CA FINAL

FINANCIAL REPORTING

OLD COURSE

5 DAYS FACE TO FACE REVISION BATCH

BY

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DAY – 1

ACCOUNTING STANDARD – 22

ACCOUNTING FOR TAXES ON INCOME

DEFINITIONS

1. **Accounting income** is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving.

2. **Taxable income (tax loss)** is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined.

3. **Tax expense (tax saving)** is the aggregate of Current tax and Deferred tax charged or credited to the statement of profit and loss for the period.

4. **Current tax** is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.

5. **Deferred tax** is the tax effect of timing differences.

6. **Timing differences** are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

7. **Permanent differences** are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently. Permanent differences do not result in deferred tax assets or deferred tax liabilities,

DTL	DTA
Create without any Restrictions	Create Subject to para 15 & 17 Para 15 talks about reasonable certainty Para 17 – Virtual Certainty (in case of Unabsorbed Dep & C/f Losses)

UNABSORBED DEPRECIATION AND CARRY FORWARD OF LOSSES

Unabsorbed depreciation and carry forward of losses which can be set off against future taxable income are also considered as timing difference and result in deferred tax assets, subject to consideration of prudence.

PRUDENCE LIMITS: VIRTUAL CERTAINTY

Expect in the situations stated in paragraph 17, deferred tax assets should be recognized and carried forward only to the extent that there is a *reasonable certainty* that sufficient future *taxable income* will be available against which such deferred tax assets can be realized. (Para 15)

Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognized only to the extent that there is *virtual certainty supported by convincing evidence* that sufficient future taxable income will be available against which such deferred tax assets can be realized. (Para 17)

Q1. PQR Ltd.'s accounting ends on 31.03.2001. The company made a loss of Rs. 2,00,000 for the year ending 31.03.2001. For the year ending 31.03.2002 and 31.03.2003, it made profits of Rs. 1,00,000 and Rs. 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for the eight years and tax rate is 40%. By the end of 31.03.2001, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be setoff. There is no difference between taxable income and accounting income expect that the carry forward loss is allowed in the years ending 2002 and 2003 for the tax purposes. Prepared a statement of Profit and Loss for the years ending 2001, 2002 and 2003. **(Nov. 2003)**

(Ans.: Loss 1,20,000, Profit 60,000 and 72,000)

Measurement

Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.

Deferred tax assets and liabilities should be measured **using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date**.

Take Weighted Avg Tax Rate in case Income is chargeable to tax under slab rates.

Application of MAT

MAT calculation shall not affect the working of Deferred Taxes.
Consider only Normal Tax Rate for Calculation of Deferred Taxes.
For Timing Differences compare Accounting Income (PBT) and Taxable Income. Ignore Book profit as per MAT provisions.

Q2. Book Profit	Rs.10,00,000
Accounting Income	Rs.2,00,000
Regular Tax Rate	30%
Taxable Income	Rs.1,50,000

Difference between Accounting Income & Taxable Income is due to timing Difference

Mat Rate	18%

Prepare Extracts of Profit and Loss account and Balance Sheet.

DISCOUNTING

Deferred tax assets and liabilities **should not be** discounted to their present value.

Review of Deferred Tax Assets

The carrying amount of deferred tax assets should be reviewed at each balance sheet date.

Presentation and Disclosure

An enterprise should offset assets and liabilities representing tax if the enterprise:

(a) has a legally enforceable right; and

(b) intends to settle the asset and the liability on a net basis.

TAX HOLIDAY

(a) The deferred tax in respect of timing differences which reverse during the tax holiday period is not recognised.

(b) Deferred tax in respect of timing differences which reverse after the tax holiday period is recognised in the year in which the timing differences originate. However,

recognition of deferred tax assets is subject to the consideration of prudence as laid down in paragraphs 15 to 18.

(c) For the above purposes, the timing differences which originate first are considered to reverse first

Q3. Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is Rs.200 lakhs and Rs. 400 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by Rs.10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

DEPRECIATION

Q4. ABC Ltd. prepares its accounts annually on 31st March. On 1st April' 2001, it purchases a machine at a cost of Rs. 1,50,000. The machine has a useful life of three years and an expected scrap value of zero. Although it is eligible for a 100% first year depreciation allowance for tax purposes, the straight-line method is considered appropriate for accounting purposes. ABC Ltd. has profits before depreciation and taxes of Rs. 2,00,000 each year and the corporate tax rate for 2002, 2003 and 2004 are 40%, 35% and 38% respectively. Show the profit and loss account and pass the journal entries as per Accounting Standard-22.
Ans.: Deferred Tax Liability Rs. 40,000 , Rs. 17,500 and Rs. Nil.

Q5. Company A has a block of assets with a written down value of Rs.100,000 on April 1, 20X I for tax purposes. The book value of the assets for accounting purposes is also Rs. 100,000. The assets are depreciated on written down value basis at 25 per cent per annum for both accounting and tax purposes. Of the entire block, assets costing Rs. 5,000 on April 1, 20XI, were sold for Rs. 10,000 on March 31, 20X3. Compute the deferred tax asset/liability assuming tax rate of 40 per cent. **(RTP Nov. 2014)**

Ans.: Depreciation for income tax purposes is computed on block of assets, rather than for individual assets. Further, as per section 50 of the Income tax Act, 1961, the entire sale consideration received on sale of fixed assets be reduced from the written down value of the relevant block. For example, if the block had a written down value of Rs. 10,000 and an asset costing Rs. 2,000 was sold for Rs. 3,000, the block would be reduced

by Rs 3,000 rather than by Rs. 2,000. Conversely, if the asset had been sold for Rs. 1,000 the block would have been reduced by Rs. 1000 and not by Rs. 2,000.

It may be noted that Appendix 1 to AS 22 gives examples of timing differences. One of the examples is "Differences in method of calculation e.g. calculation of depreciation with reference to individual assets in the books but on block basis for tax purposes ... .

In view of the above, in the case of Company A in question, the following computations will be made:

20X1-X2

In this year, depreciation for both accounting and taxation purposes would be Rs. 25,000 (25 per cent of Rs. 100,000). Accordingly no timing difference arises on this account.

20X2-X3

Depreciation for the year would be Rs.18,750 (25 per cent of Rs. 75,000) as per the books of account, while for tax purposes it would be Rs. 16,250 as sale proceeds of Rs. 10,000 would be reduced from the block of assets prior to the computation of depreciation. Accordingly, the following timing differences arise:

Depreciation for tax purposes is Rs. 16,250 and for accounting purposes Rs. 18,750 giving rise to a timing difference of Rs. 2,500

Profit on sale of fixed asset amounting to Rs. 7,188 (Rs. 10000 – Rs. 2812 being the WDV of the asset as on 31st March 20X3) is recognised for accounting purposes. However, for tax purposes this income is not considered. This will result in a timing difference of Rs.7,188.

The net timing difference would be Rs. 4,688 by which the accounting income would exceed the taxable income, thus requiring creation of a deferred tax liability of Rs. 1,875 (4,688-0.4).

The difference of 74,688 would reverse in future years when depreciation for accounting purposes would be higher as compared to depreciation for tax purposes because depreciation for accounting purposes would be computed on a higher carrying amount of fixed assets as compared to carrying amount of those assets for tax purposes. Rs. 4,688 is also the difference between the accounting and tax. written down values of the assets as on March 31, 20X3 (i.e., assets for accounting purposes of Rs. 53,438 (75,000 - 18,750 - 2,812) less assets for tax purposes of Rs. 48,750 (75,000 - 10,000 - 16,250).

Q6. Ultra Ltd. has provided the following information:

Depreciation as per accounting records	Rs. 2,00,000
Depreciation as per tax records	Rs. 5,00,000
Unamortised preliminary expenses as per tax records	Rs. 30,000

There is adequate evidence of future profit sufficiency. How much deferred Tax asset/liability should be recognized as transition adjustment? Tax rate is 50%.

Ans.: Calculation of difference between taxable income and accounting income

Particulars	**Amount (Rs.)**
Excess depreciation as per tax (5,00,000 - 2,00,000)	3,00,000
Less: Expenses provided in taxable income	30,000
Timing difference	2,70,000

Tax expense is more than the current tax due to timing difference. Therefore deferred tax liability = 50%*2,70,000 = Rs. 1,35,000

Q7. From the following information given below you are required to computed Deferred Tax Assets and Deferred Tax Liability for Ramanujam Ltd. as on 31st March, 2014. The tax applicable is 35%.

(1) The company has charged Rs. 7,42,900 in the books of accounts while as per Income Tax Computation, the depreciation available for the company is Rs. 8,65,400.

(2) The Company has made provision for doubtful debts for Rs. 54,300 during the year.

(3) The company has debited share issue expenses of Rs. 6,23,500 which will be available for deduction under the income tax Act from the next year.

(4) The expenses of Rs. 7,84,500 has been charged to profit and loss account which are disallowed under the income tax act.

(5) The company has made donation of Rs. 2,00,000 which has been debited to Profit and loss account and only 50% thereof will be allowed as deduction as per Income Tax law. **(November 2014, 5 Marks)**

Comparison of AS 22 and IND AS 12

BASIS	AS 22 – Accounting for Taxes on Income	IND. AS 12 – Income Taxes
Calculation base	Deferred tax is computed on Timing differences.	Deferred Tax is computed for Temporary differences.
Approach	It Follows Profit and Loss A/c Approach – Compares Revenue items as per Accounting Books and Income Tax.	It Follows Balance Sheet Approach – Compares Carrying amount of Assets and Liabilities as per Accounting Books and Tax base.
Recognition of DT in OCI	No specific guidance in AS 22.	Current Tax and DT is to be recognized in OCI or directly in equity if the items on which CT and DT is calculated is recognized in OCI or in Equity.
Recognition of DTA	DTA is recognized only to the extent that there is *virtual certainty supported by convincing evidence* that sufficient future taxable income will be available against such deferred tax assets can be realised. For all other unsed tax credits/timing differences – DTA is recognized if there is *reasonable certainty.*	DTA is recognized if it is *probable* that future taxable profit will be available against which the unused tax losses and tax credits can be utilized.
DT on Revaluation of Assets	DT on revaluation is ignored as it is considered as permanent difference.	DT is recognized as per Balance Sheet approach through Equity.

GUIDANCE NOTE ON ACCOUNTING FOR CREDIT AVAILABLE IN RESPECT OF MINIMUM ALTERNATIVE TAX UNDER THE INCOME TAX ACT, 1961

Q1.Whether MAT credit is a deferred tax asset?

Payment of MAT, dose not by itself, result in any timing difference since it does not give rise to any difference between the accounting income and the taxable income which are arrived at before adjusting the tax expense, namely, MAT. In other words, under AS 22, deferred tax asset and deferred tax liability arise on account of difference in the item of income and expenses credited or charged in the profit and loss account as compared to the items of income that are taxed or items of expense that are allowed as deduction, for the purpose of the Act. Thus, deferred tax assets and deferred tax liabilities do not arise on account of the amount of tax expense itself. In view of this, it is not appropriate to consider MAT credit as a deferred tax asset for the purposes of AS 22.

Q2. Whether MAT credit can be considered as an 'asset'

"An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise".

MAT paid in a year in respect of which the credit is allowed during the specified period under the Act is a resource controlled by the company as a result of past event, namely, the payment of MAT. MAT credit has expected future economic benefits in the form of its adjustment against the discharge of the normal tax liability if the same arises during the specified period. Accordingly, MAT credit is an 'asset'.

Where MAT credit is recognized as an asset the same should be reviewed at each balance sheet date. A company should write down the carrying amount of the MAT credit asset to the extent there is no longer a convincing evidence to the effect that the company will pay normal income tax during the specified period.

Q3. Show Presentation of MAT credit in the financial statements.

Where a company recognizes MAT credit as an asset, the same should be presented under the head 'Loans and Advances' since, it is of the nature of a pre-paid tax which would be adjusted against the normal income tax during the specified period. The asset may be reflected as 'MAT credit entitlement'.

In the year of set-off of credit, the amount of credit availed should be shown as a deduction from the 'Provision for Taxation' on the liabilities side of the balance sheet. The unavailed amount of MAT credit entitlement, if any, should continue to be presented under the head 'Loans and Advance'.

The tax expense arising on account of payment of MAT should be charged at the gross amount, in the normal way, to the profit and loss in the year of payment of MAT. In the year in which the MAT credit becomes eligible to be recognized as an asset in accordance with the recommendations contained in this Guidance Note, the said asset should be created by way of a credit to the profit and loss account and presented as separate line item therein.

