

Exposure Draft

Accounting Standard for Local Bodies (ASLB) 5

Property, Plant and Equipment (Based on corresponding IPSAS 17)

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PROPERTY, PLANT AND EQUIPMENT

(Based on IPSAS 17)

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INVITATION TO COMMENT

The Committee on Accounting Standards for Local Bodies of the Institute of Chartered Accountants of India invites comments on any aspect of this Exposure Draft of Accounting Standard for Local Bodies (ASLB) 5, 'Property, Plant and Equipment'. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

*Comments should be submitted in writing to the Secretary, Committee on Accounting Standards for Local Bodies, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to be received not later than, **October 31, 2009**. Comments can also be sent by e-mail at caslb@icai.org or caslb@icai.in.*

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ACCOUNTING STANDARD FOR LOCAL BODIES (ASLB) 5

PROPERTY, PLANT AND EQUIPMENT (Based on corresponding IPSAS 17)

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objectives and the Preface to the Accounting Standards for Local Bodies¹).*

The Accounting Standard for Local Bodies (ASLB) 5, 'Property, Plant and Equipment', issued by the Council of the Institute of Chartered Accountants of India, will be recommendatory in nature in the initial years for use by the local bodies. This Standard will be mandatory for Local Bodies in a State from the date specified in this regard by the State Government concerned².

The following is the text of the Accounting Standard for Local bodies.

Objective

1. The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The

¹ Attention is specifically drawn to paragraph 4.2 of the 'Preface to the Accounting Standards for Local Bodies', according to which Accounting Standards are intended to apply only to items which are material.

² Reference may be made to the paragraph 7.1 of the 'Preface to the Accounting Standards for Local Bodies' providing the discussion on the compliance with the Accounting Standards for Local Bodies.

principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for property, plant and equipment, except:**
 - (a) **When a different accounting treatment has been adopted in accordance with another Accounting Standard for Local Bodies; and**
 - (b) **In respect of heritage assets. However, the disclosure requirements of paragraphs 78, 79 and 82 apply to those heritage assets that are recognised.**
3. **This Standard applies to entities described as local bodies in the Preface to the Accounting Standards for Local Bodies³.**
4. This Standard applies to property, plant and equipment including infrastructure assets⁴.
5. This Standard does not apply to:
 - (a) Biological assets, i.e., living animals or plants, related to agricultural activity;
 - (b) Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources; and
 - (c) Natural resources like natural lakes.

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in 5(a) to 5(c).

6. Accounting Standards for Local Bodies may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, ASLB on 'Leases'⁵ requires an entity to evaluate its recognition of an item leased property, plant and equipment on the basis of the transfer of risks and rewards.

³ Refer paragraph 1.3 of the '*Preface to the Accounting Standards for Local Bodies*'.

⁴ Assets under Service Concession Arrangements are not included. Separate pronouncement is under preparation.

⁵ The Accounting Standard for Local Bodies is under preparation.

However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard. Guidance on accounting for leases can be found in Accounting Standard (AS) 19, 'Leases' until the ASLB on this subject is formulated.

7. An entity shall apply this Standard to property that is being constructed or developed for future use as investment property but does not yet satisfy the definition of 'investment property' in ASLB on '*Investment Property*'⁶. Once the construction or development is complete, the property becomes investment property and the entity is required to apply ASLB on '*Investment Property*'. ASLB on '*Investment Property*' also applies to investment property that is being redeveloped for continued future use as investment property. An entity using the cost model for investment property in accordance with ASLB on '*Investment Property*' shall use the cost model in this Standard. Guidance on accounting for investment property can be found in Accounting Standard (AS) 13, '*Investments*' until the ASLB on this subject is formulated.

Heritage Assets⁷

8. This Standard does not require an entity to recognise heritage assets that would otherwise meet the definition of, and recognition criteria for, property, plant and equipment. If an entity does recognise heritage assets, it must apply the disclosure requirements of this Standard and may, but is not required to, apply the measurement requirements of this Standard.
9. Some assets are described as 'heritage assets' because of their cultural, environmental or historical significance. Examples of heritage assets include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art. Certain characteristics, including the following, are often displayed by heritage assets (although these characteristics are not exclusive to such assets):
 - (a) Their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;
 - (b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;
 - (c) They are often irreplaceable and their value may increase over time even if their physical condition deteriorates; and

⁶ The Accounting Standard for Local Bodies is under preparation.

