AMENDMENT IN EXISTING ACCOUNTING STANDARDS

AS 2

Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, Property, Plant & Equipment. Such items are accounted for in accordance with Accounting Standard 10.

AS 4

If the dividend is proposed after the balance sheet date, it will be considered as a non-adjusting event. So No liability for proposed dividend has to be created now. Such proposed dividends are to be disclosed in the notes.

AS 13

An investment property is accounted for in accordance with cost model as prescribed in Accounting Standard (AS) 10, Property, Plant & Equipment. The cost of any shares in a cooperative society or company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

AS 14

The statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g. Amalgamation Adjustment Reserve) which is presented as a separate line item. When the identity of statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

AS 21

A parent which presents consolidated financial statements should consolidate all subsidiaries, domestic as well as foreign. Where an enterprise does not have a subsidiary but has an associate and/or a joint venture such an enterprise should also prepare consolidated financial statements in accordance with AS 23 and AS 27 respectively.

AS 29

The amount of provision should not be discounted to its present value except in case of decommissioning, restoration and similar liabilities that are recognized as cost of Property, Plant and Equipment. The discount rate (or rates) should be a pre-tax rate (or rates) that reflects current market assessments of the time value of money and the risks specific to the liability. Periodic unwinding of discount should be recognized in the statement of profit & loss.

All the existing provisions for decommissioning, restoration and similar liabilities should be discounted prospectively with the corresponding effect to the related item of property, plant and equipment.

AS 10 PROPERTY, PLANT & EQUIPMENT

Illustration 1 (Capitalising the cost of "Remodelling" a Supermarket)

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalized or not.

Solution

The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of remodelling can be measured reliably, therefore, it should be capitalised.

Illustration 2

What happens if the cost of the previous part/inspection was/ was not identified in the transaction in which the item was acquired or constructed? (Related to Issue 2 and 3)

Solution

De-recognition of the carrying amount occurs **regardless** of whether the cost of the previous part/inspection was identified in the transaction in which the item was acquired or constructed. There are ways and procedure prescribed the AS to find out the amount to be derecognised.

Illustration 3

What will be your answer in the above question, if it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection?

Solution

It may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/existing inspection component was when the item was acquired or constructed.

Illustration 4

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

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

Can these costs be capitalised into the cost of the new building?

Solution

These costs are not to be included in the cost of the asset as they are not 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. The costs to be incurred by the company do not meet the requirement of AS 10 and therefore, cannot be capitalised.

Illustration 5 (Capitalisation of directly attributable costs)

Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the supermarket will be closed.

Management has prepared the budget for this period including expenditure related to construction and remodelling costs, salaries of staff who will be preparing the store before its opening and related utilities costs. What will be the treatment of such expenditures?

Solution

Management should capitalise the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. The supermarket cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset.

However, the cost of salaries, utilities and storage of goods are operating expenditures that would be incurred if the supermarket was open. These costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and should be transferred to Profit and Loss Account.

Illustration 6 (Operating costs incurred in the start-up period)

An amusement park has a 'soft' opening to the public, to trial run its attractions. Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later. Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner. Accordingly, the net operating costs incurred should be capitalised. Comment.

Solution

The net operating costs should not be capitalised, but should be recognised in the Statement of Profit and Loss.

Even though it is running at less than full operating capacity (in this case 80% of operating capacity), there is sufficient evidence that the amusement park is capable of operating in the manner intended by management. Therefore, these costs are specific to the start-up and, therefore, should be expensed as incurred.

Illustration 7 (Consideration received comprising a combination of non-monetary and monetary assets)

Entity A exchanges surplus land with a book value of ₹10,00,000 for cash of ₹20,00,000 and plant and machinery valued at ₹25,00,000. What will be the measurement cost of the assets received?

Solution

Since the transaction has commercial substance. The plant and machinery would be recorded at ₹25,00,000, which is equivalent to the fair value of the land of ₹ 45,00,000 less the cash received of ₹20,00,000.

