AS-10 PROPERTY PLANT AND EQUIPMENT

Hello students, welcome to this class on Unit 2 Accounting Pronouncements. I will be teaching you Accounting Standard 10 that is Property, Plant and Equipment. In this module you will study the objectives of the standard, scope of the standard, certain important definitions, recognition criteria, measurement of costs, elements of cost and the meaning of depreciation and the treatment when an asset is derecognized and the disclosure requirements of assets.

After studying this module you will be able to explain the objectives and the scope of AS10. You will be able to identify Property, Plant and Equipment based on the recognition criteria and you will be able to identify items included in the cost of an item of Property,Plant and Equipment.

What is property, plant and equipment?

For an item to be classified as Property, Plant and Equipment, it must satisfy two criteria. The first criteria iis that it should be held for use in production and supply of goods and services, for rental to others or administrative purposes, so these are the first 3 uses that any item of property and plant and equipment should satisfy.The next criteria is that this item should be used for more than 12 months. So the first criteria is that it should be held for use in the production or supply of goods and services. It should be held for rental to others and it should be also held as administrative purposes. For example, if you have a tableting machine that creates tablets,that could be an example of use in production of supply of goods and services. If you own a building which is let out on a commercial basis for rent to offices, then it will be an example of a property that is held for rental to others. If you own furniture or your own computer systems, it will be considered as assets held for administrative purposes. All these assets which are used for more than 12 months are also to be classified as property, plant and equipment, so it should satisfy these three users and also be expected to be used for more than 12 months.

What is the objective of the Standard?

The objective of the standard is to prescribe the accounting treatment for Property,Plant and Equipment and help users or financial statements understand information about the investment in items of Property, Plant, and Equipment, and if these investments have undergone any change from one year to the next.

Now when you study Property, Plant and EquipmentThere are four principal issues that you deal with.

1. The first is the recognition criteria of property, plant and equipment. What are the criteria that needs to be satisfied for an expense to be classified as Property, Plant and Equipment.
2. The next is determination of carrying amounts. At what rate or at what cost, should an item of property plant and equipment be shown in the books of accounts.
3. The depreciation charge. You have to write off or you have to make a provision to replace the asset at the end of its useful life. What method of depreciation are you going to charge and
4. What is the impairment loss to be recognized?

Scope of the standard.

It applies to accounting for Property, Plant and Equipment, except when the Accounting Standard or another accounting standard prescribes an alternative treatment. Now this standard is not applicable in four cases.

1. The first case is that it is not applicable to assets held for sale. For example, if you produce any product in your company, you cannot call that an asset of your company as it is held for sale.
2. Biological assets related to agriculture other than bearer plants. For example, if you own Paddy crops or if you own a wheat crop, you cannot call that as your asset because it is a biological asset related to agriculture. However, there is an exception to the rule in that bearer plants are also called as assets. Bearer plants are those plants that bear fruit and you will not cut them after the plant has borne fruit. For example, if you own an apple orchard, or if you own a mango orchard, the mango Orchard will bear fruit every season, but at the end of the season you are not going to cut the mango tree and plant a new one. So in that case your bearer plant will be or asset to you, but your paddy crop or your wheat crop is not an asset because at the end of the season you will harvest and you will cut away the.crop.
3. The next item for which this standard is not applicable is when you have measurement of exploration and evaluating assets. For example, if you use any asset for the purpose of mining or for the purpose of drilling or for the purpose of geological studies, this standard will not apply.
4. This standard will not apply to assets such as mineral rights and mineral reserves. So the standard is not applicable to any rights on a particular mine or any extract from that particular mine.

Carrying Amount

Carrying amount is the amount at which an asset is to be recognized. In the books of accounts, minus the accumulated depreciation and impairment losses.

Impairment Loss

impairment loss is the amount by which the carrying amount or the book value exceeds the recoverable amount. When you sell an asset, if its value is lower than the book value, it will be called an impairment loss.

Depreciation

Depreciation is the systematic allocation of the expense that you would make on an asset over the useful life of that asset. So when we calculate a depreciable amount, the depreciable amount is equal to the cost of the asset minus its residual value.

Useful Life of An Asset

Useful life of the asset can be defined in two ways:

a. The period over which an asset is useful and
b. the number of expected units that an asset is expected to produce throughout its life.

Cost

Cost is the amount of cash or cash equivalent paid or the fair value for any other type of consideration given to acquire the asset. When an asset is initially purchased, it is always valued at cost.

Residual Value

Residual Value is the amount obtained from the disposal of the asset after deducting the estimated costs of disposal, if that asset is at the age and expected life that you had estimated.

