FINANCIAL REPORTING (Amendment Book)

For C.A. Final Examination Group-1

For May 2017 Exam

Students appearing in May 2017 or later may require Amendment Classes, for changes that may occur post completion of course

By

CA. PARVEEN SHARMA

B.Com (H), F.C.A., A.C.M.A., C.S.

Post Graduation in Accounting Standards, US GAAP & Certified Valuer

AS 10: Property, Plant and Equipment

Question 1

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

Solution

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

Question 2

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

Solution

De-recognition of the carrying amount occurs **regardless** of whether the cost of the previous part/inspection was identified in the transaction in which the item was acquired or constructed.

Question 3

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

Solution

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

Question 4

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

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

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

Solution

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not to be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company do not meet the requirement of AS 10 and therefore, cannot be capitalised.

Question 5

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

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

Solution

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

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

Question 6

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

Solution

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

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

Question 7

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

Solution

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

Question 8

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

Solution

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

Question 9

Entity A is a large manufacturing group. It owns a number of industrial buildings, such as factories and warehouses and office buildings in several capital cities. The industrial buildings are located in industrial zones, whereas the office buildings are in central business districts of the cities. Entity A's management want to apply the revaluation model as per AS 10 to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings.

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

Solution

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

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

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

Question 10

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

Solution

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

Useful life means the period over which the asset is expected to be available for use by the entity. Depreciation should commence as soon as the asset is acquired and is available for use.

Question 11

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

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

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

Solution

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

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

The remaining useful life is 4 years.

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

Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000/4 years).

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

Question 12

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

Solution

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

Question 13

A property costing ₹ 10,00,000 is bought in 2016. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years.

The estimated residual value in 20 years' time, based on 2016 prices, is:

Case (a) ₹ 10,00,000

Case (b) ₹ 9,00,000.

Calculate the amount of depreciation.

Solution

Case (a)

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

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

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹ 9,00,000 and the depreciable amount is, therefore, ₹ 1,00,000.

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

Question 14

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

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

Solution

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

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

Question 15

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

Solution

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

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

Question 16

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

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

Calculate depreciation for the year 2016-17.

Solution

Statement showing amount of depreciation as per Componentisation Method

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

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

Question 17

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

Solution

Calculation of Revaluation surplus:

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

Working note:

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

Question 18

XYZ Ltd. has acquired a heavy road transporter at a cost of ₹ 1,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, the power train (one of its component) requires replacement, as further maintenance is uneconomical due to the off-road time required. The remainder of the vehicle is perfectly roadworthy and is expected to last for the next four years. The cost of a new power train is ₹ 45,000.

Can the cost of the new power train be recognized as an asset, and, if so, what treatment should be used?

Answer

The new power train will produce economic benefits to XYZ Ltd., and the cost is measurable. Hence the item should be recognized as an asset as per AS 10 (Revised) as the recognition criteria is satisfied.

The original invoice for the transporter did not specify the cost of the power train. However, its cost of the replacement is ₹ 45,000 which can be used as an indication (usually by discounting factor) of the likely cost, six years previously.

If an appropriate discount rate is 5% per annum, ₹ 45,000 discounted back six years amounts to ₹ 33,570 (45,000 x 0.746), which would be written out of the asset records.

The cost of the new power train, ₹ 45,000, would be added to the asset record, resulting in a new asset cost of ₹ 1,11,430 (₹ 1,00,000 – ₹ 33,570 + ₹ 45,000).

Question 19

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

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

Please advise ABC Ltd. on the costs that can be capitalized in accordance with AS 10 (Revised).

Answer

According to AS 10 (Revised), these costs can be capitalized:

1.	Cost of the plant	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants' fees	₹ 7,00,000
5.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
		₹ 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalized. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 20

A Ltd. has an item of plant with an initial cost of ₹ 1,00,000. At the date of revaluation, accumulated depreciation amounted to ₹ 55,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be ₹ 65,000.

Pass Journal Entries with regard to Revaluation?