AS – 10 (R) PROPERTY, PLANT & EQUIPMENT (PPE) Previously – Accounting for Fixed Assets	IND AS – 16 PROPERTY, PLANT & EQUIPMENT

PROPERTY PLANT AND EQUIPMENT:

Any Tangible item will be called as PPE if it satisfies the following Conditions:

Condition – 1	Condition – 2
Held for Use in Production or Supply of goods and services For Rental to Others For Administrative Purposes	Expected to be Used for more than 12 Months.

BEARER PLANT IS ALSO A PPE COVERED UNDER AS - 10

Biological Assets: It means Living Plants and Animals. AS 10 applies on Bearer Plants only.

Bearer Plant: a plant that satisfies all the 3 conditions:

Bearer Plant is a	Is used in the production or supply	• Of Agricultural produce
	Is expected to bear produce	• For more than a period of 12 months

plant which	Has a remote likelihood of being sold as Agricultural produce	•Except for incidental scrap sales

Note: When bearer plants are no longer used to bear produce they might be cut down and sold as scrap. For example - use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a Bearer Plant.

Example of bearer plant is Mango Tree, Coconut Tree etc

RECOGNITION CRITERIA FOR PPE

The ***cost of an item of PPE*** should 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 enterprise, and
(b) The cost of the item can be measured reliably.

Treatment of Spare Parts, Stand by Equipment and Servicing Equipment

Case I: If they meet the definition of PPE as per AS 10: Recognised as PPE as per AS 10

Case II: If they do not meet the definition of PPE as per AS 10: Such items are classified as Inventory as per AS 2.

Treatment of different subsequent expenditure on PPE:

1. **Cost of day to day servicing:** This cost is directly recognised in the Statement of Profit and Loss.

2. **Replacement of parts of PPE:** Capitalise in the carrying amount of PPE if the recognition criteria are met.
   Example: 1) Aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe.
   2) Replacing the interior walls of a building, or to make a non-recurring replacement.

3. **Regular Major Inspection:** When each major inspection is performed, its cost is recognised in the carrying amount of the item of PPE as a replacement, if the recognition criteria are satisfied.

Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognized.

MEASUREMENT OF PPE

At Initial Recognition	After Initial Recognition
COST MODEL	COST MODEL or REVALUATION MODEL

Cost of an item of PPE comprises:

COST Includes	COST Excludes
Purchase Price including Import duties and Non refundable Taxes	Cost of Opening new business such as inauguration cost
Any Directly attributable Costs bringing the inventory to its 'location and condition' **Eg.** Cost of Employee benefits on construction or acquisition of PPE Installation Cost Cost of Testing the PPE Professional Fees	Cost of introducing a new product including advertising Initial operating losses Cost of relocating or reorganizing part or all the operations of an enterprises.
Decommissioning Restoration and Similar Liabilities *Initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'Decommissioning, Restoration and similar Liabilities'*	Administrative and other general overheads

INITIAL RECOGNITION AT - COST:

Cost of an item of PPE is the **CASH PRICE EQUIVALENT** at the recognition date.

(a) If payment is deferred beyond normal credit terms:

Total payment - Cash price equivalent

- Is recognised as Interest over the period of credit
- unless such interest is capitalised in accordance with AS 16

(b) PPE acquired in Exchange for a Non-monetary Asset or Assets or a combination of Monetary and Non-monetary Assets:

Cost of such an item of PPE is **measured at fair value unless:**

(i) Exchange transaction lacks commercial substance; Or

(ii) Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

If the PPE acquired is not measured at Fair Value, its cost is measured at the **carrying amount of the asset given up**.

(c) Government Grant related to PPE:

The carrying amount of an item of PPE may be reduced by government grants in accordance with AS 12 (Accounting for Government Grants).

MEASUREMENT AFTER RECOGNITION

An enterprise should choose

- **Either** Cost model,
- **Or** Revaluation model

as its accounting policy and should apply that policy to an entire **class of PPE**.

Class of PPE: A class of PPE is a grouping of assets of a **similar nature and use** in operations of an enterprise.

Examples of separate classes:

(a) Land

(b) Land and Buildings

(c) Machinery

(d) Ships

(e) Aircraft

(f) Motor Vehicles

(g) Furniture and Fixtures

(h) Office Equipment

(i) Bearer plants

Cost Model

After recognition as an asset, an item of PPE should be carried at:

Cost - Any Accumulated Depreciation - Any Accumulated Impairment losses

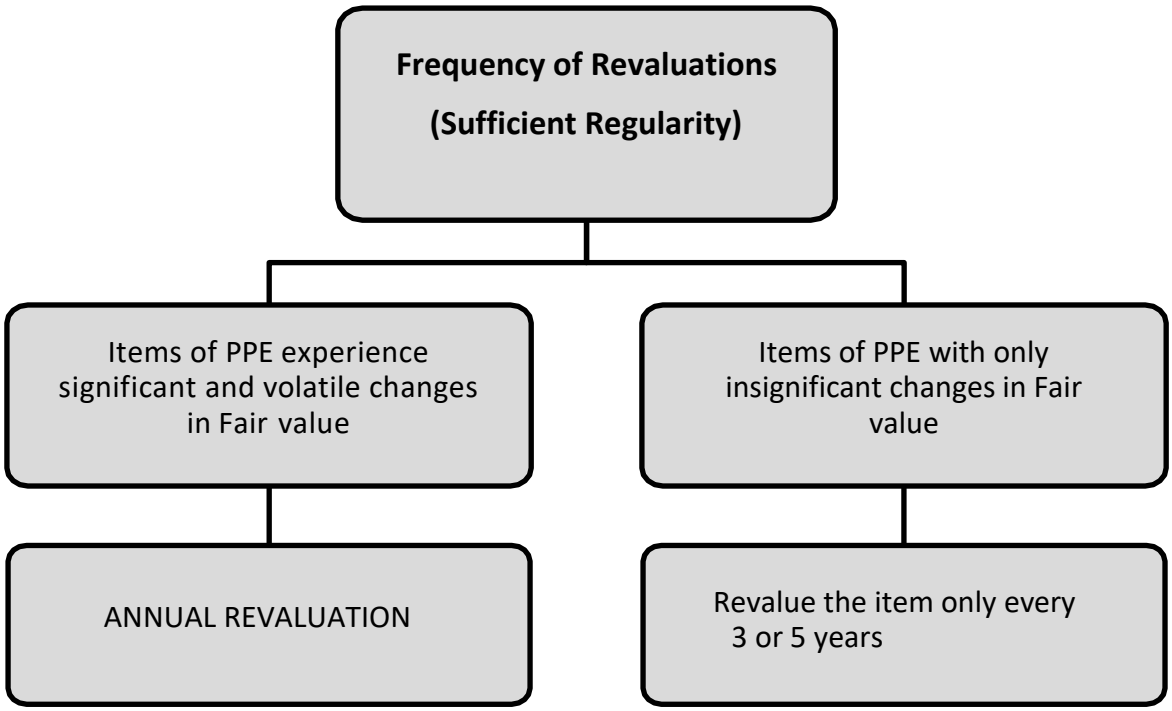
Revaluation Model

After recognition as an asset, an item of PPE whose fair value can be measured reliably should be carried at a revalued amount.

Fair value at the date of the revaluation	-
Less: Any subsequent accumulated depreciation	(-)
Less: Any subsequent accumulated impairment losses	(-)
Carrying value	=

Revaluation for entire class of PPE

If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.

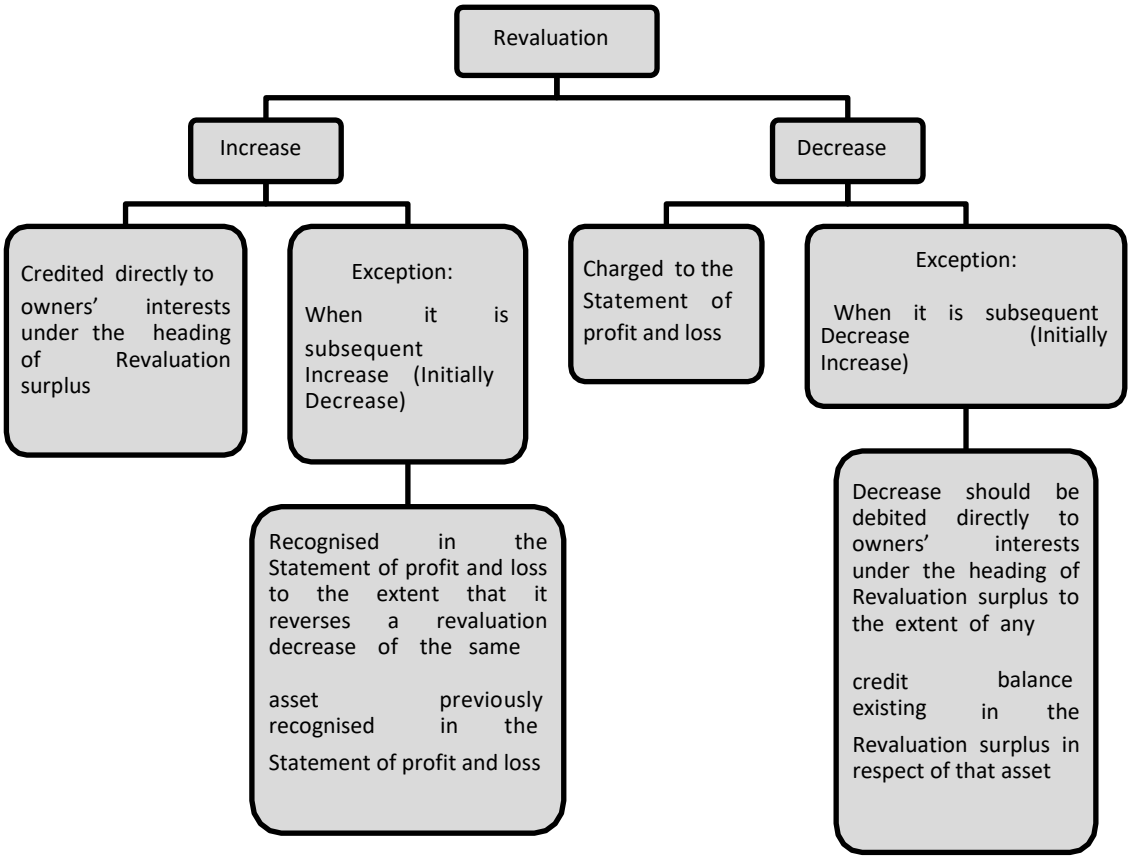


ACCOUNTING TREATMENT OF REVALUATIONS

NET METHOD:

GROSS METHOD:

Revaluation - Increase or Decrease



Treatment of Revaluation Surplus

The revaluation surplus included in owners' interests in respect of an item of PPE may be transferred to the **Revenue Reserves when the asset is derecognised.**

Case I : When whole surplus is transferred:

When the asset is:

- Retired; Or
- Disposed of

Case II : Some of the surplus may be transferred as the asset is used by an enterprise:

In such a case, the amount of the surplus transferred would be:

Depreciation (based on Revalued Carrying amount) – Depreciation (based on Original Cost)

Transfers from Revaluation Surplus to the Revenue Reserves are not made through the Statement of Profit and Loss.

DEPRECIATION

Component Method of Depreciation:

Each part of an item of PPE with a cost that is **significant in relation to the total cost** of the item should be depreciated separately.

Example: It may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.

Is Grouping of Components possible?

Yes.

A significant part of an item of PPE 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 illustrate this, suppose a composite asset costs Rs. 100, whose useful life as a whole can be considered as 8 years. It has a major component X, whose cost is Rs. 40. This component is expected to have a life of 4 years while the rest of the asset is expected to have a life of 10 years.

In the absence of component approach, the position would be as follows:

Year	Annual Charge to P&L Account
1 to 4	12.5 (100/8)
5	12.5 + 40 = 52.5
6-8	12.5

Thereby, it is evident that charging replacement cost of X in the year of replacement would distort the True and Fair View.

However, if the aforesaid component is treated as a separate asset, the annual depreciation charge would be as follows:

Depreciation on major Component X	40/4 = 10
Depreciation on rest of the assets	60/10 = 6
Total	**13**

From above we can see that this is the best way of accounting for assets having major components whose useful lives differ significantly.

Accounting Treatment:

Depreciation charge for each period should be recognised in the Statement of Profit and Loss unless it is included in the carrying amount of another asset.

