

(PPE)  
**PROPERTY, PLANT & EQUIPMENT**

<b>Meaning</b>	<p>Property, plant and equipment (PPE) are <b>tangible items</b> that:</p> <p>a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and</p> <p>b) are expected to be used during more than a period of 12 months. (&gt;12M)</p> <p><b>Example:</b> Building, Plant &amp; Machinery, Furniture, etc.</p>
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**“Administrative purposes”:** The term ‘Administrative purposes’ has been used in wider sense to include all business purposes. Thus, PPE would include assets used for:

- Selling & distribution
- Finance & accounting
- Personnel & other functions of Enterprise

Items of PPE may also be acquired for **safety or environmental reasons**. The acquisition of such PPE, although not directly increasing the future economic benefits of any particular existing item of PPE, may be necessary for an enterprise to obtain the future economic benefits from its other assets.

**Example:** A chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the enterprise is unable to manufacture and sell chemicals

<b>Non Applicability</b>	<ul style="list-style-type: none"> <li>❖ biological assets (<b>other than bearer plants</b>) related to agricultural activity. This AS applies to bearer plants but it does not apply to the produce on bearer plants; and</li> <li>❖ wasting assets including mineral rights, expenditure on exploration for &amp; extraction of minerals, oil, natural gas and similar non-regenerative resources.</li> </ul> <p><i>AS 10 applies to PPE used to develop or maintain the assets described above</i></p>
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**OTHER DEFINITIONS**

<b>Biological Asset</b>	It is a <u>living animal or plant</u> .
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<b>Bearer Plant</b>	<p>is a plant that</p> <p>a) is used in the production or supply of agricultural produce; <i>Mango tree, Apple tree</i></p> <p>b) is expected to bear produce for more than a period of 12 months; and</p> <p>c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. <i>Keep chonus hai</i></p>
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*AS 10 applicable*

The following are **not Bearer Plants**:

(a) Plants cultivated to be **harvested as** Agricultural produce  
**Example:** Trees grown for use as lumber

(b) Plants cultivated to produce Agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales  
**Example:** Trees which are cultivated both for their fruit and their lumber

(c) Annual crops  $\rightarrow < 12M$   
**Example:** Maize and wheat

**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.

## 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

### Notes:

- It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value.
- An enterprise may decide to expense an item which could otherwise have been included as PPE, because the amount of the expenditure is not material.

## TREATMENT OF SPARE PARTS, STAND BY EQUIPMENT & SERVICING EQUIPMENT

Case I	If they meet the <u>definition of PPE</u> as per <u>AS 10</u> : - Recognised as <u>PPE</u> as per <u>AS 10</u>
Case II	If they <u>do not meet the definition of PPE</u> as per <u>AS 10</u> : - Such items are classified as <u>Inventory as per AS 2</u>

## TREATMENT OF SUBSEQUENT COSTS

### COST OF DAY-TO-DAY SERVICING

<i>Meaning</i>	These are primarily the costs of labour and consumables and may include the cost of small parts. The purpose of such expenditures is often described as for the ' <u>Repairs and Maintenance</u> ' of the item of PPE.
<i>Accounting Treatment</i>	Recognised in the Statement of Profit and Loss as incurred.

### REPLACEMENT OF PARTS OF PPE

<i>Meaning</i>	Parts of some items of PPE may require replacement at regular intervals. <b>Examples:</b> <ul style="list-style-type: none"> <li>○ Seats or Engine in Aircraft</li> <li>○ Turbine in Machine</li> </ul>
<i>Accounting Treatment</i>	Cost of new part is recognized (added) and Carrying Amount of old part is derecognized. <b>New Carrying Amount</b> Carrying Amount of PPE on date of replacement + Cost of new part - Carrying Amount of old part on date of Replacement <b>Note:</b> If carrying Amount of old Part is not given then: 1) Start with <u>cost of New Part</u> & compute <u>its Present Value</u> to the <u>date of recognition of old Part</u> : It is considered as <u>cost of old Part</u> 2) Deduct <u>Depreciation on above amount upto the date of Part replacement</u> to get <u>carrying Amount of old Part on date of Replacement</u> .

## REGULAR MAJOR INSPECTIONS

<i>Accounting Treatment</i>	Same treatment as of <u>Replacement of Parts</u>
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→ First Time  
Initial Recognition: **Cost Model**



**MEASUREMENT OF PPE (At Recognition: Cost Model)**

Cost of PPE includes the following:

Purchase price (Net of Trade discount & rebates)	XX
Add: Taxes & Duties (Non-refundable) <i>ITC x cost ✓</i>	XX
Add: Costs 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*	XX
Add: Estimated Decommissioning, Restoration costs etc. (Consider at <b>Present value</b> if given or can be calculated)	XX
<b>Cost of PPE</b>	XX

*Tod Fed ka kharca*

*upto Ready to use*

\* **Examples of directly attributable costs are:**

- Costs of employee benefits (as defined in AS 15) arising directly from construction or acquisition of the item of PPE
- Costs of site preparation
- Initial delivery and handling costs (*Freight Inward*)
- Installation and assembly costs
- Costs of testing whether the asset is functioning properly, after deducting net proceeds from selling any items produced while bringing asset to that location & condition (such as samples produced when testing equipment)
- Professional fees

*Testing Costs = 50000  
- sale of scrap (10000)  
40000*

**Cash / Direct purchase**

**Costs that are not included in carrying item of PPE: (EXCLUSIONS)**

- ❖ Costs of opening a new facility or business, such as, inauguration costs;
- ❖ Costs of introducing a new product or service (including costs of advertising and promotional activities);
- ❖ Costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
- ❖ Administration and other general overhead costs
- ❖ Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.
- ❖ Initial operating losses, such as those incurred while demand for the output of an item builds up. and
- ❖ Costs of relocating or reorganizing part or all of the operations of an enterprise.

*Jio/ Amusement Park*

**Example:** Income may be earned through using a building site as a car park until construction starts because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in the Statement of Profit & Loss and included in their respective classifications of income & expense.

*Loan → Building const. yet to start  
↓  
used for carrying income → (P&L)*

**Self constructed assets**

- Any **internal profits are eliminated** in arriving at such costs.
- Cost of **abnormal amounts** of wasted material, labour, or other resources is **not included** in the cost of asset.
- Borrowing Costs (interest costs) to be added to the cost of a self-constructed item of PPE as per AS 16.

*X Ltd.*

*Dept. A → Dept B Building → DL or 2-20L  
C = DL → 220000*

AS 13: Investments

↳ Investment Property (Inv. in Land/Building)  
↓

Only cost model as per AS 10. Revaluation model not allowed. AS 10

Refer in Notebook

<u>MEASUREMENT OF COST</u>	
(Cost of an item of PPE is the cash price equivalent at the recognition date)	
<u>In Exchange for Non-monetary Asset</u>	Cost of such an item of PPE is measured at <u>fair value</u> unless: a) Exchange transaction lacks commercial substance; Or b) Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable. <b>Note:</b> • If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.
<u>Purchase for Consolidated Price</u>	Where several items of PPE are purchased for a consolidated price, the consideration is <u>apportioned</u> to the various items on the <u>basis of their respective fair values</u> at the date of acquisition.
<u>Deferred Consideration</u>	Total payment - Cash price equivalent = 108000 - 100000 = 8000 • Is recognised as <u>Interest</u> over the period of credit • unless such interest is capitalised in accordance with AS 16

