Ind AS for the quarter year ended 30th June, 20X1. During the 3 months ended 30th June, 20X1 following events occurred:

On 1st April, 20X1, the Company has decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with the Company collecting any outstanding trade receivables relating to the division and settling any current liabilities.

On 1st April, 20X1, the carrying amount of the assets of the division were as follows:

- Purchased Goodwill – Rs. 60,000
- Property, Plant & Equipment (average remaining estimated useful life two years) - Rs. 20,00,000
- Inventories - Rs. 10,00,000

From 1st April, 20X1, the Company has started to actively market the division and has received number of serious enquiries. On 1st April, 20X1 the directors estimated that they would receive Rs. 32,00,000 from the sale of the division. Since 1st April, 20X1, market condition has improved and as on 1st August, 20X1 the Company received and accepted a firm offer to purchase the division for Rs. 33,00,000.

The sale is expected to be completed on 30th September, 20X1 and Rs. 33,00,000 can be assumed to be a reasonable estimate of the value of the division as on 30th June, 20X1. During the period from 1st April to 30th June inventories of the division costing Rs. 8,00,000 were sold for Rs. 12,00,000. At 30th June, 20X1, the total cost of the inventories of the division was Rs. 9,00,000. All of these inventories have an estimated net realisable value that is in excess of their cost.

The Company has approached you to suggest how the proposed sale of the division will be reported in the interim financial statements for the quarter ended 30th June, 20X1 giving relevant explanations.

Question 20 – Identify

Identify which of the following is a disposal group at 31 March 20X1:

(1) On 21 March 20X1, XYZ announced the Board's intention to sell its shares in a subsidiary company, Alpha, contingent upon the approval of Alpha's shareholders. It seems unlikely that approval will be granted in the near future and no specific potential buyer has been identified.

(2) PQR has entered into a contract to sell the entire delivery fleet of vehicles operated from its warehouse to a competitor, ABC, on 14 March 20X1. The assets will be transferred on 28 April 20X1 from which date the Group will outsource its delivery activities to another company, LMN.

(3) On 16 January 20X1, DEF's management and shareholders approved a plan to sell its retail business in Mumbai and a consultant is hired to manage the sale. As at 31 March 20X1 heads of agreement had been signed although due diligence and the negotiation of final terms are still in process. The transaction is expected to be completed in April 20X1.

Thanks ….

CHAPTER

8

IND AS 23 – BORROWING COST

CONCEPTS COVERED

1. INTRODUCTION
2. SCOPE
3. BORROWING COST
4. QUALIFYING ASSET
5. RECOGNITION
6. PERIOD OF CAPITALISATION
   - COMMENCEMENT
   - SUSPENSION
   - CESSATION
7. DISCLOSURE
8. SELF PRACTICE QUESTIONS

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1. INTRODUCTION :

This standard requires borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset. Other borrowing costs are recognized as an expense.

2. SCOPE :

- An entity shall apply this standard in accounting for borrowing costs.
- The Standard does not apply to actual or imputed cost of equity, including preferred capital not classified as a liability.

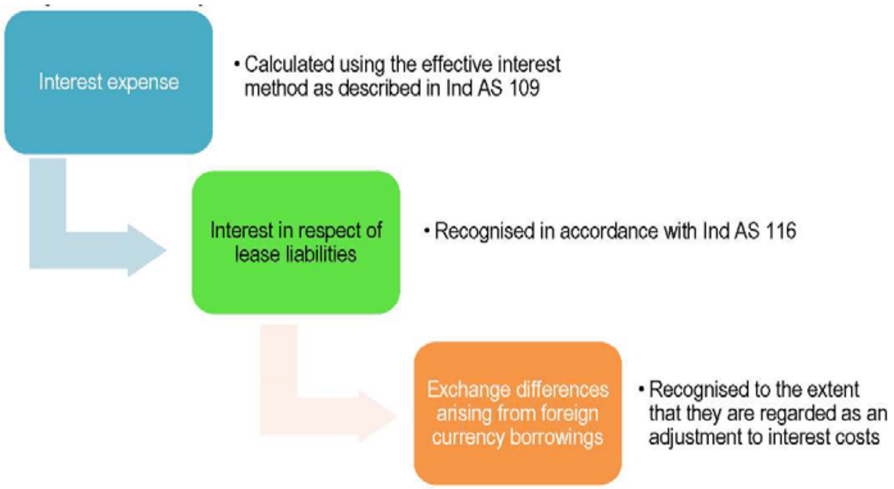
For example: Dividend paid on equity shares, cost of issuance of equity, cost on Irredeemable preference share capital will not be included as borrowing cost within the purview of this standard.

- An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:
  - (a) a qualifying asset measured at fair value, for example, a biological asset accounted for under Ind AS 41; or
  - (b) inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis. and that take a substantial period to get ready for sale. For example, whisky, wines etc. takes substantial period of time, may be years to get ready for the intended purpose are out of scope from the purview of this standard.

3. BORROWING COST :

These are interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs may include:

- interest expense calculated using the effective interest rate method as described in Ind AS 109 *Financial Instruments;*
- interest in respect of lease liabilities recognised in accordance with Ind AS 116, Leases; and
- exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs



Question 1 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.50. The loan is not due for repayment.
Calculate the amount of total borrowing cost.

Question 2 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.41. The loan is not due for repayment.
Calculate the amount of total borrowing cost.

Question 3 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.50. The loan is not due for repayment.
Calculate the amount of total borrowing cost.
If the exchange rate on March 31, 2013, is $ 1 = Rs.48. Discuss what shall be the accounting treatment at the end of year 2013.

Question 4 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.50. The loan is not due for repayment.
Calculate the amount of total borrowing cost.
If the exchange rate on March 31, 2013, is $ 1 = Rs.44. Discuss what shall be the accounting treatment at the end of year 2013.

Question 5 – An entity

An entity can borrow funds in its functional currency (Rs) @ 12%. It borrows $ 1,000 @ 4% on April 1, 2011 when $ 1 = Rs.40. The equivalent amount in functional currency is Rs.40,000. Interest is payable on March 31, 2012. On March 31, 2012, exchange rate is $ 1 = Rs.50. The loan is not due for repayment.
Calculate the amount of total borrowing cost.

If the exchange rate on March 31, 2013, is $ 1 = Rs.44. Discuss what shall be the accounting treatment at the end of year 2013 assuming $ 600 of the borrowings was paid on March 31, 2012.

Question 6 – ABC Ltd.

ABC Ltd. has taken a loan of USD 20,000 on April 1, 2011 for constructing a plant at an interest rate of 5% per annum payable on annual basis.
On April 1, 2011, the exchange rate between the currencies i.e USD vs Rupees was Rs.45 per USD. The exchange rate on the reporting date i.e. March 31, 2012 is Rs.48 per USD.
The corresponding amount could have been borrowed by ABC Ltd from State bank of India in local currency at an interest rate of 11% per annum as on April 1, 20X1.
Compute the borrowing cost to be capitalized for the construction of plant by ABC Ltd.

4. QUALIFYING ASSET :

- An Asset is a resource under the control of the entity which is the result of the past event and from which the future economic benefits are going to arrive to enterprise
- It should substantial period of time to get ready for its intended use or sale
- Substantial period of time is not defined in IND AS. It is to be understood on case to case basis. Generally a period of more than 12 months is considered substantial. However any shorter period, if justifiable can also be taken as substantial period.
- Generally inventory are not considered as Qualifying Asset as they are produced on repetitive basis over a short period of time. However if the nature of inventory is such that it takes substantial period of time to get ready for its intended use or sale then inventory can be classified as Qualifying Asset.
  Foe e.g. – Wine, Rice, Cheese Etc.
- If an Asset is ready for its intended use then it cannot be classified as Qualifying Asset. However if an Asset is a part of larger asset or project then it is not independent and therefore should be looked along with bigger asset than it should be capitalised.

Depending on the circumstances, any of the following may be qualifying assets:

(a) inventories
(b) manufacturing plants
(c) power generation facilities
(d) intangible assets
(e) investment properties
(f) bearer plants.

Financial assets and inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

Question 7 – A Company deals

A company deals in production of dairy products. It prepares and sells various milk products like ghee, butter and cheese. The company borrowed funds from bank for manufacturing operation. The cheese takes substantial longer period to get ready for sale.

State whether borrowing costs incurred to finance the production of inventories (cheese) that have a long production period, be capitalised?

Question 8 – A company

A company is in the process of developing computer software. The asset has been qualified for recognition purposes. However, the development of computer software will take substantial period of time to complete.

(i) Can computer software be termed as a 'qualifying asset' under Ind AS 23?

(ii) Is management intention considered when assessing whether an asset is a qualifying asset?

Question 9 – A telecom company

A telecom company has acquired a 3G license. The licence could be sold or licensed to a third party. However, management intends to use it to operate a wireless network. Development of the network starts when the license is acquired.

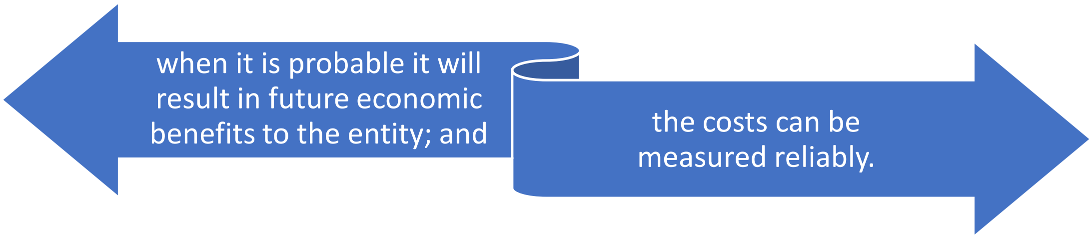
Should borrowing costs on the acquisition of the 3G license be capitalised until the network is ready for its intended use?

Question 10 – A real estate

A real estate company has incurred expenses for the acquisition of a permit allowing the construction of a building. It has also acquired equipment that will be used for the construction of various buildings.

Can borrowing costs on the acquisition of the permit and the equipment be capitalised until the construction of the building is complete?

5. RECOGNITION :



- Other borrowing costs are recognised as an expense in the period in which they are incurred.
- When an entity applies Ind AS 29 Financial Reporting in Hyperinflationary Economies, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period

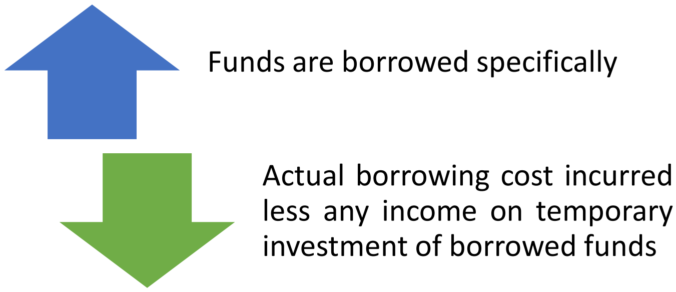
General Borrowing Cost :

- When a qualifying asset is funded from a pool of general borrowings, the amount of the borrowing costs eligible for capitalisation is not so obvious. It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided.
- Such a difficulty occurs, for example, when the financing activity of an entity is coordinated centrally. Difficulties also arise when a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other entities in the group.
- To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset.
- The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

Total general borrowing costs for the period (excluding specific borrowings) ÷ Weighted Average total general borrowings (excluding specific = Capitalization Rate

Specific Borrowing Cost :

When an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity should determine the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.



Question 11 – ABC Ltd.

Alpha Ltd. on 1st April, 2011 borrowed 9% Rs.30,00,000 to finance the construction of two qualifying assets. Construction started on 1st April, 2011. The loan facility was availed on 1st April, 2011 and was utilized as follows with remaining funds invested temporarily at 7%.

	Factory Building	Office Building
1st April 2011	5,00,000	10,00,000
1st Oct 2011	5,00,000	10,00,000

Calculate the cost of the asset and the borrowing cost to be capitalized.

Question 12 – ABC Ltd.

On 1st April, 20X1, A Ltd. took a 8% loan of Rs. 50,00,000 for construction of building A which is repayable after 6 years ie on 31st March 20X7. The construction of building was completed on 31st March 20X3. A Ltd. started constructing a new building B in the year 20X3-20X4, for which he used his existing borrowings. He has outstanding general purpose loan of Rs. 25,00,000, interest on which is payable @ 9% and Rs. 15,00,000, interest on which is payable @ 7%.

Is the specific borrowing transferred to the general borrowings pool once the respective qualifying asset is completed? Why?

Question 13 – Beta Ltd.

Beta Ltd. had the following loans in place at the end of 31st March, 2012:

Loan	1st April, 2011	31st March 2012
18 % Bank Loan	1000	1000
16 % Term Loan	3000	3000
14% Debentures	-	2000

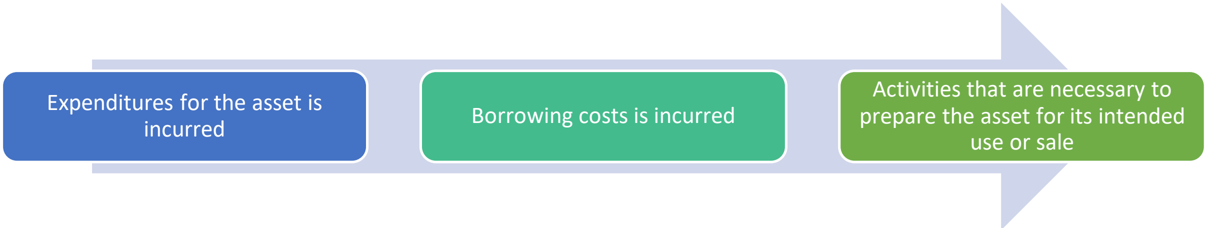
14% debenture was issued to fund the construction of Office building on 1st July, 2011 but the development activities has yet to be started.
On 1st April, 2011, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: Rs.500,000 on 1st April, 20X1 and Rs.2,500,000 on 1st January, 2012.
Required : Calculate the borrowing cost that can be capitalized for the plant.

6. PERIOD OF CAPITALIZATION :

1. COMMENCEMENT :

An entity is required to begin the capitalizing of borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalization is the date when the entity first meets all of the following conditions cumulatively on a particular date:

- It incurs expenditure for the Asset.
- It incurs borrowing cost.
- It undertakes activities that are necessary to prepare the asset for its intended use or sale.



Question 14 – X Ltd.

X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:
(i) 15th May, 2011: Loan interest relating to the project starts to be incurred
(ii) 2nd June, 2011 : Technical site planning commences
(iii) 19th June, 2011 : Expenditure on the project started to be incurred
(iv) 18th July, 2011 : Construction work commences Identify commencement date.

2. SUSPENSION :

- An entity is required to suspend the capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset. Such costs are costs of holding partially completed assets and do not qualify for capitalisation.
- An entity does not required to suspend capitalising borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographical region involved.

Example: Suspension of Capitalisation

Construction suspended between October, 2011 to January, 2012 during which period certain heavy construction equipment under use was shifted to another site. In this case, capitalization of borrowing costs needs to be suspended since active development is interrupted.

When Qualifying Asset construction is about to complete, there was temporary delay of 20 days on account of some technical reasons. In this case, capitalization of borrowing costs shall be continued.

3. CESSATION :

- An entity should cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.
- When an entity completes the construction of a qualifying asset in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.
- A business park comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being usable while construction continues on other parts.

  An example of a qualifying asset that needs to be complete before any part can be used is an industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

Example:

An entertainment park consisting of several rides and facilities, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being usable while construction continues on other parts. On the other side in a case of an industrial undertaking such as a steel mill, all parts have to be completed before any earlier completed part can be put to use.

8. DISCLOSURE :

Entities are required to disclose:

(a) The amount of borrowing costs capitalized during the period; and

(b) The capitalization rate used to determine the amount of borrowing costs eligible for capitalization.

9. SELF PRACTICE QUESTIONS :

Question 15 – Marine Transport Limited

Marine Transport Limited ordered 3 ships for its fleet on April 1, 2010. It pays a down payment of 25% of the contract value of each of the ship out of long term borrowings from a scheduled bank. The delivery has to commence from the financial year 2017. On March 1, 2012, the ship builder informs that it has commenced production of one ship. There is no progress on other 2 ships. Marine Transport Limited prepares its financial statements on financial year basis.

Is it permissible for Marine Transport Limited to capitalize any borrowing costs for the financial year ended March 31, 2011 or March 31, 2012.

Question 16 – X Limited

X Limited has a treasury department that arranges funds for all the requirements of the Company including funds for working capital and expansion programs. During the year ended March 31, 2012, the Company commenced the construction of a qualifying asset and incurred the following expenses:

Date	Amount (Rs)
July 1, 2011	2,50,000
December 1, 2011	3,00,000

The details of borrowings and interest thereon are as under:

Particulars	Average Balance (Rs.)	Interest (Rs.)
Long Term Loan @ 10%	10,00,000	1,00,000
Working Capital	5,00,000	65,000
Total	15,00,000	1,65,000

Compute the borrowing costs that need to be capitalised.

Question 17 – An entity constructs

An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1. Directly attributable expenditure at the beginning of the month on this asset are Rs. 100,000 in September 20X1 and Rs. 250,000 in each of the months of October to December 20X1.

The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 10% debentures with a face value of Rs. 20 lacs and had an overdraft of Rs. 500,000, which increased to Rs. 750,000 in

December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%.

Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'.

Question 18 – K Ltd.

K Ltd. began construction of a new building at an estimated cost of Rs. 7 lakh on 1st April, 20X1. To finance construction of the building it obtained a specific loan of Rs. 2 lakh from a financial institution at an interest rate of 9% per annum.

The company's other outstanding loans were:

Amount	Rate of Interest per annum
Rs. 7,00,000	12%
Rs. 9,00,000	11%

The expenditure incurred on the construction was:

April, 20X1	Rs. 1,50,000
August, 20X1	Rs. 2,00,000
October, 20X1	Rs. 3,50,000
January, 20X2	Rs. 1,00,000

The construction of building was completed by 31st January, 20X2. Following the provisions of Ind AS 23 'Borrowing Costs', calculate the amount of interest to be capitalized and pass necessary journal entry for capitalizing the cost and borrowing cost in respect of the building as on 31st January, 20X2.

Question 19 – Entity A

On 1st April, 20X1, entity A contracted for the construction of a building for Rs. 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 20X2, and during the period the following payments were made to the contractor :

Payment date	Amount (Rs. '000)
1st April, 20X1	200
30th June, 20X1	600
31st December, 20X1	1,200
31st March, 20X2	200
Total	**2,200**

Entity A's borrowings at its year end of 31st March, 20X2 were as follows:

a. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 20X2 amounted to Rs. 7,00,000. Interest of Rs. 65,000 was incurred on these borrowings during the year, and interest income of Rs. 20,000 was earned on these funds while they were held in anticipation of payments.

b. 12.5% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to Rs. 1,000,000 and remained unchanged during the year; and

c. 10% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to Rs. 1,500,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?

Question 20 – Parent Company "P"

In a group with Parent Company "P" there are 3 subsidiaries with following business:

"A" – Real Estate Company

"B" – Construction Company

"C" – Finance Company

- Parent Company has no operating activities of its own but performs management functions for its subsidiaries.
- Financing activities and cash management in the group are coordinated centrally.
- Finance Company is a vehicle used by the group solely for raising finance.
- All entities in the group prepare Ind AS financial statements.

The following information is relevant for the current reporting period 20X1-20X2:

Real Estate Company

- Borrowings of Rs. 10,00,000 with an interest rate of 7% p.a.
- Expenditures on qualifying assets during the period amounted to Rs. 15,40,000.
- All construction works were performed by Construction Company. Amounts invoiced to Real Estate Company included 10% profit margin.

Construction Company

- No borrowings during the period.
- Financed Rs. 10,00,000 of expenditures on qualifying assets using its own cash resources.

Finance Company

- Raised Rs. 20,00,000 at 7% p.a. externally and issued a loan to Parent Company for generalcorporate purposes at the rate of 8%.

Parent Company

- Used loan from Finance Company to acquire a new subsidiary.
- No qualifying assets apart from those in Real Estate Company and Construction Company.
- Parent Company did not issue any loans to other entities during the period.

What is the amount of borrowing costs eligible for capitalisation in the financial statements of each of the four entities for the current reporting period 20X1-20X2?

Question 21 – Y Ltd.

How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of Rs. 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

Question 22 – Nikka Limited

Nikka Limited has obtained a term loan of Rs. 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 20X2. An expenditure of Rs. 510 lacs was incurred on installation of Plant and Machinery, Rs. 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of Rs. 56 lacs has been used for working capital purposes. Management of Nikka Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of Rs. 68.20 lacs during financial year 20X1-20X2 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 20X2?

Thanks ....

CHAPTER

9

IND AS 36 – IMPAIRMENT OF ASSETS

CONCEPTS COVERED

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1. INTRODUCTION :

Assets as defined by Framework for preparation and Presentation of Financial Statements means "Any resource controlled by an enterprise and from which future economic benefit are expected by that enterprise from that resource.

As per the above definition assets represents future economic benefit and hence should be measured according to benefit expected out of it. However if there is decline in amount of benefit expected than the asset should be revalued to reflect the amount i.e expected benefit.

If the carrying amount of asset is more than its recoverable amount, the excess of carrying amount over its recoverable amount is called as Impairment Loss.

"Impairment Loss = Carrying Amount – Recoverable Amount"

2. SCOPE :

This Standard shall be applied in accounting for the impairment of all assets, other than:

1. Inventories (as covered in Ind AS 2)
2. Contract assets and assets arising from costs to obtain or fulfill a contract (Ind AS 115)
3. Deferred tax assets (Ind AS 12)
4. Assets arising from employees benefits (Ind AS 19)
5. Biological Assets measured at fair value less cost to sell (Ind AS 41)
6. Deferred acquisition costs and intangible assets arising from insurance contracts (Ind AS 104)
7. Non-current assets (or disposal groups) classified as held for sale (as covered in Ind AS 105)
8. Financial Assets (within the scope of Ind AS 109)

3. DEFINITIONS :

The following are the key terms used in this standard:

1. **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.

