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IND AS 16: ITs IMPACT ON VALUATION OF TANGIBLE ASSETS

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ABSTRACT

International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) have become the global language of accounting in recent times with around 126 countries around the world accepting IFRS for all or most of the domestic publicly accountable entities (listed companies and financial institutions) in their capital market. Property, plant & equipment occupy a vital place in any business entity which is responsible for generating revenue for the entity. Further, investors and other agencies are also interested in the status of these assets as it helps them in making informed decisions. Thus, a standardized approach shall have to be taken in presenting and valuing such assets. Thus, Ind AS 16 covers the entire area of valuation of such assets, however earlier AS 6: Depreciation Accounting and AS 10: Accounting for fixed assets were separately covering these issues. Thus considering the above, the paper covers the following objectives:

- *To examine the impact of Ind AS 16 on revenue, income and expenditure measurement of the companies and on the valuation of assets & liabilities.*

KEYWORDS: *IFRS, IASB, Capital Market, AS 6, AS 16, AS 10, Depreciation Accounting.*

Introduction

Accounting comprises of diverse practices, policies, rules and conventions. Such diversity in accounting statement presentation shall defeat the very purpose for which accounting is done i.e. transparency, reliability and comparability and thus a set of standards are required to make them less diverse. Accounting standards are tools which harmonizes these diverse issues, practices, policies, rules and conventions by issuing standard rules of preparation and presentation of accounting information.

History of Accounting Standards in India

The study of history of Accounting Standards in India takes us back to the 4th Century BC when Kautilya in his Arthshastra states as follows:

"All accounts should be in the form prescribed in the 'Arthshastra'. Failure to do so will be punished."

This proves that India has a very rich and strong accounting heritage and philosophical backup. Even though accounting practices were not standardized as we have today, but still there was a strong ideology to ensure transparency and reliability of accounting records. Thus Accounting Standards have always been a part of our accounting structure. However, the history of the present shape of Accounting Standards dates back to April 21, 1977 when The Institute of Chartered Accountants of India (ICAI), the apex body of accounting and auditing, constituted the Accounting Standards Board (ASB). Since then the Board is regularly issuing standards on various areas of accounting and as on date there are 28 mandatory Accounting Standards (AS). These standards are applied by all entities operating in India as per the applicability guidelines specified in the respective standards.

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Need for Harmonization of Accounting Standards

Harmonization may be defined as reconciliation or bridging the gap between various views and practices. Thus, International Accounting Harmonization implies the unification of accounting standards of various countries so as to ensure standardization and comparability of financial statements across the globe. The Liberalization, Privatization and Globalization initiative undertaken by the Govt. of India in 1991 integrated the Indian economy with the world economy. Further, it got all the more necessary after the Satyam Computer Services type scams which resulted in an increased demand for transparency, relevance and comparability of financial information and this can be achieved only with internationally acclaimed accounting standards. International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) have become the global language of accounting in recent times with around 126 countries around the world accepting IFRS for all or most of the domestic publicly accountable entities (listed companies and financial institutions) in their capital market.[9] Considering the above, Indian Accounting Standards (Ind AS) were issued by the Ministry of Corporate Affairs which has been refined and fine-tuned to suit the Indian conditions.

Review of Literature

Following are the details of various publications dedicated to the subject of accounting standards and reporting of financial information:

C. Richard Baker and Elena M. Barbu (2007) in their article 'Evolution of research on international accounting harmonization: a historical and institutional perspective' has discussed about the importance of international accounting harmonization research and its prospects. They have expressed their optimism about the future of harmonization practices internationally and that it will lead towards uniformity of both accounting practices and accounting research.

Shankarbhai Somabhai Sodha (2015) in his article "A Study Of IFRS And Its Impact On Selected Companies" has concluded that adoption of IFRS in the financial statements of companies change their business process and operations and that the disclosure shall benefit the stakeholders at large. However, he expects the application of IFRS to raise the compliance costs of companies.

Arash Naderian (2014) in his article "Problems of International Financial Reporting Standards Convergence In India" has opined that most of the countries are in the process of convergence to IFRS. Further different countries mould the IFRS as per their requirements and situations and effect modification in their standards accordingly.

Ms. Dimple (2014) in her research work 'Convergence With International Financial Reporting Standards: Challenges And Opportunities' concluded that disclosures as per accounting standards have been better in public sector industries than in private sector industries and that adoption of latest trends in accounting is a compulsion and not a optional effort.

Prakash Bhatia (2013) in his research work "Convergence Of Accounting Standards With International Financial Reporting Standards In India: Impact On Profitability Of Selected Companies" has identified the opportunities and threats arising out of IFRS implementation in India and has concluded that there is not much difference in the provisions of IFRS and Ind AS.