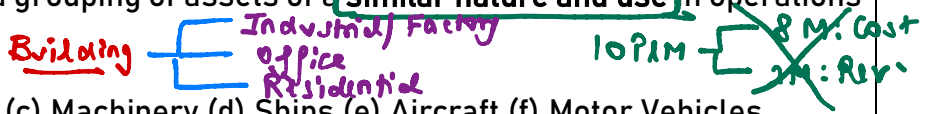
MEASUREMENT AFTER RECOGNITION

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

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



<u>Cost Model</u>	After recognition as an asset, an item of PPE should be carried at: <u>AS 28</u> <u>Cost - Any Accumulated Depreciation - Any Accumulated Impairment losses</u>								
<u>Revaluation Model</u>	After recognition as an asset, an item of PPE whose fair value can be measured reliably should be carried at a revalued amount. <table border="1"> <tr> <td><u>Fair value</u> at the date of the revaluation</td> <td>XX</td> </tr> <tr> <td>Less: Any subsequent accumulated depreciation</td> <td>(XX)</td> </tr> <tr> <td>Less: Any subsequent accumulated impairment losses</td> <td>(XX)</td> </tr> <tr> <td>Carrying value</td> <td>XX</td> </tr> </table>	<u>Fair value</u> at the date of the revaluation	XX	Less: Any subsequent accumulated depreciation	(XX)	Less: Any subsequent accumulated impairment losses	(XX)	Carrying value	XX
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Less: Any subsequent accumulated impairment losses	(XX)								
Carrying value	XX								
<u>Frequency of Revaluations</u>	A. Items of PPE experience significant and volatile changes in Fair value Annual revaluation shall be done. B. Items of PPE with only insignificant changes in Fair value Revaluation shall be done at an interval of <u>3 or 5 years</u>								

REVALUATION: INCREASE OR DECREASE

<u>First Revaluation</u>	<u>Upward</u>	Use <u>Revaluation Surplus (R/S)</u>																									
	<u>Downward</u>	Use <u>P&amp;L A/c</u>																									
<u>Subsequent Revaluation</u>	<table border="1"> <thead> <tr> <th>Case</th> <th>1<sup>st</sup></th> <th>2<sup>nd</sup></th> <th>1<sup>st</sup></th> <th>2<sup>nd</sup></th> </tr> </thead> <tbody> <tr> <td>1</td> <td>↑</td> <td>↑</td> <td>R/S</td> <td>R/S</td> </tr> <tr> <td>2</td> <td>↓</td> <td>↓</td> <td>P &amp; L</td> <td>P &amp; L</td> </tr> <tr> <td>3</td> <td>↑</td> <td>↓</td> <td>R/S</td> <td>Use R/S 1<sup>st</sup> then P&amp;L</td> </tr> <tr> <td>4</td> <td>↓</td> <td>↑</td> <td>P &amp; L</td> <td>Use P&amp;L 1<sup>st</sup> then R/S</td> </tr> </tbody> </table>		Case	1 <sup>st</sup>	2 <sup>nd</sup>	1 <sup>st</sup>	2 <sup>nd</sup>	1	↑	↑	R/S	R/S	2	↓	↓	P & L	P & L	3	↑	↓	R/S	Use R/S 1 <sup>st</sup> then P&L	4	↓	↑	P & L	Use P&L 1 <sup>st</sup> then R/S
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2	↓	↓	P & L	P & L																							
3	↑	↓	R/S	Use R/S 1 <sup>st</sup> then P&L																							
4	↓	↑	P & L	Use P&L 1 <sup>st</sup> then R/S																							

<p><u>Treatment of Revaluation Surplus</u></p> <p>Extra/ Addl. Dep. →</p>	<p>The revaluation surplus <b>may be transferred to Revenue Reserves</b> when the asset is derecognised. <span style="color: green;">(Free Reserve)</span></p> <p><u>Case I: When whole surplus is transferred:</u> When the asset is: - Retired Or - Disposed of</p> <p><u>Case II: Some of the surplus may be transferred as asset is used by an enterprise:</u> <span style="color: red;">→ Optional</span></p> <p>In such a case, the amount of the surplus transferred would be: Dep. (based on Revalued Carrying amount) - Dep. (based on Original Cost)</p> <p>Transfers from Revaluation Surplus to the Revenue Reserves are <b>not made</b> through the Statement of Profit and Loss</p>
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**ACCOUNTING TREATMENT OF REVALUATION** (If there is Acc. Dep.)

<p><u>Technique 1</u></p>	<p>Proportionate Increase/Decrease in Gross Carrying Amount &amp; Accumulated Depreciation</p> <p><u>Steps:</u></p> <p>1) Find Revaluation Gain/Loss (%)  <math display="block">\frac{\text{Revaluation Gain/Loss}}{\text{Carrying Amount}} \times 100</math></p> <p>2) Increase Gross Block &amp; Acc. Dep. by (%)</p> <p>3) PPE A/c-Dr              To Accumulated Depreciation A/c              To Revaluation Gain A/c</p>
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<p><u>Technique 2</u></p>	<p>Accumulated depreciation is eliminated</p> <p>1) Accumulated Depreciation A/c-Dr              To PPE A/c</p> <p>2) PPE A/c -Dr              To Revaluation Gain A/c</p>
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**DEPRECIATION**

<p><u>Component Method of Depreciation</u></p>	<p>Each part of an item of PPE with a <b>cost that is significant</b> in relation to the <b>total cost</b> of the item should be <b>depreciated separately</b>.</p> <p>Example: It may be appropriate to depreciate separately the <u>airframe</u> and <u>engines</u> of an aircraft</p>
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<p><u>Depreciable Amount</u></p>	<p><b>Depreciable amount is:</b> Cost of asset or other amount substituted for cost i.e. Revalued amount - Residual value</p> <p>The depreciable amount of an asset should be <b>allocated on a systematic basis</b> over its useful life</p>
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<p><u>Useful Life</u></p>	<p><u>Based on period</u></p>	<p>The <u>period</u> over which a depreciable asset is expected to be used by the enterprise</p>
	<p><u>Based on units</u></p>	<p>The <u>number of production or similar units</u> expected to be obtained from the use of the asset by the enterprise</p>
	<p><u>Notes</u></p>	<ul style="list-style-type: none"> <li>• Useful life means <u>economic life</u> of the asset and is generally <u>shorter than its physical life</u>.</li> <li>• It is estimated after considering the following factors:                             <ul style="list-style-type: none"> <li>✓ Expected <u>physical wear and tear</u>.</li> <li>✓ Pre-determined by legal or contractual limits such as <u>expiry dates of related leases</u>.</li> <li>✓ <u>Obsolescence</u> such as <u>technological changes</u>, <u>improvement in production method</u> etc.</li> <li>✓ No of <u>shifts</u> in which the asset is to be used.</li> </ul> </li> </ul>

<b>Review of Residual Value and Useful Life</b>	Residual value and the useful life of an asset should be reviewed <b>at least at each financial year-end</b> and, if expectations differ from previous estimates, the change(s) should be accounted for as a <b>change in an accounting estimate</b> . <b>(Prospective Effect)</b>
<b>Commence</b>	Depreciation of an asset begins when it is <b>available for use</b>
<b>Cessation of Depreciation</b>	I. When <b>asset's residual value exceeds its carrying amount</b> II. <b>Earlier of:</b> <ul style="list-style-type: none"> <li>The date that the asset is retired from active use &amp; is held for disposal, <b>and</b></li> <li>The date that the asset is derecognised <b>(Disposal)</b></li> </ul> Therefore, <b>depreciation does not cease</b> when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated. <b>However</b> , under usage methods of depreciation, the depreciation charge can be zero while there is no production.
<b>LAND AND BUILDINGS</b>	
Land & buildings are <b>separable assets</b> & accounted separately, even when they are acquired together	
<b>A. Land</b>	Land has an <b>unlimited useful life</b> and therefore is not depreciated. <b>Exception: Where land has limited useful life (i.e. Leasehold Land)</b>
<b>B. Buildings</b>	Buildings have a <b>limited useful life</b> and therefore are <b>depreciable assets</b> .
<b>DEPRECIATION METHOD</b>	
The depreciation method used should reflect the <b>pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.</b>	
<b>Straight-line Method</b>	Results in a <b>constant charge over the useful life.</b> Straight Line Depreciation = $\frac{\text{Cost Less Residual Value}}{\text{Useful Life}}$ IL 10% = 10000 90000 10% = 9000
<b>Diminishing Balance Method</b>	Results in a <b>decreasing charge over the useful life.</b> Depreciation Amount for each year is computed by applying a <b>fixed % on the Opening Balance of the Asset (i.e. Diminishing Balance of the Asset.)</b>
<b>Units of Production Method</b>	Results in a charge based on the <b>expected use or output</b>
<b>REVIEW OF DEPRECIATION METHOD</b>	
If there has been a <b>significant change in the expected pattern of consumption of the future economic benefits</b> , the method should be changed to reflect the changed pattern. Such a change should be accounted for as a <b>change in an accounting estimate</b> . <b>(Prospective effect)</b> <b>Depreciation Method based on Revenue: Not appropriate</b>	
<b>CHANGES IN EXISTING DECOMMISSIONING, RESTORATION &amp; OTHER LIABILITIES</b>	
Cost of PPE may undergo changes subsequent to its acquisition/construction on account of: <ul style="list-style-type: none"> <li>Changes in Liabilities</li> <li>Price Adjustments</li> <li>Changes in Duties</li> <li>Changes in initial estimates of amounts provided for <b>Dismantling, Removing, Restoration &amp;</b></li> <li>Similar factors</li> </ul> The above are included in the <b>cost of the asset</b> .	

