# Depreciation under the Companies Act, 2013

# Depreciation as per AS -6

- AS – 6 issued by ICAI lays down general principles of Accounting for depreciation. It also provides that the statute governing an enterprise may provide the basis for computation of depreciation.

- Companies Act 2013 requires Companies to compute the depreciation as per Schedule II to the Companies Act. Accordingly, provisions governing charge of depreciation in the erstwhile Schedule XIV to the Companies Act,1956 have been replaced with Schedule II to the Companies Act,2013.

# AS -6 …….. continued

* AS states that depreciation is a systematic allocation of the depreciable amount of an asset over its useful life.

- The depreciable amount of an asset is the cost of an asset less its residual value.

- The useful life of an asset is the period over which the asset is available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity.

- Schedule XIV Companies Act 1956 and Schedule II Companies Act 2013 define depreciation similarly.

# Conceptual issues

* Schedule XIV Companies Act 1956 prescribed rates of depreciation to be applied under SLM or WDV. These were the minimum rates. The enterprise could adopt a higher rate based on technological evaluation.

- Schedule II Companies Act 2013 prescribes the useful life in part 'C' to be applied under SLM or WDV. The useful life leads to deriving of depreciation rates. The enterprise can adopt a useful life higher or lower than that prescribed in part 'C' based on technical advice , thereby adopt a lower or higher depreciation rate than prescribed in part 'C'.

- The flexibility provided by Schedule II Companies Act 2013 has brought us closer to the concept of depreciation as the earlier Schedule XIV Companies Act 1956 was rigid on depreciation rates being lower than prescribed in the Schedule.

# Conceptual issues…… continued

* However, still some anomalies prevail in adopting the complete concept of depreciation under Schedule II Companies Act 2013

- By prescribing increase by 50% in case of double shift use and 100% in case of triple shift use, and directly increasing the depreciation amount, the concept of useful life of the asset becomes unstable.

- It would have been better to eliminate the extra shift allowances as the useful life would takes care of the situation.

# Schedule II
# Useful life to compute Depreciation
# Part 'A'

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| 1. Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its residual value. The useful life of an asset is the period over which an asset is expected to be available for use by an entity, or the number of production or similar units expected to be obtained from the asset by the entity | Same as per AS -6 |
| 2. For the purpose of this Schedule, the term depreciation includes amortisation. | Same as per AS -6 |

3. Without prejudice to the foregoing provisions of paragraph 1,—

(i) The useful life of an asset shall not ordinarily be different from the useful life specified in Part C and the residual value of an asset shall not be more than five per cent of the original cost of the asset:

Provided that where a company adopts a useful life different from what is specified in Part C or uses a residual value different from the limit specified above , the Financial Statements shall disclose such difference & provide justification in this behalf duly supported by technical advice.

Comments:-

- Companies have an option of depreciating the asset over useful life which could be different from the useful life prescribed in Schedule II

- The useful life could be higher or lower than that prescribed in Schedule II, but such useful life is to be supported by technical advice & needs to be disclosed.

- The determination of useful life is a matter of estimation c& at times quite challenging , especially where the asset uses new technology.

- Useful life can undergo a change during the period of use which implies companies to take a continuous technical advice on the asset's useful life.

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| | ➢Simply adopting the useful life given in Part C could lead to either over-provisioning or under-provisioning of depreciation amount.<br><br>➢The residual value needs to be estimated which again is difficult matter where the residual value is NIL or upto or equal to 5% , no technical advice is required by the company.<br><br>➢Where the residual value is expected to be more than 5%, the same is required to be based on the technical advice and requires disclosure.<br><br>➢The useful life may be shorter than the economic life e.g.: the company may have a policy of replacing all its motor cars in 3 years. In such cases, the company will depreciate them over 3 years down to the estimated residual value. |
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| (ii) For intangible assets, the provisions of the accounting standards applicable for the time being in force shall apply, except in case of Intangible Assets (Toll Roads) created under 'Build Operate and Transfer', 'Build Own Operate and Transfer', or any other form of Public Private Partnership route in case of road projects. | Comments-<br>➢ this was introduced as an amendment dated Marsh 31, 2014 to reaffirm the position of using revenue based amortization for BOT Assets relating to Toll Roads. For other intangible assets, amortization is to be done over the useful life in accordance with the AS -26 |