From the above literature review, we conclude that no specific work has been done on identifying the impact of Ind AS implementation on valuation of fixed assets. Keeping this in view, the following objective was formulated.

Objective of the Study

- To examine the impact of Ind AS 16 on revenue, income and expenditure measurement of the companies and on the valuation of assets & liabilities;

Scope of the Study

The present study aims to identify the deviations of Ind AS 16 with AS 10 and AS 6 its impact on the financial statements of the selected companies.

Research Methodology

- **Data Collection**

The study is primary based on analysis of secondary data i.e. audited annual reports of selected companies, Accounting Standards, Companies Act, 2013, magazines, publications, journals, internet and newspapers etc.

- **Period of Study**

  Period of study for the purpose of our research is from 2015 to 2017.

Sample Selection

A sample of top ten companies from ten sectors (having highest turnover) has been selected from NSE Nifty Fifty Index Companies as on 31-03-2016. Following is the list of selected companies and the sectors to which they belong:

S. No.	Sector	Companies Selected
1	Energy	Indian Oil Corporation Ltd.
2	Information Technology	Tata Consultancy Services Ltd.
3	Automobiles	Maruti Suzuki India Ltd.
4	Metals & Mining	Coal India Ltd.
5	Electric Utility	NTPC Ltd.
6	Infrastructure	Larsen & Toubro Ltd.
7	Consumer Goods	I T C Ltd.
8	Telecommunications	Bharti Airtel Ltd.
9	Cement	UltraTech Cement Ltd.
10	Pharmaceuticals	Lupin Ltd.

Limitation of Study

During our exercise of analysis of standalone balance sheets of sample companies, we observed that certain changes in valuations were occurring due to the application of some other Ind AS which were not considered in our analysis. Further, certain companies had not bifurcated their figures about changes which were occurring due to the application of some other Ind AS and thus we had considered the entire amount in our analysis.

Ind AS 16: Property, Plant & Equipment

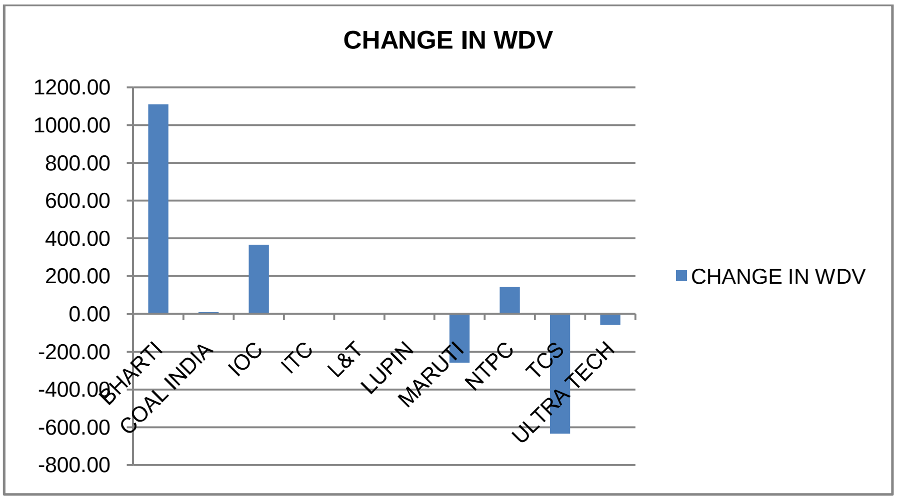
Property, plant & equipment occupy a vital place in any business entity which is responsible for generating revenue for the entity. Further, investors and other agencies are also interested in the status of these assets as it helps them in making informed decisions. Thus, a standardized approach shall have to be taken in presenting and valuing such assets. Thus, Ind AS 16 covers the entire area of valuation of such assets, however earlier AS 6: Depreciation Accounting and AS 10: Accounting for fixed assets were separately covering these issues.