Illustration 8 (Exchange of assets that lack commercial substance)

Entity A exchanges car X with a book value of ₹13,00,000 and a fair value of ₹13,25,000 for cash of ₹15,000 and car Y which has a fair value of ₹13,10,000. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received?

Solution

The entity recognises the assets received at the book value of car X. Therefore, it recognises cash of ₹15,000 and car Y as PPE with a carrying value of ₹12,85,000.

Illustration 9 (Revaluation on a class by class basis)

Entity A is a large manufacturing group. It owns a 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. Entity A's management want to apply the revaluation model as per AS 10 to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings.

State whether this is acceptable under AS 10 or not with reasons?

Solution

Entity A's management can apply the revaluation model only to the office buildings. The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location. AS 10 permits assets to be revalued on a class by class basis.

The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement models can, therefore, be applied to these classes for subsequent measurement.

All properties within the class of office buildings must, therefore, be carried at revalued amount.

Illustration 10

Entity A has a policy of not providing for depreciation on PPE capitalised in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

Solution

The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful life. The depreciation method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Useful life means the period over which the asset is expected to be available for use by the entity.

Depreciation should commence as soon as the asset is acquired and is available for use and it should stop when the asset is sold.

Illustration 11 (Change in estimate of useful life)

Entity A purchased an asset on 1st January 2013 for ₹1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil.

On 1st January 2017, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years.

Calculate the amount of depreciation for each year, if company charges depreciation on Straight Line basis.

Solution

The entity has charged depreciation using the straight-line method at ₹10,000 per annum i.e. (1,00,000/ 10 years).

On 1st January 2017, the asset's net book value is [1,00,000 – (10,000 x 4)] ₹60,000.

The remaining useful life is 4 years.

The company should amend the annual provision for depreciation to charge the unamortised cost over the revised remaining life of four years.

Consequently, it should charge depreciation for the next 4 years at ₹15,000 per annum i.e.

(60,000 / 4 years).

Note: Depreciation is recognised even if the Fair value of the Asset exceeds its Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

Illustration 12

Entity B constructs a machine for its own use. Construction is completed on 1st November 2016 but the company does not begin using the machine until 1st March 2017. Comment

Solution

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 2016. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.

Illustration 13 (Depreciation where residual value is the same as or close to Original cost)

A property costing ₹10,00,000 is bought in 2016. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years. The estimated residual value in 20 years' time, based on 2016 prices, is:

Case (a) ₹10,00,000

Case (b) ₹ 9,00,000.

Calculate the amount of depreciation.

Solution

Case (a)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost.

There is, therefore, no depreciable amount and depreciation is correctly zero.

Case (b)

Annual depreciation (on a straight line basis) will be ₹5,000 [{10,00,000 – 9,00,000} ÷ 20].

Illustration 14 (Determination of appropriate Depreciation Method)

Entity B manufactures industrial chemicals and uses blending machines in the production process. The output of the blending machines is consistent from year to year and they can be used for different products.

However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management.

Solution

Management should determine the depreciation method based on production output. The straight-line depreciation method should be adopted, because the production output is consistent from year to year.

Factors such as maintenance costs or technical obsolescence should be considered in determining the blending machines' useful life.

Illustration 15 (Gain on replacement of Insured Assets)

Entity A carried plant and machinery in its books at ₹2,00,000. These were destroyed in a fire. The assets were insured 'New for old' and were replaced by the insurance company with new machines that cost ₹20,00,000. The machines were acquired by the insurance company and the company did not receive the ₹20,00,000 as cash compensation. State, how Entity A should account for the same?

Solution

Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carrying value of plant and machinery in accordance with AS 10.

Entity A should separately recognise a receivable and a gain in the income statement resulting from the insurance proceeds under AS 29 once receipt is virtually certain. The receivable should be measured at the fair value of assets that will be provided by the insurer.

As the asset is already replaced the new Asset is recognized by crediting the receivable.

Illustration 16

A fixed asset with original cost of ₹1,000 and accumulated depreciation of ₹400 is revalued at ₹1,500. Explain the two techniques in which it can be done.

