What are Property, Plant and Equipment (PPE)?
The Property, Plant and Equipment (PPE) also generally known as fixed assets; these fixed assets are tangible property in contrast to the intangible property which is dealt by another AS-26.

These tangible assets are:
♦ Held for use in production or supply of goods and services, for rental to others, or for administrative purposes.
♦ Expected to be used during more than one period.
♦ Not held for sale in the normal course of business.

The examples of Property, Plant and Equipment (PPE) are land, building, plant and machinery, furniture and fitting and office equipment etc.

Objective – The principal issues in accounting for PPE are:
♦ The recognition of the assets,
♦ Determination of their carrying amounts, and
♦ The depreciation charges and impairment losses to be recognised in relation to them.

Scope
♦ This Standard prescribes the accounting for PPE except when another AS permits different accounting treatments.
This Standard does not apply to:

(a) Biological assets related to agricultural activity other than bearer plants. This Standard applies to bearer plants but it does not apply to the produce on bearer plants (bearer plants is explained in next Para);

(b) Wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.

However, this Standard applies to items of property, plant and equipment used to develop or maintain the assets described in (a) and (b) above.

- Investment property is an investment in land or buildings that are not intended to be occupied substantially for use in the operations of the investing enterprise. The investment property is not PPE and it should be accounted for only in accordance with the cost model prescribed in this Standard.

What is biological asset, Agriculture activity, Agriculture produce and bearer plant?

The standard defines these terms as under:

- **Biological Asset** is a living animal or plant and is core income producing asset of agricultural activity, therefore not covered by PPE.

- **Agricultural Activity** is the management by an enterprise of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

- **Agricultural Produce** is the harvested product of biological assets of the enterprise.
♦ **Bearer plant** is a plant that:

(a) is used in the production or supply of agricultural produce;

(b) is expected to bear produce for more than a period of twelve months; and

(c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

The following are *not* bearer plants:

(i) Plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber);

(ii) Plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and

(iii) Annual crops (for example, maize and wheat). When bearer plants are no longer used to bear, produce they might be cut down and sold as scrap, for example, for use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a bearer plant.
**Example 1:** Mango tree is a bearer plant and it covered by AS-10 PPE, however mango grown in tree is a produce of bearer plant and is not covered by this Standard. Further in wheat crop the plant of the wheat is not a bearer plant because it is cut down and sold as scrap.

**Recognition of assets**

*Criteria for Recognition* - The cost of an item of PPE should be recognized as an asset *if and only if:*

- It is probable that future economic benefits associated with the asset will flow to the entity and,

- The cost of the item can be measured reliably.

The *degree of certainty* attached to the flow of future economic benefits must be assessed. This should be based on the evidence available at the date of initial recognition (usually the date of purchase). The entity should thus be assured that it will receive the rewards attached to the asset and it will incur the associated risks, which will only generally be the case when the rewards and risks have actually passed to the entity. Until then, the asset should not be recognized.

**Example 2:** A plant and machinery is purchased for Rs. 20 lakhs. It satisfied the recognition criteria: future economic benefits will flow to the entity in the form of the capability to produce goods using the machinery, sell them and earn profits. Similarly, its price can be measured reliably from the purchase invoice. Therefore, it qualifies to be recognized as property, plant and equipment (PPE).

*Spare parts* are usually treated as inventory and recognized in the profit or loss as and when consumed.
**Example 3:** Small spare parts for machinery are purchased at a cost of Rs. 1.25 lakhs and stored by the entity. These are regularly issued whenever required by the maintenance department.

The balance of the spares on hand at the Balance Sheet date was worth Rs. 70,000. The consumed part of Rs. 55,000 should be shown as an expense in the Statement of Profit and loss. The balance of Rs. 70,000 should be carried forward as inventory it accounting should be as per AS-2.

Major spare parts and standby equipment are treated as property, plant and equipment when they are expected to be used over more than one period. They are included in non-current assets from the date the cost is incurred.

**Example 4:** Induga Ltd purchased an item of machinery for Rs. 2 lakhs, together with major spare parts worth Rs. 25,000 not readily available in the market. It should recognise the total of Rs. 2.25 lakhs and PPE

Those which can be used exclusively with an item of PPE are accounted for as PPE.
**Example 5:** Z Ltd purchases a ‘made to order’ machine for Rs. 5 lakhs and alongside also purchased spare parts worth Rs. 60,000 which can be used only on this machinery and not any machinery elsewhere. Advise Z Ltd on the accounting treatment of spare parts.

