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RECOGNITION, MEASUREMENT AND DISCLOSURE OF PROPERTY, PLANT AND EQUIPMENT : AN ANALYSIS OF INDIAN ACCOUNTING STANDARD (IND AS) 16

Debansu Das
Associate Professor, Department of Commerce
University of Kalyani
West Bengal, India
Email: debansudas_ku@yahoo.co.in

ABSTRACT

Indian Accounting Standard (Ind AS) 16 deals with recognition, measurement and disclosure of property, plant & equipment (PP&E) and related depreciation. Ind AS 16 has been issued as a part of the process of harmonizing Indian accounting standards with global accounting standards. In line with International Accounting Standard 16, Ind AS 16 provides specific criteria for recognition of PP&E, prescribes inclusion of the initial estimate of costs of dismantling and removing an item of PP&E and restoring the site on which it is located, permits both cost and revaluation model for measurement of PP&E and allows component approach of measuring depreciation. Following IAS 16, it has incorporated the derecognition criteria of PP&E. The standard also prescribes the same disclosure requirements in respect of PP&E as are required by IAS 16.

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Since PP&E constitute a significant portion of total assets in most industries, it plays a crucial role in the assessment of financial position and performance of enterprises. Hence, from users' standpoint recognition, measurement and disclosure of these assets are very important. But for proper implementation of new Ind AS 16, understanding and analysis of this standard are the primary requirements. The failure to implement this standard may result in a loss of comparability of Indian financial statements at the international level. In this backdrop, the present paper has discussed and analysed accounting treatments and reporting requirements of PP&E and related depreciation & impairment losses so as to facilitate proper understanding and implementation of Indian Accounting Standard (Ind AS) 16.

Keywords: Ind AS, IAS, Property, Plant & Equipment, Depreciation, Impairment, Recognition, Measurement, Disclosure, Harmonisation Process, Financial Statement Analysis.

1. INTRODUCTION

There are certain benefits of harmonisation of domestic accounting standards with international accounting standards like reduction of cost of capital in global financial markets. In order to enjoy such benefits, India has initiated the process of harmonising its accounting standards with global accounting standards. In this endeavor, it has already issued 39 accounting standards which are converged with International Accounting Standards (IASs)/ International Financial Reporting Standards (IFRSs). These converged accounting standards are known 'Indian Accounting Standards' (Ind ASs) which will be applicable[1] for certain category of companies in a phased manner starting from the accounting periods beginning on or after 1st April, 2016. But

[1] For non-specified companies, the existing 'Accounting Standards', not converged with (IASs)/ (IFRSs) are applicable. Thus, from the accounting periods beginning on or after 1st April, 2016, two separate set of accounting standards, namely, 'Accounting Standards' and 'Indian Accounting Standards', will operate simultaneously for different categories of companies in India.

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before implementation of Indian Accounting Standards (Ind ASs), there is a need for all round preparedness particularly on the part of accounting professionals and academicians. Understanding and analysis of these new Indian Accounting Standards (Ind ASs) are extremely necessary for their proper implementation.

Indian Accounting Standards (Ind AS) 16 on *Property, Plant and Equipment* is an important accounting standard which deals with recognition, measurement and disclosure of property, plant & equipment (PP&E) and related depreciation. However, the standard specifies that where other accounting standards prescribe different accounting treatments, it does not apply to those cases. For example, the standard would not apply to PP&E classified as held for sale in accordance with Ind AS 105 or biological assets related to agricultural activity other than bearer plants (See Ind AS 41, Agriculture), etc.

Indian Accounting Standards (Ind AS) 16 has defined property, plant and equipment (PP&E) as those tangible assets which are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and are expected to be used during more than one accounting period. These assets constitute a significant proportion of total assets of an enterprise. As a result, users of the financial statements are interested in information about an entity's investment in its property, plant and equipment and the changes in such investment. This information plays a crucial role in the financial statement analysis. Unless these assets are properly accounted for and reported in financial statements, the objectives of accounting harmonisation could not be achieved.
In this backdrop, the present paper attempts to discuss and analyse the major provisions of Indian Accounting Standards (Ind AS) 16.

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2. OBJECTIVES OF STUDY

To facilitate proper understanding and implementation of Indian Accounting Standard (Ind AS) 16, the present study seeks to:

(i) Discuss and analyse provisions regarding recognition, measurement and disclosure of property, plant and equipment (PP&E) and

(ii) Discuss and analyse provisions regarding recognition, measurement and disclosure of depreciation charges and impairment losses in relation to PP&E.

