

Query No. 27

Subject: Recognition of miscellaneous scrap items generated in the plant and scrapped assets awaiting disposal under Ind AS Framework.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a public sector enterprise under the administrative control of the Ministry of Mines, Government of India and is engaged in mining of bauxite, manufacturing of alumina and aluminium, generation of power at captive power plant for use in smelter, and selling of alumina and aluminium both in domestic and international markets. Besides, the Company is also engaged in generation of wind power with setting up of wind power plants at distinct locations in the Country. The Company has four production units. Details are furnished below:

- a. Fully mechanised Open Cast Bauxite Mine having excavation capacity of 68,25,000 tonnes per annum;
- b. Aluminium Refinery having production capacity of 22,75,000 tonnes per annum;
- c. Captive Power Plant having power generation capacity of 1200 megawatt (MW); and
- d. Aluminium Smelter Plant of 460,000 tonnes capacity per annum.

In addition, there are 4 Wind Power plants of about 50MW each located in different states.

2. Mines Division, which is located uphill, serves feed-stock to the alumina refinery located 16 km downhill. Apart from domestic and export sale of alumina, the refinery unit provides alumina to the Company's smelter plant which is about 600 km away by specially designed alumina wagons by rail transport. For production of 1 metric tonne (MT) of aluminium at smelter, about 13,600 kilowatt-hour (kWh) of power is required, which is met by captive power plant situated at 4 km away from the smelter plant. Calcined alumina and thermal power are two important inputs for producing aluminium metal. The production process starting from bauxite mines to alumina refinery to aluminium smelter and captive power plant is fully integrated. Sale of calcined alumina and aluminium metal is the main stream of revenue for the Company. Its product profile includes hydrate, calcined alumina, ingots, billets, wire rod and rolled products.

3. *Accounting for scrap followed by the Company:*

The scrap generated at the plant is of two types:

- a. Process scrap (aluminium scraps, anode rejects and butts)
- b. Miscellaneous scrap (used spares, used oil and lubricants, incoming packing materials, discarded and scrapped assets etc.)

a. *Process Scrap:* Scraps generated in the process of aluminium metal production are known as ‘Process Scrap’ and are re-used in the process by remelting the same. The process scraps are not sold in the market. The generation of such scrap is recognised as ‘change in inventory of finished goods and work-in-process’ in the Statement of Profit and Loss of the Company and the inventory on the reporting date is presented as an

¹ Opinion finalised by the Committee on 10.2.2023.

intermediary under the inventory in the Balance Sheet of the Company. Such scraps, being reusable in the production process are not intended for sale and are valued at cost.

- b. *Miscellaneous Scrap*: This category of scrap is mainly generated from used spares, oil and lubricants, packing materials and scrapped plant and machineries. These items have no use other than selling as scrap. The miscellaneous scraps are sold through e-auction platform. Such kind of scraps are collected in the scrap yard for disposal and are measured at every reporting date. The same is valued at the available market price (based on the last sale transaction) or the estimated price fixed by the management for disposal. The change in inventory and sales of miscellaneous scraps are recognised as 'Other Income' in the Statement of Profit and Loss. The inventory of miscellaneous scrap as on the reporting date is disclosed under the head 'Inventory' in the Balance Sheet with a distinct sub-head as '*Scrap*' at the Note No. 15 to the financial statements of the Company for the financial year (F.Y.) 2021-22. The recognition of miscellaneous scrap by the Company is as follows:
- i. Such miscellaneous scraps are tangible items having economic value and are having market for disposal.
 - ii. The items are regularly generated during operation of plant and are being sold/ disposed through e-tendering. Income from sale of miscellaneous scrap is recognised as other income.
 - iii. On generation of stock of miscellaneous scrap, the Company makes the valuation at the available market price or the estimated price fixed by the management for disposal. The change in such inventory of scrap is recognised as other income.