2. The **recoverable amount** of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use.

3. **Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (refer Ind AS 113 Fair Value Measurement).

4. **Useful life** is either: a) the period of time over which an asset is expected to be used by the entity; or b) the number of production or similar units expected to be obtained from the asset by the entity.

5. A **cash-generating unit** is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

6. **Corporate assets** are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.

7. **Costs of disposal** are incremental costs directly attributable to the disposal of an asset or cash-generating unit, excluding finance costs and income tax expense.

8. **Depreciable amount** is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.

9. **Depreciation (Amortisation)** is the systematic allocation of the depreciable amount of an asset over its useful life.

10. An **impairment loss** is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.

11. **Value in use** is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

4. IDENTIFYING AN ASSET THAT MAY BE IMPAIRED :

4.1 IDENTIFYING AN ASSET THAT MAY BE IMPAIRED – GENERAL :

- An asset is impaired when its carrying amount exceeds its recoverable amount.

- An entity shall **assess** at the end of each reporting period whether there is any **indication** that an asset may be impaired. If any such indication exists, the entity is required to estimate the **recoverable amount** of the asset.
- Irrespective of whether there is any indication of impairment, an entity is required to test following items for impairment at least annually:

For above three assets, the entity should not have wait for Impairment indicators, rather there is mandate of impairment testing. We will discuss this aspect in detail in the next section.

Question 1 – Rainbow Limited

Jupiter Ltd, a leading manufacturer of steel is having a furnace, which is carried in the balance sheet on 31.03.2011 at Rs.250 lakh. As at that date the value in use and Fair value is Rs.200 lakh. The cost of disposal is Rs.13 lakh.
Calculate the Impairment Loss to be recognised in the books of the Company?

Question 2 – Venus Ltd.

Venus Ltd. has an asset, which is carried in the Balance Sheet on March 31, 2011 at Rs.500 lakh. As at that date the value in use is Rs.400 lakh and the fair value less costs to sells is Rs.375 lakh.
From the above data:
(a) Calculate impairment loss.
(b) Prepare journal entries for adjustment of impairment loss.
(c) Show, how impairment loss will be shown in the Balance Sheet.

Question 3 – X Ltd.

X Ltd. is having a plant (asset) carrying amount of which is Rs.100 lacs on 31.03.2015. Its balance useful life in 5 years and residual value at the end of five years is Rs.5 lacs. Estimated future cash flows from using the plant in next five years are :

For the year ended on	Estimated Cash flows (Rupees in lacs)
31.03.2016	50
31.03.2017	30
31.03.2018	30
31.03.2019	20
31.03.2020	20

Calculate "value in use" for plant if the applicable discounts rate is 10% and also calculate the recoverable amount if the net selling price of plant on 31.03.2015 is Rs.60.00 lacs.

Question 4 – Uttaranchal Industries Ltd.

Uttaranchal Industries Ltd. gives the following estimates of cash flows relating to fixed asset on 31.12.2015. The discount rate is 15%

Year	Cash Flows (Rs. In lacs)
2016	2000
2017	3000
2018	3000
2019	4000

2020	2000

Residual value at the end of 2020 is Rs.500 lacs
Fixed asset purchased on 01.01.2013 for Rs.20000 lacs
Useful life is 8 years
Residual value estimated Rs.500 lakhs at the end of 8 years
Net Selling price Rs.10,000 lacs
Calculate on 31.12.2015

a. Carrying amount at the end of 2015
b. Value is use on 31.12.2015
c. Recoverable amount on 31.12.2015
d. Impairment loss to be recognized for the year ended 31.12.2015
e. Revised carrying amount
f. Depreciation charges for 2016.

4.2 INDICATIONS OF IMPAIRMENT

External sources of information

- Significant decline in market value (more than normal decline)
- Significant changes in technology, market, economic or legal environment with adverse effect on entity
- Increase in market interest rates or rate of returns
- Carrying amount of net assets of entity is more than its market capitalisation

Internal sources of information

- Obsolescence or physical damage of an asset
- Significant changes in use or expected to be used of an asset with an adverse effect on entity
- Internal reporting indicating worse economic performance of asset than expected

Investment in a subsidiary, joint venture or associate

- Carrying amount of investment (in separate financial statements) > Carrying amounts of investee's net assets (including associated goodwill) in the consolidated financial statements
- Dividend > Total Comprehensive income of investee

5. REQUIREMENT OF ANNUAL REVIEW :

5.1 ITEMS REQUIRED TO BE TESTED FOR IMPAIRMENT AT LEAST ANNUALLY :

Irrespective of whether there is any indication of impairment, an entity is required to test following items for impairment at least annually:

a) intangible asset with an indefinite useful life;
b) intangible asset not yet available for use; and
c) goodwill acquired in a business combination for impairment.

5.2 INTANGIBLE ASSETS REQUIRED TO BE TESTED FOR IMPAIRMENT AT LEAST ANNUALLY :

Intangible asset with an indefinite useful life and intangible assets not yet available for use to be tested for impairment

a) annually; and

b) and whenever there is an indication, at the end of a reporting period, that the asset may be impaired

by comparing its carrying amount with its recoverable amount, irrespective of whether there is any indication that it may be impaired.

- This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year and whenever there is an indication, at the end of a reporting period, that the asset may be impaired.

Example :

Intellectual Property rights (IPR) having Indefinite useful life has been tested for Impairment in the first quarter of FY 20X1-20X2. Impairment testing on such assets needs to be mandatory done in the same time frame i.e first quarter of FY 20X2-20X3. Suppose, there is indication of impairment in third quarter of FY 20X2-20X3, in such case, the company needs to do impairment testing in third quarter apart from mandatory annual review.

- Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period
- However, the most recent detailed calculation of such an asset's recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period, provided all of the following criteria are met:
  a) if the intangible asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets and is therefore tested for impairment as part of the cash-generating unit to which it belongs, the assets and liabilities making up that unit have not changed significantly since the most recent recoverable amount calculation;
  b) the most recent recoverable amount calculation resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and
  c) based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the asset's carrying amount is remote.

5.3 GOODWILL :

1. CGUs to which goodwill has been allocated :

A cash-generating unit to which goodwill has been allocated is tested for impairment both:

a) annually, and

b) whenever there is an indication that the unit may be impaired, by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. If the recoverable amount of the unit exceeds the carrying amount of the unit, the unit and the goodwill allocated to that unit shall be regarded as not impaired. If the carrying amount of the unit exceeds the recoverable amount of the unit, the entity recognises an impairment loss in accordance with the requirement of this standard.

2. Timing of impairment tests :

- The annual impairment test for a cash-generating unit to which goodwill has been allocated may be performed at any time during an annual period, provided the test is performed at the same time every year. Different cash-generating units may be tested for impairment at different times.
- However, if some or all of the goodwill allocated to a cash-generating unit was acquired in a business combination during the current annual period, that unit shall be tested for impairment before the end of the current annual period.

3. Individual assets to be tested before CGU to which goodwill has been allocated :

- If the assets constituting the CGU to which goodwill has been allocated are tested for impairment at the same time as the unit containing the goodwill, they shall be tested for impairment before the unit containing the goodwill.
- Similarly, if the CGUs constituting a group of CGUs to which goodwill has been allocated are tested for impairment at the same time as the group of units containing the goodwill, the individual units shall be tested for impairment before the group of units containing the goodwill.
- At the time of impairment testing a CGU to which goodwill has been allocated, there may be an indication of an impairment of an asset within the unit containing the goodwill. In such circumstances, the entity tests the asset for impairment first, and recognises any impairment loss for that asset before testing for impairment the cash-generating unit containing the goodwill.
- Similarly, there may be an indication of an impairment of a cash-generating unit within a group of units containing the goodwill. In such circumstances, the entity tests the cash-generating unit for impairment first, and recognises any impairment loss for that unit, before testing for impairment the group of units to which the goodwill is allocated.

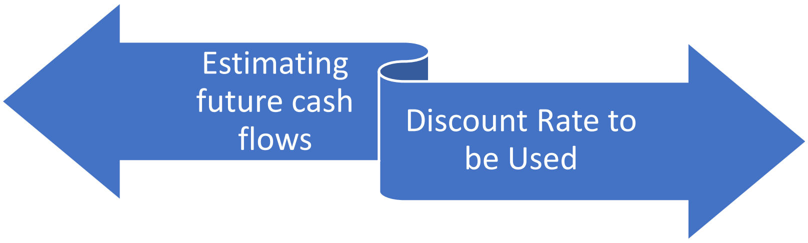
4. CGUs to which it has not been possible to allocate goodwill :

- When goodwill relates to a CGU but has not been allocated to that unit, the unit shall be tested for impairment, whenever there is an indication that the unit may be impaired, by comparing the unit's carrying amount, excluding any goodwill, with its recoverable amount. Any impairment loss is recognised in accordance with the requirement of this standard.
- If a CGU as described above includes in its carrying amount an intangible asset that has an indefinite useful life or is not yet available for use and that

asset can be tested for impairment only as part of the CGU, the unit also to be tested for impairment annually.

6. VALUE IN USE :

Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.
Primarily two key decisions are involved in determining value in use:



Estimation of expected future cash flows :

The following elements shall be reflected in the calculation of an asset's value in use:

a) an estimate of the future cash flows the entity expects to derive from the asset;
b) expectations about possible variations in the amount or timing of those future cash flows;
c) the time value of money, represented by the current market risk-free rate of interest;
d) the price for bearing the uncertainty inherent in the asset; and
e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

Estimating the value in use of an asset involves the following steps:

a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and
b) applying the appropriate discount rate to those future cash flows.

When estimating expected future cash flows, the following rules apply :

a) Projections of cash flows shall be based on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence.
a) Management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.
b) Base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to

arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified.

c) Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason, management's estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if it is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

d) Estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.

e) Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches objective information about patterns over a product or industry lifecycle. If appropriate, the growth rate is zero or negative.

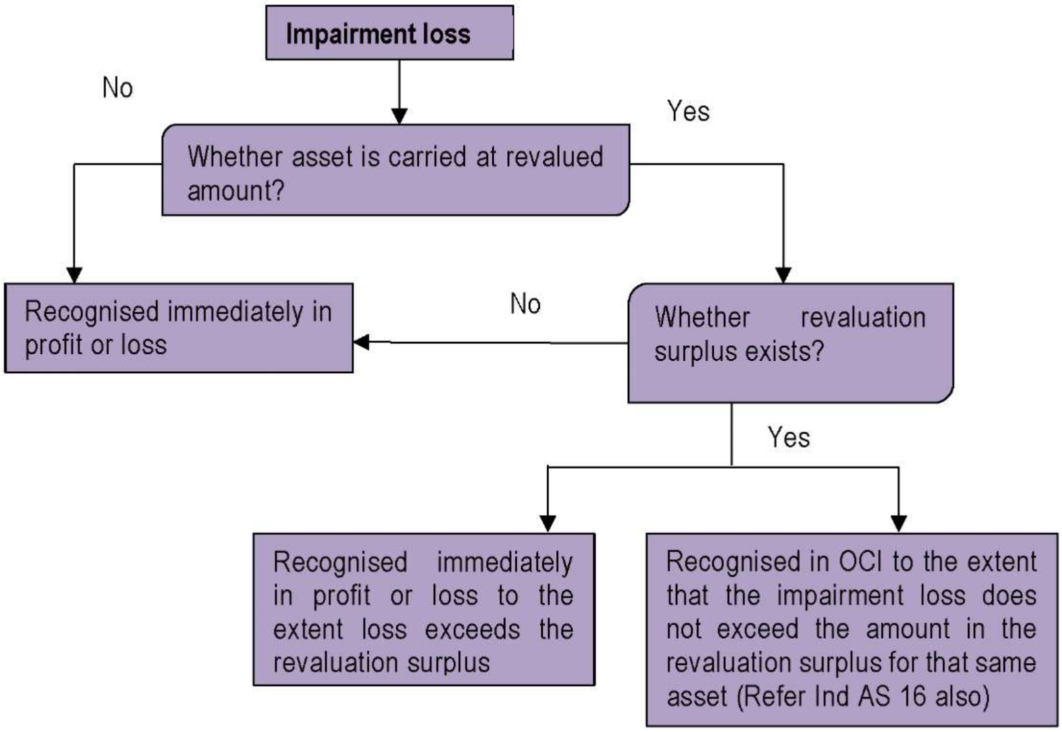
f) Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation. Therefore, if the discount rate includes the effect of price increases attributable to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the effect of price increases attributable to general inflation, future cash flows are estimated in real terms (but include future specific price increases or decreases).

Question 5 – Saturn Ltd.

Saturn India Ltd is reviewing one of its business segments for impairment. The carrying value of its net assets is 40 million. Management has produced two computations for the value-in-use of the business segment. The first value of Rs. 36 million excludes the benefit to be derived from a future reorganization, but the second value of Rs. 44 million includes the benefits to be derived from the future reorganization. There is not an active market for the sale of the business segments.

Whether the business segment needs to be Impaired?

7. RECOGNISING IMPAIRMENT LOSS :



Question 6 –

From the following details of an asset, find out:

(a) Impairment loss and its treatment.

(b) Current year depreciation for the year end.

Particulars of assets:

Cost of Asset	Rs 56 lakhs
Usefull Life	10 years
Salvage Value	Nil
Carrying Value at the beginning of the year	Rs 27.30 lakhs
Remaining useful life	3 years
Recoverable amount at the beginning of the year	12 lakhs
Upward revaluation done in last year	14 lakhs

Question 7 – NDA Ltd.

NDA Ltd. acquired plant on 01.04.2008 for Rs.50.00 lakhs having 10 years useful life and provides depreciation on SLM with nil residual value. On 01.04.2013. NDA Ltd revalued the plant at Rs.29 lakhs against its book value of Rs.25 lakhs and credited Rs.4 lakhs to revaluation reserve.

On 31.03.2015 the plant was impaired and its recoverable amount on this date was Rs.14 lakhs. Calculate the Impairment loss and how this loss should be treated in the accounts.

Question 8 – G Ltd.

G Ltd., acquired a machine on 1st April, 2010 for Rs.7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2014, the carrying value of the machine was reassessed at Rs.5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 2016, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only Rs.79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

Question 9 – X Ltd.

X Ltd. purchased a Property, Plant and Equipment four years ago for Rs.150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at Rs.75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is Rs.67.50 lakhs and expected disposal costs are Rs.3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at Rs.60 lakhs?

Question 10 –

From the following details of an asset, find out:

(a) Impairment loss and its treatment.

(b) Current year depreciation for the year end.

Particulars of assets:

Cost of Asset	Rs 56 lakhs
Usefull Life	10 years
Salvage Value	Nil
Carrying Value at the beginning of the year	Rs 27.30 lakhs
Remaining useful life	3 years
Recoverable amount at the beginning of the year	12 lakhs
Upward revaluation done in last year	14 lakhs

8. CASH GENERATING UNIT :

- A ***cash-generating unit*** is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
- If there is any indication that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount

of the individual asset, an entity is required to determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

- The recoverable amount of an individual asset cannot be determined if:
- the asset's value in use cannot be estimated to be close to its fair value less costs of disposal (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and
- the asset does not generate cash inflows that are largely independent of those from other assets.
- In such cases, value in use and, therefore, recoverable amount, can be determined only for the asset's cash-generating unit.
- If recoverable amount cannot be determined for an individual asset, an entity identifies the lowest aggregation of assets that generate largely independent cash inflows.

Question 11 – A publisher

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?

Question 12 – A mining entity

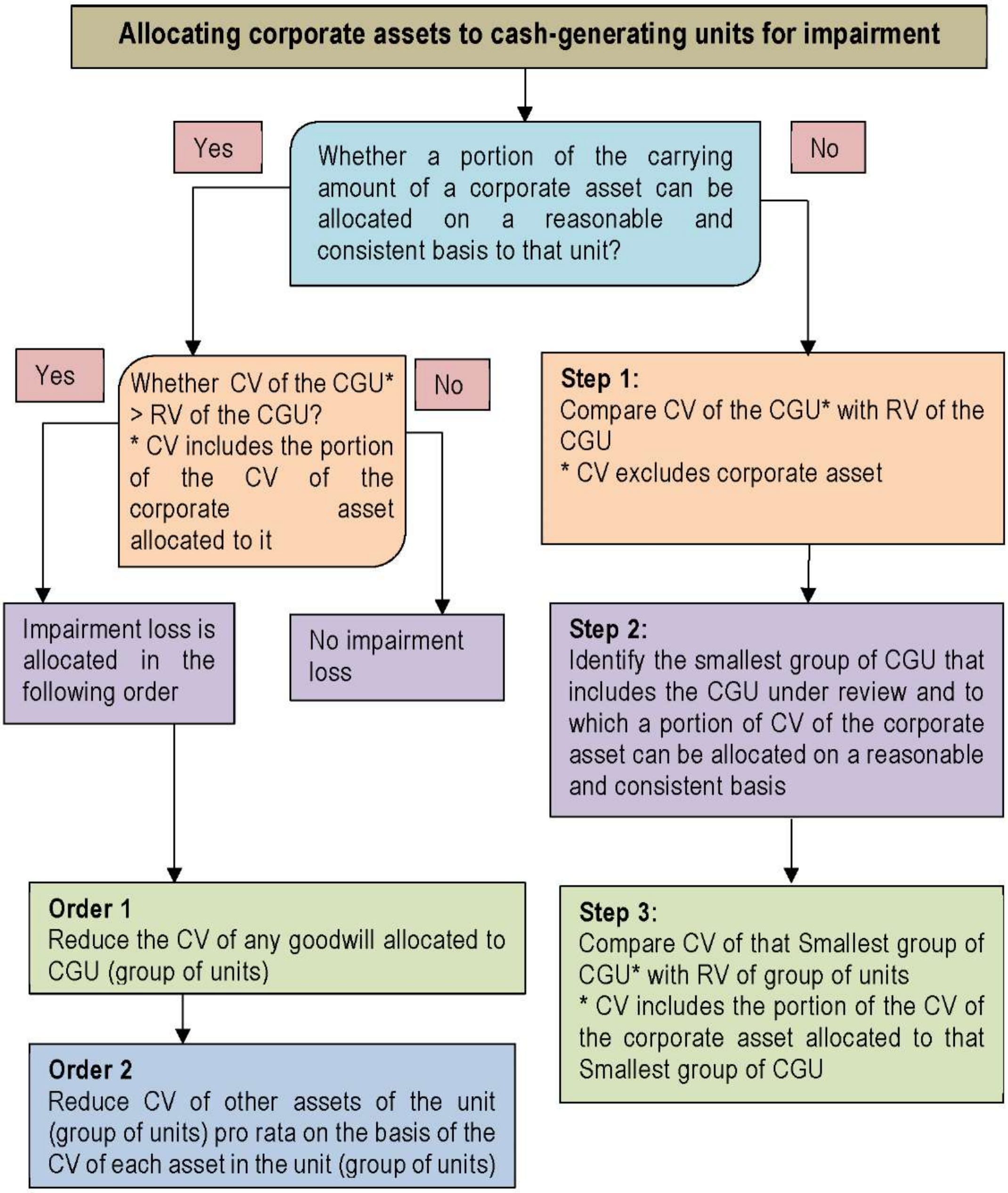
A mining entity owns a private railway to support its mining activities. The private railway could be sold only for scrap value and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the mine. Should the entity determine the recoverable amount for the private railway or for the mining business as a whole?

Question 13 – In north campus

In north campus there are ten college under Delhi University having their own canteens, which provides food and beverage to be students and staff. Under a policy of the University the contract of running all the ten college canteens will be given to only one contractor. Out of these 7 canteens are profitable but 3 are loss making. Identify cash generating units.

9. GOODWILL :

Goodwill does not generate cash flows independently from other assets or groups of assets and, therefore, the recoverable amount of goodwill as an individual asset cannot be determined. As a consequence, if there is an indication that goodwill may be impaired, recoverable amount is determined for the cash-generating unit to which goodwill belongs. This amount is then compared to the carrying amount of this cash-generating unit and any impairment loss is recognized. If goodwill can be allocated on a reasonable and consistent basis, an enterprise applies the 'bottom-up' test only. If it is not possible to allocate goodwill on a reasonable and consistent basis, an enterprise applies both the 'bottom-up' test and 'top-down' test



Question 14 – Entity A acquires Entity B

Entity A acquires Entity B for Rs. 50 million, of which Rs. 35 million is the fair value of the identifiable assets acquired and liabilities assumed. The acquisition of B Ltd. is to be integrated into two

Rs. in million

	CGU 1	**CGU 2**	**Total**

Fair value of acquired identifiable tangible and intangible assets	25	10	35

In addition to the net assets acquired that are assigned to CGU 2, the acquiring entity expects CGU 2 to benefit from certain synergies related to the acquisition (e.g. CGU 2 is expected to realise higher sales of its products because of access to the acquired entity's distribution channels). There is no synergistic goodwill attributable to other CGUs.

Entity A allocated the purchase consideration of the acquired business to CGU 1 and CGU 2 as Rs. 33 million and Rs. 17 million respectively.

Determine the allocation of goodwill to each CGU?

Question 15 – Earth Infra Ltd.

Earth Infra Ltd has two cash-generating units, A and B. There is no goodwill within the units' carrying values. The carrying values of the CGUs are CGU A for Rs. 20 million and CGU B for Rs. 30 million. The company has an office building which it is using as an office headquarter and has not been included in the above values and can be allocated to the units on the basis of their carrying values. The office building has a carrying value of Rs. 10 million. The recoverable amounts are based on value-in-use of Rs. 18 million for CGU A and Rs. 38 million for CGU B.

Determine whether the carrying values of CGU A and B are impaired.

Question 16 – A Ltd.

A Ltd. has 3 CGU with the fair value of Assets of these units in the ratio of 3 : 2 : 1 for unit A, B and C respectively.

