B S R & Co. LLP

Ind AS 16, Property, plant and equipment (PPE)

What will you learn?

By completing this module you will be able to:

- Explain the definition of PPE
- Explain the initial recognition and measurement of PPE
- Explain the subsequent measurement of PPE

Agenda

Scope

Definition of PPE

Initial recognition and measurement

Depreciation and subsequent measurement

Derecognition and compensation

Q & A

Scope

Within the scope of Ind AS 16

Accounting for Property, Plant and Equipment (PPE) except when another Standard requires or permits a different accounting treatment.

Outside the Scope of Ind AS 16

- Non-current Assets Held for Sale and Discontinued Operations (Ind AS 105)

- Biological assets related to agricultural activity (Ind AS 41)

- Exploration for and Evaluation of Mineral Resources (Ind AS 106)

- Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

Agenda

Scope

Definition of PPE

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Definition of PPE

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

&

expected to be used during more than one period

Spare parts, stand-by equipment and servicing equipment to be recognised as PPE if they meet the definition of PPE

Agenda

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Recognition

Cost of PPE to be recognised as an asset if:

Probable future economic benefits will flow

&

Cost can be measured reliably

Judgment is required in applying the recognition criteria to an entity's specific circumstances

Question

- A public sector company is manufacturing industrial chemicals and fertilizers. In the manufacture of the same, it uses many inputs as well as catalysts. As per design, catalysts are directly used in the production process to facilitate reaction. As these catalysts do not participate in the reaction these are classified as process chemicals and consumables rather than raw material inputs. Catalysts are of high value. Such catalysts are replaced when their charge gets over or does not support the performance as desired. The company uses various catalysts in its production which is product/plant specific. The charge of some of the catalysts, normally called as the life of the catalyst, may be over in one year whereas sometimes it gets extended up to 5-7 years. The first charge of the catalyst is capitalised along with the plant. Whether the catalyst will be classified as inventory or property, plant and equipment?

Question

- ABC Ltd is setting up a new refinery outside the city limits. To facilitate the construction of the project and its operations, the company needs to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC incurs (or contributes to) the expenditure on the construction/development, it will not have ownership rights on these items and they are also be available for use to others. Whether ABC can capitalize expenditure incurred on these items as property, plant and equipment (PPE)? If yes, how should these items be depreciated and presented in the financial statements?
- ABC Ltd is setting up a new refinery outside the city limits. Under an understanding with local authorities, ABC is required to construct a school, which will be subsequently handed over to be managed by an independent trust. Though ABC Ltd., incurs expenditure on the construction/development of the school, it will not have ownership rights and the assets will also be available for use to the general public (however preference will be given to employees of the Company). Whether ABC Ltd., can capitalise expenditure incurred as its property, plant and equipment?

Measurement

Cost includes expenditure directly attributable to bringing the asset to location and condition necessary for it to be capable of operating in the manner intended by management

Includes

- Import duties and non-refundable purchase taxes
- Dismantling and site restoration cost
- Borrowing cost on qualifying assets

Excludes

- Feasibility assessment costs
- Cost of staff training
- Administration and overhead costs

Borrowing cost

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying assets are capitalized as part of cost of the asset

Key consideration on capitalization of borrowing costs

- Determination of qualifying asset – no specific guidance on how long a ‘substantial period of time’ is
- Whether refurbishment costs qualify for capitalization if refurbishment takes substantial period of time
- Specific borrowings viz-viz general borrowings
  - Determination of weighted average borrowing rate
  - Reduction of investment income, if any, from costs
- Cessation of borrowing cost in case of partial completion of qualifying asset

Example: directly attributable expenditure

- Company G is installing a major piece of equipment at one of its factories. One of G's existing engineers is assigned to manage the installation on a full-time basis and installation is expected to take six weeks.
  - The cost of the engineer - including all employee benefits - during the period of installation should be included in the cost of the equipment even though those costs would have been incurred in any event. This is because the costs incurred need not be external or incremental to be directly attributable.

