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## UNIT 4 URBAN ASSETS MANAGEMENT

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### 4.1 INTRODUCTION

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Urban infrastructure development and assets creation are critical to urban development. There are several important steps in fixed assets management so far as ULBs are concerned. The first step is identification and categorization; the second step is location; the third step is valuation; the fourth step is recording, the fifth, updating, the sixth, accounting, and the seventh, presentation. Municipal staff has to deal with some of the very common problems which may commonly include:

- i) the non-availability of records pertaining to the various fixed assets - including sometimes their original cost, date of acquisition or construction etc.;
- ii) the difficulty of locating a fixed asset - for instance, a road roller which had been purchased and appears on the books, but was physically scrapped a long time ago and no record of its disposal remains; and
- iii) lack of data on current condition and remaining useful life.

After studying this unit, you will be able to:

- Discuss the appropriate value, useful life and depreciation of municipal fixed assets and their reporting in the financial statements;
- Explain the effectiveness of control over municipal fixed assets; and
- Describe municipalities true financial position in facilitating budgetary planning and control over resources.

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### 4.2 DEFINITION AND CATEGORIZATION OF ASSETS

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There are several definitions of assets that are commonly used in various parts of the world, as different accounting and standards exist in different countries. Accounting Standard 10 on 'Accounting for Fixed Assets', promulgated by the Institute of Chartered Accountants of India (ICAI), defines a fixed asset as:

“An asset held with the intention of being used for the purpose of producing and providing goods or services and is not held for sale in the normal course of business”.

The context of Urban Local Bodies (ULB) is different from commercial bodies to which these accounting standards generally apply. Hence, a set of Accounting Standards for Public Sector Bodies have been developed by the International Public Sector Accounting Standards Board (IPSASB), a constituent of the International Federation of Accountants (IFAC).

The definition of Assets as per the IPSASB is:

“Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity”.

The concept of control of an asset’s economic benefit is a key issue in determining whether that asset should be reported in the financial statements of a ULB. This concept of control is what leads to non-owned assets like Hire Purchase assets, Leasehold property to be recognized as assets. This concept is important because governments are required to maintain control over public property in a fiduciary capacity and hence any loss of control is not only a financial but also a fiduciary loss. To determine whether a ULB should be reporting an asset, it is necessary to look to the indicators of control. According to AS26, ‘control’ is identified when the enterprise has the power to obtain future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits.

Where the control of the asset has been affected, say where municipal land has been encroached, the ‘Technical Guide for Accounting by ULBs’ issued by ICAI provides that a provision equal to virtually the entire carrying amount of land shall be provided. Even in such cases, the right to take possession remains with the ULB.

#### 4.2.1 Classification of Assets

The classification of fixed assets can be done in several ways - ‘function-wise’ for example water works and sewerage and drainage or ‘nature-wise’ such as plant and machinery, etc.

The fixed assets can be divided into two main categories :

- i) Infrastructure Assets; and
- ii) Other Assets

Infrastructure assets- are long-lived capital assets associated with governmental activities that normally are stationary in nature and can be preserved for a significantly greater number of years than most capital assets the examples are roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems. Buildings are excluded from the definition of infrastructure assets unless they are an ancillary part of a network of infrastructure.

As per IPSAS, infrastructure assets displays following characteristics:

- They are part of the system or network.
- They are specialized in nature and do not have alternative uses.

- They are immovable; and
- They are subject to constraints on disposal.

Apart from this, several municipalities may have their own classification systems based on local laws (accounting rules) or practices. In some cases, the maintenance of fixed asset registers is done as per these classifications i.e. Tools Register, Plant & Equipment Register, etc.

#### 4.2.2 Asset Classification as per National Municipal Accounting Manual ( NMAM)

However, the account coding structure prescribed in NMAM, 2005, Government of India does not maintain this distinction and classifies assets into 11 major groups, all under the Broad head of 'Fixed Assets'. The choice of minor heads is left to states. The proposed classification of Fixed Asset as per NMAM code of accounts is into 11 categories as follows:

- i) Land
- ii) Buildings
- iii) Roads & bridges
- iv) Sewerage and drainage
- v) Water works
- vi) Public lighting
- vii) Plant & machinery
- viii) Vehicles
- ix) Furniture, fixtures, fittings and electrical appliances
- x) Office & other equipments
- xi) Other fixed assets

Among these, items (iii), (iv), (v) and (vi) can be classified as 'infrastructure assets'.