W.D.V

Book value = 50000 | 50000  
 NRV = 40000 | 70000  
 Value = 40000 | 50000  
 Loss 10000

B/S : Assets  
 ↓  
 Asset held for disposal  
 ↓  
 Non Current      Current

No formal dep. classification as current asset

RETIREMENT	
<b>Meaning</b>	Asset is retired from active use & held for disposal
<b>Treatment</b>	<ul style="list-style-type: none"> <li>❖ Recorded in the books at Carrying Amount or NRV, whichever is lower.</li> <li>❖ Any expected loss is recognized immediately in the P&amp;L statement.</li> </ul>
DE-RECOGNITION	
<b>When</b>	<p>The carrying amount of an item of PPE should be derecognised:</p> <ul style="list-style-type: none"> <li>- On disposal                             <ul style="list-style-type: none"> <li>o By sale</li> <li>o By entering into a finance lease, or</li> <li>o By donation, or</li> </ul> </li> <li>- When no future economic benefits are expected from its use or disposal</li> </ul>
<b>Treatment</b>	The gain or loss arising from derecognition should be included in the statement of profit and loss
DISCLOSURES	
<b>General Disclosures</b>	<p>The financial statements should disclose, for each class of PPE:</p> <ul style="list-style-type: none"> <li>❖ The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;</li> <li>❖ The depreciation methods used;</li> <li>❖ The useful lives or the depreciation rates used. In case useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;</li> <li>❖ The gross carrying amount &amp; accumulated depreciation (aggregated with accumulated impairment losses) at the beginning &amp; end of the period; and</li> <li>❖ A reconciliation of the carrying amount at the beginning &amp; end of the period</li> </ul>
<b>Additional Disclosures</b>	<p>The financial statements should also disclose:</p> <ul style="list-style-type: none"> <li>❖ The existence and amounts of restrictions on title, and property, plant &amp; equipment pledged as security for liabilities;</li> <li>❖ The amount of expenditure recognised in carrying amount of an item of property, plant and equipment in the course of its construction;</li> <li>❖ The amount of contractual commitments for the acquisition of property, plant and equipment;</li> <li>❖ If it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant &amp; equipment that were impaired, lost or given up that is included in the statement of P&amp;L; and</li> <li>❖ The amount of assets retired from active use and held for disposal.</li> </ul>
<b>Disclosures related to Revalued Assets</b>	<p>If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed:</p> <ul style="list-style-type: none"> <li>❖ The effective date of the revaluation;</li> <li>❖ Whether an independent valuer was involved;</li> <li>❖ Methods &amp; significant assumptions applied in estimating fair values of item</li> <li>❖ The extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and</li> <li>❖ The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.</li> </ul>

No Dep.

## ASSIGNMENT QUESTIONS

**Question 1** *(RTP May 2018) / (ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

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 & will include a restaurant. Management is preparing the budgets for the year after store reopens, which include the cost of remodelling & the expectation of 15% increase in sales resulting from the store renovations, which will attract new customers. State whether 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** *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

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:

- a) Setup costs of ₹ 5,00,000 to install machinery in the new location.
  - b) Rent of ₹ 15,00,000
  - c) Removal costs of ₹3,00,000 to transport machinery from old location to 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 are in the nature of costs of relocating or reorganising operations of the company and do not meet the requirement of AS 10 and therefore cannot be capitalised.

**Question 3** *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

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

As per provisions of AS 10, any cost directly attributable to bring the assets to location and condition necessary for it to be capable of operating in the manner indicated by management are called directly attributable costs and would be included in the costs of an item of PPE. Management of Entity A should capitalize 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 construction and remodelling expenditure and thus the expenditure should be considered part of the asset.

However, if the cost of salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the supermarket was open, then 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. → P&L Not to be capitalised.

**Question 4 (ICAI Study Material)**

Pg no. \_\_\_\_\_

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 5 (ICAI Study Material) (Similar)**

Pg no. \_\_\_\_\_

With reference to AS-10 Revised, classify the items under the following heads:

**HEADS**

- (i) ✓ Purchase Price of Property, Plant and Equipment (PPE) — Purchase price (net of trade disc.) Non Refundable tax
- (ii) ✓ Directly attributable cost of PPE or
- (iii) ✗ Cost not included in determining the carrying amount of an item of PPE.

**ITEMS**

- (i) (1) Import duties and non-refundable purchase taxes.
- (ii) (2) Initial delivery and handling costs.
- (ii) (3) Costs of testing whether asset is functioning properly, after deducting the net proceeds
- (iii) (4) Initial operating losses, such as those incurred while demand for the output of an item builds up.
- (iii) (5) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.
- (i) (6) Trade discounts and rebates.
- (ii) (7) Costs of relocating or reorganizing part or all of the operations of an enterprise.
- (iv) (8) Installation and assembly costs.
- (ii) (9) Cost of site preparation
- (iii) (10) Administration and other general overhead costs.

**Solution**

	ITEMS	HEADS	ITEMS	HEADS
(i)	→	1, 6		
(ii)	→	2, 3, 8, 9		
(iii)	→	4, 5, 7, 10		

\*Considered that this cost of testing is after deducting net proceeds from selling any items produced while bringing asset to that location & condition otherwise if net proceeds are after fixing the asset to its location and condition (asset ready for use), it will be classified under category (iii) i.e. Cost not included in determining the carrying amount of an item of PPE.

**Question 6** (RTP May 2021)

Pg no. \_\_\_\_\_

You are required to give correct accounting treatment for the following in line with provisions of AS 10:

ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/ development of railway siding, road and bridge. Though ABC Ltd. incurs the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Can ABC Ltd. capitalize expenditure incurred on these items as property, plant and equipment (PPE)?

**Solution**

AS 10 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

- (a) it is probable that future economic benefits associated with item will flow to the entity; &  
(b) the cost of the item can be measured reliably.

Further, the standard provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. The cost of an item of property, plant and equipment comprise any costs 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.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalization of the said expenditure even though the company cannot restrict the access of others for using the assets individually.

It is apparent that the aforesaid expenditure is 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.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalized as a part of overall cost of the project.

From this, it can be concluded that, in the given case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalized as part of the items of property, plant and equipment of the refinery.

**Question 7** (RTP May 2019) (Similar) / (RTP Nov 2023) / (ICAI Study Material)

Pg no. \_\_\_\_\_

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

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

**Solution**

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

Cost of the plant (cost per supplier's invoice plus taxes)	25,00,000
Initial delivery and handling costs	2,00,000
Cost of site preparation	6,00,000
Consultant's fees	7,00,000
Estimated dismantling costs to be incurred after 7 years	3,00,000
	<b>43,00,000</b>

**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 8 (RTP May 2023) / (ICAI Study Material)**

Pg no. \_\_\_\_\_

Star Limited purchased machinery for 6,80,000 (inclusive of GST of 40,000). Input credit is available for entire amount of the GST paid.