# Schedule II
# Useful life to compute Depreciation
# Part 'B'

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| 4. The useful life or residual value of any specific asset, as notified for accounting purposes by a Regulatory Authority constituted under an Act of Parliament or by the Central Government shall be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of this Schedule. | E.g: The Companies engaged in generation/ Supply of Electricity will charge depreciation in accordance with the Electricity Act & not in accordance with the Schedule II of the Companies Act 2013. |

# Schedule II
# Useful life to compute Depreciation
# Part 'C'

* Based on the useful life given in Part C, **on similar Shift Basis & a residual value of 5%, the depreciation rate chart of certain assets is given below:-**

| Nature of Assets | | Useful Life | Rate [SLM] | Rate [WDV] |
|---|---|---|---|---|
| **I** | **Buildings [NESD]** | | | |
| | (a) Building (other than factory buildings) RCC Frame Structure | 60 Years | 1.58% | 4.87% |
| | (b) Building (other than factory buildings) other than RCC Frame Structure | 30 Years | 3.17% | 9.50% |
| | (c) Factory buildings | 30 Years | 3.17% | 9.50% |
| | (d) Fences, wells, tube wells | 5 Years | 19.00% | 45.07% |
| | (e) Other (including temporary structure, etc.) | 3 Years | 31.67% | 63.16% |

| Nature of Assets | | Useful Life | Rate [SLM] | Rate [WDV] |
|---|---|---|---|---|
| **II** | **Bridges, culverts, bunkers, etc. [NESD]** | 30 Years | 3.17% | 9.50% |
| **III** | **Roads [NESD]** | | | |
| | (a) Carpeted Roads | | | |
| | (i) Carpeted Roads - RCC | 10 Years | 9.50% | 25.89% |
| | (ii) Carpeted Roads - other than RCC | 5 Years | 19.00% | 45.07% |
| | (b) Non-carpeted roads | 3 Years | 31.67% | 63.16% |
| **IV** | **Plant and Machinery** | | | |
| | **(a) General rate applicable to Plant and Machinery not covered under Special Plant and Machinery** | | | |
| | (i) Plant and Machinery other than continuous process plant not covered under specific | 15 Years | 6.33% | 18.10% |
| | (ii) Continuous process plant for which no special rate has been prescribed under (ii) below **[NESD]** | 25 Years | 3.80% | 11.29% |

| Nature of Assets | | Useful Life | Rate [SLM] | Rate [WDV] |
|---|---|---|---|---|
| **V** | **Furniture and fittings [NESD]** | | | |
| | (a) General furniture and fittings | 10 Years | 9.50% | 25.89% |
| | (b) Furniture and fittings used in hotels, restaurants and boarding houses, schools, colleges and other education institutions, libraries, welfare centres, meeting halls, cinema houses, theatres and circuses and furniture and fittings let out on hire for used on occasion of marriages and similar functions | 8 Years | 11.88% | 31.23% |
| **VI** | **Motor Vehicles [NESD]** | | | |
| | (a) Motor cycles, scooters and other mopeds | 10 Years | 9.50% | 25.89% |
| | (b) Motor buses, motor lorries, motor cars and motor taxies used in a business of running them on hire | 6 Years | 15.83% | 39.30% |
| | (c) Motor buses, motor lorries, motor cars and motor taxies other than those used in a business of running them on | 8 Years | 11.88% | 31.23% |
| | (d) Motor tractors, harvesting combines and heavy vehicles | 8 Years | 11.88% | 31.23% |
| | (e) Electrically operated vehicles including battery powered or fuel cell powered vehicles | 8 Years | 11.88% | 31.23% |

| Nature of Assets | Useful Life | Rate [SLM] | Rate [WDV] |
|---|---|---|---|
| **XI Office equipments [NESD]** | 5 Years | 19.00% | 45.07% |
| **XII Computers and data processing units [NESD]** | | | |
| (a) Servers and networks | 6 Years | 15.83% | 39.30% |
| (b) End user devices, such as, desktops, laptops, etc. | 3 Years | 31.67% | 63.16% |
| **XIII Laboratory equipment [NESD]** | | | |
| (a) General laboratory equipment | 10 Years | 9.50% | 25.89% |
| (b) Laboratory equipments used in education institutions | 5 Years | 19.00% | 45.07% |
| **XIV Electrical Installations and Equipment [NESD]** | 10 Years | 9.50% | 25.89% |

