Assets Related Accounting Standards

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Various assets related Accounting Standards

Accounting for Assets	
	AS 2 ~ Inventories
	AS 10 ~ Property, Plant and Equipment
	AS 26 ~ Intangible Assets
	AS 28 ~ Impairment of Assets
	AS 12 ~ Government Grants
	AS 13 ~ Accounting for Investments
	AS 16 ~ Borrowing Costs
	AS 19 ~ Leases

AS 2 ~ Inventories

Core Concepts

Not applicable to shares, debentures and other financial instruments held as stock-in-trade

Inventories are assets: (a). held for **sale in the ordinary course** of business; (b). in the **process of production** for such sale; or (c). in the form of materials or supplies to be **consumed in the production process or in the rendering of services**

Inventories should be valued at the **lower of cost and net realisable value**

The **cost of inventories** should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their **present location and condition**

Net realisable value is the **estimated selling price** in the ordinary course of business **less the estimated costs** of completion and the estimated costs necessary to make the sale

Cost Exclusions: abnormal costs, admin overheads, selling and distribution overheads

Cost Formulae: FIFO, Weighted Average, Specific Identification, **LIFO basis not permitted**

Case Study 1

- A company is in the business of manufacturing chemicals, say Chemical X. Manufacturing of Chemical X requires consumption of Chemical A and Chemical B. Chemical A and Chemical B undergo a process in the tank and Chemical X is manufactured. During this process, Chemical A and Chemical B get consumed. The production process is such that certain quantity of Chemical A and Chemical B will always remain in the production process. Chemical A and B are added constantly so that the quality of manufactured Chemical X is maintained.
- Whether the company can treat the quantity of Chemical A and Chemical B which always remains in the production process as a capital work-in-progress or fixed asset ?

Answer

- No, Chemical A and Chemical B get consumed in the production process and are not held as such for producing the goods and, hence, cannot be capitalized as in the case of fixed assets as specified under AS 10.
- These materials are in the nature of work-in-progress to be disclosed as inventory as per guidelines under AS 2.

Case Study 2

- In the books of a leading real estate developer (say "X"), there are residential complexes which are constructed but not sold at the end of financial year. X has shown them as inventory. For the purpose of valuation of inventory of residential complexes, it has revalued cost of land on which those complexes are constructed. Ultimately, X has revalued cost of inventory of complexes.
- Whether, inventory valuation policy of X is correct or not?

Answer

- No. There is no provision is given under AS 2, "Valuation of Inventories" to revalue cost of items of inventory. As well, as per AS 2, inventories should be valued at the lower of cost and net realisable value. Therefore, in respect of both aspects inventory valuation policy followed by X is not correct.

Case Study 3

- A soap manufacturing company has valued its stock of finished goods at cost or realisable value whichever is lower and other items of inventory, like raw materials, work-in-progress and spare parts, at cost. It has disclosed its accounting policy regarding valuation of inventory in the financial statements appropriately.
- Whether the company's accounting policy regarding valuation of inventory is correct?

Answer

- No.
- If a company value its finished goods at lower of cost or realisable value, then it results in non-deduction of costs of completion of goods and estimated costs necessary to make the sale of goods from the selling price. Therefore, in the given case, the company's accounting policy regarding valuation of finished goods is not correct.
- While valuation of raw materials, work-in-progress and spare parts at cost is in order (provided the net realisable value of finished goods is more than its cost).

AS 10 ~ Property, Plant and Equipment

Core Concepts

Not applicable to biological assets related to agricultural activity other than bearer plants, wasting assets

PPE are tangible items that: (a). are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b). are expected to be used during more than a period of twelve months.

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.

Cost = purchase price (net) + directly attributable costs + initial estimate of decommissioning, restoration and similar liabilities [**Note: cost of an item of PPE is the cash price equivalent at the recognition date**]

Measurement after recognition: cost model or revaluation model

Component Accounting: 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

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

The **depreciation method applied to an asset should be reviewed** at least at each financial year-end

Case Study 1

On 1.4.2016, X Limited acquired a machine for Rs. 50 lakhs. The down payment is 20% and balance shall be paid over 5 equal annual instalments. Incremental borrowing rate is 11%. Find out the cost of machine.