The company incurred the following other expenses for installation.

	₹
Cost of preparation of site for installation	21,200
Total labour charges (200 out of total of 500 men hours worked, were spent for installation of the machinery)	56,000
Spare parts and tools consumed in installation	5,000
Total salary of supervisor (time spent for installation was 25% of the total time worked.)	26,000
Total technical expenses (1/10 relates to the plant installation)	34,000
Test run & experimental production charges	18,000
Consultancy charges to architect for plant set up	11,000
Depreciation on assets used for the installation	12,000

The machine was ready for use on 15-1-2022 but was used from 1-2-2022. Due to this delay further expenses of ₹ 8,900 were incurred.

Calculate the value at which the plant should be capitalized in the books of Star Limited.

**Question 9 (RTP Nov 2019) / (RTP Nov 2020) (Similar)**

Pg no. \_\_\_\_\_

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at ₹ 49,500 per month after adding 10% profit margin. The machine was purchased at ₹ 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. ₹ 55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site. Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shrishti Limited. Internally booked profits should be eliminated in arriving at the cost of machine.

$$\text{GST} = 63L \times \frac{5}{105} = 3L$$

CA NITIN GOEL

$$\text{Exp} = 110 \text{ Lakhs}$$

$$\text{Scrip} = 63 \text{ Lakhs (incl. 5\% GST)}$$

$$\downarrow$$

$$\text{Without GST} = 63L - 3L = 60L$$

AS 10

**Question 10** (ICAI Study Material)

Pg no. \_\_\_\_\_

Preet Ltd. intends to set up a steel plant, for which it has acquired a dilapidated factory having an area of 5,000 acres at a cost of ₹ 60,000 per acre. Preet Ltd. has incurred ₹ 1.10 crores on demolishing the old Factory Building thereon. A sum of ₹ 63,00,000 (including 5% GST thereon) was realized from the sale of material salvaged from the site. Preet Ltd. incurred Stamp Duty and Registration Charges of 7% of land value, paid legal and consultancy charges ₹ 8,00,000 for land acquisition and incurred ₹ 1,25,000 on title guarantee insurance. Compute the value of the land acquired.

**Solution**

Particulars	₹ (in Lakhs)
Purchase Price: 5,000 acres x ₹ 60,000 per acre	3,000.00
Stamp Duty and Registration Charges at 7% (3000 x 7%)	210.00
Legal and Consultancy Fees	8.00
Title Guarantee Insurance	1.25
Demolition Expenses (Net of Salvage Income) [₹ 110 lakhs (-) ₹ 60 lakhs (₹ 63 lakhs x 100/105)]	50.00
<b>Cost of Land</b> or 63L - (63L x 5/105)	<b>3,269.25</b>

**Question 11** (ICAI Study Material)

Pg no. \_\_\_\_\_

Entity A exchanges 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? (Consider that transaction has commercial substance)

**Solution**

In the given case, Plant & Machinery is valued at ₹ 25,00,000, which is assumed to be fair value in absence of information. Further, since fair value of land (asset given up) is not given, the transaction will be recorded at fair value of assets acquired of ₹ 45,00,000 (Cash 20,00,000 + Plant & Machinery 25,00,000). Since land of book value ₹ 10,00,000 is transferred in exchange of assets worth ₹ 45,00,000, a gain of ₹ 35,00,000 will be recognised in the books of Entity A.

ENTRY:

Plant & Mach. A/c - Dr 25L } → 45L  
 Cash A/c - Dr 20L }  
 To Land 10L (At carrying Amt)  
 To Profit (Obj.) 35L

**Question 12** (ICAI Study Material)

Pg no. \_\_\_\_\_

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?

Ignore Fair value in Ques.

**Solution**

Since the transactions lacks commercial substance, the entity recognizes the assets received at the book value of car X. Therefore, it recognizes cash of ₹ 15,000 and car Y as PPE with a carrying value of ₹ 12,85,000.

ENTRY:

Cash A/c - Dr 15000  
 Car Y A/c - Dr 1285000 (1300000 - 15000)  
 To Car X 1300000

**Question 13** - *(ICAI Study Material)* Pg no. \_\_\_\_\_

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 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**

*Sahi Kiya Mgt. ne.*

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.

However, all properties within the class of office buildings must be carried at revalued amount.

**Question 14** Pg no. \_\_\_\_\_

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?

**Question 15** *(RTP May 2020) / (ICAI Study Material)* Pg no. \_\_\_\_\_

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**

*No*

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. Thus, the policy of Entity A is not acceptable.

**Question 16** *(RTP May 2018)* Pg no. \_\_\_\_\_

In the year 2021-22, an entity has acquired a new freehold building with a useful life of 50 years for ₹ 90,00,000. 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	50,00,000
		<u>90,00,000</u>

*Depreciation*  
-  
40000  
25000  
50000  
100000  
215000

Calculate depreciation for the year 2021-22 as per componentization method

**Question 17 (ICAI Study Material)** Pg no. \_\_\_\_\_

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 18** Pg no. \_\_\_\_\_

A machinery with a useful life of 6 years was purchased on 1st April, 2019 for ₹ 1,50,000. Depreciation was provided on straight line method for first three years considering a residual value of 10% of cost.

In the beginning of fourth year the company reassessed the remaining useful life of the machinery at 4 years and residual value was estimated at 5% of original cost.

The accountant recalculated the revised depreciation historically and charged the difference to profit and loss account. You are required to comment on the treatment by accountant and calculate depreciation to be charged for the fourth year.

**Question 19** Pg no. \_\_\_\_\_

Argon Ltd. purchased a shop on 1st January, 2007 at a cost of ₹ 8,50,000. The useful life of the shop is estimated as 30 years with residual value of ₹ 25,000 and depreciation is provided on a straight line basis. The shop was revalued on 30th June, 2021 for ₹ 19,50,000 and the revaluation was incorporated in the accounts. Calculate:

- a) The surplus on revaluation;
- b) Depreciation to be charged in the Profit and Loss account for the year ended on 31st December, 2021.

**Question 20 (ICAI Study Material)** Pg no. \_\_\_\_\_

Skanda Ltd. acquired a machinery for ₹ 2,50,00,000 five years ago. Depreciation was charged at 10% p.a. on SLM basis, useful life being 10 years. At the beginning of Year 3 the machinery was revalued to ₹ 3,00,00,000 with the surplus on revaluation being credited to Revaluation Reserve. Depreciation was provided on the revalued amount over the balance useful life of 8 years. The machinery was sold in the current year for ₹ 1,12,50,000. Give the accounting treatment for the above in the Company's accounts. What will be the treatment if the machinery fetched only ₹ 42,50,000 now?

**Solution**

Particulars	₹
Original Cost of the Asset	2,50,00,000
Less: Depreciation for 2 years (₹ 2,50,00,000 x 10% x 2 years)	(50,00,000)
Book Value at the beginning of Year 3	2,00,00,000
Add: Revaluation Surplus (balancing figure)	1,00,00,000
Revalued Amount as given (= revised depreciable value)	3,00,00,000
Less: Depreciation for Years 3-5 (₹ 3,00,00,000 ÷ 8 yrs x 3 yrs)	(1,12,50,000)
Carrying Amount at the end of Year 5	1,87,50,000

Total = 10 yrs After 2 yrs Bal. & yrs-

Mech. Cr To RR

Dep. from 3rd year =  $\frac{3cr}{8} = 375000$  p.a.

