Ind AS Standards dealing with Property, Plant & Equipment

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Agenda

1. **Property Plant & Equipment - Ind AS 16**
2. **Investment Property – Ind AS 40**
3. **Appendix C of Ind AS 17 : Whether an arrangement contains Lease**
4. **Impairment – Ind AS 36**

Property Plant & Equipment – Ind AS 16

- Measurement
- Depreciation
- Component Accounting
- Site Restoration & Decommissioning Obligations
- Non Current Assets Held for Sale – Ind AS 105
- Indian GAAP vs. Ind AS
- Ind AS vs. IFRS
- Related Exemptions under Ind AS 101
- Issues discussed by Ind AS Facilitation Transition Group

Measurement – At Recognition

- An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.

The cost of an item of property, plant and equipment comprises:

- Net purchase price.
- directly attributable costs for bringing the asset to the location and condition
- Site Restoration obligation *(discussed in detail later)*

Measurement – After Recognition

An entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an **entire class** of Property, Plant & Equipment

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

1. Cost Model:

carried at its cost less any accumulated depreciation and any accumulated impairment losses, or

2. Revaluation Model:

carried at its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

- Increase in Carrying amount – due to revaluation, recognize Income under OCI & accumulate it under Equity as revaluation reserve.
- Decrease in Carrying amount – due to revaluation, recognize in Profit & Loss Account.

Measurement

Spare parts and Replacement costs

- Spare parts and servicing equipment are usually carried as inventory and recognised in profit or loss as consumed except:
  - Major spare parts and stand-by equipment with expected use during **more than one period**
  - Spare parts and servicing equipment which can only be used in connection with an item of PPE
- Replacements which leads a capital asset to its full productive capacity or a contribution after damage, accident, or prolonged use, without increase in its previously estimated service life or productive capacity.
  - Should be charged to profit & loss as and when incurred.
- Improvements or betterments leading to increase in estimated service life or productive capacity.
  - Should be capitalized
- Cost of new component purchased for replacement will be capitalized and depreciated over the period not exceeding the useful life of the principal asset.

Depreciation

- The entity selects the method of depreciation that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

- The following methods can be used to allocate the depreciable amount of an asset:
  1. Straight Line Method
  2. Diminishing Balance Method and
  3. Units of Production Method

- The method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

- Land & Buildings are separable assets and are accounted for separately, even when they are acquired together.

- Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

Component accounting

- Cost of each significant item of PPE to be recognised separately which ***may not have different useful life***
- Item of PPE means parts having a cost that is **significant** to total cost
- Identification of such parts required to recognise replacement cost, if required

Example :

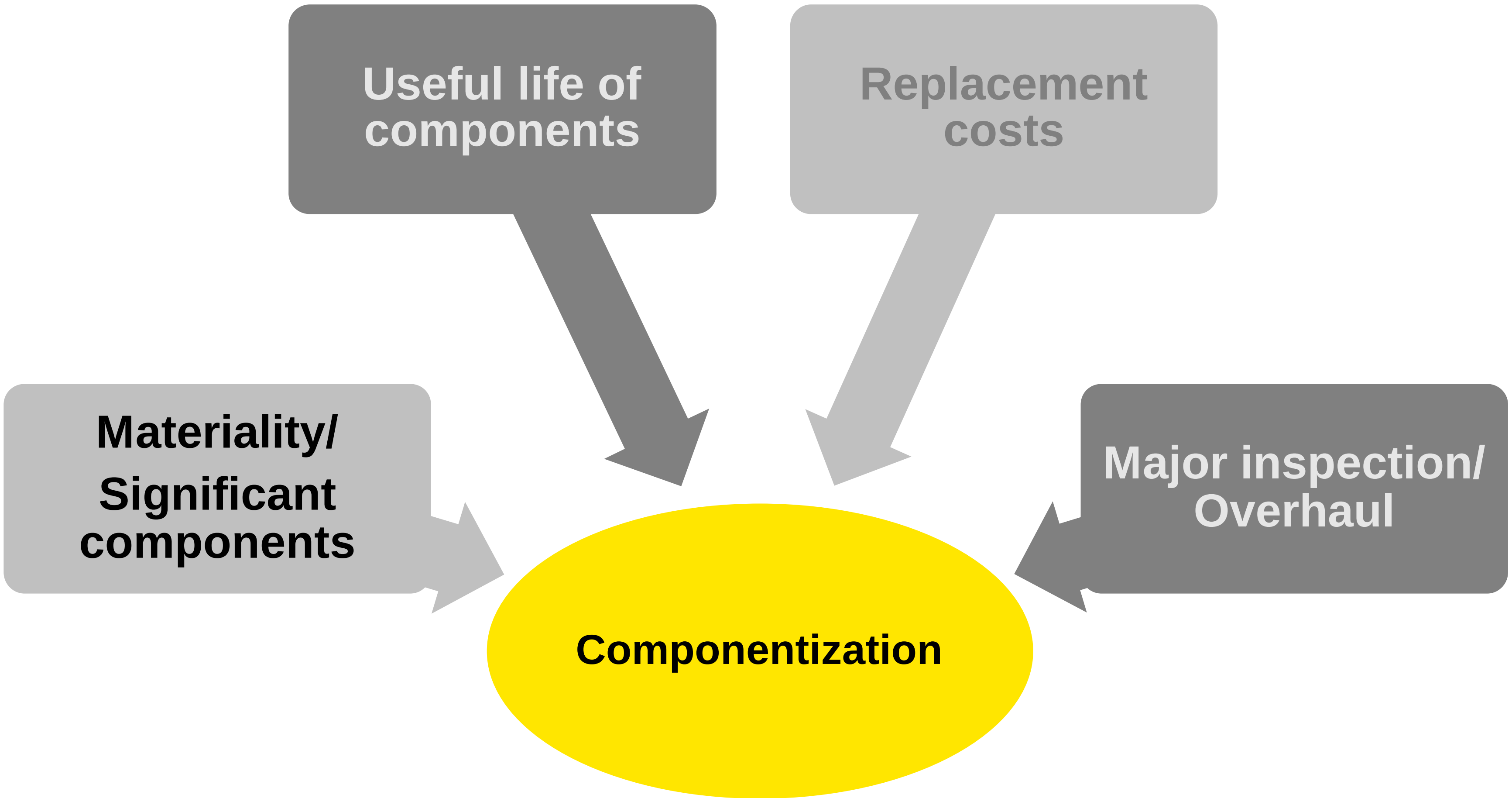
Ship costs 150, useful life 10 years,
Estimated docking cost 15, planned after 3 years