Answer

The entries to be passed would be:

		₹	₹
Accumulated depreciation	Dr.	55,000	
To Asset A/c			55,000
(Being elimination of accumulated depreciation against the cost of the asset)			
Asset A/c	Dr	20,000	
To Revaluation Surplus			20,000
(Being increase of net asset value to Fair value)			

Note: The net result is that the asset has a carrying amount of ₹ 65,000 [1,00,000 – 55,000 + 20,000.]

Question 21

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

At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to ₹ 10,000.

How would the above changes in estimates be made by B Ltd.?

Answer

The above changes in estimates would be effected in the following manner:

The asset has a carrying amount of ₹ 56,000 at the end of year 8 [₹ 2,00,000 – ₹ 1,44,000] i.e. Accumulated Depreciation.

Accumulated depreciation is calculated as

Depreciable amount {Cost less residual value} = ₹ 2,00,000 – ₹ 20,000 = ₹ 1,80,000. Annual depreciation = Depreciable amount/Useful life = 1,80,000/10 = ₹ 18,000. Accumulated depreciation = 18,000 × No. of years (8) = ₹ 1,44,000.

Revision of the useful life to 12 years results in a remaining useful life of 4 years (12 – 8). The revised depreciable amount is ₹ 46,000. (56,000 – 10,000)

Thus, depreciation should be charged in future at ₹ 11,500 per annum (₹ 46,000/4 years).

Question 22

Determine if the following costs can be added to the invoiced purchase price and included in the initial recognition of the cost of the asset:

1. *Consultants fees for choosing the new asset*
2. *A trade discount received of 5% of the purchase price of the asset*
3. *A discount received for paying the invoice within 90 days*
4. *Interest paid on a short term loan taken to provide the necessary cash for payment of the purchase price*
5. *Import duties paid*
6. *Shipping costs and cost of road transport*
7. *Insurance for the shipping*
8. *An economic development rebate from the state*
9. *VAT paid on the purchase*
10. *Cost of laying a new concrete slab and installing special rubber mounted footings for the new press in order to reduce vibration during use*
11. *Hire of a crane to transfer the press from the vehicles into the factory*
12. *Costs associated with removing a section of the factory roof to allow the machine to be dropped into place and subsequently refitting the roof*
13. *Cost of installing soundproofing in the roof at the same time in order to provide protection for workers in other parts of the factory building*
14. *Professional fees charged by consulting engineer for overseeing the installation process*
15. *Electricians fees for connecting the press to the power supply*
16. *A portion of the operating costs (salaries, office expenses) of the purchasing department*
17. *Costs of materials (papers and inks) used in calibrating the machine and setting it up for operation*
18. *Costs of training the operators of the new machine*
19. *A portion of the inefficiencies in production for the first month of use while the operators became comfortable with using the machine*

Answer

Included in Cost:

Point No. 1, 2, 5, 6, 7, 8, 10, 11, 12, 14, 15 and 17

Excluded from Cost:

Point No. 3, 4, 9, 13, 16, 18 and 19

(ICAI Answers says point 1 is to be excluded, which is incorrect)

Question 23

A Ltd. has carried out certain works on various machines in their engineering plant, which manufactures high quality metal patterns and templates for use in industry.

Determine in each case whether the costs of the improvements can be added to the existing carrying value of the assets concerned?

1. *The cost of an annual machine overhaul which will maintain the originally assessed standard of performance of the machine for the coming 12 months.*
2. *The cost of repairs to a press machine, which was damaged by the emergency services while trying to extricate the arm of a worker who had become trapped in the press.*
3. *Modifications to a cutting machine which will increase its rate of output from 500 to 560 patterns per shift.*
4. *Modifications to a lathe which will replace the current water cooling system with an oil-based system, thereby extending the life of the lathe by a forecast 2 years.*
5. *The upgrading of a cutting machine with new software which will improve the accuracy of its measurement and cutting tolerances by a number of microns, thereby raising the quality of output.*
6. *Alterations to a production line which will allow automatic feeding from a machine to the next one in the production process, thereby removing the need for an employee to manually load the second machine.*

Answer

Point 1: No. This may not be capitalized as subsequent expenditure, since it merely maintains the originally assessed standard of performance of the asset.

Point 2: Yes. An impairment loss should have been recognized when the damage occurred and any insurance payment received as compensation should have been recognized as income in the Statement of Profit and Loss when received.