Besides, the NMAM has classified Assets into 'Movable' and 'Non-movable' category. This distinction is especially useful when the objective is to physically verify the assets.

- i) Land:** Land includes parks, playgrounds, agricultural land, dhobighat, dumping ground, tonga, rickshaw, taxi (other than underground taxi stands) and cycle stand, parking places (other than those which are covered) and any vacant site on which no construction has taken place. Where assets such as buildings, roads, bridges etc. are constructed on land, all land (including cove land) should be shown as under this head.
- ii) Buildings (including structures):** Buildings include office-buildings, school-buildings, public-conveniences, hospitals, dispensaries, maternity and child welfare centers, shopping-complex, town hall building, community centers, staff quarters, rest-house, milk dairy, workshop buildings, fire station, stores building, covered taxi stands, covered parking areas, lavatory blocks, urinals, dhalaos and dustbins and garbage vats, etc. structures include public

fountains and others which cannot be classified as buildings but are nevertheless of a permanent nature. Land under buildings should be separated and shown distinctly under 'land'.

- iii) **Roads & bridges:** This includes several types of assets including roads, pavements, footpaths, bridges, subways over bridges, flyovers, culverts, and causeways.
- iv) **Sewerage and drainage:** This includes items like roadside drains, underground drains, sewerage network, etc. Plant and machinery for stations including pumps etc. would be classified under this head.
- v) **Water works:** This includes all items related to water works such as bore wells, treatment plants, reservoir, overhead tanks, pipelines, plant and machinery for water works, etc.
- vi) **Public lighting:** This covers all assets related to lighting and includes electrical installations like transformers, cables etc, lamps and fittings and poles. Any electrical installations other than for public lighting would be covered under subsequent head of 'furniture, fixture, fittings & electrical appliances'.
- vii) **Plant and machinery:** Plant and machinery include all engineering equipments like road rollers, bull dozers, etc.; medical equipments used in hospitals, dispensaries and maternity centers, scientific equipments, generators, clock tower, etc. This will not include plant and machinery used specifically in waterworks, pumping stations, sewerage treatment plant, etc. which are already classified under those heads. However, plant and machinery used for other purposes should be included under this head.
- viii) **Vehicles:** Vehicles include all types of trucks, water tankers, buses, jeeps, cars, two-wheelers, three-wheelers and loaders, etc. Mobile machinery such as road rollers and bulldozers would not be classified as vehicles as their primary purpose is not transportation.
- ix) **Office & Other equipments:** All items of office use such as computers, peripherals, photocopy machines, type-writers, communication and telecom equipments would be recorded under this head. Other equipment should also be recorded under this head.
- x) **Furniture, fixture, fittings & electrical appliances:** They include metal as well as wooden chairs, tables, racks, cupboards, water coolers, fans, air conditioners, refrigerators, TV, etc. Items which can be classified as office and other equipment should be first classified under that head. Else, should be included here.

It would also include all types of installation cables, lampposts, mercury vapor lamps, sodium vapor lamps, light fittings, power points, etc., used in the buildings and other premises used by the ULB (other than those used for street-lighting as they are included under the heading 'Public lighting').

- xi) **Other fixed assets:** This will include all other assets not specifically covered in any of the earlier heads. It will include for instance, intangible assets such as software, etc. Specific assets with different valuation or re-use norms (such as heritage assets, works of art etc.) may also be classified as separate sub-groups under this head.

### 4.2.3 Capital Work in Progress

In addition to the above categories, one more category is important ‘Capital Works in Progress’. This includes costs of constructing fixed assets before construction is substantially complete. The identification of an items of construction as ‘Capital Work in Progress’ means that the item is intended to be capitalized once it is complete / put into use. Capital Work in Progress (CWIP) is included in the ‘Fixed Assets’ group of assets but is only an interim account, until the asset is put into use. In particular following:

- a) CWIP is not recorded in any of the ‘asset’ registers. Instead, a separate CWIP Register is maintained to record progressive bills for construction;
- b) Any amount paid for purchase / construction of an asset which has not been completed / put to use should be shown as CWIP and recorded in CWIP Register;
- c) No depreciation is charged on CWIP since the asset has not been put to use;
- d) The asset should be transferred from CWIP to Fixed Asset Register when it is put into use. Hence, CWIP register should be reviewed regularly for such items.