Component 1
Cost: 135
Life: 10 years

Total Ship Cost 150

Component 2
Cost: 15
Life: 3 years
Capitalise as incurred

Componentization- key considerations



Componentization- key considerations

Materiality/Significant components

- Identification of material/ significant components separately may involve complex judgement. Item may not be material in a particular year become so in later years.
- Materiality is a matter of management and needs to be decided on the facts of each case. Normally, a component having original cost
  - equal to or less than 5% of the original cost - Not material
  - equal to 25% of the original cost - Material
- Consider impact on
  - retained earnings
  - current year profit or loss
  - future profit or loss

  to decide materiality. Component with material impact will require separate identification.

Componentization- key considerations

Useful life of components

- Each significant component of the asset having useful life, which is different from the useful life of the remaining asset, is depreciated separately.

► Useful life of component	<	Useful life of principal asset	-	Consider lower life
► Management’s estimate of useful life	<	Statute	-	Consider lower life
► Useful life of the component	>	Useful life of the principal asset	-	Option to use either the higher or lower useful life*

*higher useful life for a component can be used only when management intends to use the component even after expiry of useful life for the principal asset.

Componentization- key considerations

Useful life of components

Illustration

- Useful life of an asset under Schedule II is 10 years. The management has estimated that useful life of principal asset is 10 years. If a component of asset has useful life of 8 years, AS 6 requires the company to depreciate the component using 8 year life only.
- If the component has 12 year life, the company has an option to either depreciate the component using either 10 year life as prescribed in the Schedule II or over its estimated useful life of 12 years, with appropriate justification.
- However, higher useful life for the component can be used only when management intends to use the component even after expiry of useful life for the principal asset.

Componentization- key considerations

Replacement costs

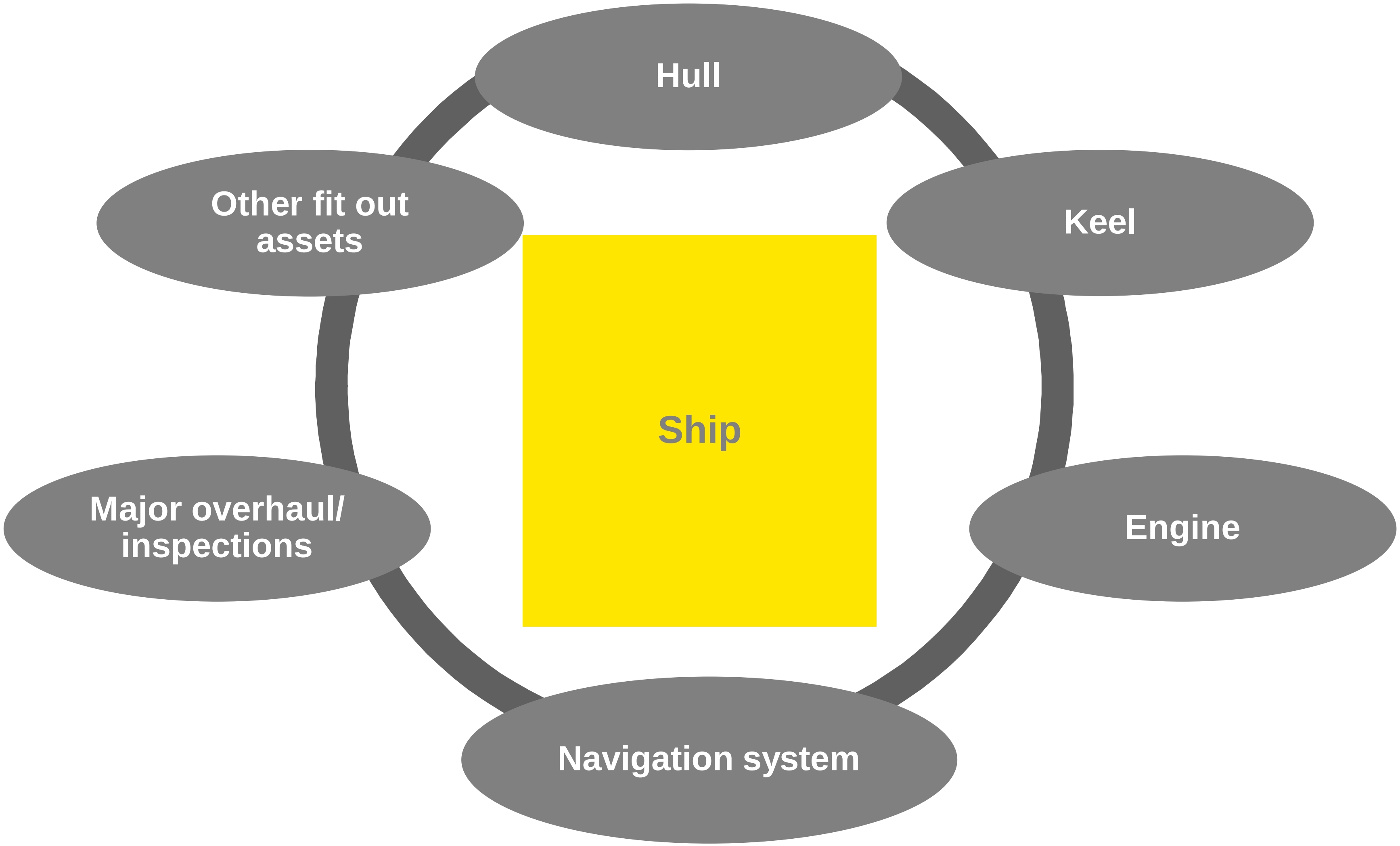
- Currently, replacement costs are expensed off
- Under component accounting, companies will capitalize these costs as a separate component of the asset, with consequent expensing of net carrying value of the replaced component. i.e. derecognised previous part.
- If it is not practicable to determine carrying amount of the replaced component, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.
- Under component accounting also, the costs of the day-to-day servicing of the item are not recognised in the carrying amount of an item of fixed asset. These costs are expensed in the statement of profit and loss as incurred.