When expenditure is incurred to restore the asset, such expenditure is added to the carrying amount of the asset to the extent that it is probable that future economic benefits will flow to the enterprise.

Point 3: Yes. The cost of such modifications may be added to the carrying amount of the asset. Point 4: Yes. Such costs may be capitalized.

Point 5: Yes. Such costs may be capitalized. Point 6: Yes. Such costs may be capitalized.

Question 24

An entity bought a plot of land for development of office buildings. Development of the land was scheduled into six phases. The land scheduled for development in phases five and six was leased to another entity on a short-term basis as a parking lot for heavy vehicles.

What is the treatment of rental income from car parking lot?

Answer

Rental income from the car park lease is recognized in the Statement of Profit and Loss for the period.

The car park activity is incidental to the entity₹s principal activity of property development. Operations that are incidental to the construction or development of property, plant and equipment are not necessary to bring the asset to its working condition for its intended use.

The income and related expenses of incidental operations are recognized in the Statement of Profit and Loss for the period.

Question 25

An entity acquires the right to use an underground cave for gas storage purposes for a period of 50 years. The cave is filled with gas, but a substantial part of that gas will only be used to keep the cave under pressure in order to be able to get gas out of the cave. It is not possible to distinguish the gas that will be used to keep the cave under pressure and the rest of the gas.

Evaluate whether AS 10 would apply or AS 2?

Answer

The total volume of gas must be virtually split into

(i) Gas held for sale, and

(ii) Gas held to keep the cave under pressure.

The former must be accounted for under AS 2 as Inventories. The latter must be accounted for as PPE under AS 10 and depreciated over the period the cave is expected to be used.

Question 26

An entity operates an oil refining plant. For the refining process to take place, the plant must contain a certain minimum quantity of oil. This can only be taken out once the plant is abandoned and would then be polluted to such an extent that the plant's value is significantly reduced.

Evaluate whether AS 10 would apply or AS 2?

Answer

The part of the crude that is necessary to operate the plant and cannot be recouped (or can be recouped but would then be significantly impaired), even when the plant is abandoned, should be considered as an item of PPE under AS 10 and amortized over the life of the plant.

Question 27

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

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

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

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

Question 28

(Taking the information given in the above Example)

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

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

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

Ind AS 11: Construction Contracts

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

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

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

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

Ind AS 18: Revenue

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

Resulting in Carve Out

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

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

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

Not Resulting in Carve Out

1. *Recognition and Measurement of Interest:* Paragraph 1A is inserted in Ind AS 18 which states that recognition of interest is dealt in this standard whereas measurement of interest is dealt in accordance with Ind AS 109, *Financial Instruments.*

2. *Impairment of Contractual Right*: Paragraph 1B is inserted in Ind AS 18, which prescribes the impairment of any contractual right to receive cash or another financial asset arising from this standard, shall be dealt in accordance with Ind AS 109, *Financial Instruments*.

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

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

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

---

* The term 'IFRS' includes not only the International Financial Reporting Standards (IFRSs) issued by the IASB, it also includes the International Accounting Standards (IASs), IFRICs and SICs.

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

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

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

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

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

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

Question 29

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

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

Solution

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

Question 30

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

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

Solution

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

Question 31

A Limited is a company incorporated under the Companies Act and engaged in the business of oil exploration. Keeping in view the requirement in Schedule XIV it was depreciating its oil and gas assets on SLM basis. In the financial year 2014-15, when A applies Schedule II it decides to depreciate the said assets by following the UOP method.

How should change in method be accounted for?

Solution

In this case, in accordance with AS 6, A Limited should calculate depreciation on all such assets following the UOP method since the assets came into existence and recognise any deficiency/gain in the statement of profit and loss for the period ending on March 31, 2015.

Question 32

B Limited is a company engaged in various projects of infrastructure development. B's basic business model is to enter into various infrastructure development projects with the Central and State Governments controlled enterprises under Public Private Partnership (PPP) Model. During the year 2013-2014, B Limited entered into a contract with the State Government of Haryana for developing a coal-fired thermal power plant serving the states of Haryana, Delhi, Rajasthan and Punjab.

