AS 10, Fixed assets

AUDIT ▪ TAX ▪ ADVISORY

Scope, objective and definition

Fixed assets

AS 10

- Tangible assets (for Intangibles – refer to AS 26)
- Held for production or supply of goods or services and not for sale in the normal course of business
- Thus fixed assets include those held for rental to others or those held for administrative purposes

Other related accounting standards

- **Depreciation (AS 6)**
- **Government grants (AS 12)**
- **Borrowing costs (AS 16)**
- **Leases (AS 19)**
- **Intangible assets (AS 26)**
- **Impairment (AS 28)**

Scope, objective and definition

AS 10 does not deal with items to which special considerations apply

- Forests, plantations and similar regenerative natural resources
- Wasting assets including mineral rights and similar non-regenerative resources
- Expenditure on real estate development
- Livestock

Except

Fixed assets used to develop or maintain these activities

but

separable from those activities

Recognition

Fixed asset should be recognised as an asset when:

- **Asset is brought to its working condition for its intended use i.e. ready for commercial production**

Initially, measure at cost

May be appropriate to

- Aggregate insignificant items and apply criteria to aggregate value
- Expense an item of fixed asset if the amount is not material
- Allocate expenditure to material component parts of a fixed asset if
  - parts are separable and
  - useful lives for each component can be estimated and are different

Components of cost

Purchase price

(including import duties and non-refundable purchase taxes or levies)

- any trade discounts or rebates deducted

+ any directly attributable costs

+ borrowing costs as per AS 16

= Cost of fixed asset

- **Site preparation**
- **Initial delivery and handling cost**
- **Installation cost**
- **Professional fee**

Other expenses

Administration and other general overhead costs not included

unless

Such expenses are specifically attributable

- ***to construction of a project or***
- ***to acquisition of fixed asset or***
- ***bringing it to its working condition***

Start-up, test runs and similar pre-production costs

- ***Included only till asset is ready for commercial production***
- ***Not included if incurred after commercial production even if the plant will be taken over after satisfactory completion of guarantee period***

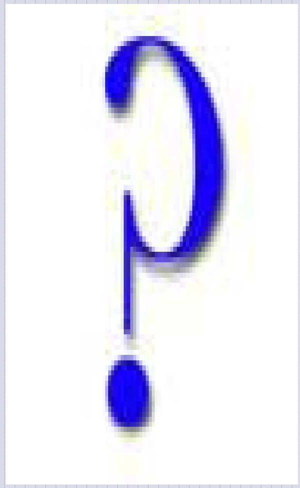
Expenditure during period of delayed commercial production

Self constructed fixed assets

Same principles as stated earlier

- **Direct costs**
- **Costs attributable to construction which can be allocated to the asset**
- **Internal profits are eliminated**

Cost



Can the following costs be capitalised?

- **Administrative, selling and general overheads which cannot be attributed to making the asset ready for use**
- **Clearly identified abnormal costs including those of inefficiencies**
- **Expenditure on training the staff to operate the asset**

Cost

The cost may change subsequently due to:

- Changes in duties
- Other similar factors
- Exchange fluctuations
- Price adjustments

Cost of fixed asset acquired in exchange of another asset

Cost of fixed asset acquired in exchange of another asset

Fair value of the consideration given
or
Fair value of asset acquired
(whichever is more clearly evident)

OR

Net book value of the asset given up

Adjust for any balancing payment or receipt of cash/other consideration

Subsequent expenditure

Subsequent expenditure

Add to book value only if it increases the future benefits from the existing asset beyond its previously assessed standard of performance

- extends useful life
- increases capacity
- substantially improves output quality
- substantially reduces operating costs

Addition/extension

- **Capitalise to existing asset if of capital nature and an integral part of existing asset**
- **Capitalise separately if separate identity and capable of being used after existing asset is disposed of**

Special cases – machinery spares

Implication of non-inclusion of ASI 2 (machinery spares) in notified standards

Relevant guidance under notified standards

- **Para 4 - AS 2, Inventories**
- **Para 8.2 - AS 10, Accounting for Fixed Assets**

"Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular such machinery spares are accounted for in accordance with Accounting Standard (AS) 10, Accounting for Fixed Assets."	***"Machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of fixed asset and their use is expected to be irregular it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item."***

The principles of ASI 2 were consistent with the above but were prescriptive

Special cases – machinery spares

Impact of non-inclusion

- **Machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular can not be included as inventories in view of specific exclusion in paragraph 4 of AS 2**
- **As per paragraph 8.2 of AS 10, "it may be appropriate" to capitalise such spares to be depreciated over a period not exceeding the useful life of the principal item**