Along with the cost of machinery, the cost of spares also, should be capitalised i.e., recognized in the carrying value, thus, the total carrying value is Rs. 5.60 lakhs.

Any expenditure incurred that meets these recognition criteria must be accounted for as an asset (PPE). The Standard makes reference to individually insignificant items that can be aggregated.

However, very often, in practice, entities adopt an accounting policy to expense items that are below a predetermined minimum level in order to avoid undue cost in maintaining the relevant records, which includes tracking the whereabouts of the asset. The definition and recognition criteria can also be applied to spare parts, although these are often carried as inventory and expensed as and when utilized. However, major spare parts are usually recognized PPE when an entity expects to use them during more than one period.

**Safety and environmental equipment**

- The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of PPE, may be necessary for an entity to obtain the future economic benefits from its other assets.
- Such items of PPE qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what
could be derived had those items not been acquired.

*For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognized as an asset because without them the entity is unable to manufacture and sell chemicals.*

♦ However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with AS-28, Impairment of Assets.

**Initial measurement**

Once an item of property, plant and equipment qualifies for recognition as an asset, it will be initially measured at cost.

*What is cost* – The cost of items of PPE comprises:

♦ Purchase price, including import duties, non-refundable purchase taxes, less trade discounts and rebates.

♦ Costs directly attributable to bringing the asset to the location and condition necessary for it to be used in a manner intended by management.

♦ Initial estimates of cost of dismantling/decommissioning, removing, and site restoration at *present value* if the entity has an obligation that it incurs on acquisition of the asset or as a result of using the asset other than to produce inventories. AS-29 prescribes the discounting of such provisions and provision is made at present value by applying pretax discount rate.

**Example 6:** NDA Ltd has put plant in 2010 on leasehold land; the leasehold period is 15 yrs. NDA Ltd has to dismantle the plant removing from the leasehold land and restore the leasehold land at the same position at the time of inception of lease. *The estimated cost of dismantling the plant after 15 years will be Rs.20 crores.*
The pretax rate of the time value of money and risk specific to the liability is 10%.

Calculate the amount to be included in the cost of the plant,

The PV of cost of dismantling of the plant to be paid after 15 years = 20 crores/1.1
\[ P = \frac{20 \text{ crores}}{1.1} = 18.18 \text{ crores} \]
\[ A = \frac{18.18 \text{ crores}}{1.1} = 16.52 \text{ crores} \]  

This amount to be included in the cost of the Plant in 2010

Examples of directly attributable costs include:

- Employee benefits of those involved in the construction or acquisition of an asset
- Cost of site preparation
- Initial delivery and handling costs
- Installation and assembly costs
- Costs of testing, less the net proceeds from the sale of any product arising from test production
- Borrowing costs to the extent permitted by AS-16, Borrowing Costs
- Professional fees

Examples of costs that are not directly attributable costs and therefore must be expensed in the income statement include:

- Costs of opening a new facility (often referred to as preoperative expenses)
- Costs of introducing a new product or service including Advertising and promotional costs
- Costs of conducting business in a new location or with a new class of customer
- Training costs
- Administration and other general overheads
- Costs incurred while an asset, capable of being used as intended, is yet to...
be brought into use, is left idle, or is operating at below full capacity

♦ Initial operating losses
♦ Costs of relocating or reorganizing part or all of an entity’s operations
♦ The income and related expenses of operation that are incidental to the construction or development of an item of PPE should be recognized in the income statement. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognized in profit or loss and included in their respective classifications of income and expense.

**Cost of dismantling/decommissioning**

♦ The elements of cost to be incorporated in the initial recognition of an asset are to include the estimated costs of its eventual dismantlement (‘decommissioning cost’). That is, the cost of the asset is "grossed up" for these estimated terminal costs, with the offsetting credit being posted to a liability account.

♦ It is important to stress that recognition of a liability can only be affected when all the criteria set forth in AS-29 for the recognition in provisions are met.

♦ It seems odd to capitalize decommissioning costs that are not going to emerge until later in the asset's life. However, if there is an obligation as a direct consequence of acquiring or constructing property, plant and equipment to incur further costs in the future that cannot be avoided.

♦ A provision is recognized in accordance with AS-29. Therefore, the
decommissioning costs at the end of the asset’s life are just as much a cost of acquiring or constructing the asset as the costs incurred at the start of the asset's life.

♦  Decommissioning or similar costs such as dismantling expenditure can often arise in connection with operating leases and leasehold improvements.