Solution

A. Technique – 1

PPE is revalued to ₹1,500 consisting of ₹2,500 Gross cost and ₹1,000 Depreciation based on observable market data.

Details of the PPE before and after revaluation are as follows:

Particulars	Cost/ Revalued Cost	Accumulated Depreciation	Net Book Value
PPE before revaluation	1,000	400	600
Fair Value			1,500
Revaluation Gain			900
Gain allocated proportionately	1,500	600	900
to cost and depreciation			
PPE after revaluation	2,500	1,000	1,500

The increase on revaluation is ₹ 900 (i.e., ₹ 1,500 – ₹ 600).

B. Technique 2: Accumulated depreciation Is eliminated against the Gross Carrying amount of the asset

Case Study on Technique II

(Taking the information given in the above Example)

Details of the PPE before and after revaluation are as follows:

Particulars	Cost/ Revalued Cost	Accumulated depreciation	Net book value
PPE before revaluation	1,000	400	600
PPE after revaluation	1,500		1,500
Revaluation gain	500	400	

The increase on revaluation is ₹ 900 (i.e., ₹ 500 + ₹ 400).

IND AS 11: CONSTRUCTION CONTRACTS

Ind AS 11 prescribes the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed.

1. Scope

The Standard shall be applied in accounting for construction contracts in the financial statements of contractors A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

The requirements of this Standard are usually applied separately to each construction contract. However, in certain circumstances, it is necessary to apply the Standard to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.

Contract revenue shall comprise:

(a) the initial amount of revenue agreed in the contract; and

(b) variations in contract work, claims and incentive payments:

  (i) to the extent that it is probable that they will result in revenue; and

  (ii) they are capable of being reliably measured. Contract revenue is measured at the fair value of the consideration received or receivable.

Contract costs shall comprise:

(a) costs that relate directly to the specific contract;

(b) costs that are attributable to contract activity in general and can be allocated to the contract; and

(c) such other costs as are specifically chargeable to the customer under the terms of the contract.

2. Recognition of Contract Revenue and Expenses

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract shall be

expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period.

When the outcome of a construction contract cannot be estimated reliably:

(a) revenue shall be recognised only to the extent of contract costs incurred that it is probable will be recoverable; and

(b) contract costs shall be recognised as an expense in the period in which they are incurred

3. Recognition of Expected Losses

Appendix A of Ind AS 11 gives guidance on accounting by operators for service concession arrangements.

An operator shall not recognise the public service infrastructure (within the scope of this appendix) as its Property, Plant and Equipment because the contractual service arrangement does not convey the right to control the use of the infrastructure. It only gives operator the access to operate the infrastructure to provide public service on behalf of the grantor.

The operator shall account for revenue and costs relating to construction or upgrade services in accordance with Ind AS 11 and those relating to operation services in accordance with Ind AS 18. The consideration received or receivable shall be recognised at its fair value. The consideration may be rights to a financial asset or an intangible asset.

The operator recognises a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services.

The operator shall recognise an intangible asset to the extent that it receives a right (a license) to charge users of the public service.

4. Major Changes in Ind AS 11 vis-à-vis Notified AS 7

(i) ***Inclusion of Borrowing costs:*** Existing AS 7 includes borrowing costs as per AS 16, Borrowing Costs, in the costs that may be attributable to contract activity in general and can be allocated to specific contracts, whereas Ind AS 11 does not specifically make reference to Ind AS 23.

(ii) ***Fair Value:*** Existing AS 7 does not recognise fair value concept as contract revenue is measured at consideration received/receivable, whereas Ind AS 11 requires that contract revenue shall be measured at fair value of consideration received/receivable.

(iii) ***Accounting for Service Concession Arrangements:*** Existing AS 7 does not deal with accounting for Service Concession Arrangements, i.e., the arrangement where private sector entity (an operator) constructs or upgrades the infrastructure to be used to provide the public service and operates and maintains that infrastructure for a specified period of time, whereas Appendix A of Ind AS 11 deals with accounting aspects involved in such arrangements and Appendix B of Ind AS 11 deals with disclosures of such arrangements.