- **Conceptually preferred treatment of such spares is capitalisation**
- **Was made mandatory by ASI 2**
- **Permissive wording of AS 10 viewed with non-inclusion of ASI 2**
  - **Company has a CHOICE of expensing such spares when FIRST PUT TO USE**
  - **Pending use, shown SEPARATELY as current assets other than inventories**

Special cases – machinery spares

If a company changes its treatment of aforesaid machinery spares pursuant to notified standards

- ✓ **Constitutes a change in accounting policy**
- ✓ **Should be applied to all such spares, irrespective of their date of acquisition**

Special cases

Hire purchase »

Recorded at their cash value

- *If not available then calculate assuming appropriate rate of interest*
- *Appropriate disclosure that enterprise does not have full ownership*

Joint assets »

Disclose:

- *Enterprise's share in such asset*
- *Proportion of original costs*
- *Accumulated depreciation*
- *Written down value*

OR

Group pro rata costs of such assets with fully owned assets with appropriate disclosure

Special cases

Stand-by and servicing equipment » **Separate fixed asset in its own right**

- **Where several fixed assets are purchased for a consolidated price**

  Apportion consideration to various assets on fair basis determined by competent valuers

- **Goodwill**

  Record only when some consideration in money or money's worth has been paid for it

Subsequent measurement

Benchmark treatment

Historical cost

Depreciation of cost over useful life

Allowed alternative

Revaluation

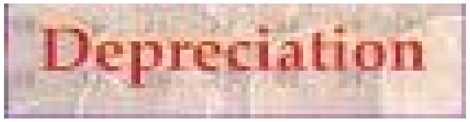
Depreciation of revalued amount over useful life

Revaluation

- **Revalue atleast all asset of the same class**
  - If not, select assets on a systematic basis (and disclose the basis)
- **Revaluation increase credited to owner's interest (revaluation reserve)**
  - unless the asset was previously revalued downward and the related charge was made to expense » take to Statement of profit and loss
  - any accumulated depreciation should not be credited to profit and loss account
- **Revaluation decrease charged to expense**
  - unless the asset was previously revalued upward and the related credit was made to revaluation surplus » charge against earlier increase

Net book value after revaluation should not exceed recoverable value (see AS 28)

Depreciation



Dealt with in AS 6, Depreciation accounting

- **Fixed asset is subject to systematic allocation of cost minus residual value to expense (freehold land excluded) over its useful life**

- **Periodically review:**
  - useful life
  - depreciation method

Impairment

Assess at each balance sheet date indications of impaired fixed assets

Yes

Carrying value

Lower of

Written down value

Recoverable amount

Higher of

Net realisable value

Value in use

Recognise impairment loss* as an expense immediately

- unless carried at revalued amount (treated as revaluation decrease as long as it does not exceed amount held in revaluation reserve)
- use "new" carrying amount to calculate future depreciation

* ***Refer to AS 28 on how to compute impairment loss***

Retirements and disposals

- **Eliminate items of fixed assets on disposal**

If retired from active use and held for disposal

– State at the lower of net book value or net realisable value

– Loss recognised immediately in profit and loss account

– Shown separately in financial statements

- **Difference between carrying amount and net disposal proceeds recognised as income or expense**

For revalued assets:

– Loss to the extent of unutilised revaluation reserve is charged to that account

– Balance of revaluation reserve is transferred to general reserve

Disclosure

Distinction, as far as possible, has been made between expenditure upon:

- **Goodwill**
- **Land**
  - ***Freehold***
  - ***Leasehold***
- **Buildings**
- **Railway sidings**
- **Plant and machinery**
- **Furniture and fittings**
- **Development of property**
- **Patents, trade marks and designs**
- **Livestock**
- **Vehicles**
- **Others (specify)**

Disclosure

- **Accounting policy**

- **A reconciliation of gross and net book values of each class of fixed assets at the beginning and end of period showing:**

– original cost – additions – disposals – acquisitions (through business combinations etc)	– any other movements – revaluations – impairment losses – reversal of impairment losses – depreciation, for the year and accumulated

- **Where a fixed asset has been acquired from outside India and the rate of exchange has changed after acquisition, the increase/reduction in liability for repayment of the whole or part of the money borrowed in any foreign currency for acquisition has been adjusted to the cost of the asset**

Disclosure (continued)

- **The amount of expenditures on account of fixed asset in the course of construction or acquisition**
- **Existence and amounts of restrictions on title to assets**
- **Fixed assets pledged as securities for liabilities**
- **Capital commitments**