**For example,** the terms of an operating lease may allow the tenant to tailor the property to meet their specific needs by, say, building an additional internal wall, but on condition that the tenant returns the property at the end of the lease in its original state, this will entail dismantling the internal wall. On building the internal wall, the tenant creates an obligation to remove the wall, which it cannot avoid, therefore, must recognize a provision for that obligation in accordance with AS-29. The cost to the tenant, therefore, of the leasehold improvement is not only the cost of building the wall, but also the cost of restoring the property at the end of the lease by dismantling the internal wall. As such, both costs are capitalised when the internal wall is built and will be recognized in the profit and loss account over the useful life of the asset (generally the expected lease term) as part of the depreciation charge.

Examples of decommissioning costs that may be capitalised as part of the cost of the asset typically arise in oil and gas and electricity industries where environmental damage is caused by, say the construction and commissioning of the facility (for example, the oil platform, as in the example referred to above, or nuclear plant). Similar costs are incurred in other industries such as: abandonment costs in the mining and extractive industries; clean up and restoration costs of landfill sites and environmental; cleanup costs in the number of industries.

♦  It is to be noted that estimated cost of dismantling is to be included in the cost of the property, plant and equipment will be at its present value as per AS-29.
Cost of self-constructed asset –

The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (AS-2). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. AS-16 Borrowing Costs establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of property, plant and equipment.

Exchange of assets - AS-10 specifies that exchange of items of PPE, regardless of whether the assets are similar, are measured at fair value, unless:

(a) the exchange transaction lacks commercial substance, or
(b) the fair value of neither of the assets exchanges can be measured reliably.

If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Whether an exchange transaction has commercial substance depends on the extent to which the reporting entity's future cash flows are expected to change as a result of the transaction. If the expected cash flows after the exchange differ from what would have been expected without this occurring, the exchange has commercial substance and is to be accounted for at fair value. If the transaction does not have commercial substance, or the fair value of neither the asset received nor the asset given up can be measured reliably, then the asset acquired is valued at the carrying amount of the asset given up.
less settle-up paid or received in cash or a cash equivalent, this is often referred to as boot.

**Example 7:** Indnga Ltd exchanges car X with a hook value of Rs. 13,000 having a fair value of Rs. 13,250 for cash of Rs. 150 and car Y which has a fair value of Rs. 13,100. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange; it is in the same position as it was before the transaction.

The Induga Ltd recognizes the assets received at the book value of car X. Therefore, it recognizes cash of Rs. 150 and car Y as property, plant and equipment with a carrying value of Rs. 12,850.

**Example 8:** J& Co. exchanges an automobile with a carrying value of Rs. 2500 with S & Co. for a tooling machine with a fair market value of Rs. 3200. No boot is exchanged in the transaction. The fair value of the automobile is not readily determinable.

In this case, J& Co. has recognized a gain of Rs. 700 (3200 - 2500) on the exchange, and the gain should be included in the determination of net income. The entry to record the transaction would be as follows:

```
Machine         Dr.       Rs. 3200
To Automobile   Rs. 2500
To Gain on exchange of automobile Rs. 700
```

**Measurement of cost**

The cost of an item of PPE is the *cash price equivalent at the recognition date*. If payment is deferred beyond normal credit terms, the difference between the cash
price equivalent and the total payment is recognized as interest over the period of credit unless such interest is capitalised in accordance with AS-16.

The cost of an item of PPE held by a lessee under a finance lease is determined in accordance with AS-19.

Cost of Bearer Plants

Bearer plants are accounted for in the same way as self-constructed items of property, plant and equipment before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Subsequent costs

♦ The issue is whether subsequent expenditure is capital expenditure (i.e., to the Balance Sheet) or revenue expenditure (i.e., profit or loss statement.

♦ An entity does not recognize in the carrying amount of an item of PPE the costs of the day-to-day servicing of the item. Rather, these costs are recognized in profit or losses as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the ‘repairs and maintenance' of the item of property, plant and equipment.

♦ To qualify for capitalization, cost must be associated with incremental benefit for example, modification to the asset made to extend its useful life or to increase its capacity would be capitalised. Similarly if the expenditure results in an improve quality of output or results in saving the cost it will qualify for capitalization.
Part replacement

- Some items (e.g. aircraft, ships, gas, turbine etc.) are series of linked parts which require regular replacement at different intervals and so have different useful lives.
- The cost of such regular replacement is capitalised, if the recognition criteria are met.
- The carrying amount of replaced parts (old parts) is derecognized (i.e., treated as a disposal)

Major inspection/ overhaul costs

- Performing regular major inspections for faults, regardless of whether parts of the item are replaced, may be a condition of continuing to operate an item of PPE (e.g. an aircraft).
- The cost of each major inspection performed is recognized in the carrying amount (capitalised), as a replacement, if the recognition criteria are satisfied.
- Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognized.

