**Query No. 20**

Subject: Accounting for book value of fixed assets demolished for expansion purpose.[1]

## A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is an infrastructure company, which is developing, constructing, operating and maintaining an international airport. The company has in its Fixed Asset Register (FAR), various assets, which include buildings and other infrastructure assets used for the airport operations. Depreciation is provided on straight line method (SLM) based on the useful life of the assets in line with the rates prescribed under Schedule XIV to the Companies Act, 1956 which are considered as the minimum rates.

2. The querist has stated that after 3 years of commencement of operations, the company is planning to expand the existing terminal building in order to cater to the increase in passenger traffic movement. Due to this, portion/part of the existing building and other infrastructure assets may have to be demolished and the book value of those assets are material amounts. Net realisable values arising from disposal of those assets are not material. This demolition is required exclusively for the expansion of terminal building.

Kind of assets demolished include:

- Part of building
- Escalators
- Furniture and fittings
- Electrical Installations

[1] Opinion finalised by the Expert Advisory Committee on 24.5.2012.

3. The company has ascertained the below-mentioned options to treat the above book value of the assets on demolition:

(i) To treat the same as expenditure on demolition and charge to profit and loss account.

(ii) To treat the book value as depreciation and charge it to profit and loss account in the year of demolition.

(iii) To treat the above book value loss as those cost that relate directly to the specific asset and to capitalise it by referring to paragraph 21 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets' and till such time, to retain under 'capital work-in-progress'. The said paragraph is reproduced by the querist as follows:

> **"21.** ***The cost of a self-constructed fixed asset should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset."***

(iv) Nothing to be removed from the FAR and instead add the cost of the asset demolished to the cost of the new asset and to depreciate over the new useful life based on the ground that the extension *increases the future benefits from the existing asset beyond its previously assessed standard of performance*. The querist has referred to paragraphs 12 and 23 of AS 10 in this context. (Emphasis supplied by the querist.)

4. As per the querist, impact of the above-mentioned first 2 options will be debit/charge to the profit and loss account and impact of 3rd and 4th option will be capitalisation as part of expansion. Further, in case of first two options, the accounting treatment may not be appropriate as the demolition has been carried out exclusively for the expansion of the existing infrastructure facility. Taking into account that the demolition was needed for the purpose of bringing a new asset into existence and is necessary to create the asset, the company believes that the correct treatment would be to capitalise taking the 3rd or 4th option or any other option available in this scenario.

## B. Query

5. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the treatment of the above value in the books of the company based on the above alternative options or any other option.

## C. Points considered by the Committee

6. The Committee notes that the basic issue raised in the query relates to accounting for book value of fixed assets, which are demolished for expansion of business. Accordingly, the Committee has examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting treatment of cost of demolition, accounting treatment of construction of new assets, ascertainment of book value of demolished fixed asset, accounting for use of the material salvaged from dismantling/demolition in the construction of new asset, etc. The Committee notes that in the extant case, the fixed assets register is being maintained wherein the details of various assets, viz., buildings, escalator, etc. are being recorded separately and, therefore, the assets which are being demolished can be identified separately. Further, it is understood from the Facts of the Case that the existing assets are being demolished and there is no intention to refurbish such assets. Further, these assets will not be used in future. The Committee is also of the view that there could be a possibility of time gap between the time when these assets are retired from their active use and the time when these are demolished/disposed off. However, the Committee has not examined accounting for assets retired from active use and held for disposal since the querist has not raised that issue.

7. The Committee notes paragraphs 14.1, 14.3, 25 and 26 of AS 10, notified under the Companies (Accounting Standards) Rules, 2006, which are reproduced as below:

"14.1 An item of fixed asset is eliminated from the financial statements on disposal."

"14.3 In historical cost financial statements, gains or losses arising on disposal are generally recognised in the profit and loss statement."

***"25. Fixed asset should be eliminated from the financial statements on disposal or when no further benefit is expected from its use and disposal.***

***26. Losses arising from the retirement or gains or losses arising from disposal of fixed asset which is carried at cost should be recognised in the profit and loss statement."***

From the above, the Committee notes that a fixed asset should be eliminated from the financial statements on disposal or when no further benefit is expected from its use and disposal. The Committee is of the view that as per the requirements of AS 10, when an already existing fixed asset is demolished for construction of a new asset, it is the derecognition principles of AS 10, which are to be first applied to the existing asset before recognition of a new asset, irrespective of the purpose for which it is being demolished/disposed off. Accordingly, the Committee is of the view that on disposal/demolition of the existing fixed assets, the carrying amounts of the portion/items of the fixed assets demolished/disposed off should be eliminated from the financial statements and the gain or loss on derecognition, i.e., the difference between the net disposal proceeds (if any) and the net book value of such fixed assets should be recognised in the statement of profit and loss. As regards the argument of the querist relating to capitalisation of book value of the demolished asset to the cost of new asset to be constructed, the Committee is of the view that although demolition/disposal of the existing asset may be necessary for the construction of a new asset, the demolished asset is not part of the construction activity and accordingly, cannot be said to be directly related to the specific asset or attributable to the construction activity in general. Therefore, the book value of the demolished/disposed off asset should not be capitalised as part of the cost of the new asset.

## D. Opinion

8. On the basis of the above and considering the observations in paragraph 6 above, the Committee is of the opinion that on disposal/demolition of the existing fixed assets, the carrying amount of the portion/items of the fixed assets demolished/disposed off should be eliminated from the financial statements and the gain or loss on derecognition should be recognised in the statement of profit and loss, as discussed in paragraph 7 above.

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