If revalued amounts:	• **Reduced/increased figures** • **Date of reduction/increase** • **The method to compute revalued amounts** • **Nature of any indices used** • **The year of any appraisal made** • **Whether independent valuer was involved** • **The revaluation surplus, including movement** • **The amount of reduction/increase for the five subsequent years**

Illustrative issues

1. **Is this correct?**
   - **Fixed assets, individually costing less than Rs. 5,000 and written off fully in the year of acquisition are not entered in the Fixed Asset Register**
   - **Fixed assets are excluded form the Fixed Asset Register as soon as they are depreciated to their residual value. No other record of such fully depreciated assets is maintained**

2. **The surplus arising on revaluation of land and buildings has been credited to the profit and loss account to the extent of depreciation charged thereon in previous years. It is argued that. To this extent, depreciation need not have been charged in those years**

3. **The building account has been debited with the cost of land on which the building stands and depreciation has been provided thereon**

Illustrative issues

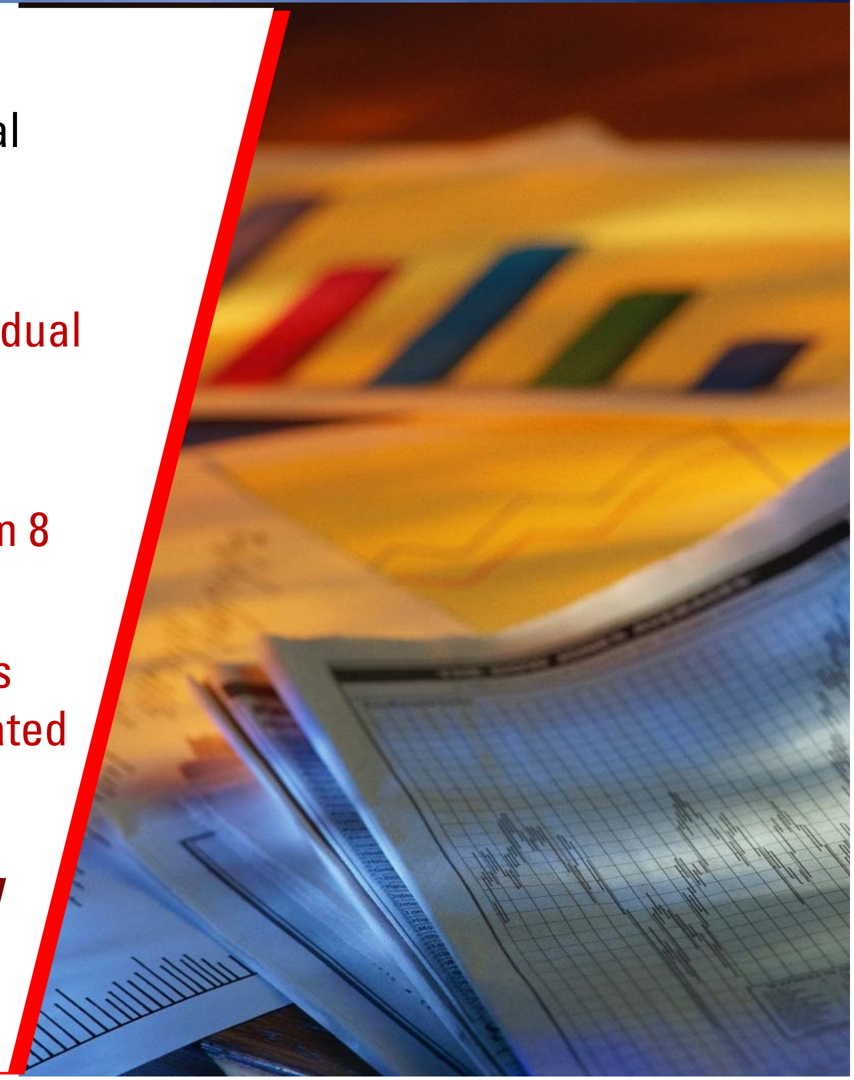
5. **The Company has incurred capital expenditure on assets which is not owned by it. For e.g. expenditure incurred on setting-up a electricity transformer. Can this be capitalised as a capital expenditure?**

6. **On the basis of a report of valuers showing that the book value of the enterprise is much lower than their market value, the difference has been accounted for as goodwill. Is this correct?**

Financial Reporting- Depreciation

Depreciation

- Increased significance on useful life and residual values- companies can choose life and residual value that is different from Schedule II
- Justification required in case, 'useful life' or residual value is different from 'Schedule II'
- Depreciation rates rationalized- useful life of Continuous Process Plant raised to 25 years from 8 years
- Revenue-based amortisation of intangible assets (toll roads) permissible- MCA notification reinstated as part of Schedule II.



! **Component accounting continues to be mandatory**

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