Land and Buildings

Land and buildings are separable assets and are accounted for separately, **even when they are acquired together.**

A. **Land:** Land has an unlimited useful life and therefore is not depreciated.

   Exceptions: Quarries and sites used for landfill.

   Depreciation on Land:

I. **If land itself has a limited useful life:**

It is depreciated in a manner that reflects the benefits to be derived from it.

II. 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.

B. **Buildings:**

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.

DEPRECIATION METHOD

The depreciation method used should **reflect the pattern in which the future economic benefits** of the asset are expected to be consumed by the enterprise.

The method selected is applied **consistently from period to period** unless:

- There is a change in the expected pattern of consumption of those future economic benefits; Or
- That the method is changed in accordance with the statute to best reflect the way the asset is consumed.

REVIEW OF DEPRECIATION METHOD:

The depreciation method applied to an asset should be 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 should be accounted for as a change in an accounting estimate in accordance with AS 5.

RETIREMENTS

Items of PPE retired from active use and held for disposal should be stated at the lower of:

- Carrying Amount, and
- Net Realisable Value

Note: Any write-down in this regard should be recognised immediately in the Statement of Profit and Loss.

DE-RECOGNITION

The carrying amount of an item of PPE should be derecognised:

- On disposal
  - By sale
  - By entering into a finance lease, or
  - By donation, Or
- When no future economic benefits are expected from its use or disposal

Accounting Treatment:

Gain or loss arising from de-recognition of an item of PPE should be included in the **Statement of Profit and Loss when the item is derecognized** unless AS 19 on Leases, requires otherwise on a sale and leaseback (AS 19 on Leases, applies to disposal by a sale and leaseback.)

Where,

Gain or loss arising from de-recognition of an item of PPE

= Net disposal proceeds (if any) - Carrying Amount of the item

Note: Gains should **not** be classified as revenue, as defined in AS 9 'Revenue Recognition'.

IMPORTANT QUESTIONS:

Q1 - Replacement Cost

Sun Ltd has acquired a heavy road trailer at a cost of ` 100,000 (with no breakdown of component parts). The estimated useful life is 10 years. At the end of the sixth year, the engine requires replacement, as further maintenance is uneconomical due to the off-road time required. The remainder of the vehicle is perfectly road worthy and is expected to last for the next four years. The cost of the new engine is ` 45,000. The discount rate assumed is 5%.

Whether the cost of new engine can be recognised as the asset, and if so, what treatment should be followed?

(Hint Answer: Revised Cost = (100,000 - 33,580 + 45,000) = 111,420)

Q2 - Deferred Payment Credit

On 1st April 20X1, an item of property is offered for sale at ` 10 million, with payment terms being three equal installments of ` 33,33,333 over a two years period (payments are made on 1st April 20X1, 31st March 20X2 and 31st March 20X3).

The property developer is offering a discount of 5 percent (i.e. ` 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.

Q3 – Exchange of Assets

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

Show the necessary treatment as per Ind AS 16.

(Hint: Profit on Exchange – 5000; Private Jet recognize at 18000)

Q4: Accumulated depreciation at the date of revaluation

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

Find out the entries to be passed?

Solution

Method – I:

Accumulated depreciation	Dr.	55,000	
To Asset Cost			55,000
Asset Cost	Dr.	20,000	
To Revaluation reserve			20,000

The net result is that the asset has a carrying amount of ` 65,000 (100,000 – 55,000 + 20,000).

Method – II:

Carrying amount (100,000 – 55,000) =	45,000	
Fair value (revalued amount)	65,000	
Surplus	20,000	
% of surplus (20,000/ 45,000)	44.44%	
Entries to be Made:		
Asset (1,00,000 x 44.44%)	Dr.	44,444
To Accumulated Depreciation	55000x 44.44%	24,444
To Surplus on Revaluation		20,000

Q5: Utilisation of Revaluation Surplus

An item of PPE was purchased for ` 9,00,000 on 1 April 20X1. It is estimated to have a useful life of 10 years and is depreciated on a straight line basis. On 1 April 20X3, the asset is revalued to` 9,60,000. The useful life remains unchanged at ten years.

Show the necessary treatment as per Ind AS 16.

Q6: *On April 1, 20X1, XYZ Ltd. acquired a machine under the following terms:*	
List price of machine	*80,00,000*
Import duty	*5,00,000*
Delivery fees	*1,00,000*
Electrical installation costs	*10,00,000*
Pre-production testing	*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, 20X1. At what cost the asset will be recognised?

(Hint: 92,00,000)

ACCOUNTING STANDARD - 26
"INTANGIBLE ASSETS"

APPLICABILITY:

- Financial assets like Cash, Ownership interest in another enterprise.
- Intangible assets covered by AS 14, AS 21, AS 22
- Intangible assets arising in the insurance enterprises
- Expenditure incurred to obtain any right in respect of exploration or extraction of Oil, Gas and any other mineral or natural resources

However this standard specifically applies to:

- Goodwill
- Expenditure on Advertising
- Expenditure on Training
- Research and Development activities
- Patents, Copyrights and Trademarks
- Rights under licensing agreements such as video recordings, plays, picture films.

ASSET:

- Controlled by the enterprise as a result of past events and,
- From which *Future Economic Benefits* are expected to flow to the enterprise.
  (Road sidings are not controlled but Rail sidings are controlled.)

INTANGIBLE ASSETS: An Intangible asset is:

- An identifiable
- Non – Monetary asset
- Without physical substance
- Held for use in the production or supply of goods or services, for rental to others, or for administrative purpose.

Examples:

- Identifiable means capable of Sale/Rental to others.
- An intangible asset is identifiable if the future economic benefits are flow to the enterprise from that intangible asset.
- Employees loyalty, staff training etc cannot be identifiable though they are beneficial for entity but can not be sold/rental to others.
- However purchased goodwill, patents, trademarks, licenses are identifiable
- Non – monetary asset means the value to be received against the asset is not fixed.
- Computer softwares/Websites/Films/License/Trademarks are intangible asset since it has no physical substance, however the software is contained in CDs or DVDs being physical substance but the cost of physical substance is insignificant as compared to intangible non physical substance.
- Ringtones of telecom companies (Airtel, Idea, Reliance etc) are Intangible Assets since it satisfy all the conditions of being an Intangible Asset.
- If the cost/ value of physical substance is more, than asset should be treated as per AS- 10 i.e. Fixed asset.

NOTE: For clarification, following are not Intangible Assets as per AS – 26, hence they should be written off in P&L immediately:

(a) Preliminary expenses (non – identifiable)
(b) Pre-Operating expenses (non – identifiable)
(c) Staff Training
(d) Heavy Advertisement expenses

RECOGNITION OF INTANGIBLE ASSETS:

If the following conditions are satisfied then, an intangible asset should be recognized/recorded in the books of accounts, otherwise treated as an expense:

- It is probable that future economic benefits from the intangible asset will flow to the enterprise; and
- The **COST** of intangible can be measured reliably.

INITIAL MEASURMENT: As per AS 26, Intangible assets should be recognized only at COST.

COST MEANS WHAT?:

Separate Acquisition – Cost will be purchase price including non refundable duties and taxes and any other directly attributable expenses.
Exchange of Assets – Cost will be the fair value of assets given up.
By Issue of Shares/Securities – Cost will be the fair value of intangible asset acquired or fair value of shares/securities issued, whichever is more evident.
Acquisition as a part of Amalgamation – If Intangible assets are obtained in scheme of amalgamation, they would be recorded at Fair values as per AS -26. In case of amalgamation in the nature of purchase, difference between PC and acquired assets is regarded as Goodwill under AS – 14.
Acquisition by way of Govt. Grants – Should be recognized as per AS – 12 (Govt. Grants). As per AS – 12, such assets are recorded at nominal value. For example import quota given to exporters as free are to be recorded as nominal value.
Self Generated Goodwill – Cost cannot be measured reliably hence, not recognized.
Internally generated Intangible assets like Brands, Customer Lists; Good and Trained employees should not be recognized as intangible assets. Publishing Titles such as "India Today", "Champak" cannot be recorded as IA.

RESEARCH AND DEVELOPMENT:
Research Phase: Gaining of scientific or technical knowledge. Cost of Research activity should not be capitalized as an intangible asset, it should be treated as expense and transfer to P&L a/c as par AS 26.

Development Phase: It is the activity which converts the result of the research to a marketable product (Gained knowledge is applied). Cost of Development activity should be capitalized only if it meets the recognition criteria i.e. the future economic benefits will flow to the enterprise by such activity otherwise treat it as expense.
If all of the following conditions are satisfied then it is considered as Development phase:

- Technical feasibility has been established.

- Intention of entity to develop assets should exist.
- Marketability of asset should be proved as per survey report.
- Resources for development should be available.

SUBSEQUENT EXPENDITURE:

Subsequent Expenditure on already recognized Intangible Asset should be Capitalized if the following two conditions are fulfilled:

- Subsequent Expense increases the future economic benefits of Intangible Assets.
- Such expense can be measured reliably.

If the above two conditions are not fulfilled than the subsequent expense should be transferred to P&L A/c.

AMORTIZATION (Depreciation) OF INTANGIBLE ASSETS:

1. **Amortization Period:** Depreciable amount of Intangibles should be allocated on a systematic basis over the best estimate of its useful life. There is presumption that the useful life of an intangible asset will not exceed the Ten Years from the date when the asset is available for use unless there is significant evidence that the useful life is more than 10 years.
2. **Amortization Method:**
    - The amortization method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise.
    - If that pattern cannot be determined reliably the Straight Line Method (SLM) should be used.

    a. Residual Value: The residual value of intangibles should be assumed to be Zero unless:

    (a) There is a commitment by the third party to purchase the asset at the end of its useful life; or

    (b) There is a active market for the asset and:

    (i) Residual value can be determined by reference to that marked; and

    (ii) It is probable that such a market will exist at the end of the asset's useful life.
3. **Review of Amortization period and method:**
    - The amortization period and method should be reviewed at least at each financial year end.
    - If the expected useful life is significantly different from the previous estimates, the amortization period should be changed accordingly.

- If there has been change in expected pattern of economic benefits from the asset, the amortization method should be changed to reflect such changed pattern.

IMPAIRMENT OF INTANGIBLE ASSETS:

- Intangible Asset should be impaired if its Recoverable amount is less than the Carrying amount (i.e. book value).
- In such case, impairment loss equal to recoverable amount minus carrying amount should be recognized in the P&L a/c.

RETIREMENT AND DISPOSAL OF INTANGIBLE ASSETS:

An intangible asset should be derecognized (eliminated from the Balance sheet) if:

- It is disposed; or
- No future economic benefits are expected from its use.

Gain/Loss arising on retirement or disposal of intangibles should be recognized as income or expense in P&L A/c.

Difference Between AS 26 and Ind AS 38:

Basis	Ind AS 38	AS 26
Payment deferred beyond normal credit term	On acquisition of Intangible Assets, if payment is deferred beyond normal credit terms, the difference between the amount paid and the amount recognised is Interest expense to be amortised over the period of credit unless it is capitalized as per Ind AS 23 (AS 16)	There is no such provision in the existing standard.
Useful Life	The rebuttable presumption of 10 years is not in this standard. Here the useful life can even be indefinite and in such case it should not be amortised but should be tested for Impairment.	There is an assumption that useful life of an Intangible Asset is always finite, and includes a rebuttable presumption that useful life can not exceed 10 years.
Change in method of amortization	This change would be treated as Change in Accounting Estimate.	The change will be treated as change in Accounting Policy.
Valuation Model	This standard permits the entity to choose either Cost model or	Revaluation Model is not permitted.