Example 1 - Furnace

- A new furnace was installed on 1 January 2008 in a heat treatment plant.
- Total expenditure on the furnace amounted to Rs. 5 million.
- The furnace's expected useful life, given the nature of the plant's production, is estimated to be 20 years, which is in accordance with the useful lives normally recommended by technical experts for this type of asset.
- Various components identified at the time of capital expenditure are:

	Useful life	Amt.
1. Hearth brickwork, vault, walls	6 years	1,500,000
2. Heating system: burners, pipe work, lever, ventilators	10 years	600,000
3. Control mechanism, cervo motors, mechanism for controlling the temperature and operating parameters	5 years	300,000
4.Visits and overhauls by an external maintenance company every two years of the mechanical sections, input and output feeds, rollers, etc.	2 years	200,000
Furnace (main element and others)	20 years	2,400,000
Total capital expenditure		**5,000,000**

Example 2: Components of a Ship



Site restoration and decommissioning obligations

Recognition

Recognised at the time of initial recognition of PPE

Measurement

Requires significant judgment due to:

- Dependency on scale of operations,
- Environmental damage caused,
- Uncertainty regarding timing of decommissioning,
- Costs which may be directly attributable to decommissioning etc.

Site-Restoration and Decommissioning Obligations

Discounting

- Where the effect of the time value of money is material, the amount of a provision shall be at discounted value.
- The periodic unwinding of the discount shall be recognized in profit or loss as a finance cost as it occurs. The same cannot be capitalized under Ind AS 23.

Accounting

- The associated decommissioning costs should also be capitalized
- It should form part of the cost of the assets acquired or constructed
- It may also be necessary to recognise a further decommissioning provision during the production phase

Site restoration and decommissioning obligations
Case study

- The facts relevant to well are summarized below:
  - Cost
  - Decommissioning costs : INR 14000
  - Discount rate : 10%
  - Net present value : INR 800
  - Period : 30
- Show accounting treatment of site restoration and decommissioning obligation.

Response:

- Management should include INR 800 in the carrying amount of the asset at the time of installation and corresponding provision with equivalent amount.
- Each year an adjustment is made for the amount of borrowing cost; calculated as the current balance of provision multiplied by the discount rate
  - § Year 1 : INR 800*10% = INR 80
  - § Year 2 : INR (800 + 80)*10% = INR 88

  Similarly for the rest of the years

Site restoration and decommissioning obligations

Case study (Contd.)

Response (Contd.):

Year	Opening balance-Provision	Interest @10%	Closing balance-Provision
1	800	80	880
2	880	88	968
...			
30	12727	1273	14000

- Entries:
  - Recognition of decommissioning costs while recognising asset

    PPE-Dr 800

    Provisions decommissioning-Cr 800
  - Year1 for interest

    Interest expense –Dr 80

    Provisions decommissioning-Cr 80
  - Year 30 for interest

    Interest expense – Dr 1273

    Provisions decommissioning-Cr 1273

Non-current assets held for sale - Ind AS 105

Non-current assets held for sale are 'those assets whose carrying amount will be recovered principally through a sale transaction rather than through continuing use'.

Must be available for immediate sale in its present condition	Sale must be highly probable	Must genuinely be sold, not abandoned

- **Recognition*** : Lower of carrying amount and fair value less costs to sell.
- Although Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale should continue to be recognized, such assets should not be depreciated/ amortized.
- **Impairment**:
  - Requirement to measure a non-current asset at the lower of carrying amount and fair value less costs to sell may give rise to a write down in value (impairment loss).
  - Any subsequent increase in fair value less costs to sell of an asset up to the cumulative impairment loss previously recognized should be recognized as a gain.

*When the sale is expected to occur beyond one year, the costs to sell should be measured at their present value. And increase in present value due to passage of time shall be charged to profit and loss.

Indian GAAP Vs. Ind AS

Particulars	Indian GAAP	Ind-AS
Cost of acquisition	Transaction value is considered as the purchase cost of fixed assets.	Amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset. The concept of fair value of consideration would have implications in cases of deferred payment arrangements.
Asset retirement obligations	No specific guidelines	To be included as part of initial cost of asset and a liability equivalent to the present value of such costs would need to be recognised.

Indian GAAP Vs. Ind AS

Particulars	Indian GAAP	Ind-AS
Foreign Exchange Difference	Following the notification issued by MCA on 31 March 2009, several companies have elected to either capitalise foreign exchange differences or accumulate exchange differences in FCMITD	Ind AS does not permit the capitalisation of foreign exchange differences. However, in certain cases, exchange differences may be treated as part of borrowing costs and accordingly be capitalised as additional interest costs.
Rate of depreciation-Review	No specific requirement	Ind AS requires the residual value, useful life estimates and depreciation method to be reviewed at least at the end of each financial year.
Method of depreciation	Choice with companies to follow either the SLM or WDV	Ind AS requires that the depreciation needs to reflect the pattern in which the asset's future economic benefits are expected to be consumed by the company.

Indian GAAP Vs. Ind AS

Particulars	Indian GAAP	Ind-AS
Substantial period of time definition	A period of 12 months is ordinarily considered as a substantial period of time, unless a shorter or longer period can be justified.	No bright line rules for determining what constitutes 'a substantial period of time'.
Interest expenses	Contractual interest expense is considered as a part of borrowing costs.	Under Ind AS, the amount of interest expense to be included as borrowing costs is based on the effective interest rate method.
Borrowing rate	Borrowing costs are capitalised based on company level borrowings and no separate adjustments are made to compute group borrowing rate.	Ind AS requires that the consolidated group's average borrowing rate needs to be considered for capitalisation of general borrowing costs.

Indian GAAP Vs. Ind AS

Particulars	Indian GAAP	Ind-AS
Component Accounting	Recommendatory but not mandatory	Ind AS requires that components, which are significant and have a significantly different useful life, should be depreciated separately.
Revaluation	Current practice allows a company to selectively revalue its fixed assets and record all gains in a separate revaluation reserve.	Choice to follow the revaluation model for a class of assets. Revaluation would have to be frequent such that the asset are representative of their fair values at each reporting period. Gains arising on revaluation are recorded directly in reserves which cannot be used to adjust any incremental depreciation arising due to the revaluation.

