Workshop on IND AS – Property, plant & equipment

WIRC of the ICAI – April 23, 2016

Contents

BACKGROUND

Background

- 3 interpretations replaced (SICs) – SIC 6 Modifying Existing Software, SIC 14 PPE, Compensation for Impairment or Loss of Items & SIC 23 PPE Major Inspection or Overhaul Costs
- Excludes biological assets related to agricultural activity and mineral rights
- But applies to PPE used to develop/maintain above assets
- Deals with recognition principles for costs incurred at the time they are incurred and costs incurred subsequently to replace a part of or service an item
- States that the cost of PPE includes costs of its dismantlement, removal or restoration
- Asset exchange transactions – at fair value, if acquired in exchange for a non monetary asset (unless transaction lacks commercial substance)
- Component accounting consent specifically introduced

Scope

- Applied in the recognition, measurement and disclosure of PPE
- Excludes
  - biological assets related to agricultural activity,
  - PPE held for sale (covered by IFRS 5),
  - exploration and evaluation assets and
  - mineral rights and reserves
- But applies to PPE used develop/maintain PPE in the first and last bullet point

DEFINITIONS

Definition

Property, plant and equipment are tangible items that are

- Held for use in the production or supply of goods or services, for rental to others or for administrative purposes and
- Are expected to be used during more than one period

Deals with recognition of PPE, determining their carrying amounts, depreciation charges and impairment losses to be recognised

Case study

- All assets held for rental to others are PPE?
- Administrative assets – definition v/s Indian GAAP
- Specific inclusion of assets held for administrative purposes in the definition
- AS 10 excludes administrative assets in its definition

RECOGNITION & MEASUREMENT

Recognition

- PPE to be recognised as an asset only when
  - Probable that future economic benefits will flow to the entity
  - Cost of the asset can be measured reliably
- Spare parts, stand-by equipment and servicing equipment PPE or inventory (eg insurance spares). Accounting standards amendment Rules transition provisions
- Unit of measure not prescribed. Allows aggregation of individually insignificant items and apply the standard to the aggregate value.
- Initial recognition at cost

Case study

- Accounting of moulds and dies.
- Units of measure
- Items acquired for safety or environmental reasons? PPE?
- But tested for impairment as per IAS 36. What does this mean?

Recognition – Determination of Cost

- Components of cost
  - Purchase price
  - Import duties and non refundable purchase taxes
  - Reduced by trade discounts or rebates, and
  - Initial cost of dismantling and removing the item and restoring site on which it is located
- Costs directly attributable to bringing the asset to its location and condition necessary for it to be capable of operating in the manner intended
- Directly attributable costs include
  - Cost of employee benefits directly arising from the construction/acquisition of the asset
  - Costs of site preparation
  - Initial delivery & handling costs, costs of testing whether asset functioning properly
  - Professional fees

Recognition – Determination of Cost

- Items that are not cost
  - Cost of opening a new facility
  - Costs of introducing a new product (eg advt costs)
  - Costs of doing business in a new location or with a new customer (eg staff training)
  - Admin and other general overhead costs

Recognition – Determination of Cost

- If purchase price deferred beyond normal credit terms, to be discounted
- If an item acquired in exchange for a non-monetary asset, the cost of such an item measured at fair value, unless
  - Transaction lacks commercial substance
  - The fair value of neither the asset received nor the asset given up is reliably measurable
- In such a case the carrying value of the asset given up is the cost of the new asset
- Transaction has commercial substance if
  - The risk, timing and amount of cash flows of asset received differs from that of the asset transferred or
  - Entity specific value of the portion of the entity's operations affected by the exchange are altered
  - Differences referred to above are significant relative to fair value of assets exchanged

Reliability of fair value

Fair value can be determined reliably if

- Variability in range of reasonable fair values in not significant for that asset or
- Probabilities of the various estimates within the range can be reasonably assessed

Case study

- Cost of construction of a factory is Rs 100 crores. The permit for construction includes an obligation to restore the site on which the factory is located to its original condition.
- Cost is estimated to be Rs 15 crores.
- Any accounting implications?