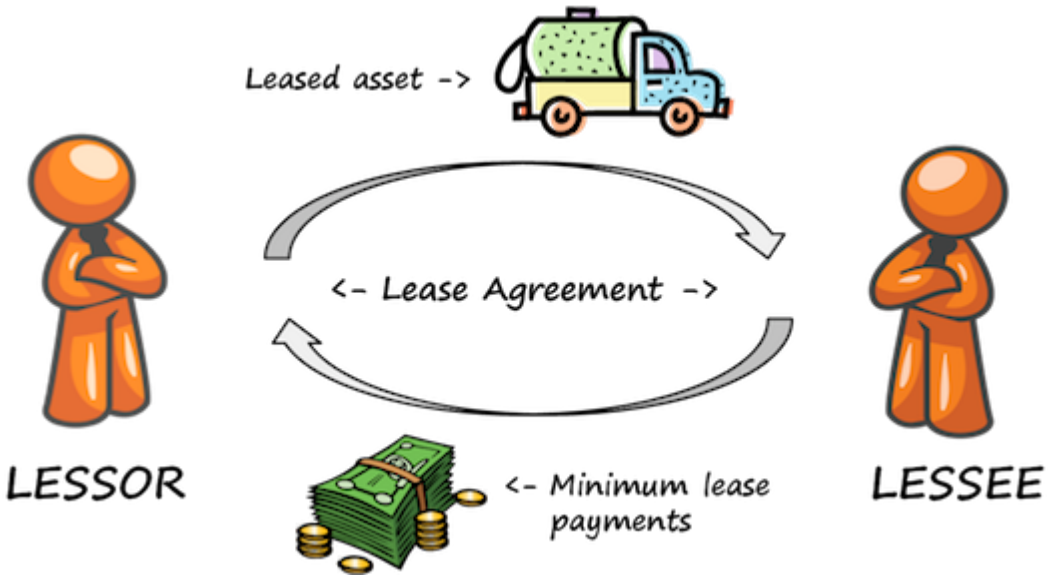
	revaluation model.	

INDAS 17 - LEASES

What is Lease?

A lease is an agreement whereby lessor conveys to the lessee in return for a payment or series of payments (minimum lease payments) right to use an asset for the agreed period of time (lease term).

The lease relationship is illustrated in the following picture:



The ***Inception of The Lease*** is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date: (a) a lease is classified as either an operating or a finance lease; and (b) in the case of a finance lease, the amounts to be recognised at the commencement of the lease term are determined.

The ***Commencement of The Lease*** term is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (ie the recognition of the assets, liabilities, income or expenses resulting from the lease, as appropriate).

Example:

A lessee may sign an agreement to lease a car on 31 March 20X1 but does not take delivery of the car until 30 June 20X1.

Lease classification is made at the inception of the lease i.e on 31 March 20X1.
The recognition of the related assets, liabilities, income and expense in the financial statements will not take place until 30 June 20X1. Commencement of the lease will be on 30 June 20X1.

Unguaranteed residual value is that portion of the residual value of the leased asset, the realisation of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.

The **Interest Rate Implicit In The Lease** is the discount rate that, at the inception of the lease, causes the aggregate present value of (a) the minimum lease payments and (b) the unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset and (ii) any initial direct cost of the lessor.

The ***Lessee's Incremental Borrowing Rate*** *of interest* is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

Classification of Leases

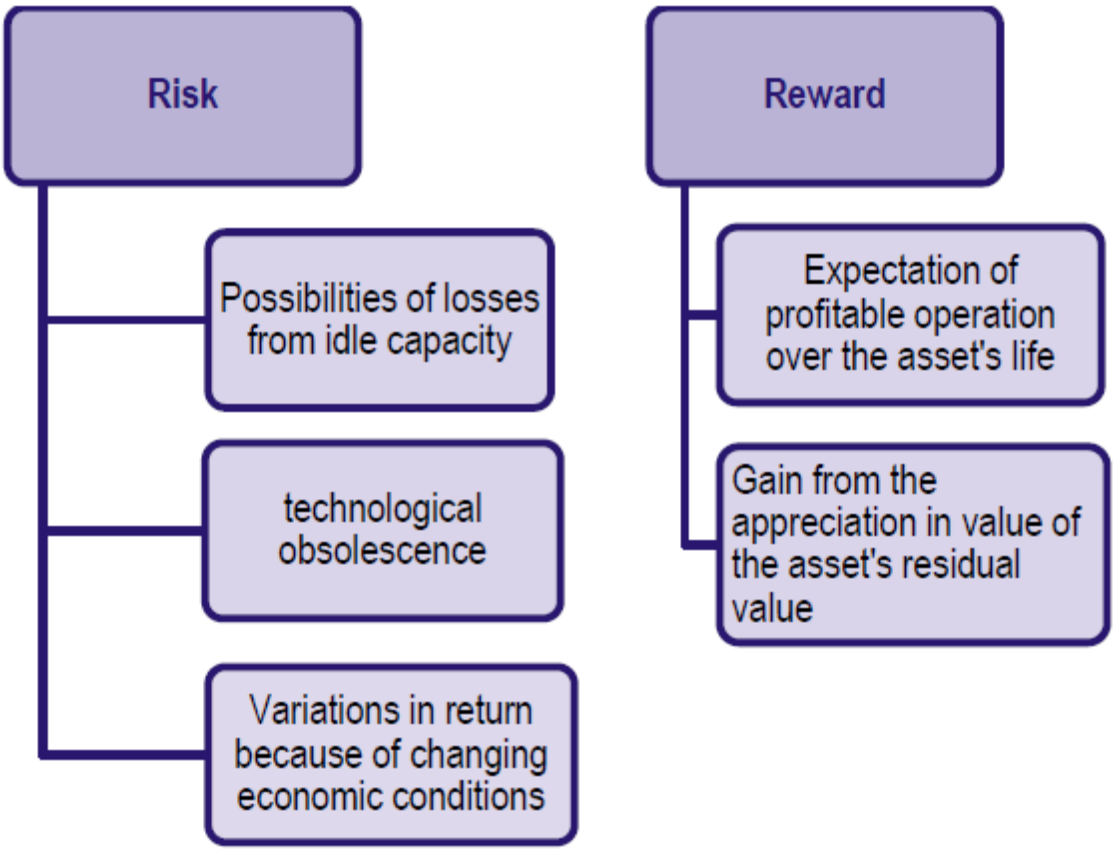
Types of Leases

There are 2 types of leases defined in INDAS 17:

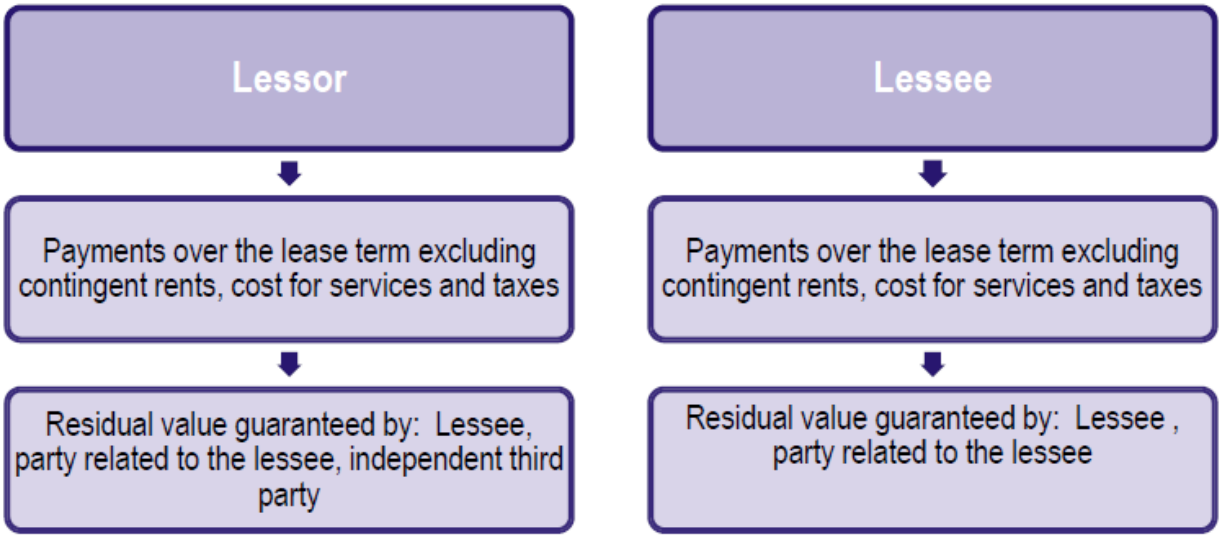
1. ***An Operating Lease*** is a lease other than a finance lease.
2. ***A Finance Lease*** is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Legal title may or may not eventually be transferred.

The classification of leases has to be performed at the inception of the lease, before recognizing any amounts related to the lease in the financial statements.

FINANCE LEASE



Minimum Lease Payments under Finance Lease



Situations and Indicators of Finance Lease

AS 19 outlines examples of ***situations*** that would normally lead to a lease being classified as ***a finance lease***:

- The ***lease transfers ownership*** of the asset to the lessee by the end of the lease term.
- 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 of the option exercisability. It is reasonably certain, at the inception of the lease, that the option will be exercised.
- The ***lease term is for the major part of the economic life*** of the asset even if the title is not transferred.
- At the inception of the lease the present value of the **minimum lease payments** amounts to at least substantially all of the fair value of the leased asset.
- The leased assets are of such a **specialized nature** that only the lessee can use them without major modifications.

Financial Statements of LESSEE

(A) Initial Recognition

At the commencement of the lease term, lessee should recognize ***an asset and a lease liability*** at:

- **Lower of the fair value of the asset and**
- **Present value of the minimum lease payments.**

The discount rate for calculating the present value of the minimum payments is ***the interest rate implicit in the lease.***

The accounting entry is as follows:

DEBIT: Property, Plant and Equipment (Leased Asset) / CREDIT: Finance Lease Liability

(B) Subsequent Measurement

There are 2 things to take care about after initial recognition:

1. ***Minimum lease payments*** should be apportioned between the finance charge (interest) and the reduction of the outstanding lease liability. The finance charge should be allocated so as to produce a constant periodic rate of interest (interest rate implicit in the lease) on the remaining balance sheet liability. In practice, actuarial method is used a lot to work out the allocation.

The basic accounting entry of minimum lease payment paid to the lessor is as follows:

DEBIT: Finance Charge (interest) } / CREDIT: Cash
DEBIT: Finance Lease Liability }

2. Lessee should charge the ***depreciation expense*** related to the assets held under finance leases.

Illustration 1:
On 1 April 20X1, Venus ltd began to lease a property that was used in the production process. The lease was for 4 years and annual rental (payable in advance on 1st April each year) was Rs 20,00,000.

The rate of interest implicit in this lease was 9% p.a. and the present value of the minimum lease payments was very close to the fair value of the property at the inception of the lease, which was estimated at Rs 71,00,000.

Required:
Explain the accounting treatment for the above property lease and produce appropriate extracts from the financial statements of Venus ltd for the year ended 31 March 20X2.

Solution:
The lease is a finance lease.

Initial recognition:-
Leased Asset A/c Dr. 71,00,000
To liability (P.V. of MLP) 71,00,000

The effective finance cost of the liability is 9% p.a.:

Rs. 000

Opening balance	Lease rental payment	Balance in period	Finance Cost	Closing Balance
71,000	20,000	51,000	4,590	55,590

Balance Sheet on 31st March 20X2

Liability		

Current Liability Non-Current Liability	20,000 35,590	 55,590
Asset Leased Asset Less: Depreciation (71,000/4)	 71,000 (17,750)	 53,250

Statement of Profit and Loss for the year ended 31st March 20X2

Depreciation over 4 years	71,000/4	17,750
Finance Cost		4,590

Illustration 2:

The below facts are given for the Earth Heavy Movers Limited:

1. The lease is non-cancellable and is initiated on 1 April 20X1 for equipment with an expected useful life of five years.

2. Three payments are due to the lessor of the amount of 51,000 per year beginning 31 March 20X2. Included in the lease payments is a sum of 1,000, to be paid annually by the lessee for insurance.

3. The lessee guarantees a 10,000 residual value on 31 March 20X4 to the lessor.

4. Irrespective of the 10,000 residual value guaranteed, the leased asset is expected to have only Rs. 1,000 residual value to the lessee at the end of the lease term.

5. The Lessee company depreciates similar equipment that it owns on a straight-line basis.

6. The Fair value of the equipment at 1 April 20X1 is 1,32,000.

7. The Lessor's implicit rate is 10%. This fact is known to the lessee company.

Requirements: As per provision of AS 19: Leases-

1. How should lessee's company classify and record the lease transaction at its inception on 1 April 20X1 (indicate journal entries)?

2. What are the journal entries the lessee is required to make to record the lease payments and the interest, insurance and depreciation expenses on 31 March 20X2 through 31 March 20X4?

3. What entry should the lessee make on 31 March 20X4 to record the guaranteed residual value payment (assuming an estimated residual value of 1,000) and to clear the lease related accounts from the lessee's books?

4. What would be the Current and Non-Current classification in the books of Lessee in year 1?

Solution:

1. The Lessee company should record the asset as a finance lease as the risk and reward is being transferred and inspite of the fact the estimated residual value of the asset will be 1,000 still Lessee is guaranteed lessor residual value of Rs 10,000. Further the lease payment substantially covers the fair value of leased asset as per calculation given below.