In this section you studied definition and categorization of assets. Now, you should be able to answer some questions relating to this section given in Check Your Progress-1.

#### Check Your Progress 1

- Note:** a) Write your answer in about 50 words  
 b) Check your answer with possible answers given at the end of the unit.

1) Define fixed assets?

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2) What are the characteristics of “infrastructure assets”?

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## 4.3 VALUATION OF ASSETS - GENERAL PRINCIPLES

### 4.3.1 Models of Valuation of Fixed Asset

There are two models for valuation of fixed assets:

- i) Cost Model; and
- ii) Revaluation Model

#### i) The cost model

The cost model requires that:

After recognition as an asset, an item of property, plant and equipment shall be carried at cost less any accumulated depreciation and any accumulated impairment losses. This is the traditional 'historical cost' model based on which assets are generally valued for financial reporting purposes in India.

#### ii) Revaluation Model

Under the revaluation model, the valuation of assets is continually reviewed to reflect the fair market value as much as possible. The model is described below:

After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall 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.

The fair value of items of assets is usually determined from market-based evidence by appraisal. However, many ULBs have assets for which it may be difficult to establish market value because absence of market for these assets. In such cases, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location.

The recommended valuation model for fixed assets is that:

- a) Assets should be valued at initial (historical) cost paid to acquire them;
- b) Depreciation should be charged periodically to reflect the written down value of the asset;
- c) Revaluation would be permitted, with some restrictions.

### 4.3.2 Principles of Assessment of Fixed Assets Costs

Following principles are generally taken into consideration while valuating the fixed assets costs:

#### i) Recognition of Fixed Assets

The principle for determining capitalization is given below:

The cost of an item shall be recognized as a fixed asset if:

- i) the asset is held for producing or providing goods or services and is not held for the normal course of business;
- ii) the future economic benefits or service potential associated are expected to fit the entity;

- iii) the estimated useful life of the asset is beyond one year; and
- iv) is beyond the minimum threshold limit for recognition as fixed asset.

## **ii) Historical Cost**

This is the bedrock of the valuation principle and is stated as follows:

Fixed assets are to be reported at Historical Cost. The cost of a fixed asset includes not only its purchase price or construction cost but also related charges necessary to place the assets in its intended location and condition for use. Since the historical cost of donated / gifted assets is NIL, they are to be valued at a nominal cost of Rs.1/

The fixed assets includes:

- a) purchase price, less trade discounts and rebates, if any;
- b) import duties;
- c) other taxes or levies which are non-refundable in nature;
- d) transportation cost, if charged separately from the purchase price;
- e) cost of inspection, if paid separately;
- f) handling costs;
- g) cost of site preparation;
- h) installation cost, including cost of such permanent or temporary structures that are considered necessary for installation;
- i) professional fees for engineers or architects or inspectors, etc.; and
- j) any other cost incurred to put the asset at its location and use.

## **iii) Self Constructed Assets**

In cases where a ULB constructs the asset itself (school building, primary health clinic, etc.), the cost of construction of that building and other costs which are directly attributable should be taken into consideration in arriving at the value of the building. This means that all the material costs of construction, payments made to the various contractors, etc., should be included. For example, if the ULB appoints an Assistant Engineer whose only work is to look after the construction of the building, then the salary of the Assistant Engineer for the construction period should also be added.

## **iv) Assets acquired under exchange**

Sometimes, a ULB may acquire some fixed assets in exchange for some other fixed assets. This can happen for instance, when old office machinery is exchanged for a newer model. Where assets exchanged are similar, the net book value of the asset (the office machinery) which is exchanged should be taken, and to it the extra amount that is paid, if any, is added. If instead an extra payment, a refund is involved, the necessary adjustment will have to be made. In case of dissimilar assets, the assets acquired should be recognized at its fair value.