IND AS 18: REVENUE

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity which result in increases in equity, other than increases relating to contributions from equity participants.

The Standard shall be applied in accounting for revenue arising from the following transactions and events: (a) the sale of goods; (b) the rendering of services; and (c) the use by others of entity assets yielding interest and royalties The Standard deals with recognition of interest. However, measurement of interest and recognition and measurement of dividend are dealt in accordance with Ind AS 109, *Financial Instruments*.

The impairment of any contractual right to receive cash or another financial asset arising from this Standard shall be dealt in accordance with Ind AS 109, *Financial Instruments.*

1. **Identification of the transaction**

   The recognition criteria in this Standard are usually applied separately to each transaction.

   However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed.

   Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

2. **Measurement of revenue**

   Revenue shall be measured at the fair value of the consideration received or receivable. The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity.

3. **Sale of goods**

   Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied: (a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods; (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; (c) the amount of revenue can be measured reliably; (d) it is probable that the economic benefits associated with the transaction will flow to the entity; and (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

4. **Rendering of services**

   When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of the reporting period. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied: (a) the amount of revenue can be measured reliably; (b) it is probable that the economic benefits associated with the transaction will flow to the entity; (c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and (d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

5. **Interest and Royalties**

   Revenue arising from the use by others of entity assets yielding interest and royalties shall be recognised when: (a) it is probable that the economic benefits associated with the transaction will flow to the entity; and (b) the amount of the revenue can be measured reliably.

   Revenue shall be recognised on the following bases: (a) interest shall be recognised using the effective interest method as set out in Ind AS 109; (b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement.

6. Major Changes in Ind AS 18 vis-à-vis IAS* 18

Resulting in Carve Out

As per IFRS: On the basis of principles of the IAS 18, IFRIC 15, Agreement for Construction of Real Estate, prescribes that construction of real estate should be treated as sale of goods and revenue should be recognised when the entity has transferred significant risks and rewards of ownership and retained neither continuing managerial involvement nor effective control.

Carve out: IFRIC 15 has not been included in Ind AS 18 to scope out such agreements from Ind AS 18. A separate guidance note on accounting for real estate developers (for Ind AS compliant entities) has been issued by the ICAI to address the matter.

Reason: It was observed that requirement will lead to recognition of revenue in the financial statements by real estate developers based on the completion method, i.e., only in the last year of the completion of project. It was felt that in case the revenue for the whole project is recognised in the last year of completion of project, it will not reflect the true performance of the business of the real estate developer. Further, it was felt that since Ind AS 11 requires recognition of revenue of all construction contracts by reference to stage of completion, it may lead to inappropriate accounting in case of certain real estate development projects in case this Ind AS is applied for all real estate development projects. Therefore, it was considered appropriate that rather than making changes in Ind AS 11 or Ind AS 18, a separate Guidance note (for Ind AS-compliant entities) should be issued in line with the Guidance note on Accounting for Real Estate Transactions issued by the Institute of Chartered Accountants of India (for entities on which AS are applicable).

7. Major Changes in Ind AS 18 vis-à-vis Notified AS 9

(i) ***Definition of 'Revenue':*** Definition of 'revenue' given in Ind AS 18 is broad compared to the definition of 'revenue' given in existing AS 9 because it covers all economic benefits that arise in the ordinary course of activities of an entity which result in increases in equity, other than increases relating to contributions from equity participants. On the other hand, as per the existing AS 9, revenue is gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

(ii) ***Measurement of Revenue:*** Measurement of revenue is briefly covered in the definition of revenue in the existing AS 9, while Ind AS 18 deals separately in detail with measurement of revenue. As per existing AS 9, revenue is recognised at the nominal amount of consideration receivable. Ind AS 18 requires the revenue to be measured at fair value of the consideration received or receivable.