Ind AS vs. IFRS

Issue	Ind AS	IFRS
Property, plant and equipment		
Government grant	Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance does not permit the option of reducing the carrying amount of an item of property, plant and equipment by the amount of government grant received in respect of such an item.	IFRS permits such reduction in carrying amounts by the amount of grant.

Related Exemptions under Ind AS 101

- Deemed cost - Fair Value or revaluation or Previous GAAP's carrying Value
- Decommissioning, restoration and similar liabilities

Deemed cost

Fair value or revaluation or previous GAAP's carrying value

FTA may adopt any of the options as deemed cost at transition date:

Use fair value of assets at transition date

Fair value

Previous GAAP's revaluation amount

If revalued amount at the date of revaluation was broadly comparable to:

- Fair value or
- Cost or depreciated cost in accordance with Ind AS, adjusted to reflect changes in general or specific price index

- This option may be elected asset by asset
- Applicable to intangible assets only if active market exists

Where there is no change in entity's functional currency, recognize assets at carrying value of previous GAAP after making necessary adjustments

Previous GAAP's carrying value

- If selected, becomes applicable to all assets
- This option is not available under IFRS

Deemed cost

Previous GAAP's carrying value

If entity avails option of considering previous GAAP's carrying value as deemed cost, then:

- Necessary adjustments to be made for decommissioning liabilities
- No further transitional adjustment is required to determine deemed cost in the opening balance sheet that other Ind ASs might require
- Applicable to PPE, investment property and intangible assets

Decommissioning, restoration and similar liabilities

- **Appendix A to Ind AS 16 requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life.**

A FTA may not apply above requirements for changes in such liabilities that occurred before transition date. If a FTA uses this exemption, it shall:

- Measure the decommissioning liability at transition date as per Ind AS 37
- Capitalize discounted liability back to the date the obligation arose (using the best estimate of historical risk-adjusted discount rates)
- Calculate accumulated depreciation on that amount at transition date (calculated by applying current estimated life and entity's depreciation policy for the asset under Ind AS)

Note:
If an entity opts for FV measurement of PPE, it would need to determine whether the FV of the asset is inclusive or exclusive of the decommissioning obligation in order to make the necessary adjustment to remove any potential overstatement

Issues discussed by Ind AS Facilitation Transition Group

Deemed cost exemption vs. revaluation model

A Co is covered under phase 1 of Ind AS roadmap (i.e. FY 2016-17 and transition date is 1 April 2015). Co is evaluating various options related to PPE measurement at the transition date and revaluation model for its subsequent measurement. How these two aspects interact with each other?

Response:

Below are various options available for PPE valuation:

- Historical cost determined by applying Ind AS 16 retrospectively
- Fair value at the date of transition to Ind AS used as deemed cost
- Revaluation in accordance with previous GAAP that meets criteria in Ind AS 101 as deemed cost
- Fair value at the date of an event such as a privatisation or initial public offering as deemed cost
- Previous GAAP carrying amount as deemed cost, provided that this option is used for all items of PPE.

Deemed cost exemption vs. revaluation model (cont'd)

Consider below given values for PPE, at what value Co will recognize PPE where it uses revaluation model for subsequent measurement:

Acquisition cost (depreciated to Ind - AS amount as at 31 March 2015)	INR 90,000
Revalued amount under previous GAAP (March 2013) (depreciated to Ind - AS amount as at 31 March 2015)	INR 185,000
Previous GAAP carrying value (31 March 2015)	INR 185,000
Fair value (1 April 2015)	INR 200,000

Transition date fair value as deemed cost	• Ind AS revaluation reserve is zero (INR 200,000 – INR 200,000)
Previous GAAP revaluation/carrying amount as deemed cost	• Ind AS revaluation reserve is INR 15,000 (INR 200,000 – INR 185,000) • Transfer revaluation reserve under previous GAAP to retained earnings
Ind AS 16 applied retrospectively	• Ind AS revaluation reserve is INR 110,000 (INR 200,000 – INR 90,000)

Deemed cost exemption:
Bulletin 3, Issue 11 & Bulletin 5, Issue 3

- Whether the entity applying previous GAAP carrying value exemption as deemed cost has an option to FV few items of PPE and taking carrying amounts of the remaining items of PPE as the deemed cost on the date of transition?

- Whether para D7AA can be applied for capital work in progress?

Response:

- No. A FTA has the option to elect to continue with the carrying value of ***all*** of its PPE as at transition date measured as per the previous GAAP and use that as its deemed cost. Valuation of PPE can not be done on selective basis in such case.

  (Attention is also drawn to Exposure draft on Ind AS 101 which is under discussion as of date.)

- Capital work in progress is in the nature of PPE under construction and accordingly, provisions of Ind AS 16 apply to it. Thus, exemption under para D7AA will be available for CWIP as well

Deemed cost exemption & amortization of loan / government grant:

*Bulletin 5 Issue 4 (**Revised**)*

Co has adopted Ind AS and availed exemption as per D7AA. It had adjusted value of PPE under previous GAAP due to below given reason. How should it be treated under Ind AS?

It had capitalized processing fees on a loan as part of fixed assets as per previous GAAP. The loan needs to be accounted for as per amortised cost method as per Ind AS 109.

Response:

- The carrying amount of loan needs to be restated to its amortised cost as per Ind AS 109 on transition date.
- The carrying amount of PPE as at the date of the transition should be reduced by the amount of processing cost net of depreciation provided.
- The difference between the adjustments to the carrying amount of loan and to fixed assets should be recognised in retain earnings as on the date of transition.

Deemed cost exemption & amortization of loan / government grant:

*Bulletin 5 Issue 5 (**Revised**)*

Co has adopted Ind AS and availed exemption as per D7AA. It had adjusted value of PPE under previous GAAP due to below given reason. How should it be treated under Ind AS?

Government grant received was deducted from the carrying value of fixed asset as per AS 12.