## **v) Process of Valuation**

The process of valuation of assets is required:

- a) When the first (opening balance sheet) is being prepared; and
- b) At the time of preparing annual financial statements

In this section you studied valuation of assets-general principles assets. Now, you should be able to answer some questions relating to this section given in Check Your Progress-2.

**Check Your Progress 2**

**Note:** a) Write your answer in about 50 words

b) Check your answer with possible answers given at the end of the unit.

1) What is a revaluation model for valuation of assets?

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2) What are the principles for determining capitalization of fixed assets?

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**4.4 VALUATION OF ASSETS FOR OPENING OF BALANCE SHEET**

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**i) Process for Preparation of Opening of Balance Sheet**

The following steps need to be followed for preparation of Opening Balance Sheet:

- a) **Identification of assets** - using various sources of data,
- b) **Verification of assets** - This is prescribed to be carried out as current identification initiatives may either miss out existing assets or take in assets which do not belong to the ULB. Hence, some test checks or verification, with records and physical inspection are recommended;
- c) **Identification of assets that require valuation** - This shortlists the assets which need to be valued in accordance with the following procedures and have not outlived their useful life in which case a summary valuation of Re./- can be made;
- d) **Valuation of assets** - This is the subject matter of this manual. Although accounting norms / policies for these are provided, ULBs lack guidance in practical matters of asset valuation.
- e) **Passing of opening entries** - This is the process for preparation of First (Opening) Balance Sheet. Taking cognizance of the assets value in the accounting records brings it within the purview of the new accrual based double entry accounting system.



- f) **Maintenance and updating of fixed asset records** - The details of assets are also recorded in appropriate Fixed Asset Registers and a system has to be developed through which these registers are continually updated with any addition, modification or disposal of these assets.

ii) **Basic Premises**

The basic premises proposed in the NMAM for the valuation methodology are:

- a) Considering the current practices in asset record maintenance, most ULBs do not have readily available records about existing assets;
- b) The purpose of valuation is not to determine the 'correct value' of an asset. It is to get a reasonable estimate of the book value for the purpose of including in a statement which reflects the 'true and fair' financial position of the ULB; and
- c) Unlike other entities where valuation of assets affects share prices and / or prospective takeovers based on valuation of the company, this concern is not relevant to ULBs.

iii) **Asset received as a gift**

If evidence exists, or it is known that an asset was received by the ULB as a gift i.e. without any consideration being paid, it should be recognized at Re.1/-. This is in line with the basic policy of historical cost reporting i.e. to report an asset at the consideration paid for it.

However, these assets may be of considerable value in the market and hence, their nominal valuation should not take away the importance to maintain and monitor them appropriately. It is not necessary that there should be a document establishing the gift - mere knowledge should suffice.

iv) **Historical cost based**

Where the details of purchase are available (this will usually happen in case of recent years assets), the amount of purchase cost and date of purchase would be available. In such a case valuation should be done as follows:

- a) Step 1: Determine historical cost as on the date of purchase
- b) Step 2: Determine depreciation till valuation date
- c) Step 3: Deduct depreciation (a) from historical cost and (b) to arrive at the book value on the date of valuation.

This is the closest we can get to the historical cost of the asset. All other methods are improvisations to overcome deficient information about the existing assets.

Although policies for capitalizing assets require inclusion of ancillary expenses such as borrowing cost, these require significant analysis and are elaborate. Unless the amount of such expense is likely to be significant, they can be ignored for valuation of existing assets in the opening Balance Sheet.

## 4.5 VALUATION OF ASSETS – ONGOING

Once the asset have been valued and included in the Balance Sheet, their carrying value leads to be periodically recomputed to provide for depreciation and other transactions.

Aspects such as revaluation of assets, depreciation of assets, etc. which arise on a regular basis in the ULB are discussed as follows.

- i) **Depreciation of Assets:** Depreciation has a significant effect on the determination and presentation of the financial position of a ULB. Depreciation is charged in each accounting period by reference to the extent of the depreciable amount.

ULBs need to report depreciation accurately in their financial statements for two main reasons:

- a) to match expenses with the incomes generated because of or with, those expenses; and
- b) to ensure that the asset values in the balance sheet are not overstated. An asset acquired in Year 1 is unlikely to be worth the same amount in Year 5.