3. RESEARCH METHODOLOGY

The present research is theoretical in nature and is based on relevant provisions of the International Accounting Standard 16, Framework for the Preparation and Presentation of Financial Statements, Indian Accounting Standard (Ind AS) 16, Companies Act, 2013 and other relevant literature. Findings of the study are made from the examination and analyses of these literatures.

4. RECOGNITION OF PROPERTY, PLANT & EQUIPMENT

Recognition is the process of incorporating in the balance sheet or statement of profit and loss an item that meets the definition of an element (i.e., assets, liabilities, equity, income and expenses) and satisfies the criteria for recognition of the respective element (ICAI, 2000). The standard deals with recognition of property, plant, and equipment as an asset as well as recognition of depreciation charge as an expense.

4.1 Recognition Criteria

For recognizing cost of an item of property, plant, and equipment, Ind AS 16 reiterates the basic recognition criteria of an asset as stated in Framework for the Preparation and Presentation of

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Financial Statements. According to this standard the cost of an item of property, plant and equipment is to be recognised only when the following two conditions are satisfied:

(a) It is probable that future economic benefits associated with the item will flow to the entity; and

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

4.2 Recognition Criteria to be Applied to All PP&E Costs

This recognition principle should be applied to all PP&E costs when they are incurred. These costs include

(i) Initial costs (i.e., costs incurred initially to acquire or construct an item of PP&E) and

(ii) Subsequent costs (i.e., costs incurred subsequently to add to PP&E, replace part of PP&E, or service an item of PP&E)

4.3 Recognition of Some Specific Items

4.3.1 Spare Parts, Stand-by Equipment and Servicing Equipment

If spare parts, stand-by equipment and servicing equipment meet the definition of property, plant and equipment, they are recognised as PP&E. In other cases, such items are classified as inventory and recognised in the statement of profit or loss as consumed.

4.3.2 Costs of the Day-to-day Servicing of an Item of PP&E

Costs of day-to-day servicing of an item of PP&E primarily comprise the costs of labour and consumables. In some cases, such costs may include the cost of small parts. Instead of recognising these costs in the carrying amount of an item of PP&E, they are recognised in the statement of profit or loss as incurred.

4.3.3 Regular Replacement of Parts

Parts of some items of PP&E may require replacement at regular intervals. A furnace may, for example, require relining after a specified number of hours of use. Cost of replacing part of such an item is recognised in the carrying amount of the asset when that cost is incurred if the recognition criteria are met. On the other hand, carrying amount of the replaced parts is derecognised when they are sold or when no future economic benefits are expected from their use or disposal.

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses. An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount. Recoverable amount is the higher of an asset's fair value minus costs to sell and its value in use. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

4.3.4 Regular Major Inspection Costs

An item of PP&E (for example, an aircraft) may require regular major inspections for checking faults for continuing its operation with or without replacement of parts of the item. When each major inspection is performed, its cost is recognised in the carrying amount of the item of PP&E as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised.

5. MEASUREMENT OF PROPERTY,PLANT & EQUIPMENT

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and statement of profit and loss (ICAI, 2000). Measurement is to be done both at the time of recognition and after recognition.

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5.1 Measurement at Recognition

When an item of PP&E qualifies for recognition as an asset it is measured at its cost. The standard defines cost as the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Indian Accounting Standards (for example, Ind AS 102, Share-based Payment).

5.1.1 Elements of Cost

(i) Cost of Acquired PP&E

The cost of an item of PP & E comprises:

(a) Its purchase price including import duties and non-refundable purchase taxes less trade discounts and rebates;

(b) Any costs directly attributable for bringing the asset to the location and condition intended by management and

(c) The initial estimate of the costs of dismantling and removing the asset and restoring the site on which it is located.

(ii) Cost of a Self-Constructed Asset

The same principles are used for determining the cost of a self-constructed asset as is used for an acquired asset. Cost of self-constructed assets does not include any internal profit. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset.

(iii) Cost of Bearer Plants

As per Ind AS 16, a bearer plant is a living plant that:

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(a) is used in the production or supply of agricultural produce;

(b) is expected to bear produce for more than one period; and

(c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

Bearer plants are accounted for in the same way as self-constructed items of property, plant and equipment before they are in the location and condition intended by management.