⁷ The Accounting Standard on '*Heritage Assets*' is under preparation.

- (d) It may be difficult to estimate their useful lives, which in some cases could be several hundred years. Entities may have large holdings of heritage assets that have been acquired over many years and by various means, including purchase, donation, bequest and sequestration. These assets are rarely held for their ability to generate cash inflows, and there may be legal or social obstacles to using them for such purposes.
10. Some heritage assets have service potential other than their heritage value, for example, an historic building being used for office accommodation or for commercial purposes. In these cases, they may be recognised and measured on the same basis as other items of property, plant and equipment. For other heritage assets, service potential is limited to their heritage characteristics, for example, monuments and ruins. The existence of alternative service potential can affect the choice of measurement base.
11. The disclosure requirements in paragraphs 78 to 83 require entities to make disclosures about recognised assets. Therefore, entities that recognise heritage assets are required to disclose in respect of those assets such matters as, for example:
- (a) The measurement basis used;
 - (b) The depreciation method used, if any;
 - (c) The gross carrying amount;
 - (d) The accumulated depreciation at the end of the period, if any; and
 - (e) A reconciliation of the carrying amount at the beginning and end of the period showing certain components thereof.

Definitions

12. The following terms are used in this Standard with the meanings specified:

Carrying amount (for the purpose of this Standard) is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses⁸.

Class of property, plant and equipment means a grouping of assets of a similar nature or function in an entity's operations that is

⁸ Guidance on accounting for impairment losses on cash generating assets can be found in Accounting Standard (AS) 28, 'Impairment of Assets' until the ASLB on this subject is formulated.

shown as a single item for the purpose of disclosure in the financial statements.

Cost is the amount of cash or cash equivalents paid and the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Property, plant and equipment are tangible items that:

- (a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) Are expected to be used during more than one reporting period.

The **residual value** of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:

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

Terms defined in other Accounting Standards for Local Bodies are used in this Standard with the same meaning as in those other Standards.

Recognition

13. The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:

- (a) It is probable that future economic benefits or service potential associated with the item will flow to the entity;

and

(b) The cost or fair value of the item can be measured reliably.

14. Spare parts and servicing equipment are usually carried as inventory and recognised in the statement of income and expenditure as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are accounted for as property, plant and equipment.
15. This standard does not prescribe the unit of measure for recognition, i.e. what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as library books, computer peripherals and small items of equipment, and to apply the criteria to the aggregate value.
16. An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it⁹.

Infrastructure Assets

17. Some assets are commonly described as 'infrastructure assets'. While there is no universally accepted definition of infrastructure assets, these assets usually display some or all of the following characteristics:
 - (a) They are part of a system or network;
 - (b) They are specialised in nature and do not have alternative uses;
 - (c) They are immovable; and
 - (d) They may be subject to constraints on disposal.

Although ownership of infrastructure assets is not confined to Local Bodies, significant infrastructure assets are frequently found in the Local Bodies. Infrastructure assets meet the definition of property, plant and equipment and should be accounted for in accordance with this Standard. Examples of infrastructure assets include road

⁹ See paragraph 21

networks, sewer systems, water and power supply systems and communication networks.

Initial Costs

18. Items of property, plant and equipment may be required for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits or service potential of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits or service potential from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits or service potential from related assets in excess of what could be derived had those items not been acquired. For example, fire safety regulations may require a hospital to retro-fit new sprinkler systems. These enhancements are recognised as an asset because without them the entity is unable to operate the hospital in accordance with the regulations.

Subsequent Costs

19. Under the recognition principle in paragraph 13, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in the statement of income and expenditure as incurred. Costs of day-to-day servicing are primarily the costs of labor 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.
20. Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a road may need resurfacing every few years, or a furnace may require relining after a specified number of hours of use. Items of property, plant and equipment may also be required to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a non-recurring replacement. Under the recognition principle in paragraph 14, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 72 to 77).
21. A condition of continuing to operate an item of property, plant and equipment (for example, a water treatment plant) may be performing

regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of previous inspection (as distinct from physical parts) is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Measurement at Recognition