- ii) **Accounting Principles:** The basic principles with regard to depreciation are:

- a) Depreciation shall be provided at the rates prescribed by the state. Depreciation on all fixed assets is to be provided consistently on either Written Down Value or Straight Line Method. Whatever method is used, it should be applied consistently.
- b) Depreciation shall be provided at full rates for assets, which are purchased / constructed before October 1 of an Accounting Year. Depreciation shall be provided at half the rates for assets, which are purchased / constructed on or after October 1 of an Accounting Year.
- c) Depreciation shall be provided at full rates for assets, which are disposed on or after October 1 of an Accounting Year.

- iii) **Straight-line Method (SLM):** Straight-line depreciation is the simplest and most often used technique, in which the ULB estimates the “salvage value” of the asset after the length of time over, which it will be used to generate revenues or provide service (useful life), and will recognize a portion of that original cost in equal increments over that amount of time.

- iv) **Written Down Value Method (WDV):** The WDV method is a type of accelerated depreciation because it recognizes a higher depreciation cost earlier in the asset’s lifetime. Under this method, each year’s depreciation is applied to the opening net book value of the asset rather than original cost of the asset. This process continues until we reach the residual/salvage value or the end of the asset’s useful life.

Residual or Salvage value is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

- v) **Amortization:** In the case of an intangible asset, the term ‘amortization’ is generally used instead of depreciation. Both terms have the same meaning.

The period of amortization will depend on the asset. In case of items like software, where technological advances will result in a quicker obsolescence, a time frame of 5 years is recommended.

Intangible assets below Rs.25,000 can be expensed and need not be capitalized. The higher limit (compared to tangible assets) is prescribed to avoid detailed recording and amortization of minor items like software which generally cost below Rs.25,000.

- vi) **Impairment of Assets:** ‘Impairment’ is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset’s future economic benefits or service potential through depreciation.

In other words, if the carrying amount of an asset is more than the amount that is to be recovered through use or sale of the asset, then the asset is said to be ‘impaired’. It basically means that although there may be useful life left of an asset, the productivity of the asset has gone down sharply. For example, if by policy of the government, certain items are decided not to be produced by the ULB, the future cash flows would be affected that the existing recoverable value of assets used in the production could go below its carrying amount.

- vii) **Disposal of Assets:** When an asset is retired from service, it should be treated in accordance with the following procedures :

- a) No depreciation should be charged after disposal/retirement of the asset;
- b) In case the disposal happens before October 1, 50% of the depreciation should be charged. If it is on or after October 1, full depreciation should be charged;
- c) The assets which are out of service should be recorded in a separate register;
- d) Once an asset is disposed, its movement should be updated in the Fixed Asset Register.

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## 4.6 ASSET MANAGEMENT

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The following strategies are used during asset management.

- i) **Asset Life-cycle**

An asset proceeds through a number of sequential phases during its life cycle acquisition, operation and maintenance, refurbishment or enhancement, and, finally, disposal. The life cycle of an asset begins with a planning process that identifies the need for that asset and determines how and when it is to be procured. The asset is then acquired - either an existing asset is purchased or a new one is created. The asset then enters its operational phase.

As the asset ages, it may deteriorate or become obsolete, at which stage a decision is made to either refurbish, enhance or dispose it of. If the need still exists for the service provided by the asset, the cycle recommences.

There are essentially three broad stages in the life cycle of an asset:

- a) Acquisition;
  - b) Operation and Maintenance; and
  - c) Disposal.
- ii) **Asset life-cycle management strategy:** Asset Life Cycle Management (ALCM) is a strategic, integrated approach to maintenance that considers all the elements that affect the productive life of an asset - from design to disposal. It is a proactive process that compliments existing policies by providing strategic focus and perspective.

Asset-intensive organizations including ULBs which successfully adopt asset life cycle management will reduce maintenance costs and improve productivity through superior planning. From design to disposal, an asset's life cycle includes the following stages:

- a) Clarify the need or requirement to be satisfied by the asset;
- b) Identify the type of asset suitable for the requirement and fulfill the need;
- c) Determine the maintenance strategy, cycle and plan for the life of the asset
- d) Purchase the asset;
- e) Commission, operate and maintain the asset; and
- f) Dispose of the asset at the end of its economical life.