5.1.2 Measurement of Cost

(i) PP&E Acquired in Cash

The cost of an item of PP&E is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as interest over the period of credit. Such interest can be capitalised in accordance with Ind AS 23.

(iii) PP&E Acquired in Exchange Transaction

Some items of PP&E may be acquired in exchange for other assets. The cost of such an item of PP&E is measured at fair value unless:

(i) the exchange transaction lacks commercial substance or

(ii) the fair value of neither the asset received nor the asset given up is reliably measurable.

An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. The fair value of an asset is reliably measurable if (a) the variability in the range of reasonable fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used while measuring fair value. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

5.2 Measurement after Recognition

After recognition, an entity can choose either of the following two models as its accounting policy for measurement of PP&E and has to apply that policy to an entire class of PP&E.

(i) Cost model

(ii) Revaluation model

5.2.1 Cost Model

Under this model, an item of PP&E is to be carried at its carrying amount, i.e., at cost less any accumulated depreciation and any accumulated impairment losses.

5.2.2 Revaluation Model

If fair value of an item of PP&E can be measured reliably, it can be carried at a revalued amount. Revalued amount is the fair value of the asset at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The standard requires that revaluation should be made with sufficient regularity so that the carrying amount does not differ materially from fair value at the end of the reporting period.

(i) Selective Revaluation Not Permitted

In order to avoid selective revaluation of assets, the standard requires that if an item of PP&E is revalued, the entire class of PP&E to which that asset belongs shall be revalued. However, a class of assets may be revalued on a rolling basis subject to the condition that revaluation of the class of assets is completed within a short period. A class of PP&E is a grouping of assets of a similar nature and use in an entity's operations (e.g., land, land and buildings, machinery, motor vehicles, furniture and fixtures, etc.)

(ii) Frequency of Revaluation

Frequency of revaluation depends upon volatility in fair values of the asset. Items of PP&E which experience significant and volatile changes in fair value require annual revaluation. Items of PP&E with only insignificant changes in fair value may be revalued at an interval of every three to five years.

(iii) Adjustment to the Carrying Amount of PP&E and Accumulated Depreciation as a Result of Revaluation

When an item of PP&E is revalued, the carrying amount of that asset and related accumulated depreciation is adjusted on the revaluation date in one of the following ways:

(a) The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses; or

(b) The accumulated depreciation is eliminated against the gross carrying amount of the asset.

(iv) Revaluation Surplus (Increase in Carrying Amount of PP&E)

If an asset's carrying amount is increased as a result of a revaluation, the increase, i.e., revaluation surplus shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, revaluation surplus shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

Journal Entry

	Rs.	Rs
Property, Plant and Equipment A/C Dr. (Revaluation surplus) To Profit and Loss A/C (To the extent of revaluation loss earlier debited to P/L A/C) To Revaluation Surplus A/C (Remaining revaluation surplus)		

(v) Revaluation Loss (Decrease in Carrying Amount of PP & E)

If an asset's carrying amount is decreased as a result of a revaluation, the decrease, i.e., revaluation loss shall be recognised in profit or loss. However, the revaluation loss shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

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Journal Entry

	Rs.	Rs
Revaluation Surplus A/C Dr. (To the extent of revaluation surplus earlier credited to revaluation surplus A/C) Profit and Loss A/C Dr. (Remaining revaluation loss) To Property, Plant and Equipment A/C (Total revaluation loss)		

(vi) Treatment of Revaluation Surplus

When an item of PP&E is derecognised (i.e., retired or disposed of), the whole of the revaluation surplus in respect of that asset may be transferred directly to retained earnings. When an item of PP&E is in use, a part of the revaluation surplus in respect of that asset may be transferred to retained earnings. The amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Transfers from revaluation surplus to retained earnings are not made through profit or loss.