Income recognised against such miscellaneous scrap and inventory of scrap during the last three years are as follows:

	2021-22	2020-21	2019-20
Income recognised during the year (₹ in crore)	33.77	15.71	19.52
Inventory at the year ending date (₹ in crore)	16.91	13.82	14.71

4. *Observations of Audit*: During the course of audit of annual accounts of the Company for F.Y. 2021-22, the statutory auditors of the Company have advised to review the accounting policy of the Company with regard to the miscellaneous scrap items. The observations are as below:

- a. *With regard to valuation of miscellaneous scrap*: Generally, the miscellaneous scraps are generated from the discarded/ broken parts of equipment, packing materials etc. whose cost has already been charged off in the Statement of Profit and Loss and hence, cost of the discarded parts is Nil. As per paragraph 9 of Indian Accounting Standard (Ind AS) 2, 'Inventories', the inventory shall be measured at lower of cost or net realisable value (NRV). In the present case, since the cost is nil, the miscellaneous scrap etc. shall be valued as 'Nil' and revenue shall be recognised as income on completion of sale only. There should not be any recognition on generation of scrap.
- b. *With regard to presenting the miscellaneous scrap under 'Inventories' in the Balance Sheet and revenue under 'other income'*: The auditors are of the view that the 'miscellaneous scrap' does not fall within the definition of inventory as

per paragraph 6 of the Ind AS 2, 'Inventories'. Therefore, the same shall not be included in inventory. Further, if the Company includes the miscellaneous scrap under inventory, then the Company should classify the revenue in 'Revenue from operations' instead of 'Other Income'.

5. The classification of scrap has not been defined in Ind AS. Therefore, the Company followed paragraph 10 of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', which states that in the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that reflects the economic substance of a transaction. Accordingly, the Company mentions the classification and valuation of scrap in its accounting policy at Note No. 3.10 to the financial statements of the Company for F.Y. 2021-22.

- a. *With regard to valuation of miscellaneous scrap:* Scraps generated are the tangible assets generated in the process of production having economic value, which is recognised as inventory based on net realizable value (NRV). As these scraps are having no measurable cost of purchase/ manufacturing, the Company carries these miscellaneous scraps at its fair value i.e. net realizable value or estimated price in the books of account to reflect the economic substance of the assets. Recognition of income from scrap only on completion of sale and not recognising the same at the time of generation of scrap would not comply the accrual basis of accounting.
- b. *With regard to presenting the miscellaneous scrap under 'Inventories' in the Balance Sheet and revenue under 'other income':* The Schedule III to the Companies Act, 2013 classifies the inventories as:
 - i. Raw materials;
 - ii. Work-in-progress;
 - iii. Finished goods;
 - iv. Stock-in-trade (in respect of goods acquired for trading);
 - v. Stores and spares;
 - vi. Loose tools;
 - vii. Others (specify nature).

Since, there is an option to include additional line item, i.e., 'Others (specify nature)', the Company included the scrap under this head and reported under 'Inventories' in the Balance Sheet.

6. With regard to the nature of miscellaneous scrap and nature of items covered thereunder, the querist has separately clarified that the miscellaneous scraps are generated from various sources and constitute of scrapped property, plant and equipment (PPE), used spares, used transformer oil, electrical cables, steel scraps, empty containers carrying input materials, used tyres, etc. The major source of generation of such scraps and its accounting treatment before these are declared as scraps are given below:

Sl No.	Source of Scraps	Accounting treatment before it is considered as scrap
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1	Scrapped property, plant, equipment: When an item of PPE is discarded after it completes its useful life or becomes uneconomical to be operated, the same is removed from the PPE and kept as inventory after scrapping. The Company does not sell any item of fixed assets as such. All these discarded items of PPE are scrapped and sold as machine scraps.	Before an item of PPE is scrapped, the same is continued as fixed asset at its carrying value (WDV).
2	Used spares: When a spare part of any plant and machinery is replaced with new one after expiry of its useful life and the old used spare is collected for disposal and recognised as scrap.	a. Major Spares: As it forms part of the PPE, accounting treatment explained at Sl. No. 1 is also followed for major spares. b. General Spares: Spares other than major spares are charged to repair and maintenance expenses when it is issued from the store for consumption. So, before scrapping, these spares are considered as revenue expenses.
3	Used transformer oil: After a certain period of operation, old transformer oil is taken out and is replenished with fresh oil. The old used oil is kept as scrap.	Fresh oil issued for the transformer is charged to expenses before replenishment.
4	Empty Containers/ bags carrying input materials: Many chemicals used in the plants are supplied by the vendors in containers/ bags. The empty containers/ bags are kept as scrap for disposal.	There is no identified price element of such containers which is otherwise included in the material/ input cost. Hence, there is no such specific accounting of such containers before it is considered as a scrap item.
5	Used tyres: Many heavy earth moving machineries (HEMMs) and equipments are engaged in Mining and movement of materials. Damaged tyres of such HEMMs are replaced with new one and the old one is kept as scrap.	The cost of the tyres is charged to expenses when these are issued from the stores and fitted into the HEMMs. So, before considering them as scrap, the tyres are charged to revenue expenses.

