

Asset Recognition & Measurement

AS -6 , 10, 16, 19, 26, 28

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INTANGIBLE ASSETS

AS – 26

DEFINITIONS OF KEY TERMS

- **Intangible asset.** An identifiable, non-monetary asset without physical substance.
- **Asset:** a resource controlled by an entity as a result of past events and from which FEB are expected to flow to the entity
- **Useful life.** The period over which an asset is expected to be utilized, or the number of production units expected to be obtained from the use of the asset.

Identifiability

An asset is identifiable if it either:

- (a) is ***separable*** i.e is capable of being separated from the entity and ***sold, transferred, licensed, or rented*** either individually or in combination with a related contract, asset, or liability, regardless of whether entity intends to do so ; *or*
- (b) ***Arises from contractual or other legal rights***, regardless of whether those rights are transferable or separable from the entity or other rights or obligations.

Recognition of Intangible Assets

(A) Intangible Assets

Identifiable

Non- Monetary Asset

Without Physical
Substance

Entity Controls the
Asset

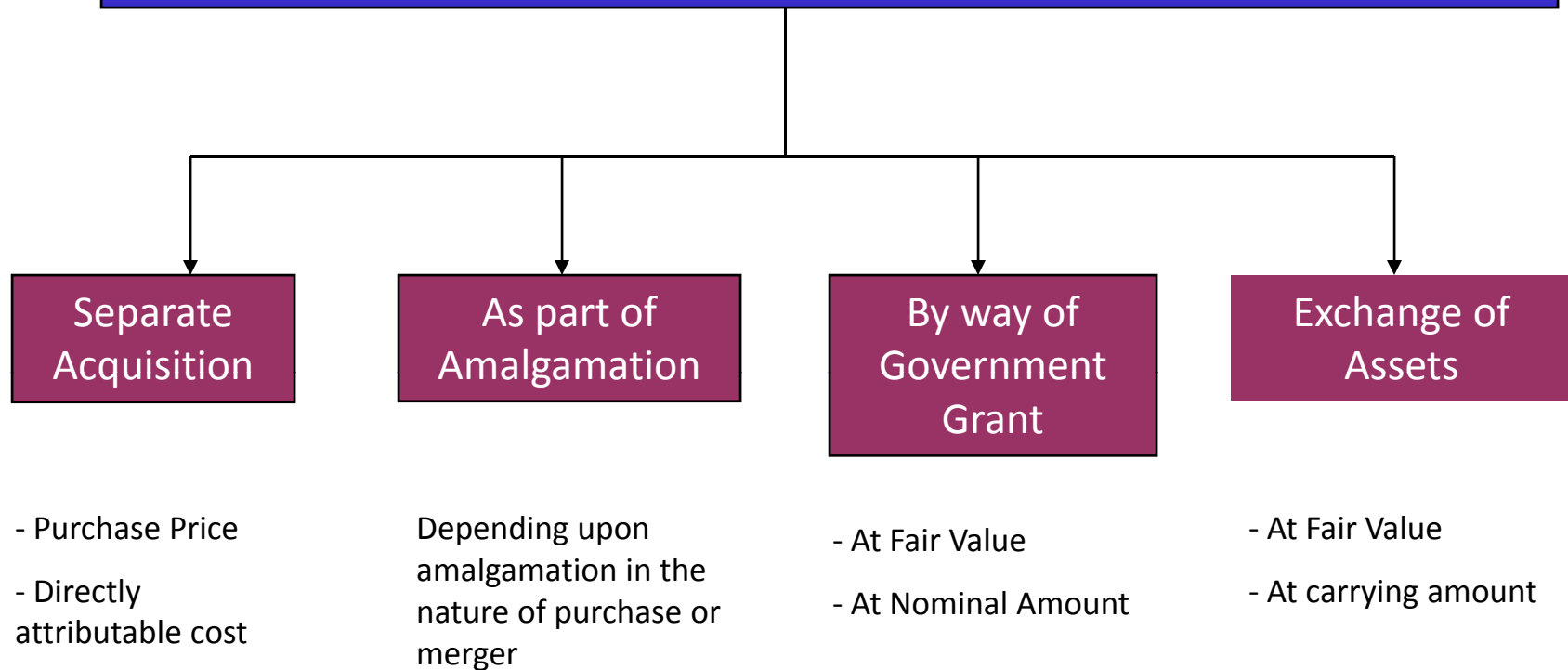
FEB expected to flow to
the entity

(B) Recognition Criteria

FEB flow to the entity –
Probable

Cost Measurable

Acquisition of Intangible Assets



Subsequent expenditure - whether intangible asset?

Internally Generated Intangible Assets

- Internally Generated Goodwill
- internally generated brands, mastheads, publishing titles, customer lists, and similar items, and expenditure thereon

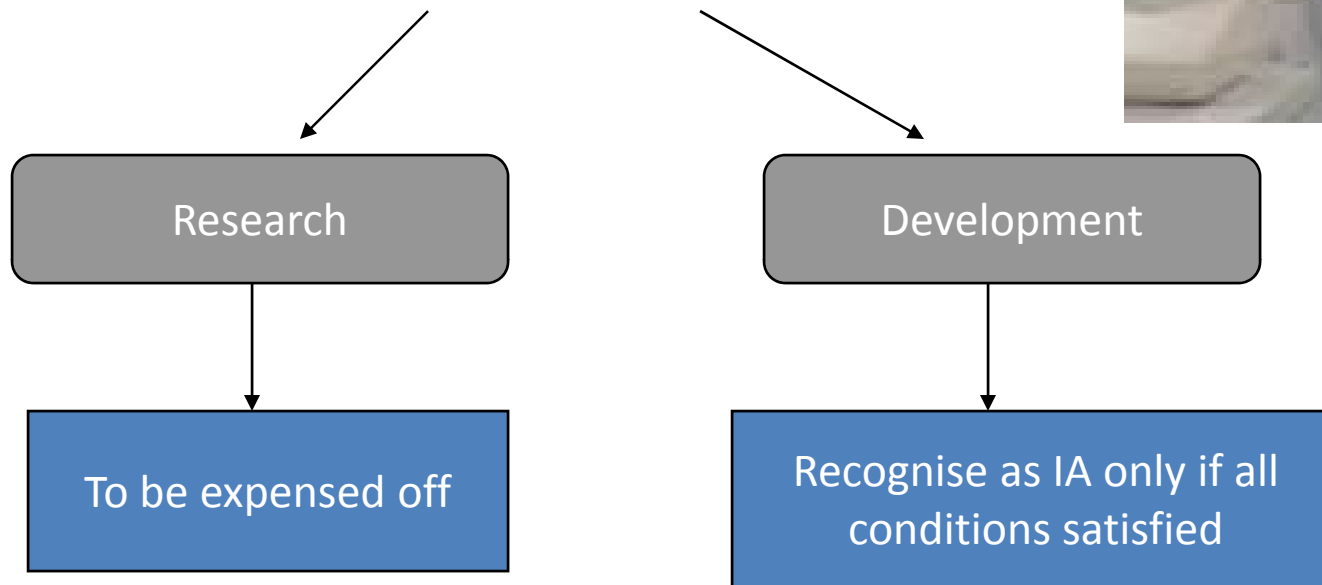
Research and Development Exp.

Definition

Research: Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development: The application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems, or services before the start of commercial production or use.

Research and Development Exp.



If above can not be segregated then consider entire expenses as Research

Research and Development Exp.