Response:

- to recognise the amount of unamortised deferred income as at the date of the transition, the corresponding adjustment needs to be made to the carrying amount of PPE and retained earnings, respectively, as the grant is directly linked to the PPE.
- Since the adjustment to the PPE is only consequential and arising because of applying the transition requirements, it would not be construed as an adjustment to the deemed cost of PPE

Accounting for spare parts:

Bulletin 2, Issue 4 & Bulletin 5, Issue 6

- A Company has certain spare parts that were recognized as inventory under previous GAAP but meets the definition of PPE under Ind AS. Company has applied D7AA exemption.
- At what amount spares can be recognized? Whether depreciation should be charged from the date when it becomes available for use or date of actual use? How will useful life determined?

Response:

recognition

Ind AS should be applied retrospectively since it meets the definition and recognition criteria of Ind AS 16. Entity can not apply D7AA deemed cost exemption in this case as it is available only for PPE which was earlier recognized as inventory

depreciation

The depreciation begins when asset is available for use which, in case of spare part, may be from its date of purchase, as spare part is readily available for use.

useful life

In determination of the useful life of spare part, life of the machine in respect of which it can be used can be one of the determining factors

Retrospective application of Ind AS 16:

Bulletin 3 Issue 14

- A Ltd. measure its PPE by applying Ind AS 16 retrospectively in first Ind AS FS. Under previous GAAP, it followed depreciation rates specified in Schedule XIV to the Companies Act, 1956.
- Whether A Ltd need to re-compute depreciation based on useful lives from the date of initial capitalisation of PPE or it will have to apply depreciation rates applied under previous GAAP till the date of opening balance sheet?

Response:

- When entity apply Ind AS 16 retrospectively, all requirements including component accounting and depreciation based on estimated useful life are applied retrospectively. If entity’s previous GAAP’s depreciation methods and rates are acceptable under Ind AS, it accounts for any change in estimated useful life or depreciation pattern prospectively from when it makes that change in estimate.
- If depreciation rates were adopted solely based on useful lives/ rates prescribed in Schedule XIV/ Schedule II and do not reflect a reasonable estimate of the asset’s useful life as per Ind AS, and If those differences have a material effect on the financial statements, the entity adjusts accumulated depreciation in its opening Ind AS balance sheet retrospectively so that it complies with Ind AS.

ASB's FAQ on Deemed cost of PPE

Bulletin 8, Issue 4

- If an entity avails deemed cost exemption under para D7AA, whether the entity should use the original cost or the net book value as deemed cost? whether accumulated depreciation and impairment loss is considered as nil? Whether impairment loss recognized under previous GAAP can be reversed?

Response:

Deemed cost

- Entity should consider the net book value (NBV) at transition date as the deemed cost of PPE and not its original value. As the previous GAAP carrying value here means net book value.
- The future depreciation charge on PPE will be based on the NBV and the remaining useful life on transition date to Ind AS

Depreciation and Impairment loss

- Since NBV is deemed cost, previously recognized depreciation and impairment loss is considered to be Nil. Thus, reversal of previously recognized impairment loss is not permitted.

Incorrect Capitalization of PPE under Previous GAAP

Bulletin 8, Issue 3

ABC Ltd. is a FTA adopter of Ind AS and has opted for deemed cost exemption. It had capitalised an item of property, plant and equipment under previous GAAP even though it did not meet the definition of an asset. Whether this asset cost can also be continued to be capitalised under deemed cost exemption?

Response:

- The option of deemed cost exemption can be availed for property, plant and equipment measured as per previous GAAP. The incorrect capitalisation of the item of PPE did not meet the definition of asset as per previous GAAP and the definition of 'PPE' as per Ind AS 16, accordingly the deemed cost exemption under paragraph D7AA of Ind AS 101 cannot be availed for those assets.

- The incorrect capitalisation of asset which does not meet the definition of tangible asset will be covered under Ind AS 101 being an error, and the disclosure of the same should be done as per Ind AS 101.

Treatment of Revaluation Reserve & Deferred Tax on transition

Bulletin 8, Issue 7

- A company is a FTA of Ind AS. It has opted for exemption under paragraph D7AA of Ind AS 101, *First-time Adoption of Indian Accounting Standards* and also elected the cost model under Ind AS 16, *Property, Plant and Equipment* for subsequent measurement.

On the date of transition to Ind AS:

  - What will be the accounting treatment of the balance outstanding in the “Revaluation Reserve” created as per previous GAAP.

Response:

- in the given case balance outstanding in the revaluation reserve should be transferred to retained earnings or if appropriate, another category of equity. This is because after transition, the Company is no longer applying the revaluation model of Ind AS 16, instead it has elected to apply the cost model approach.
- It may be noted that the requirements of Companies Act, 2013 for declaration of dividend will be required to be evaluated separately.

Treatment of Revaluation Reserve & Deferred Tax on transition

Bulletin 8, Issue 7

- On the date of transition to Ind AS, what will be the treatment of deferred tax on this transition revaluation reserve?

Response:

In accordance with Ind AS 12, *Income Taxes*, deferred tax would need to be recognised on any difference between the carrying amount and tax base of assets and liabilities. No deferred tax is created on equity components. However, since the asset has been revalued, there will be difference for the amount between carrying value and tax base. Hence, deferred tax will have to be recognised on such asset.

Investment Property – Ind AS 40

- Definition, Scope & Measurement
- Certain Examples
- Ind AS vs. IFRS

Investment Property - Ind AS 40

Definition

Property held* to earn rentals or for capital appreciation or both, rather than for:

- Use in the production or supply of goods or services, or for administrative purposes; or
- Sale in the ordinary course of business

*Held as owner or as a lessee in finance lessee. Property held under an operating lease is not included.

Scope

Does not deals with:

- Classification of leases as finance leases or operating leases;
- Lease income recognition from investment property;
- Measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;
- Measurement in a lessor's financial statements of its net investment in a finance lease;
- Accounting for sale and leaseback transactions; and
- Disclosure about finance leases and operating leases.

Investment Property - Ind AS 40

Measurement

- **Initial recognition** : Measured at cost
- **Subsequent recognition** : According to Ind AS 16 requirements of cost model other than held for sale assets under Ind AS 105
- Entities are encouraged, but not required, to determine fair value of investment property on the basis of a valuation by an independent valuer mainly for disclosure purposes.