Scraps collected are valued at their respective fair value (reserved price/ market price) and recognised in the books of account.

B. Query

7. In view of above, the querist has sought the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) on the following issues:

- (i) Whether the practice followed by the Company to recognise miscellaneous scrap as inventory is correct.

- (ii) Whether practice followed by the Company with regard to valuation of scrap at its fair value is correct.
- (iii) Whether practice of the Company to recognise the income out of sale/change in stock as 'Other Income' is correct.

C. Points considered by the Committee

8. The Committee notes that the basic issues raised by the querist relate to appropriateness of recognition of miscellaneous scrap as inventory, its valuation at fair value and recognition of the income out of sale/change in stock as 'Other Income'. The Committee has, therefore, examined only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for sale of alumina, aluminium and calcined alumina, accounting for power generated from captive plant and captive consumption of alumina, accounting for process scrap (aluminium scraps, anode rejects and butts), appropriateness of accounting for replaced parts of PPE, accounting for spares not scrapped, etc. Further, the Indian Accounting Standards referred to in the Opinion are the Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time.

9. The Committee notes from the Facts of the Case that major sources of miscellaneous scraps are scrapped property, plant and equipment, used spares (major spares and general spares), used transformer oil, empty containers/bags carrying input materials and used tyres. With regard to scrapped property, plant and equipment, the Committee notes that after an item of PPE completes its useful life or becomes uneconomical to be operated, the same is removed from PPE and kept as inventory by the Company and is sold as machinery scraps. Similar accounting is followed for major spares. In case of general spares, transformer oil, empty containers/bags carrying input materials, tyres etc., these are considered as revenue expense when these are issued. The Committee notes that Ind AS 16 does not deal with accounting for spares on the basis of their classification into 'major' or 'general' spares. Accordingly, in the opinion hereinafter, the Committee has used the expressions 'spares treated as PPE' and 'spares not treated as PPE' in accordance with requirements of the aforesaid standard.

10. With regard to the recognition of miscellaneous scrap containing scrapped items of PPE and spares treated as PPE, as 'inventory', the Committee notes the definition of 'inventories' as per Ind AS 2, 'Inventories' as follows:

“Inventories are assets:

- (a) held for sale in the ordinary course of business;**
- (b) in the process of production for such sale; or**
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.”**

The Committee notes from the above that since miscellaneous scrap items as stated above cannot be considered as finished product/by-product held for sale, or intermediate product/work-in-progress in the process of production, or raw material/inputs/supplies to be consumed in the production process, the same does not meet the definition of 'inventories' as per Ind AS 2. Therefore, the Committee is of the view that such scrap items should not be

recognised as inventory. Accounting for other items of miscellaneous scrap has been dealt with in paragraph 14 below.

11. With regard to accounting for scrapped items of property, plant and equipment and used spares that are treated as PPE, the Committee notes the following paragraphs of Ind AS 16, 'Property, Plant and Equipment', which state as follows:

- “53 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.”
- “67 **The carrying amount of an item of property, plant and equipment shall be derecognised:**
- (a) **on disposal; or**
- (b) **when no future economic benefits are expected from its use or disposal.**
- 68 **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless Ind AS 116, *Leases*, requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.”**
- “70 If, under the recognition principle in paragraph 7, 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.
- 71 **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.**
- 72 The amount of consideration to be included in the gain or loss arising from the derecognition of an item of property, plant and equipment is determined in accordance with the requirements for determining the transaction price in paragraphs 47-72 of Ind AS 115. Subsequent changes to the estimated amount of the consideration included in the gain or loss shall be accounted for in accordance with the requirements for changes in the transaction price in Ind AS 115.”