These planned maintenance strategies improve reliability, overall productivity, the length of an asset's life, and ultimately total cost of asset ownership.

- ii) **Asset Management Unit (AMU):** It would be clear from the foregoing discussions that ALCM would greatly enhance productivity and performance of ULBs. However, currently there is no unified department in ULBs which looks at all aspects of asset management. In most ULBs, the acquisition assets is the responsibility of the Stores and Purchase Department. Similarly, the account department normally records only the financial transaction and is not concerned with maintenance and management of the asset.

For these reasons, it may be useful for the ULBs to set up an Asset Management Unit (AMU) so that various aspects of asset life cycle are properly managed. This AMU may be centrally located and under the charge of the head of Finance or the Commissioner. The justification for the cell to report directly to the Commissioner arises from the fact that the use of many of the fixed assets such as land and building has policy overtones, and the alternatives in these respects may have to be examined from a larger perspective.

In this connection it is also to be noted that planning for assets (capital budgeting) is a specialized and time consuming exercise by itself, and most departments of finance and accounts in ULBs do not have the wherewithal in terms of either time or human resources to spare for it. Hence, the AMU can have specialized and dedicated staff for exclusively focusing on these issues.

**b) Structure of AMU**

The AMU could consist of the following staff and officers:

- a) Head, AMU - preferably a person with Asset Management experience, including MIS and computer systems;
- b) Procurement plan Officer- responsible for purchase planning, scheduling and design;
- c) Recording Officer - for review / maintenance of Fixed Asset registers. Also to keep track of disposed assets, sales and preparation of various reports including depreciation schedules;
- d) Maintenance plan Officer - To oversee all scheduled, planned maintenance, to co-ordinate with relevant departments to ensure all assets are in working condition and serviced in time; and
- e) Other staff as may be needed

The AMU staff and officers must all be computer literate and reasonably proficient in working with electronic spreadsheets. If capacity building measures are necessary in these regards, the ULB must speedily plan for the same and implement necessary programs.

Attention is to be paid to the qualifications and experience of the officers deputed to the AMU. At the minimum, officers should have formal accounting qualifications, with in-service training or external diplomas or other qualifications in information technology. Staff should be appropriately chosen with regard to experience in accounting, procurement, and MIS.

**c) Functions of AMU**

The functions of the AMU shall be, without any loss of generality, as follow:

**i) Procurement Planning**

- a) To prepare short and medium term asset acquisition plans in consultation with the proposer/user departments and to present the same with due financial impact exercises and alternatives for consideration of Competent Authority.
- b) To prepare general Procurement Plan for fixed assets before the beginning of the fiscal year in terms of the approved asset acquisition plans and to layout necessary timelines, parameters and benchmarks.

**ii) Asset Acquisition**

- a) To assist and facilitate the purchase department in the process of acquisition of assets as per Asset Procurement Plan.
- b) To assist and facilitate the other execution departments to carry out the Procurement Plan.

**iii) Recording and Reporting**

- a) To develop, update and maintain an asset tracking database with respect to the location, condition, and other parameters per fixed assets;
- b) To develop, update and maintain a Capital Works in Progress database and to generate necessary MIS there from;
- c) To develop, update and maintain the Fixed Assets Register and to record all fixed asset related transactions which add to or subtract from the book-value of the asset.
- d) To separately maintain the register of impaired assets and assets scheduled for disposal with due attention to computation of value in use and recovery/salvage values. To also assure that due process is followed in determination of fair values and market prices.
- e) to prepare evaluative and analytical reports for the management from time to time.
- f) to prepare depreciation schedules.

**iv) Maintenance**

- a) To prepare, in consultation with other departments, planned maintenance schedules and to oversee their implementation.
- b) To prepare, in consultation with concerned departments, schedules for conditional assessment and plans for major renovations, repairs, and modifications.

**v) Disposal of Assets**

- a) To prepare and follow through on the annual disposal plan for fixed assets.
- b) To prepare Asset renewal plan which will feed into the capital procurement plan.

In this section you studied valuation of assets for opening of balance sheet, valuation of assets- ongoing and asset management. Now, you should be able to answer some questions relating to this section given in Check Your Progress-3.