- 22. An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost.**
- 23. Where an asset is acquired at nil or nominal consideration, its cost should be measured at its fair value as at the date of acquisition.**
- 24. An item of property, plant and equipment may be acquired at nil or nominal consideration. For example, land may be contributed/ transferred to a Local Body by a State Government or a Government agency or a developer at no or nominal consideration, to enable the Local Body to develop parks, roads and paths in the development. An asset may also be acquired at nil or nominal consideration by the exercise of powers of acquisition. Under these circumstances the cost of the item is its fair value as at the date it is acquired.
- 25. For the purposes of this Standard, the measurement at recognition of an item of property, plant and equipment, acquired at no or nominal cost, at its fair value consistent with the requirements of paragraph 23, does not constitute a revaluation. Accordingly, the revaluation requirements in paragraph 38, and the supporting commentary in paragraphs 39 to 42, only apply where an entity elects to revalue an item of property, plant and equipment in subsequent reporting periods.

Elements of Cost

- 26. The cost of an item of property, plant and equipment comprises:
 - (a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
 - (b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of

operating in the manner intended by management.

- (c) The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

27. Examples of directly attributable costs are:

- (a) Costs of employee benefits¹⁰ arising directly from the construction or acquisition of the item of property, plant and equipment;
- (b) Costs of site preparation;
- (c) Initial delivery and handling costs;
- (d) Installation and assembly costs;
- (e) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
- (f) Professional fees.

28. An entity applies ASLB on '*Inventories*'¹¹, to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. Guidance on accounting for '*Inventories*' can be found in Accounting Standard (AS) 2, '*Valuation of Inventories*' until the ASLB on this subject is formulated. The obligations for costs accounted for in accordance with ASLB on '*Inventories*' and this Standard are recognised and measured in accordance with ASLB on '*Provisions, Contingent Liabilities and Contingent Assets*'¹². Guidance on accounting for '*Provisions, Contingent Liabilities and Contingent Assets*' can be found in Accounting Standard (AS) 29, '*Provisions, Contingent Liabilities and Contingent Assets*' until the ASLB on this subject is formulated.

29. Examples of costs that are not costs of an item of property, plant and equipment are:

¹⁰ Guidance on accounting for employee benefits can be found in AS 15 (Revised 2005) until the ASLB on this subject is formulated.

¹¹ The Accounting Standard for Local Bodies is under preparation.

¹² The Accounting Standard for Local Bodies is under preparation.

- (a) Costs of opening a new facility;
 - (b) Costs of introducing a new product or service (including costs of advertising and promotional activities);
 - (c) Costs of providing service in a new location or with a new class of users (including costs of staff training); and
 - (d) Administration and other general overhead costs.
30. Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:
- (a) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;
 - (b) Initial operating losses, such as those incurred while demand for the item's output builds up; and
 - (c) Costs of relocating or reorganising part or all of the entity's operations.
31. Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, revenue 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 revenue and related expenses of incidental operations are recognised in the statement of income and expenditure, and included in their respective classifications of income and expense.
32. 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 operations, the cost of the asset is usually the same as the cost of constructing an asset for sale (see ASLB on '*Inventories*'). Therefore, any internal surpluses are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labor, or other resources incurred in

self-constructing an asset is not included in the cost of the asset. ASLB 4, '*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.

Measurement of cost

33. The cost of an item of property, plant and equipment is the cash price equivalent or, for an item referred to in paragraph 23, its fair value at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is recognised in the carrying amount of any item in accordance with ASLB 4, '*Borrowing Costs*'.
34. One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The cost of such an item of property, plant and equipment is measured at the fair value of the consideration given. It may be appropriate to consider also the fair value of the asset acquired if this is more clearly evident. An alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, is to record the asset acquired at the net book value of the assets given up; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration.
35. The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with ASLB on '*Leases*'¹³. Guidance on accounting for '*Leases*' can be found in Accounting Standard (AS) 19, '*Leases*', until the ASLB on this subject is formulated.

Measurement after Recognition

36. **An entity should choose either the cost model in paragraph 37 or the revaluation model in paragraph 38 as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.**

Cost Model

37. **After recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated**

¹³ The Accounting Standard for Local Bodies is under preparation.

depreciation and any accumulated impairment losses.