# Schedule II
# Useful life to compute Depreciation
# Notes -

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| 1. "Factory buildings" does not include offices, godowns, staff quarters. | They have to be depreciated as Normal Buildings |
| 2. Where, during any financial year, any addition has been made to any asset, or where any asset has been sold, discarded, demolished or destroyed, the depreciation on such assets shall be calculated on a pro rata basis from the date of such addition or, as the case may be, up to the date on which such asset has been sold, discarded, demolished or destroyed. | ➢ It may be noted that a company may group additions & disposals in appropriate time periods e.g.: 15 days, a month, a quarter etc for the purpose of charging of pro-rata depreciation in respect of Additions & Disposals of its assets keeping in view the materiality of the amount involved.<br>(Para 24 of the Guidance note on Accounting for Depreciation in Companies) |

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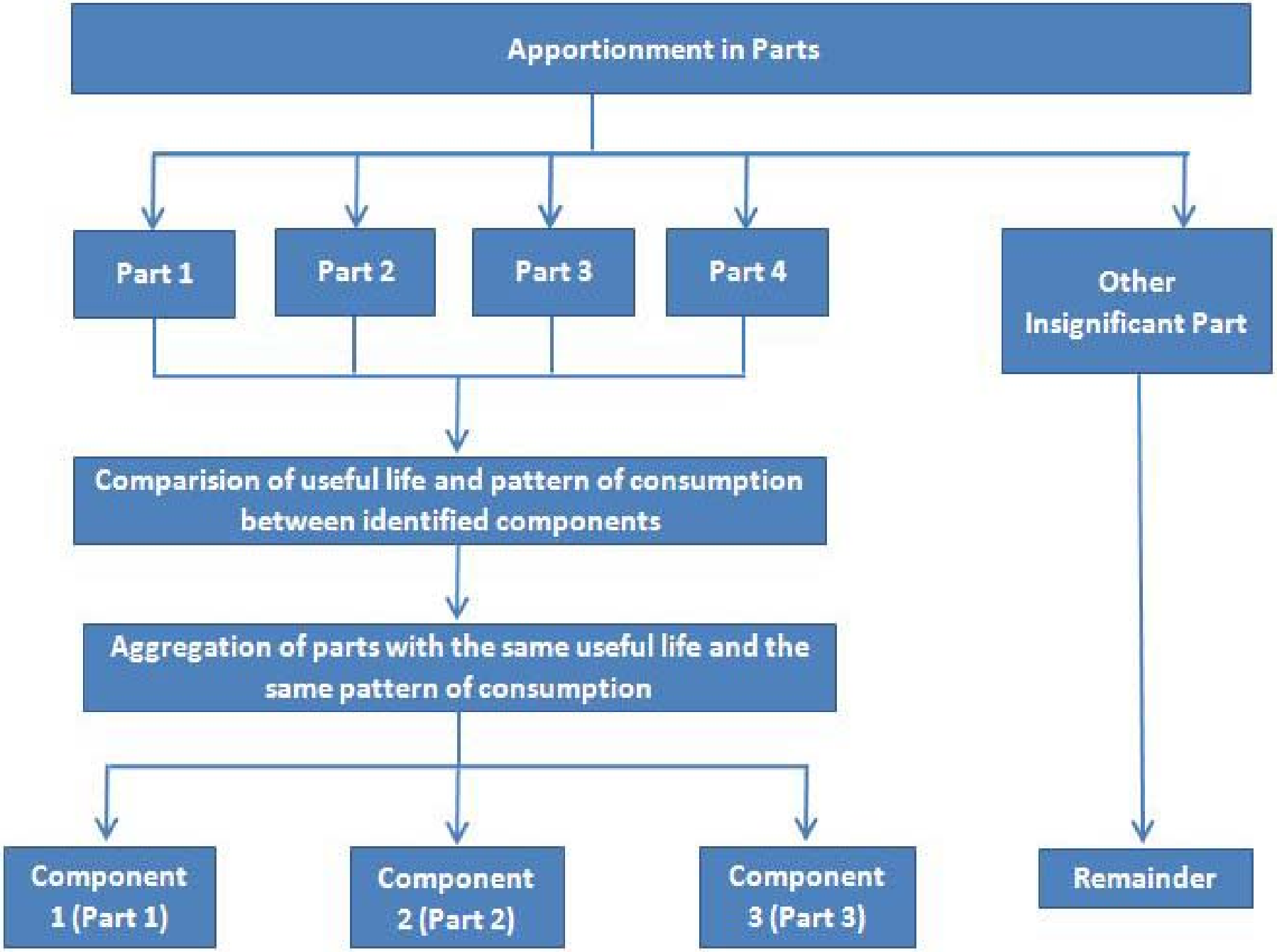
| 3. The following information shall also be disclosed in the accounts, namely:—<br>i) depreciation methods used; and<br>ii) the useful lives of the assets for computing depreciation, if they are different from the life specified in the Schedule. | Comments-<br><br>➢ It may be noted that the useful life needs to be disclosed & not the depreciation rates |
| 4. (a) Useful life specified in Part C of the Schedule is for whole of the asset & where cost of a part of the asset is significant to total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of that significant part shall be determined separately.<br><br>(b) The requirement under sub-paragraph (a) shall be voluntary in respect of financial year commencing on or after 1st April, 2014 and mandatory for financial statements in respect of financial years commencing on or after 1st April, 2015 | This is a new feature of Companies Act,2013 which is commonly referred to as ***"Component Accounting".***<br><br>The provision is voluntary in respect of the financial year commencing on or after April 1, 2014 but mandatory for financial years commencing on or after April 1,2015.<br><br>This approach is best explained by this example |