Acquisition cost = PV of cash flows @ 11% = Rs. 39.57

Year	Cash Flows	PVF	PV	Finance Cost	Creditors
0	10	1	10.00	0	29.57
1	8	0.9009	7.21	3.25	24.82
2	8	0.8116	6.49	2.73	19.55
3	8	0.7312	5.85	2.15	13.70
4	8	0.6587	5.27	1.51	7.21
5	8	0.5935	4.75	0.79	0.00
	50.00		39.57	10.43	

The finance cost shall be recognised over the period of deferred credit

Date	Particulars	Dr.	Cr.
1.4.2016	PPE – Machine A/c Dr.	39.57	
	To S. Crs. A/c		29.57
	To Bank A/c		10.00
31.3.2017	Finance Costs A/c Dr.	3.25	
	To S. Crs. A/c		3.25
31.3.2017	S. Crs. A/c Dr.	8.00	
	To Bank A/c		8.00

Case Study 2

- An entity has acquired a building for Rs. 15,00,000, with a useful life of 5 years;
- The cost of demolishing the building (i.e., asset retirement obligation or ARO) at the end of its use as required by local regulations has the nominal value of INR 500,000;
- Discount rate applicable for the entity is 10%.
- **Sol.:** Recognise ARO of INR 310,461 (PV of Rs. 5,00,000 @10%)

Year	Op. Prov.	Intt. Exp.	Cl. Prov.	Dep.
1	310,461	31,046	341,507	62,092
2	341,507	34,151	375,657	62,092
3	375,657	37,565	413,223	62,092
4	413,223	41,322	454,545	62,092
5	454,545	45,454	500,000	62,092

Particulars	Dr.	Cr.
PPE A/c Dr.	18,10,461	
To Sundry Creditors A/c		15,00,000
To Prov. For Decommission Liab. A/c		3,10,461
Interest – Finance Cost A/c Dr.	31,046	
To Prov. For Decommission Liab. A/c		31,046
Dep. A/c Dr. [3,00,000 + 62,092]	3,62,092	
To PPE A/c		3,62,092

Case Study 3

- A Company say, P Ltd. is an infrastructure company which is engaged in the business of developing, constructing, operating and maintaining infrastructural projects. In order to expand the terminal building of international airport - one of its infrastructural project, P Ltd. has demolished the major parts of the existing building of the airport including some other infrastructural assets. The demolition process was necessary in order to expand the terminal building of the airport. The book value of the demolished building is material as compared to the net realizable value arising from the disposal of such assets.
- Considering that demolition process is necessary for expansion of terminal building, P Ltd. capitalized the book value of the demolished assets as a part of the cost of new asset i.e. terminal building as per AS 10. Whether the accounting treatment adopted by P Ltd. is correct as per the relevant accounting standard?

Answer

- Considering the provisions contained in AS 10, the fixed assets should be eliminated from the financial statements either on disposal or where no future economic benefits are expected to arise from its use and disposal.
- Further, any losses or gains in respect of above disposals should be recognized in the Statement of Profit and Loss.
- In the instant case, the already existing fixed assets are demolished for the purpose of construction of new asset. Although, the demolition process was conducted exclusively for expansion process but it is not directly related or attributable to the construction of new asset and therefore, the book value of the demolished assets cannot be capitalized as a part of the cost of new asset. In order to recognize the new asset in its books, P ltd. should first apply the derecognition principles for the existing asset so that the carrying amount of existing asset can be eliminated from the financial statements. Also, any gain or loss arising from such elimination should be recognized in the statement of profit and loss.