Example

Particulars	Rs.
Gross carrying amount of an Item of PP&E	1,00,000
Less: Accumulated depreciation	20,000
Net carrying amount	80,000

Market Value of the Item of PP&E at its present condition Rs.1,20,000

First Alternative

Gross carrying amount (as a percentage of net carrying amount) before revaluation

= {(1,00,000)/(80,000)} x 100

= 125% of net carrying amount

Accumulated depreciation (as a percentage of gross carrying amount) before revaluation

= {(20,000)/(1,00,000)} x 100

= 20% of gross carrying amount

Gross carrying amount after revaluation

= 125% of net carrying amount after revaluation

= 125% X Rs.1,20,000

= Rs.1,50,000

Accumulated depreciation after revaluation to be proportionately increased to 20% of gross carrying amount after revaluation, i.e., (Rs.1,50,000 x 20%) = Rs. 30,000.

So, gross carrying amount is to be increased by (Rs. 1,50,000 – Rs. 1,00,000) or Rs. 50,000 and accumulated depreciation is to be increased by (Rs. 30,000 - Rs. 20,000) or by Rs. 10,000.

Journal Entry

Particulars	**Rs.**	**Rs**
Property, Plant and Equipment A/C Dr.	50,000	
To Accumulated Depreciation A/C		10,000
To Revaluation Surplus A/C		40,000

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Disclosure

Description	Before Revaluation Rs.	After Revaluation Rs.
Gross carrying amount	1,00,000	1,50,000
Less: Accumulated depreciation	20,000	30,000
Net carrying amount	80,000	1,20,000

Second Alternative

Journal Entry

	Particulars		Rs.	Rs
(i)	Accumulated Depreciation A/C	Dr.	20,000	
	To Property, Plant and Equipment A/C			20,000
(ii)	Property, Plant and Equipment A/C	Dr.	40,000	
	To Revaluation Surplus A/C			40,000

Disclosure

Description	Before Revaluation Rs.	After Revaluation Rs.
Gross carrying amount	1,00,000	1,20,000
Less: Accumulated depreciation	20,000	Nil
Net carrying amount	80,000	1,20,000

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6. DERECOGNITION OF AN ITEM OF PROPERTY, PLANT & EQUIPMENT

Derecognition is the reverse process of recognition which involves elimination from the balance sheet or statement of profit and loss of an item that meets the definition of an element (i.e., assets, liabilities, equity, income and expenses). Ind AS 16 provides that the carrying amount of an item of PP&E shall be derecognized

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

The difference between the net disposal proceeds of an item of PP&E, if any, and its carrying amount gives the measure of gain or loss on derecognition of an item of PP&E. Such gain or loss on derecognition is included in profit or loss[2] when the item is derecognized. However, the standard requires that gains arising from the derecognition of an item of PP&E should not be classified as revenue.

7. RECOGNITION OF DEPRECIATION CHARGE

Depreciation charge for each period is usually recognised as an expense in profit or loss. However, when future economic benefits embodied in an asset are absorbed in producing other assets, depreciation charge is included in the cost of the other asset. For example, depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (Ind AS 2). Similarly, depreciation of PP&E used for development activities may be included in the cost of an intangible asset recognised in accordance with Ind AS 38 *Intangible Assets*.

[2] Unless Ind AS 17 requires otherwise on a sale and leaseback, Paragraph 68 of Ind AS 16.

8. MEASUREMENT OF DEPRECIATION

8.1 Depreciation as an Allocation Process

According to Ind AS 16, the depreciable amount of an asset is to be allocated on a systematic basis over its useful life. The standard defines depreciation as the systematic allocation of the depreciable amount of an asset over its useful life. Depreciable amount represents either the cost of an asset, or other amount substituted for cost, less its residual value. The residual value of an asset means the undiscounted amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the assets were already of the age and in the condition expected at the end of its useful life. Useful life has been defined as (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.

8.2 Revision of Residual Value and Useful Life

The standard requires that the residual value and the useful life of an asset shall be reviewed at least at each financial year-end. If expectations regarding residual value and useful life are changed, the change(s) shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

8.3 Beginning and Cessation of Depreciation

Depreciation of an asset begins when it is available for its intended 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 at the earlier of (i) the date on which asset is classified as held for sale in accordance with Ind AS 105 and (ii) the date on which the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

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8.4 Depreciation on Parts of an Item of PP & E

Ind AS 16 prescribes the use of component approach for measurement of depreciation. This requires a careful examination of an item of PP&E so as to identify its components or parts having a cost that is significant in relation to the total cost of the item. Each component or part of an item of PP & E, whose cost is significant in relation to the total cost of the item, is to be depreciated separately. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft. However, an entity is also at liberty to depreciate separately the parts of an item with an insignificant cost.