(iii) ***Barter Transactions***: Ind AS 18 specifically deals with the exchange of goods and services with goods and services of similar and dissimilar nature. In this regard specific guidance is given regarding barter transactions involving advertising services. This aspect is not dealt with in the existing AS 9.

(iv) ***Recognition of Separately Identifiable Components:*** Ind AS 18 provides guidance on application of recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. Existing AS 9 does not specifically deal with the same.

(v) ***Recognition of Interest:*** Existing AS 9 requires the recognition of revenue from interest on time proportion basis. Ind AS 18 requires interest to be recognised using effective interest rate method as set out in Ind AS 109, Financial Instruments.

(vi) ***Guidance Regarding Revenue Recognition in Specific Cases:*** Ind AS 18 specifically provides guidance regarding revenue recognition in case the entity is under any obligation to provide free or discounted goods or services or award credits to its customers due to any customer loyalty programme. Existing AS 9 does not deal with this aspect.

(vii) ***Disclosure of Excise Duty***: Existing AS 9 specifically deals with disclosure of excise duty as a deduction from revenue from sales transactions. Ind AS 18 does not specifically deal with the same.

(viii) ***Disclosure Requirements:*** Disclosure requirements given in the Ind AS 18 are more detailed as compared to existing AS 9.

GUIDANCE NOTE ON ACCOUNTING FOR DEPRECIATION IN COMPANIES IN THE CONTEXT OF SCHEDULE II TO THE COMPANIES ACT, 2013

Illustration 1

A Limited is a company incorporated under the Companies Act, 1956, engaged in the business of manufacturing of toys. A Limited purchased a unit of machinery costing ₹ 60 lakhs as on April 01, 2014. As per Schedule II the general useful life of the assets is15 years. However, as per A Ltd.'s estimation, the useful life of the asset is 20 years supported by the technical advice.

Should the company use the useful life as 15 years or 20 years?

Solution

In this case, keeping in view the requirements under Schedule II, A Ltd. should depreciate the machinery over its useful life of 20 years as determined by the company and not over 15 years as indicated in Schedule II. A limited should also provide disclosures in this regard as recommended later in this Guidance Note in the notes to accounts to justify the reason for difference between the indicative use life and A's estimated useful life.

Illustration 2

B Limited had considered the minimum rates of depreciation mentioned in Schedule XIV for depreciating all its fixed assets till March 31, 2014. Based on the rates mentioned for SLM and WDV in Schedule XIV, B Limited had derived the useful lives for the assets. Schedule II of the Companies Act, 2013 is now applicable to B Limited w.e.f. April 1, 2014.

Whether B Limited needs to follow the useful lives mentioned in the Schedule II or derived useful lives considered till March 31, 2013 can be considered?

Solution

W.e.f. April 1, 2014, B limited should estimate the remaining useful lives of its assets based on the definition of useful life in Schedule II and the factors specified in AS 6 for recognising depreciation in the statement of profit and loss. There is no relevance of the derived useful life as per Schedule XIV. However, if B Limited estimates useful lives different from those specified in Schedule II, it should disclose such differences in the financial statements and provide justification in this behalf duly supported by technical advice.

PART – II: QUESTIONS AND ANSWERS ON AS AND GN

AS 19

Question

Kiran Limited wishes to obtain a machine costing ₹ 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Prakash Ltd., for a lease rental for ₹ 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Kiran Limited is not sure about the treatment of these lease rentals and seeks your advise.

Solution:

As per AS 19 'Leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment* amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV - Annuity Factor can be computed as follows:

Annuity Factor (Year 1 to Year 5)	**3.36** (approx.)**
Present value of minimum lease payments (for ₹3 lakhs each year)	₹10.08 lakhs (approx.)

Thus, present value of minimum lease payments is ₹ 10.08 lakhs and the fair value of the machine is ₹ 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

AS 17

Question

A Company has an inter-segment transfer pricing policy of charging at cost less 5%. The market prices are generally 20% above cost. Is the policy adopted by the company correct?

Solution:

AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if followed consistently.