Case Study 4

- A Company say, P Ltd. is engaged in the business of petrochemicals. In order to increase the productivity, P Ltd. has decided to expand the production capacity of its existing plant. The expansion of existing plant was of complex nature and therefore, it took nearly 18 months to complete the major activities of the said project.
- The plant was operating at 80% of its capacity and declared as ready for commercial production. Soon after completion of expansion project, frequent defects and technical issues were faced by P Ltd. and plant had to undergo immediate shut down to address the various issues faced. It took nearly 12 months to achieve the required capacity and successful stabilization of the plant.
- P Ltd. has capitalized the entire expenditure incurred during the stabilization period as part of cost of the project.
- Whether the accounting treatment adopted by P Ltd. is correct as per the relevant accounting standard?

Answer

- No, the accounting treatment adopted by P Ltd. is not correct.
- As per AS 10, all the expenditure incurred on commissioning of project, test runs and experimental production till plant is ready for commercial production should be capitalized as a part of cost of such plant. However, any expenditure incurred after plant has begun commercial production should be expensed off in the statement of profit and loss.
- From the above guidance of AS 10, the expenditure incurred after the plant has begun commercial production cannot be capitalized in the books. Further, commercial production means when plant is ready to produce in feasible quantity and not in commercially practicable manner. Looking into the facts, it can be seen that plant is ready to produce in commercially feasible quantity even when the plant was detected with some stabilization issues. Thus, the cost incurred during the stabilization period cannot be capitalized instead, it should be charged to the statement of profit and loss in the year of incurrence.

AS 26 ~ Intangible Assets

Core Concepts ~ 1

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 purposes

To be **identifiable**, it is necessary that the intangible asset is separable, i.e., the enterprise could rent, sell, exchange or distribute etc. **or** arises from contractual or other legal rights

Control = power to obtain the future economic benefits (+) restrict the access of others to those benefits

Recognition = probable that economic benefits will flow to the enterprise (+) cost can be measured reliably ~ initial measurement at cost ~ revaluation not allowed

Internally generated goodwill should not be recognised as an asset

Expenditure on research (or on the research phase of an internal project) should be **recognised as an expense** when it is incurred

An **intangible asset arising from development** (or from the development phase of an internal project) should be **recognised subject to technical feasibility** and probable future economic benefits

Core Concepts ~ 2

Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should **not be recognised as intangible assets**

Capitalise subsequent expenditure if it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance

The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life

There is a **rebuttable presumption** that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use

The **amortisation period and the amortisation method should be reviewed** at least at each financial year end

Website Costs = **planning costs** ~ expensed; **development costs** ~ capitalised; **content costs for advertising products/ services** ~ expensed; **operating costs** ~ expensed

An **intangible asset arising from development** (or from the development phase of an internal project) should be **recognised subject to technical feasibility** and probable future economic benefits

Case Study 1

- Company X Ltd. purchased a copyright for a period of 20 years for an amount of Rs. 2,00,000. As per the agreement, an additional consideration is also payable after completing 10 years which will be equal to 10% of revenue earned in respect of those years.
- While preparing financial statements, X Ltd. adopted the following accounting treatment:

a). Amortize the copyright over a period of 20 years.

b). Amortized Rs. 2,00,000 as cost of copyright.

- The company neither disclosed the reasons for amortizing the copyright for more than 10 years nor it disclosed the amount payable after a period of 10 years as an additional consideration for such intangible asset.
- Whether the treatment adopted by X Ltd. is in line with AS 26 ?

Answer

- No, the accounting treatment adopted by X Ltd. is not in line with AS 26.
- As per AS 26, if any intangible asset is amortized over more than 10 years, then reasons explaining the factors which played an important role in amortizing the asset over more than 10 years should be disclosed in financial statements.
- Further for amortization the cost of an intangible asset should include the amount(s) paid or payable i.e. the total cost of an intangible asset.
- Since the company has to pay an additional consideration after a period of 10 years, the company should estimate such amount of additional consideration payable and, accordingly, the total cost of such copyright should be capitalized and amortized.

