

IND AS 16: Property, Plant and Equipment and Depreciation

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Abstract: Accounting is called the language of business. It is through the accounting statements that stakeholders of the business get information about its performance. Therefore, every business should communicate with them by preparing financial statements according to their countries Generally Accepted Accounting Principles (GAAP). But to ensure uniformity in reporting and to make comparisons between different companies across the globe possible, many countries are now adopting the International Financial Reporting Standards (IFRS). The IFRS helps in synchronization of accounting standards of different countries, thus making financial statements truly comparable. India too has kept up with this changing trend of financial reporting and has chosen the path of IFRS convergence. Convergence means harmonization. The Indian standard setters have modified certain IFRS to suit Indian requirements and have come up with a new set of accounting standards known as IND AS.

Introduction

The Ministry of Corporate Affairs notified these standards through the Companies (Indian Accounting Standards) rules, 2015 on 16th February, 2015. Though IND AS has come a long way and is now quite close to IFRS, certain differences between the IFRS and IND AS still remain. They are to be as carve-outs or carve-ins. The roadmap for adoption of IND AS has also been laid down, requiring the following companies to mandatorily adopt the new standards for the accounting periods beginning on or after April 1, 2016.

- Companies (listed and unlisted) whose net worth is equal to or greater than 500 crores INR.
- Holding, subsidiary, joint venture or associate companies of the listed and unlisted companies covered above. The following companies will have to mandatorily adopt the new standards for the accounting periods beginning on or after April 1, 2017.
- Unlisted companies whose net worth is equal to or greater than 250 crores INR and all listed companies.
- Holding, subsidiary, joint venture or associate companies of the listed and unlisted companies covered above.

Companies not under the mandatory roadmap may voluntarily adopt the IND AS from the financial years 2015-16 and follow the same for the subsequent years. The notification clarifies that the roadmap will not be applicable to the following:

- Companies whose securities are listed or in the process of being listed on any SME exchange.
- Insurance companies, banking companies and non-banking finance companies.

Objective

- To have a conceptual understanding of IND AS 16 which deal with accounting for property, plant and equipment and depreciation.
- To compare IND AS 16 with the existing AS 10, Accounting for fixed asset and AS 10 which deal with depreciation accounting.
- To study the impact of changes in accounting standard on the financial statements.

Research methodology

The study is mainly qualitative in nature. It has been carried out primarily on the basis of secondary data.

IND AS 16

The objective of this standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amount and the depreciation charges and impairment losses to be recognized in relation to them. This standard does not apply to:

- Property, plant and equipment classified as held for sale in accordance with IND AS 105 Non-current assets held for sale and discontinued operation;

- Biological assets related to agricultural activity
- The recognition and measurement of exploration and evaluation assets
- Mineral rights and mineral reserves such as oil, natural gas and non-regenerative resources.

Property, plant and equipment is measured initially at cost. cost includes fair value of the consideration given to acquire the assets (net of discount and rebates) and any directly attributable cost of bringing the asset to working condition for its intended use (inclusive of important duties and Non-refundable purchase taxes).directly attributable cost includes cost of site preparation delivery, installation costs, relevant professional fees and estimated cost dismantling and removing the asset and restoring the site.

Classes of PPE are carried at either the cost model or the revaluation model. The cost model means historical cost less accumulated depreciation and any accumulated impairment losses. The revaluation model means the revalued amount less any accumulated depreciation and subsequent accumulated impairment losses. The other provisions of IND AS 16 can be understood further through the following differences between IND AS 16 of the companies(Indian accounting standard)Rules,2015 and AS 10 and AS 6 of the companies(accounting standard)Rules, 2006.

Differences

1. Cost of an item of Property, plant and equipment: According to AS 16, the cost of property, plant and equipment is the cash equivalent paid or the fair value of other consideration given to acquire the asset. If payment is deferred beyond normal credit terms, the difference between the amount capitalized and the full transaction value is treated as imputed interest cost to be charged to the profit and loss account as and when paid.
2. Subsequent costs related to fixed assets: Existing AS 10, Subsequent expenditures related to an item of fix asset are capitalized only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance.
3. Cost of major spares: IND AS 16 requires that major spare parts qualify as property, plant and equipment when an entity expects to use them during more than one period and when they can be used only in connection with an item of property, plant and equipment.

IND AS 16 recognized it as plant and equipment, if it meets the criteria of recognition. Otherwise it is classified as inventory.

4. Componentization and Replacement: IND AS 16 is based on the component approach. Under this approach, each major part of an item of property, plant and equipment with a cost of replacing such parts is capitalized, if recognition criteria are met with consequent de-recognition of carrying amount of the replaced part. The cost of replacing those parts which have not been depreciated separately is also capitalized with the consequent de-recognition of the replaced parts.

The impact of componentization accounting of fixed assets can be seen through the following example:

Raavi Ltd. has fixed asset costing Rs.10,00,000 as on 31st March 2015. The rate of depreciation on this composite asset is 10% under straight line method and its useful life is 10 years. Treatment of the asset under the existing accounting standard: The asset will be shown at Rs. 9,00,000 in the balance sheet as on 31.3.2016. The amount of the Rs.1,00,000 will be charged as depreciation in the profit and loss account for the year 2015-16. Treatment of the composite asset as per IND AS 16: The composite asset will be broken into significant parts. Say, its three major component are X,Y and Z having cost of Rs.4,80,000, Rs. 3,20,000 and Rs. 2,00,000 and useful life of 8 years, 10 years and 5 years respectively. The impact of componentization will be as under:

Balance sheet	Written Down value	Depreciation(SLM)charged to profit and loss account
Part X	Rs. 4,20,000	Rs. 60,000
Part Y	Rs. 2,88,000	Rs. 32,000
Part Z	Rs. 1,60,000	Rs. 40,000
Total	Rs. 8,68,000	Rs. 1,32,000

Thus, there is a change in WDV from Rs.9,00,000 to Rs.8,68,000. The amount of depreciation to be changed to profit and loss account also changes from Rs.1,00,000 to 1,32,000 due to componentization of fixed assets.