B Ltd. acquired all the three cash generating units of A Ltd. at a price of Rs.2,500 lacs and recognised a goodwill of Rs.600 lacs at the time of acquisition. After a few years, it is found that unit A is incurring losses and the recoverable amount of unit A is 750 lacs. Presently the carrying amount of these units are Rs.725 lacs, Rs.500 lacs and Rs.220 lacs. The goodwill is appearing at Rs.420 lacs in the financial statements. Find the impairment loss to be recognised for CGU A, if

A. Goodwill can be allocated to cash generating units on a reasonable basis, and

B. Goodwill cannot be allocated to cash generating units and the recoverable amount of the three units taken together is

   () Rs. 1700 or

   (ii) Rs. 1400

Question 17 –

A cash generating unit has these net assets

	Rs in million
Goodwill	10
Property	20

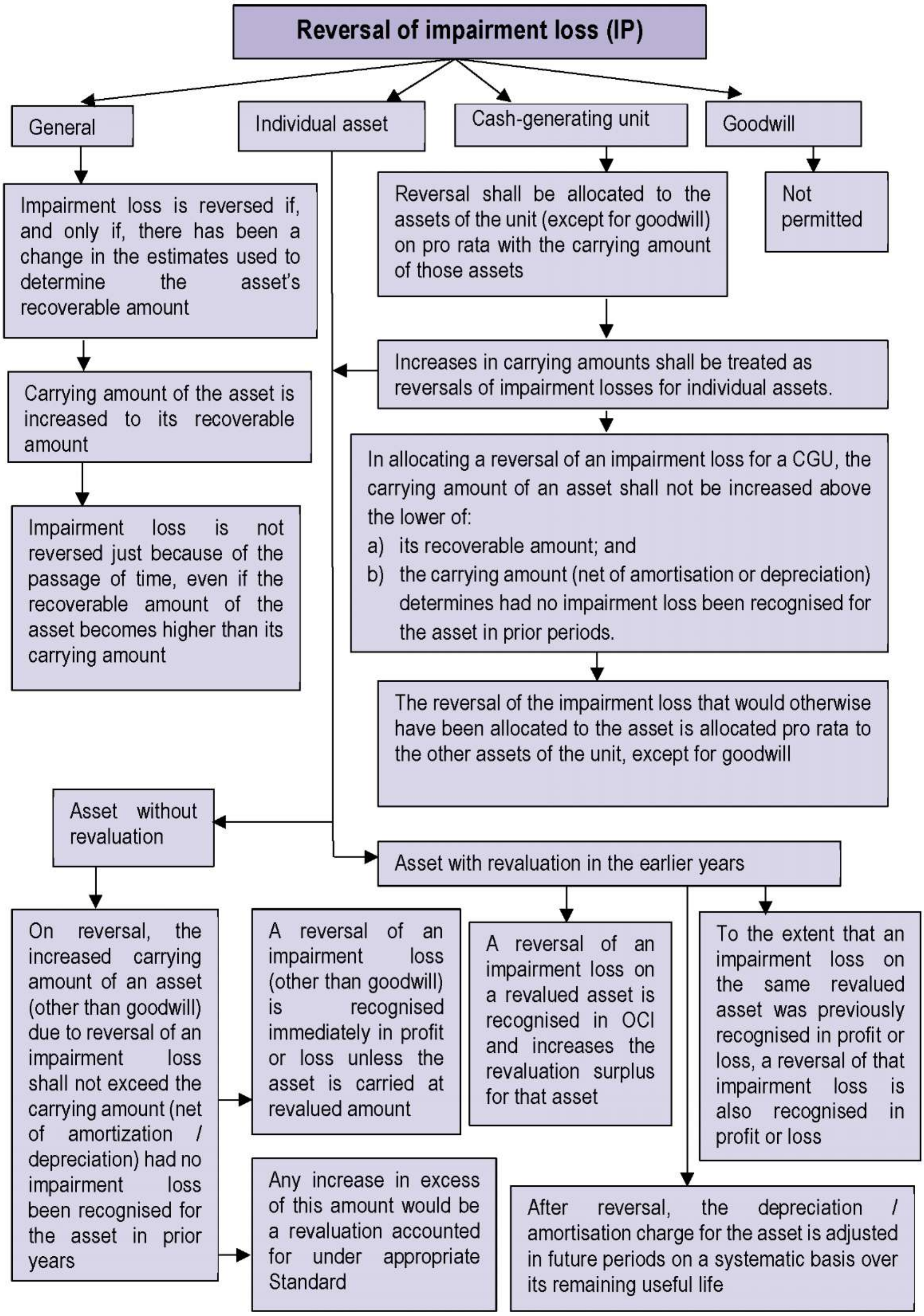
Plant and Equipment	30
Total	**60**

The recoverable Amount has been determined at Rs.45 million.

Required :

Allocate the impairment loss to net assets of the entity.

10. REVERSAL OF IMPAIRMENT LOSS :



Question 18 – Venus Ltd.

On 1st April 20X1, Venus Ltd acquired 100% of Saturn Ltd for Rs. 4,00,000. The fair value of the net identifiable assets of Saturn Ltd was Rs. 3,20,000 and goodwill was Rs. 80,000. Saturn Ltd is in coal mining business. On 31st March, 20X3, the government has cancelled licenses given to it in few states.

As a result Saturn's Ltd revenue is estimated to get reduce by 30%. The adverse change in market place and regulatory conditions is an indicator of impairment. As a result, Venus Ltd has to estimate the recoverable amount of goodwill and net assets of Saturn Ltd on 31st March, 20X3.

Venus Ltd uses straight line depreciation. The useful life of Saturn's Ltd assets is estimated to be 20 years with no residual value. No independent cash inflows can be identified to any individual assets. So, the entire operation of Saturn Ltd is to be treated as a CGU. Due to the regulatory entangle it is not possible to determine the selling price of Saturn Ltd as a CGU. Its value in use is estimated by the management at Rs. 2,12,000.

Suppose by 31st March, 20X5 the government reinstates the licenses of Saturn Ltd. The management expects a favourable change in net cash flows. This is an indicator that an impairment loss may have reversed. The recoverable amount of Saturn's Ltd net asset is reestimated. The value in use is expected to be Rs. 3,04,000 and fair value less cost to disposal is expected to be Rs. 2,90,000.

Calculate the impairment loss, if any. Also show the accounting treatment for reversal of impairment loss and the subsequent depreciation thereon.

11. SELF PRACTICE QUESTIONS :

Question 19 –

From the following details of an asset, find out:

(a) Impairment loss and its treatment.

(b) Current year depreciation for the year end.

Particulars of assets:

Cost of asset	Rs. 56 lakh
Useful life	10 years
Salvage value	Nil
Carrying value at the beginning of the year	Rs. 27.30 lakh
Remaining useful life	3 years
Recoverable amount at the beginning of the year	Rs. 12 lakh
Upward revaluation done in last year	Rs. 14 lakh

Question 20 – Venus Ltd.

Venus Ltd. has an asset, which is carried in the Balance Sheet on 31st March, 20X1 at Rs. 500 lakh. As at that date the value in use is Rs. 400 lakh and the fair value less costs to sells is Rs. 375 lakh.

From the above data:

(a) Calculate impairment loss.

(b) Prepare journal entries for adjustment of impairment loss.

Question 21 – A significant raw

A significant raw material used for plant Y's final production is an intermediate product bought from plant X of the same entity. X's products are sold to Y at a transfer price that passes all margins to X. 80% of Y's final production is sold to customers outside of the entity.

60% of X's final production is sold to Y and the remaining 40% is sold to customers outside of the entity. For each of the following cases, what are the cash-generating units for X and Y?

(a) If X could sell the products it sells to Y in an active market and internal transfer prices are higher than market prices, what are the cash-generating units for X and Y?

(b) If there is no active market for the products X sells to Y, what are the cash-generating units for X and Y?

Question 22 – XYZ Limited

XYZ Limited produces a single product and owns plants 1, 2 and 3. Each plant is located in a different country. Plant 1 produces a component that is assembled in either Plant 2 or Plant 3. The combined capacity of Plant 2 and Plant 3 is not fully utilised. XYZ Limited's products are sold worldwide from either Plant 2 or Plant 3, e.g., Plant 2's production can be sold in Plant 3's country if the products can be delivered faster from Plant 2 than from Plant 3. Utilisation levels of Plant 2 and Plant 3 depend on the allocation of sales between the two sites. If there is no active market for Plant 1's products, what are the cash-generating units for Plant 1, Plant 2 and Plant 3?

Question 23 – XYZ Limited

XYZ Limited has a cash-generating unit 'Plant A' as on 1st April, 20X1 having a carrying amount of Rs. 1,000 crore. Plant A was acquired under a business combination and goodwill of Rs. 200 crore was allocated to it. It is depreciated on straight line basis. Plant A has a useful life of 10 years with no residual value. On 31st March, 20X2, Plant A has a recoverable amount of Rs. 600 crore. Calculate the impairment loss on Plant A. Also, prescribe its allocation as per Ind AS 36.

Question 24 – Apex Ltd.

Apex Ltd. is engaged in manufacturing of steel utensils. It owns a building for its headquarters. The building used to be fully occupied for internal use. However, recently the company has undertaken a massive downsizing exercise as a result of which 1/3rd of the building became vacant. This vacant portion has now been given for on lease for 6 years. Determine the CGU of the building.

Question 25 – ABC Ltd.

ABC Ltd. has three cash-generating units: A, B and C, the carrying amounts of which as on 31st March, 20X1 are as follows:

(Rs. in crore)

Cash-generating units	Carrying amount	Remaining useful life
A	500	10
B	750	20
C	1,100	20

ABC Ltd. also has two corporate assets having a remaining useful life of 20 years

(Rs. in crore)

Corporate asset	Carrying amount	Remarks
X	600	The carrying amount of X can be allocated on a reasonable basis (i.e., pro rata basis) to the individual cash-generating units.
Y	200	The carrying amount of Y cannot be allocated on a reasonable basis to the individual cash generating units.

Recoverable amount as on 31st March, 20X1 is as follows:

Cash-generating units	Recoverable amount (Rs. in crore)
A	600

B	900
C	1,400
ABC Ltd.	3,200

Calculate the impairment loss, if any. Ignore decimals.

Question 26 – A Ltd.

A Ltd. purchased a machinery of Rs. 100 crore on 1st April, 20X1. The machinery has a useful life of 5 years. It has nil residual value. A Ltd. adopts straight line method of depreciation for depreciating the machinery. Following information has been provided as on 31st March, 20X2 :

Financial year	Estimated future cash flows (Rs. in crore)
20X2-20X3	15
20X3-20X4	30
20X4-20X5	40
20X5-20X6	10

Discount rate applicable : 10%

Fair value less costs to sell as on 31st March, 20X2 : Rs. 70 crore

Calculate the impairment loss, if any.

Question 27 –

Assuming in the above question, as on 31st March, 20X3, there is no change in the estimated future cash flows and discount rate. Fair value less costs to sell as on 31st March, 20X3 is Rs. 40 crore. How should it be dealt with under Ind AS 36?

Question 28 – A Ltd.

A Ltd. purchased an asset of Rs. 100 lakh on 1st April, 20X0. It has useful life of 4 years with no residual value. Recoverable amount of the asset is as follows:

As on	Recoverable amount
31st March, 20X1	Rs. 60 lakh
31st March, 20X2	Rs. 40 lakh
31st March, 20X3	Rs. 28 lakh

Calculate the amount of impairment loss or its reversal, if any, on 31st March, 20X1, 31st March, 20X2 and 31st March, 20X3.

Question 29 – A Ltd.

On 1 January Year 1, Entity Q purchased a machine costing Rs. 2,40,000 with an estimated useful life of 20 years and an estimated zero residual value. Depreciation is computed on straight-line basis. The asset had been re-valued on 1 January Year 3 to Rs. 2,50,000, but with no change in useful life at that date. On 1 January Year 4 an impairment review showed the machine's recoverable amount to be Rs. 1,00,000 and its estimated remaining useful life to be 10 years.

Calculate:

a) The carrying amount of the machine on 31 December Year 2 and the revaluation surplus arising on 1 January Year 3.

b) The carrying amount of the machine on 31 December Year 3 (immediately before the impairment).

c) The impairment loss recognised in the year to 31 December Year 4 and its treatment thereon

d) The depreciation charge in the year to 31 December Year 4.

Note: During the course of utilization of machine, the company did not opt to transfer part of the revaluation surplus to retained earnings.

Thanks ....

CHAPTER

10

IND AS 116 – LEASES

CONCEPTS COVERED

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1. OVERVIEW :

Ministry of Corporate Affairs (MCA) has notified new standard on leases i.e Ind AS 116 vide its notification dated 30th March, 2019. Lease accounting has undergone significant changes on introduction of Ind AS 116 which is fully converged with IFRS 16. This new standard replaced the erstwhile Ind AS 17 and is effective from financial periods beginning on or after 1st April, 2019.

1.1 OBJECTIVE :

Ind AS 116, Leases, identifies arrangements that are to be accounted for as leases. This unit discusses how to identify which arrangements, or components within an arrangement, should be accounted for under Ind AS 116 and sets out the principles for the recognition, measurement, presentation and disclosure of leases.

1.2 SCOPE :

Ind AS 116 shall be applied to ALL LEASES, including leases of Right-of-Use (ROU) assets in a sub-lease, EXCEPT for:

No.	Particulars	Reason
1	Leases to explore for or use minerals, oil, natural gas and similar nonregenerative resources	Within the scope of Ind AS 106 'Exploration for and Evaluation of Mineral Resources'
2	Leases of biological assets held by a lesse	Within the scope of Ind AS 41 'Agriculture'
3	Service concession arrangements	Within the scope of Appendix D of Ind AS 115 'Revenue from Contracts with Customers'
4	Licences of intellectual property granted by a lessor	Within the scope of Ind AS 115 'Revenue from Contracts with Customers'
5	Rights held by a lessee under licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights	Within the scope of Ind AS 38 'Intangible Assets'

#A lessee may, but is not required to, apply Ind AS 116 to leases of intangible assets other than those described herein.

1.3 RECOGNITION EXEMPTIONS :

In addition to above scope exclusions, a lessee can elect not to apply Ind AS 116's recognition requirements to:

1. Short-term leases; and
2. Leases for which the underlying asset is of low-value

If a lessee elects to apply the above recognition exemption, the lessee shall recognise the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis, if that basis is more representative of the pattern of the lessee's benefit.

1. **Short term leases:**

A short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less and does not include an option to purchase the underlying asset. As the determination is made at the commencement date, a lease cannot be classified as short-term if the lease term is subsequently reduced to less than 12 months.

Question 1 – Scenario A

Scenario A :

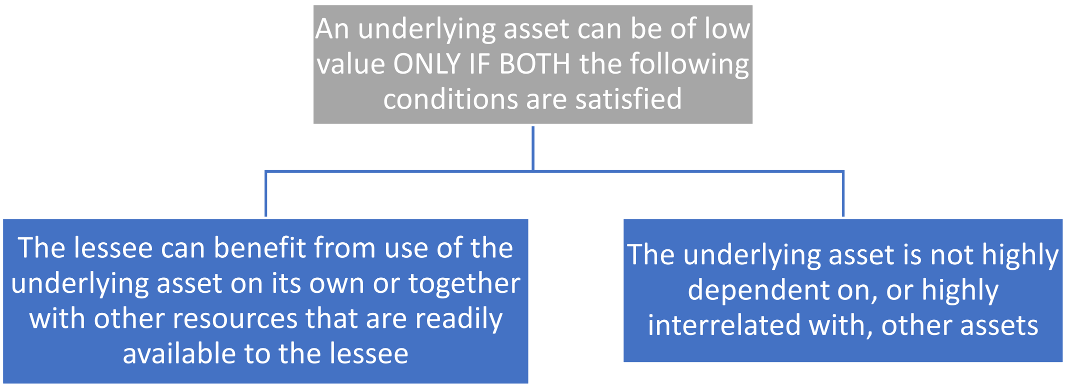
A lessee enters into a lease with a nine-month non-cancellable term with an option to extend the lease for four months. The lease does not have a purchase option. At the lease commencement date, the lessee is reasonably certain to exercise the extension option because the monthly lease payments during the extension period are significantly below market rates. Whether the lessee can take a short-term exemption in accordance with Ind AS 116?

Scenario B :

Assume the same facts as Scenario A except, at the lease commencement date, the lessee is not reasonably certain to exercise the extension option because the monthly lease payments during the optional extension period are at what the lessee expects to be market rates and there are no other factors that would make exercise of the renewal option reasonably certain. Will your answer be different in this case?

2. **Leases of low-value assets :**

Though Ind AS 116 does not explicitly define the leases of low-value assets, it provides the conditions based on which an asset can be treated as of low-value



The election for leases for which the underlying asset is of low value can be made on a lease-bylease basis. For example, an entity enters into a rental contract for a large number of laptops. Each laptop within the contract constitutes an identified asset. Entity has considered that the value of individual laptop would be low, even though the contract for all the laptops is not.

The exemption for leases of low—value items intends to capture leases that are high in volume but low in value — e.g. leases of small IT equipment (laptops, mobile phones, simple printers), leases of office furniture etc. Ind AS 116 is silent on any threshold to determine the value for classifying any asset as low value assets.

The following boxes depicts the important points regarding the leases of low-value assets:

1. Value of an underlying asset to be assessed based on the value of the asset when it is new, regardless of the age of the asset being leased*
2. Leases of low-value assets are exempted regardless of whether those leases are material to the lessee
3. The assessment performed on an absolute basis. It is not affected by the size, nature or circumstances of the lessee.

Examples of low-value underlying assets can include :

- tablet
- personal computers
- small items of office furniture
- telephones

Note : It is very important to note that if a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset, i.e., an intermediate lessor who subleases, or expects to sublease an asset, cannot account for the head lease as a lease of a low-value asset

2. WHAT IS A LEASE?

A lease is defined as

Lease

- a contract, or part of a contract
- that conveys the right
- to control the use
- of an identified asset
- for a period of time
- in exchange for consideration

The inception date is defined as the earlier of the following dates:

date of a lease agreement

date of commitment by the parties to the principal terms and conditions of the lease

2.1 IDENTIFIED ASSET :

An arrangement only contains a lease if there is an identified asset. Under Ind AS 116, an identified asset can be explicitly specified in a contract or implicitly specified at the time that the asset is made available for use by the customer.

Question 2 – Customer XYZ

Customer XYZ enters into a ten-year contract with Supplier ABC for the use of rolling stock specifically designed for Customer XYZ.
The rolling stock is designed to transport materials used in Customer XYZ's production process and is not suitable for use by other customers. The rolling stock is not explicitly specified in the contract but, Supplier ABC owns only one rolling stock that is suitable for Customer XYZ's use. If the rolling stock does not operate properly, the contract requires Supplier ABC to repair or replace the rolling stock.
Whether there is an identified asset?

Question 3 – Customer XYZ

Customer XYZ enters into a ten-year contract with Supplier ABC for the use of a car. The specification of the car is specified in the contract (i.e., brand, type, colour, options, etc.). At inception of the contract, the car is not yet built.
Whether there is an identified asset?

2.2 SUBSTANTIVE SUBSTITUTION RIGHTS :

As per IND AS 116 even if an asset is specified, a customer does not have the right to use an identified asset if, at inception of the contract, a supplier has the substantive right to substitute the asset throughout the period of use.

A supplier's right to substitute an asset is SUBSTANTIVE when BOTH of the following conditions are met:

1. The supplier has the **PRACTICAL ABILITY** to substitute alternative assets throughout the period of use
2. The supplier would **BENEFIT ECONOMICALLY** from the exercise of its right to substitute the asset

If the supplier has a right or an obligation to substitute the asset only on or after either a particular date, or the occurrence of a specified event, the supplier's substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use.

Ind AS 116 further clarifies that a customer should **presume** that a supplier's substitution right is **not substantive** when the customer **cannot readily determine** whether the supplier has a substantive substitution right. This requirement is intended to clarify that a **customer is not expected to exert undue effort to provide evidence that a substitution**

right is not substantive. However, suppliers should have sufficient information to make a determination of whether a substitution right is substantive.

Contract terms that allow or require a supplier to substitute alternative assets only when the underlying asset is not operating properly (for e.g., a normal warranty provision) or when a technical upgrade becomes available do not create a substantive substitution right.

Question 4 – Scenario A

Scenario A:

An electronic data storage provider (supplier) provides services through a centralised data centre that involve the use of a specified server (Server No. 10). The supplier maintains many identical servers in a single accessible location and determines, at inception of the contract, that it is permitted to and can easily substitute another server without the customer's consent throughout the period of use. Further, the supplier would benefit economically from substituting an alternative asset, because doing this would allow the supplier to optimise the performance of its network at only a nominal cost. In addition, the supplier has made clear that it has negotiated this right of substitution as an important right in the arrangement, and the substitution right affected the pricing of the arrangement. Whether the substitution rights are substantive and whether there is an identified asset?

Scenario B:

Assume the same facts as in Scenario A except that Server No. 10 is customised, and the supplier does not have the practical ability to substitute the customised asset throughout the period of use. Additionally, it is unclear whether the supplier would benefit economically from sourcing a similar alternative asset.

Whether the substitution rights are substantive and whether there is an identified asset?

2.3 IDENTIFIED ASSET – PHYSICALLY DISTINCT :

An identified asset must be physically distinct. A physically distinct asset may be an entire asset or a portion of an asset. For example, a building is generally considered physically distinct, but one floor within the building may also be considered physically distinct if it can be used independent of the other floors. Similarly, a capacity or other portion of an asset that is not physically distinct (for e.g., a capacity portion of a fibre optic cable) is not an identified asset unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

Question 5 – Customer XYZ

Customer XYZ enters into a 15-year contract with Supplier ABC for the right to use five fibres within a fibre optic cable between Mumbai and Pune. The contract identifies

five of the cable's 25 fibres for use by Customer XYZ. The five fibres are dedicated solely to Customer XYZ's data for the duration of the contract term. Assume that Supplier ABC does not have a substantive substitution right.
Whether there is an identified asset?