Changes in existing Decommissioning, Restoration and Other Liabilities

The cost of property, plant and equipment may undergo changes subsequent to its acquisition or construction on account of:
- changes in liabilities,
- price adjustments,
- changes in duties,
- changes in initial estimates of amounts provided for dismantling,
- removing, restoration and similar factors and included in the cost of asset.
If the related asset is measured using the cost model:

♦ Changes in the liability should be added to, or deducted from, the cost of the related asset in the current period.

♦ The amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the statement of profit and loss.

♦ If the adjustment results in an addition to the cost of an asset, the enterprise should consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the enterprise should test the asset for impairment by estimating its recoverable amount, and should account for any impairment loss, in accordance with AS-28.

If the related asset is measured using the revaluation model:

Changes in the liability alter the revaluation surplus or deficit previously recognised on that asset.

(a) A decrease in the liability should be:

• credited directly to revaluation surplus or;

• In case there is no revaluation surplus on that asset, the decrease in liability should be credited to the statement of profit and loss.

(b) An increase in the liability should be:

• debited in statement of profit and loss

• If revaluation surplus is existing on that asset it should be debited to revaluation surplus, any excess than the revaluation surplus should be
debited to statement of profit and loss.

(c) In the event that a decrease in the liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess should be recognized immediately in the statement of profit and loss.

**Measurement subsequent to initial recognition**

**Accounting policy:** An entity may choose between the cost model and the revaluation model. However, the same policy must be applied to each entire class of PPE. Classes include land, land and buildings, factory plant, aircraft, vehicles, office equipments, fixtures and fittings etc.

**Cost Model:** Carry at cost less any accumulated depreciation and any accumulated impairment losses.

**Revaluation Model**

- Carry at a revalued amount, being fair value at the date of the revaluation less any subsequent accumulated depreciation and any accumulated impairment losses.
- To use this model, fair values must be reliably measurable.

**Revaluations**

**Fair value**

*Land and Buildings* - Market value is determined by appraisal normally undertaken by professionally qualified valuers.
**Plant and Equipment**

- Fair value is usually market value determined by appraisal.
- If there is no market based evidence of fair value (e.g. because items are of a specialized nature or rarely sold), fair value is estimated using
  - Depreciated replacement cost; or
  - An income approach

**Frequency**

- Revaluation must be made sufficiently regularly to ensure no material difference between carrying amount and fair value at the end of the reporting period.
- Frequency depends on movements in fair values. When fair value differs materially from carrying amount, a further revaluation is necessary.
- Items within a class may be revalued on a rolling basis within short period of time provided revaluations are kept up to date.

**Accumulated depreciation** - At the date of the revaluation accumulated depreciation is either:

- Restated proportionately with the change in gross carrying amount so that the carrying amount after revaluation equals is revalued amount.
- Elimination against gross carrying amount and the net amount restated to the revalued amount.

*The latter method is simpler and most commonly used for buildings.*
Increase/decrease due to revaluation

On an asset by asset basis:

- Increase should be credited directly to owners 'interests under the heading of revaluation surplus in the Balance Sheet. However a revaluation increase must be recognized in profit and loss to the extent that it reverses a revaluation decrease of the asset that was previously recognized as an expense.

- Decrease should be recognized as an expense’ in profit and loss. However, a revaluation decrease must be charged directly against any related revaluation surplus, to the extent that it is covered by that surplus.

- The revaluation surplus may be transferred directly to retained earnings when the surplus is realized (e.g., on disposal of the asset or during the asset's remaining useful life)
**Depreciation**

- Depreciable amount should be allocated on a systematic basis over useful life.
- Useful life and residual value must be reviewed at least at each financial year end. If expectations differ from previous estimates the changes are to be accounted for as a change in an accounting estimate. In accordance with AS-5 "Net profit or loss for the period, Prior Period Items and Changes in Accounting Policies" (i.e., adjusting depreciation charge for current and future periods)
- Depreciation method should reflect the pattern in which the asset's economic benefits are consumed.
- Depreciation charge for each period should be recognized as an expense unless it is included in the carrying amount of another asset.
- AS-10 does not specify a method to be used.
- AS-10 requires that each part of an item of PPE that has a cost that is significant when compared to the total cost of the item should be depreciated separately:
  - For example, it may be appropriate to depreciate separately airframe and engines of an aircraft.
  - Whilst the Standard's require identify and depreciate separately significant components mandatory except, where one significant part has a useful life and a depreciation method that is the same as those of another part of the same item of PPE, the two parts may be grouped together for depreciation purpose.
  - Standard allows depreciate separately remaining parts that are not significant individually in terms of their cost compared to the total cost of an item.
**Depreciable amount** - The Depreciable amount of an Asset shall be allocated on a systematic basis over its useful life.