5. Cost of major inspections: Under IND AS 16, the cost of major inspection or overhaul of an item occurring at regular intervals over the useful life of the amount of the cost of the previous inspection.
6. Provision of cost of dismantling and removing the item of property, plant and equipment: In this regard, AS 10 offers no specific treatment, whereas IND AS 16 requires that the initial estimate of the cost of dismantling and removing the item and restoring the site on which it is located should be include in the cost of the respective items .
7. Revaluation: IND AS 16 requires an entity to choose either the cost model or the revaluation model as its accounting policy and to apply that policy to an entire class of property, plant and equipment. IND AS also prescribes that revaluations should be made with sufficient regularity so that the revalued amount represents the fair value of the asset, while AS 10 does not prescribe any specific requirement on the frequency of revaluation.
8. Treatment of Revaluation Surplus: IND AS 16 provides that the revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred to the retained earnings when the asset is derecognized. This may involve transferring the whole of the surplus when transferred as the asset is used by an entity. In such a case, the amount of the

surplus transferred would be the difference between the depreciation based on the revalued carrying amount of the asset and depreciation based on the revalued carrying amount of the asset and depreciation based on its original cost.

9. Review of residual value and useful life: AS 16 has made it obligatory for companies to make an annual review of the residual value and useful life of its assets.

The accounting impact due to review of residual life of an asset can be understood through the below mentioned example:

Example: Megha Ltd. has the following assets on 31.03.14 and depreciation charged on straight line method (SLM) based on their useful lives as prescribe under the companies Act:

Assets	Book value	Rate of depreciation	Useful life
Building	Rs. 4,00,000	10%	10 years
Plant and machinery	Rs. 1,50,000	20%	5 years
Computers	Rs. 48,000	25%	4 years

Treatment as per existing accounting practice: The written-down value (WDV) of assets and depreciation (SLM) will be as under in the subsequent year 2014-15:

Assets	Written-Down value	Depreciation charged	Useful life
Building	Rs. 3,60,000	40,000	10 years
Plant and machinery	Rs. 1,20,000	30,000	5 years
Computers	Rs. 36,000	12,000	4 years
Total	Rs. 5,16,000	82,000	

Treatment as per IND AS 16: The useful life of each asset will be reviewed at the close of year 2014-15 and depreciation (SLM) will be charged accordingly. The useful life of each asset as on 31.03.2015 and WDV and depreciation will be as under:

Assets	Written-Down value	Depreciation charged	Useful life
Building	Rs. 3,20,000	80,000	5 years
Plant and machinery	Rs. 1,20,000	30,000	5 years
Computers	Rs. 40,000	8,000	6 years
Total	Rs. 4,80,000	1,18,000	-

The change of useful life will have an effect on the amount of depreciation charged to profit and loss account. Also, written down value will affect the amount of capital employed and ultimately affect the return on capital employed.

10. Review of method of depreciation: AS 16 also prescribes an annual review of depreciation method and clarifies that if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the assets, the method should be changed to reflect the changed pattern. In existing AS 6, Change in depreciation method can be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements. IND AS 16 requires that change in depreciation method should be considered as a change in accounting estimate and that it shall have a prospective effect.

11. Compensation for impairment: while compensation for impairment or loss of plant and equipment from third party is included in the profit and loss account in IND AS 16, the amount is offset against replaced item of plant and equipment according to AS 10.

12. Gain arising on de-recognition: IND AS 16 specifically provides that gains arising should not be treated as revenue. AS 10 is silent on this aspect.

13. Other differences: According to AS 10, any capital advances made towards to purchase of fixed asset have to be shown as "Long term Loan and Advances" in Non Current Asset, while IND AS 16 includes it in Capital-work-In-Progress. Under IFRS and IND AS, provisions for decommissioning, restoration and similar liabilities that have previously been recognized as a part of the cost of an item of property, plant and equipment are adjusted for changes in the amount or timing of future costs and for changes in the market-based discount rates. The AS 10 provides no specific guidance in the matter.

Foreign exchange differences are allowed to be capitalized in AS 10, but IND AS does not permit such capitalization, though in some cases, exchange differences may be treated as a part of borrowing costs and be allowed to be capitalized as addition interest cost. The disclosure requirements of IND AS 16 are significantly elaborate as compared to AS 10/ AS 6. Also, extensive use of fair values helps reflect more relevant information.

Conclusion

The adoption of the new accounting standards will certainly improve the presentation of financial statements and bring it in line with international standards, but at the same time it will require, not just technical but even functional changes to the existing accounting system of firms. As Indian entities have the benefit of learning from the experience of other countries who have already adopted the IFRS, the key lessons to be learnt for the top management is that it should conduct a thorough assessment of all probable changes. Instead of looking for top-side solutions, it would be more effective to push the conversions to the transaction level throughout the organization. Necessary time will have to be invested to roll out the business process changes and communicate it all concerned. Even the IT department should be involved at an early stage to study the tax implications of the conversion process so that the entity gets enough time to address to its tax issues and incorporates necessary changes.

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