AS 9

Question

Shashi Ltd. is an Indian subsidiary of a company Sam based in Canada. Shashi Ltd. has set up an office in India and have engaged about 200 employees, to render services to Head Office in Canada. In consideration thereof, Sam Ltd. reimbursed the expenditure on salaries and other expenses amounting to ₹ 350 lakhs and also allowed margin of profit at 20% being ₹ 70 lakhs. Whether the accounts should show the amount of turnover at ₹ 350 lakhs or ₹ 420 lakhs?

Solution:

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, rendering of services and the use by others of enterprise resources yielding interest, royalties and dividends.

In the given case, Shashi Ltd., the subsidiary has set up an office and establishment in India to render services to the head office for which the later has reimbursed the expenditure on salaries and other expenses amounting to ₹ 420 lakhs including margin of profit of ₹ 70 lakhs, hence the turnover to be shown in the books shall be ₹ 420 lakhs.

AS 10

Question

In the year 2016-17, an entity has acquired a new freehold building with a useful life of 50 years for ₹70,00,000. The entity desires to calculate the depreciation charge per annum using a straight-line method. It has identified the following components (with no residual value of lifts & fixtures at the end of their useful life) as follows:

Component	**Useful life (Years)**	**Cost**
Land	Infinite	₹ 20,00,000
Roof	25	₹ 10,00,000
Lifts	20	₹ 5,00,000
Fixtures	10	₹ 5,00,000
Remainder of building	50	₹ 30,00,000
		₹ 70,00,000

Calculate depreciation for the year 2016-17.

Solution:

Statement showing amount of depreciation as per Componentisation Method

Component	**Depreciation (Per annum) (₹)**
Land	Nil
Roof	40,000
Lifts	25,000
Fixtures	50,000
Remainder of Building	60,000
	1,75,000

Note: When the roof requires replacement at the end of its useful life the carrying amount will be nil. The cost of replacing the roof should be recognised as a new component.

AS – 10

Question

An entity acquires an item of PPE for ₹ 50,000, which is depreciated over 20 years. Three years later, the asset is revalued to ₹ 60,000. Compute the amount of Revaluation Surplus?

Solution:

Calculation of Revaluation surplus:

Revaluation Amount	₹ 60,000
Less: Carrying amount = ₹ 50,000 - ₹ 7,500 =	(₹ 42,500)
Revalue Surplus at the end of 3rd year	₹ 17,500

Working note:

Depreciation for first 3 years = (₹ 50,000 / 20 years) x 3 years = ₹ 7,500.

AS 12

Question

An Indian company is engaged by a research company based in USA to carry out research in India, in consideration of billing to be done by Indian company based on cost plus 20% mark up. The Company based in USA paid a sum of ₹ 10 crores to an Indian company to acquire equipment to be used for research. The equipment is owned by the Indian company and a condition is attached in the agreement with the US company that such equipment is to be used for at least 5 years for research work of that company. How should the amount of ₹ 10 crores be accounted- as capital reserve or as credit to profit and loss account or by credit to the account of the equipment?

Solution:

As per AS 12 'Government Grants', grants meant to subsidize or reduce expenses is taken to the Statement of Profit and loss in proportion to the savings and where the grant is related to fixed assets, the value of the fixed asset is stated net of grant and depreciation is provided accordingly.

Government Grants in the nature of promoters contribution is however taken to Capital reserves.

In the given case, the Company has received an amount from a research company in USA to acquire equipment's to be used in research in India which is to be owned by the Indian Company only. The same can be considered as private grant and AS 12 do not apply to private grants. Since the amount received is towards capital items, therefore it is not possible that credit arising out of a grant can be taken to statement of profit and loss. If such grant received is credited to profit and loss, profit or loss position could be easily manipulated through such private grants.

However, in the present case, grant should either be shown as Capital Reserve (not revenue reserves) with proper disclosures or credited to Equipment Account.

AS 16

Question

A company incorporated in June 2016, has setup a factory within a period of 8 months with borrowed funds. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. Answer with reference to AS 16.