8.5 Grouping of Different Parts with Similar Useful Life and Same Depreciation Method

When two different and significant parts of the same item of PP&E have similar useful life and same depreciation method, such parts may be grouped for determining the depreciation charge.

8.6 Depreciation on Insignificant Remainder Parts of Same PP & E

While depreciating some significant parts of an item of PP&E separately, the remainder of the item, consisting of parts which are individually insignificant, is also required to be depreciated separately. For depreciating such remainder, approximation techniques may be necessary. This approximation technique should be such that it can faithfully represent the consumption pattern and/or useful life of its parts.

8.7 Depreciation Method

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. The depreciation method used should reflect the pattern in which the asset’s future economic benefits are expected to be

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consumed by the entity. For example, if equal amount of the asset's future economic benefits is expected to be consumed in each year, straight-line method should be used. On the other hand, if the amount of future economic benefits expected to be consumed from the asset gradually decreases over the year, the entity should use diminishing balance method of depreciation.

Once a depreciation method is selected, it should be applied consistently from period to period unless there is a change in the expected pattern of consumption of future economic benefits embodied in the asset. For identifying such change, the depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.

9. IMPAIRMENT

Ind AS 16 lays down that impairments or losses of items of PP&E, 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 of items of PP&E are recognised in accordance with Ind AS 36;

(b) Derecognition of items of PP&E retired or disposed of is determined in accordance with this Standard;

(c) Compensation from third parties for items of PP&E that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and

(d) The cost of items of PP&E restored, purchased or constructed as replacements is determined in accordance with this Standard.

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10. DISCLOSURE

Ind AS 16 requires disclosure of a large number of information items in financial statements. These information items relate to recognition and measurement of PP&E and depreciation.

The standard requires that for each class of PP&E, the financial statements shall disclose the following:

(a) the measurement bases 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 additions, depreciation, impairment losses, net exchange differences arising on the translation of the financial statements, etc.

The standard also requires that financial statements shall disclose:

(a) the existence and amounts of restrictions on title, and PP&E pledged as security for liabilities;

(b) the amount of expenditures recognised in the carrying amount of an item of PP&E in the course of its construction;

(c) the amount of contractual commitments for the acquisition of PP&E; and

(d) if it is not disclosed separately in the statement of profit and loss, the amount of compensation from third parties for items of PP&E that were impaired, lost or given up that is included in profit or loss.

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In respect of revalued items of PP&E, Ind AS 16 prescribes following disclosures in addition to the disclosure requirements required by Ind AS 113 (in respect of Fair Value Measurement):

(a) the effective date of the revaluation;

(b) whether an independent valuer was involved;

(c) for each revalued class of PP&E, the carrying amount that would have been recognised had the assets been carried under the cost model; and

(d) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

11. CONCLUSION

Except some minor differences like deletion of some non-applicable provisions of IAS 16 (reduction of the carrying amount of an item of property, plant and equipment by the amount of government grant received), use of different terminology, etc., Ind AS 16 has been properly converged with International Accounting Standard (IAS) 16. In line with International Accounting Standard 16, Ind AS 16 provides specific criteria for recognition of PP&E, prescribes inclusion of initial estimate of the costs of dismantling and removing an item of PP&E and restoring the site on which it is located, permits both cost and revaluation model for measurement of PP&E and allows component approach of measuring depreciation. Following IAS 16, it has incorporated the derecognition criteria of PP&E. The standard also prescribes the same disclosure requirements in respect of PP&E as are required by IAS 16.

Thus, subject to a few exceptions, the Institute of Chartered Accountants of India has made Ind AS 16 at par with IAS 16. The standard has been given mandatory legal status[3] under the Companies Act, 2013. Now, the crucial task is proper application of this standard in accounting

[3] Indian Accounting Standard (Ind AS) 16 is to be implemented from the accounting periods beginning on or after 1st April, 2016.

and reporting of property, plant and equipment. The failure in implementation of the standard will result in a loss of comparability of Indian financial statements at the international level which may expose Indian companies to a higher degree of risk perceived by foreign investor leading to a higher cost of capital.

In the years to come, it will be interesting to investigate how far the provisions of Indian Accounting Standards (Ind AS) 16 are complied with in the preparation and presentation of financial statements and thereby contribute towards achieving the goal of making financial statements of Indian companies comparable with international standard.

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