Factors to be considered:

- Expected usage assessed by reference to expected capacity or physical output;
- Expected physical wear and tear (depends on operational factors e.g. number of shifts, repair and maintenance programme, etc.)
- Technical obsolescence arising from changes or improvements in production; or changes in market demand for product or service output.
- Legal or similar limits on the use (e.g., expiry dates of related leases).

- Asset management policy may involve disposal of assets after a specified time therefore useful life may be shorter than economic life.
- Repair and maintenance policies may also affect useful life (e.g., by extending it or increasing residual value) but do not negate the need for depreciation.

**Residual value**

- It is estimated value of depreciable assets at the end of its useful life.
- Depreciable amount is net of residual value. Residual value is often insignificant and immaterial to the calculation of the depreciable amount.
- Depreciation is always recognized, even if fair value exceeds carrying amount, except when residual value is greater than carrying amount (in which case the depreciation charge is zero).
**Depreciation period**

- Depreciation commences when an asset is available for use.
- Depreciation ceases at the earlier of the date the asset is:
  - retired from active use and
  - held for disposal
- Depreciation does not cease when an asset is idle or retired from use for sale (unless it is fully depreciated). However, depreciation may be zero under the “units of production method”.

**Land and buildings**

- These are separable assets and are separately accounted for, even when they are acquired together:
  - Land normally has an unlimited useful life and is therefore not **depreciated**.
  - Buildings normally have a limited useful life and are **depreciable** asset.

- Where land has a limited useful life (e.g., a landfill site, mine, quarry) it is depreciated.

**Depreciation methods**

- Straight line - a constant charge over useful life
- Diminishing balance - a decreasing charge over useful life
- Sum of the units - charge based on expected use or output
- Review periodically and, if significant, change method to reflect a change in
pattern of consumption of future benefits. Account for as a change in accounting estimate and adjust depreciation charge for current and future period.

**Review of depreciation method** –

The depreciation method should also be reviewed at least of each financial year end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits from those assets, the method should be changed to suit this changed pattern. When such a change in depreciation takes place the change should be accounted for as a change in accounting estimate and the depreciation charge for the current and future periods should be adjusted.

**Depreciation as per Schedule II of the Companies Act, 2013 and Guidance Note thereon**

As per Schedule II of the Companies Act, 2013, depreciation to be charged on the basis of useful life of asset. Revised AS-10, Property, Plant and Equipment (PPE) also prescribe the same principle of useful life.

The Schedule II prescribes that the useful life of an asset shall not ordinarily be different from the useful life specified in the Schedule and the residual value of an asset shall not be more than 5% of the original cost of the asset.

Provided that where a company adopts a useful life different from what is specified in the Schedule or uses a residual value different from the limit specified
above, the financial statements shall disclose such difference and provide justification in this behalf duly supported by technical advice.

**Useful life or residual value governed by other regulatory authority**-

Part B of the Schedule II states that the useful life or residual value of any specific asset, as notified for accounting purposes by a Regulatory Authority constituted under an Act of Parliament or by the Central Government shall be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of this Schedule.

For example, the MCA had issued a General Circular dated 31 May, 2011, which states that for companies engaged in generation/supply of electricity, rates of depreciation prevail over the Schedule XIV to the Companies Act, 1956.

Accordingly, in accordance with Part B of the Schedule II, electricity companies will still continue to charge depreciation in accordance with the Electricity Act.

**Component Accounting**-

As per note 4 Schedule II to the Companies Act, 2013 -“Useful life specified in Part C of the Schedule is for whole of the asset.

Where cost of a part of the asset is significant to total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of that significant part shall be determined separately.”
As per the amendment dated August 29, 2014 notified by the MCA, the said requirement shall be voluntary in respect for the financial year commencing on or after the April 1, 2014 and mandatory for financial statements in respect of financial years commencing on or after April 1, 2015.