Solution:

As per para 3.2 to AS 16 'Borrowing Costs', a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Further, Explanation to the above para states that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

The above paras imply that there is a rebuttable presumption that a 12 months period constitutes substantial period of time.

Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It may so happen that an asset under normal circumstances may take more than 12 months to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

Therefore, if the factory is constructed in 8 months then it shall be considered as a qualifying asset. The interest on borrowings for the same shall be capitalised although it has taken less than 12 months for the asset to get ready to use.

GUIDANCE NOTES

Question 1

The Schedule III provides that in the 'Statement of Profit and Loss', the head "Other Income" includes interest income under which "Interest from customers on amounts overdue" is specifically included.

However, under AS 17, the same is treated as Operating Income and not as Other Income. Then, should interest income from customers on amounts overdue instead be classified under other operating income?

Solution:

Accounting Standards override Schedule III. In AS 17, segment reporting, particularly interest income and interest expense is not treated as segment revenue. Further, Schedule III has specifically included interest income as operating income for finance companies. Also, in specific cases of industries (such as power generation); interest could be part of the operating income as this also forms the basis for tariff setting.

In case of a manufacturing company, normally, interest income is not material and business is not done with the aim of earning interest. In practice, it is generally difficult to enforce the interest clause even though it is normally contained in all cases. Based on materiality and provisions in AS 17, the interest income on overdue outstanding is not an operating income.

However, if a company, on the facts of its own case, determines that it would be appropriate to treat it as an operating income, it would have to disclose it as an accounting policy, if material.

Question 2

How will a company classify its investment in preference shares, which are convertible into equity shares within one year from the balance sheet date? Will it classify the investment as a current asset or a non-current asset?

Solution:

In accordance with the Schedule III, an investment realizable within 12 months from the reporting date is classified as a current asset. Such realization should be in the form of cash or cash equivalents, rather than through conversion of one asset into another non-current asset. Hence, company must classify such an investment as a non-current asset, unless it expects to sell the preference shares or the equity shares on conversion and realize cash within 12 months.

Ind As 16 Vs AS 10

Question 3

Explain the major differences in Ind AS 16 'Property, Plant and Equipment' and AS 10 'Property, Plant and Equipment'.

Question 4

Major Changes in Ind AS 16 vis-à-vis Notified AS 10

(a) Fixed Assets retired from Active Use and Held for Sale: Ind AS 16 does not deal with the assets 'held for sale' because the treatment of such assets is covered in Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations. Existing AS 10 deals with accounting for items of fixed assets retired from active use and held for sale.

(b) Stripping Costs in the Production Phase of a Surface Mine: Ind AS 16 provides guidance on measuring 'Stripping Costs in the Production Phase of a Surface Mine'. Existing AS does not contain this guidance.

FINANCIAL STATEMENTS OF A COMPANY REQUIRED TO COMPLY WITH Ind AS

PART I – BALANCE SHEET

Name of the Company ……………………..

Balance Sheet as at ……………………….

(Rupees in…………)

	Particulars	*Note No.*	*Figures as at the end of current reporting period*	*Figures as at the end of the previous reporting period*
	1	*2*	*3*	*4*
(1)	**ASSETS**			
	Non-current assets			
	(*a*) Property, Plant and Equipment			
	(*b*) Capital work-in-progress			
	(*c*) Investment Property			
	(*d*) Goodwill			
	(*e*) Other Intangible assets			
	(*f*) Intangible assets under development			
	(*g*) Biological Assets other than bearer plants			
	(*h*) Financial Assets			
	(*i*) Investments			
	(*ii*) Trade receivables			
	(*iii*) Loans			
	(*iv*) Others (to be specified)			
	(*i*) Deferred tax assets (net)			
	(*j*) Other non-current assets			
(2)	**Current assets**			
	(*a*) Inventories			
	(*b*) Financial Assets			
	(*i*) Investments			
	(*ii*) Trade receivables			
	(*iii*) Cash and cash equivalents			
	(*iv*) Bank balances other than (iii) above			
	(*v*) Loans			
	(*vi*) Others (to be specified)			
	(c) Current Tax Assets (Net)			
	(*d*) Other current assets			
	Total Assets			
	EQUITY AND LIABILITIES Equity			
	(*a*) Equity Share capital			
	(*b*) Other Equity			
	LIABILITIES			
(1)	**Non-current liabilities**			
	(*a*) Financial Liabilities			
	(*i*) Borrowings			
	(*ii*) Trade payables			
	(*iii*) Other financial liabilities (other than those specified in item (b), to be specified)			