2. Calculation of Present value of Minimum Lease Payments (MLP)

PV of MLP is calculated as per implicit rate of return of 10%

Year	**Discount Factor**	**Minimum Lease payments (see note below)**	**Present Value of MLP**
Annual Lease Rentals			
31 March 20X2	0.909	50,000	45,450
31 March 20X3	0.826	50,000	41,300
31 March 20X4	0.751	50,000	37,550
Guaranteed Residual Value			
31 March 20X4	0.751	10,000	7,510
Total		**1,31,810**	

Note: The Contingent rent, taxes, Insurance, Maintenance expenses etc if paid by the lessee to the lessor, then it does not form part of the Minimum lease payments and it will be expensed when incurred. Hence in the above case, for calculation of Present value of Minimum Lease payments only lease rental of ₹ 50,000 has been considered.

At the time of Initial Recognition, the Lessee will recognise the Leasehold asset at lower of below:

Present value of MLP	1,31,810
Fair Value of Leased Asset	1,32,000

Hence, Lease hold asset will be recognised at 1,31,810

Accounting Entry for Recognition would be:

Leasehold Equipment	Dr.	1,31,810	
To Leasehold Obligation			1,31,810

Lease rentals should be split between Principal portion of leasehold obligation and finance costs. Same is computed in the below table:

Year	Payments	Finance Costs @ 10%	Reduction in Liability	Closing obligation
1 April 20X1				1,31,810
31 March 20X2	50,000	13,181	36,819	94,991
31 March 20X3	50,000	9,499	40,501	54,499
31 March 20X4	50,000	5,501	44,499	10,000

Entries at the time of Subsequent measurement at the reporting date:

Particulars	31 March 20X2		31 March 20X3		31 March 20X4	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Insurance Expenses	1,000		1,000		1,000	
Leasehold obligation	36,819		40,501		44,499	
Interest Expenses	13,181		9,499		5,501	
Depreciation	43,619		43,619		43,619	
Cash		51,000		51,000		51,000
Accumulated Depreciation		43,619		43,619		43,619
Total	**94,619**	**94,619**	**94,619**	**94,619**	**94,619**	**94,619**

3. Entries at the End of Lease period

Leasehold Obligation Account	Dr.	10,000	
Accumulated Depreciation Account	Dr.	1,30,810	
To Profit and Loss Account			9,000
To Leasehold Equipment Account			1,31,810

4. The Current and Non-Current Classification at the end of year 1 in the books of Lessee is as follows:

Particulars	Amount
Non Current Asset	
Leasehold Asset	
- Gross Block	1,31,810
- Accumulated Depreciation	(43,619)

Non Current Liability	
Leasehold Obligation (payable after 12 months)	49587
Current Liability	
Leasehold Obligation (payable within 12 months)	45455
Total Liability	**95042**

Note:

DTA/DTL on above question may also be calculated based on AS 22

Financial Statements of LESSORS

(A) Initial Recognition

At the commencement of the lease term, lessor should recognize ***Lease Receivable*** in his statement of financial position. The amount of the receivable should be **equal to net investment in the lease.**

Net investment in the lease equals to gross investment in the lease (minimum lease payments receivable by the lessor under the finance lease + any unguaranteed residual value accruing to the lessor) discounted by **the interest rate implicit in the lease**.

The accounting entry is to debit Lease Receivable and credit Property, plant and equipment (sometimes directly cash).

If lessor incurs any direct and incremental costs in negotiating leases, those must be recognized over the lease term and not to the expenses when incurred.

(B) Subsequent Measurement

The lessor should split minimum payments received into finance income and reduction of the lease receivable. ***Finance income*** shall be recognized based on a pattern reflecting constant periodic rate of return on the lessor's net investment in the lease.

The accounting entry is as follows:

DEBIT: Cash / { CREDIT: Finance Income (Interest)
CREDIT: Lease Receivable

(C) Manufacturers or Dealer Lessor

Manufacture or dealer lessors shall recognise selling profit or loss in the period, in accordance with the policy followed by the entity for outright sales.

Initial direct costs are excluded from the net investment in the lease and are recognised as an expense when the selling profit is recognised, which for a finance lease is normally at the commencement of the lease term. Manufacture or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacture or dealer lessor gives rise to two types of income:

a) Profit or loss equivalent to profit or loss resulting from an outright sale of the asset being leased, at normal selling price; and
b) Finance income over the lease term.

Sale Revenue -

The sales revenue recognised at the commencement of the lease term by a manufacturer or dealer lessor **is the fair value of the asset, or, if lower, the present value of the minimum lease payments accruing to the lessor**, computed at a market rate of interest.

Journal Entry would be:

Lease Receivable A/c	Dr.	Net Investment in Lease
To Sales A/c		Fair value or PV of MLP (whichever is lower)
To Profit on Sales		(Balancing figure)

Manufacture or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest was charged. Costs incurred in connection with negotiating and arranging a lease shall be recognised as an expense when the selling profit is recognised.

Costs incurred by manufacturers or dealer lessor in negotiating and arranging the lease shall be recognized as an expense when selling profit is recognized.

Illustration: 3

X Ltd. given an asset on a finance lease to Y Ltd. Y Ltd. has to pay Rs 10,000 per annum for 5 years.

Unguaranteed residual value accruing to X Ltd. is Rs 5,000. Interest rate implicit in the lease is 15%. Calculate gross investment, net investment and unearned finance income.

Solution:

Year	MLP 1	Unguaranteed residual value 2	Gross Investment 3 = (1+2)	P.V.F.@ 15% 4	Net Investment 5 = (3 x 4)
1	10,000	-	10,000	0.8696	8,696
2	10,000	-	10,000	0.7561	7,561
3	10,000	-	10,000	0.6575	6,575
4	10,000	-	10,000	0.5718	5,718
5	10,000	5,000	15,000	0.4972	7,458
			55,000		**36,008**

Unearned finance income = Gross investment in lease – Net investment in lease = Rs 55,000 – Rs 36,008 = Rs 18,992.

OPERATING LEASE

LESSEE:

Lease payments **(excluding costs for services such as insurance and maintenance)** under an operating lease shall be recognized as an **expense on a straight-line basis**, even if the payments are not on that basis, over the lease term unless either:

(a) another *Systematic Basis* is more representative of the time pattern of the user's benefit even if the payments to the lessor are not on that basis; or

(b) the payments to the lessor are *structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases.* If payments to the lessor vary because of factors other than general inflation, then this condition is not met.

LESSOR:

Lease income from operating leases (excluding amounts for services such as insurance and maintenance) shall be recognised in income on a straight-line basis (even if the receipts are noton such a basis) over the lease term, unless either:

another *Systematic Basis* is more representative of the time pattern in which use benefit derived from the leased asset is diminished, even if the payments to the lessors are not on that basis; or

Illustration 4:
On 1 April 20X1, Mercury Ltd leased a machine from Pluto Ltd on a three-year lease. The expected future economic life of the machine on 1 April 20X1 was eight years. If the machine breaks down, then under the terms of the lease, Pluto Ltd would be required to repair the machine or provide a replacement. Pluto Ltd agreed to allow Mercury Ltd to use the machine for the first six months of the lease without the payment of any rental as an incentive to Mercury Ltd to sign the lease agreement. After this initial period, lease rentals of Rs 2,10,000 were payable six-monthly in arrears, the first payment falling due on 31 March 20X2.

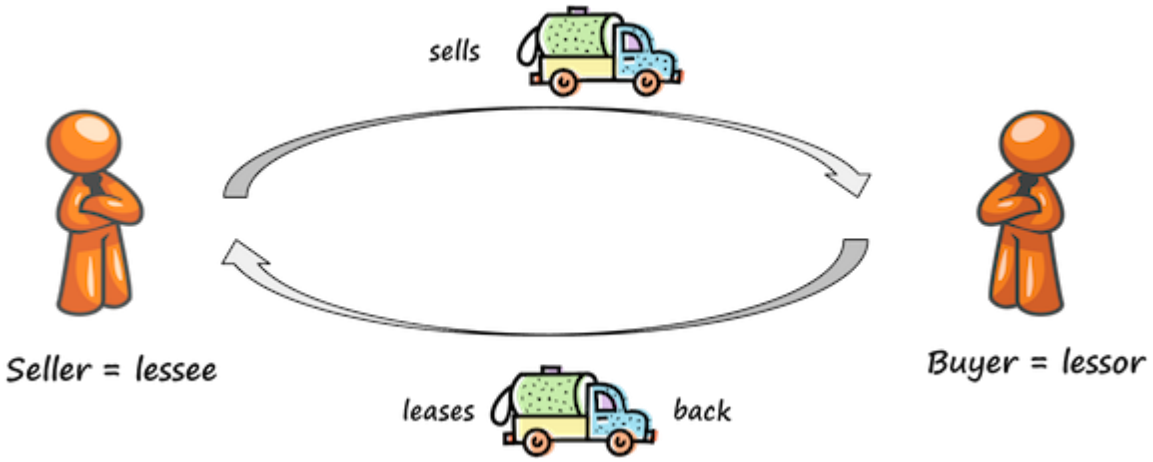
Required:
Explain the treatment required in accordance of Ind AS 17 in the financial statements of Mercury Ltd for the year ended 31 March 20X2.

Solution:

- Under the principles of Ind AS 17 – *Leases* – the lease of the machine is an operating lease because the risks and rewards of ownership of the machine remain with Pluto Ltd. The lease is for only three years of the eight-year life and Pluto ltd is responsible for breakdowns, etc.
- Therefore Mercury ltd will recognise lease rentals as an expense in the statement of profit or loss. Ind AS 17 states that this shall normally be done on a straight-line basis.
- The total lease rentals payable over the whole lease term are Rs 1,050,000 (Rs 210,000 x 5). Therefore the charge for the current year is Rs 350,000 (Rs 1,050,000 x 1/3).
- The difference between the charge for the period (Rs 350,000) and the rent actually paid (Rs 210,000) will be shown as a liability in the statement of financial position at 31 March 20X2.
- This amount will be Rs 140,000. Rs 70,000 (2 x Rs 210,000 – Rs 350,000) of this liability will be current and Rs 70,000 non-current.

SALE AND LEASEBACK TRANSACTIONS

A ***sale and leaseback transaction*** involves the sale of an asset and the leasing the same asset back. In this situation, a seller becomes a lessee and a buyer becomes a lessor. This is illustrated in the following scheme:



Accounting treatment of sale and leaseback transactions depends on the character of the resulting lease.

(A) Sale and Leaseback with Finance Lease

If the resulting lease is a ***finance lease***, then in fact, the transaction is a loan securitized by the leased asset and seller / lessee keeps recognizing the asset. Any excess of proceeds over the carrying amount of the leased asset is deferred and amortized over the lease term. **(i.e. Profit/Loss is to be deferred and amortised)**

(B) Sale and Leaseback with Operating Lease

If the resulting lease is an operating lease, then a seller/lessee **derecognizes the asset** and a buyer/lessor recognizes the asset. Further accounting treatment depends on the sale price:

- If the sale price is close to asset's fair value, then the profit or loss from sale should be recognized immediately.
- If the sale price is below asset's fair value, then it is necessary to check the rental payments. If the future payments are below market price, then the loss from the sale of asset should be amortized over the period of use. If the future payments are close to market rentals, then the loss from the sale of asset should be recognized immediately.
- If the sale price is above fair value, then the excess over fair value or "profit from sale" should be deferred and amortized over the period of use.

Illustration 5:

On 1st April 20X1 Earth ltd sold a property it owned for Rs 90 lakh and leased it back on a 10-year operating lease for rentals of Rs8 lakh per annum, payable on 31st March in

arrears. The carrying value of the property in the financial statements of Earth ltd at 1st April was Rs 55 lakh and its market value on that date was Rs 70 lakh.
Required:
Compute the amounts that will be shown in the financial statement for the year ended 31st March 20X2 in respect of the sale and leaseback.

Solution:

Since the lease is an operating lease the property will be removed from the financial statements. A profit on sale of Rs 15 lakh (Rs 70 lakh – Rs 55 lakh) will be shown as other income in the statement of profit and loss. The rental expense of Rs 8 lakh will be shown as an operating cost in the statement of profit and loss.

The difference of Rs 20 lakh between the disposal proceeds (Rs 90 lakh) and the market value of the asset (Rs 70 lakh) will be shown as deferred income and released to the statement of profit and loss over the lease term of 10 years.