Revaluation Model

38. **After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. 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 reporting date. The accounting treatment for revaluations is set out in paragraphs 45 to 47.**
39. The fair value of items of property, plant and equipment is usually determined from market-based evidence by appraisal in a manner set out in the Appendix by a person holding a recognised and relevant professional qualification for valuation. For many assets, the fair value will be readily ascertainable by reference to quoted prices in an active and liquid market. For example, current market prices can usually be obtained for land, non-specialised buildings, motor vehicles and many types of plant and equipment.
40. For some assets, it may be difficult to establish their market value because of the absence of market transactions for these assets. Some entities may have significant holdings of such assets. Guidelines for determination of fair value of such assets are given in Appendix.
41. The frequency of revaluations depends upon the changes in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.
42. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is treated in one of the following ways:
 - (a) Restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to its depreciated replacement cost.
 - (b) Eliminated against the gross carrying amount of the asset and

the net amount restated to the revalued amount of the asset. This method is often used for buildings.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 46 and 47.

- 43. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued.**
44. A class of property, plant and equipment is a grouping of assets of a similar nature or function in an entity's operations. The following are examples of separate classes:
- (a) Land;
 - (b) Buildings;
 - (i) Commercial buildings such as office complexes, markets; and
 - (ii) Non-commercial buildings such as administrative buildings, community centers, schools, health centers;
 - (c) Roads;
 - (d) Machinery;
 - (e) Electricity transmission networks;
 - (f) Pipelines;
 - (g) Drains;
 - (h) Bridges;
 - (i) Motor vehicles;
 - (j) Furniture and fixtures; and
 - (k) Office equipment.
45. The items within a class of property, plant and equipment are revalued simultaneously in order to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period say the relevant financial

year and provided the revaluations are kept up to date.

46. **If the carrying amount of a class of assets is increased as a result of a revaluation, the increase should be credited directly to revaluation surplus. However, the increase should be recognised in the statement of income and expenditure to the extent that it reverses a revaluation decrease of the same class of assets previously recognised in statement of income and expenditure.**
47. **If the carrying amount of a class of assets is decreased as a result of a revaluation, the decrease should be recognised in statement of income and expenditure. However, the decrease should be debited directly to revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that class of assets.**
48. **Revaluation increases and decreases relating to individual assets within a class of property, plant and equipment must be offset against one another within that class but must not be offset in respect of assets in different classes.**
49. Some or all of the revaluation surplus included in net assets/equity in respect of property, plant and equipment may be transferred directly to accumulated surpluses or deficits when the assets are derecognised. This may involve transferring some or the whole of the surplus when the assets within the class of property, plant and equipment to which the surplus relates are retired or disposed of. However, some of the surplus may be transferred as the assets are used by the entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets' original cost. Transfers from revaluation surplus to accumulated surpluses or deficits are not made through **statement of income and expenditure**.

Depreciation

50. **Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.**
51. An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, in most cases, it would be required to depreciate separately the pavements, formation, curbs and channels, footpaths, bridges and lighting within a road system.
52. A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the

depreciation charge.

53. To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.
54. An entity may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.
55. **The depreciation charge for each period should be recognised in the statement of income and expenditure unless it is included in the carrying amount of another asset.**
56. The depreciation charge for a period is usually recognised in **statement of income and expenditure**. However, sometimes, the future economic benefits or service potential embodied in an asset is absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of a concrete mixer used in the construction of a building is included in the cost of the building.

Depreciation Amount and Depreciation Period

57. **The depreciable amount of an asset should be allocated on a systematic basis over its useful life.**
58. **The residual value and the useful life of an asset should be reviewed at least at each annual reporting date and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with ASLB 2, *'Accounting Policies, Changes in Accounting Estimates and Errors'*¹⁴. Guidance on accounting for changes in accounting estimates can be found in Accounting Standard (AS) 5, *'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'* until Accounting Standard for Local Bodies on the subject is formulated.**
59. Depreciation is recognised even if the fair value of the assets exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Repair and maintenance of an asset does

¹⁴ The Accounting Standard for Local Bodies is under preparation.

not negate the need to depreciate it. Conversely, some assets may be poorly maintained or maintenance may be deferred indefinitely because of budgetary constraints. Where asset management policies exacerbate the wear and tear of an asset, its useful life should be reassessed and adjusted accordingly.