The treatment of Gain / Loss on Disposal / Revaluation is as below:

Particulars	Disposal Proceeds = ₹ 1,12,50,000	Disposal Proceeds = ₹ 42,50,000
Book Value Less Disposal Proceeds = <u>Loss recognized in Profit or Loss</u>	₹ 1,87,50,000 - ₹ 1,12,50,000 = ₹ <u>75,00,000</u> (Loss)	₹ 1,87,50,000 - ₹ 42,50,000 = ₹ <u>1,45,00,000</u> (Loss)
Revaluation Surplus directly transferred to Retained Earnings ( <u>Revenue Reserve</u> )	✓ ₹ 1,00,00,000	✓ ₹ 1,00,00,000

**Question 21** (ICAI Study Material)

Pg no. \_\_\_\_\_

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?

loss of Mach: 2L (P/L) | P/L (loss) 2L To Mach. 2L (E) Mach. A/c Dr 20L To P/L (gain) 20L

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

**Question 22** (RTP Nov 2022)

Replacement of Parts

Pg no. \_\_\_\_\_

RS Ltd. has acquired a heavy plant at a cost of ₹ 2,00,00,000. The estimated useful life is 10 years. At the end of the 2nd year, one of the major components i.e. the Boiler has become obsolete (which was acquired at price of ₹ 50,00,000) and requires replacement, as further maintenance is uneconomical. The remainder of the plant is perfect and is expected to last for next 8 years. The cost of a new boiler is ₹ 60,00,000. Can the cost of the new boiler be recognised as an asset, and, if so, what should be the carrying value of the plant at the end of second year?

**Solution**

Recognition of Asset: The new boiler will produce economic benefits to RS Ltd., and the cost is measurable. Hence, the item should be recognized as an asset. The cost old boiler should be de-recognized and the new boiler will be added.

**Statement showing cost of new boiler and machine after year 2**

Particulars	₹
Original cost of plant	₹ 2,00,00,000
Less: Accumulated depreciation [(2,00,00,000 / 10) x 2]	₹ 40,00,000
Carrying value of the plant after two years	₹ 1,60,00,000
Less: Current Cost of Old Boiler to be derecognized	
WDV of Boiler (replaced) after 2 years (50,00,000/10 x 8)	40,00,000
	<u>1,20,00,000</u>
Add: Cost of new Boiler to be recognized	60,00,000
Revised carrying amount of Plant	1,80,00,000

Replacement of Parts

**Question 23** (ICAI Study Material) / (RTP Jan 2025) (Similar) Pg no. \_\_\_\_\_

Bharat Infrastructure Ltd. acquired a heavy machinery at a cost of ₹ 1,000 lakhs, the breakdown of its components is not provided. The estimated useful life of the machinery is 10 years. At the end of Year 6, the turbine, which is a major component of the machinery, needed replacement, as further usage and maintenance was uneconomical. The remainder of the machine is in good condition and is expected to last for the remaining 4 years. The cost of the new turbine is ₹ 450 lakhs. Give the accounting treatment for the new turbine, assuming SLM Depreciation and a discount rate of 8%.

**Solution**

As per AS 10, Property, Plant and Equipment, the derecognition of the carrying amount of components of an item of Property, Plant and Equipment occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, 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.

In the given case, the new turbine will produce economic benefits to Bharat Infrastructure Ltd. and the cost is measurable. Since the recognition criteria is fulfilled, the same should be recognised as a separate item of Property, Plant and Equipment.

However, since the initial breakup of the components is not available, the cost of the replacement of ₹ 450 lakhs can be used as an indication based on the guidance given above, discounted at 8% for the 6-year period lapsed.

Thus, estimate of cost 6 years back = ₹ 450 lakhs ÷ 1.08<sup>6</sup> = ₹ 283.58 lakhs

Current carrying amount of turbine (to be de-recognised) =

Estimated cost ₹ 283.58 lakhs (-) SLM depreciation at 10% (useful life 10 years) for 6 years  
₹ 170.15 lakhs = ₹ 113.43 lakhs.

Hence revised carrying amount of the machinery will be as under:

Particulars	₹ in lakhs
Historical Cost [₹ 1,000 lakhs (-) SLM Dep. at 10% for 6 years]	400.00
Add: Cost of new turbine	450.00
Less: Derecognition of current carrying amount of old turbine	(113.43)
<b>New Carrying Amount of Machinery</b>	<b>736.57</b>

**Question 24** (ICAI Study Material) Pg no. \_\_\_\_\_

Akshar Ltd. installed a new Plant (not a qualifying asset), at its production facility, and incurred the following costs:

- Cost of the Plant (as per supplier's invoice): ₹ 30,00,000 ✓ (5L)
- Initial delivery and handling costs: ₹ 1,00,000 ✓
- Cost of site preparation: ₹ 2,00,000 ✓
- Consultant fee for advice on acquisition of Plant: ₹ 50,000 ✓
- Interest charges paid to supplier against deferred credit: ₹ 1,00,000 ✗
- Estimate of Dismantling and Site Restoration costs: ₹ 50,000 after 10 years (Present Value is ₹ 30,000) ✓
- Operating losses before commercial production: ₹ 40,000 ✗

The company identified motors installed in the Plant as a separate component and a cost of ₹ 5,00,000 (Purchase Price) and other costs were allocated to them proportionately. The company estimates the useful life of the Plant and those of the Motors as 10 years and 6 years respectively and SLM method of Depreciation is used.

At the end of Year 4, the company replaces the Motors installed in the Plant at a cost of ₹ 6,00,000 and estimated the useful life of new motors to be 5 years. Also, the company revalued its entire class of Fixed Assets at the end of Year 4. The revalued amount of Plant as a whole is ₹ 25,00,000. At the end of Year 8, the company decides to retire the Plant from active use and also disposed the Plant as a whole for ₹ 6,00,000.

There is no change in the Dismantling and Site Restoration liability during the period of use. You are required to explain how the above transaction would be accounted in accordance with AS 10.

### Solution

#### Cost at Initial Recognition:

Particulars	₹
Cost of the Plant (as per Invoice)	30,00,000
Initial Delivery and Handling Costs	1,00,000
Cost of Site Preparation	2,00,000
Consultants' Fees	50,000
Estimated Dismantling and Site Restoration Costs	30,000
<b>Total Cost of Plant including Motors</b>	<b>33,80,000</b>
Less: Cost of Motors identified as a separate component (1/6)*	(5,63,333)
<b>Cost of the Plant (excluding Motors - balance 5/6)</b>	<b>28,16,667</b>

\* Purchase price of Motors = ₹ 5,00,000 out of ₹ 30,00,000 i.e., 1/6 of value of Plant

**Note:** Since the asset is not a qualifying asset, payment of interest to the supplier is not capitalized. Further, operating losses of ₹ 40,000 incurred before commercial production is not a directly attributable cost, and hence excluded from cost of asset. These costs are expensed to the P/L as and when they are incurred.

#### 1) Recognition of Motors Replacement

Particulars	₹
Cost of Motors determined above	5,63,333
Less: Depreciation for 4 years (as per SLM)	3,75,555
5,63,333 ÷ 6 years x 4 years	
<b>Carrying Amount of Motors at the end of Year 4</b>	<b>1,87,778</b>

**Accounting:** The company should derecognize the existing Carrying Amount of Motors replaced of ₹ 1,87,778. Further, the acquisition cost of new motors of ₹ 6,00,000 would be capitalized as a separate component. This amount will be depreciated over the next 5 years at ₹ 6,00,000 ÷ 5 years = ₹ 1,20,000 p.a.

#### 2) Revaluation

Particulars	₹
Cost of the Plant at initial recognition [from (1) above]	28,16,667
Less: SLM Depreciation for 4 years: ₹ 28,16,667 ÷ 10 years x 4 years	(11,26,667)
Carrying Amount of Plant at the end of Year 4	16,90,000
Revalued Amount of Plant (Excluding Motors, since the same is treated as a separate component: ₹ 25,00,000 - ₹ 6,00,000)	19,00,000
<b>Therefore, Gain on Revaluation credited to Revaluation Reserve</b>	<b>2,10,000</b>
<b>Revised Depreciation Charge p.a.: 19,00,000 ÷ 6 years</b>	<b>3,16,667</b>

**3) Derecognition**

Particulars	Motors	Plant (excluding Motors)
Cost / Revalued Amount at end of Year 4	6,00,000	19,00,000
Less: Depreciation for Years 5-8	1,20,000 x 4 = 4,80,000	3,16,667 x 4 =12,66,668
Carrying Amount before Disposal / De- recognition	1,20,000	6,33,332
Less: Disposal Proceeds ₹ 6,00,000 allocated in ratio of carrying amount	95,575	5,04,425
<b>Loss to be written off to P/L</b>	<b>24,425</b>	<b>1,28,907</b>

**Notes:**

- The Revaluation Surplus of ₹ 2,10,000 would be transferred directly to Retained Earnings.
- The allocation of disposal proceeds of ₹ 6,00,000 for the plant as whole is apportioned based on carrying amount of motors and plant (excluding motors)

Alternatively, it may be apportioned as 1/6 towards motors and 5/6 plant (excluding motors) based on the reasoning that the initially, motors amounted to 1/6 of the entire plant. This approach may not be preferable because there has been a revaluation of the plant (excluding motors) and a disposal and subsequent acquisition of the Motor, which is not in the initial proportion of 5/6 and 1/6 respectively.