- Development expenditure may be recognized as an intangible asset when, and only when, **ALL** of the following can be demonstrated:
 - ✓ The technical feasibility of completing the asset so that it will be available for use or sale
 - ✓ The intention to complete the asset and use or sell it
 - ✓ The ability to use or sell the asset
 - ✓ How the asset will generate probable future economic benefit, including demonstrating a market for the asset's output, or for the asset itself, or the asset's usefulness
 - ✓ The availability of sufficient technical, financial, and other resources to complete the development and to use or sell the asset
 - ✓ The ability to reliably measure the expenditure attributable to the asset during its development

Amortisation of Intangible Assets

- Amortise over the best estimated useful life of the asset.
- Rebuttable presumption is that useful life can not exceed more than 10 years.
- Persuasive evidence required to justify useful life of more than 10 years.
- Amortisation period of more than 10 years requires:
 - Annual impairment review
 - Disclosure for reasons for rebuttable presumption and factors for determining useful life.

Fixed Assets

AS – 10



Recognition Principle

- To be recognised if
 - It is probable that FEB associated with the item will flow to the entity
 - Reliable measurement of the cost of the item
- Safety/Environmental Equipments

Quick Check?

- Installation or erection charges?
- Testing cost ?
- Administration and general overheads ?
- Initial operating loss while demand for item's output builds up ?
- Sale of samples during trial run ?
- Cost of relocating or re-organising ?

Derecognition

- To be derecognised
 - On disposal or
 - When no FEBs are expected from its use
- Gain or loss on de-recognition to be recognised in Income Statement
- Gain not to be classified as revenue

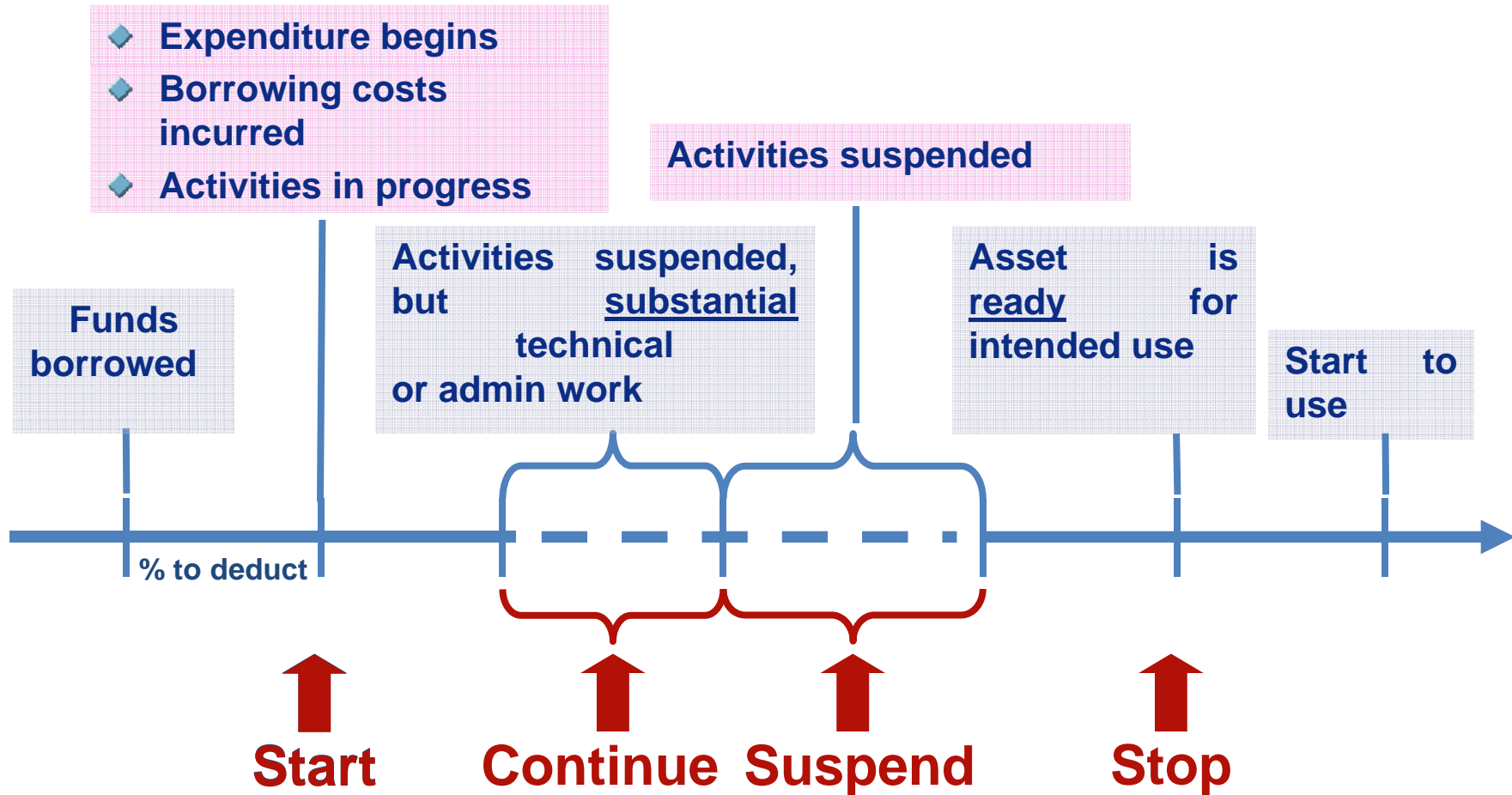
Borrowing Costs eligible for capitalisation