60. The depreciable amount of an asset is determined after deducting its residual value. In practice, the residual value of an asset is often insignificant and therefore immaterial in the calculation of the depreciable amount.
61. The residual value of an asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's depreciation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.
62. Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use and held for disposal unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.
63. The future economic benefits or service potential embodied in an item of property, plant and equipment are consumed by the entity principally through the use of the asset. However, other factors such as technical or commercial obsolescence and wear and tear while an asset remains idle often result in the diminution of the economic benefits or service potential that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:
 - (a) Expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.
 - (b) Expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.
 - (c) Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.
 - (d) Legal or similar limits on the use of the asset, such as the expiry dates of related leases.

64. The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of an entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits or service potential embodied in the asset. Therefore, the useful life of asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgment based on the experience of the entity with similar assets.
65. Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.
66. If the cost of land includes the cost of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits or service potential obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits or service potential to be derived from it.

Depreciation Method

67. **The depreciation method should reflect the pattern in which the asset's future economic benefits or service potential is expected to be consumed by the entity.**
68. **The depreciation method applied to an asset should be reviewed at least at each annual reporting date and, if there has been a significant change in the expected pattern of the consumption of the future economic benefits or service potential embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with ASLB 2, *'Accounting Policies, Changes in Accounting Estimates and Errors'*¹⁵.**
69. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of

¹⁵ The Accounting Standard for Local Bodies is under preparation.

production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits or service potential embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits or service potential.

Compensation for impairment or losses

- 70. Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up should be included in statement of income and expenditure when the compensation becomes receivable.**
71. Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:
- (a) Impairments or losses of items of property, plant and equipment are recognised;
 - (b) Derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
 - (c) Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining surplus or deficit when it becomes receivable; and
 - (d) The cost of items of property, plant and equipment restored, purchased or constructed as replacement determined in accordance with this Standard.

Derecognition

- 72. The carrying amount of an item of property, plant and equipment should be derecognised: -**
- (a) **On disposal; or**
 - (b) **When no future economic benefits or service potential is expected from its use or disposal.**
- 73. The gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement**

of income and expenditure when the item is derecognised (unless ASLB on ‘Leases’ requires otherwise on a sale and leaseback). Gains should not be classified as revenue.

74. The disposal of an item of property, plant and equipment may occur in a variety of ways (e.g. by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an entity applies the criteria in ASLB 3, ‘*Revenue from Exchange Transactions*’ for recognising revenue from the sale of goods. ASLB on ‘Leases’ applies to disposal by a sale and leaseback.
75. If, under the recognition principle in paragraph 13, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.
76. **The gain or loss arising from the derecognition of an item of property, plant and equipment should be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.**
77. The consideration receivable on disposal of an item of property, plant and equipment is recognised initially at its fair value. If payment for the item is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with ASLB 3 reflecting the effective yield on the receivable.

Disclosure

78. **The financial statements should disclose, for each class of property, plant and equipment recognised in the financial statements:**
 - (a) **The measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;**
 - (b) **The depreciation methods used;**
 - (c) **The useful lives or the depreciation rates used;**
 - (d) **The gross carrying amount and the accumulated**

depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

- (e) A reconciliation of the carrying amount at the beginning and end of the period showing:**
 - (i) Additions;**
 - (ii) Disposals;**
 - (iii) Acquisitions through entity combinations;**
 - (iv) Increases or resulting from revaluations under paragraphs 38, 46 and 47 and from impairment losses (if any) recognised or reversed directly in net assets/equity;**
 - (v) Impairment losses recognised in the statement of income and expenditure;**
 - (vi) Impairment losses reversed in the statement of income and expenditure;**
 - (vii) Depreciation; and**
 - (viii) other changes.**

79. The financial statements should also disclose for each class of property, plant and equipment recognised in the financial statements:

- (a) The existence and amounts of restrictions on title, and property, plant and equipment pledged as securities for liabilities;**
- (b) The amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;**
- (c) The amount of contractual commitments for the acquisition of property, plant and equipment; and**
- (d) If it is not disclosed separately on the face of the statement of income and expenditure, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of income and expenditure.**

80. Selection of the depreciation method and the estimation of the useful life of the assets are matters of judgment. Therefore, disclosure of the

methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other entities. For similar reasons, it is necessary to disclose:

- (a) Depreciation, whether recognised in the **statement of income and expenditure** or as a part of the cost of other assets, during a period; and
 - (b) Accumulated depreciation at the end of the period.
81. In accordance with ASLB 2 on '*Accounting Policies, Changes in Accounting Estimates and Errors*' an entity discloses nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:
- (a) Residual values;
 - (b) The estimated costs of dismantling, removing or restoring items of property, plant and equipment;
 - (c) Useful lives; and
 - (d) Depreciation methods.
82. **If a class of property, plant and equipment is stated at revalued amounts, the following should be disclosed:**
- (a) **The effective date of the revaluation;**
 - (b) **Whether an independent valuer was involved;**
 - (c) **The methods and significant assumptions applied in estimating the assets' fair values;**
 - (d) **The extent to which the assets' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques;**
 - (e) **The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to owners;**
 - (f) **The sum of all revaluation surpluses for individual items of property, plant and equipment within that class; and**

(g) The sum of all revaluation deficits for individual items of property, plant and equipment within that class.

83. Users of financial statements may also find the following information relevant to their needs:

- (a) The carrying amount of temporarily idle property, plant and equipment;
- (b) The gross carrying amount of any fully depreciated property, plant and equipment that is still in use;
- (c) The carrying amount of property, plant and equipment retired from active use and held for disposal; and
- (d) When the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

Therefore, entities are encouraged to disclose these amounts.

Transitional Provisions

84. **An entity that adopts accrual accounting for the first time in accordance with Accounting Standards for Local Bodies should initially recognise property, plant and equipment at cost or fair value. For items of property, plant and equipment that were acquired at no cost, or for a nominal cost, cost is the item's fair value as at the date of acquisition. The same principle will apply for items of property, plant and equipment which exists at the time when accrual accounting is adopted for the first time but recognised in subsequent years after the adoption of accrual accounting for the first time.**

85. **The entity should recognise the effect of the initial recognition of property, plant and equipment as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the property, plant and equipment is initially recognised.**

86. Prior to first application of this Standard, an entity may recognise its property, plant and equipment on a basis other than cost or fair value as defined in this Standard, or may control assets that it has not recognised. This Standard requires entities to initially recognise items of property, plant and equipment at cost or, fair value as at the date of initial recognition in accordance with this Standard. Where assets are initially recognised at cost and were acquired at no cost, or for a nominal cost, cost will be determined by reference to the asset's fair value as at the date of acquisition. Where the cost of acquisition of an

asset is not known, its cost may be estimated by reference to its fair value as at the date of acquisition.

87. When an entity initially recognises an item of property, plant and equipment at cost in accordance with this Standard, it shall also recognise any accumulated depreciation and any accumulated impairment losses that relate to that item, as if it had always applied those accounting policies.
- 88. When an entity takes advantage of the transitional provisions in paragraphs 84 that fact should be disclosed. When an entity takes advantage of the transitional provisions for a second or subsequent reporting period, details of the assets or classes of asset that were not recognised at the previous reporting date but that are now recognised should be disclosed.**

Appendix A

Implementation Guidance 1: Determination of Fair Value of Property, Plant and Equipment by Appraisal

This guidance accompanies, but not a part of, ASLB 5.

1. If no evidence is available to determine the market value in an active and liquid market of an item of property, plant and equipment, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location. For example, the fair value of vacant land that has been held for a long period during which time there have been few transactions may be estimated by reference to the market value of land with similar features and topography in a similar location for which market evidence is available. In the case of specialised buildings and other man made structures, fair value may be determined by a valuer using depreciated replacement cost, or the restoration cost or service units approaches. In many cases, the depreciated replacement cost of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. In some cases, an asset's reproduction cost will be the best indicator of its replacement cost. For example, in the event of loss, a building belongs to a Local Body may be reproduced rather than replaced with alternative accommodation because of its significance to the community.
2. If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment, an entity may need to estimate fair value using, for example, reproduction cost, depreciated replacement cost, or the restoration cost or service units approaches. The depreciated replacement cost of an item of property, plant or equipment may be established by reference to the market buying price of components used to produce the asset or the indexed price for the same or a similar asset based on a price for a previous period. When the indexed price method is used, judgment is required to determine whether production technology has changed significantly over the period, and whether the capacity of the reference asset is the same as that of the asset being valued.

Implementation Guidance 2 – Frequency of Revaluation of Property, Plant and Equipment

This guidance accompanies, but is not part of, ASLB 5.