Certain Examples

1. Land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business – **YES**

2. Land held for a currently undetermined future use. (The entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.) - **YES**

3. Property being constructed or developed on behalf of third parties. - **NO**

4. Building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases. - **YES**

5. Building that is vacant but is held to be leased out under one or more operating leases. - **YES**

Certain Examples (cont'd)

6. Property that is being constructed or developed for future use as investment property. – **YES**

7. Property that is leased to another entity under a finance lease. - **NO**.

8. Property occupied by employees (whether or not the employees pay rent at market rates) - **NO**

Ind AS vs. IFRS

Issue	Ind AS	IFRS
Investment property		
Measurement of investment property	Ind AS 40 permits only the cost model	IAS 40 permits both cost model and fair value model (except in some situations) for measurement of investment properties after initial recognition.

Appendix C of Ind AS 17
Whether an arrangement contains Lease

- Land & Building Lease – Composite Leases
- Land Leases
- Appendix C to Ind AS 17
- Related Exemptions under Ind AS 101
- Issues discussed by Ind AS Facilitation Transition Group

Leases - Land and buildings (Composite Leases)

- The land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification under Ind AS 17

- Composite lease of land and buildings:

  - Minimum lease payments are allocated among them in proportion to the relative fair values at the inception of the lease. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases.

  - Amount that would initially be recognised for the land element is immaterial, the land and buildings may be treated as a single unit and classified as a finance or operating lease in accordance usual criteria and the economic life of the buildings is regarded as the economic life of the entire leased asset.

- Buildings element:
  - Classified as either finance or operating lease, using the usual criteria

Leases - Land leases

- AS 19 scopes out lease of land from its scope. Ind AS 17 deals with lease of land.
- As per the recent EAC opinion, lease of land for longer period (say, 99 years) is treated as finance lease.
- Since land normally has an indefinite economic life, lease of land is normally operating lease unless the title passes on to the lessee by the end of the lease term.
  - Upfront premium received should be recognized as lease rental income on straight line basis over the period of lease
- In case of composite leases, land lease need to be separated from building.
- Land element of Composite Lease under Ind AS 17:
  - *"When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately in accordance with paragraphs 7-13. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life."*

Appendix C to Ind AS 17

Determining whether an arrangement contains a lease

- Introduction
- Scope
- Issues
- Factors to be considered
- Separating payments for the lease from other payments

Introduction

- Features of arrangement containing a lease
  - A single transaction or a series of related transactions
  - Legal form is NOT of a lease
  - Conveys a right to use an asset (e.g., an item of property, plant or equipment)
  - In return for a payment or series of payments

- Examples of arrangement containing a lease
  - outsourcing arrangements
  - arrangements in the telecommunications industry
  - power purchase agreement or other take-or-pay contracts

- Accounting/classification is not discussed in Appendix C.

Scope

Excludes from its scope:

- All leases excluded from the scope of Ind – AS 17, or
- Public-to-private service concession arrangements within the scope of Appendix C of Ind AS 115 *Service Concession Arrangements*

Issues

- The issues addressed in this Appendix are:
  - how to determine whether an arrangement is, or contains, a lease;
  - when the assessment or a reassessment should be made; and
  - how the payments for the lease should be separated from payments for any other elements in the arrangement

Factors to be considered

- The assessment of an arrangement and the identification of a lease should be based on the substance of the arrangement.
- The factors to consider are:
  - *whether "fulfilment of the arrangement is dependent on the use of* ***a specific asset or assets*** and
  - *whether the arrangement* ***conveys a right to use the asset(s)****"*

Fulfilment of the arrangement is dependent on the use of a specific asset

- Fulfilment of the arrangement is dependent on use of specific asset (s)
  - Although an asset may be **explicitly identified** in an arrangement, it is not the subject of a lease if fulfilment of arrangement is not dependent on its use.
    - For example, if the supplier is obliged to deliver a specified quantity of goods or services and has the right and ability to provide those goods or services using other assets not specified in the arrangement, then fulfilment of the arrangement is not dependent on the asset.
  - Asset could be **implicitly specified**
    - For example, the supplier owns or leases only one asset and it is not economically feasible or practicable to perform its obligation through alternative assets.

Example 1: Dependence on the use of a specific asset

- Entity A outsources its product delivery department to entity S.
- Entity S is obliged to make available a certain number of delivery vehicles of standard specification on need basis.
- Entity S is a delivery organisation with many other vehicles available.
- Entity S is free to provide alternate vehicles on availability basis to entity A.

Response:

- Delivery vehicles are neither explicitly nor implicitly identified in the arrangement.
- Thus, fulfilment of the arrangement is not dependent upon use of the specific asset.
- However, if the supplier has to supply and maintain a specified number of specialist vehicles in the purchaser’s delivery, then this arrangement is more likely to contain a lease.

Example 2: Dependence on the use of a specific asset

- A purchaser enters into a take-or-pay contract to buy industrial gases from a supplier B Ltd.
- B Ltd. is a large company operating similar plants at various locations.
- Both parties anticipate that the gases will be supplied from a particular plant.
- B Ltd. has the contractual right to supply gas from other plants as well which are located in other cities. However, this is not economically feasible or practicable.

Response

- Yes, the fulfilment of the arrangement is dependent upon use of the specific asset.
- Though B Ltd. has contractual right to supply power from other plants as well which are located in other cities, it is not economically feasible or practicable.

Fulfilment of the arrangement is dependent on the use of a specific asset

Asset versus 'Portion' of an asset

- The phrase 'right to use an asset' does not preclude the asset from being a portion of a larger asset.
- Ind AS 17 does not address what constitutes the underlying asset in an arrangement
- It merely states that 'arrangements in which the underlying asset would represent a unit of account in either Ind AS 16 or Ind AS 38 are within the scope of the appendix
- A plant that consists of more than one production unit or line might be regarded as a single asset or alternatively each of its units or lines may be regarded as a separate 'portion'. Depending on other aspects of the arrangement, a particular production line may be the asset that is the subject of a lease, if the supplier cannot use different lines to supply the goods.