At the year-end, i.e., 31st March, 2017, for providing amortisation on the intangible assets arising from the above mentioned projects for developing thermal power plant, B Limited was of the view that the revenue-based amortisation methodology as permitted by the Schedule II may be applied. Whether the view taken by B Limited is appropriate?

Solution

In this case, use of revenue-based amortisation is inappropriate as Schedule II permits revenue based amortisation only for intangible assets arising from toll road projects and not from any other infrastructure projects even though they are entered into through PPP model, BOT or BOOT.

Question 33

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

Solution

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

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

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

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

Question 34

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

Solution

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

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

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

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

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

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

Question 35

A company incorporated under section 25 of the Companies Act having main objectives to promote the trade by organizing trade fairs/exhibitions. When the company was organizing the trade fair and exhibitions it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to income & expenditure account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/exhibitors etc due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visit the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The following accounting treatment and disclosure was made by the company in its financial statements:

1. *5% contingency charges are treated as income and matching provision for the same is also being made in accounts.*
2. *A suitable disclosure to this effect is also made in the notes forming part of accounts.*

Required:

(i) Whether creation of provision for contingencies under the facts and circumstances of the case is in conformity with AS29.

(ii) If the answer of (i) is "No" then what should be the treatment of the provision which is already created in the balance sheet with a specific reference to Schedule III of the Companies Act, 2013.

Solution

(i) As per paragraph 14 of AS 29, a provision should be recognised when:

1. an enterprise has a present obligation as a result of a past event
2. it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and
3. a reliable estimate can be made of the amount of obligation.

If these conditions are not met, no provisions should be recognised.

As per paragraph 10.4 of AS 29, a contingent liability is:

(1) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(2) a present obligation that arises from past events but is not recognised because:

- (a) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
- (b) a reliable estimate of the amount of the obligation cannot be made.

In this case company is required to assess the probability of occurrence of contingencies on the basis of such events taken place in earlier period.

Though there is a present obligation based on such past event and it is probable that an outflow of resources will be required, a reliable estimate of amount of obligation cannot be made.

Hence no provision for the same is to be created and the same is to be disclosed as contingent liability.

(ii) Treatment of Provision already created in the Balance Sheet:

- Reversal of provision should be netted off against the relevant expenditure and should not be shown as “Other Income”.
- Where the reversal is greater than the current year’s expenditure, the net amount would be negative which may be reflected as other income.
- If such provision is related to earlier year, then the same should be disclosed as prior period income.
- As required by AS 29, specific disclosure should be given for reversal of provision in the notes to accounts and reference of note should be given in the specific line item of expenditure in which reversal of provision is made.

Question 36

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

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

Solution

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

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

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

Question 37

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

Solution

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

Question 38

While closing its books of account on 31st March, 2017 a Non-Banking Finance Company has its advances classified as follows:

	₹ in lakhs
Standard assets	*67,200*
Sub-standard assets	*5,360*
Secured portions of doubtful debts:	
– *upto one year*	*1,280*
– *one year to three years*	*360*
– *more than three years*	*120*
Unsecured portions of doubtful debts	*388*
Loss assets	*192*

Calculate the amount of provision, which must be made against the advances as per

(i) *the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016; and*

(ii) *Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.*

Solution

Calculation of provision required on advances as on 31st March, 2017 as per the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016

	Amount ₹ in lakhs	*Percentage of provision*	*Provision ₹ in lakhs*
Standard assets	67,200	0.25	168.00
Sub-standard assets	5,360	10	536.00
Secured portions of doubtful debts–			
– upto one year	1,280	20	256.00
– one year to three years	360	30	108.00
– more than three years	120	50	60.00
Unsecured portions of doubtful debts	388	100	388.00
Loss assets	192	100	192.00
			1,708.00

Calculation of provision required on advances as on 31st March, 2017 as per the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016

	Amount *₹ in lakhs*	*Percentage of provision*	*Provision* *₹ in lakhs*
Standard assets	67,200	0.35	235.20
Sub-standard assets	5,360	10	536.00
Secured portions of doubtful debts–			
– upto one year	1,280	20	256.00
– one year to three years	360	30	108.00
– more than three years	120	50	60.00
Unsecured portions of doubtful debts	388	100	388.00
Loss assets	192	100	192.00
			1,775.20

Question 39 (ICAI Study Material)

X Ltd., a domestic company, has distributed on 5th April, 2015, dividend of ₹ 230 lakh to its shareholders. Compute the Dividend Distribution tax payable by X Ltd.