1. Paragraph 38 of ASLB 5 requires entities that adopt the revaluation

model to measure its assets at a revaluated amount does not differ significantly from that which would be determined using fair value at the reporting date. Paragraph 41 of ASLB 5 specifies that the frequency of revaluations depends upon the changes in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. The purpose of this guidance is to assist entities that adopt the revaluation model to determine whether carrying amounts differ materially from the fair value as at reporting date.

2. An entity assesses at each reporting date whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. If any such indication exists, the entity determines the asset's fair value and revalues the asset to that amount.
3. In assessing whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date, an entity considers, as a minimum, the following indications:

External sources of information

- (a) Significant changes affecting the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated;
- (b) Where market exists for the assets of the entity, market values are different from their carrying amounts;
- (c) During the period, a price index relevant to the asset has undergone a material change;

Internal sources of information

- (d) Evidence is available of obsolescence or physical damage of an asset;
- (e) Significant changes affecting the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. Adverse changes include the asset becoming idle, or plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite. Favourable changes include capital expenditure incurred during the period to improve or enhance an asset in excess of its standard of

performance assessed immediately before the expenditure is made; and

- (f) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse or better than expected.
4. The list in paragraph 3 is not exhaustive. An entity may identify other indications that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. The existence of these additional indicators would also indicate that the entity should revalue the asset to its current fair value as at the reporting date.

Implementation Guidance 3 – Illustrative Disclosures Examples

This guidance accompanies, but is not part of, ASLB 5.

A Local Body controls a wide range of property, plant and equipment and is responsible for replacement and maintenance of the property. The following are extracts from the notes to its Balance Sheet as at 31 March 20X1 and illustrate the principal disclosures required in accordance with this Standard.

Notes

1. Land

- (a) Land consists of five thousand hectares at various locations. Land is valued at fair value as at 31 March 20X1, as determined by an authorised independent valuer.
- (b) Restrictions on Titles:

Five hundred hectares of land (carried at Rs 62 lakh) is designated as public interest land and may not be sold without the approval of the state legislature. Two hundred hectares (carried at Rs 25 lakh) of the public interest land and a further two thousand hectares (carried at Rs. 250 lakh) of other land are subject to title claims by former owners in jurisdictional High Court and the Court has ordered that the land may not be disposed of until the claim is decided; the Local Body recognises the jurisdiction of the Court to hear these cases.

2. Buildings

- (a) Buildings consist of administrative buildings and commercial buildings at various locations.
- (b) Buildings are initially recognised at cost, but are subject to revaluation to fair value on an ongoing basis. An authorised

valuer from a panel of recognised valuers determines fair value. All revaluations within a class of assets is completed within the financial year. Revaluations are kept up to date.

- (c) Depreciation is calculated on a straight-line basis over the useful life of the building. Administrative buildings have a useful life of twenty-five years, and commercial buildings have a useful life of fifteen years.
- (d) The Local Body has entered into five contracts for the construction of new buildings; total contract costs are Rs. 250 lakh.

3. Machinery

- (a) Machinery is measured at cost less depreciation.
- (b) Depreciation is calculated on a straight-line basis over the useful life of the machine.
- (c) The machinery has various useful lives:
Tractors: 20 years
Concrete Mixer: 14 years
Cranes: 15 years
- (d) The Local Body has entered into a contract to replace the cranes it uses to clean and maintain the buildings – the contracted cost is Rs. 100 lakh.

4. Furniture and Fixtures

- (a) Furniture and fixtures are measured at cost less depreciation.
- (b) Depreciation is calculated on a straight-line basis over the useful life of the furniture and fixtures.
- (c) All items within this class have a useful life of seven years.

5. Infrastructure Assets

- (a) **Infrastructure assets are shown at cost less depreciation.**
- (b) **Useful lives of various categories of infrastructure assets:**
Flyovers: 25years
Water supply net work: 30 years
Storm water drains: 25 years

Reconciliations

(Amount in Rs. Lakh)