Arrangement conveys a right to use the asset

- An arrangement conveys right to use the asset if **any one** of the following conditions is met:
  - purchaser has the ability or **right to operate the asset** or direct others to operate the asset in a manner it determines while obtaining > insignificant amount of output
  - purchaser has the ability or **right to control physical access** to the underlying asset while obtaining > insignificant amount of output
  - facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output during the term of the arrangement, and the price is
    - neither contractually fixed per unit of output;
    - nor is equal to the current market price per unit

Arrangement conveys a right to use the asset

- **Right to operate the asset may be evidenced by:**
  - ability to hire, fire or replace the operator of the asset
  - ability to specify significant operating policies and procedures

- **Right to direct others to operate the asset** in a manner it determines:
  - who decides on staffing levels
  - shift working arrangements
  - safety issues, supply sourcing, maintenance arrangements,
  - ability to make any changes in the production process to improve efficiency – e.g. changing paint nozzles, introducing new robotics or IT etc.

Example: Right to control physical access

The 'right to control physical access' is similar to the previous condition and relates to the ability to prevent others from using or accessing the asset for their needs or restricting the ability of the supplier to move or use the asset as it desires.

- Entity A has outsourced its storage of confidential data.
- The data storage is controlled by means of a computer system owned by the supplier and located at its premises, that was developed specifically to meet A's requirements
- The computer system is required to meet specific criteria for interfacing with A's own systems.
- A takes 80% of the capacity with the other 20% being used to supply services to two other entities.
- A has the right to approve or reject new customers for services that involve the use of the computer system.

Example: Right to control physical access

Evaluation

- Is the fulfilment of the arrangement dependent on the use of a specific asset or assets?

  Yes, the computer system was developed specifically to meet A's requirements and must meet specific criteria for interfacing with A's own systems.

- Whether the arrangement conveys a right to use the asset?

  - Does the purchaser obtain or control more than an insignificant amount of the output or other utility of the asset?

    Yes, A takes 80% of the capacity.

  - Does the purchaser have the ability or right to control physical access to the underlying asset?

    Yes. Entity A has the right to control physical access as a result of its right to approve or reject new customers for services that involve the use of the computer system.

- The arrangement contains a lease within the scope of Ind AS 17.

Example: Fixed price criterion

- Purchaser P and supplier S enter in a parts supply agreement for the lifetime of the finished product.
- To produce the part S uses a tooling equipment that is specific to the needs of P. The tooling is explicitly identified and S could not use alternative asset.
- Estimated capacity of the tooling equipment is 500,000 units which corresponds to total production of the finished product units over its life cycle.
- Purchaser P and supplier S agree upon the following unit price reductions in the parts supply agreement to reflect S's increasing efficiencies and economics of scale:

  -from 0 to 100,000 units, price per each unit CU150;
  -from 100,001 to 200,000, price per each unit CU140;
  -from 200,001 to 300,000, price per each unit CU135;
  -from 300,001 to 400,000, price per each unit CU132;
  -above 400,000 price per each unit CU130.

- P takes substantially all of the output produced by S.

Example: Fixed price criterion

Evaluation

- Is the fulfilment of the arrangement dependent on the use of a specific asset or assets?

  Yes, the tooling is explicitly identified and S could not use an alternative asset.

- Whether the arrangement conveys a right to use the asset?
  - Is it remote that one or more parties other than the purchaser will take more than an insignificant amount of the output during the term of the arrangement.

    Yes. The tooling is designed to meet only the needs of P – the likelihood is remote that one or more parties other than the P will take more than an insignificant amount of the tooling's output. As the estimated capacity of the tooling equipment corresponds to the total production of the finished product units produced by P, P takes substantially all of the output produced using that tooling.
  - Is the price that the purchaser will pay for the output neither contractually fixed per unit of output nor equal to the current market price per unit of output?

    Yes. Stepped pricing does not mean price 'fixed per unit of output' and, particularly as the stepped pricing is agreed in advance, it is not equal to the current market price per unit as of the time of delivery of the output.

The arrangement contains a lease within the scope of Ind AS 17

Separating lease and other payments

- Ind AS 17 is applied to the lease element. Other elements of the arrangement must be accounted in accordance with the appropriate standards.
- Payments separated at the inception into lease payments and for other elements (e.g. services) based on relative fair values
- It may require estimation
- If not practicable to separate payments reliably:
    - For finance lease, recognise an asset and liability at FV of the specified asset
    - For operating lease, all payments are lease payments for disclosure

Related Exemptions – Ind AS 101 for Appendix C of Ind AS 17

- A FTA may determine whether an arrangement existing at the date of transition to Ind As contains a lease on the basis of facts and circumstances existing at the transition date.
- If a FTA made the same determination of whether an arrangement contained a lease in accordance with previous GAAP as that required by Appendix C of Ind AS-17 but at a date other than transition date, the FTA need not reassess that determination when it adopts Ind ASs.
- When a lease includes both land and building elements, a FTA may assess the classification of each element as finance or an operating lease at the date of transition to Ind ASs on the basis of the facts and circumstances existing as at that date.

Leases – example

Fact Pattern

An entity's first Ind AS financial statements are for a period that ended on 31 March 2017 and include comparative information for 31 March 2016 only. Its date of transition to Ind AS is 1 April 2015. On 1 January 2012, the entity entered into a take-or-pay arrangement to supply gas. On 1 June 2013, there was a change in the contractual terms of the arrangement

At what date should entity perform assessment under Appendix C of Ind AS 17?

Response

If the entity avails the exemption in Ind AS 101, then it shall determine whether the arrangement contains a lease by applying the criteria in paragraphs 6–9 of Appendix C of Ind AS 17 on the basis of facts and circumstances existing on the transition date i.e. 1 April 2015.

Alternatively, had the entity not availed the exemption, the date of assessment would have been 1 June 2013 i.e. on modification of contract. Thus, the entity is not required to reassess on the date of transition to Ind AS

Impairment – Ind AS 36

- When should impairment testing be conducted?
- Impairment testing of Goodwill
- Goodwill and NCI
- Disclosure challenges
- Indian GAAP vs. Ind AS

When should impairment testing be conducted under Ind AS 36 ?