Question 6 – Customer XYZ

Scenario A:
Customer XYZ enters into a ten-year contract with Supplier ABC for the right to transport oil from India to Bangladesh through Supplier ABC's pipeline. The contract provides that Customer XYZ will have the right to use of 95% of the pipeline's capacity throughout the term of the arrangement. Whether there is an identified asset?

Scenario B:
Assume the same facts as in Scenario A, except that Customer XYZ has the right to use 65% of the pipeline's capacity throughout the term of the arrangement. Whether there is an identified asset?

2.4 RIGHT TO CONTROL :

To assess whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

1. The right to obtain substantially all of the economic benefits from use of the identified asset; and
2. The right to direct the use of the identified asset

Question 7 – ABC Ltd.

ABC Ltd enters into a contract with XYZ Ltd, which grants ABC Ltd exclusive rights to use a specific grain storage facility over a five-year period in the months of May and June. During these months, ABC Ltd has the right to decide which crops are placed in storage and when to remove them. XYZ Ltd provides the loading and unloading services for the warehouse activities. During the other ten months each year, XYZ Ltd has the right to determine how the warehouse will be used.
Which party has the right to control the use of the identified asset during the period of use?

1. **Right to Obtain Substantially All of the Economic Benefits:**
   Economic benefits from use of an asset include:
   - the asset's primary outputs (i.e., goods or services)
   - any by-products (for e.g., renewable energy credits that are generated through the use of the asset), including potential cash flows derived from these items.
   - benefits from using the asset that could be realised from a commercial transaction with a third party (for e.g., subleasing the asset)

Question 8 – Company MNO

Company MNO enters into a 15-year contract with Power Company PQR to purchase all of the electricity produced by a new solar farm. PQR owns the solar farm and will receive tax credits relating to the construction and ownership of the solar farm, and MNO will receive renewable energy credits that accrue from use of the solar farm.). Who has the right to substantial benefits from the solar farm?

2. Right to Direct the Use of the Identified Asset

A customer has the right to direct the use of an identified asset whenever it has the right to direct how and for what purpose the asset is used throughout the period of use (i.e., it can change how and for what purpose the asset is used throughout the period of use).

Ind AS 116 provides the following examples of decision-making rights that grant the right to change how and for what purpose an asset is used:

Particulars	Examples
The right to change the type of output that is produced by the asset	(i) Deciding whether to use a shipping container to transport goods or for storage (ii) Deciding on the mix of products sold from a retail unit
The right to change when the output is produced	Deciding when an item of machinery or a power plant will be used
The right to change where the output is produced	(i) Deciding on the destination of a truck or a ship (ii) Deciding where a piece of equipment is used or deployed
The right to change whether the output is produced and the quantity of that output	Deciding whether to produce energy from a power plant and how much energy to produce from that power plant

Question 9 – Customer X

Customer X enters into a contract with Supplier Y to use a vehicle for a five-year period. The vehicle is identified in the contract. Supplier Y cannot substitute another vehicle unless the specified vehicle is not operational (for e.g., if it breaks down). Under the contract:

- Customer X operates the vehicle (i.e., drives the vehicle) or directs others to operate the vehicle (for e.g., hires a driver).
- Customer X decides how to use the vehicle (within contractual limitations). For example, throughout the period of use, Customer X decides where the vehicle goes, as well as when or whether it is used and what it is used for. Customer X can also change these decisions throughout the period of use.
- Supplier Y prohibits certain uses of the vehicle (for e.g., moving it overseas) and modifications to the vehicle to protect its interest in the asset.

Whether Customer X has the right to direct the use of the vehicle throughout the period of lease?

Question 10 – Supplier H

Entity A contracts with Supplier H to manufacture parts in a facility. Entity A designed the facility and provided its specifications. Supplier H owns the facility and the land. Entity A specifies how many parts it needs and when it needs the parts to be available. Supplier H operates the machinery and makes all operating decisions including how and when the parts are to be produced, as long as it meets the contractual requirements to deliver the specified number on the specified date. Assuming supplier H cannot substitute the facility and hence is an identified asset.
Which party has the right to control the use of the identified asset (i.e., equipment) during the period of use?

Question 11 – Entity L

Entity L enters into a five—year contract with Company A, a ship owner, for the use of an identified ship. Entity L decides whether and what cargo will be transported, and when and to which ports the ship will sail throughout the period of use, subject to restrictions specified in the contract. These restrictions prevent Entity L from sailing the ship into waters at a high risk of piracy or carrying explosive materials as cargo. Company A operates and maintains the ship, and is responsible for safe passage.
Who has the right to direct the use of the ship during the period of use?

2.5 SEPARATION OF LEASE AND NON LEASE COMPONENTS :

Sometimes, there are contracts that contain rights to use multiple assets (for e.g., a building and an equipment, multiple pieces of equipment, etc.). The right to use each such asset is considered as a 'separate' lease component **ONLY IF BOTH** the following conditions are satisfied:

- The lessee can benefit from the use of the asset either on its own **OR** together with other resources that are readily available to the lessee (i.e., goods or services that are sold or leased separately, by the lessor or other suppliers, or that the lessee has already obtained from the lessor or in other transactions or events) **AND**
- The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

If one or both of these criteria are not met then, the right to use multiple assets is considered a 'single' lease component, i.e., not a 'separate' lease component.

Question 12 – Scenario A

Scenario A:
A lessee enters a lease of an excavator and the related accessories (for e.g., excavator attachments) that are used for mining purposes. The lessee is a local mining company

that intends to use the excavator at a copper mine. How many lease and non-lease components are there?

Scenario B:

Assume the same facts as in Scenario A, except that the contract also conveys the right to use an additional loading truck. This loading truck could be deployed by the lessee for other uses (for e.g., to transport iron ores at another mine).

2.6 SEPARATING LEASE COMPONENTS FROM NON – LEASE COMPONENTS :

There may be many contracts containing a lease coupled with an agreement to purchase or sell other goods or services (i.e., the non-lease components under Ind AS 116). For example, a supplier may lease a truck and also operate the leased asset on behalf of a customer (i.e., provide a driver). This service is not related to securing the use of the truck. Only items that contribute to securing the output of the asset are lease components. In this example, only the use of the truck is considered a lease component.

Question 13 – Entity L

Entity L rents an office building from Landlord M for a term of 10 years. The rental contract stipulates that the office is fully furnished and has a newly installed and tailored HVAC system. It also requires Landlord M to perform all common area maintenance (CAM) during the term of the arrangement. Entity L makes single monthly rental payment and does not pay for the maintenance separately. The office building has a useful life of 40 years and the HVAC system and office furniture each has a life of 15 years.

What are the units of account in the lease?

Ind AS 116 provides a practical expedient that permits lessees to make an accounting policy election, by CLASS OF UNDERLYING ASSET, to account for each separate lease component of a contract and any associated non-lease components as a SINGLE LEASE COMPONENT. It is important to note the such practical expedient is not permissible for lessor.

2.7 DETERMINING AND ALLOCATING THE CONSIDERATION IN THE CONTRACT – LESSEE :

Lessees that do not make an accounting policy election (by class of underlying asset) to use the practical expedient, as discussed above, to account for each separate lease component of a contract and any associated non-lease components as a single lease component, are required to allocate the consideration in the contract to the lease and non-lease components on a RELATIVE STAND-ALONE PRICE BASIS.

Question 14 – Scenario A

Scenario A :

A lessee enters into a five-year lease of equipment, with fixed annual payments of Rs.10,000. The contract contains fixed annual payments as follows: Rs.8,000 for rent, Rs.1,500 for maintenance and Rs.500 of administrative tasks. How the consideration would be allocated?

Scenario B :

Assume the fact pattern as in scenario A except that, in addition, the contract requires the lessee to pay for the restoration of the equipment to its original condition. How the consideration would be allocated?

Question 15 – A lessee enters

A lessee enters into a lease of an equipment. The contract stipulates the lessor will perform maintenance of the leased equipment and receive consideration for that maintenance service. The contract includes the following fixed prices for the lease and non-lease component:

Lease	Rs. 80,000
Maintenance	Rs. 10,000
Total	Rs. 90,000

Assume the stand-alone prices cannot be readily observed, so the lessee makes estimates, maximising the use of observable information, of the lease and non-lease components, as follows:

Lease	Rs. 85,000
Maintenance	Rs. 15,000
Total	Rs. 90,000

In the given scenario, assuming lessee has not opted the practical expedient, how will the lessee allocate the consideration to lease and non-lease component?

2.8 DETERMINING AND ALLOCATING THE CONSIDERATION IN THE CONTRACT – LESSORS :

Lessor are required to allocate the consideration in the contract to the lease and any associated non-lease components by applying Ind AS 115 Revenue from Contracts with Customers.

2.9 CONTRACT COMBINATIONS :

Ind AS 116 requires that two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty) be considered a 'single' contract IF ANY ONE of the following criteria is met:

1. The contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together **OR**
2. The amount of consideration to be paid in one contract depends on the price or performance of the other contract **OR**

The rights to use the underlying assets conveyed in the contracts (or some of the rights to use underlying assets conveyed in each of the contracts) are a single lease component.

2.10 PORTFOLIO APPLICATION :

Ind AS 116 applies to individual leases. However, entities that have a large number of leases of similar assets (for e.g., leases of a fleet of similar rolling stock) may face practical challenges in applying the leases model on a lease-by-lease basis.

Thus, Ind AS 116 includes a practical expedient that allows entities to use a portfolio approach for leases with similar characteristics if the entity reasonably expects that the effects on the financial statements would not differ materially from the application of the standard to the individual leases in that portfolio.

3. KEY CONCEPTS :

3.1 INCEPTION AND COMMENCEMENT OF LEASE :

Ind AS 116 requires customers and suppliers to determine whether a contract is or contains a lease at the inception of the contract.

The inception date is defined as the earlier of the following dates:

- date of a lease agreement
- date of commitment by the parties to the principal terms and conditions of the lease

The commencement date is defined as the date on which a lessor makes an underlying asset available for use by a lessee.

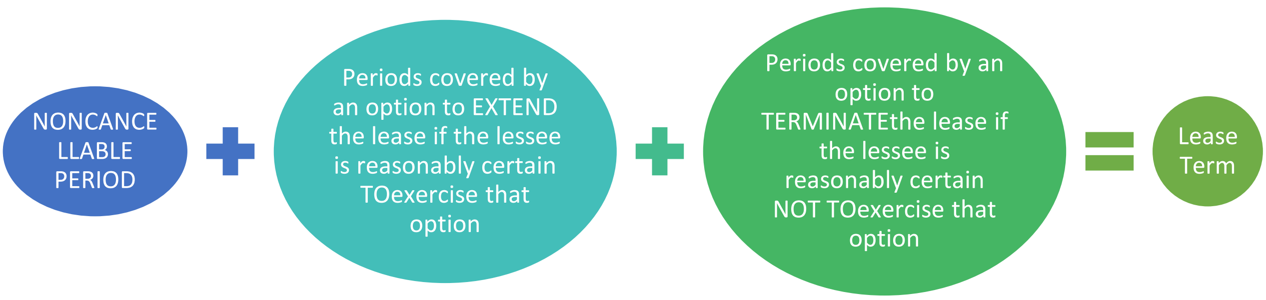
As discussed earlier, inception date is the date when an entity shall assess if the contract is or contains lease. While the commencement date is relevant because on that date:

(i) a lessee (except where the exemption of short-term lease or low-value asset is taken) initially recognises a lease liability and related Right of Use Asset (hereinafter referred to as "ROU Asset") on the commencement date

(ii) a lessor (for finance leases) initially recognises its net investment in the lease on the commencement date.

3.2 LEASE TERM :

In simple terms, lease term is the summation of the following



Question 16 – Scenario A

Scenario A:

Entity ABC enters into a lease for equipment that includes a non-cancellable term of six years and a two-year fixed-priced renewal option with future lease payments that are intended to approximate market rates at lease inception. There are no termination penalties or other factors indicating that Entity ABC is reasonably certain to exercise the renewal option. What is the lease term?

Scenario B:

Entity XYZ enters into a lease for a building that includes a non-cancellable term of eight years and a two-year, market-priced renewal option. Before it takes possession of the building, Entity XYZ pays for leasehold improvements. The leasehold improvements are expected to have significant value at the end of eight years, and that value can only be realised through continued occupancy of the leased property. What is the lease term?

Scenario C:

Entity PQR enters into a lease for an identified retail space in a shopping centre. The retail space will be available to Entity PQR for only the months of October, November and December during a non-cancellable term of seven years. The lessor agrees to provide the same retail space for each of the seven years. What is the lease term?

3.3 CANCELLABLE LEASES :

In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable. A 'contract' is defined as an agreement between two or more parties that creates enforceable rights and obligations.

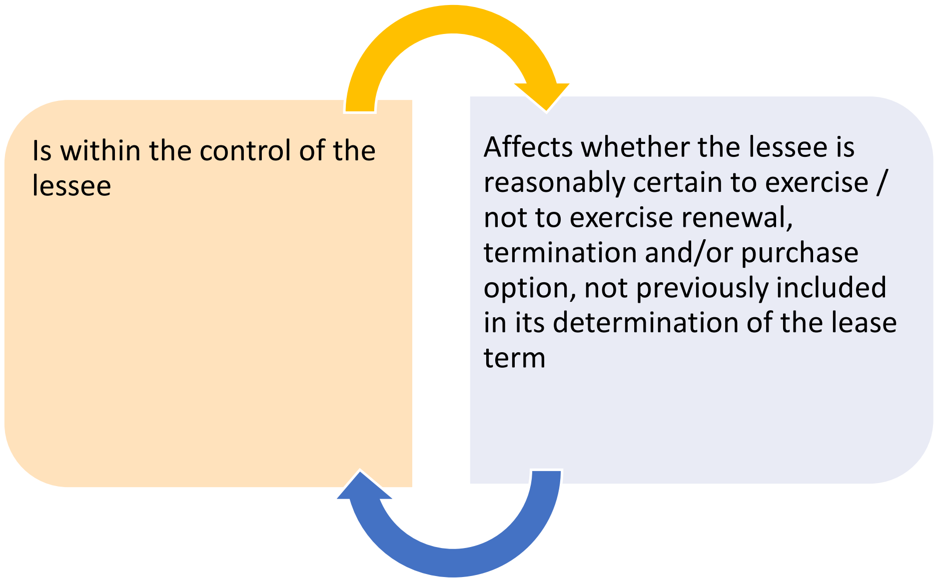
An arrangement is not enforceable if:

(i) both the lessor and lessee each have the right to terminate the lease without permission from the other party; AND

(ii) with no more than an insignificant penalty

Reassessment of lease term and purchase options (for lessees):

After the lease commencement, Ind AS 116 requires lessees to monitor leases for significant changes that could trigger a change in the lease term. Lessees are required to reassess the lease term upon the occurrence of either a significant event OR a significant change in the circumstances that:



Following are some of the examples of significant events or significant changes in circumstances within the lessee's control:

1) Constructing significant leasehold improvements that are expected to have significant economic value for the lessee when the option becomes exercisable

2) Making significant modifications or customisations to the underlying asset

3)Making a business decision that is directly relevant to the lessee's ability to exercise, or not to exercise, an option (e.g., extending the lease of a complementary asset or disposing of an alternative asset)

4) Subleasing the underlying asset for a period beyond the exercise date of the option

Question 17 – Retailer M

Retailer M enters into a five-year lease for a building floor, followed by two successive five-year renewal options. On the commencement date, Retailer M is not reasonably certain to exercise the extension option. At the end of third year, Retailer M extended to include another floor from year 4 due to a business acquisition. For this purpose, the lessee concludes a separate seven-year lease for an additional floor in the building already leased. Is Retailer M required to reassess the lease term in this case?

Question 18 – Company N

Company N has taken 10 vehicles on lease for an initial period of 5 years with an extension option at the option of the lessee for a further period of 5 years at the same rental amount. The remaining useful life of the vehicles as on the commencement date of the lease is 15 years. Company N has determined at the commencement date that it is reasonably certain to exercise the extension option and hence it has taken a period of 10 years for the lease. At the end of 4th year, there is an announcement by the government that all the cars of this particular model have to be discontinued from the road within 1 year due to the change in the pollution norms in the country. Will the lease term be reassessed in this case?

3.4 LEASE PAYMENTS :

Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

(a) fixed payments (including in-substance fixed payments), less any lease incentives

(b) variable lease payments that depend on an index or a rate

(c) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option

(d) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

(e) Expected Residual Value Guarantee

1. Fixed Lease Payment :

'Fixed payments' are defined as payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.

Question 19 – Entity M

Entity M and Lessor A enter into a 10-year lease of an office building for fixed annual lease payments of Rs.200,000. Per the terms of the lease agreement, annual fixed lease payments comprise Rs.170,000 for rent and Rs.30,000 for real estate taxes. What are the fixed lease payments for purposes of classifying the lease?

In-substance Lease Payment :

As mentioned above, lease payments also include any in-substance fixed lease payments which are the payments that may, in form, contain variability but that, in substance, are unavoidable.

Question 20 – Entity Q

Entity Q enters into a seven-year lease for a piece of machinery. The contract sets out the lease payments as follows.

– If Q uses the machinery within a given month, then an amount of 2,000 accrues for that month.

– If Q does not use the machinery within a given month, then an amount of 1,000 accrues for that month. What is considered as lease payment in this case?

Question 21 – Entity P

Entity P enters into a five-year lease for office space with Entity Q. The initial base rent is Rs 1 lakh per month. Rents increase by the greater of 1% of Entity P's generated sales or 2% of the previous rental rate on each anniversary of the lease commencement date. What are the lease payments for purposes of measuring lease liability?

Question 22 – Entity P

Company N leases a production line. The lease payments depends on the number of operating hours of the production line – i.e., N has to pay Rs.1,000 per hour of use. The annual minimum payment is Rs.10,00,000. The expected usage per year is 1,500 hours.

2. **Variable Payments :**

'Variable lease payments' are defined as the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

These may include, for e.g., payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates. Such payments are included in the lease payments and are measured using the prevailing index or rate at the measurement date (e.g., lease commencement date for initial measurement).

Question 23 – An entity

An entity enters into a 10-year lease of property. The lease payment for the first year is Rs 1,000. The lease payments are linked to the consumer price index (CPI), i.e., not a floating interest rate. The CPI at the beginning of the first year is 100. Lease payments are updated at the end of every second year. At the end of year one, the CPI is 105. At the end of year two, the CPI is 108. What should be included in lease payments?

Variable lease payments that do not depend on an index or rate and are not, in substance, fixed (as discussed above – In-substance fixed lease payments).

Examples may include payments such as those based on performance (for e.g., a percentage of sales) or usage of the underlying asset (for e.g., the number of hours flown, the number of units produced), are not included as lease payments. Instead, they are recognised in profit or loss in the period in which the event that triggers the payment occurs (unless they are included in the carrying amount of another asset in accordance with other Ind AS).

Question 24 – Entity XYZ

Entity XYZ is a medical equipment manufacturer and a supplier of the related consumables. Customer ABC operates a medical centre. Under the agreement entered into by both parties, Entity XYZ grants Customer ABC the right to use a medical laboratory machine at no cost and Customer ABC purchases consumables for use in the equipment from Entity XYZ at Rs 100 each.

The consumables can only be used for that equipment and Customer ABC cannot use other consumables as substitutes. There is no minimum purchase amount required in the contract.

Based on its historical experience, Customer ABC estimates that it is highly likely to purchase at least 8,000 units of consumables annually. Customer ABC has appropriately assessed that the arrangement contains a lease of medical equipment. There are no residual value guarantees or other forms of consideration included in the contract. Whether these payments affect the calculation of lease liability and ROU Asset? How does Entity XYZ and Customer ABC would allocate these lease payments?

Question 24 – Entity XYZ

Entity XYZ is a medical equipment manufacturer and a supplier of the related consumables. Customer ABC operates a medical centre. Under the agreement entered into by both parties, Entity XYZ grants Customer ABC the right to use a medical laboratory machine at no cost and Customer ABC purchases consumables for use in the equipment from Entity XYZ at Rs 100 each.

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Based on its historical experience, Customer ABC estimates that it is highly likely to purchase at least 8,000 units of consumables annually. Customer ABC has appropriately assessed that the arrangement contains a lease of medical equipment. There are no residual value guarantees or other forms of consideration included in the contract. Whether these payments affect the calculation of lease liability and ROU Asset? How does Entity XYZ and Customer ABC would allocate these lease payments?

Question 25 – Entity XYZ

Entity A enters into a five-year lease of an office building. The lease payments are ` 5,00,000 per year and the contract includes an additional water charge calculated as ` 0.50 per litre consumed. Payments are due at the end of year. Entity A elects to apply the practical expedient to combine lease and non-lease components

3. Exercise price of a purchase option :

If the lessee is reasonably certain to exercise a purchase option, the exercise price is included as a lease payment, i.e., entities consider the exercise price of asset purchase options included in lease contracts consistently with the evaluation of lease renewal and termination options (as discussed earlier).

4. Penalties for terminating a lease :

If it is reasonably certain that the lessee will not terminate a lease, the lease term is determined assuming that the termination option would not be exercised, and any termination penalty is excluded from the lease payments. Otherwise, the lease termination penalty is included as a lease payment. The determination of whether to include lease termination penalties as lease payments is similar to the evaluation of lease renewal options (as discussed earlier).

5. Residual value guarantees (lessees) :

'Residual value guarantee' is defined as a guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.

Question 26 – An entity

An entity (a lessee) enters into a lease and guarantees that the lessor will realise Rs.20,000 from selling the asset to another party at the end of the lease. At lease commencement, based on the lessee's estimate of the residual value of the underlying asset, the lessee determines that it expects that it will owe Rs.8,000 at the end of the lease. Whether the lessee should include the said payment of Rs.8,000 as a lease payment?