**PRACTICE QUESTIONS****Question 1** *(Inter Nov 2018) (5 Marks)*

Pg no. \_\_\_\_\_

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new-restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed. Management has prepared the following budget for this period –

Salaries of the staff engaged in preparation of restaurant before its opening ₹ 7,50,000  
Construction and remodelling cost of restaurant ₹ 30,00,000. Explain the treatment of these expenditures as per provisions of AS 10 "Property, Plant and Equipment".

**Solution**

As per provisions of AS 10, any cost directly attributable to bring the assets to the location and conditions necessary for it to be capable of operating in the manner indicated by the management are called directly attributable costs and would be included in the costs of an item of PPE.

Management of Neon Enterprise should capitalize the costs of construction and remodelling the restaurant, because they are necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management. The restaurant cannot be opened without incurring the construction and remodelling expenditure amounting ₹ 30,00,000 and thus the expenditure should be considered part of the asset.

However, the cost of salaries of staff engaged in preparation of restaurant ₹ 7,50,000 before its opening are in the nature of operating expenditure that would be incurred if the restaurant was open and these costs are not necessary to bring the restaurant to the conditions necessary for it to be capable of operating in the manner intended by management. Hence, ₹ 7,50,000 should be expensed.

**Question 2** *(RTP May 2021)*

Pg no. \_\_\_\_\_

You are required to give correct accounting treatment for the following in line with provisions of AS 10: Trozen Ltd. operates a major chain of supermarkets all over India. It acquires a new store in Pune which requires significant renovation expenditure. It is expected that the renovations will be done in 2 months during which the store will be closed. The budget for this period, including expenditure related to construction and remodelling costs (₹ 18 lakhs), salaries of staff (₹ 2 lakhs) who will be preparing the store before its opening and related utilities costs (₹ 1.5 lakhs), is prepared. The cost of salaries of the staff and utilities are operating expenditures that would be incurred even after the opening of the supermarket. What will the treatment of all these expenditures in the books of accounts?

**Solution**

Trozen Ltd. should capitalize 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. The supermarket cannot be opened without incurring the remodelling expenditure. Therefore, this construction and remodelling expenditure of ₹ 18 lakh should be considered as part of the cost of the asset. However, the cost of salaries of the staff ₹ 2 lakh and utilities cost ₹ 1.5 lakh are operating expenditures that would be incurred even after the opening of the supermarket. Therefore, 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 the management and should be expensed.

**Question 3** *(RTP May 2020)*

Pg no. \_\_\_\_\_

The following items are given to you:

**ITEMS**

- (1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment);
- (2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training);
- (3) Costs of opening a new facility or business, such as, inauguration costs;
- (4) Purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

With reference to AS 10 "PPE", classify the items under the following heads:

- (i) Purchase Price of PPE
- (ii) Directly attributable cost of PPE or
- (iii) Cost not included in determining the carrying amount of an item of PPE.

**Solution**

- (1) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment) will be classified as "Directly attributable cost of PPE".
- (2) Costs of conducting business in a new location or with a new class of customer (including costs of staff training) will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.
- (3) Costs of opening a new facility or business, such as, inauguration costs will be classified under head (iii) as it will not be included in determining the carrying amount of an item of PPE.
- (4) Purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates will be included in determination of Purchase Price of PPE.

**Question 4** *(RTP May 2022)*

Pg no. \_\_\_\_\_

A Ltd. has incurred the following costs. Determine if the following costs can be added to the invoiced purchase price and included in the initial recognition of the cost of the item of property, plant and equipment:

1. Import duties paid
2. Shipping costs and cost of road transport for taking the machinery to factory
3. Insurance for the shipping
4. Inauguration costs for the factory
5. Professional fees charged by consulting engineer for the installation process
6. Costs of advertising and promotional activities
7. Administration and other general overhead costs
8. Cost of site preparation.

**Solution**

**Included in Cost:** Point no. 1,2,3,5,8

**Excluded from Cost:** Point no. 4,6,7

**Question 5** *(RTP Nov 2018)*

Pg no. \_\_\_\_\_

ABC Ltd. is installing new plant at its production factory. It provides you following information:

Cost of the plant (cost per supplier's invoice plus taxes)	31,25,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Initial Operating losses before commercial production	3,75,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants used for advice on the acquisition of the plant	6,50,000

Please advise ABC Ltd. on the costs that can be capitalised for plant in accordance with AS 10: Property, Plant and Equipment.

### Solution

As per AS 10 'Property, Plant and Equipment', the costs to be capitalized by ABC Ltd. are:

Cost of the plant (cost per supplier's invoice plus taxes)	31,25,000
Estimated dismantling costs to be incurred after 5 years	2,50,000
Initial delivery and handling costs	1,85,000
Cost of site preparation	4,50,000
Consultants used for advice on the acquisition of the plant	6,50,000
	<b>46,60,000</b>

**Note:** Operating losses before commercial production amounting to ₹ 3,75,000 will not be capitalized as per AS 10. They should be written off to the Statement of Profit and Loss in the period they are incurred.

### Question 6 (RTP Nov 2020) / (ICAI Study Material) Pg no. \_\_\_\_\_

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month.

The machine was purchased at ₹ 1,58,00,000 and ₹ 50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.

You are required to ascertain the amount at which the Machinery should be capitalized.

### Solution

Particulars		Amount
Purchase Price	Given	1,58,00,000
Add: Site Preparation Cost	Given	1,40,000
Technician's Salary	Specific/Attributable overheads for 3 months (45,000 x3)	1,35,000
Initial Delivery Cost	Transportation	50,000
Professional Fees for Installation	Architect's Fees	30,000
<b>Total Cost of Asset</b>		<b>1,61,55,000</b>

### Question 7 (Inter July 2021) (5 Marks) Pg no. \_\_\_\_\_

- (i) A Limited has contracted with a supplier to purchase machinery which is to be installed at its new plant in four months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 2,10,000. These activities were supervised by an Architect during the entire period, who is employed for this purpose at a salary of ₹ 35,000 per month. The machinery was purchased for ₹ 1,27,50,000 and a sum of ₹ 2,12,500 was incurred towards transportation charges to bring the machinery to the plant site. An

Engineer was appointed at a fees of ₹ 37,500 to supervise the installation of the machinery at the plant site. You are required to ascertain the amount at which the machinery should be capitalized in the books of A Limited.

- (ii) B Limited, which operates a major chain of retail stores, has acquired a new store location. The new location requires substantial renovation expenditure. Management expects that the renovation will last for 4 months during which the store will be closed. Management has prepared the budget for this period including expenditure related to construction and re-modelling costs, salary of staff who shall be preparing the store before its opening and related utilities cost. How would such expenditure be treated in the books of B Limited?