- Qualifying Assets
 - An asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Borrowing costs eligible for capitalisation are those directly attributable to acquisition, construction or production of a qualifying asset which would have been avoided otherwise

- Specific borrowings
 - Actual borrowing costs less any investment income on the temporary investment of borrowed funds
- General borrowings
 - Use weighted average borrowing rate as capitalisation rate and the expenditure on the asset to calculate eligible amount

Period of Capitalisation





Objective & Scope

- To ensure that assets are carried at no more than their recoverable amount, and to define how recoverable amount is calculated.

Scope:

Applies to all assets except:

- inventories (AS 2)
- assets arising from construction contracts
- deferred tax assets (AS 22)
- financial assets including Investments (AS 13)

Impairment v. Depreciation

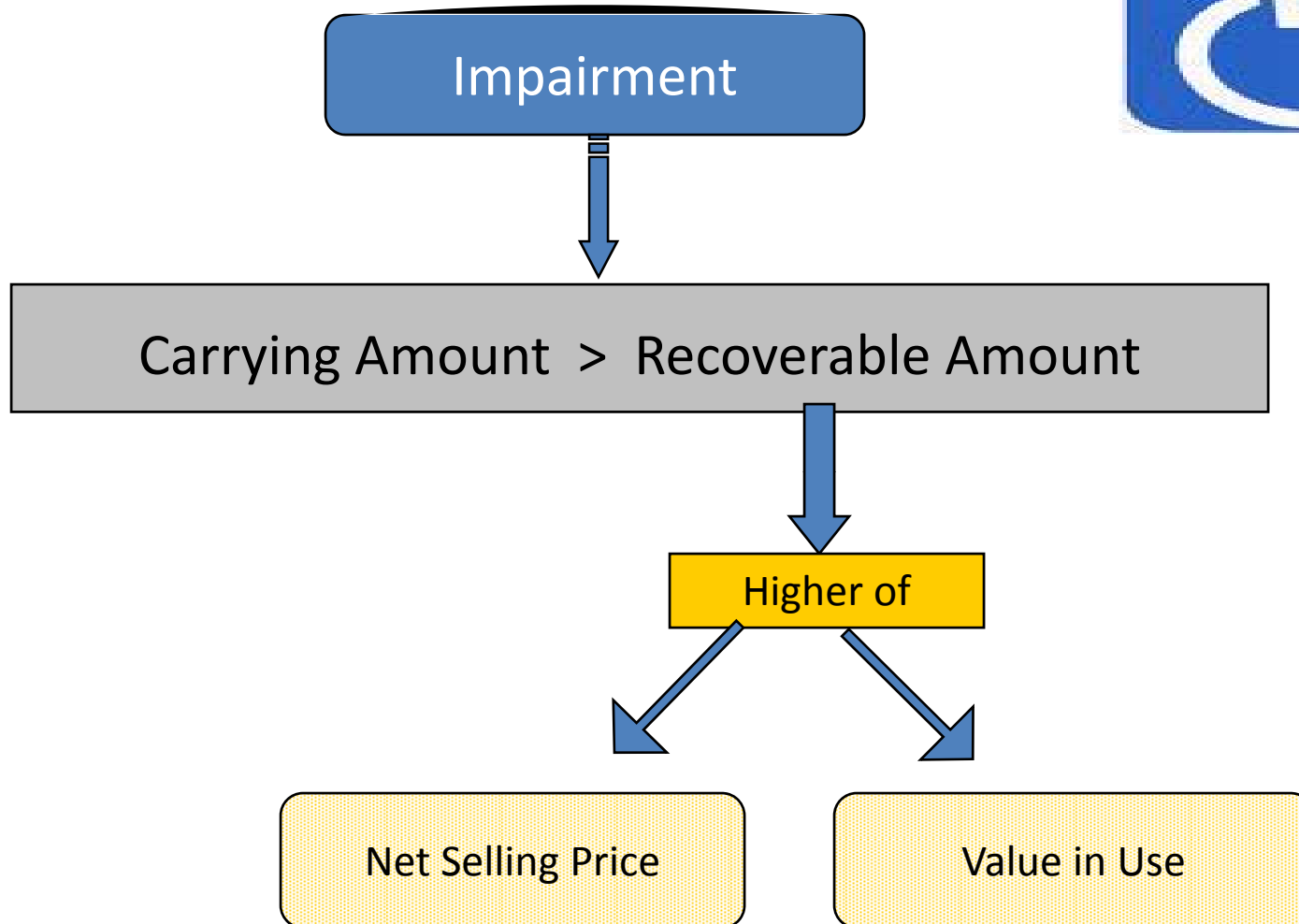
- Impairment is diminution in the value of asset otherwise than depreciation.

Depreciation

- The objective is to charge the cost of asset over its useful economic life.
- Matching concept is applied.

Impairment

- The objective is to bring down the carrying amount to its recoverable amount.
- Prudence concept is applied.