- For any asset, assess at each reporting date if indicator exists
- Following assets are to be tested for impairment even if no indicators exist:
  - Intangible asset with an indefinite useful life
  - Intangible asset not yet available for use
  - Goodwill

Impairment test under Ind AS 36

- Recognise **impairment** when **carrying amount** of an asset or a CGU exceeds its **recoverable amount**
- Recoverable amount = **higher of** value in use (**VIU**) and fair value less costs to sell (**FVLCS**)

Carrying amount of the asset or CGU

Compared to

Recoverable amount of the asset or CGU

Higher of

FVLCS

VIU

Allocation of goodwill to CGUs

- Goodwill allocated to each of acquirer's CGUs or group of CGUs that are expected to benefit from the synergies of the combination.

- Each CGU or group of CGUs to which goodwill is allocated must:

  - Represent the lowest level within the entity at which the goodwill is monitored for internal management purposes

  - Not be larger than an operating segment as defined under Ind AS 108 before aggregation

Re- allocation of goodwill to CGUs

- Reorganization of reporting structure in a way that changes the composition of one or more CGUs to which goodwill is allocated;

or

- Disposal of an operation within a CGU or disposal of a CGU within a group of CGUs

- Goodwill reallocated on the basis of relative value to units affected based on relative value, unless other method better reflects the goodwill associated with the reallocated operation or operation disposed

NCI measurement and Goodwill impairment

- Measurement option for NCI at acquisition date:
  - Fair value
  - Proportionate share of acquiree's identifiable net assets

- Would the option have any bearing on subsequent goodwill impairment?

NCI measurement and Goodwill impairment: Example 1

- A Ltd acquires 80% in Subsidiary for 3,200. At date of acquisition, subsidiary's identifiable net assets is 3,000. A elects to measure NCI at proportionate share of net identifiable assets. It recognizes

Purchase consideration	3,200
NCI	600
Less: Net assets	(3,000)
Goodwill	800

- At the end of next FY, subsidiary's carrying amount is reduced to 2,700 (excluding goodwill).
- Recoverable amount of subsidiary's asset is 2,000.

NCI measurement and Goodwill impairment: Solution 1

Particulars	Goodwill	Other asset	Total
Carrying amount	800	2,700	**3,500**
Unrecognized NCI (notional) (800/80%X20%)	200	-	**200**
Notional Total	**1,000**	**2,700**	**3,700**
Recoverable amount	-	-	**2,000**
Total Impairment loss	**-**	**-**	**(1,700)**
Impairment loss recognized in CFS	(800)	(700)	**(1,500)**
Carrying amount after impairment	-	2,000	**2,000**

Impairment loss on:	Parent	NCI
Goodwill	(800)	-
Other assets	(560)	(140)
Total	**(1,360)**	**(140)**

NCI measurement and Goodwill impairment: Example 2

- A Ltd acquires 80% in Subsidiary for 3,200. At date of acquisition, subsidiary's identifiable net assets is 3,000. A elects to measure NCI at proportionate share of net identifiable assets. It recognizes

Purchase consideration	3,200
NCI	**600**
Less: Net assets	**(3,000)**
Goodwill	**800**

- At the end of next FY, subsidiary's carrying amount is reduced to 2,700 (excluding goodwill).
- Recoverable amount of subsidiary's asset is **2,800**.

NCI measurement and Goodwill impairment: Solution 2

Particulars	Goodwill	Other asset	Total
Carrying amount	800	2,700	**3,500**
Unrecognized NCI (notional) (800/80%X20%)	200	-	**200**
Notional Total	**1,000**	**2,700**	**3,700**
Recoverable amount	-	-	**2,800**
Total Impairment loss	**-**	**-**	**900**
Impairment loss recognized in CFS	(720)	-	**(720)**
Carrying amount after impairment	80	2,700	**2,780**

Impairment loss on:	Parent	NCI
Goodwill	(720)	-
Total	**(720)**	**-**

Indian GAAP Vs. Ind AS

Particulars	Indian GAAP	Ind-AS
Applicability	Does not Apply to these assets Does not specifically exclude Biological assets	Applies to Financial Assets, classified as: (i) Subsidiaries as defined under in Ind AS 27 (ii) Associates as defined under Ind AS 28 (iii) Joint Ventures as defined under Ind AS 31 It specifically excludes Biological Assets
Impairment Testing	Unless there are impairment indicators, does not require impairment testing	Requires annual impairment testing for an intangible asset with an indefinite useful life or not yet available for use and goodwill acquired in a business combination.
Reversal of Impairment losses on Goodwill	The impairment loss recognised for goodwill should be reversed in a subsequent period when it was caused by a specific external event of an exceptional nature which is not expected to occur and the subsequent external events have occurred that reverse the effect of such event	Prohibits the recognition of reversals of impairment loss for goodwill

Indian GAAP Vs. Ind AS

Particulars	Indian GAAP	Ind-AS
Allocation of Goodwill	Goodwill is allocated to CGUs only when it can be done on a reasonable and consistent basis. Two levels of Impairment tests are carried out – top down & bottom up tests.	Goodwill is allocated to CGU that are expected to benefit from synergies of Business Combination from which it arose

Ind AS 36 gives additional guidance on the following aspects:

- Estimating the value in use of an asset
- For managements to assess the reasonableness of the assumptions on which cash flows are based and
- Using present value techniques in measuring an asset's value in use

Key disclosures

- Extensive disclosures apply to CGUs/CGU groups containing goodwill or intangible assets with indefinite useful lives
- Impairment testing inherently includes a significant level of uncertainty.
  - Appropriate disclosures are key to address this uncertainty
  - Expectation from users of financial statements and regulators
- Ind AS 36 specifically requires disclosures regarding:
  - Key assumptions applied and the basis for determining those assumptions
  - Sensitivity analysis on key assumptions
- Although Ind AS 36 does not require a formal reconciliation between market capitalisation of the entity, fair value less cost of disposal (FVLCD) and VIU, entities need to be able to understand the reason for the shortfall.

Regulatory focus on disclosures – areas of concern

- Key assumptions of management
- Sensitivity analysis
- Determination of recoverable amount
- Determination of growth rates
- Disclosure of an average discount rate
- Boilerplate disclosures and not entity-specific

Thank you