Recognition – Subsequent costs (replacement)

- Day to day servicing costs, to be expensed
- Replacement of parts of items of PPE
- Recognised in the carrying amount of PPE the cost of such part when incurred (ie capitalized)
- Carrying amount of parts that are replaced is de-recognised

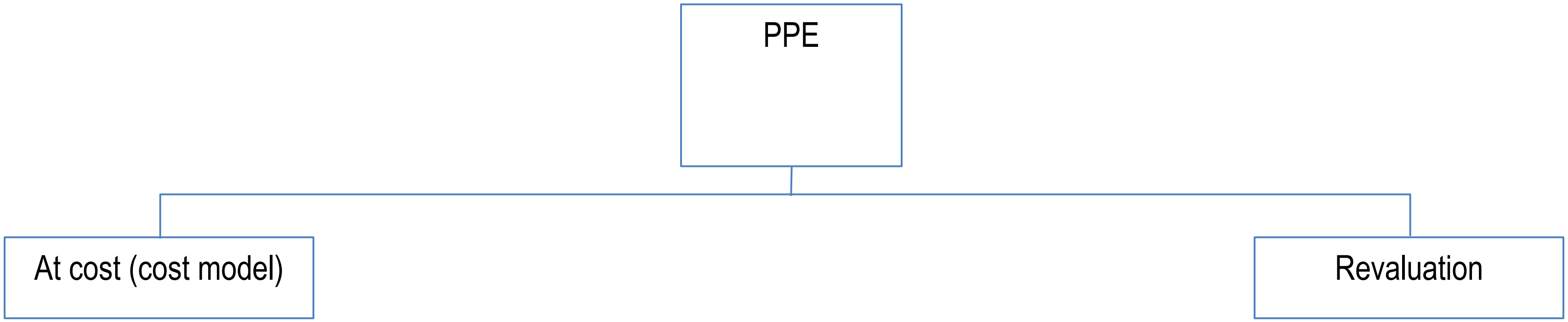
Case study

- Practical application? How to find out the WDV of the part being replaced?
- May not be possible to identify the cost of these items separately on acquisition
- Use the cost of the replaced past as an indication of what is the cost of the replaced part included in the original cost of the asset

Recognition – Subsequent costs (major overhaul)

- Many assets require periodic inspections (eg engines in aircraft, dry docking for ships
- Cost of each major inspection is capitalized
- Carrying amount of previous inspections is de recognised
- Practical application? How to find out carrying value of the previous inspection?
- Use the cost of the replaced part as an indication of what is the cost of the replaced part included in the original cost of the asset. Can similar method be applied?
- First inspection after acquisition of the asset
- While componentising asset initial cost of an asset to include a major inspection component

Measurement after recognition



- When revaluation model used, to be applied to entire class of assets
- Revaluation to be frequent enough to keep carrying values close to fair value
- Frequency of revaluation – annual if value of asset is volatile else every 3-5 years (eg oil rigs v/s plant and machinery)
- Carrying amount reduced by any accumulated depreciation under both models. Practical impact?
- Increase on account of revaluation to be taken to revaluation surplus in equity (via other comprehensive income) unless it reverses a previous revaluation decrease taken to p&l
- Decrease - in p&l after setting of any amount lying in revaluation surplus <u>for that asset</u>

Recognition – Revaluation surplus some other points

- Revaluation surplus transferred directly to retained earnings when the PPE is derecognised
- Can also be transferred as the asset is used by the entity
- Measured as the difference between depreciation on original cost and revaluated amount
- However, difference will not be routed through p&l
- Depreciation and net income would be affected. No impact on equity
- This guidance is similar to the guidance recently issued by the ICAI in its Application Guidance on Schedule II of the Cos Act, 2013