Therefore, Rs 2 lakh (Rs 20 lakh x 1/10) will be credited to the statement of profit and loss in the year ended 31st March 20X2, probably as a reduction in operating costs. The remaining deferred income balance of Rs 18 lakh (Rs 20 lakh – Rs 2 lakh) will be included as a liability in the balance sheet. Rs 2 lakh of this will be a current liability and Rs 16 lakh (Rs 18 lakh – Rs 2 lakh) will be non-current.

Basis of Differences	**IndAS – 17**	**AS – 19**
LAND	Ind AS 17 does not have such scope exclusion. It has specific provisions dealing with leases of land and building applicable.	AS 19 excludes leases of land from its scope.
Treatment of initial direct costs under Ind AS 17 differs from the treatment prescribed under the existing standard.		
Finance Lease Non-manufacturer/ Non-dealer Lessor	Interest rate implicit in the lease is defined in such a way that the initial direct costs included automatically in the finance lease receivable; there is no need to add	Either recognised as expense immediately or allocated against the finance income over the lease term.

	them separately.	
Operating lease- Lessoraccounting	Added to the carrying amount of the leased asset and recognized as expense over the lease term on the same basis as lease income	Either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or recognized as expense in the period in which incurred.
Sale and Lease Back transactions	Ind AS 17 retains the deferral and amortisation principle, it does not specify any method of amortisation.	Deferred and amortised in the proportion of Depreciation of the leased asset.

AS – 28

IMPAIRMENT OF ASSETS

NON APPLICABILITY:

AS – 28	INDAS – 36
Inventories (covered AS 2)	Inventories (as covered in Ind AS 2)
Assets arising from construction contracts (AS 7)	Assets arising from construction contracts (Ind AS 11)
Deferred tax assets (AS 22)	Deferred tax assets (Ind AS 12)
	Assets arising from employees benefits (Ind AS 19)
	Biological Assets measured at fair value less cost to sell (Ind AS 41)
Financial Assets including Investments covered under AS 13	Financial Assets (within the scope of Ind AS 109)

RELEVANT DEFINITIONS

1. **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.

2. 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.

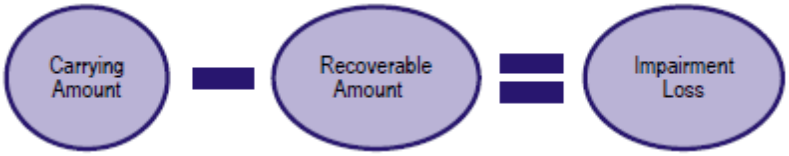
3. **Corporate assets** are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.

4. **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.

5. **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).

6. **Net selling price** is the amount obtainable from the sale of an asset in an **arm's length transaction** between knowledgeable, willing parties, less the costs of disposal. **(AS 28)**

7. An **Impairment loss** is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.



8. 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 (INDAS 36)

   As per AS 28 – Recoverable Amount means = Higher of Net Selling Price and Value in Use.

9. **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.

10. **Value in use** is the present value of the future cash flows expected to be derived from an asset or cash-generating unit and from its disposal at the end of its useful life.

Indications of Impairment

In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External source of Information (AS 28 AND INDAS 36)

The following are external source of information which may indicate that an asset is impaired:

a) during the period, an asset's **market value** has **declined significantly** more than would be expected as a result of the passage of time or normal use.;
b) significant changes with an **adverse effect** on the entity have taken place during the

period, or will take place in the near future, in the **technological, market, economic or legal environment** in which the entity operates or in the market to which an asset is dedicated;

c) market **interest rates** or other market rates of return on investments have **increased** during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially; and

d) the carrying amount of the net assets of the entity is more than its market capitalisation.

Internal source of Information (AS 28 & INDAS 36)

The following are internal source of information which may indicate that an asset is impaired:

a) evidence is available of **obsolescence or physical damage** of an asset;

b) significant changes with an **adverse effect** on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, **an asset is used or is expected to be used**. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite;

c) Evidence is available from internal reporting that indicates that the **economic performance of an asset is, or will be, worse than expected**.

The above list is not exhaustive. An entity may identify other indications that an asset may be impaired.

IDENTIFYING AN ASSET THAT MAY BE IMPAIRED

Asset is impaired only when Carrying Amount is More Than Recoverable Amount

= CA – RA = IMPAIRMENT LOSS

Irrespective of any indication of impairment, Following Assets shall be Tested for Impairment **at least annually**:	In case of any indication of impairment at the end of each reporting period:
Goodwill acquired in an Amalgamation of Business	ALL OTHER ASSETS Eg. PPE, Investment Properties

MEASUREMENT OF RECOVERABLE AMOUNT

RECOVERABLE AMOUNT	
INDAS 36	**AS 28**
Higher of - Fair Value less cost of disposal and Value in Use	Higher of - Selling Price less cost to sell and Value in Use

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).

Steps for assessing Fair value *less* costs to sell

⇩

First Preference: Binding sale agreement

⇩

Second Preference: Active market
Current bid price
If current bid prices not available, the price of the most recent transaction

⇩

Third Preference: Best information available at the end of the reporting date

⇩

If all the above are not available: Ignore Fair value *less* costs to sell, take Value in use only.

COST OF DISPOSAL:

Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale.

However, termination benefits (as defined in Ind AS 19) and costs associated with reducing or reorganizing a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

VALUE IN USE:

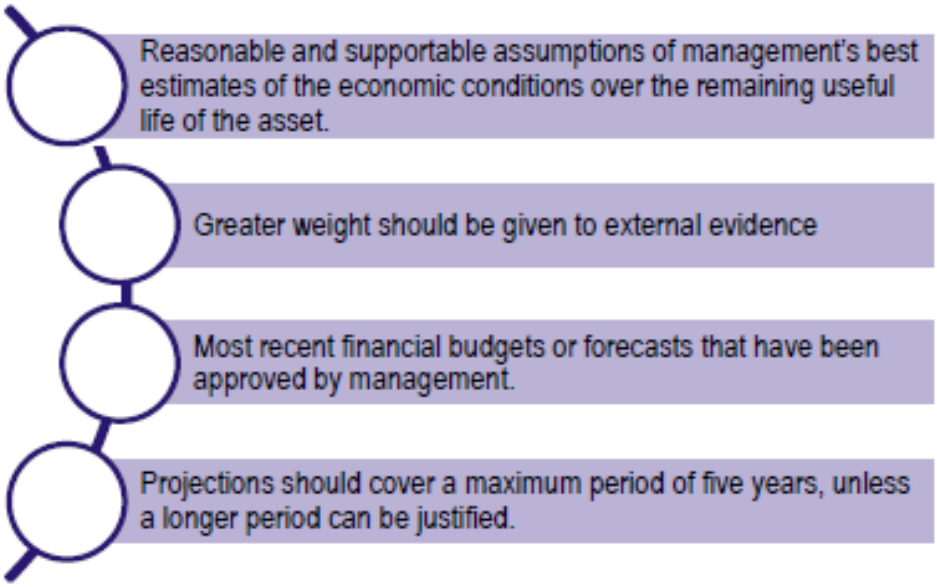
Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

Primarily two key decisions are involved in determining value in use:

Estimating future cashflows

Discount rate to be used

When estimating expected future cash flows, the following rules apply:



Foreign currency future cash flows:
Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. An entity translates the present value using the **spot exchange rate at the date of the value in use calculation**.

Illustration 1
Mars Ltd. gives the following estimates of cash flows relating to property, plant and equipment on 31-03-20X4. The discount rate is 15%

Year	Cash Flow (INR Lakhs)
20X4-20X5	2,000
20X5-20X6	3,000
20X6-20X7	3,000
20X7-20X8	4,000
20X8-20X9	2,000
Residual Value at 31.03.20X9	500

Property, plant & equipment was purchased on 1.04.20X1 for Rs 20,000 lakhs
Useful Life was 8 Years
Residual Value estimated at the end of 8 years Rs 500 lakhs
Fair value less cost to disposal Rs10,000 lakhs

Solution

(a) Calculation of Carrying Amount on 31.03.20X4

(INR lakhs)

Particular	Amount
Original Cost on 1.04.20X1	20,000
Less Depreciation (20,000-500)*3/8	7,313
Carrying Amount	12,687

(b) Calculation of Value in Use

Year	Cash Flows	P.V.	Amount
20X4-20X5	2,000	.869	1,738
20X5-20X6	3,000	.756	2,268
20X6-20X7	3,000	.658	1,974
20X7-20X8	4,000	.572	2,288
20X8-20X9 (including residual value)	2,500	.497	1242
Total			**9,510**

(c) Calculation of Recoverable Amount

Particular	Amount
Value in Use	9,510
Fair value less costs of disposal	10,000
Recoverable Amount	10,000

(d) Calculation of Impairment Loss

Carrying Amount – Recoverable Amount
12,687 – 10,000 = 2,687

(e) Calculation of Revised Carrying Amount

Particular	Amount
Carrying Amount	12,687
Less: Impairment Loss	2,687
Revised Carrying Amount	10,000

(f) Calculation of Revised Depreciation

$$\frac{\text{Revised Carrying Amount – Residual Value}}{\text{Remaining Life}} = 1900$$

RECOGNISING AND MEASURING AN IMPAIRMENT LOSS

CHARGE TO P&L	CHARGE TO REVALUATION SURPLUS (OCI)	IF IL IS MORE THAN CA	DEPRECIATION AFTER IMPAIRMENT	DEFERRED TAX
Impairment loss shall always be recognised in SPL in case of Assets not subject to Revaluation.	Impairment loss of Assets carried at Revaluation Model (e.g. AS 10) shall be treated as Revaluation Decrease. Impairment loss is recognised in OCI to the extent it does not exceed the revaluation surplus on the same asset. Remaining IL if any would be transferred to SPL	If Impairment loss exceeds the carrying amount of asset then the Liability should be recognised in accordance with any related AS (eg. AS 29) Entire CA shall be w/off.	Depreciation or Amortisation after Impairment should be charged on Revised CA less residual value on systematic basis over its remaining useful life.	DTA/DTL should be worked out as per AS 22.

Illustration 2

Mercury ltd has an identifiable asset with a carrying amount of Rs1,000. Its recoverable amount is Rs 650. The tax rate is 30% and the tax base of the asset is Rs 800. Impairment losses are not deductible for tax purposes. The effect of the impairment loss is as follows:

Solution:

	Identifiable assets before impairment loss	Impairment loss	Identifiable assets after impairment loss
	Rs	Rs	Rs
Carrying amount	1,000	(350)	650
Tax Base	800	-	800
Taxable (deductible) temporary difference	200	(350)	(150)
Deferred tax liability (asset) at 30%	60	(105)	(45)

In accordance with AS 22, the entity recognises the deferred tax asset to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized.

Impairment Loss of a Cash-Generating Unit (CGU) and Goodwill

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.

Always try to impair Individual Asset first for which indication of impairment exist and estimate the recoverable amount of that 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).

ALLOCATION OF ASSETS AND LIABILITIES TO CGU's

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.

GOODWILL:

Goodwill does not generate cash flows independently of other assets or groups of assets and, therefore, it will always be tested for impairment as part of a CGU or a group of CGUs.

INDAS 36 -

For the purpose of impairment testing, goodwill acquired in a business combination shall,

from the acquisition date, **be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination**, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units.

AS 28 -

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.**

CORPORATE ASSETS:

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. Corporate assets include group or divisional assets such as the building of a headquarters or a division of the entity, EDP equipment or a research center.

Corporate Assets can-not be tested for impairment individually because they do not generate separate cash flows. Therefore they are allocated on a reasonable basis to different CGU's

Corporate Assets – Allocable to CGU's	**Corporate Assets – Not Allocable to CGU's**
Apply Bottom-up Approach	Apply Top Down Approach
Allocate the Carrying amount of Corp. Assets to CGU's and applying impairment testing.	Apply impairment testing of CGU without considering carrying amount of Corp. Assets.
Impairment loss shall be apportioned between the assets of CGU and Corp. Assets in the ratio of related individual Carrying Amount	Then Compare the RA of entire organization/entity with the CA of all the assets and liabilities including CA of Corp. Assets. If any IL arise then such IL shall be attributed to Corporate Assets.