Case Study 2

- A Company say, A ltd. is engaged in the business of newspaper publishing and radio broadcasting. The company is one of the leading media houses and generally A Ltd. has to put on efforts to build strong goodwill in the market, in the form of promoting achievements, promotional branding, events, campaigns, advertising through agencies, etc. A Ltd. has incurred a substantial amount on above mentioned expenditure. The benefits of such expenditure will accrue to the company for a period longer than one year. Therefore, A Ltd. amortized such expenditure over a reasonable period of time rather than charging the same in the statement of profit and loss in the year of incurrence.
- Whether the accounting treatment adopted by A Ltd. is correct as per relevant accounting standard?

Answer

- No, the accounting treatment adopted by A Ltd. is not correct as per AS 26.
- An asset is a resource controlled by the entity as a result of past events from which future benefits are expected to flow. ***Any expenditure incurred by an entity on promotional and advertising activities does not give rise to an asset that is being controlled by an entity.***
- ***Further, as per AS 26, internally generated goodwill should not be recognized as an asset.***
- Considering the provisions contained in the standard, expenditure incurred on branding and advertising cannot be recognized as an asset in the books of accounts. Though, it may provide future economic benefits to the entity but no such asset is created from the expenditure incurred which can be measured and recognized.
- Hence, the expenditure incurred cannot be deferred and amortized over a period of time instead, it should be charged to the statement of profit and loss in the year of incurrence.

Case Study 3

- A company is in the business of power generation and conducting feasibility study on whether a power plant can be set-up? As per the company's accounting policy, training expenditure incurred before start of plant is treated as deferred revenue expenditure and amortised over a period of 3 years once the plant is started.
- Whether the company's accounting policy is correct ?

Answer

- No, the accounting treatment adopted by the company is not correct.
- As per AS 26, the following expenditure are expensed off when incurred:
  a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);
  b) expenditure on training activities;
  c) expenditure on advertising and promotional activities; and
  d) expenditure on relocating or re-organising part or all of an enterprise.

Case Study 4

- A Company say B Ltd. has incurred expenditure amounting to Rs. 50 crore as preliminary expenses for Registration of the Company, which includes Rs. 35 crore as fees paid to Registrar of Companies (ROC) and balance is paid for legal and professional fees. B Ltd. considered the above expenses as share issue expenses and amortized the expenditure over a period of five years. B Ltd. disclosed the unamortized expenditure as other current assets under the head 'Current Assets'.
- Whether the accounting treatment adopted by B Ltd. is correct? If not, what should be the correct accounting treatment for above expenditure?

Answer

- No, the accounting treatment adopted by B Ltd. is not correct.
- The term share issue expenses includes the amount spent in connection with the issuance and allotment of shares such as brokerage, legal and professional fees, underwriting commission. In the instant case, Rs. 50 crore is spent for the registration purpose which is to be completed before the issuance and allotment of shares. Issuance of share is an independent process which begins after the successful registration of the company with the ROC. Further, no asset - tangible or intangible is created or acquired with the incurrence of above expenditure and accordingly, the above amount spent should be recognized as an expense as and when it is incurred.
- Thus, B Ltd. should recognize the above amount paid to ROC and other incidental costs incurred as expenditure in the statement of profit and loss.

AS 28 ~ Impairment of Assets

Core Concepts ~ 1

Not applicable to inventories, construction contracts and deferred tax

An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount, i.e., **impairment loss = carrying amount (-) recoverable amount**

Carrying amount = asset in the balance sheet after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon

Recoverable amount = higher of an asset's net selling price and its value in use

Net selling price = amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

Value in use = PV of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life ~ Future cash flows should be estimated for the asset in its current condition.

An **enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired**. If any such indication exists, the enterprise should estimate the recoverable amount of the asset.

