

**IND AS 40****Example (Modified)**

Sun Ltd acquired a building in exchange of a warehouse whose fair value is ₹ 5,00,000 and payment of cash is ₹ 2,00,000. The fair value of the building received by the Company is ₹ 8,00,000. The company decided to keep that building for rental purposes.

The Building is acquired with the purpose to earn rentals. Hence, it is a case of Investment Property acquired in exchange for a combination of monetary and non- monetary asset.

Therefore, Journal entry at the time of acquisition is :

Investment Property (Building) (5,00,000 + 2,00,000)	Dr.	7,00,000
To Cash		2,00,000
To PPE (Property, Plant and Equipment) i.e. Warehouse		5,00,000

Note: When the fair value of both the asset given up and acquired is mentioned, it is presumed that both the fair values are equally evident. In such a case, the fair value of the asset given up is considered as the cost of the asset purchased.

However, if the fair value of property acquired is more clearly evident, then the fair value of the asset acquired is considered. In such a situation, the Journal Entry at the time of acquisition (taking information given in the above example) would be

Investment Property (Building)	Dr.	8,00,000
To Cash		2,00,000
To PPE (Warehouse)		5,00,000
To Gain on Sale of PPE		1,00,000

**Question 92**

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

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

Ans: Cost of Investment Property

As per Ind AS 40, the cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs). Accordingly, on initial recognition, the one-time joining fee of ₹ 6,25,000 should be added to the purchase price. Therefore, the investment property should be measured at ₹ 5,06,25,000 (i.e. cost of the commercial office space + one-time joining fee). Writing off the amount of ₹ 6,25,000 to the P&L is not appropriate.

Use as Administrative Office

If the property is used as an administrative centre, it is not an investment property, but rather an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

Even under Ind AS 16, all direct costs relating to the acquisition of the asset should be added to the purchase price. Hence, cost of the asset under Ind AS 16 would be ₹ 5,06,25,000.

### Question 93

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

- a) ₹ 2,00,000 planning permission.
- b) ₹ 7,00,000 construction costs (including ₹ 40,000 refundable purchase taxes)

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

Ans: As per Ind AS 40, the cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs).

Accordingly, cost of the Building is arrived at as under:

Particulars	Amount in ₹	Total ₹
Purchase price		30,00,000
Add: Property transfer taxes		1,00,000
Direct legal costs		20,000
Fee for planning permission		2,00,000
Construction costs	7,00,000	
Less: Refundable purchase taxes	<u>40,000</u>	6,60,000
<b>Cost of the Building as per Ind AS 40</b>		<b>39,80,000</b>

Note: The building does not qualify the substantial period criteria for redevelopment of property. Hence, borrowing cost of loan fund has not been capitalised.

### Question 94

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

Ans: Using either payment method, the cost will be ₹ 1,00,00,000. If the second payment option is used, ₹ 20,00,000 will be treated as interest expenses over the credit period of 2 years.

### Question 95

X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 20X1, X Ltd. purchased a large property (consisting of land) for ₹ 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were ₹

20,00,000. On 31st March, 20X5, the fair value of the property was ₹ 2,60,00,000. Under the terms of the lease, Y Ltd. was able to cancel the lease by giving six months' notice in writing to X Ltd. Y Ltd. gave this notice on 31st March, 20X5 and vacated the property on 30th September, 20X5. On 30th September, 20X5, the fair value of the property was ₹ 2,90,00,000. On 1st October, 20X5, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X Ltd. spent a total of ₹ 60,00,000 on this conversion project between 30th September, 20X5 to 31st March, 20X6. The project was incomplete at 31st March, 20X6 and the directors of X Ltd. estimate that they need to spend a further ₹ 40,00,000 to complete the project, after which each flat could be sold for ₹ 50,00,000.

Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 20X6 as per Ind AS.

Ans: From 1st April, 20X1, the property would be regarded as an investment property since it is being held for its investment potential rather than being owner occupied or developed for sale.

The property would be measured under the cost model. This means it will be measured at ₹ 2,00,00,000 at each year end.

On 30th September, 20X5, the property ceases to be an investment property. X Ltd. begins to develop it for sale as flats.

As per para 59 of Ind AS 40, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes. Hence, the carrying value of the reclassified property will be ₹ 2,00,00,000.

Since the lease of the property is an operating lease, rental income of ₹ 10,00,000 (₹ 20,00,000 x 6/12) would be recognised in P/L for the year ended 31st March, 20X6.

The additional costs of ₹ 60,00,000 for developing the flats which were incurred up to and including 31st March, 20X6 would be added to the 'cost' of inventory to give a closing cost of ₹ 2,60,00,000.

The total selling price of the flats is expected to be ₹ 5,00,00,000 (10 x ₹ 50,00,000). Since the further costs to develop the flats total ₹ 40,00,000, their net realisable value is ₹ 4,60,00,000 (₹ 5,00,00,000 – ₹ 40,00,000), so the flats will be measured at a cost of ₹ 2,60,00,000.

The flats will be shown in inventory as a current asset.