	(*b*) Provisions			
	(*c*) Deferred tax liabilities (Net)			
	(*d*) Other non-current liabilities			
(2)	**Current liabilities**			
	(*a*) Financial Liabilities			
	(*i*) Borrowings			
	(*ii*) Trade payables			
	(*iii*) Other financial liabilities (other than those specified in item (c)			
	(*b*) Other current liabilities			
	(*c*) Provisions			
	(*d*) Current Tax Liabilities (Net)			
	Total Equity and Liabilities			

STATEMENT OF CHANGES IN EQUITY

Name of the Company…………………….

Statement of Changes in Equity for the period ended …………………..

(Rupees in………………)

A. Equity Share Capital

Balance at the beginning of the reporting period	Changes in equity share capital during the year	Balance at the end of the reporting period

B. Other Equity

	Share application money pending allotment	Equity component of compound financial instruments	Reserves and Surplus				Debt instruments through Other Comprehensive Income	Equity Instruments through Other Comprehensive Income	Effective portion of Cash Flow Hedges	Revaluation Surplus	Exchange differences on translating the financial statements of a foreign operation	Other items of Other Comprehensive Income (specify nature)	Money received against share warrants	Total
			Capital Reserve	Securities Premium Reserve	Other Reserves (specify nature)	Retained Earnings								
Balance at the beginning of the reporting period														
Changes in accounting policy or prior period errors														
Restated balance at the beginning of the reporting period														
Total Comprehensive Income for the year														
Dividends														
Transfer to retained earnings														
Any other change (to be specified)														
Balance at the end of the reporting period														

	PART II – STATEMENT OF PROFIT AND LOSS			
	Name of the Company……………………			
	Statement of Profit and Loss for the period ended ……………………..			
	(Rupees in………..)			
	Particulars	***Note No.***	***Figures for the current reporting period***	***Figures For the previous reporting period***
I	Revenue From Operations			
II	Other Income			
III	Total Income (I+II)			
IV	EXPENSES			
	Cost of materials consumed			
	Purchases of Stock-in-Trade			
	Changes in inventories of finished goods, Stock-in -Trade and work-in-progress			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expense			
	Other expenses			
	Total expenses (IV)			
V	Profit/(loss) before exceptional items and tax (I- IV)			
VI	Exceptional Items			
VII	Profit/(loss) before tax (V-VI)			
VIII	Tax expense:			
	(1) Current tax			
	(2) Deferred tax			
IX	IX Profit (Loss) for the period from continuing operations (VII-VIII)			
X	Profit/(loss) from discontinued operations			
XI	Tax expense of discontinued operations			
XII	Profit/(loss) from Discontinued operations (after tax) (X-XI)			
XIII	Profit/(loss) for the period (IX+XII)			
XIV	Other Comprehensive Income A (*i*) Items that will not be reclassified to profit or loss (*ii*) Income tax relating to items that will not be reclassified to profit or loss B (*i*) Items that will be reclassified to profit or loss (*ii*) Income tax relating to items that will be reclassified to profit or loss			
XV	Total Comprehensive Income for the period (XIII+XIV) (Comprising Profit (Loss) and Other Comprehensive Income for the period)			
XVI	Earnings per equity share (for continuing operation): (1) Basic (2) Diluted			
XVII	Earnings per equity share (for discontinued operation): (1) Basic (2) Diluted			
XVIII	Earnings per equity share(for discontinued & continuing operations) (1) Basic (2) Diluted			