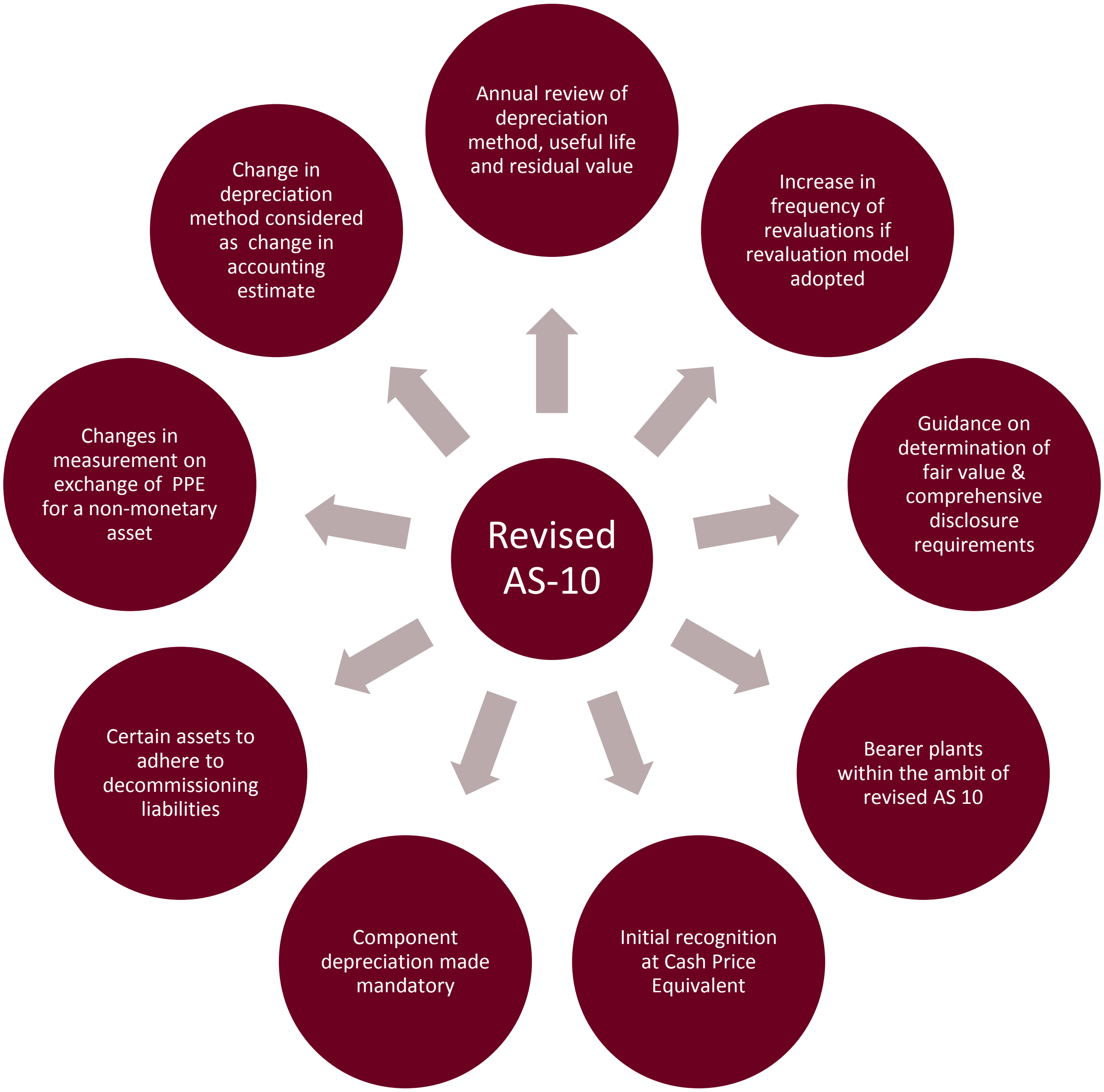
# Bridging the GAP between Indian GAAP and Ind AS – emphasis on AS-10 and others

With the notification of the Ministry of Corporate Affairs; the Companies (Accounting Standards) Amendment Rules, 2016, replaced 7 existing accounting standards with effect from April 01, 2016 thus making it mandatory for ALL companies to adhere to the NEW standards bringing them closer to those which are mandatorily required to follow Ind AS.