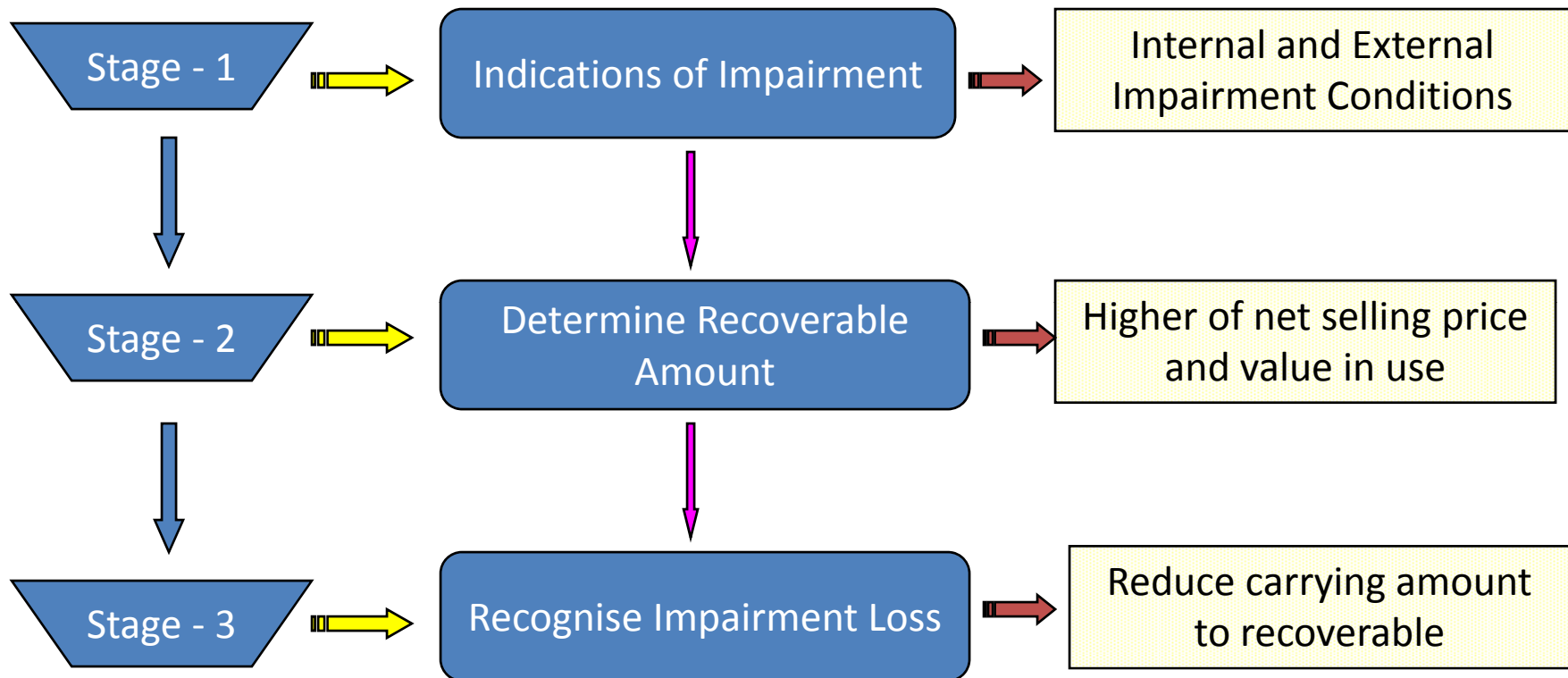


Definitions



- Carrying amount: the amount at which an asset is recognised in the statement of financial position after deducting accumulated depreciation and accumulated impairment losses
- Net Selling Price: The amount obtainable from the sale of an asset in arms length transaction between knowledgeable, willing parties less cost of disposal.
- Value in use: The discounted present value 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.

Impairment – 3 stages approach



- Frequency : Assess ***at the end of each reporting period*** whether there is indication of impairment