	Gross Block					Depreciation				Net Block	
	Opening balance	Additions during the year	Disposals	Revaluations (net)	Closing balance	Opening balance	Depreciation during the year	Depreciation written back	Closing balance	At the end of the year	At the beginning of the year
Land	25,000	1,500	100	1,000	27,400	19,150	2,397	12	21,535	5,865	5,850
Buildings	10,000	600		200	10,800	5,850	475	-	6,325	4,475	4,150
Plant & Machinery	3,000	150	25	-	3,125	1,250	103	3	1,350	1,775	1,750
Infrastructure assets	65,000	15,000	-	(1,500)	78,500	44,500	1,425	-	45,925	32,575	20,500
Vehicles	150	50	-	-	200	25	20	-	45	155	125
Office equipments	250	30	-	-	280	52	13	-	65	215	198
Other assets	7,500	150	100		7,550	4,500	295	45	4,750	2,800	3,000
Total	1,10,900	17,480	225	(300)	1,27,855	75,327	4,728	60	79,995	47,860	35,573

Appendix B

Note: This Appendix is not a part of the Accounting Standard for Local bodies. The purpose of this appendix is only to bring out the major differences between this Accounting Standard for Local Bodies (ASLB) and the corresponding International Public Sector Accounting Standard (IPSAS) 17, Property, Plant and Equipment.

Comparison with IPSAS 17, '*Property, Plant and Equipment*'

Definition

1. IPSAS 17 defines the terms 'Entity Specific Value', 'Exchange Transactions', 'Non-exchange Transactions', 'Impairment Loss of Cash Generating Assets', 'Impairment Loss of Non-cash Generating Assets', 'Recoverable Amount' and 'Recoverable Service Amount'. ASLB 5, '*Property, Plant and Equipment*' does not define these terms for the reasons given below:
 - (a) 'Entity Specific Value': This term is defined in the context of determining commercial substance of an exchange transaction. The concept of commercial substance is not used in ASLB 5 for measuring fair value of assets acquired in exchange for a non-monetary asset(s) with a view to simplify the requirements in this regard as the accrual accounting in Local Bodies in India is at its inception stage.
 - (b) 'Exchange Transactions' and 'Non-exchange Transactions': For accounting for items of property, plant and equipment acquired without incurring any obligation, ASLB 5 uses the terms 'Nil' and 'nominal consideration' in paragraph 23 in place of the term 'non-exchange transactions'. Accordingly, neither the term 'Non-exchange Transactions' nor the term 'Exchange Transactions' has been used. The aforesaid terms are not used because, these have different connotations in the ASLB 3, '*Revenue from Exchange Transactions*'.
 - (c) 'Impairment Loss of Non-cash Generating Assets' and 'Recoverable Service Amount': The concept of impairment loss of non-cash generating assets has not been dealt with keeping in view the complexities involved in its application at the very early stage of adoption of accrual basis of accounting in Local Bodies in India.
 - (d) 'Impairment Loss of Cash Generating Assets' and 'Recoverable Amount': Since, at present, there is no ASLB on the above subject and reference has been made for guidance to Accounting Standard (AS) 28, '*Impairment of Assets*', till formulation of ASLB on this subject, these terms have not been defined in ASLB 5.

Measurement of Cost

2. IPSAS 17 requires to measure a property, plant and equipment acquired in exchange for non-monetary asset(s) or combination of non-monetary asset(s) at fair value unless the exchange transaction lacks commercial substance or the fair value of neither assets received nor the assets given up is reliably measurable. IPSAS 17 gives detailed guidance on when an exchange transaction has commercial substance. Under the proposed ASLB 5, '*Property, Plant and Equipment*', an entity measures such acquired assets at fair value. The standard recognises an alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, to record the asset acquired at the net book value of the assets given up.

Since the Local Bodies are at early stage of adoption of accrual basis of accounting, it would be difficult for Local Bodies to apply the complexity of determining the exchange transactions that have commercial substance.

Transitional Provisions

3. IPSAS 17 contains a transitional provision providing relief from the requirement to recognize all property, plant and equipment for five years following the date of first adoption of accrual accounting. ASLB 5 does not provide for the same. However, on the lines of other ASLBs, ASLB 5 also requires in the introductory paragraph that the Standard will be recommendatory in nature in initial years for use by local bodies and mandatory for local bodies in a State from the date specified in this regard by the State Government concerned.

Terminology

4. ASLB 5 uses different terminology, in certain instances, from IPSAS 17. For example, the use of the term 'statement of income and expenditure' in ASLB 5. The equivalent terms in IPSAS 17 are 'surplus or deficit' and/or 'statement of financial performance', because in India, the Local Bodies do not, at present, use these terms.