**Check Your Progress 3**

**Note:** a) Write your answer in about 50 words

- b) Check your answer with possible answers given at the end of the unit.

1) What is an Asset Life Cycle?

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2) Explain an Asset Life Cycle Management Strategy?

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## 4.7 ISSUES IN VALUATION

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The valuation of urban assets many times confronted with issues. A few important issues associated with valuation of urban assets are narrated below:

i) **Freehold Land:** All land ownership of which vests with the ULB should be included in the opening balance sheet. The categories are:

**Land acquired through purchase**

The land will be recorded at the purchase price paid/payable and other incidental costs such as registration charges incurred to bring the asset to its present location and condition.

**Lands acquired through compulsory acquisition**

The land will be recorded at the total compensation paid/ payable for the acquisition of land.

**Compensation paid:** It shall be valued at compensation actually paid.

**No Compensation Paid:** If the asset was acquired without paying any compensation then shall be valued at Re.1/-. However, any developmental work done should be capitalized cost.

**Compensation in dispute:** The amount paid will be recorded as the asset value. Any extra amount that may be payable, if determinable, should be shown as contingent liabilities. When any further amount is paid to the previous owner, it will be added to the asset in 1 year of payment.

ii) **Vested Government Lands:** Vested government lands are those lands which are not owned by the ULBs nor does any economic benefit accrue to the ULB. The ownership of these lands vest with the State/Central government and the ULB merely acts as a trustee for these lands. As per Technical Guide issued by ICAI for ULBs, vested government land shall not be recorded as asset as neither ownership nor economic benefits is with ULBs. The description of such lands shall form a part of the number to the balance sheet.

**Land improvement**

Original cost of any improvement to land such as land development and land filling should be capitalized as an improvement to the land.

### **Land acquired through government grants**

If the ULB has purchased land from government grants, then the cost of the land will be shown at gross value i.e. cost paid/ payable or as determined. The grant received should be shown as Capital Reserve in the Balance Sheet.

iii) **Buildings:** The valuation of buildings shall be carried out as follows:

#### **Buildings purchased**

Purchase cost of the building shall include the purchase price cost and incidental costs such as registration charges and other costs incurred to bring the asset to its present location and condition.

#### **Building constructed**

If the building has been constructed, then the cost of construction will be taken as the cost.

#### **Heritage Buildings**

Heritage buildings are generally to be valued in the same manner as other buildings. However, they are to be disclosed separately under the Head 'Heritage Assets' under Other Assets. The purpose is to distinguish the assets for their historical, cultural and / or religious significance and to recognize the restrictions on their use or sale.

#### **Art and Historical items**

ULBs should capitalize works of art, historical treasures, and similar assets at their historical cost. These items can be classified under 'Heritage Assets' under 'Other Assets'.

Governments should disclose information about their works of art and historical collections. Capitalized collections or individual items that are exhaustible, such as exhibits whose useful lives are diminished by display or educational or research applications, should be depreciated over their estimated useful lives. Depreciation is not required for collections or individual items that are inexhaustible.

iv) **Value of land under Roads:** Roads are generally built on property that is owned by the ULB. Hence, apart from the road, the land under the road also needs to be valued and accounted.

Such land is to be kept under 'Land' and not included in 'Roads & Bridges'. The value of such land should be taken at the historical cost i.e. if any amount is paid to acquire it then at the compensation paid, etc. If the amount cannot be ascertained, a nominal value of Re. 1/- should be considered for the land under each road.

v) **Pipe networks:** Networks will normally have trunks, mains, and sub-mains. This is equally valid for water supply as well as sewerage network. Those parts of network which are relatively stand alone should be considered separate assets on their own. The criterion to be also used is that failure of the smaller network is not critical to the continued operation of the larger one.



While computing historical costs, original costs of digging an earth work should be included.

Any major cost for improvement of network functioning (for instance, removal of sediments and coating from mains or trunks) should be added to the book value.

- vi) **Intangible Assets:** Intangible assets in ULBs will generally be in the nature of expenditure on software. The ULB will assess the expenditure made in development or purchase of the intangible asset in the last 2 years and capitalize it as fixed asset. In case the intangible asset has been provided free of cost on a sharing basis, it should not be shown in the balance sheet.