Apportionment in Parts
Part 1
Part 2
Part 3
Part 4
Other Insignificant Part
Comparision of useful life and pattern of consumption between identified components
Aggregation of parts with the same useful life and the same pattern of consumption
Component 1 (Part 1)
Component 2 (Part 2)
Component 3 (Part 3)
Remainder

Steps to be taken :

- Step 1 : Identify the various key or significant components of the assets say building ( principal asset)
  - i) RCC structural expenses
  - Ii) Elevators
  - Iii) Electrical systems
  - Iv) Water systems
  - V) Cooling systems

- For identification, the criteria should be significant cost ie materiality . 5% of total cost may not be material but more than 10% should generally be and more than 25% should necessarily be.

- Depreciation impact should also be considered for such identification of component.

- Step 2 : The useful life of such significant component should be determined.

- If the useful life of the component is lower than the useful life of the principal asset, such lower useful life should be used.

- If the useful life of the component is higher, than the useful life of the principal asset, the Company has a choice of choosing either the higher or lower useful life. Higher useful life for a component can be used only when management intends to use the component even after expiry of the useful life for the principal asset.

- Step 3 : Components having same useful life may be clubbed together for ease in computation.

- For an existing unit, identification of components and allocation of cost to such components as on 01.04.2014 ( voluntary) or 01.04.2015 ( mandatory) is very challenging. It requires technical advice for identifying and allocation of cost to such components .

- Allocating of cost to components need to be based on :
  a) Break up given by the vendor
  b) cost break up given by internal/external technical expert
  c) Current replacement cost of component as % of current value of principal asset and applying the same basis on the historical cost.

- Replacement cost which in many cases are expensed out would now have to be capitalized. In such cases, the net carrying cost would have to be expensed out.

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| 5. The useful lives of assets working on shift basis have been specified in the Schedule based on their single shift working. Except for assets in respect of which no extra shift depreciation is permitted (indicated by NESD in Part C above), if an asset is used for any time during the year for double shift, the depreciation will increase by 50% for that period and in case of the triple shift the depreciation shall be calculated on the basis of 100% for that period. | Comments:<br>➢Schedule XIV of the Companies Act 1956 prescribes separate rates of depreciation for the single, double and triple shift use of assets. For e.g. With regard to general plant and machinery, single , double and triple shift depreciation rates under schedule XIV were 4.75% ,7.42% and 10.34% respectively.<br><br>➢Under Schedule II of the Act, no separate rates are prescribed for extra shift working. Rather, it states that for the prescribed period of time an asset is used in double shift, depreciation will increase by 50% and 100% in case of triple shift working. |

- Both under Schedule XIV and Schedule II, extra shift depreciation is applicable only for actual number of days.

- Multiple shift depreciation IN Schedule II gives rise to few challenges but the concept of useful life and its periodical revision should take care of the situation. This may call for periodical or yearly technical advise to reset the useful life .

- Transition from Schedule XIV to Schedule II is quite complex but again the concept of useful life as on 01.04.2014 should encompass the expired depreciation and based on the view of the management on the working of asset on multiple shift should assess the useful life.