The above requirement is commonly known as 'component accounting'. Companies will need to identify and depreciate significant components with different useful lives separately. The revised AS-10, Property, Plant and Equipment (PPE) also prescribe the component accounting.

The determination as to whether a part of an asset is significant requires a careful assessment of the facts and circumstances. This assessment would include at a minimum:

- comparison of the cost allocated to the item to the total cost of the aggregated property, plant and equipment; and
- Consideration of potential impact of componentization on the depreciation expense.

Component accounting requires a company to identify and depreciate significant components with different useful lives separately. The application of component accounting is likely to cause significant change in the measurement of depreciation.
As component accounting was hitherto not mandatory in India, it is possible that the separate cost of each significant component of an asset is not available in the books of account. In order to determine the cost of such component following criteria can be used:

(a) Break up cost provided by the vendor
(b) Cost break up given by internal/external technical expert
(c) Current replacement cost of component of the related asset and applying the same basis on the historical cost of asset

Component accounting is required to be done for the entire block of assets as at 1 April, 2014 if a company opts to follow it voluntarily and as at 1st April, 2015 mandatorily. It cannot be restricted to only new assets acquired after 1st April 2014 or 1st April, 2015 as the case may be.

The first step is to identify key components requiring separate depreciation. Schedule II requires separate depreciation only for parts of an item of tangible fixed asset having:

(i) Significant cost, and
(ii) Different useful lives from remaining parts of the asset.

The company must split the fixed asset into various identifiable parts to the extent possible. The identified parts should be grouped together if they have the same or similar useful life for the purpose of separate depreciation. Insignificant parts may be combined together in the remainder of the asset or with the principal asset.
For instance:

(a) A Building may be split up into the following components:

♦ Structural design
♦ Elevators
♦ Heating system
♦ Water system
♦ Electrical system

(b) A Ship may be bifurcated into the following components:

♦ Hull
♦ Kee
♦ Engine
♦ Navigation system
♦ Major overhaul/inspections
♦ Other fit out assets

Identification of significant parts is a matter of judgment and decided on case-to-case basis. Identification of separate parts of an asset and determination of their useful life is not merely an accounting exercise; rather, it involves technical expertise. Hence, it may be necessary to involve technical experts to determine the parts of an asset.

A company needs to identify only material/significant components separately for depreciation. Materiality is a matter of judgment and needs to be decided on the facts of each case. For example, a component having original cost equal to or less than 5% of the original cost of an asset may not be material. Similarly, a
component having original cost equal to 25% or more of the original cost of complete asset may be material. The Company may consider 10% of original cost of the asset as a threshold to determine whether a component is material/significant.

In addition, a company also needs to consider impact on retained earnings, current year profit or loss and future profit or loss (say, when part will be replaced) to decide materiality. If a component may have material impact from either perspective, the said component will be material and require separate identification.

Each significant component of the asset having useful life, which is different from the useful life of the remaining asset, should be depreciated separately. If the useful life of the component is lower than the useful life of the principal asset as per Schedule II, such lower useful should be used. On the other hand, if the useful life of the component is higher than the useful life of the principal asset as per Schedule II, the company has a choice of using either the higher or lower useful life. However, 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.

To illustrate, assume that the useful life of an asset as envisaged under the Schedule II is 10 years. The management has also estimated that the useful life of the principal asset is 10 years. If a component of the asset has useful life of 8 years, AS-10 requires the company to depreciate the component using 8 year life only.
However, if the component has 12-year life, the company may depreciate the component using either 10-year life as prescribed in the Schedule II.

**Transitional provision under Schedule II** - From the date Schedule II comes into effect i.e. 1st April, 2014, the carrying amount of the asset as on that date:

(a) Shall be depreciated over the remaining useful life of the asset.

(b) After retaining the residual value, may be recognized in the opening balance of retained earnings or may be charged off to Statement of Profit and Loss where the remaining useful life of an asset is Nil.

Hence the company will have to reassess the useful life of its existing fixed assets in accordance with Schedule II. For example, Useful Life of General Furniture and Fittings has been reduced from 15 years to 10 years. Consider the below scenarios for different age of a piece of furniture on the date of applicability of Schedule II:

- The furniture is 8 years old - The remaining WDV of the furniture shall be depreciated over the remaining 2 years.

- The furniture is 12 years old - Company has an option of charging the remaining WDV of the furniture to the retained earnings of the company or charging the same to the statement of profit and loss.