Residual value guarantees (lessors) :

Ind AS 116 requires lessors to include in the lease payments, any residual value guarantees provided to the lessor by the lessee, a party related to the lessee, or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. This amount included in the lease payments is different from that for a lessee which only includes the amount expected to be payable by lessee only (as discussed above).

3.5 LESSEE INVOLVEMENT BEFORE COMMENCEMENT DATE :

An entity may negotiate a lease before the underlying asset is available for use by the lessee. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Thus, based on the terms and conditions of the contract, a lessee may be required to make payments relating to the construction or design of the asset.

Costs relating to the construction or design of an underlying asset do not include payments made by the lessee for the right to use the underlying asset since, payments for the right to use an underlying asset are the payments for a lease, regardless of the timing of those payments. Thus, if the lessee incurs such costs, they are accounted by applying other Ind AS (such as Ind AS 16, Property, Plant and Equipment).

The lessee may obtain legal title to an underlying asset before that legal title is transferred to the lessor and the asset is leased to the lessee. Obtaining legal title does not in itself determine how to account for the transaction. If the lessee controls (or obtains control of) the underlying asset before that asset is transferred to the lessor, the transaction is a 'sale and leaseback transaction' (Please refer Section 3.6.2 'Sale and Leaseback Transactions' for further discussion)

However, if the lessee does not obtain control of the underlying asset before the asset is transferred to the lessor, the transaction is not a 'sale and leaseback transaction'. For e.g., this may be the case if a manufacturer, a lessor and a lessee negotiate a transaction for the purchase of an asset from the manufacturer by the lessor, which is in turn leased to the lessee. The lessee may obtain legal title to the underlying asset before legal title transfers to the lessor. In this case, if the lessee obtains legal title to the underlying asset, but does not obtain control of the asset before it is transferred to the lessor, the transaction is not accounted for as a sale and leaseback transaction, but it is rather accounted as a lease.

3.6 INITIAL DIRECT COSTS :

'Initial direct costs' are defined as the incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease.

Examples of costs included and excluded from initial direct costs is provided below.

	Included	Excluded
1	Commission (including payments to employees acting as selling agents)	Employee salaries
2	Legal fees resulting from the execution of the lease	Legal fees for services rendered before the execution of the lease
3	Lease document preparation costs incurred after the execution of the lease	Negotiating lease term and conditions
4	Certain payments to existing tenants to move out	Advertising

5	Consideration paid for a guarantee of a residual asset by an unrelated third party	Depreciation and amortization

3.7 DISCOUNT RATES :

Discount rates are used to determine the present value of the lease payments, which are used to determine Right of Use asset and Lease liability in case of a lessee and to measure a lessor's net investment in the lease.

For a Lessee :

As per Ind AS 116, the Discount Rate to be used should be:

THE INTEREST RATE IMPLICIT IN THE LEASE, if that rate can be readily determined.

OR

If not, then the lessee shall use THE LESSEE'S INCREMENTAL BORROWING RATE.

Where,

'Interest rate implicit in the lease' is defined as the rate of interest that causes the following

The present value of lease payments made by the lessee for the right to use the underlying asset + The unguaranteed residual value = The fair value of the underlying asset + Any initial direct costs of the lessor

the lessee's incremental borrowing rate is the rate of interest that

- the lessee would have to pay to borrow over a similar term,
- and with a similar security,
- the funds necessary to obtain an asset of a similar value to the Right of use Asset
- in a similar economic environment.

3.8 ECONOMIC LIFE :

'Economic Life' is defined as either

- the period over which an asset is expected to be economically usable by one or more users or
- the number of production or similar units expected to be obtained from an asset by one or more users.

4. LESSEE ACCOUNTING :

A 'lessee' is defined as an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.

4.1 INITIAL RECOGNITION AND MEASUREMENT :

At the commencement date, a lessee shall recognise a ROU Asset and a Lease Liability. Ind AS 116 requires lessees to recognise a liability to make lease payments and an asset representing the right to use the underlying asset (i.e., the ROU Asset) during the lease term for ALL leases (except for short-term leases and leases of low-value assets, if they choose to apply such exemptions).

Measurement :

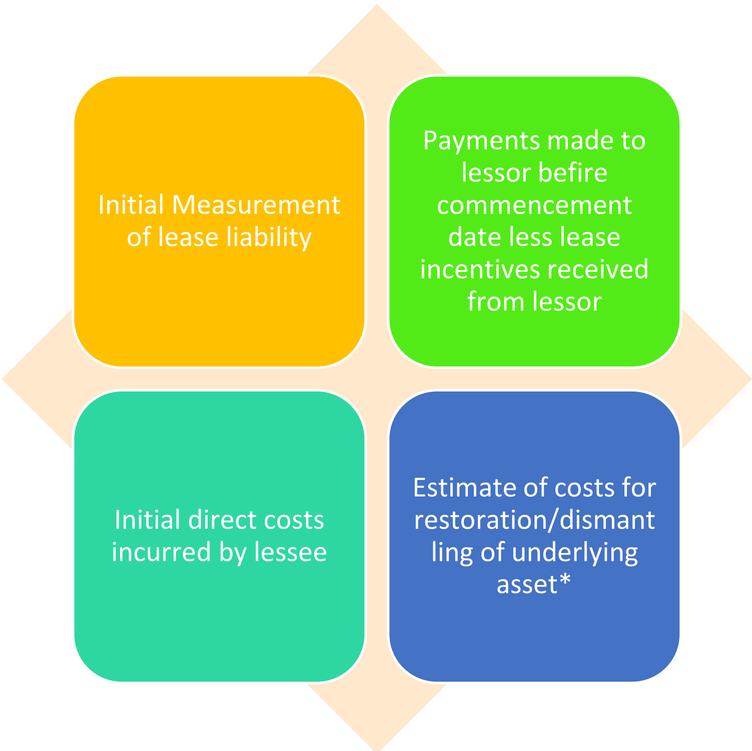
At the commencement date, a lessee initially measures the Lease Liability at the present value of the remaining lease payments to be made over the lease term, discounted using the rate implicit in the lease (or if that rate cannot be readily determined, the lessee's incremental borrowing rate). Lease payments used in measuring the lease liability are amounts due to the lessor excluding any payments that a lessee makes before lease commencement.

Question 27 – Entity L

Entity L enters into a lease for 10 years, with a single lease payment payable at the beginning of each year. The initial lease payment is Rs 100,000. Lease payments will increase by the rate of LIBOR each year. At the date of commencement of the lease, LIBOR is 2 per cent. Assume that the interest rate implicit in the lease is 5 per cent. How lease liability is initially measured?

Measuring the right-of-use asset :

A lessee initially measures the ROU Asset at COST, which consists of ALL of the following:



Question 28 – Entity Y and Entity Z

Entity Y and Entity Z execute a 12-year lease of a railcar with the following terms on January 1, 2016:

- The lease commencement date is February 1, 2016.
- Entity Y must pay Entity Z the first monthly rental payment of Rs.10,000 upon execution of the lease.
- Entity Z will pay Entity Y Rs.50,000 cash incentive to enter into the lease payable upon lease execution.

Entity Y incurred Rs.1,000 of initial direct costs, which are payable on February 1, 2016. Entity Y calculated the initial lease liability as the present value of the lease payments discounted using its incremental borrowing rate because the rate implicit in the lease could not be readily determined; the initial lease liability is Rs.850,000. How would Lessee Company measure and record this lease?

Question 29 – Company H

Company H leases an aircraft for a period of 5 years. The aircraft must undergo a planned check after every 100,000 flight hours. At the end of the lease, company H must have a check performed (or refund the costs to the lessor), irrespective of the actual number of flight hours. What are the lease payments for purposes of calculating ROU asset?

4.2 SUBSEQUENT MEASUREMENT - RIGHT-OF-USE ASSETS (ROU ASSET) :

After the commencement date, the right-of-use asset should be measured using a cost model, unless it applies the revaluation model as specified under Ind AS 16.

Cost model for right-of-use assets :

To follow the cost model, an entity measures a right-of-use asset at cost:

(a) Less accumulated depreciation and accumulated impairment losses (recognised in accordance with Ind AS 36, Impairment of Assets); and

(b) Adjusted for re-measurements of the lease liability

Depreciation for right-of-use assets :

ROU Assets measured under the cost model should be depreciated in accordance with the depreciation requirements given in Ind AS 16, subject to the following:

- If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term, or if the cost of the ROU Asset reflects that the lessee will exercise a purchase option, the ROU Asset should be depreciated from the commencement date to the end of the useful life of the underlying asset;
- otherwise, the right-of-use asset should be depreciated from the commencement date to the earlier of the end of the useful life of the ROU Asset and the end of the lease term.

Lease liability :

A Lease Liability should be accounted for in a manner similar to other financial liabilities (i.e., on an amortised cost basis).

Expense recognition :

Lessees recognise the following items in expense for leases:

- Depreciation of the ROU Asset
- Interest expense on the Lease Liability
- Variable lease payments that are not included in the lease liability (for e.g., variable lease payments that do not depend on an index or rate)
- Impairment of the ROU Asset

Question 30 – Entity ABC

Entity ABC (lessee) enters into a three-year lease of equipment. Entity ABC agrees to make the following annual payments at the end of each year:

Rs.20,000 in year one

Rs.30,000 in year two

Rs.50,000 in year three.

For simplicity purposes, there are no other elements to the lease payments (like purchase options, lease incentives from the lessor or initial direct costs). Assumed a discount rate of 12% (which is Entity ABC's incremental borrowing rate because the interest rate implicit in the lease cannot be readily determined). Entity ABC depreciates the ROU Asset on a straight-line basis over the lease term.

How would Entity ABC would account for the said lease under Ind AS 116?

Question 31 – Company EFG

Company EFG enters into a property lease with Entity H. The initial term of the lease is 10 years with a 5- year renewal option. The economic life of the property is 40 years and the fair value of the leased property is Rs 50 Lacs. Company EFG has an option to purchase the property at the end of the lease term for Rs 30 lacs. The first annual payment is Rs 5 lacs with an increase of 3% every year thereafter. The implicit rate of interest is 9.04%. Entity H gives Company EFG an incentive of Rs 2 lacs (payable at the beginning of year 2), which is to be used for normal tenant improvement. Company EFG is reasonably certain to exercise that purchase option.

How would EFG measure the right-of-use asset and lease liability over the lease term?

4.3 REMEASUREMENT :

Ind AS 116 requires lessees to REMEASURE LEASE LIABILITIES upon a change in lease payments on account of ANY of the following:

- The reassessment of lease term on account of reasonable certainty to exercise/not exercise of extension and/or termination option
- The reassessment of whether the lessee is reasonably certain to exercise an option to purchase the underlying asset

- In-substance fixed lease payment
- The amounts expected to be payable under residual value guarantees
- Future lease payments resulting from a change in an index or rate

When to use the 'original' and a 'revised' discount rate?

Revised Discount Rate	Original Discount Rate
Lessees use a revised discount rate when lease payments are updated for - reassessment of the lease term OR - a reassessment of a purchase option. The revised discount rate is based on the interest rate implicit in the lease for the REMAINDER of the lease term. If that rate cannot be readily determined, the lessee uses its incremental borrowing rate.	Lessees use the original discount rate when lease payments are updated for - a change in expected amounts for residual value guarantees AND - payments dependent on an index or rate, unless the rate is a floating interest rate. - the variability of payments is resolved so that they become in-substance fixed payments.

Question 32 – Entity W

Entity W entered into a contract for lease of retail store with Entity J on January 01/01/2017. The initial term of the lease is 5 years with a renewal option of further 3 years. The annual payments for initial term and renewal term is Rs.100,000 and Rs.110,000 respectively. The annual lease payment will increase based on the annual increase in the CPI at the end of the preceding year. For example, the payment due on 01/01/18 will be based on the CPI available at 31/12/17.

Entity W's incremental borrowing rate at the lease inception date and as at 01/01/2020 is 5% and 6% respectively and the CPI at lease commencement date and as at 01/01/2020 is 120 and 125 respectively.

At the lease commencement date, Entity W did not have a significant economic incentive to exercise the renewal option. In the first quarter of 2020, Entity W installed unique lease improvements into the retail store with an estimated five-year economic life. Entity W determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.

Is Entity W required to remeasure the lease in the first quarter of 2020?

4.4 LEASE MODIFICATION :

A 'lease modification' is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for e.g., adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

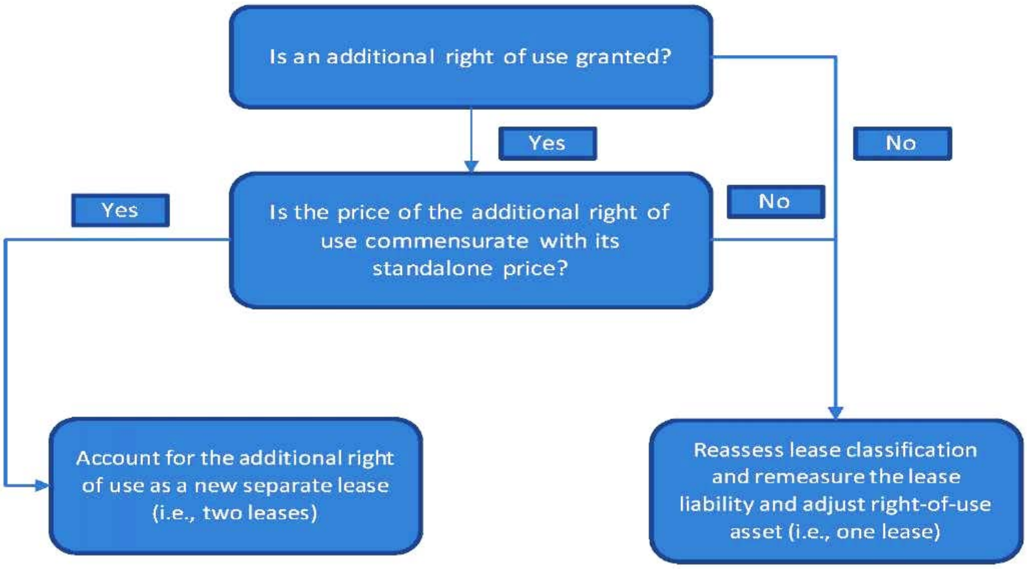
The following are examples of lease modifications that may be negotiated after the lease commencement date:

- A lease extension
- Early termination of the lease

- A change in the timing of lease payments
- Leasing additional space in the same building
- Surrendering a part of the underlying asset.

If a lease is modified (as stated above), the modified contract is evaluated to determine whether it is or contains a lease.
If a lease continues to exist, lease modification can result in:

- A separate lease OR
- A change in the accounting for the existing lease (i.e., not a separate lease).



Modification – Separate lease :

A lease modification is accounted for as a separate lease if both:

a. The modification increases the scope of the lease by adding the right to use one or more underlying assets; and

b. The consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope.

If both criteria are met, a lessee would follow the previous guidance on the initial recognition and measurement of lease liabilities and right-of-use assets.

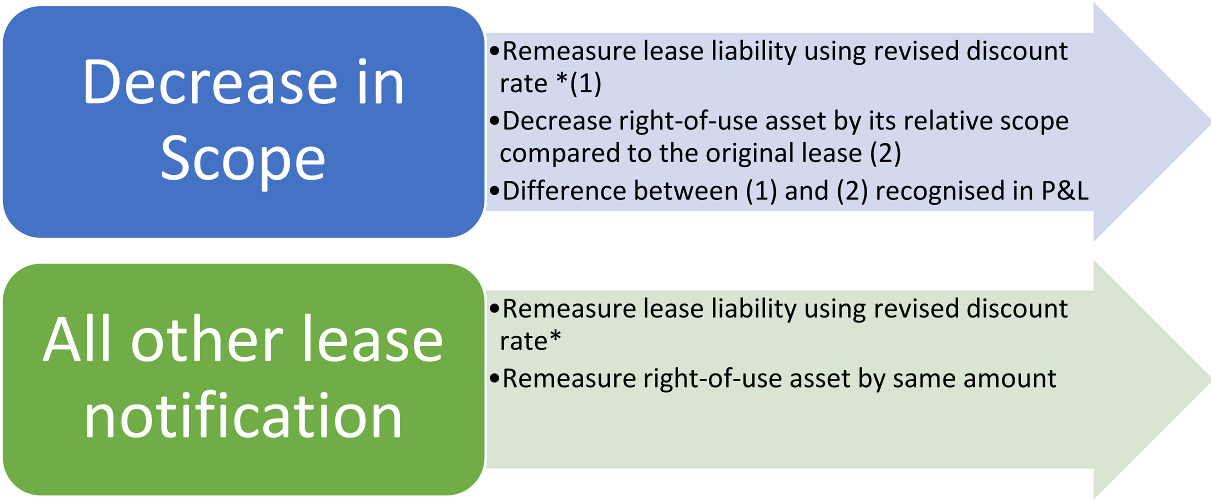
Question 33 – Lessee enters

Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).
How should the said modification be accounted for?

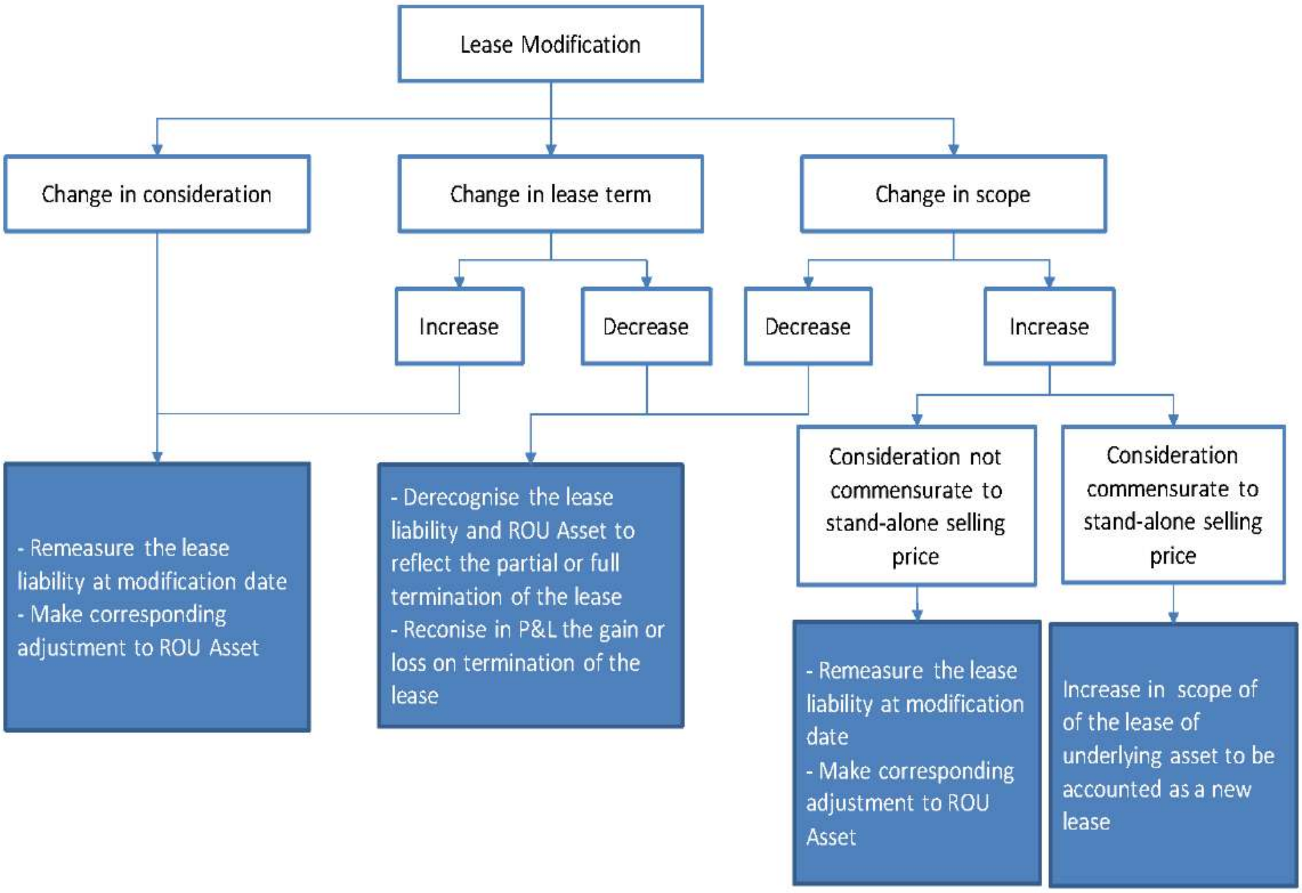
Modification- Not Separate Lease:

If a lease modification fails the test above (e.g. additional right of use granted, but not at a standalone price) or the modification is of any other type (e.g. a decrease in scope from the original contract), the lessee must modify the initially recognised components of the lease contract.

The accounting treatment required for lease modifications that are not accounted for as separate leases is summarised below:



Lease modification can be summarised as follows :



Question 34 – Lessee enters

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are Rs.1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., Rs.1,00,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7% p.a.

How should the said modification be accounted for?

Question 35 – Lessee enters

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are Rs.50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are Rs.30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5% p.a.

How should the said modification be accounted for?

Question 36 – Lessee enters

Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from Rs.1,00,000 per year to Rs.95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a. The annual lease payments are payable at the end of each year.

How should the said modification be accounted for?

Question 37 – Lessee enters

Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are Rs.1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a.

At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to:

A. include an additional 1,500 square metres of space in the same building starting from the beginning of Year 6 and

B. reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is Rs.1,50,000 payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a.

The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.

How should the said modification be accounted for?