### Solution

- (i) Showing the Computation of the amount at which the Machinery should be capitalized in the books of A Limited

Particulars		Amount (₹)
Purchase cost of machinery	Given	1,27,50,000
Add: Site Preparation Cost	Given	2,10,000
Architect's Salary	Specific/ Attributable overheads for 4 months (₹ 35,000 x 4)	1,40,000
Initial Delivery Cost	Transportation	2,12,500
Professional Fees for Installation	Engineer's Fees	37,500
<b>Total Cost of Machinery to be capitalized</b>		<b>1,33,50,000</b>

- (ii) Management should capitalize the costs of construction and remodelling the store, 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 store cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset. However, if the cost of salaries, utilities and storage of goods are in the nature of operating expenditure that would be incurred if the store was open, then 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 8 (ICAI Study Material) Pg no. \_\_\_\_\_

Entity B constructs a machine for its own use. Construction is completed on 1st November 2021 but the company does not begin using the machine until 1st March 2022. Comment

### Solution

The entity should begin charging depreciation from the date the machine is ready for use – that is, 1st November 2021. 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 9 Pg no. \_\_\_\_\_

In the year 2021-22, an entity has acquired a new freehold building with a useful life of 25 years for ₹ 45,00,000. 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	10,00,000
Roof	25	5,00,000

Lifts	10	2,50,000
Fixtures	5	2,50,000
Remainder of building	25	25,00,000
		<b>45,00,000</b>

- (i) Calculate depreciation for the year 2021-22 as per componentization method.  
(ii) Also state the treatment, in case Roof requires replacement at the end of its useful life.

### Solution

- (i) Statement showing amount of depreciation as per Componentization Method

Component	Depreciation = Cost / Useful life	Depreciation (p.a.)
Land	-	Nil
Roof	5,00,000/25	20,000
Lifts	2,50,000/10	25,000
Fixtures	2,50,000/5	50,000
Remainder of building	25,00,000/25	1,00,000
		<b>1,95,000</b>

- (ii) 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 10 (ICAI Study Material) / (RTP Nov 2021) (Similar) Pg no. \_\_\_\_\_

A property costing ₹ 10,00,000 is bought in 2021. 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 2021 prices, is:

Case (a) ₹ 10,00,000 Case (b) ₹ 9,00,000

Calculate the amount of depreciation.

### Solution

#### Case (a)

The company considers that residual value, based on prices prevailing at the balance sheet date, will equal the cost. There is, therefore, no depreciable amount and depreciation is 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 11 (RTP May 2020) / (ICAI Study Material) Pg no. \_\_\_\_\_

Entity A purchased an asset on 1st January 2018 for ₹ 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 2022, the directors review the estimated life and decide that the asset will probably be useful for a further 4 years. Calculate amount of depreciation for each year, if company charges depreciation on Straight Line basis.

### Solution

The entity has charged depreciation using the SLM at ₹ 10,000 p.a. i.e (1,00,000/10 years).

On 1st January 2022, the asset's net book value is [1,00,000 - (10,000 x 4)] ₹ 60,000.

Remaining useful life is 4 years. The company should amend annual provision for depreciation to charge the unamortised cost over the revised remaining life of 4 years. Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000 / 4 years).

**Question 12** (ICAI Study Material) Pg no. \_\_\_\_\_

Arka Ltd. purchased machinery for ₹ 3,000 lakhs. Depreciation was charged at 10% on SLM basis for a useful life of 10 years. At the end of Year 4, the machinery was revalued to ₹ 2,700 lakhs and the same was adopted. What will be the carrying amount of the asset at the end of Year 5 and Year 6? Assume no change in the useful life.

**Solution**

Particulars	₹ in lakhs
Original Cost of the Asset	3,000.00
Less: Depreciation for 4 years (₹ 3,000 lakhs x 10% x 4 years)	(1,200.00)
Book Value at the end of Year 4	1,800.00
Add: Revaluation Surplus (balancing figure)	900.00
Revalued Amount as given (= revised depreciable value)	2,700.00
Less: Depreciation for Year 5 (₹ 2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 5	2,250.00
Less: Depreciation for Year 6 (₹ 2,700 lakhs ÷ 6 years)	450.00
Carrying Amount at the end of Year 6	1,800.00

**Question 13** Pg no. \_\_\_\_\_

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.?

**Solution**

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 14** (Inter Nov 2020) (5 Marks) Pg no. \_\_\_\_\_

A Ltd. had following assets. Calculate depreciation for the year ended 31st March, 2022 for each asset as per AS 10 (Revised):

- Machinery purchased for ₹ 10 lakhs on 1st April, 2017 and residual value after useful life of 5 years, based on 2017 prices is ₹ 10 lakhs.
- Land for ₹ 50 lakhs.
- Machinery is constructed for ₹ 5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2021, but the company does not begin using the machine until 31st March, 2022.
- Machinery purchased on 1st April, 2019 for ₹ 50,000 with useful life of 5 years & residual value is Nil. On 1st April, 2021, management decided to use this asset for further 2 years only

**Solution****Computation of Amount of Depreciation as per AS 10**

		Amount
(i)	Machinery purchased on 1/4/17 for ₹ 10 lakhs (having residual value of ₹ 10 lakhs) <b>Reason:</b> The company considers that residual value, based on prices prevailing at the balance sheet date, will equal the cost. Therefore, there is no depreciable amount and depreciation is correctly zero.	Nil
(ii)	Land (50 lakhs) (considered freehold) <b>Reason:</b> Land has an unlimited useful life and therefore, it is not depreciated.	Nil
(iii)	Machinery constructed for own use (₹ 5,00,000/10) <b>Reason:</b> The entity should begin charging depreciation from the date the machine is ready for use i.e. 1st April, 2021. 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.	50,000
(iv)	Machinery having revised useful life <b>Reason:</b> The entity has charged depreciation using the SLM at 10,000 p.a. i.e. (50,000/5 years). On 1 <sup>st</sup> April, 2021 the asset's net book value is [50,000 - (10,000 x 2)] i.e. ₹ 30,000. The remaining useful life is 2 years as per revised estimate. The company should amend annual provision for depreciation to charge unamortized cost over revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years).	15,000

**Question 15 (Inter May 2022) (5 Marks)**

Pg no. \_\_\_\_\_

XYZ Limited provided you the following information for the year ended 31<sup>st</sup> March, 2022.

- (i) The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciation ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance in the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000. You are required to calculate revaluation loss as per AS 10 and give its treatment in the books of accounts.
- (ii) An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash. You are required to explain how the disposal should be accounted for in the financial statements as per AS 10 (Revised).

**Solution**

- (i) As per AS 10, a decrease in the carrying amount of an asset arising on revaluation should be charged to the statement of profit and loss. However, the decrease should be debited directly to owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

**Calculation of revaluation loss and its accounting treatment**

		₹
Carrying value of the asset as on 31st March, 2022	a	2,16,000
Revalued amount of the asset	b	(1,90,000)
Total revaluation loss on asset	c=a-b	26,000
Adjustment of previous revaluation reserve	d	(20,000)
Net revaluation loss to be charged to the Profit & loss account	e=c-d	6,000

- (ii) AS 10 states that the carrying amount of an item of property, plant and equipment is derecognized on disposal of the asset. It further states that the gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognized. Gains should also not be classified as revenue.

**Calculation of loss on disposal of the asset and its accounting treatment**

		₹
Original cost of the asset	a	76,000
Accumulated depreciation till date	b	62,000
Carrying value of the asset as on 31st March, 2022	c=a-b	14,000
Cash received on disposal of the asset	d	4,000
Loss on disposal of asset charged to the Profit and loss account	e=c-d	10,000

**Question 16** (Inter May 2023) (5 Marks)

Pg no. \_\_\_\_\_

In the books of Topmaker Limited, carrying amount of Plant and Machinery as on 1<sup>st</sup> April, 2022 is ₹ 56,30,000.

On scrutiny, it was found that a purchase of Machinery worth ₹ 21,12,000 was included in the purchase of goods on 1<sup>st</sup> June, 2022. On 30<sup>th</sup> June, 2022 the company disposed a Machine having book value of ₹ 9,60,000 (as on 1<sup>st</sup> April, 2022) for ₹ 8,25,000 in part exchange of a new machine costing ₹ 15,65,000.

The company charges depreciation @ 10% p.a. on written down value method on Plant and Machinery.