The above application is fairly simple if the company uses straight line method (SLM) of depreciation and the asset will be depreciated equally over the new remaining useful life of the asset determined as per
Schedule II. However, if a company uses Written Down Value (WDV) method of depreciation, it will need to calculate a new rate for depreciation to depreciate the asset over their remaining useful life using the formula for calculation of rate for depreciation as per WDV method which is reproduced below:

\[ R = \left(1 - \left(\frac{s}{c}\right)^{\frac{1}{n}}\right) \times 100 \]

Where:
- \( R \) = Rate of Depreciation (in %)
- \( n \) = Remaining useful life of the asset (in years)
- \( s \) = Scrap value at the end of useful life of the asset
- \( c \) = Cost of the asset/Written down value of the asset

**Example 10:** The Company is a Special Purpose Vehicle floated to execute a project in accordance with the service concession agreement signed with the grantor. Service concession agreement is for 30 years and the company has option to renew it for additional period of 30 years. Assets created by the Company is capitalised as Tangible assets under the various applicable heads. While applying Schedule II, how the company should assess useful life of its various assets?

In such a situation, the Company needs to assess the renewable option and evaluate the likelihood of renewal. If the Company is reasonably certain at the inception of the service concession period that it will be renewed for further period of 30 years and accordingly the same needs to be considered for evaluating the useful life of various assets. The useful life of the various assets will be lower of the following:

- Useful life of assets as mentioned in the Schedule II or as assessed by the Company based on the technical justification or
♦ Service concession period of 30 years or 60 years as the case may be.

**Impairment**

♦ To determine whether an item of PPE is impaired an entity applies AS-28, Impairment of Assets.

♦ Impairment losses are accounted for accordance with AS-28.

**Compensation for impairment**

♦ In certain circumstances a third party will compensate an entity for an impairment loss. For example, insurance for fire damage or compensation for compulsory purchase of land for a motorway. Such compensation must be included in profit or loss when it becomes receivable.

♦ Recognizing the compensation as deferred income or deducting it from the impairment loss or from the cost of a new asset is not appropriate.

**Derecognition: Accounting treatment**

♦ In Balance Sheet: Eliminate on disposal or when no future economic benefits are expected from use (“retirement”) or disposal.

♦ Statement of Profit and Loss: Recognize gain or loss (difference between estimated net disposal proceeds and carrying amount) in profit or loss unless a sale and leaseback (AS-19).

♦ Gains are not classified as revenue.
**Derecognition date**

- The revenue recognition principle in AS - 9 *Revenue Recognition*, for sales of goods applies also to sales of items of PPE only to determine the date of sale.

**Disclosure**

*For each class*

- Measurement bases used for determining gross carrying amount.
- Depreciation method used.
- Useful lives or the depreciation rates used.
- Gross carrying amount and accumulated depreciation at beginning and end of period. Accumulated impairment losses are aggregated with accumulated depreciation.
- A reconciliation of carrying amount at beginning and end of period showing:
  - Additions (i.e., capital expenditure);
  - Assets classified as held for sale and other disposals;
  - Acquisitions through business combinations;
  - Increase/decrease resulting from revaluations;
  - Impairment losses (i.e., reductions in carrying amount);
  - Reversal of impairment losses;
  - Depreciation;
  - Net exchange differences arising on translation of functional currency into reporting currency;
  - Other movements, in case of translation of a foreign operation.
**Others**

- Existence and amounts of restrictions on title, and PPE pledged as security
- Expenditures on account of PPE in course of construction.
- Contractual commitment for the acquisition of PPE.
- Compensation from third parties for items impaired, lost or given up that is included in profit or loss, if not disclosed separately in the statement of Profit and Loss.

**Items stated at revalued amounts**

- Effective date of revaluation.
- Whether an independent valuer was involved.
- Methods and significant assumptions applied to estimate fair values.
- The extent to which fair values were:
  - Determined directly (i.e., by reference to observable prices in an active market or recent market transactions on arm’s length terms)
  - Estimated using other valuation techniques. For example, indices may be used to determine replacement cost.
- Carrying amount of each class of PPE that would have been included in the financial statements had the assets been carried under the cost model.
- Revaluation surplus, indicating movement for period and any restrictions on distribution of balance to shareholders.
Disclosure encouraged

♦ Carrying amount of temporarily idle PPE.
♦ Gross carrying amount of any fully depreciated PPE that is still in use.
♦ Carrying amount of PPE retired from active use and not classified as held for sale.
♦ When the cost model is used, the fair value of PPE when this is materially different from the carrying amount.