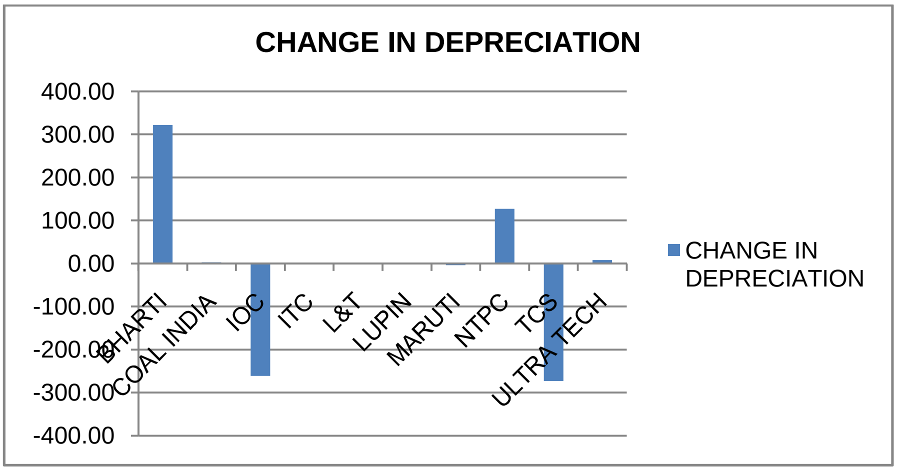
Impact

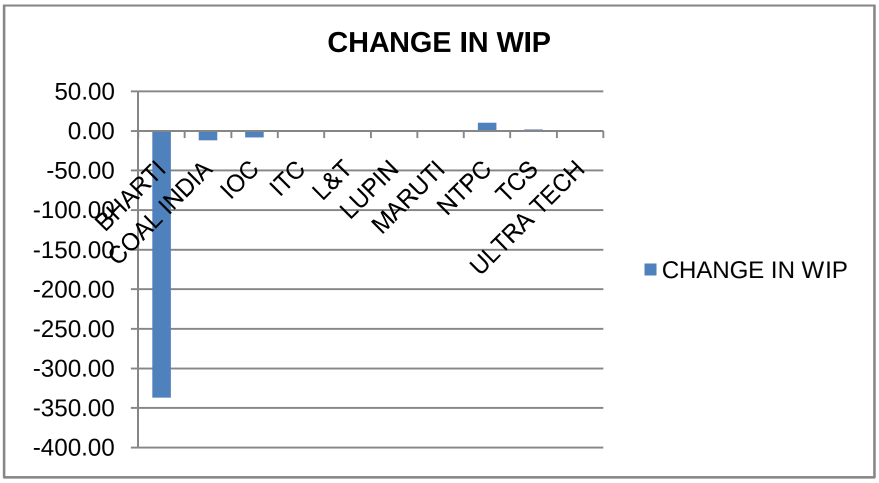
The impact of the changes incorporated in the standard shall be vital in the financial statements. The standard has brought new concepts and major changes in the accounting structure of such assets which can be studied as follows:

- The various provisions of this standard shall have an impact on the profits and losses figure of the entity which may be positive or negative for any given entity. Changes proposed like treatment of spares, moulds, tools & dies, policy relating to depreciation etc. shall affect the figures of profit & loss account.
- Revaluation provisions shall change the very basis in which accounting for fixed assets are being done. An entity adopting this method shall have to regularly review and incorporate changes in its value and make suitable adjustments. This method is aimed at giving realistic figures of such assets to the users of such statements.
- Land becomes a depreciable asset under certain circumstances under this standard. Thus, it shall affect both the profit & loss account and the balance sheet. Companies which have installed equipment which indirectly help in earning future economic benefits like equipment for complying with environmental laws shall have the liberty to treat such assets under equipment, plant & machinery under Ind AS 16.

According to our study, introduction of Ind AS 16 has had a marginal effect on sample companies. There has been an overall increase of 0.12% i.e. Rs. 680.57 cr. in the value of Written Down Value. An overall decrease of 0.09% i.e. Rs. 77.72 cr. has been observed in depreciation thereby affecting profitability of companies. A decrease of 0.27% i.e. Rs. 344.76 cr. in the value of Capital Work in Progress has also been observed. Following is a pictorial representation of the same in which we get a bird's eye view of the impact of Ind AS on various areas of financial statements of sample companies:







*Figures in the above diagrams represent Rs. in Crores.

**Source: Annual Audited Financial Statements of sample companies issued for the F.Y. 2016-17.

A detailed analysis of the causes of such differences has been done by us and presented in the below table:

Sample Company	Change in WDV (` in cr.)	Change in WIP (` in cr.)	Change in Depreciation (` in cr.)	Reason
Bharti Airtel Ltd.	1110.00	-337.00	322.00	• Changes in Existing Decommissioning, Restoration and Similar Liabilities (Appendix-A to Ind AS 16). • De-Capitalisation of foreign exchange gains/ losses (Due to application of Ind AS 21). • Measurement of non-current assets at present value.
Coal India Ltd.	9.32	-11.71	2.85	Changes in Existing Decommissioning, Restoration and Similar Liabilities (Appendix-A to Ind AS 16).
Indian Oil Corporation Ltd.	366.73	-8.34	-261.33	• Recognition of stores & spares as property, plant & equipments. • Capitalisation of assets as enabling assets since they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired.
I T C Ltd.	-224.81	-81.66	130.80	Leasehold properties classified as prepayments within non-current assets instead of fixed assets and amortised over the period of lease. (Not considered in our impact analysis)
Larsen & Toubro Ltd.	9.30	-2.53	131.51	Due to Joint Ventures : Ind AS 111 (Not considered in our impact analysis)
Lupin Ltd.	0.00	0.00	0.00	N.A.
Maruti Suzuki India Ltd.	-257.80	0.00	-3.70	No explanation provided by the company.
NTPC Ltd.	143.54	10.45	127.50	• Recognition of stores & spares as property, plant & equipments with corresponding reversal of repair and maintenance expenses. • Capitalization of major inspections/ overhauls with corresponding reversal of repair and maintenance expenses, transaction cost adjustment, unwinding of discount on vendor liabilities, amortization of leased land treated as finance lease.
Tata Consultancy Services Ltd.	-633.22	1.84	-273.05	Change of method of depreciation from Written Down Value to Straight Line Method which was treated prospectively as a change in accounting estimate as per the provisions of the Ind AS.
Ultra Tech Cement Ltd.	-58.00	0.00	8.01	• Recognition of stores & spares as property, plant & equipments with corresponding reversal of repair and maintenance expenses. • Leasehold properties classified as prepayments within other non-current assets instead of fixed assets and amortised over the period of lease. • Right to use jetty has been classified as Intangible asset as on the date of transition. • Changes in Existing Decommissioning, Restoration and Similar Liabilities (Appendix-A to Ind AS 16).