4.5 PRESENTATION :

Balance Sheet	Profit and Loss Account	Cash Flow Statements
ROU Assets: They are presented either: - Separately from other assets (e.g., owned assets) OR - Together with other assets as if they were owned, with disclosures of the balance sheet line items that include ROU Assets and their amounts ROU Assets that meet the definition of investment property are presented as investment property **Lease Liabilities :** They are presented either: - Separately from other liabilities OR - Together with other liabilities with disclosure of the balance sheet line items that includes lease liabilities and their amounts	**Depreciation and Interest:** Depreciation on Right of use asset and interest expense accreted on lease liabilities are presented separately (i.e., they CANNOT be combined). This is because interest expense on the lease liability is a component of finance costs, which paragraph 82(b) of Ind AS 1 Presentation of Financial Statements requires to be presented separately in the statement of profit or loss.	**Principal portion of the lease liability: -** These cash payments are presented within financing activities **Interest portion of the lease liability: -** These cash payments are presented within financing activities **Short-term leases and leases of low-value assets:-** Lease payments pertaining to them (i.e., not recognised on the balance sheet as per Ind AS 116) are presented within operating activities **Variable lease payments not included in the lease liability:** - These are also presented within operating activities **Non-cash activity :** Such activity is disclosed as a supplemental non-cash item (e.g., the initial recognition of the lease at commencement)

4.6 DISCLOSURE :

Ind AS 116 requires lessees to present all disclosures in:

- a single note OR
- separate section in the financial statements.

Quantitative Disclosure Requirement		
Balance Sheet	**Profit and Loss Account**	**Cash Flow Statement**
– Additions to right-of-use assets. – Carrying value of right-of use assets at the end of the reporting period by class. – Maturity analysis of lease liabilities separately from other liabilities based on Ind AS 107 requirements.	– Depreciation for assets by class. – Interest expense on lease liabilities. – Short-term leases expensed* – Low-value leases expensed* – Variable lease payments expensed. – Income from subleasing. – Gains or losses arising from sale and leaseback transactions.	– Total cash outflow for leases.

Qualitative Disclosure Requirements

- A summary of the nature of the entity's leasing activities;
- Potential cash outflows the entity is exposed to that are not included in the measured lease liability, including:
- Variable lease payments;
- Extension options and termination options;
- Residual value guarantees; and
- Leases not yet commenced to which the lessee is committed.
- Restrictions or covenants imposed by leases; and
- Sale and leaseback transaction information.

5. LESSOR ACCOUNTING :

5.1 LEASE CLASSIFICATION :

A 'lessor' is defined as an entity that provides the right to use an underlying asset for a period of time in exchange for consideration.

At inception, lessors classify all leases as FINANCE LEASE or OPERATING LEASE.

- Where, a 'Finance Lease' is defined as a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset.
- Where, an 'Operating Lease' is defined as a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Ind AS 116 lists a number of examples that individually, or in combination, would normally lead to a lease being classified as a FINANCE LEASE:

- **Ownership**
  - The lease transfers ownership of the asset to the lessee by the end of the lease term
- **Purchase option**
  - The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised
- **Lease term**
  - The lease term is for the major part of the economic life of the asset even if title is not transferred
- **PV of Minimum Lease Payments**
  - At the inception date, the present value of the lease payments amounts to at least substantially all* of the fair value of the asset
- **Specialised Nature**
  - The asset is of such a specialised nature that only the lessee can use it without major modifications

Additionally, Ind AS 116 lists the following indicators of situations that, individually or in combination, could also lead to a lease being classified as a FINANCE LEASE:

- **Loss on cancellation**
  - If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
- **Risk of fair value of the residual asset**
  - Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (e.g., in the form of a rent rebate that is equal to most of the sale proceeds at the end of the lease)
- **Option to extend lease**
  - The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent

Lease classification test for land and buildings:

For a lease that includes both land and buildings elements, the lessor separately assesses the classification of each element as a finance lease or an operating lease, having fact that land normally has an indefinite economic life.

The lessor allocates lease payments between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception date. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case, the entire lease is classified as an operating lease.

For a lease of land and buildings in which the amount for the land element is immaterial to the lease, the lessor may treat the land and buildings as a single unit for the purpose of lease classification and classify it as a finance lease or an operating lease. In such a case, the lessor regards the economic life of the buildings as the economic life of the entire underlying asset.

Key concepts applied by the lessor:

'Gross investment in the lease' is the SUM of:

(a) the lease payments receivable by a lessor under a finance lease; AND

(b) any unguaranteed residual value accruing to the lessor.

'Net investment in the lease' is the gross investment in the lease discounted at the interest rate implicit in the lease.

'Unguaranteed residual value' is that portion of the residual value of the underlying asset, the realisation of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

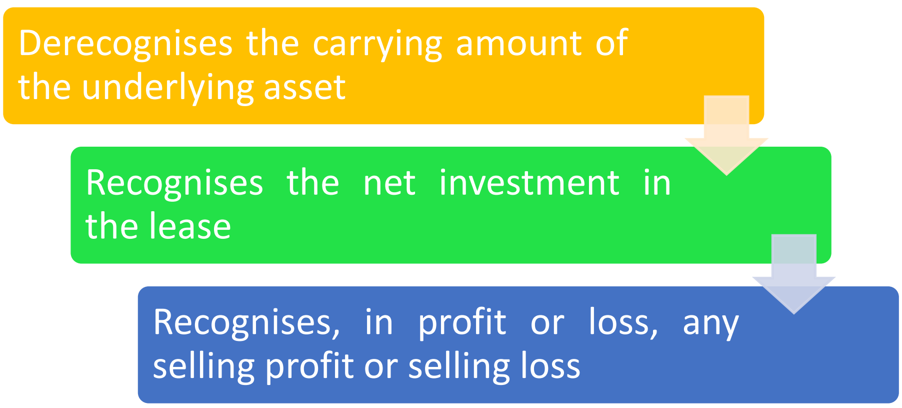
5.2 FINANCE LEASES :

Recognition :

At the commencement date, a lessor shall recognise assets held under a finance lease in its balance sheet and present them as a receivable at an amount equal to the net investment in the lease.

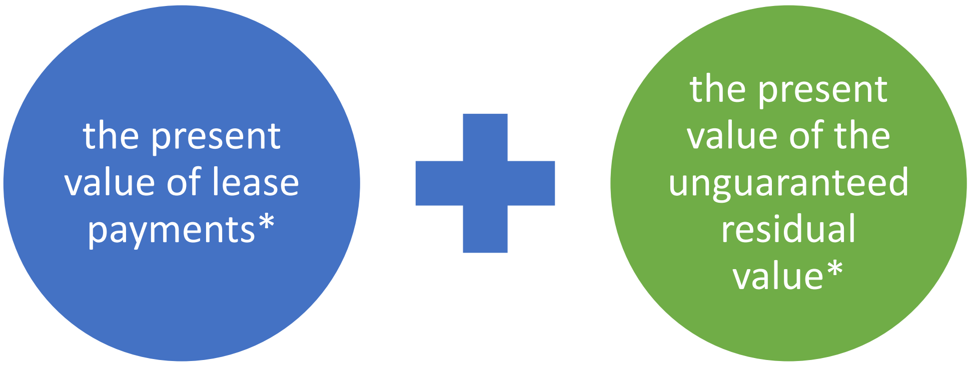
Initial Measurement :

At lease commencement, a lessor accounts for a finance lease, as follows:



For finance leases (other than those involving manufacturer and dealer lessors), initial direct costs are included in the initial measurement of the finance lease receivable. Initial direct costs are included in the lease, and are not added separately to the net investment in lease.

The net investment in the lease is initially measured as the sum of:

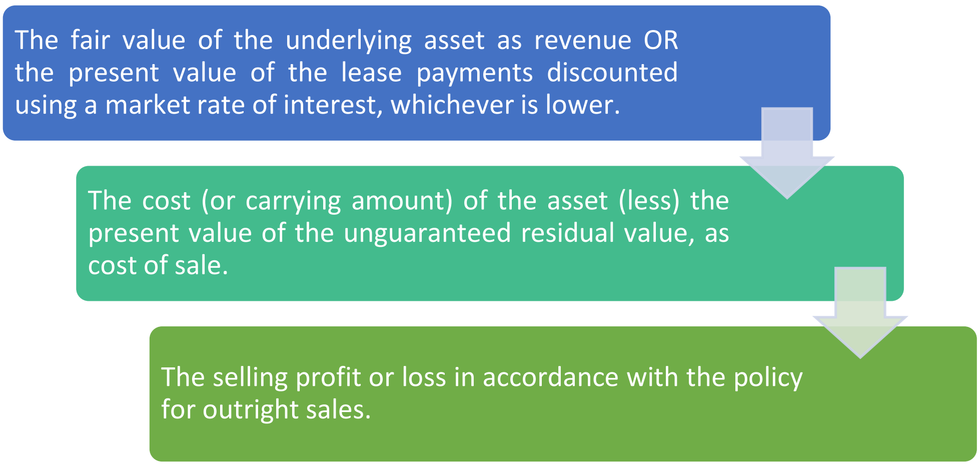


Any selling profit or loss is measured as the difference between the fair value of the underlying asset or the lease receivable, if lower, and the carrying amount of the underlying asset, net of any unguaranteed residual asset.

Initial Measurement – Manufacturer or Dealer Lessors :

At the commencement date, a manufacturer or dealer lessor recognises selling profit or loss in accordance with its policy for outright sales to which Ind AS 115 applies.

Therefore, at lease commencement, a manufacturer or dealer lessor recognises the following:



Accounting for initial direct costs shall be done in the following manner :

Finance Lease:

Ind AS 116 requires 'lessors' (other than manufacturer or dealer lessors) to include initial direct costs in the initial measurement of their net investments in finance leases and reduce the amount of income recognised over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease and they are not added separately. (Initial direct costs related to finance leases incurred by manufacturer or dealer lessors are expensed at lease commencement).

Operating Lease :

Ind AS 116 requires lessors to include initial direct costs in the carrying amount of the underlying asset in an operating lease. These initial direct costs are recognised as an expense over the lease term on the same basis as lease income.

Subsequent Measurement :

After lease commencement, a lessor accounts for a finance lease, as follows:

- Recognises finance income (in profit or loss) over the lease term in an amount that produces a constant periodic rate of return on the remaining balance of the net investment in the lease (i.e., using the interest rate implicit in the lease).
- Income is recognised on the components of the net investment in the lease, which is Interest on the lease receivables.
- Reduces the net investment in the lease for lease payments received (net of finance income calculated above)
- Separately recognises income from variable lease payments that are not included in the net investment in the lease (e.g., performance- or usage-based variable payments) in the period in which that income is earned
- Recognises any impairment of the net investment in the lease

Remeasurement of the net investment in the lease:

After lease commencement, the net investment in a lease is NOT REMEASURED UNLESS in either of the following situations:

- The lease is modified (i.e., a change in the scope of the lease, or the consideration for the lease, that was not part of the original terms and conditions of the lease) and the modified lease is not accounted for as a separate contract

OR

- The lease term is revised when there is a change in the non-cancellable period of the lease.

Question 38 – A Lessor enters

A Lessor enters into a 10-year lease of equipment with Lessee. The equipment is not specialised in nature and is expected to have alternative use to Lessor at the end of the 10-year lease term. Under the lease:

- Lessor receives annual lease payments of Rs.15,000, payable at the end of the year
- Lessor expects the residual value of the equipment to be Rs.50,000 at the end of the 10-year lease term
- Lessee provides a residual value guarantee that protects Lessor from the first Rs.30,000 of loss for a sale at a price below the estimated residual value at the end of the lease term (i.e., Rs.50,000)
- The equipment has an estimated remaining economic life of 15 years, a carrying amount of Rs.1,00,000 and a fair value of Rs.1,11,000
- The lease does not transfer ownership of the underlying asset to Lessee at the end of the lease term or contain an option to purchase the underlying asset

- The interest rate implicit in the lease is 10.078%.

How should the Lessor account for the same in its books of accounts?

5.3 OPERATING LEASES :

Recognition and Measurement :

A lessor shall recognise lease payments from operating leases as income on either a straight-line basis OR another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit derived from the use of the underlying asset is diminished.

Lessors subsequently recognise lease payments over the lease term on either a straight-line basis or another systematic and rational basis if that basis better represents the pattern in which benefit is expected to be derived from the use of the underlying asset. After lease commencement, lessors recognise variable lease payments that do not depend on an index or rate (e.g., performance- or usage- based payments) as they are earned.

Ind AS 116 also requires lessors of operating leases to defer initial direct costs at lease commencement and recognise them over the lease term on the same basis as lease income.

5.4 LEASE MODIFICATIONS :

A 'lease modification' is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for e.g., adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

Modification- Separate lease :

A lease modification is accounted for as a separate lease if both:

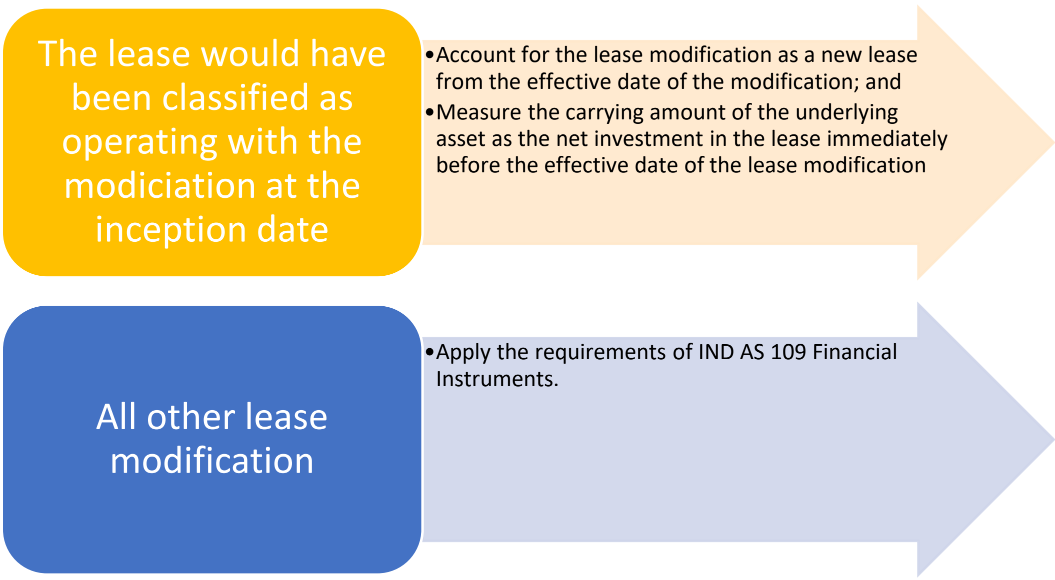
A. The modification increases the scope of the lease by adding the right to use one or more underlying assets; and

B. The consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope.

If both criteria are met, a lessor would follow the existing lessor guidance on initial recognition and measurement.

Modification- Not Separate lease :

If a lease modification fails the test to be considered as separate lease as mentioned above, the lessor follows the following guidance:



Operating Lease Modification:

A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

5.5 PRESENTATION :

Lessors have the following presentation requirements under Ind AS 116, depending on the classification of the leases:

Finance Leases	Operating Leases
Lessors recognise assets held under a finance lease in the balance sheet and present them as a receivable at an amount equal to the net investment in the lease under Ind AS 116. In addition, the net investment in the lease is subject to the same considerations as other assets in classification as current or non-current assets in a classified balance sheet.	Lessors are required to present underlying assets subject to operating leases according to the nature of that asset in the balance sheet under Ind AS 116.

5.6 DISCLOSURE :

Following are the disclosure requirements under Ind AS 116 for lessors:

Quantitative Disclosure Requirement		
Finance Lease	–	Selling profit or loss;
	–	Finance income on the net investment;
	–	Income from variable lease payments;
	–	Qualitative and quantitative explanation of changes in the net investment; and
	–	Maturity analysis of lease payments receivable.

Operating Lease	– Lease income, separately disclosing variable lease payments; – Disclosure requirements of Ind AS 16 for leased assets, separating leased assets from non-leased assets; – Other applicable disclosure requirements based on the nature of the underlying asset (eg. Ind AS 36, Ind AS 38, Ind AS 40 and Ind AS 41); and – Maturity analysis of lease payments.
Qualitative Disclosure Requirements	
This disclosure would include the nature of the lessor's leasing activities and how the lessee manages risks associated with those activities, including risk management on rights retained in underlying assets and risk management strategies including: – Buy-back agreements; – Residual value guarantees; – Variable lease payments for excess use; and – Any other risk management strategies.	

6. OTHER MATTERS :

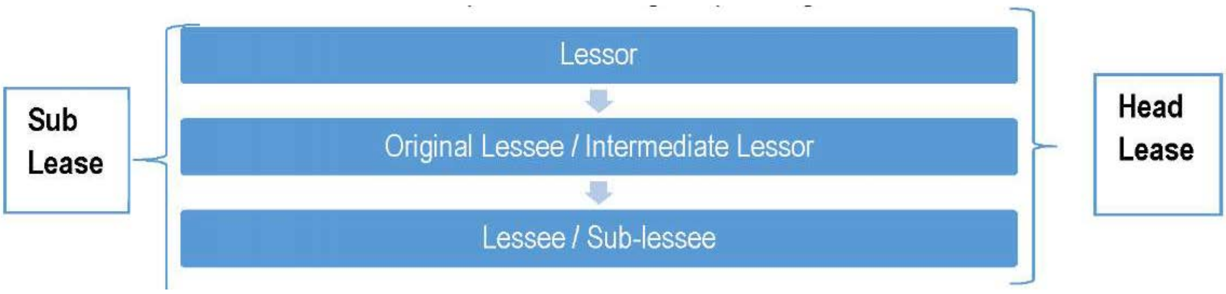
6.1 SUB LEASES :

Recognition and Measurement :

A 'Sub-lease' is defined as a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the lease ('head lease') between the head lessor and lessee remains in effect.

Lessees often enter into arrangements to sublease a leased asset to a third party while the original lease contract is in effect, where, one party acts as both the lessee and lessor of the same underlying asset. The original lease is often referred to as a 'head lease', the original lessee is often referred to as an 'intermediate lessor' or 'sub-lessor' and the ultimate lessee is often referred to as the 'sub-lessee'.

It can be demonstrated with the help of a following simple diagram:



Intermediate Lessor Accounting :

Where an underlying asset is re-leased by a lessee to a third party and the original lessee retains the primary obligation under the original lease, the transaction is a sublease, i.e., the original lessee generally continues to account for the original lease (the head lease) as a lessee and accounts for the sublease as the lessor (intermediate lessor).

Question 39 – Entity ABC

Entity ABC (original lessee/intermediate lessor) leases a building for five years. The building has an economic life of 40 years. Entity ABC subleases the building for four years.
How should the said sublease be classified by Entity ABC?

The intermediate lessor accounts for the sublease as follows :

If the sublease is classified as a 'Finance Lease'	If the sublease is classified as an 'Operating Lease'
The original lessee derecognises the ROU Asset on the head lease at the sublease commencement date and continues to account for the original lease liability in accordance with the lessee accounting model. The original lessee (as the intermediate lessor) recognises a net investment in the sublease and evaluates it for impairment.	The original lessee continues to account for the lease liability and ROU asset on the head lease like any other lease. If the total remaining carrying amount of the ROU asset on the head lease exceeds the anticipated sublease income, this may indicate that the ROU asset associated with the head lease is impaired (which is assessed for impairment under Ind AS 36).

An intermediate lessor who subleases, or expects to sublease an asset, CANNOT account for the head lease as a lease of a low-value asset even when the required criteria w.r.t. 'leases of lowvalue assets' (as discussed earlier) are satisfied.

Question 40 – Entity XYZ

Head lease:
An intermediate lessor enters into a five-year lease for 10,000 square metres of office space (the head lease) with Entity XYZ (the head lessor).
Sublease:
At the beginning of Year 3, the intermediate lessor subleases the 10,000 square metres of office space for the remaining lease term i.e. three years of the head lease to a sub-lessee. How should the said sublease be classified and accounted for by the Intermediate Lessor?

Question 41 – Entity PQR

Head lease:
An intermediate lessor enters into a five-year lease for 10,000 square metres of office space (the head lease) with Entity PQR (the head lessor).
Sublease:
At the commencement of the head lease, the intermediate lessor subleases the 10,000 square metres of office space for two years to a sub-lessee. How should the said sublease be classified and accounted for by the Intermediate Lessor?

6.2 SALE AND LEASEBACK TRANSACTIONS :

A sale and leaseback transaction involves the transfer of an asset by an entity (the seller-lessee) to another entity (the buyer-lessor) and the leaseback of the same asset by the seller-lessee.

Sale and leaseback transactions would no longer provide lessees with a source of off-balance sheet financing because under Ind AS 116, lessees are required to recognise most leases on the balance sheet (i.e., all leases except for leases of low-value assets and short-term leases depending on the lessee's accounting policy election).

Further, both the seller-lessee and the buyer-lessor are required to apply Ind AS 115 to determine whether to account for a sale and leaseback transaction as a sale and purchase of an asset.

How to determine whether the transfer of an asset is a sale:

As discussed above, when determining whether the transfer of an asset should be accounted for as a sale or purchase, both the seller-lessee and the buyer-lessor shall apply the requirements of Ind AS 115 on when an entity satisfies a performance obligation by transferring 'control' of an asset. Thus, there are following two possibilities in this scenario:

If Control is passed	If Control is NOT passed
If the control of an underlying asset is passed to the buyer-lessor, the transaction is accounted for as a 'sale or purchase' of the asset and a 'lease'.	If the control of an underlying asset is NOT passed to the buyer-lessor, both the seller-lessee and the buyer-lessor account for the transaction as a 'financing transaction'.

Transactions in which the transfer of an asset is a 'SALE':

If the transfer of an asset by the seller-lessee satisfies the requirements of Ind AS 115 to be accounted for as a 'sale' of the asset:

Seller-lessee	Buyer-lessor
The seller-lessee shall measure the ROU asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor. Thus, the seller-lessee will: - Derecognise the underlying asset - Recognise the gain or loss, if any, that relates to the rights transferred to the buyer-lessor (adjusted for off market terms)	The buyer-lessor shall account for the purchase of the asset, applying applicable Ind ASs and for the lease, applying the lessor accounting requirements under Ind AS 116. Thus, a buyer-lessor accounts for the purchase of the asset in accordance with other Ind ASs based on the nature of the asset (for e.g., Ind AS 16 for property, plant and equipment).