Indications of impairment – Illustrative list

External sources

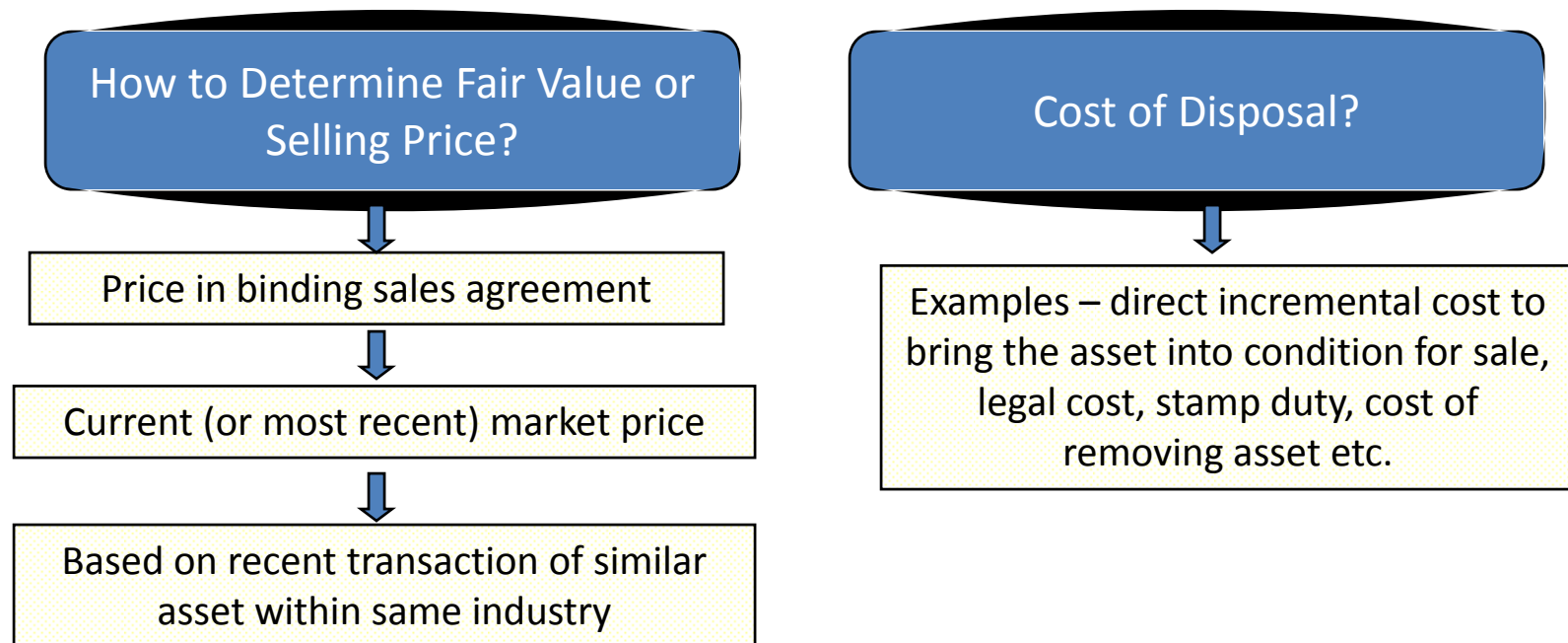
- market value declines
- negative changes in technology, markets, economy, or laws
- increases in market interest rates
- company stock price is below book value

Internal sources

- obsolescence or physical damage
- asset is part of a restructuring or held for disposal
- worse economic performance than expected

Recoverable Amount – Net Selling Price

- Amount obtainable from sale in an arm's length transaction between knowledgeable, willing parties less costs of disposal



Recoverable Amount – Value in Use

- Present value of estimated future cash flows expected to arise from:
 - continuing use of the asset *and*
 - disposal at the end of its useful life
- DCF calculation
 - Cash flows and discount rate

Cash Generating Units

- Smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets
- **Allocating Goodwill to CGU**
 - Goodwill is allocated to CGUs that is expected to benefit from the synergies of the combination.
 - Each unit or group of units to which goodwill is allocated shall
 - represent lowest level within entity at which goodwill is monitored for internal management purpose
 - Not be larger than operating segment

LEASES

AS 19

Key Definitions



- **Lease**

An agreement to convey the ***right to use*** property, plant or equipment (land or depreciable assets or both) usually for a stated period of time.

Finance Lease

If ***substantially all of the benefits and risks*** of ownership have been transferred to the lessee, the lessee records the lease as a capital lease at its inception.

Any of the following criteria if met than substantially all the risks and benefits are deemed to have been transferred.

- ▶ Ownership transferred to lessee at end of lease
- ▶ Lessee contains a bargain purchase option
- ▶ Lease term is major part of asset's economic life
- ▶ Present value of minimum lease payments at the beginning of the lease term is substantially all of the fair value.
- ▶ Leased asset is of specialised nature that only lessee can use it without major modification

Finance Leases: *Lessee Accounting*

- Recognise asset as PPE
- Recognise liability for obligation
- Measure asset and liability at lower of:
 - fair value of asset (less grants/tax credit) and
 - present value of minimum lease payments
- Allocate finance charge over period of lease
- Depreciate asset in accordance with IAS 16

Finance Leases: *Lessor Accounting*

- Recognise Receivable (Asset) at an amount equal to **Net Investment** in the lease
 - Debit Receivable A/c
 - Credit Assets A/c
- Recognition of **Finance Income**:- Allocate finance income over period of lease based on net investment outstanding
 - Debit Cash A/c.
 - Credit Receivable A/c.
 - Credit Finance Income A/c.