Measurement after recognition

	Indian GAAP (Rs.)	IFRS (Rs.)	
		Cost option	Revaluation
Machinery (cost price - 100,000)			
Year 1	95,000	95,000	100,000
Year 2	90,000	90,000	
Year 3	85,000	85,000	155,000
Year 4	80,000	80,000	
Depreciation/ Fair value gain/ (loss)			
Year 1	(5,000)	(5,000)	(5,000)
Year 2	(5,000)	(5,000)	(5,000)
Year 3	(5,000)	(5,000)	**50,000 [65,000 reval & 5,000 dep]**
Year 4	(5,000)	(5,000)	**(9,117)**

DEPRECIATION

Depreciation

- Depreciation of each significant component to be depreciated separately
- Requires allocation of initial cost of PPE to its significant parts
- Depreciation charge to be expensed unless capitalizable to another asset
- Depreciation should be calculated at depreciable amount , ie cost or revalued amount less its residual value (no mandatory useful life)
- To be calculated over its useful life
- Residual value to be reviewed at least at each financial year-end
- Practical issues may arise when assets are bought externally eg
  - Turnkey contract awarded for engineering services, procurement and construction and supervision for a lumpsum amount
  - Contract given for construction of a ship, aircraft, etc
  - Specialised facilities like nuclear plants, refineries, etc

Depreciation method

- Should reflect the pattern in which the asset's benefits are expected to be consumed by the entity
- To be reviewed at least at each financial year end
- Straight line method, WDV method and units of production method
- Change in method to be applied prospectively

Depreciation – practical issues?

- Specified useful life in Companies Act, 2013 v/s estimated useful life in IND AS?
- Residual value – Mandatory 5% as per Companies Act, 2013
- IND AS states it is often immaterial and ignored
- Depreciation to be charged even if fair value greater than carrying amount
- If residual value > carrying amount – depreciation is zero.

DISCLOSURES

Disclosure requirements

- For each class of PPE disclosure required of
  - Measurement basis (cost, valuation if acquired in exchange or in a business combination, etc)
  - Depreciation method used and useful lives or depreciation rates (Currently in India disclosed only if separate from that specified in statute)
  - Gross carrying amount and accumulated depreciation (which includes accumulated impairment loss) at the beginning and the end of the year
- Existence of amounts and restrictions on title and assets pledged as security
- Expense capitalized for assets in construction (CWIP)
- Contractual commitments of acquisition of PPE

Disclosure requirements

- Movements in PPE giving
  - additions,
  - assets classified as held for sale
  - acquisition through a business combination
  - increases/decreases due to revaluation and
  - impairment losses and reversals (separately for impairment in p&l and in OCI)
  - depreciation and translation differences and any other changes
  - depreciation capitalized and that charged to p&l and accumulated depreciation
- Compensation from third parties for assets that were impaired, lost or given up
- Nature and effect of a change in accounting estimates – residual values, dismantling costs, useful lives and depreciation methods

Disclosure requirements – revalued assets

Additional disclosures for PPE carried under the revaluation model include

- The date of the revaluation
- Whether independent valuer was involved
- For each class of PPE the carrying amount if the assets had been carried under the cost model
- Revaluation surplus indicating change during the period and any restrictions in distribution thereof to shareholders
- Compensation from third parties for assets that were impaired, lost or given up
- Nature and effect of a change in accounting estimates – residual values, dismantling costs, useful lives and depreciation methods

Disclosure requirements – additional

Additional disclosures for PPE (IFRS states users may find this useful and hence encourages disclosures for the same)

- Carrying amount of temporarily idle PPE
- Gross carrying amount of fully depreciated PPE that is still in use
- Carrying amount of PPE retired from use and not classified as held for sale
- Fair value of PPE accounted for under the cost model

DIFFERENCES IN IND AS

Differences with IFRS

- Cost of asset cannot be reduced with the amount of Government Grant in IND AS
- Existing carrying values can be carried forward as carrying cost in IND AS on first time adoption
- Exchange differences and other items (eg gen and admin costs capitalized or borrowing costs expensed) will not be adjusted on first time adoption
- Post first time adoption the same cannot be capitalized

Thank you