General Recognition Criteria

An item of property, plant and equipment will be recognized if it is probable that future benefits will flow to a particular entity and those future benefits can be reliably measured. So if you are expected to get some benefit of that asset in the future, and you can estimate or you can estimate the cost reliably, then you can recognize that particular item as aniItem of Property, Plant and Equipment. There are certain points when to make note of in case of general recognition criteria:

1. In case of spare parts, standby equipment and servicing equipment, these all will be classified as Property, Plant and Equipment if they meet the definition of the same. Otherwise they are classified as inventory.
2. If there are certain insignificant items, but if you gather them or you aggregate them together, they have a significant value then these items will also be classified as an item of Property Plant and Equipment.
3. Suppose if you acquire an item for safety or Environment Protection. So for example, you acquire an air filter which is required by a factory by law to have that air filter, then this items are also classified as assets or they are also classified as property plant and equipment.
4. The next is repair and maintenance. If done on a daily basis, is recognized in the profit and loss account. These repairs and maintenance are not considered as assets.
5. Replacement of parts. If a major replacement is carried out, and this major replacement fulfills the criteria of property, plant and equipment. Then we will classify it as property, plant and equipment. The old parts of a particular asset are derecognized and written off the books.

Measurement and Recognition Criteria

The next is Measurement and Recognition. So once you recognize that a particular item is classified as property, plant and equipment, you have to measure it.

Included in the cost of the asset will be these three items.

1. Purchase price plus any import duty plus any non refundable purchase tax minus any rebates and trade discounts.
2. Any directly attributable costs related to the asset and

3. The initial costs of dismantling, removal and restoration of the site in order to construct this, or in order to install this particular asset.
   Now some examples of directly attributable costs are costs of site preparation, initial delivery and handling costs, employee benefits (for those that are involved in the construction of this asset), any installation costs, professional fees, borrowing costs, and costs of testing.

Costs Expensed to the Profit and Loss Account

1. Suppose you open a new business in a new location, or you cater to a new type of consumer, these will all be considered as expenses that will be debited to the profit and loss account. This is because costs incurred in introducing a new product and service, opening a new facility, administrative and overhead costs are incurred when an item is yet to be brought into use.
2. Initial operating losses and relocation of staff.
3. Costs incurred during incidental operations. Now suppose if you are incurring some kind of cost in connection with the construction of the Property, Plant, and Equipment, but this cost is not incurred in bringing that item to its present location and condition, it will not be included in the cost of that particular asset. For example, if you are constructing a building and you let out the vacant lot as a parking lot for truck drivers, this will not be included in the cost of your asset. It will be recognized as an income or expense in that particular year when it is incurred.

From our definitions and from the recognition and measurement criteria, let us see an illustration.
You have to identify the total cost to be capitalized. Now in this example you have different items of expenditure. You have to classify which items are to be recognized as part of Property, Plant and Equipment.

Take a minute and see if you have understood these definitions and see if you can classify.

Now let's see if your solution is right.

- Site preparation costs will be included in the cost of property, plant and equipment. As this is the mentioned in the recognition criteria,
- Direct Materials will also be part of the cost.
- Direct labor is also part of the cost, but the amount incurred due to strike should be deducted from the same
- Testing or factory processes, equipment installation and estimated costs of dismantling are also included as the cost of the asset.
- What is not included is relocation to staff to new factory. This will be expensed during the period in which it is incurred.

Concept of Depreciation

Depreciation is nothing but the allocation of the expense or for particular asset on a systematic basis over its useful life. Now each item of property, plant and equipment that has a significant cost should be disclosed separately. Useful life and residual value must be reviewed each and every year, and any change should be accounted for under IndAS 8.

An asset that does not depreciate is the asset called land. Land has an unlimited useful life and therefore we do not consider depreciation on land.

Now the depreciation method that you use should reflect the pattern in which the assets are consumed. Any change in the method of depreciation must be disclosed. It should be done in accordance with Indian AS8.

When will depreciation begin?

Whenever an asset is available to be used and it is in the location and condition necessary for it to be operated in the manner intended by management. So there are two points when you want to consider the commencement of depreciation.

1. the asset is available for use and t
2. the asset is present in the location and it is present in that condition that is required by management to be operating.

Cessation of Depreciation/When does depreciation cease

Depreciation stops when the asset is classified as held for sale or when the date on which the asset is derecognized. Cessation of depreciation or stoppage of depreciation occurs when an asset is classified as held for sale or when an asse tis derecognized from the books of accounts.

Types of Depreciation

There are three types of depreciation methods.

1. Straight line method
2. Diminishing Balance Method or the Reducing Balance Method
3. the units of production method.

Now in the straight line method, the depreciation is equal over the useful life of the asset.
Under the diminishing balance method,the depreciation of an asset is decreasing over its useful life,and in the units of production method depreciation is charged based on the expected output.

Derecognition of an asset.

When an asset is derecognized from the books of accounts?
An asset should be derecognized when it is sold or disposed of and when you are certain that there is no future economic benefit expected from that asset. When you derecognize an asset, there may be a gain if the disposal proceeds are more than the book value. You will get a loss if the disposal proceeds are less than the book value.

Disclosures

The disclosures that are to be made in case of PPE are as follows:

1. The measurement basis used for determining the carrying amount,
2. Depreciation method, useful life, the gross carrying amount and the depreciation and the impairment loss at the beginning and the end of the period.

3. if this particular asset is pledged for security, that should also be disclosed.
4. Suppose if you are constructing the asset, then the expenditure that is to be recognized in the carrying amount should also be disclosed.
5. If you have any contractual commitment for the acquisition of property,plant and equipment, this should also be disclosed.

Thank you.