Decommissioning cost

- Cost of PPE includes
  - estimated cost of dismantling and removing the asset; and
  - Site restoration cost

- Decommissioning cost to be discounted where effect of time value of money is material
- Decommissioning cost to change subsequently when
  - changes in the estimate of the amount or timing of expenditure required to settle the obligation;
  - changes in the current market-based discount rate; and
  - the unwinding of the discount.

Example: directly attributable expenditure

- Company G is opening a new plant in a town where it has not previously operated. In addition to obtaining a certificate to confirm that the plant meets environmental specifications, G is required to obtain general permits that allow it to conduct business in the town.
  - we believe that the cost of the permits should not be capitalised because they are a general business cost that does not relate specifically to the asset.

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Principles of depreciation

Systematic allocation of depreciable amount of an asset over useful life

Amount determined after deducting residual value

Changes are changes in estimates

Review of key assumptions at least each year-end

Useful life

Useful life is :

- the period over which an asset is expected to be available for use by an entity; or
- the number of production or similar units expected to be obtained from the asset by an entity

Factors in assessing useful life

- Expected usage, expected wear and tear
- Technical or commercial obsolescence
- Legal or similar limits

Methods of depreciation

- Straight-line
- Diminishing balance
- Unit-of-production

Component accounting

Item consists of individual components

Depreciation method / useful life different for each component

Components can be physical (parts) or non-physical (*e.g.* overhaul costs)

Components significant in relation to total cost of item

Question

- A Company acquires a ship for Rs. 500 crores. The useful life of the ship is 20 years. The ship is mandatorily required to undergo major periodic inspection and repairs (‘dry-docking’) as per statute at least once in every three years. Dry-docking costs are estimated to be Rs. 100 crores for similar ships based on current market price which comprises of inspection costs of Rs.30 crores and replacement of parts amounting to Rs.70 crores. How should the company treat these dry dock cost when incurred i.e
  - Whether inspection costs can be capitalized?
  - Whether cost of replacement of parts can be capitalized? If yes, should this considered as a separate component?

Subsequent measurement

Cost model

- Cost less accumulated depreciation and any accumulated impairment losses

Revaluation model

- Revalued amount less accumulated depreciation and any accumulated impairment losses
- Frequency of revaluations depends on change in fair value of PPE
- Entire class to which the assets belongs to be revalued
- Surplus revaluation generally recognised in OCI

Impairment

Key consideration for impairment

- tested at the individual asset level whenever possible; otherwise at the CGU level
- Goodwill is allocated to CGUs at a level not greater than an operating segment (pre-aggregation)
- Recoverable amount is the higher of FVLCD and VIU
- An impairment loss is recognised when recoverable amount is less than the carrying amount
- Extensive disclosures required

Key differences between AS 28 & Ind AS 36

AS 28 – Impairment of assets	Ind AS 36– Impairment of assets
Allocation of goodwill to cash generating units (CGU)	
▪ Goodwill should be allocated to CGUs only on a reasonable and consistent basis – If the above requirement is not met for a CGU, the smallest CGU to which the carrying amount of goodwill can be allocated should be identified and the impairment test carried out at this level When all or a portion of, goodwill cannot be allocated to the CGU being tested for impairment on a reasonable and consistent basis, two levels of impairment tests are carried out – bottom-up test and top-down test	▪ Goodwill is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination from which it arose. – There is no bottom-up or top-down approach for of goodwill
Reversal of impairment	
▪ Reversal of impairment of goodwill is allowed when following conditions are met: a) the impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur; and b) subsequent external events have occurred that reverse the effect of that event	▪ Reversals of impairment in respect of goodwill is not permitted.