Transitional Provisions

♦ Where an entity has in past recognized expenditure in the statement of profit and loss which is eligible to be included as a part of the cost of a project for construction of property, plant and equipment in accordance with AS-10 (Revised), it may do so retrospectively for such a project. The effect of such retrospective application of this requirement should be recognised net-of-tax in revenue reserves.

♦ The requirements regarding the initial measurement of an item of PPE acquired in an exchange of assets transaction should be applied prospectively only to transactions entered into after this Standard becomes mandatory.

♦ On the date of this Standard becoming mandatory, the spare parts, which hitherto were being treated as inventory under AS-2, Valuation of Inventories, and are now required to be capitalised in accordance with the requirements of this Standard, should be capitalised at their respective carrying amounts. The spare parts so capitalised should be depreciated over their remaining useful lives prospectively as per the requirements of this Standard.
The requirements regarding the revaluation model should be applied prospectively. In case, on the date of this Standard becoming mandatory, an enterprise does not adopt the revaluation model as its accounting policy but the carrying amount of item(s) of PPE reflects any previous revaluation it should adjust the amount outstanding in the revaluation reserve against the carrying amount of that item. However, the carrying amount of that item should never be less than residual value. Any excess of the amount outstanding as revaluation reserve over the carrying amount of that item should be adjusted in revenue reserves.

**Treatment of CENVAT credit on capital goods (PPE)**

AS-10 on "Property, Plant and Equipment" requires that only non-refundable taxes and duties in respect of the PPE should be included in the cost of that PPE.

Cenvatable excise duty can be considered as a refundable tax. Therefore, CENVAT credit of such duty should be reduced from the purchase cost of capital goods concerned and recognized as a separate asset if the following conditions are satisfied:

(i) The entity is entitled to the CENVAT credit as per the Rules,

(ii) There is a reasonable certainty that the CENVAT credit would be utilized, and

(iii) Entity intends to avail the CENVAT credit.

The CENVAT credit in respect of capital goods is allowed for an amount not exceeding 50% of the duty paid on such capital goods in the financial year in which the goods are received in factory and the balance will be allowed in the
subsequent year(s). If the conditions specified above are met and the entity decides to take CENVAT credit, the entire amount of CENVAT credit should be deducted from the cost of capital goods. The amount of CENVAT credit taken in the financial year, in which goods are received, should be debited to an appropriate account, say, “CENVAT Receivable (Capital goods) Account” and balance may be debited in another appropriate account say “CENVAT credit Deferred Account”.

In the subsequent financial year(s), when the balance CENVAT credit is availed of, the appropriate adjustment for the same should be made, i.e., amount of “CENVAT credit Deferred Account" with a corresponding debit to “CENVAT Credit Receivable (Capital Goods) Account”.

On actual utilization, the account will be adjusted against excise duty on the final products. Accordingly, the purchase cost of the capital goods would be net of the specified duty on capital goods. The unadjusted balance standing in the MOD VAT Credit Receivable (Capital Goods) Account, if any, should be shown on the asset side under the head "Advances".

In following cases excise duty, even though Cenvatable should be included in the cost of PPE:

(i) The entity does not intended to avail it; or

(ii) The recognition criteria is not satisfied.
Review of balance in CENVAT credit receivable accounts –

Balance in CENVAT Credit Receivable Accounts, pertaining to capital goods, should be reviewed at the end of the year, if it is found that the balance of the CENVAT credit are not likely to be used in the normal course of business within a reasonable time, then, notwithstanding the right to carry forward such excess credit in the Excise Rules, the non-usable credit should be adjusted in the accounts.

As a result, the balance of the CENVAT credit receivable accounts in the financial account may be lower than the credit available as per CENVAT credit registers. In such a case, a reconciliation statement would have to be prepared indicating the amounts adjusted so that a track is kept for the difference between the balance and the difference between financial accounts and the credit available as per the excise registers can be explained in subsequent years also.

The adjustment of excess credit related to capital goods should be made to the concerned Capital Goods Account. The excess CENVAT credit, which is not utilizable in future within reasonable time, either availed or deferred, which related to fixed assets acquired, should be added to the cost of the relevant fixed asset.

For accounting purposes, depreciation on the revised unamortized depreciation amount should be provided prospectively over the residual useful life of the asset. In case the fixed asset no longer exists, the relevant amount should be written off in the profit and loss account. To facilitate aforesaid treatment, CENVAT credit record should be maintained fixed asset-wise in the relevant R.G. Register.