DEPRECIATION UNDER COMPANIES ACT, 2013

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APPLICATION GUIDE ON PROVISIONS OF SCHEDULE II TO THE COMPANIES ACT, 2013

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Scope

- Application guide includes provisions of the Companies Act and Schedule II relating to depreciation and provides application guidance for implementing the requirements of the Schedule II.
- Application guide is applicable to all companies for preparation of its financial statements commencing on or after April 1, 2014.

WHY DEPRECIATION?

METHODS OF DEPRECIATION

S.L.M

W.D.V/R.B.M

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Example

- Historical cost – 1,00,000
- Scrap value – 20,000
- Useful life – 8 yrs.

S.L.M.	W.D.V.
Depreciation = Historical cost – Scrap value / Useful life	Rate of Dep. Is first calculated
= 10,000 or 10%	= 18.22 %

Calculation of depreciation

	S.L.M.		W.D.V.	
Year	F.T.Y	ACCUMALATED	F.T.Y	ACCUMALATED
1	10,000	10,000	18,220	18,220
2	10,000	20,000	14900	33,120
3	10,000	30,000	12185	45,305
4	10,000	40,000	9965	55,270
5	10,000	50,000	8150	63,420
6	10,000	60,000	6665	70,085
7	10,000	70,000	5450	75,535
8	10,000	80,000	4,465	80,000

CHANGE IN METHOD OF DEPRECIATION

RETROSPECTIVE EFFECT

CHANGE IN METHOD OF DEPRECIATION AFTER 5 YRS.

	S.L.M.		W.D.V.	
Year	F.T.Y	ACCUMALATED	F.T.Y	ACCUMALATED
1	10,000	10,000	18,220	18,220
2	10,000	20,000	14900	33,120
3	10,000	30,000	12185	45,305
4	10,000	40,000	9965	55,270
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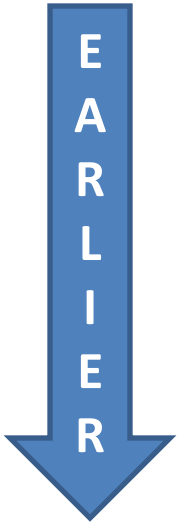
8	10,000	80,000	4,465	80,000

Minimum Rate of dep.



Schedule XIV of Companies Act. 1956

IMPORTANT TERMS

- Depreciation:- It is systematic allocation of the depreciable amount of an asset over its useful life.
- Depreciable Amount:- Cost – Scrap value
- Useful life:- It 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.
- NESD :- No Extra Shift depreciation

Over View of Key Changes

OLD	NEW
• Rate of Depreciation	• Useful Life of Asset. • Useful life for Intangible assets not given.
• Separate Rates as per Shift.	• Rate to be increased based on shifts.
• Depreciation on Asset as a Whole. • Low value asset should be written off in the year of purchase.	• Component wise Depreciation. • No reference of low value assets.

Useful life and Scrape Value of the Asset

Q) Can Company take Useful life and Scrap value other than given in Schedule II ?

Ans. Companies are allowed to follow different useful lives/residual value if an appropriate justification is given supported by technical advice.

Note:-Component accounting :- useful life of a significant part of an asset to be determined separately

AS-6 Vis-à-vis Sch. II (U.L)

Case:- The useful life estimated for asset is 10yrs (AS-6). Useful Life as per Sch II is 12 yrs, Can the company choose any useful life for depreciation?

Ans:- As Accounting Standard 6 states that depreciation rates prescribed under the statute are minimum, Company **cannot** take useful life of 12 yrs.

In this case, AS 6 requires the company to depreciate the asset using **10 year life only**. In addition, Schedule II requires disclosure of justification for using the lower life.

AS-6 Vis-à-vis Sch. II (U.L)

Case:- The useful life estimated for asset is 12yrs (AS-6). Useful Life as per Sch II is 10 yrs, Can the company choose any useful life for depreciation?

Ans:- In this case, the company **has an option** to depreciate the asset using either 10 year life prescribed in the Schedule II or the estimated useful life, i.e., 12 years. If the company depreciates the asset over the 12 years, it needs to disclose justification for using the higher life.

AS-6 Vis-à-vis Sch. II (Residual Value)

Case:- The Residual Value estimated for asset is NIL (AS-6). Residual value as per Sch II is not more than 5% of cost, Can the company choose any Residual value for depreciation?

Ans:- In this case, AS 6 depreciation is the minimum threshold. The company cannot use 5% residual value. In addition, Schedule II requires disclosure of justification only in case residual value exceeds 5% of the cost.

AS-6 Vis-à-vis Sch. II (Residual Value)

Case:- The Residual Value estimated for asset is 10% (AS-6). Residual value as per Sch II is not more than 5% of cost, Can the company choose any Residual value for depreciation?

Ans:- In this case, the company has an option to depreciate the asset using either 5% residual value prescribed in the Schedule II or the estimated AS 6 residual value, i.e., 10% of the original cost. If the company depreciates the asset using 10% estimated residual value, it needs to disclose justification for using the higher residual value.

Amortization of Intangible Asset

- Useful life of Intangible Assets not given under Schedule II.
- For BOT Assets – Revenue based amortization may be applied (Given in Schedule II).
- For Amortization of other Intangible Assets AS-26 should be applied.

Component Accounting

- As per note 4 Schedule II to the Companies Act, 2013 -“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.”

Component Accounting

- As per the amendment dated August 29, 2014 notified by the MCA, the said requirement shall be voluntary in respect for the financial year commencing on or after the April 1, 2104.

and

Mandatory for financial statements in respect of financial years commencing on or after April 1, 2015.