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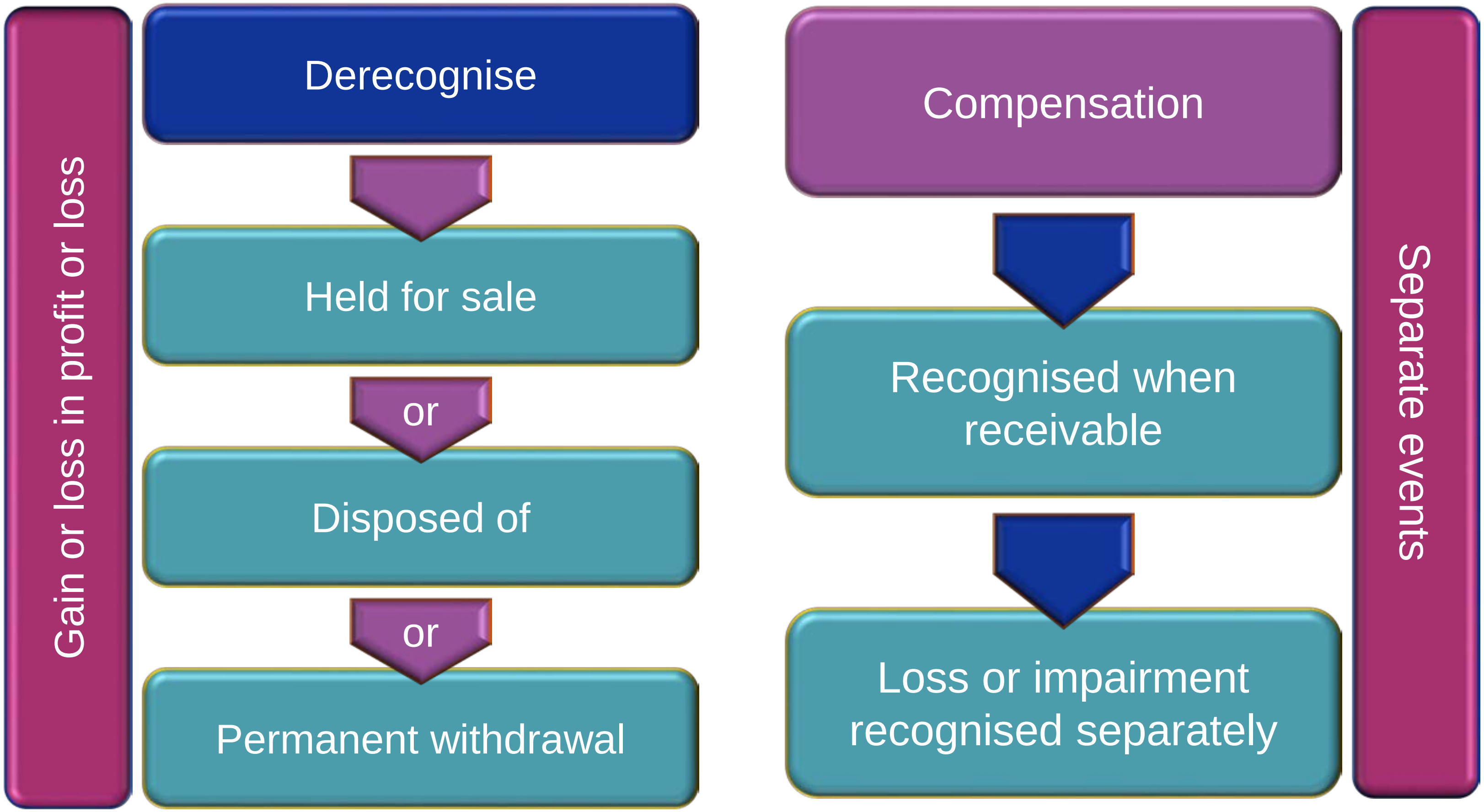
Derecognition and compensation



Example: derecognition

- Company Z operates a car rental business and also sells second-hand cars as part of its business model. Z acquires new cars with the intention of renting the cars for three years and then selling them.
  - Z recognises the cars as property, plant and equipment during the rental period and transfers the cars to inventory at their carrying amount when they cease to be rented and become held-for-sale. Z recognises the proceeds from the sale of cars as revenue.

Question

Entity A has five manufacturing units across India. On 1 April 2015, a major fire broke at one of the manufacturing units. All the fixed assets are insured under a fire insurance policy. The carrying value of the fixed assets in the manufacturing unit was Rs. 8 crores. Entity A received the insurance claim amounting to Rs. 12 crores including Rs. 10 crores for reconstructing the unit and Rs. 2 crores for loss of profits. The actual cost of rebuilding the unit is Rs. 11 crores.

- How and when will the Entity A account for the same?

Thank You

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