Core Concepts ~ 2

Indicators of impairment = external or internal

An **impairment loss should be recognised as an expense** in the statement of profit and loss immediately. However, impairment loss of a revalued asset should be treated as a revaluation decrease

Cash Generating Unit = If there is any indication that an asset may be impaired, the recoverable amount should be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an enterprise should determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

Reversal of impairment loss = An impairment loss recognised for an asset in prior accounting periods should be reversed if there has been a change in the estimates of cash inflows, cash outflows or discount rates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset should be increased to its recoverable amount

Case Study 1

- Happy Limited purchased a Fixed Asset of Rs. 45 lakhs. The useful life of the fixed asset is 15 years. At the end of each of the first six years, the recoverable amount of the Fixed Asset was Rs. 45.50 lakhs, Rs. 40.00 lakhs, Rs. 35.50 lakhs, Rs. 34.00 lakhs, Rs. 29.00 lakhs and Rs. 25.00 lakhs respectively.
- What would be the amount of impairment loss to be recognised, if any, in the respective years.

Year(s)	Carrying Amount	Recoverable Amount	Impairment Loss
(A)	(B)	(C)	(D) = (B) – (C)
1	45.00 – 3.00 = 42.00 lakhs	45.50 lakhs	NIL
2	42.00 – 3.00 = 39.00 lakhs	40.00 lakhs	NIL
3	39.00 – 3.00 = 36.00 lakhs	35.50 lakhs	0.50 lakhs
4	35.50 – 2.96 = 32.54 lakhs	34.00 lakhs	NIL
5	32.54 – 2.96 = 29.58 lakhs	29.00 lakhs	0.58 lakhs
6	29.00 – 2.90 = 26.10 lakhs	25.00 lakhs	NIL

Case Study 2

ABC Limited furnishes the following details in respect of its plant and machinery. Determine the amount of impairment loss, if any, for each of the following years:

Year	Carrying Amount	Net Selling Price (NSP)	Value in Use (VIU)
1	Rs. 450.00 lakhs	Rs. 500.00 lakhs	Rs. 450.00 lakhs
2	Rs. 400.00 lakhs	Rs. 425.00 lakhs	Rs. 437.50 lakhs
3	Rs. 350.00 lakhs	Rs. 375.00 lakhs	Rs. 325.00 lakhs
4	Rs. 300.00 lakhs	Rs. 325.00 lakhs	Rs. 325.00 lakhs
5	Rs. 250.00 lakhs	Rs. 287.50 lakhs	Rs. 292.50 lakhs

Year	NSP	VIU	Net Recoverable Amount	Carrying Amount	Impairment Loss
(1)	(2)	(3)	(4) = (2) or (3) whichever is higher	(5)	(6) = (5) – (4)
1	500.00	450.00	500.00	450.00	NIL
2	425.00	437.50	437.50	400.00	NIL
3	375.00	325.00	375.00	350.00	25.00
4	325.00	325.00	325.00	300.00	25.00
5	287.50	292.50	292.50	250.00	42.50

Case Study 3

What would be the accounting treatment as per AS 28 for the following information (all the figures are in Rs. Lakhs):

Particulars	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6 (Asset is Revalued)
NSP	5.00	N.A.	5.00	N.A.	N.A.	N.A.
VIU	N.A.	5.00	4.30	4.00	(0.50)	4.00
Carrying Amount	4.50	4.50	4.50	4.50	4.50	4.50

Particulars	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6 (Asset is Revalued)
NSP	5.00	N.A.	5.00	N.A.	N.A.	N.A.
VIU	N.A.	5.00	4.30	4.00	(0.50)	4.00
Recoverable Amount	5.00	5.00	5.00	4.00	(0.50)	4.00
Carrying Amount	4.50	4.50	4.50	4.50	4.50	4.50
Impairment Loss	Nil	Nil	Nil	0.50	5.00	0.50
Charged to Profit & Loss Account	Nil	Nil	Nil	0.50	4.50	Only if no balance is their in revaluation reserve
Amount recognised as Liability	Nil	Nil	Nil	Nil	0.50	Nil

IFRS I Corporate Laws I Due Diligence I Forensic Audits I BRSR

Thank you

Kamal Garg & Associates