So finally, when we allocate the Goodwill and Corporate Assets (if any) to a Cash Generating Unit; it's time to calculate the Impairment Loss on CGU by comparing the Carrying Amount of the Unit with its Recoverable Amount. But now question is how to allocate the total impairment loss on CGU to its assets along with Goodwill and Corporate Assets……

The answer is…… we have to allocate the impairment loss in following order:

1. *First of all reduce the carrying amount of allocated Goodwill to CGU (if any)*
2. *Then the remaining IL shall be allocated to all other Assets including Corporate Assets on pro rata basis of the carrying amount of each asset.*

Remember one more thing we can-not allocate the impairment loss more than the carrying amount of asset. It means after allocating impairment loss the revised carrying amount of asset can at maximum be Zero not Negative.

Illustration 3

Earth Infra Ltd has two cash-generating units, X and Y. 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 a office headquarter 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 Rs10 million. The recoverable amounts are based on value-in-use of Rs.18 million for CGU A and Rs38 million for CGU B.

Required: Determine whether the carrying values of CGU A and B are impaired.

Solution:

The office building is a corporate asset which needs to be allocated to CGU A and B on a reasonable and consistent basis:

	A	**B**	**Total**
Carrying value of CGUs	20	30	50
Allocation of office building	4	6	10
(Office building is allocated in the ratio of Carrying value of CGU's			
Carrying value of CGU after Allocation of corporate asset	24	36	60
Recoverable Amount	18	38	56
Impairment Loss	6	–	-

The impairment loss will be allocated on the basis of 4/24 against the building (Rs.1 million) and 20/24 against the other assets (Rs. 5 million).

REVERSAL OF IMPIRMENT LOSS

GOODWILL - An impairment loss recognised for goodwill shall not be reversed in a subsequent period. Since reversal will cause increase in Goodwill which is prohibited by IndAS 38 (increase in goodwill is treated as increase in internally generated assets)

AS 28 - An impairment loss recognised for goodwill should not be reversed in a subsequent period unless:
a. The impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur; and
b. Subsequent external events have occurred that reverse the effect of that event.

ASSETS other than Goodwill – If there is an Indication that shows Impairment Loss recognised earlier may no longer exists or may have decreased, then entity shall revers the impairment loss and accordingly recoverable amount is to be determined.

CONDITIONS OF REVERSAL OF IL:

Change in Estimate used to determine the Asset's recoverable amount since the last impairment was recognised. Such change in estimate may include:

- Change in estimate of **components of Fair Value less cost of disposal** (if recoverable amount was based on Fair Value)
- Change in the **amount or timing of estimated future cash flows or in the discount rate** (if recoverable amount was based on Value in use)

INDICATORS OF REVERSAL OF IMPAIRMENT LOSS:

External –

- Asset's value has increased significantly during the period;
- Significant changes with a favorable effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated; and
- Market Interest rates or other market rates of return on investments have decreased during the period, and it is directly affecting the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially.

Internal -

- Asset's performance has been significantly improved or will be improved which is favourable for the enity. It may be **because of Cost incurred during the period to improve or enhance the performance or Cost incurred to restructured the operation** during the period.
- Evidence is available from internal reporting that indicates that the **economic performance of the asset is, or will be, better than expected.**

MAXIMUM AMOUNT OF REVERSAL OF IMPAIRMENT LOSS:

Reversal shall not exceed the higher of following –

- Recoverable Amount Less Carrying Amount of Assets
- Earlier Impairment Loss – Saving in Depreciation/Amortisation due to impairment

(In short the increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.)

RECOGNITION OF IMPAIRMENT LOSS:

Assets under Cost Model – Recognise immediately in Profit and Loss.

Assets under Revalued Model – Treat it as Revaluation Increase and recognise it in OCI, however to the extent that an impairment loss on the same revalued asset was previously recognised in profit or loss, a reversal of that impairment loss is also recognised in profit or loss.

REVERSAL OF IL OF CGU:

A reversal of an impairment loss for a cash-generating unit shall be allocated to the assets of the unit, **except for goodwill, pro rata with the carrying amounts of those assets**.

REVIEW OF USEFUL LIFE, DEPRECIATION METHOD AND RESIDUAL VALUE:

Due to the indications existed as above it may be possible that there is change in estimated useful life of assets, change in depreciation (amortization) method used, or change in estimated residual value. So be very careful in this respect and we have to

review such elements even if no impairment loss is reversed.

Illustration 4: Reversal of Impairment Loss

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 favorable 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 re-estimated. The value in use is expected to be Rs3,04,000 and net selling price is expected to be Rs2,90,000.

Solution

Since the fair value less costs of disposal is not determinable the recoverable amount of the CGU is its value in use. The carrying amount of the assets of the CGU on 31st March 20X3 is as follows:

			INR
	Goodwill	**Other assets**	**Total**
Historical Cost	80,000	3,20,000	4,00,000
Accumulated Depreciation (3,20,000/20) x 2	-	(32,000)	(32,000)
Carrying Amount	80,000	2,88,000	3,68,000
Impairment Loss	(80,000)	(76,000)	(1,56,000)

Revised Carrying Amount

Impairment Loss = Carrying Amount – Recoverable Amount (Rs 3,68,000 – Rs 2,12,000) = Rs 1,56,000 is charged in statement of profit and loss for the period ending 31st March 20X3 as impairment loss.

Impairment loss is allocated first to goodwill Rs 80,000 and remaining loss of Rs 76,000 (Rs 1,56,000 – Rs 80,000) is allocated to the other assets.

Reversal of Impairment loss

Reversal of impairment loss is recognised subject to:-
The impairment loss on goodwill cannot be reversed.

The increased carrying amount of an asset after reversal of an impairment loss not to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

Calculation of carrying amount of identifiable assets had no impairment loss is recognize

	INR
Historical Cost	3,20,000
Accumulated Depreciation for 4 years (3,20,000/20) x 4	(64,000)
Carrying amount had no impairment loss is recognised on 31st March 20X5	2,56,000

Carrying amount of other assets after recognition of impairment loss

	INR
Carrying amount on 31st March 20X3	2,12,00 0
Accumulated Depreciation for 2 years (2,12,000/18) x 2 [rounded off to nearest thousand for ease of calculation]	(24,000)
Carrying amount on 31st March 20X5	1,88,000

The impairment loss recognised previously can be reversed only to the extent of lower of re-estimated recoverable amount is Rs 2,56,000 (higher of fair value less costs of disposal Rs 2,90,000 and value in use Rs 3,04,000)

Impairment loss reversal will be Rs 68,000 i.e. (Rs 2,56,000 – Rs 1,88,000). This amount is recognised as income in the statement of profit and loss for the year ended 31st March 20X5.

The carrying amount of other assets at 31st March 20X5 after reversal of impairment loss will be Rs 2,56,000.

From 1st April 20X5 the depreciation charge will be Rs 16,000 i.e. (Rs 2,56,000/16)

Illustration 5

From the following details of an asset, find out:
(a) Impairment loss and its treatment.
(b) Current year depreciation.

Particulars of assets:

Cost of asset	Rs 56 lakhs
Useful life	10 years
Salvage value	Nil
Current carrying value	Rs 27.30 lakhs
Remaining useful life	3 years
Recoverable amount	Rs12 lakhs
Upward revaluation done in last year	Rs 14 lakhs

Solution

Impairment loss

Impairment loss = Carrying amount of the asset – Recoverable amount
= Rs 27.30 lakhs – Rs 12 lakhs = Rs 15.30 lakhs

Treatment of impairment loss

As per Ind AS 36, impairment loss (whether of an individual asset of a CGU) is recognised in the following manner:

(a) Impairment loss of a revalued asset: It is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. The balance, if any, is recognised as an expense in the statement of profit and loss.

(b) Impairment loss of other assets: Impairment loss of any other asset should be recognised as an expense in the statement of profit and loss.

Since, the asset in question has been revalued upwards, the impairment loss will be adjusted first against the revaluation surplus of Rs 14 lakhs. The balance amount of Rs 1.30 lakhs will be recognised as an expense in the profit and loss account.

Current year depreciation

Revised carrying amount (after recognising impairment loss) Rs 12 lakhs
Remaining useful life 3 years
Salvage value Nil
Annual depreciation (12/3) Rs 4 lakhs

Illustration 6

Venus Ltd. has an asset, which is carried in the Balance Sheet on March 31, 20X1 at Rs500 lakhs. As at that date the value in use is Rs 400 lakhs and the fair value less costs to sells is Rs375 lakhs. 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.

Solution

According to Ind AS 36, Impairment of Assets, impairment loss is the excess of 'Carrying amount of the asset' over 'Recoverable Amount'.
In the present case, the impairment loss can be computed in the following manner:

Step 1: Fair value less costs to sell: Rs 375 lakhs
Step 2: Value in use: Rs 400 lakhs
Step 3: Recoverable amount, i.e., higher of 'fair value less costs to sell' & 'value in use'.
Thus, recoverable amount is Rs 400 lakhs

Step 4: Carrying amount of the asset Rs 500 lakhs

Step 5: Impairment loss, i.e., excess of amount computed in step 4 over amount computed in Step 3.
Rs 100 lakhs (being the difference between Rs 500 lakhs and Rs 400 lakhs).

According to Ind AS 36, an impairment loss should be recognised as an expense in the statement of profit and loss immediately, unless the asset is carried at revalued amount in accordance with another Accounting Standard. Assuming, that the asset is not carried at revalued amount, the impairment loss of Rs 100 lakhs will be charged to Profit & Loss Account.

Journal Entries

Date	**Particulars**		**Dr. Amt.**	**Cr. Amt.**
				Rs.
31.3.20X1	Impairment Loss A/c	Dr.	100	
	To Assets A/c			100
(Being impairment loss on an asset recognised)				
31.3.20X1	Statement of Profit & Loss A/c	Dr.	100	
	To Impairment Loss A/c			100
(Being impairment loss transferred to statement of profit and loss)				

QUESTIONS FROM AS – 28

Q7. Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 2007 for Rs. 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2007-08 the carrying amount was Rs. 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was

still in working order at the close of the financial year. The Machine was expected to fetch Rs. 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However the smallest group of assets comprising of this machine also, is capable of generating cash flows of Rs. 54 crore per annum and has a carrying amount of Rs. 3.46 crore. All such machines put together could fetch a sum Rs. 4.44 crore if disposed. Discuss the applicability of impairment loss.

Ans.: As per provisions of Para 91(b) of AS 28 "Impairment of Assets", impairment loss is not to be recognized for given asset if the related cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit (CGU), which is group of asset to which the damaged machine belongs, is not impaired; as the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

Q8. Ram Ltd. acquired plant on 1.4.95 for Rs. 50 lakhs having 10 years useful life and provides depreciation on straight line basis with nil residual value. On 1.4.2000, Ram Ltd. revalued the plant at Rs. 29 lakhs against book value of Rs. 25 lakhs and credited Rs. 4 lakhs to revaluation reserve. On 31.03.02 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 accounts.
(Answer: CA as on 31.03.2002: Rs. 17.40/-; Imp Loss: 3.40/-; to be set off with RR of Rs. 2.40/-**)**

Q9. A Ltd., which is in business of manufacturing and export of its product. sometimes, back in 2000, the Govt. put the restriction on export of goods exported by A Ltd. Due to that restriction A Ltd. impaired its asset. A Ltd acquired at the end of 1996 Rs. 4000 Lakhs identifiable assets and paid Rs. 6000 lakhs balance is treated as goodwill. The useful life of the identifiable assets are 15 years and depreciated on straight line basis. When Govt. put the restriction at the of 2000, the company recognized the impairment loss by determining the recoverable amount of assets of Rs. 2720 lakhs. In 2002 Govt. lift the restriction imposed on the export and due to this favourable change A Ltd, estimate recoverable amount, which was estimated of Rs. 3420 lakhs.
Required:
A. Calculation and allocation of impairment loss in 2000
B. Reversal of an impairment loss and its allocation as per AS-28 in 2002
Ans. Impairment loss Rs.614; Reversal of Loss Rs.175.

Q10. Acute Ltd is the owner of a CGU (Cash Generating Unit) block of assets whose current carrying cost is Rs. 999 lakhs. The company, after a detailed study by its technical team, has assessed the present recoverable amount of this CGU block of assets at Rs. 555 lakhs. The value of the block of assets as per the Income tax Records is Rs 777 lakhs. The Board of Directors of the company have issued a signed statement confirming that the impairment in the value of the CGU is only a temporary phenomenon which is reversible in subsequent periods and also assuring virtual certainty of taxable incomes in the foreseeable future. You are required to show Deferred Tax workings as per Accounting Standards in force, given the tax rate of 30% plus 10% surcharge thereon. The depreciation rate for tax purposes is 15% and that per books is 13.91 %. **(May 2012)(Answer: DTL Reversed – 81.18 and DTA Created – 73.26)**

AS - 16

BORROWING COSTS

MEANING OF BORROWING COST

Borrowing Cost is the:

(a) Interest and

(b) Other cost

that is incurred by an enterprise in connection with borrowing of funds.