*Source: Annual Audited Financial Statements of sample companies issued for the F.Y. 2016-17.

Analysis of Causes of Impact

There are many points of differences that exist between AS 10 & 1S 6 and Ind AS 16. Out of these the major ones relates to areas like asset retirement obligations, capitalization of spares, revaluation model, capitalization of foreign exchange differences etc. Even after Ind AS 101 First time Adoption of Indian Accounting Standards giving many relaxations with respect to first time application of Ind AS 16 to financial statements of companies, 7 out of 10 sample companies i.e. 70% of the sample companies have been affected by its application. Following is an analysis of the causes of impact of Ind AS 16 on financial statements of companies:

- **Changes in Existing Decommissioning, Restoration and Similar Liabilities:** Acquisition of any property, plant & equipment by an entity also involves obligations to dismantle and restore such items which have been termed by the standard as 'decommissioning, restoration and similar liabilities'. Ind AS 16 requires an entity to make an initial estimate of such costs which are expected to be incurred by them at the time of its retirement and include fair value of such costs in the value of such asset that is to be capitalized in the books of the entity. 3 out of 10 i.e. 30% of sample companies have been affected by the provision.
- **Recognition of stores & spares as property, plant & equipments:** Spare parts which are regularly used and consumed within a short period are recognized in the profit & loss account as per the existing GAAP. AS 10 allow capitalization only if the spares can be used in connection with an item of fixed asset and their use is expected to be irregular. However, if the life of spare parts, stand-by equipment and servicing equipment is stretched in more than one period, Ind AS 16 recognizes such expense to be capitalized under property, plant & equipment irrespective of the fact that the items may be used regularly or not. 3 out of 10 i.e. 30% of sample companies have been affected by the provision.
- **Enabling Assets:** Enabling assets can be defined as expenditure on those assets whose ownership does not vest with the entity, but it shall enable it to derive future economic benefits from them in excess of what could have been derived if the asset had not been acquired. Ind AS 16 requires recognition of an asset as Property, Plant & Equipment only if it is capable of generating future economic benefits to the entity and the cost of the same can be measured reliably.
- **Capitalization of Major Inspections/ Overhauls:** Ind AS requires costs incurred in major inspections and overhauls to be capitalized in the books of accounts if the same qualifies the asset recognition criteria prescribed by the standard. Further, it also requires de-recognition of the carrying amount of the cost of any earlier major inspection/ overhaul.
- **Change in Method of Accounting:** Depreciation method is required to be regularly reviewed under Ind AS 16 and any change in the value should be treated as a change in accounting estimate i.e. treated prospectively.

Changes Proposed

- The standard having introduced the concept of revaluation of items of property, plant & equipment has mandated its review at lease at every financial year end i.e. an entity following this model of cost shall have to revalue or review its assets at each year end. This will be an added burden on the companies which shall become a part of compliance costs. Review in the values are necessary to reflect true values, but instead of mandating such review for each year, it should be required to be done in every three years, which shall significantly reduce compliance costs of such companies.
- Revaluation of assets shall enable management to manipulate the values of fixed assets as per their requirements. Management may try to maintain a higher figure of its assets in order to portray a better position of its financial statements. This might defeat the very purpose of the incorporation of these changes. The change was proposed to ensure that assets are carried at its fair values at the date of financial statements. However, manipulations may not ensure the meeting of this object.
- AS 6 allowed expenses like moulds, tools & dies to be written off during the year in the profit & loss account if the same was immaterial considering the size of the unit. However, Ind AS 16 does not allow it. This will unnecessarily pile up the list of fixed assets and shall include figures of immaterial assets within its ambit. Thus, immaterial expense incurred should be treated as revenue expenditure to avoid such a situation.

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