When a sale occurs, both the seller-lessee and the buyer-lessor account for the leaseback in the same manner as any other lease (with adjustments for any off-market terms). Specifically, a seller-lessee recognises a lease liability and ROU asset for the leaseback (subject to the optional exemptions for short-term leases and leases of low-value assets).

An entity shall make the following adjustments to measure the sale proceeds at fair value if:

- the fair value of the consideration for the sale of an asset does not equal the fair value of the asset

OR

- the payments for the lease are not at market rates:
  - (a) any below-market terms shall be accounted for as a prepayment of lease payments; AND
  - (b) any above-market terms shall be accounted for as an additional financing provided by the buyer-lessor to the seller-lessee.

The sale transaction and the resulting lease are generally interdependent and negotiated as a package. Consequently, some transactions could be structured with a negotiated sales price that is above or below the asset's fair value and with lease payments for the resulting lease that are above or below the market rates. These off-market terms could mislead / falsify the gain or loss on the sale and the recognition of lease expense and lease income for the lease. Thus, to ensure that the gain or loss on the sale and the lease-related assets and liabilities associated with such transactions are NEITHER understated NOR overstated, Ind AS 116 requires adjustments for any off-market terms of sale and leaseback transactions, on the more readily determinable basis (as discussed above). Thus, the two possibilities of the sale price OR the present value of the lease payments being 'less' or 'greater' than the fair value of the asset OR present value of the market lease payments, respectively, is discussed in detail :

When sale price or Present Value is LESS	When sale price or Present Value is GREATER
Using the more readily determinable basis:	Using the more readily determinable basis:
When the sale price is LESS than the underlying asset's fair value OR	When the sale price is GREATER than the underlying asset's fair value OR
the present value of the lease payments is LESS than the present value of the market lease payments,	the present value of the lease payments is GREATER than the present value of the market lease payments,
a seller-lessee recognises the difference as an increase to the sales price and the initial measurement of the ROU asset as a 'lease prepayment'.	a seller-lessee recognises the difference as a reduction in the sales price and an 'additional financing received' from the buyer-lessor.
Buyer-lessors are also required to adjust the purchase price of the underlying asset for any off-market terms. Such adjustments are recognised as:	

-	'lease prepayments' made by the seller-lessee OR
-	'additional financing provided' to the seller-lessee.

Question 42 – An entity

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of Rs.30,00,000. Immediately before the transaction, the building is carried at a cost of Rs.15,00,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 20 years, with annual payments of Rs.2,00,000 payable at the end of each year.

The terms and conditions of the transaction are such that the transfer of the building by Sellerlessee satisfies the requirements for determining when a performance obligation is satisfied in Ind AS 115 Revenue from Contracts with Customers.

The fair value of the building at the date of sale is Rs.27,00,000. Initial direct costs, if any, are to be ignored. The interest rate implicit in the lease is 12% p.a., which is readily determinable by Seller-lessee.

Buyer-lessor classifies the lease of the building as an operating lease.

How should the said transaction be accounted by the Seller-lessee and the Buyer-lessor?

Transactions in which the transfer of an asset is 'NOT a SALE':

If the transfer of an asset by the seller-lessee does not satisfy the requirements of Ind AS 115 to be accounted for as a 'sale' of the asset :

Seller-lessee	Buyer-lessor
The seller-lessee shall continue to recognise the transferred asset and shall recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying Ind AS 109.	The buyer-lessor shall not recognise the transferred asset and shall recognise a financial asset equal to the transfer proceeds. It shall account for the financial asset applying Ind AS 109.
Thus, the seller-lessee accounts for the transaction as a financing transaction. The seller-lessee keeps the transferred asset subject to the sale and leaseback transaction on its balance sheet and accounts for amounts received as a financial liability in accordance with Ind AS 109. The seller-lessee decreases the financial liability by the payments made less the portion considered as interest expense.	Thus, the buyer-lessor does not recognise the transferred asset and accounts for the amounts paid as a receivable in accordance with Ind AS 109.

7. TRANSITION APPROACH :

An entity shall apply Ind AS 116 for annual reporting periods beginning on or after 01 April 2019.

For the purposes of the requirements of this 'Transition' section, the date of initial application is the beginning of the annual reporting period in which an entity first applies Ind AS 116.

Thus, Ind AS 116's transition provisions are applied at the beginning of the annual reporting period in which the entity first applies Ind AS 116 (i.e., the date of initial application). For e.g., an entity with a reporting date of 31 March 2020, applies the transition provisions on 01 April 2019.

Transition Options for Lessees :

A lessee is required to apply Ind AS 116 to its leases in either of the following ways:

Full Retrospective Approach	Modified Retrospective Approach
Retrospectively to each prior reporting period presented, applying Ind AS 8, i.e., an entity applies Ind AS 116 as if it had been applied since the inception of all lease contracts that are presented in the financial statements. If Ind AS 116 is applied at 01 April 2019, this means that, in the 31 March 2020 financial statements, the comparative period to 31 March 2019 must be restated (assuming that this is the only comparative period presented). A restated opening balance sheet at 01 April 2018 will also need to be disclosed as required by Ind AS 1. Hence, the balance sheets for 3 period will be presented: As at 31 March 2020, 31 March 2019 & 1 April 2018	Retrospectively with cumulative effect of initially applying Ind AS 116 recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of the initial application. Therefore, restatement of comparatives is not required and only Balance sheets for reporting date and comparative date is required to be presented.

1. Modified Retrospective Approach :

Leases Previously Classified as Operating Leases :

When applying the modified retrospective approach, a lessee does not restate comparative figures rather, a lessee recognises the cumulative effect of initially applying Ind AS 116 as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

For leases previously classified as operating leases under Ind AS 17, a lessee recognises a lease liability measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application. A lessee measures the ROU asset on a lease-by-lease basis, at either:

- Its carrying amount as if Ind AS 116 had always been applied since the commencement date, but using a discount rate based on the lessee's incremental borrowing rate at the date of initial application (Alternative 1)

OR

- An amount equal to the lease liability, adjusted for previously recognised prepaid or accrued lease payments (Alternative 2)

Additionally, a lessee is also permitted to apply the following practical expedients to leases previously classified as operating leases (when applying modified retrospective approach), on a **lease-by-lease basis:**

Discount rate	• Apply a single discount rate to a portfolio of leases with reasonably similar characteristics;
Onerous contracts	• Rely on its assessment of whether leases are onerous by applying Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets as opposed to performing an impairment review;
Short term leases	• Not recognise leases whose term ends within 12 months of the date of initial application of Ind AS 116. If this election is taken, these leases are accounted for as short-term leases;
Initial direct cost	• Exclude initial direct costs from the measurement of right-of-use assets at the date of initial application;
Hindsight	• Use hindsight, such as in determining the lease term for leases that contain options

Leases Previously Classified as Finance Leases :

When applying modified retrospective approach, for leases that were classified as finance leases applying Ind AS 17, the carrying amount of the ROU asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying Ind AS 17. For such leases, a lessee shall account for the ROU asset and the lease liability applying Ind AS 116 from the date of initial application. Thus, a lessee will not change its initial carrying amounts for assets and liabilities under finance leases existing at the date of initial application of Ind AS 116.

For leases previously classified as operating leases and finance leases, the below table summarises the application of Modified retrospective approach:

Operating Lease	**Lease liability**	**Measure at the present value of the remaining lease payments, discounted using lessee's incremental borrowing rate at the date of initial application**
	Right-of-use asset	Retrospective calculation, using a discount rate based on lessee's incremental borrowing rate at the date of initial application.
		or
		Amount of lease liability (adjusted by the amount of any previously recognised prepaid or accrued lease payments relating to that lease).
		Lessee can choose one of the alternatives on a lease-by-lease basis.
Finance Lease	Lease liability	Carrying amount of the lease liability immediately before the date of initial application.
	Right-of-use asset	Carrying amount of the lease asset immediately before the date of initial application.
	Application of Ind AS 116	Apply the provisions of this standard to Right of Use asset and lease liability from the date of initial application.

The standard also prescribes certain practical expedients under Modified retrospective approach to leases previously classified as operating leases applying Ind AS 17.

Question 43 – A retailer

A retailer (lessee) entered into 3-year lease of retail space beginning at 1 April 2017 with three annual lease payments of Rs 2,00,000 due on 31 March 2018, 2019 and 2020, respectively. The lease is classified as an operating lease under Ind AS 17. The retailer initially applies Ind AS 116 for the first time in the annual period beginning at 1 April 2019. The incremental borrowing rate at the date of the initial application (i.e., 1 April 2019) is 10% p.a. and at the commencement of the lease (i.e., 1 April 2017) was 12% p.a. The ROU asset is subject to straight-line depreciation over the lease term. Assume that no practical expedients are elected, the lessee did not incur initial direct costs, there were no lease incentives and there were no requirements for the lessee to dismantle and remove the underlying asset, restore the site on which it is located or restore the underlying asset to the condition under the terms and conditions of the lease.

What would be the impact for the lessee using all the following transition approaches:

Full Retrospective Approach

Modified Retrospective Approach - Alternative 1 - Alternative 2 ?

8. SELF PRACTICE QUESTIONS :

Question 44 – A retailer

A lessee enters into a ten-year contract with a lessor (freight carrier) to transport a specified quantity of goods. Lessor uses rail wagons of a particular specification, and has a large pool of similar rail wagons that can be used to fulfil the requirements of the contract. The rail wagons and engines are stored at lessor's premises when they are not being used to transport goods. Costs associated with substituting the rail wagons are minimal for lessor.

Whether the lessor has substantive substitutions rights and whether the arrangement contains a lease?

Question 45 – Customer M

Customer M enters into a 20-year contract with Energy Supplier S to install, operate and maintain a solar plant for M's energy supply. M designed the solar plant before it was constructed – M hired experts in solar energy to assist in determining the location of the plant and the engineering of the equipment to be used. M has the exclusive right to receive and the obligation to take any energy produced. Whether it can be established that M is having the right to control the use of identified asset?

Question 46 – A Customer

A Customer enters into a ten-year contract with a Company (a ship owner) for the use of an identified ship. Customer decides whether and what cargo will be transported, and when and to which ports the ship will sail throughout the period of use, subject to restrictions specified in the contract. These restrictions prevent the company from sailing the ship into waters at a high risk of piracy or carrying explosive materials. The company operates and maintains the ship, and is responsible for safe passage.

Does the customer has the right to direct how and for what purpose the ship is to be used throughout the period of use and whether the arrangement contains a lease?

Question 47 – A Lessee

A Lessee enters into a ten-year lease contract with a Lessor to use an equipment. The contract includes maintenance services (as provided by lessor). The Lessor obtains its own insurance for the equipment. Annual payments are Rs.10,000 (Rs.1,000 relate to maintenance services and Rs.500 to insurance costs).

The Lessee is able to determine that similar maintenance services and insurance costs are offered by third parties for Rs.2,000 and Rs.500 a year, respectively. The Lessee is unable to find an observable stand-alone rental amount for a similar equipment because none is leased without related maintenance services provided by the lessor.

How would the Lessee allocate the consideration to the lease component?

Question 48 – A Lessee

A Lessee enters into a non-cancellable lease contract with a Lessor to lease a building. Initially, the lease is for five years, and the lessee has the option to extend the lease by another five years at the same rental.

To determine the lease term, the lessee considers the following factors:

- Market rentals for a comparable building in the same area are expected to increase by 10% over the ten-year period covered by the lease. At inception of the lease, lease rentals are in accordance with current market rents.
- The lessee intends to stay in business in the same area for at least 20 years.
- The location of the building is ideal for relationships with suppliers and customers.

What should be the lease term for lease accounting under Ind AS 116?

Question 49 – A Lessee

A Lessee enters into a lease of a five-year-old machine. The non-cancellable lease term is 15 years. The lessee has the option to extend the lease after the initial 15-year period for optional periods of 12 months each at market rents.

To determine the lease term, the lessee considers the following factors:

- The machine is to be used in manufacturing parts for a type of plane that the lessee expects will remain popular with customers until development and testing of an improved model are completed in approximately 15 years.
- The cost to install the machine in lessee's manufacturing facility is significant.
- The non-cancellable term of lessee's manufacturing facility lease ends in 19 years, and the lessee has an option to renew that lease for another twelve years.
- Lessee does not expect to be able to use the machine in its manufacturing process for other types of planes without significant modifications.
- The total remaining life of the machine is 30 years.

What should be the lease term for lease accounting under Ind AS 116?

Question 50 – A Company

A Company leases a manufacturing facility. The lease payments depend on the number of operating hours of the manufacturing facility, i.e., the lessee has to pay Rs.2,000 per hour of use. The annual minimum payment is Rs.2,00,00,000. The expected usage per year is 20,000 hours.

Whether the said payments be included in the calculation of lease liability under Ind AS 116?

Thanks ....

CHAPTER

11

IND AS 41 – AGRICULTURE

CONCEPTS COVERED

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1. INTRODUCTION & OBJECTIVES :

Ind AS 41, Agriculture is the first standard that specifically covers the accounting and reporting requirements for the primary sector. Prior to this standard, there were no established guidance on agriculture and allied industry. This Standard introduces a fair value model to agriculture accounting which is a major shift away from the traditional cost model widely applied in primary industry.

Ind AS 41 Agriculture sets out the accounting for agricultural activity, the management of the transformation of biological assets (living plants and animals) into agricultural produce (harvested product of the entity's biological assets). The standard generally requires biological assets to be measured at fair value less costs to sell.

Ind AS 41 addresses following key critical issues:

(a) When should a biological asset or agricultural produce be recognised on the Balance Sheet?

(b) At what value should a recognised biological asset or agricultural produce be measured?

(c) How should the differences in value of a recognised biological asset or agricultural produce be accounted for between two different reporting dates?

(d) What should be the key disclosures?

2. SCOPE :

1. This Standard shall be applied to account for the following when they relate to agricultural activity:
   (a) biological assets;
   (b) agricultural produce at the point of harvest; and
   (c) government grants
2. Ind AS 41 does not apply to:
   (a) land related to agricultural activity : for example, the land on which the biological assets grow, regenerate and/or degenerate (Ind AS 16 Property, Plant and Equipment and Ind AS 40 Investment Property);
   (b) bearer plants related to agricultural activity. Such bearer plants covered within the scope of Ind AS 16, Property, plant and Equipment as accounted as per the provisions of that standard. However, this Standard applies to the produce on those bearer plants.
   (c) government grants related to bearer plants (Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance).
   (d) intangible assets associated with the agricultural activity, for example licenses and rights are covered under Ind AS 38 Intangible Assets and provisions of this standard will be applicable.

This Standard is applied to agricultural produce, which is the harvested product of the entity’s biological assets, only at the point of harvest. Thereafter, Ind AS 2 or another applicable Standard is applied.

Example:

Processing of grapes into wine by a vintner who has grown the grapes. While such processing may be a logical and natural extension of agricultural activity, and the events taking place may bear some similarity to biological transformation, such processing is not included within the definition of agricultural activity in this Standard.

Example:
Agriculture produce after the point of harvest, for example Wool, meat, fruit, rubber, logs that are processed subsequently are not covered within purview of this standard and Ind AS 2 Inventories will apply.

The table below provides examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

Biological Assets	Agricultural Produce	Products that are result of processing after harvest
Sheep	Wool	Yarn, Carpet
Trees in timber plantation	Felled Trees	Logs, Lumber
Dairy Cattle	Milk	Cheese
Pigs	Carcass	Sausages, Cured hams
Cotton Plants	Harvested Cotton	Thread, Clothing
Sugarcane	Harvested Cane	Sugar
Tobacco Plants	Picked Leaves	Cured Tobacco
Tea Blushes	Picked Leaves	Tea
Grape Vines	Picked Grapes	Wine
Fruit trees	Picked fruit	Processed fruit
Rubber trees	Harvested latex	Rubber Products

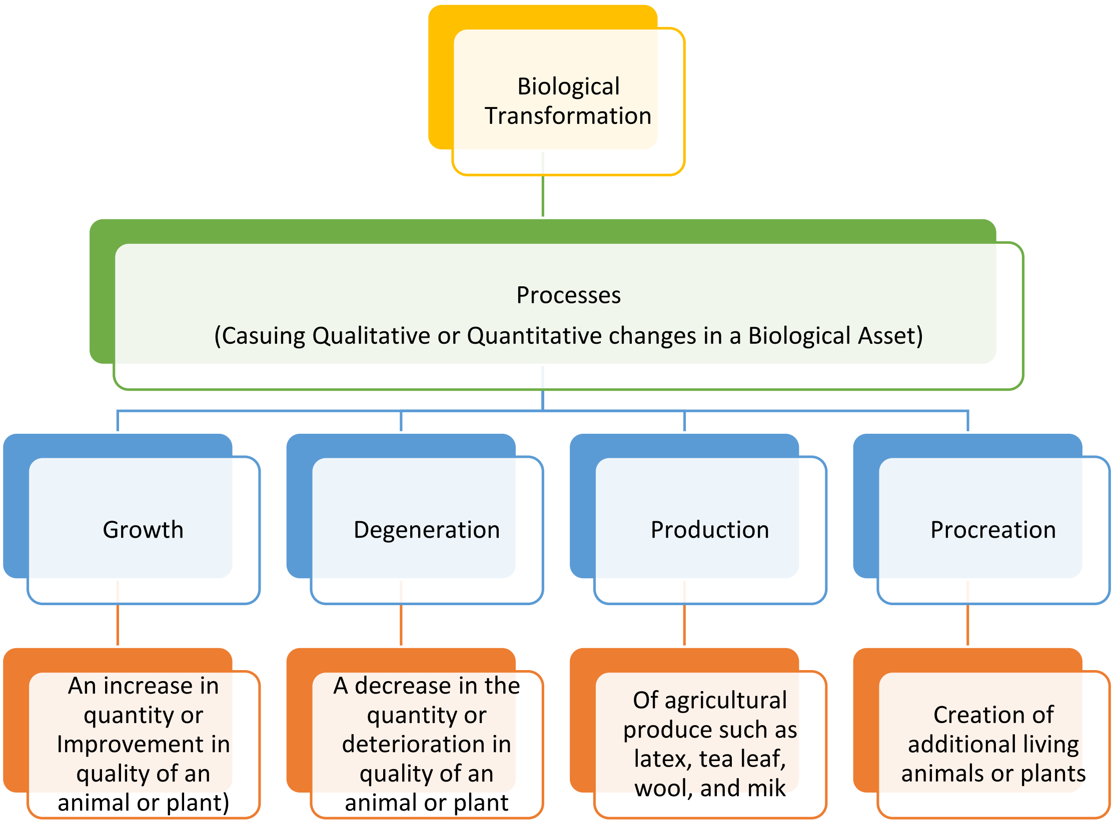
Some plants, for example, tea bushes, grape vines, oil palms and rubber trees, usually meet the definition of a bearer plant and are within the scope of Ind AS 16, Property, plant and Equipment. However, the produce growing on bearer plants, for example, tea leaves, grapes, oil palm fruit and latex, is within the scope of Ind AS 41.

3. DEFINITIONS :

1. **Agricultural Activity :**
   Agricultural activity refers to the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

2. **Biological Asset :**
   Biological Asset is defined as a living animal or plant.

3. **Biological Transformation :**
   Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in biological asset.



4. <u>Agricultural produce :</u>

Agricultural produce is the harvested product of the entity's biological assets.

5. <u>Harvest :</u>

Harvest is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

6. <u>Fair Value :</u>

Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (The definition of Fair value is as given in Ind AS 113, Fair Value Measurement)

7. <u>Costs to sell :</u>

Costs to sell are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes.

8. <u>Bearer plant :</u>

Bearer plant may be defined as a living plant that:

(i) is used in the production or supply of agricultural produce;

(ii) is expected to bear produce for more than one period; and

(iii) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

For example, tea bushes, grape vines, oil palms and rubber trees, usually meet the definition of a bearer plant and are outside the scope of Ind AS 41 and covered under Ind AS 16.

However, produce growing on bearer plant is a biological asset.

Question 1 – ABC Ltd.
ABC Ltd. grows vines, harvests the grapes and produces wine. Which of these activities are in the scope of Ind AS 41?

4. RECOGNITION OF ASSETS :

Entities are required to recognise a biological asset or agricultural produce when, and only when, all of the following conditions are met:

a) the entity controls the asset as a result of past events; Control over biological assets or agricultural produce may be evidenced by legal ownership or rights to control, for example legal ownership of cattle and the branding or otherwise marking of the cattle on acquisition, birth, or weaning.

b) it is probable that future economic benefits associated with the asset will flow to the entity; and Future economic benefits are expected to flow to the enterprise from its ownership or control of the asset. The future benefits are normally assessed by measuring the significant physical attributes.

c) the fair value or cost of the asset can be measured reliably.

5. MEASUREMENT :

Biological Asset should be measured on initial recognition and at the end of each reporting period at its fair value less costs to sell, except for the case where the fair value cannot be measured reliably.

There is a presumption that fair value can be measured reliably for a biological asset. In the following cases biological asset should be measured at its cost less any accumulated depreciation and any accumulated impairment losses in accordance with Ind AS 2, Ind AS 16 and Ind AS 36:

- quoted market prices are not available for the biological assets and;
- alternative fair value measurements are determined to be clearly unreliable.

Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its Fair value less costs to sell.

The presumption can be rebutted only on initial recognition. An entity that has previously measured a biological asset at its fair value less costs to sell continues to measure the biological asset at its fair value less costs to sell until disposal. In all cases, an entity measures agricultural produce at the point of harvest at its fair value less costs to sell. This Standard reflects the view that the fair value of agricultural produce at the point of harvest can always be measured reliably.