The following points should be considered for the purpose of borrowing cost:-

- If any enterprise has incurred ancillary cost (related) for the arrangement of funds than amortized part of such cost should also be included as a part of borrowing cost. **(V. Imp)**
    - For example: - Brokerage, commission, stamp duty charges and any other related cost.
    - CA fees for Quarterly information reports.
    - Commission given for arrangement of funds.

- Discounts / Premiums which are incurred by an enterprise in relation to arrangement of fund, than the amortized part of such amount should be included as a part of borrowing cost.
- Amount of Interest (finance charges) should also be included as a part of borrowing cost which is paid or payable for finance lease agreement (INDAS – 17).

- Exchange Diff arising from Foreign Currency Borrowings to the extent of difference in Interest cost (INDAS – 21)

Under IndAS 23
Interest Exp. calculated ***using the effective interest method*** as described in INDAS - 109 Financial Instruments.

Note: This standard does not deal with actual or imputed cost of equity including preferred capital not classified as liability.(**Dividend on Equity or Preference shares is not Borrowing Cost)**

MEANING OF QUALIFYING ASSETS

Qualifying Asset means:

- An ASSET
- that takes Substantial period of time
- to get ready for intended use or sale.

Normally a period of 12 months is considered to be the substantial period of time. But longer period or short term period than 12 month period may also be considerable as substantial period based on reasonable facts and judgments.

Depending on the circumstances, any of the following may be Qualifying Asset:

Fixed Assets: Manufacturing Plants, Power Generation Facilities, Bearer Plants, Intangible Assets

Investments: For e.g. Investment properties.
Investment in shares or debentures cannot be recognized as Qualifying assets because conditions of substantial period is not applicable on securities.

Inventories: However inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets.

RECOGNITION

As per INDAS – 23, amount of borrowing cost which is directly atributable to:

- **Acquisition;**

- **Construction; or**
- **Production of**

any Qualifying Asset is Capitalized.

Therefore such borrowing cost that would have been avoided if the expenditure on the qualifying asset had not been made.

If any borrowing cost is not having any connection with Q.A. than such amount should be transfer to P/L a/c as an exp.

COMMENCEMENT OF CAPITALIZATION OF BORROWING COSTS:

As per the provision of standard, any enterprise can capitalize its borrowing cost only if the following three conditions are satisfied.

(1) Expenditure for the

- Acquisition;
- Construction; or
- Production

of a qualifying asset is being incurred.

Example:

Payment of Cash
Transfer of Other Assets
Assumption of Interest bearing Liabilities

Note: If any amount is still pending for expenditure purpose out of borrowing funds than the pending amount will not be considered for capitalization purposes.

(2) Borrowing Costs are being incurred.

(3) Necessary Activities for preparation of qualifying assets for its intended use or sale are undertaken.

Examples:

Technical and Administration work prior to the commencement of physical construction, such as obtaining permission or licence or permit.

SUSPENSION OF CAPITALIZATION OF BORROWING COSTS:

Capitalization of Borrowing Costs to be suspended **during the extended periods** in which Active Development is Suspended/Interrupted.

Such costs are costs of holding partially completed assets and do not qualify for capitalisation.

Exception: Suspension not to taken place in case temporary delaysare necessary for preparation of qualifying assets (e.g. Seasonal Rains).

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
(a) Construction suspended between October 20X1 to January 20X2 during which period certain heavy construction equipments under use was shifted to another site.

In this case, capitalization of borrowing costs needs to be suspended since active development is interrupted.

(b) 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.

Note: Borrowing costs which are related to the suspension period should be transferred to P/L a/c as an exp.

CESSATION OF CAPITALIZATION OF BORROWING COSTS:

- Capitalization should **cease** when **substantially** all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

- Cessation to take place in part if construction of qualifying asset is completed in parts and a part is capable of being used separately.

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: 1
H Limited, a real estate company, gives immovable property on rent. It has completed on May 31, 20X1, a commercial complex consisting of various offices that could be rented out. It expects that the commercial complex will be completely rented out by June 30, 20X1. However, due to adverse market conditions, only 10% of the commercial complex could be rented out by its reporting date of March 31, 20X2. H Limited wants to capitalise the eligible borrowing costs incurred up to March 31, 20X2.

H Limited should capitalise borrowing costs only up to May 31, 20X1. The borrowing cost incurred thereafter cannot be capitalised as the asset was ready for its intended use on May 31, 20X1. The fact that only a small portion could be rented out by March 31, 20X2, is immaterial.

Example: 2
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.

IMPORTANT POINT:

As per AS 16, if any enterprise has earned temporary income by investment of unused borrowed funds then amount of temporary income should be adjusted against total borrowing cost and only thereafter principals of recognition should be applied.

Types of Borrowing

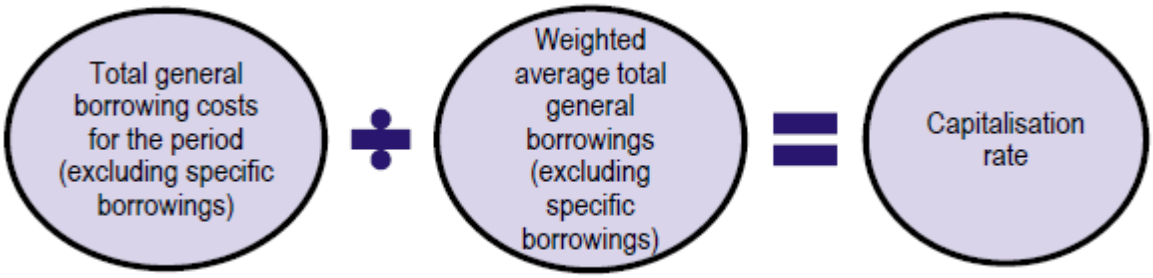
Two types of borrowing are specified in the statement as follows:-

A. Specific Borrowing
B. General Borrowing

General Borrowing Costs:

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.



Expenditure to which capitalisation rate is applied

- In calculation of borrowing costs to be capitalised, the amount of expenditure on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities.
- Expenditures **are reduced by any progress payments received and grants received** in connection with the asset (see Ind AS 20 *Accounting for Government Grants and Disclosure of Government Assistance*).
- The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalisation rate is applied in that period.

QUESTIONS FROM ICAI MODULE

Illustration 1:
ABC Ltd. has taken a loan of USD 20,000 on April 1, 20X1 for constructing a plant at an interest rate of 5% per annum payable on annual basis.
On April 1, 20X1, the exchange rate between the currencies i.e USD Vs INR was Rs45 per USD. The exchange rate on the reporting date i.e March 31, 20X2 is Rs48 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.

Solution:
In the above situation, the Borrowing cost needs to determine for interest cost on such foreign currency loan and eligible exchange loss difference if any.

(a) Interest on Foreign currency loan for the period:

USD 20,000 x 5% = USD 1,000
Converted in Rs : USD 1,000 x Rs 48/USD = Rs 48,000

Increase in liability due to change in exchange difference : USD 20,000 x (48 - 45) = Rs 60,000

(b) Interest that would have resulted if the loan was taken in Indian Currency:

USD 20,000 x Rs 45/USD x 11% = Rs 99,000

(c) Difference between Interest on Foreign Currency borrowing and local Currency borrowing :
Rs 99,000 - 48,000 = Rs 51,000
Hence, out of Exchange loss of Rs 60,000 on principal amount of foreign currency loan, only exchange loss to the extent of Rs 51,000 is considered as borrowing costs.

Total borrowing cost to be capitalized is as under:
(a) Interest cost on borrowing Rs 48,000
(b) Ex. Diff. to the extent considered to be an adjustment to Interest cost Rs 51,000
Total Rs 99,000
The exchange difference of Rs 51,000 has been capitalized as borrowing cost and the remaining Rs 9,000 will be expensed off in the Statement of Profit and loss.

Illustration 2:
Beta Ltd had the following loans in place at the end of 31st March 20X2:

(Amounts in Rs. 000s)

Loan	1st April 20X1	31st March 20X2
18% Bank Loan	1,000	1,000
16% Term Loan	3,000	3,000
14% Debentures	-	2,000

14% debenture was issued to fund the construction of Office building on 1st July 20X1 but the development activities has yet to be started.

On 1st April 20X1, 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 20X2.
Required
Calculate the borrowing cost that can be capitalised for the plant.

Solution:

Capitalisation rate	(18% x 1000)/1000+3000 + (16% x 3000)/1000+3000	16.5%
Borrowing Costs	(500,000 x 16.5%)+(2,500,000 x16.5% x 3/12)	Rs. 1,85,625

Illustration3. 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, 20X2, the Company commenced the construction of a qualifying asset and incurred the following expenses:

Date Amount	**(Rs)**
July 1, 20X1	2,50,000
December 1, 20X1	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 loan	5,00,000	65,000
	15,00,000	**1,65,000**

Compute the borrowing costs that need to be capitalised.

2. The capitalisation rate is:
Total borrowing costs / Weighted average total borrowings: 1,65,000/15,00,000 = 11%
Interest will be capitalised as under:

— On Rs 2,50,000 @ 11% p.a. for 9 months = Rs 20,625
— On Rs₹ 3,00,000 @ 11% p.a. for 4 months = Rs11,000

ADDITIONAL QUESTIONS:

(1) The borrowings profile of Santra Pharmaceuticals Ltd. set up for the manufacture of antibiotics at Navi Mumbai is as under:

Date	Nature of borrowings	Amount borrowed	Purpose of Borrowings	Incidental Expenses	Effective Interest
1/1/08	15% Demand Loan	60 Lakhs	Acquisition of Fixed Assets	8.33%	21%
1/7/08	14.5% Term Loan	40 Lakhs	Acquisition of Plant & Machinery	5%	18.5%
1/10/08	14% Bonds	50 Lakhs	Acquisition of Fixed Assets	8%	18%

Fixed assets considered as Qualified as Under:

Sterling Manufacturing Shed	Rs. 10,00,000
Plant & Machinery (Total)	Rs. 90,00,000
Other Fixed Assets	Rs. 10,00,000

The project is completed on 1st January 2009 and is ready for commercial production. Show the capitalization of the borrowing cost.

(2) X Ltd. began Construction of a new building on 1st January, 2007. It obtained Rs. 1 lakhs special loan to finance the construction of the building on 1st January, 2007 at an interest rate of 10%. The company's outstanding two non-specific loans were:

Amount	Rate
5,00,000	11%
9,00,000	13%

The expenditure that were made on the building project were as follows:

Janaury 2007	Rs. 2,00,000
April, 2007	Rs. 2,50,000

July, 2007 Rs. 4,50,000
December, 2007 Rs. 1,20,000

Building was completed by 31st December, 2007. Following the principles prescribed in INDAS – 23 Borrowing Cost. Calculate the amount of interest to be capitalized and pass one Journal Entry for capitalization of Cost and borrowing cost in respect of the building.

WIP A/c Dr. 1020000
To Bank A/c 10.20

Building A/c Dr. 1020000
To WP a/c 10.20

Interest a/c Dr 182000
To Loans a/c 182000

Building A/c Dr. 74216
To Interest a/c 74216

Profit and loss a/c dr. (182000-74216) = 107784
To Interest a/c 107784

RTP QUESTIONS:

Q1 (May 2018)

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 ₹100,000 in September 20X1 and ₹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 ₹20 lacs and had an overdraft of ₹500,000, which increased to ₹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'.

Solution:
Since the entity has only general borrowing hence first step will be to compute the capitalisation rate. The capitalisation rate of the general borrowings of the entity during the period of construction is calculated as follows:

Finance cost on ` 20 lacs 10% debentures during September – December 20X1	66,667
Interest @ 15% on overdraft of ` 5,00,000 in September 20X1	6,250
Interest @ 16% on overdraft of ` 5,00,000 in October and November 20X1	13,333
Interest @ 16% on overdraft of ` 750,000 in December 20X1	10,000
Total finance costs in September – December 20X1	**96,250**

Weighted average borrowings during period
= (20,00,000x4) + (500,000 x 3) + (750,000 x 1) / 4 = ₹ 25,62,500

Capitalisation rate = Total finance costs during the construction period / Weighted average borrowings during the construction period
= 96,250 / 25,62,500 = 3.756%