6. From the date this Schedule comes into effect, the carrying amount of the asset as on that date—

(a) shall be depreciated over the remaining useful life of the asset as per this Schedule;

(b) (b) after retaining the residual value, shall be recognized in the opening balance of retained earnings where the remaining useful life of an asset is nil.

Comments:

These refers to ***transition period.***

- It would be necessary to determine the balance useful life and residual value of the asset at the first instance as on 01.04.2014 and then compute the balance life of the asset.

- Where the balance useful life still remains, the asset is to be depreciated over the balance useful life.

- where the balance useful life is nil especially when part "C" of Schedule II is adopted then after retaining the residual value the carrying cost of the asset would have to be adjusted either in the opening balance of retained earnings or charged to P& L A/c.

Eg: Useful life of general furniture and fittings has been reduced under Schedule II from 15 years to 10 years.

Where the furniture is 6 years old, the remaining WDV of the furniture shall be depreciated over balance 4 years.

Where the furniture is 12 years old, the balance useful life would be nil. In such cases , the Company has an option to write off the carrying cost to the retained earnings or charge the same to the P& L A/c.

- The above example would work where the Company has adopted the SLM method. In case it has adopted the WDV method, the same would have to be done by applying the mathematical formula

$$R = \{1 - (S/C)^{1/N}\} \times 100$$

Where

R = Rate of Depreciation (in %)

N= Remaining useful life of the asset (in years)

S = Scrap value at the end of useful life of the asset

C= Cost of the asset/Written down value of the asset

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| 8. “Continuous process plant” means a plant which is required and designed to operate for twenty-four hours a day | ➢This definition is similar to that contained in the guidance note issued by the ICAI – “Guidance note on some important issues arising from the amendments to Schedule XIV to the Companies Act,1956”. Companies can continue to follow the guidelines. |

# Q & A

Q1 : Schedule XIV Companies Act 1956 provided for depreciation on both SLM and WDV methods. Are there two methods available even under Schedule II of the Companies Act 2013 ?

**Response :**

YES. Both methods are available. Para I of part A of Schedule II specifies that depreciation is the systematic allocation over it s useful life.

Q 2: If Company is following one method say SLM and wish to shift to WDV method on 01.04.2014 , whether the same would be covered under transition period ?

**Response :**

No, such cases will not be covered under transitional provisions of Schedule II. Here, the Company will have to first work out the effect of change in method from SLM to WDV as on 31.03.2014. The same should be charged/ credited to the P&L A/c. The change needs to be disclosed in Financial statements as arising out of change in method. The carrying cost so arising under the new method, namely WDV would then be charged over the balance useful life in accordance with Schedule II.

Q3 : What is the position of depreciation on Revalued assets ?

**Response :**

Under the Companies Act 1956 and Schedule XIV, the depreciation pertaining only to the original asset was to be charged to the P&L A/c. The incremental depreciation on the Revalued position was accounted as per ICAI guidelines and usually charged to the Revaluation Reserve.

Under the Companies Act 2013 and Schedule II the entire depreciation on Revalued asset is to be charged to the P & L A/c.

## Q4 : What is the position of assets costing less than Rs.5000/-?

**Response :**

Under the Companies Act 2013 and Schedule XIV thereof, 100% depreciation may be provided.

Under the Companies Act 2013 and Schedule II thereof, there is no such provision. The asset is to be written off over the useful life.

ICAI in its application guide has considered this issue and advised that the estimation of useful life also involves materiality of impact of such change and the size of the Company. Accordingly, the Company may have a policy to fully depreciate assets upto certain threshold limits

[in the opinion of the speaker, this may not be entirely accepted as it contradicts the concept of useful life adopted in Schedule II ]

Q5 : If the useful life is once determined at the time of purchase of asset or balance useful life is once determined at the time of transition to Schedule II, Companies Act 2013, does it become fixed or can it undergo a change and be re- set or re – fixed?

**Response :**

'Useful life' is one of the most pragmatic and forward looking approach to the working out of the depreciation charge.

Where the asset undergoes a change with a result of technological obsolence or extra use of the machinery on multiple shifts not envisaged earlier or due to any other reasons which may change its useful life , the useful life will undergo a change and so would the corresponding depreciation charge.

But, such changes can only be done based on technical advise.

# THANK YOU

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