- AS-10 on Property, Plant and Equipment *('PPE')* has undergone a sea-change and is now closely aligned with Ind AS 16;
- Corollary impact of AS-10 is felt in three other accounting standards; AS-2, AS-13 and AS-29. AS-6 stands withdrawn; &
- Minor changes in AS-4, AS-14 and AS-21.

Overall the changes embrace the term 'substance over form'.

**Key** changes/insertions between old and revised AS-10 are depicted below:



Revised AS-10

- Annual review of depreciation method, useful life and residual value
- Increase in frequency of revaluations if revaluation model adopted
- Guidance on determination of fair value & comprehensive disclosure requirements
- Bearer plants within the ambit of revised AS 10
- Initial recognition at Cash Price Equivalent
- Component depreciation made mandatory
- Certain assets to adhere to decommissioning liabilities
- Changes in measurement on exchange of PPE for a non-monetary asset
- Change in depreciation method considered as change in accounting estimate

## Initial recognition at cash price equivalent

The cost of an item of PPE will now be the cash price equivalent at the recognition date. The difference between the cash price equivalent and the total payment *(if payment is deferred beyond normal credit terms)* is recognized as 'interest' over the period of credit.

> Company ABC purchases machinery on credit. The credit period is 7 years. ABC pays INR 3.2 million for the machinery. If the 'spot payment' scheme was opted, ABC would pay INR 2.5 million;
>
> The excess payment of INR 0.7 million is attributable to the financing activity of the fixed asset rather than the acquisition cost. Per revised AS-10; INR 0.7 million would be accounted as interest cost spread over the credit period of 7 years; &
>
> Company ABC would have capitalized the entire 3.2 million per old AS 10.

## Certain assets to adhere to decommissioning obligations

The value of such liabilities will now be added to the cost of PPE at its discounted value. The unwinding of the discounted value will be recognized as an interest expense each year.

> Company ABC needs to incur a decommissioning liability of INR 1.5 million after 5 years. The pre-tax discount rate relevant to the current market assessment of time value of money is 10%;
>
> A sum of INR 0.93 million *(present value of INR 1.5 million)* will be capitalized to PPE with a corresponding credit to decommissioning liability. At the end of the year, the unwinding of the discounted liability *(increase in the present value of liability due to passage of time)* will be recognized as an interest expense. The present value of the obligation at the end of the first year is INR 1.02 million. The differential amount of INR 0.09 million will be expensed off as finance cost; &
>
> Company ABC would not have created the decommissioning liability per old AS 10.

## Changes in measurement on acquisition of PPE in exchange of a non-monetary asset

PPE acquired in exchange for a non-monetary asset will now be measured at fair value subject to certain exceptions such as the lack of commercial substance or when neither the fair value of the asset received nor the fair value of the asset given up is reliably measurable.

> Company ABC exchanges land having book value of INR 12 million with a machinery having fair value of INR 30 million. If there is commercial substance in the transaction, the machinery will be recorded at INR 30 million with appropriate impact in the profit and loss account;
>
> Company ABC exchanges land having book value of INR 12 million *(fair value of INR 18 million)* with a machinery having fair value of INR 18 million with the configuration of the cash flows not

expected to change; then the machinery will be recorded at INR 12 million as the transaction lacks commercial substance; &

Company ABC would have recorded the machinery at INR 12 million in either of the above cases per old AS 10.

**Choice of cost versus revaluation model and frequency of revaluation based on parameters**

This choice is to be applied to an entire class of PPE. Further, if the revaluation model is adopted, revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. The basis of frequency of revaluation depends on significance and volatility of changes in fair value.