The process of valuation of intangible asset would be as follows:

- a) **If Purchased:** The cost of an intangible asset comprises its purchase price, including any import duties and other taxes (excluding recoverable amount from the taxing authorities), and any directly attributable expenditure like professional fees for legal services, etc. on making the asset ready for its intended use. Any trade discounts and rebates are deducted in arriving at the cost.
- b) **If Internally Generated:** The cost of internally generated assets such as software should be determined in line with Accounting Standard 26 'Intangible Assets'. Where the asset meets the criteria for recognition, its cost will comprise all expenditure that can be directly attributed or allocated on a reasonable and consistent basis to create the asset / software for its intended use. Costs include: (i) expenditure on materials and services used in developing the asset, (ii) salaries, wages and other employment related costs of personnel directly engaged in developing the asset, (iii) any expenditure that is directly attributable to generating the asset. However, it excludes: (i) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use; (ii) clearly identified inefficiencies and initial operating losses and (iii) expenditure on training the staff to operate the asset.
- c) **If Gifted/Donated:** If the asset was acquired without paying any price and gifted to ULB (or if it is donated): then it shall be valued at Re .1/-.
- d) **If Acquired through exchange:** An intangible asset may be acquired in exchange or part exchange for old intangible asset. Where the assets exchanged are similar, the net book value of the asset which is exchanged should be taken, and to it the extra amount that is paid, if any, is added. If instead of an extra payment, a refund is involved, the necessary adjustment will have to be made. In case of dissimilar assets, the assets acquired should be recognized at its fair value. The residual value of an intangible asset in ULBs should be assumed to be zero. Hence, the full cost should be 'amortized' over the estimated useful life of the asset. Subsequent expenditure on intangible assets should be generally recognized as an expense unless it increases the capacity or the life of asset.

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## 4.8 REFERENCES AND SELECTED READINGS

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- 1) Andhra Pradesh Municipal Asset Management Manual, Department of Municipal Administration and Urban Development, Government of Andhra Pradesh, 2008
- 2) Model National Municipal Asset Valuation Methodology Manual, Ministry of Urban Development, Government of India, 2009

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## 4.9 CHECK YOUR PROGRESS- POSSIBLE ANSWERS

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### Check Your Progress 1

- 1) Define fixed assets?

An asset held with the intention of being used for the purpose of producing and providing goods or services and is not held for sale in the normal course of business.

- 2) What are the characteristics of “infrastructure assets”?

As per IPSAS, infrastructure assets display following characteristics:

- they are part of the system or network.
- They are specialized in nature and do not have alternative uses.
- They are immovable; and
- They are subject to constraints on disposal.

### Check Your Progress 2

- 1) What is a revaluation model for valuation of assets?

Under the revaluation model, the valuation of assets is continually reviewed to reflect the fair market value as much as possible. After recognition as an asset, an item of property) plant and equipment whose fair value can be measured reliably shall 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.

- 2) What are the principles for determining capitalisation of fixed assets?

The principle for determining capitalisation of fixed asset is that the :

- a) the asset is held for producing or providing goods or services and is not held for the normal course of business;
- b) the future economic benefits or service potential associated are expected to fit the entity;
- c) The estimated useful life of the asset is beyond one year; and
- d) Is beyond the minimum threshold limit for recognition as fixed asset.

**Check Your Progress 3**

## 1) What is an Asset Life Cycle?

An asset proceeds through a number of sequential phases during its life cycle acquisition, operation and maintenance, refurbishment or enhancement, and, finally, disposal. The life cycle of an asset begins with a planning process that identifies the need for that asset and determines how and when it is to be procured. The asset is then acquired and enters its operational phase. As the asset ages, it may deteriorate or become obsolete, at which stage a decision is made to either refurbish, enhance or dispose of it.

## 2) Explain an Asset Life Cycle Management Strategy?

From design to disposal, an asset's life cycle includes the following stages

- a) Clarify the need or requirement to be satisfied by the asset;
- b) Identify the type of asset suitable for the requirement and fulfill the need;
- c) Determine the maintenance strategy, cycle and plan for the life of the asset
- d) Purchase the asset;
- e) Commission, operate and maintain the asset; and
- f) Dispose of the asset at the end of its economical life.