From the above, the Committee notes that an item of PPE shall be derecognised either on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss from derecognition shall be included in profit or loss when the item is derecognised. In the extant case, no economic benefits are expected from the use of scrapped items of PPE and the used spares treated as PPE, since they have either completed their useful lives or have become uneconomical to be operated. However, since economic benefits are expected from

such scrapped items through their disposal, the same should not be derecognised after these are scrapped in view of paragraph 67(b) reproduced above.

12. The Committee is further of the view that the scrapped items of PPE and used spares that are treated as PPE would normally appear in the books at their residual value as their entire economic value has already been charged to the Statement of Profit and Loss as depreciation during their useful life, as per the principles of Ind AS 16 and Schedule II to the Companies Act, 2013 and therefore, the same should be continued to be carried in the books at their carrying amount under the net block of PPE unless these items are impaired as per the requirements of Ind AS 36 'Impairment of Assets' and recoverable amount (which in case of these items, would normally be their fair value less costs of disposal rather than value in use) is less than the carrying amount. However, since the economic benefits are expected from these items, though not from their continued use but their disposal, the Company should examine whether these meet the classification and recognition criteria of 'non-current assets held for sale' as per Ind AS 105, 'Non-current Assets Held for Sale and Discontinued Operations', in which case, these should be accounted for as per the requirements of Ind AS 105. At the time of sale as scrap, these should be derecognised, with gain or loss on sale being recognised in the Statement of Profit and Loss. The gain arising on sale may be presented as 'other income' in the Statement of Profit and Loss.

13. With regard to the scrapped items, such as, used spares not treated as PPE e.g., those used for repairs, used transformer oil, tyres, empty containers/bags etc., the Committee notes from the Facts of the Case that these are charged as expense in the Statement of Profit and Loss when these are issued or used/consumed and therefore, their entire cost has already been charged to the Statement of Profit and Loss, viz., these have already been derecognised in the books of account. Therefore, the Committee is of the view that these derecognised items should not be written back in the books of account even if they exist physically, and accordingly, question of their presentation as 'inventories' and valuation or revaluation at their fair value (reserved price or market value) or net realisable value would not arise, although for control purposes, records in respect thereof may be kept. Any income arising on sale of such scrap should be recognised as 'other operating revenue' as per the requirements of paragraph 9.1.10 of the Guidance Note on Division II – Ind AS Schedule III to the Companies Act 2013, (Revised January, 2022 Edition), issued by the ICAI, as reproduced below:

“9.1.10. To take other examples, sale of Property, Plant and Equipment is not an operating activity of a company, and hence, profit on sale of Property, Plant and Equipment should be classified as other income and not other operating revenue. On the other hand, sale of manufacturing scrap arising from operations for a manufacturing company should be treated as other operating revenue since the same arises on account of the company's main operating activity.”

D. Opinion

14. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 7 above:

- (i) The practice followed by the Company to recognise miscellaneous scrap as inventory is not correct, as discussed in paragraphs 10 and 13 above.

- (ii) As discussed in paragraph 12 above, scrapped items of PPE and used spares which are treated as PPE should be continued to be carried in the books at their carrying amount under the net block of PPE unless these items are impaired as per the requirements of Ind AS 36 'Impairment of Assets' and recoverable amount (which in case of these items, would normally be their fair value less costs of disposal rather than value in use) is less than the carrying amount. However, the Company should examine whether these scrapped items of PPE meet the classification and recognition criteria of 'non-current assets held for sale' as per Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations', in which case, these should be accounted for as per the requirements of Ind AS 105. The scrapped items, such as, used spares that are not treated as PPE e.g., those used for repairs, used transformer oil, tyres, empty containers/bags etc., these are not to be valued or revalued at their fair value (reserved price or market value) or net realisable value, as discussed in paragraph 13 above.
- (iii) At the time of sale of the scrapped items of PPE and used spares which are treated as PPE, these should be derecognised, with gain or loss on sale being recognised in the Statement of Profit and Loss. The gain arising on sale may be presented as 'other income' in the Statement of Profit and Loss, as discussed in paragraph 12 above.

With regard to the scrapped items, such as, used spares not treated as PPE e.g., those used for repairs, used transformer oil, tyres, empty containers/bags etc., any income arising on sale of such scrap should be recognised as 'other operating revenue' in the Statement of Profit and Loss, as discussed in paragraph 13 above.