Accounting for *Operating Leases*

- **Lessee**
 - recognise rental payments as expense
 - usually straight-line basis over lease term (representative of time pattern of user benefit)
- **Lessor**
 - recognise asset as PPE
 - depreciate asset in accordance with IAS 16
 - recognise income on systematic basis

Capitalisation of interest under AS 16

- (i) whether the capital addition of lease hold improvements and equipments installed in 20 medium scale projects with the capital outlay of Rs. 60-100 lakh each shall be considered as 'qualifying assets' as defined under AS 16.
- (ii) whether the project period of 3-5 months for developing the centers shall be considered as 'Substantial Period of Time' under the Accounting Standards Interpretation (ASI) 1, Substantial Period of Time (Re. AS 16)2.
- (ii) whether the interest cost on the amount borrowed for payment of security deposit during the project period shall be considered as 'activity that is necessary to prepare the asset for its intended use or sale in progress' under AS 16 and should be capitalised in the books of account.

Accounting for fixed assets held for sale

The company has identified three of its properties as the properties held for sale and has revalued these three properties, which are held for sale. Apart from these three properties, there are other properties which are not held for sale and which are not revalued. The company has made selection of assets for revaluation on systematic basis.

- Whether the principle followed, namely, revaluation of all properties, i.e., land and buildings held for sale, and continuing other land and buildings not held for sale at historical cost, amounts to a systematic basis and whether such systematic revaluation is within the requirements?

Treatment of capital expenditure on assets not owned by the company

- When a new project, for example, setting up of a new refinery is undertaken by the company, it has to incur expenditure on the construction/development of certain assets, like electricity transmission lines, railway siding, roads, culverts, bridges, etc., in order to facilitate construction of project and subsequently to facilitate its operations. The ownership of such assets (hereinafter referred to as 'enabling assets') as well as the land on which these assets are situated does not vest with the company.
- The company has followed accounting treatment of treating such expenditure incurred during construction of projects as unallocated capital expenditure and charging off the same to revenue in the year of capitalisation of such projects

Accounting for book value of fixed assets demolished for expansion purpose

- The querist has stated that after 3 years of commencement of operations, the company is planning to expand the existing terminal building in order to cater to the increase in passenger traffic movement. Due to this, portion/part of the existing building and other infrastructure assets may have to be demolished and the book value of those assets are material amounts. Net realisable values arising from disposal of those assets are not material. This demolition is required exclusively for the expansion of terminal building.
- What should be the treatment of book value of the asset on demolition:
 - (i) To treat the same as expenditure on demolition and charge to profit and loss account.
 - (ii) To treat the book value as depreciation and charge it to profit and loss account in the year of demolition.
 - (iii) To treat the above book value loss as those cost that relate directly to the specific asset and to capitalise it by referring to paragraph 21 of Accounting Standard (AS) 10,

Accounting for scheduled rent increases in case of an operating lease.

Facts of the case:

The initial term of the lease is 3 years and it is renewable at the sole and exclusive option of the lessee for two further terms of 3 years each. As per the lease agreement, the total lease period cannot exceed 9 years. The lease payments will be escalated by 10% of the last lease rent at the end of every block of 3 years.

(i) Whether the renewal of the lease for two successive terms of three years each can be considered as being reasonably certain at the inception of the lease.

(ii) If the renewal is considered reasonably certain and renewal period added to the lease term, how should the lessor and the lessee account for the lease rentals during the lease term?

THANK YOU



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