Company ABC has an asset with gross value of INR 5 million and accumulated depreciation of INR 3 million. The asset is revalued to INR 10 million. Company ABC will record appropriate adjustments to the asset and accumulated depreciation accounts to now record the asset at INR 10 million; &

Company ABC had the choice of revaluation or recording it at historical cost as per old AS 10.

**Cessation of recognition of costs in the carrying amount of an item of PPE**

Costs incurred while an item can operate in the manner intended by the management which has yet to be brought into use or it is being operated at less than full capacity must not be capitalized. Initial operating losses such as those incurred while demand for the output of an item builds up and costs of relocating or reorganizing a part or all the operations of an entity would also not be capitalized.

Company ABC has a soft opening of a theme park for the public prior to a formal launch. It incurs costs for operating the rides for the public during the soft launch. These costs would not be capitalized as the theme park can be operated in the manner intended by the management; &

Company ABC had no such guidance per old AS 10.

**Capitalization of costs related to major inspections/replacements**

These costs will be capitalized if recognition criteria are fulfilled and any remaining carrying amount of the cost of previous inspection/replacement will be derecognized.

Derecognition of the carrying amount would occur regardless of whether the cost of the previous part/inspection was identified in the transaction in which the item was acquired or constructed.

If it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection, the entity may use the cost of replacement or the estimated cost of the future inspection as an indication of what the cost of replaced part/inspection component was when the item was acquired or constructed.

### Change in depreciation method treated as change in accounting estimate

As opposed to this change being recorded as a change in accounting policy per old AS 10; the impact will now be only depicted prospectively. The depreciation method, residual value and useful life would be reassessed at each balance sheet date.

> Company ABC purchased machinery worth INR 1 million on April 1, 2016 and depreciated it at 10% per straight line method (SLM) for a period of 3 years. In the fourth year, it decided to switch to written down value method (WDV) at 10%. The book value of the machinery at the beginning of year 4 is INR 0.7 million. Had the WDV method been followed from year 1, the book value of the machinery would have been 0.73 million. Per revised AS 10 WDV method can be followed prospectively from year 4; &
>
> Company ABC would have recorded the difference between the book values under both the depreciation methods and credited the profit and loss account with INR 0.03 million with an equivalent debit to the asset account per old AS 10.

**Other** changes/insertions between old and revised AS 10 are depicted below:

## Introduction of accounting of bearer plants

### Component depreciation made mandatory

Component depreciation would affect the quantum of depreciation and will require companies to be specific with regards to record-keeping in relation to PPE. Companies would need to identify assets within assets for charging depreciation.

> Company ABC has a production unit that consists of conveyor belt and a computerized control unit. Though part of the same machinery; as these two components exhibit different useful lives depreciation will be charged separately rather than treating the entire machine as a single whole; &
>
> Company ABC may not have followed this approach per old AS 10.

### Spare parts, servicing equipment and standby equipment meeting the criteria of PPE would not be accounted as inventory.

In the Revised AS-10, accounting of spare parts depends on whether the spare is integral to the specific machine, i.e., can be used only by the machine in question or in general by other machines.

**Integral machine spares** – They should be capitalized along with the specific machine. They should be depreciated along with the machine over the remaining useful life of the specific machine

**Non-integral machine spares** – They are not specific to a machine and can be used in other machines as well. Hence, they should be treated as inventories and should be charged to the statement of profit and loss when consumed.

There was no specific guidance in the erstwhile AS 10. AS 2 stated that inventories include spares, except those which can be used only in relation to an item of fixed asset and whose use is expected to be irregular.  Such machinery spares would then be accounted for in accordance with AS 10.

## Comprehensive disclosure requirements in revised AS 10

## *Minor changes in AS 4 and AS 14*

### Change in treatment of proposed dividend as per AS-4

AS-4: Dividend proposed after the balance sheet date but before approval of accounts is no longer an adjusting event. Proposed dividend will only be disclosed in the notes to accounts.

### Change in the definition of amalgamation as per AS-14

AS-14: Definition of amalgamation includes ‘merger’. *(No major change since merger was also accounted as amalgamation even before this change)*.