You are required to compute:

- Depreciation to be charged to Profit & Loss Account.
- Book value of Plant & Machinery as on 31<sup>st</sup> March, 2023; and
- Profit/Loss on exchange of Plant & Machinery.

**Solution**

**(i) Depreciation to be charged in the Profit & Loss Account**

Particulars	Amount in ₹
Depreciation on old Machinery	1,40,750
[10% on ₹ 56,30,000 for 3 months (01.04.2022 to 30.06.2022)]	
Add: Depreciation on Machinery acquired on 01.06.2022	1,76,000
(₹21,12,000 X 10% X10/12)	
Add: Depreciation on Machinery after adjustment of Exchange	4,67,625
[10% of ₹ 56,30,000 - 9,60,000 + 15,65,000) for 9 months]	
Total Depreciation to be charged in Profit & Loss A/c	7,84,375

**(ii) Book value of Plant & Machinery as on 31.3.2023**

Particulars	Amount in ₹
Balance as per books on 01.04.2022	56,30,000
Add: Included in purchases on 01.06.2022	21,12,000
Add: Purchases on 30.06.2022	15,65,000
	93,07,000
Less: Book value of Machine sold on 30.06.2022	(9,60,000)
	83,47,000
Less: Depreciation on Machinery in use ₹ (7,84,375 -24,000)	(7,60,375)
Book Value as on 31.03.2023	75,86,625

**Note:** The computation of depreciation and book value of Plant & Machinery can be presented in the following alternative manner:

Particulars	Book Value or Cost or Acquisition	Period	Depreciation	Book Value as on 31.03.2023
Opening Value	46,70,000 (56,30,000 – 9,60,000)	01.04.2022 to 31.03.2023	4,67,000 (46,70,000 × 10%)	42,03,000
Sold	9,60,000	01.04.2022 to 30.06.2022	24,000 (9,60,000 × 10% × 3/12)	-
Purchases	21,12,000	01.06.2022 to 31.03.2023	1,76,000 (21,12,000 × 10% × 10/12)	19,36,000
New Machinery	15,65,000	01.07.2022 to 31.03.2023	1,17,375 (15,65,000 × 10% × 9/12)	14,47,625
<b>Total</b>			<b>7,84,375</b>	<b>75,86,625</b>

**(iii) Profit/Loss on Exchange of Machinery**

Particulars	Amount in ₹
Balance as per books on 01.04.2022	9,60,000
Less: Depreciation for 3 months (₹ 9,60,000 × 10 /100 × 3 / 12)	(24,000)
W.D.V. as on 30.06.2022	9,36,000
Less: Exchange value	(8,25,000)
Loss on Exchange of Machinery	1,11,000

**Question 17** *(ICAI Study Material)* Pg no. \_\_\_\_\_

A company changed its method of depreciation from SLM to WDV. How should the change be recognised?

**Solution**

As per AS 10, Property, Plant and Equipment, 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.

Accordingly, the change in method of depreciation should be accounting for as a change in accounting estimate, prospectively.

**Question 18** *(ICAI Study Material)* Pg no. \_\_\_\_\_

A company has debited the Building Account with the Cost of the Land on which the building stands & has provided depreciation on such total cost. Comment on the accounting treatment.

**Solution**

As per AS 10, Property, Plant and Equipment, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately. Further, Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets.

In the given case, land should not be depreciated unless it has a limited useful life. Accordingly, it is incorrect to debit the cost of land to the Building Account and provide depreciation on the aggregate cost.

**Question 19** *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

An entity is setting up a manufacturing plant. Construction of the plant is completed in August and the plant is ready for commercial production in November. However, the entity commences production in March. When should the company start charging depreciation.

**Solution**

As per AS 10, Property, Plant and Equipment, depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. In the given case, since the plant is ready for commercial production in November, depreciation shall commence from November. The date of commencement of commercial production is irrelevant for charging depreciation.

**Question 20** *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

Which factors should be considered by a company while determining useful life?

**Solution**

All the following factors are considered in determining the useful life of an asset:

- (a) expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.
- (b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.
- (c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.
- (d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

**Question 21** *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

An entity gave the following Note in its Financial Statements:

'The company chooses not to charge depreciation on Property, Plant and Equipment on account of:

- (a) Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery.
- (b) Depreciation being a non-cash expense has no impact on cash flows. Accordingly, it is not necessary to depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.
- (c) The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.
- (d) At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.'

You are required to state the appropriateness of the above accounting policy in line with the relevant Accounting Standards.

**Solution**

Depreciation refers to writing off the value of the asset over its useful life. Such write-off is necessitated on account of normal wear-and-tear, usage, or obsolescence. Since items of Property, Plant and Equipment are generally used in generating revenue, the pro-rated write-off in value of such item should be recorded in the books against the income earned by such an asset.

Providing depreciation is mandatory, in spite of the fact that repairs are expensed in the Statement of Profit and Loss, or the value of the Property is appreciating. Depreciation is a systematic allocation of cost of the asset against the income generated from the continued use of the asset. Further, the Companies Act, 2013 mandates depreciation to be charged in order to determine the correct profits. Thus, not charging depreciation would result in non-compliance with the Companies Act provisions as well.

The argument laid down by the company and the reasons for the same being invalid are discussed below.

- (a) Annual Maintenance Contracts being expensed thereby ensuring timely repairs of Plant and Machinery:

The fact that the company enters into Annual Maintenance Contracts for timely repairs can be regarded as a running cost. Such expense is incurred in order to ensure that the machine continues to run as intended. Thus, it implies that because the machine is being utilized, it will need regular repairs. In other words, continuous use is resulting in normal wear-and-tear which is the reason why depreciation should be charged by the company. By stating that the company incurs Annual Maintenance Expenses, the company is recording only the 'maintenance expenses', but not the wear-and-tear requiring the maintenance in the first place. Hence, this argument put forth by the company is not valid.

- (b) Depreciation being a non-cash expense has no impact on cash flows. Accordingly, it is not necessary to depreciate an asset when repairs and maintenance charges are expensed in the Statement of Profit and Loss.

When viewed from the prism of depreciation alone, it appears that the fact that depreciation is a non-cash item is correct. However, it must be noted that at the time of procurement of the asset, the company would have paid cash. Depreciation is after all writing off this amount over the life of the asset. Hence the argument that depreciation is a non-cash item is not valid. Depreciation is writing off the cost of the asset (which was already paid for) over the useful life of asset, and hence is mandatory.

- (c) The values of certain assets like Property increase with passage of time, and hence charging depreciation does not make sense.

Certain assets like immovable property do increase in value with the passage of time. However, such assets are 'used for the purposes of business' and are not 'held for sale' or held as investment property. Accordingly, since the asset is being used for carrying on business, providing depreciation will give a true and fair view of the results of the company, and hence the argument that the value of property appreciates is not valid.

If the company wants to show the fair market value of the PPE, then it has the option to apply Revaluation model. However, depreciation is mandatory to be charged in Revaluation model also.

- (d) At the end of the useful life, the asset is ultimately sold, and since the asset is at cost due to no depreciation, exact profit or loss on sale of the asset is stated.'

The value of any asset, after usage, will reduce. Accordingly, the argument that the 'exact profit or loss on sale of the asset' will be obtained is incorrect. Due to usage of the asset,

the value of the asset would be lower than the cost. Charging depreciation would seek to bring the book value approximating to such reduced value. Thereafter, on sale of the asset, the true profit or loss would be available. Accordingly, this argument is also invalid. It may be pertinent to note that Accounting Standard 1, Disclosure of Accounting Policies states that Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts. In other words, the company cannot be absolved of the fact that it has not complied with the relevant accounting standards merely by giving a disclosure of incorrect policies or practices being followed.

Thus, the company's stand of disclosing the incorrect policy as a remedy is not correct. The company is suggested to charge depreciation on a systematic basis over the useful life of the asset thereby complying with the Accounting Standards.

**Question 22** *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

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?

**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 23** *(ICAI Study Material)* \_\_\_\_\_ Pg no. \_\_\_\_\_

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.