Agricultural produce harvested from an entity's biological assets should be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying Ind AS 2 or another applicable Standard.

The fair value measurement of a biological asset or agricultural produce may be facilitated by grouping biological assets or agricultural produce according to significant attributes; for example, by age or quality. An entity selects the attributes corresponding to the attributes used in the market as a basis for pricing.

The fair value less cost to sell of a biological asset can change due to both physical changes and price changes in the market.

Entities often enter into contacts to sell their biological assets or agricultural produce at a future date. Contract prices are not necessarily relevant in measuring fair value, because fair value reflects the current market conditions in which market participant buyers and sellers would enter into a transaction. As a result, the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a contract.

Cost may sometimes approximate fair value, particularly when:

a) little biological transformation has taken place since initial cost incurrence (for example, for fruit tree seedlings planted immediately prior to the end of a reporting period or newly acquired livestock); or
b) the impact of the biological transformation on price is not expected to be material (for example, for the initial growth in a 30-year pine plantation production cycle)

Biological assets are often physically attached to land (for example, trees in a plantation forest). There may be no separate market for biological assets that are attached to the land but an active market may exist for the combined assets, that is, the biological assets, raw land, and land improvements, as a package. An entity may use information regarding the combined assets to measure the fair value of the biological assets. For example, the fair value of raw land and land improvements may be deducted from the fair value of the combined assets to arrive at the fair value of biological assets.

Determination of Fair Value :

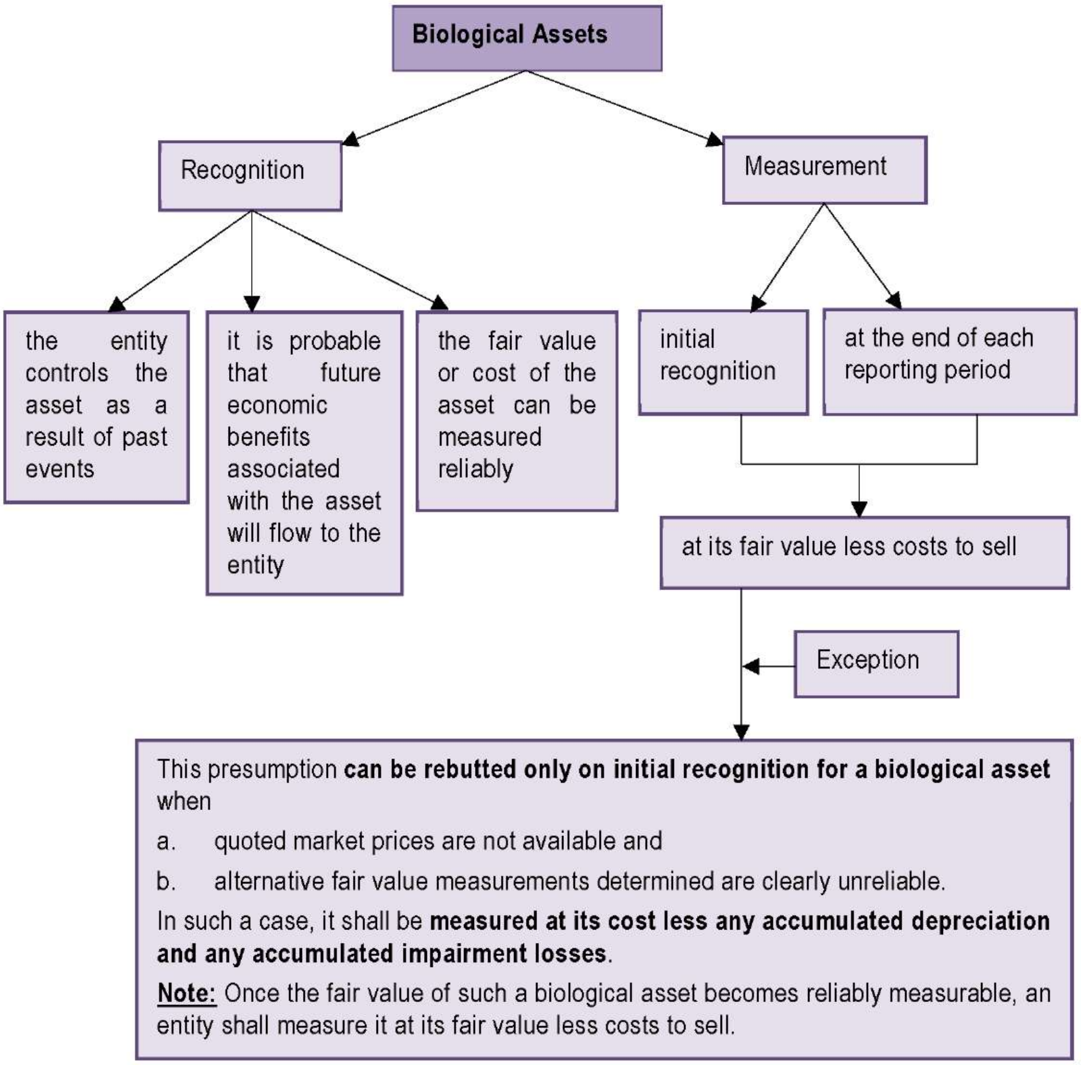
1. The Active Market Exists : The quoted market price shall be the appropriate price for determination of fair value. If the entity has access to more than one active market, then the most relevant quote will be adopted for measuring fair value.
2. In the absence of Active Market : The entity shall determine the fair value by considering one or more of the following
   A. The most recent transaction provided that there had been no change in economic circumstances between the date of transaction and the date of determining the fair value.
   B. Market prices of similar assets with necessary adjustments
   C. Sector benchmarks
3. The Reasonable Estimate of Fair Value
4. Sale in combination of Other Asset
   Sometimes the biological assets may have active market only when sold in combination with other Asset such as land. An Entity may use fair value of the combined assets to arrive at the fair value of the biological asset.

5. No active Market in present conditions

Some biological assets may not have market prices in its present condition. In that case the present value of not cash flows expected from the asset, discounted at a pre tax current market rate, shall be the fair value of the biological asset.

6. Where cost is deemed as approximate fair value

"REFER to IND AS 113"



Question 2 – A farmer

A farmer owned a dairy herd, of three years old cattle as at April 1, 2011 with a fair value of Rs.13,750 and the number of cattle in the herd was 250.

The fair value of three year cattle as at March 31, 20X2 was R. 60 per cattle. The fair value of four year cattle as at March 31, 20X2 is Rs.75 per cattle.

Calculate the measurement of group of cattle as at March 31, 2012 stating price and physical change separately.

Question 3 – XYZ Ltd.

XYZ Ltd., on 1 December 20X3, purchased 100 sheep's from a market for Rs.500,000 with a transaction cost of 2%. Sheep's fair value increased from Rs.500,000 to Rs.600,000 on 31 March 2014. Determine the fair value on the date of purchase and pass necessary journal entries.

6. GAINS AND LOSSES :

1) Biological Asset :

A gain or loss arising on initial recognition of a Biological Asset at Fair value less costs to sell and from a change in Fair value less costs to sell of a biological asset shall be included in Profit or Loss for the period in which it arises.

A loss may arise on initial recognition of a biological asset, because cost to sell are deducted in determining fair value less cost to sell of a biological asset. A gain may arise on initial recognition of a biological asset, such as when a calf is born.

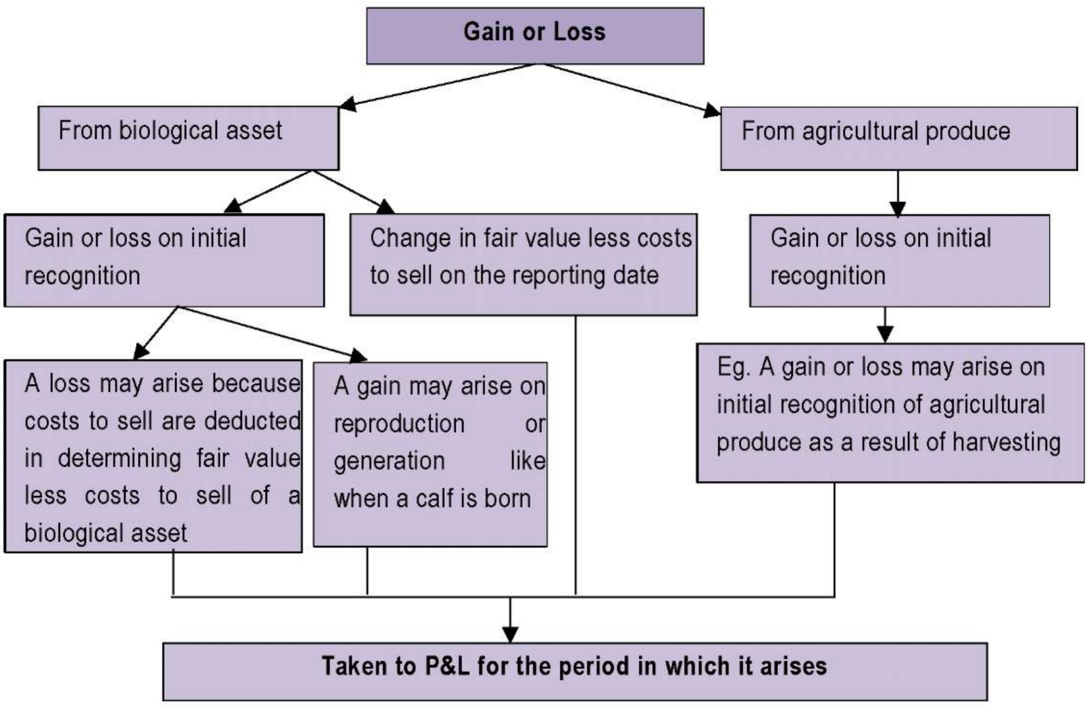
Example:

During the reporting period 2011-2012, an entity is having a cow which has given birth to a calf. The fair value less estimated cost to sell for a calf is Rs.5,000. The amount of Rs.5,000 is, therefore, immediately recognised in Statement of Profit or Loss.

2) Agriculture Produce :

A gain or loss arising on initial recognition of Agricultural produce at Fair value less costs to sell shall be included in Profit or Loss for the period in which it arises.

A gain or loss may arise on initial recognition of agricultural produce as a result of harvesting



7. GOVERNMENT GRANTS :

1) Biological Asset measured at fair value less cost to sell:-

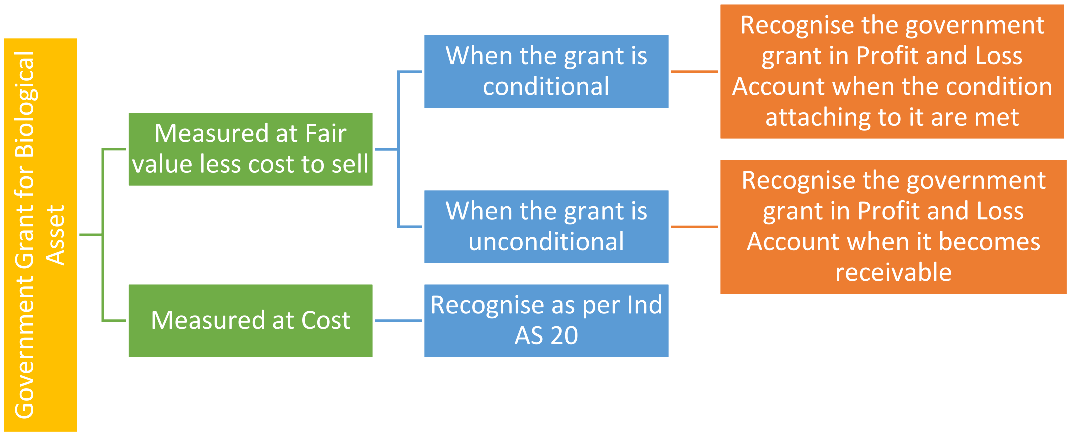
a) **Unconditional Grant:** An unconditional government grant related to a biological asset measured at its fair value less costs to sell shall be recognised in Profit or Loss when, and only when, the government grant becomes receivable.

b) **Conditional Grant :** If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity shall recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met.
Terms and conditions of government grants vary. For example, a grant may require an entity to farm in a particular location for five years and require the entity to return the entire grant if it farms for a period shorter than five years. In this case, the grant is not recognised in Profit or Loss until the five years have passed. However, if the terms of the grant allow part of it to be retained according to the time elapsed, the entity recognises that part in profit or loss as time passes.

Example:
Sun Ltd cultivated a huge plot of land. The government offers a grant of Rs.10 crore under the condition that the land is being cultivated for 5 years. If the land will be cultivated for a shorter period, the entity is required to return the entire grant.
Therefore, the government grant will be recognised as income only after 5 years of cultivation. The situation would be different if the returning obligation referred to the years of not cultivating the land is with respect to retention of grant for the period till which the entity has cultivated the land. In this case, the amount of Rs.10 crore would be recognised as income, proportionately with the time period, meaning Rs.2 crore per annum.

2. Biological Asset measured at its cost:-

If a government grant relates to a Biological Asset measured at its cost less any accumulated depreciation and any accumulated impairment losses i.e. (i.e. inability to measure fair value reliably), Ind AS 20 is applied.



8. DISCLOSURE :

1) **Description of biological assets and activities :**

The entity is required to a description of each group of biological assets. This disclosure may take the form of a narrative or quantified description. An entity is encouraged to provide a quantified description of each group of biological assets, distinguishing between consumable and bearer biological assets or between mature and immature biological assets, as appropriate.

2) **Gains and losses recognised during the period :**

An entity shall disclose the aggregate gain or loss arising during the current period on initial recognition of biological assets and agricultural produce and from the change in fair value less costs to sell of biological assets.

3) **Reconciliation of changes in biological assets :**

A detailed reconciliation is required of changes in the carrying amount of biological assets between the beginning and the end of the current period, which includes:

a) gain or loss arising from changes in fair value less costs to sell;
b) increases arising from purchases;
c) decreases attributable to sales and biological assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105;
d) decreases due to harvest;
e) increases resulting from business combinations;
f) net exchange differences arising on the translation of financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity; and
g) other changes.

4) **Restricted assets, commitments and risk management strategies :**

The entity should disclose:

a) the existence and carrying amounts of biological assets whose title is restricted, and the carrying amounts of biological assets pledged as security for liabilities;
b) the amount of commitments for the development or acquisition of biological assets; and
c) financial risk management strategies related to agricultural activity.

5) Additional disclosures when fair value cannot be measured reliably. If biological assets within the scope of Ind AS 41 are measured at cost less any accumulated depreciation and any accumulated impairment losses at the end of the period, the following disclosures are required:

a) a description of the biological assets;
b) an explanation of why fair value cannot be measured reliably;
c) the range of estimates within which fair value is highly likely to lie;
d) the depreciation method used;
e) the useful lives or the depreciation rates used; and

f) the gross carrying amount and the accumulated depreciation and impairment losses at the beginning and end of the period.

6) **Government grants :**

The following disclosures are required for government grants relating to agricultural activity:

a) the nature and extent of government grants recognised;

b) unfulfilled conditions and other contingencies attaching to government grants; and

c) significant decreases expected in the level of government grants.

Question 4 – Moon Ltd.

Moon Ltd prepares financial statements to 31 March each year. On 1 April 2011 the company carried out the following transactions:

– Purchased a land for Rs.50 Lakhs.

– Purchased 200 dairy cows (average age at 1 April 2011 two years) for Rs.10 Lakhs.

– Received a grant of Rs.1 million towards the acquisition of the cows. This grant was nonrefundable.

For the year ending 31 March 20X2, the company has incurred following costs:

– Rs.6 Lakh to maintain the condition of the animals (food and protection).

– Rs.4 Lakh as breeding fee to a local farmer.

On 1 October 2011, 100 calves were born. There were no other changes in the number of animals during the year ended 31 March 2012. As of 31 March 2012, Moon Ltd had 3,000 litres of unsold milk in inventory. The milk was sold shortly after the year end at market prices.

Information regarding fair values is as follows:

Items	**Fair Value less cost to sales**		
	1/4/2011 (Rs.)	**1/10/2011 (Rs.)**	**31/3/2012 (Rs.)**
Land	50 lakhs	60 lakhs	70 lakhs
New born calves (per calf)	1000	1100	1200
Six month old calves (per calf)	1100	1200	1300
Two year old cows (per cow)	5000	5100	5200
Three year old cows (per cow)	5200	5300	5500
Milk (per Litre)	20	22	24

Prepare extracts from the Balance Sheet and Statement of Profit & Loss that would be reflected in the financial statements of the entity for the year ended 31 March 2012.

9. SELF PRACTICE QUESTIONS :

Question 5 – Entity A

Entity A purchased cattle at an auction on 30th June 20X1

Purchase price at 30th June 20X1	Rs. 1,00,000

Costs of transporting the cattle back to the entity's farm	Rs. 1,000
Sales price of the cattle at 31st March, 20X2	Rs. 1,10,000

The company would have to incur similar transportation costs if it were to sell the cattle at auction, in addition to an auctioneer's fee of 2% of sales price. The auctioneer charges 2% of the selling price, from both, the buyer as well as the seller.

Calculate the amount at which cattle is to be recognised in books on initial recognition and at year end 31st March, 20X2.

Question 6 – XY Ltd.

XY Ltd. is a farming entity where cows are milked on a daily basis. Milk is kept in cold storage immediately after milking and sold to retail distributors on a weekly basis. On 1 April 20X1, XY Ltd. had a herd of 500 cows which were all three years old.

During the year, some of the cows became sick and on 30 September 20X1, 20 cows died. On 1 October 20X1, XY Ltd. purchased 20 replacement cows from the market for Rs. 21,000 each. These 20 cows were all one year old when they were purchased.

On 31 March 20X2, XY Ltd. had 1,000 litres of milk in cold storage which had not been sold to retail distributors. The market price of milk at 31 March 20X2 was Rs. 20 per litre. When selling the milk to distributors, XY Ltd. incurs selling costs of Rs. 1 per litre. These amounts did not change during March 20X2 and are not expected to change during April 20X2.

Information relating to fair value and costs to sell is given below:

Date	**Fair value of a dairy cow (aged)**				**Costs to sell a cow**
	1 year	1.5 years	3 years	4 years	
1st April 20X1	20,000	22,000	27,000	25,000	1,000
1st October 20X1	21,000	23,000	28,000	26,000	1,000
31st March 20X2	21,500	23,500	29,000	26,500	1,100

You can assume that fair value of a 3.5 years old cow on 1st October 20X1 is Rs. 27,000. Pass necessary journal entries of above transactions with respect to cows in the financial statements of XY Ltd. for the year ended 31st March, 20X2? Also show the amount lying in inventory if any.

Question 7 – Company X

Company X purchased 100 goats at an auction for Rs. 1,00,000 on 30 September 20X1. Subsequent transportation costs were Rs. 1,000 that is similar to the cost X would have to incur to sell the goat at the auction. Additionally, there would be a 2% selling fee on the market price of the goat to be incurred by the seller.

On 31 March 20X2, the market value of the goat in the most relevant market increases to Rs. 1,10,000. Transportation costs of Rs. 1,000 would have to be incurred by the seller to get the goat to the relevant market. An auctioneer's fee of 2% on the market price of the goat would be payable by the seller.

On 1 June 20X2, X sold 18 goats for Rs. 20,000 and incurred transportation charges of

Rs. 150. In addition, there was a 2% auctioneer's fee on the market price of the goat paid by the seller.

On 15 September 20X2, the fair value of the remaining goat was Rs. 82,820. 42 goats were slaughtered on that day, with a total slaughter cost of Rs. 4,200. The total market price of the carcasses on that day was Rs. 48,300, and the expected transportation cost to sell the carcasses is Rs. 420. No other costs are expected.

On 30 September 20X2, the market price of the remaining 40 goat was Rs. 44,800. The expected transportation cost is Rs. 400. Also, there would be a 2% auctioneer's fee on the market price of the goat payable by the seller.

Pass Journal entries so as to provide the initial and subsequent measurement for all above transactions. Interim reporting periods are of 30 September and 31 March and the company determines the fair values on these dates for reporting.

Question 8 – C Agro Ltd.

On 1st November, 20X1, C Agro Ltd. purchased 100 goats of special breed from a market for Rs. 10,00,000 with a transaction cost of 2%. Goats fair value decreased from Rs. 10,00,000 to Rs. 9,00,000 as on 31st March, 20X2.

Determine the fair value on the date of purchase and as on financial year ended 31st March, 20X2 under both the cases viz-

(i) the transaction costs are borne by the seller and

(ii) the transaction costs are incurred by the seller and purchaser both.

Also pass journal entries under both the situations on both dates.

Question 9 –

Analyse whether the following activities fall within the scope of Ind AS 41 with proper reasoning:

- Managing animal-related recreational activities like Zoo
- Fishing in the ocean
- Fish farming
- Development of living organisms such as cells, bacteria and viruses
- Growing of plants to be used in the production of drugs
- Purchase of 25 dogs for security purpose of the company's premises.

Question 10 – Pinus Radiata trees

As at 31st March, 2011, a plantation consists of 100 Pinus Radiata trees that were planted 10 years earlier. The tree takes 30 years to mature, and will ultimately be processed into building material for houses or furniture. The enterprise's weighted average cost of capital is 6% p.a.

Only mature trees have established fair values by reference to a quoted price in an active market. The fair value (inclusive of current transport costs to get 100 logs to market) for a mature tree of the same grade as in the plantation is:
As at 31st March, 2011: 171
As at 31st March, 20X2: 165
Assume that there would be immaterial cash flow between now and point of harvest.
The present value factor of Rs 1 @ 6% for
19th year = 0.331
20th year = 0.312
State the value of such plantation as on 31st March, 2011 and 2012 and the gain or loss to be recognised as per Ind AS.

Thanks ....

About The Author

Rahul Malkan is a proficient faculty of Financial Reporting and Strategic Financial Management at CA Final level. He is an MBA in business financial. He has 20 years of experience in teaching industry and has authored 20 books in academics.

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