Solution

Calculation of corporate dividend tax

Particulars	***₹ in lakh***
Dividend distributed by X Ltd.	*230*
Add: Increase for the purpose of grossing up of dividend $\left[\frac{15}{100-15}\times 230\right]$	*40.58*
Gross dividend	*270.59*
Dividend distribution tax @ 15% [15% of ₹ 270.59 lakh]	*40.59*
Add: Surcharge@12%	*4.88*
	45.47
Add: Education cess@2% and SHEC@1%	*1.36*
Dividend Distribution tax	*46.83*

PART I

BALANCE SHEET

Name of the Company…………………….

Balance Sheet as at ………………………

(Rupees in…………)

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

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
1	2	3	4
LIABILITIES			
Non-current liabilities			
(a) Financial Liabilities			
(i) Borrowings			
(ii) Trade payables			
(iii) Other financial liabilities (other than those specified in item (b), to be specified)			
(b) Provisions			
(c) Deferred tax liabilities (Net)			
(d) Other non-current liabilities			
Current liabilities			
(a) Financial Liabilities			
(i) Borrowings			
(ii) Trade payables			
(iii) Other financial liabilities (other than those specified in item (c)			
(b) Other current liabilities			
(c) Provisions			
(d) Current Tax Liabilities (Net)			
Total Equity and Liabilities			

See accompanying notes to the financial statements

STATEMENT OF CHANGES IN EQUITY

Name of the Company…………………….

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

(Rupees in……………….)

A. Equity Share Capital

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

B. Other Equity

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

Note: Remeasurment of defined benefit plans and fair value changes relating to own credit risk of financial liabilities designated at fair value through profit or loss shall be recognised as a part of retained earnings with separate disclosure of such items alongwith the relevant amounts in the Notes.

PART II

STATEMENT OF PROFIT AND LOSS

Name of the Company…………………….

Statement of Profit and Loss for the period ended ………………………

(Rupees in…………)

	Particulars	**Note No.**	**Figures for the current reporting period**	**Figures for the previous reporting period**
I	Revenue From Operations			
II	Other Income			
III	Total Income (I+II)			
IV	**EXPENSES** Cost of materials consumed			
	Purchases of Stock-in-Trade			
	Changes in inventories of finished goods, Stock-in -Trade and work-in-progress			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expense			
	Other expenses			
	Total expenses (IV)			
V	Profit/(loss) before exceptional items and tax (I- IV)			
VI	Exceptional Items			
VII	Profit/(loss) before tax (V-VI)			
VIII	Tax expense: (1) Current tax (2) Deferred tax			
IX	Profit (Loss) for the period from continuing operations (VII-VIII)			
X	Profit/(loss) from discontinued operations			
XI	Tax expense of discontinued operations			
XII	Profit/(loss) from Discontinued operations (after tax) (X-XI)			
XIII	Profit/(loss) for the period (IX+XII)			

	Particulars	**Note No.**	**Figures for the current reporting period**	**Figures for the previous reporting period**
XIV	Other Comprehensive Income A (i) Items that will not be reclassified to profit or loss (ii) Income tax relating to items that will not be reclassified to profit or loss B (i) Items that will be reclassified to profit or loss (ii) Income tax relating to items that will be reclassified to profit or loss			
XV	Total Comprehensive Income for the period (XIII+XIV)(Comprising Profit (Loss) and Other Comprehensive Income for the period)			
XVI	Earnings per equity share (for continuing operation): (1) Basic (2) Diluted			
XVII	Earnings per equity share (for discontinued operation): (1) Basic (2) Diluted			
XVIII	Earnings per equity share (for discontinued & continuing operations) (1) Basic (2) Diluted			

See accompanying notes to the financial statements