Component Accounting

Q- Is component accounting to be done only for the assets acquired after 1/4/15?

Ans- Component accounting is required to be done for the **entire block of assets** as at 1 April, 2015 mandatorily. It cannot be restricted to only new assets acquired 1 April, 2015.

Effect of component Accounting

Case A :-

X Ltd., a steel company in the process of enhancing its production capacity. The company has got another furnace commissioned. Based on its historical experience, the company determines the life of furnace to be 30 years. The cost of furnace is Rs. 90 crores. The break-down is as below:

	Useful life	**Cost (Rs. In crores)**
Structure	30	45
Internal lining of refractory	5	11
Heating components	7	14
Motors & other operating parts for controlling them	10	20
Total		**90**

Give the impact of component accounting on replacement of components after introduction of the Companies Act, 2013 and compare with the earlier situation under the Companies Act, 1956. Residual value may be assumed to be nil.

Solution:

Treatment under the Companies Act, 1956

- The component accounting was not mandatory under the Companies Act, 1956. The replacement cost was charged to the Statement of Profit and loss in the year in which it was incurred.
- Annual depreciation of furnace = Rs. 90 crores/30 = Rs. 3 crores
- Replacement cost of various components will be charged to the statement of Profit and loss.

Solution:

Treatment under the Companies Act, 2013.

Statement showing component wise annual depreciation

Furnace	amount (A)	Useful life (B)	Depreciation (SLM) (A)/(B)
Structure	45	30	1.5
Internal lining of refractory	11	5	2.2
Heating components	14	7	2
Motors & other operating parts for controlling them	20	10	2
Total			9.7

although the overall amount that will be charged to the statement of Profit and loss will be same during the entire life of the furnace, the annual charge to the statement of profit and loss will differ significantly.

Effect of component Accounting

Case B :-

- X Ltd. has purchased a ship for 38 crores. The components of ship along with the cost allocated to each component, replacement cost at the end of the useful life and the useful life are as follows:

Ship	Allocated cost (Rs.)	Residual Value (Rs.)	Useful life (Years)
Life raft	1,00,00,000	10,00,000	10
Others	5,00,00,000	50,00,000	10
Decks	10,00,00,000	50,00,000	15
Boiler	10,00,00,000	10,00,000	15
Bulkhead	9,00,00,000	99,00,000	30
Propulsion system	3,00,00,000	30,00,000	30
Total	**38,00,00,000**	**2,49,00,000**	

The overall useful life of the ship was 30 years.

Give the impact of component accounting on replacement of components after introduction of the Companies Act, 2013 and compare with the earlier situation under the Companies Act, 1956.

Solution:

Treatment under the Companies Act, 1956

- Annual depreciation of the ship= (Rs. 38,00,00,000- Rs. 2,49,00,000)/30 =

  Rs. 1,18,36,667

- Replacement cost of various components will be charged to the statement of Profit and Loss account.

Solution:

Treatment under the Companies Act, 2013.

Statement showing component wise annual depreciation

Ship	Depreciable amount (Rs.) (A)	U.L. (B)	Depreciation (Rs.)(SLM) (A)/(B)
Life raft	1,00,00,000-10,00,000 = 90,00,000	10	9,00,000
Others	5,00,00,000-50,00,000 = 4,50,00,000	10	45,00,000
Decks	10,00,00,000-50,00,000 = 9,50,00,000	15	63,33,333
Boiler	10,00,00,000-10,00,000 = 9,90,00,000	15	66,00,000
Bulkhead	9,00,00,000-99,00,000 = 8,01,00,000	30	26,70,000
Propulsion system	3,00,00,000-30,00,000 = 2,70.00,000	30	9,00,000
Total			**2,19,03,333**

When at the end of the respective useful lives of the components, the components will be replaced, the replacement cost should be capitalized and the existing carrying value (if any) should be recapitalized.

Effect of component Accounting

Case C :-

- A manufacturing company has recently acquired a new factory building for a cost of Rs. 23,00,000 with a residual value of Rs. 3,00,000. This factory building has a flat roof, which needs replacing every ten years at a cost of Rs. 5,00,000.
- Company is considering two alternative approaches:
  I. To regard the item as one asset and, therefore, to depreciate the whole factory building over its useful economic life of 20 years, charging Rs.1,00,000 per annum.
  II. To regard the roof as a significant part of the item and depreciate the cost of the roof of Rs. 5,00,000 over 10 years, giving a depreciation charge of Rs. 50,000 per annum and to depreciate the remainder of the factory building of Rs. 18,00,000 down to its residual value of Rs.3,00,000 over 20 years, giving a depreciation charge of Rs. 75,000.
- Which approach is more suitable?

Solution:-

The second approach is suitable because this approach more accurately reflects the consumption of economic benefits of the factory building.

Double/ Triple shift working

- Under Schedule II, no separate rates/ lives are prescribed
- it states that for the period of time, an asset is used in double shift depreciation will increase by 50% and by 100% in case of triple shift working.

What is double or triple shift?

- The term ‘Shift’ has not be defined in companies Act, 1956 or 2013.
- Sec 2(r) of the factories Act, 1948, defines it as under.

  “Where work of the same kind is carried out by two or more sets of workers working during different periods of the day, each of such sets is called ‘group’ or ‘relay’ and each of such periods is called a ‘shift’”.

Transitional Provision

- From the date Schedule II comes into effect i.e. 1 April 2014, the carrying amount of the asset as on that date.

(a) Shall be depreciated over the remaining useful life of the asset .

(b) After retaining the residual value, may be recognised in the opening balance of retained earnings or may be charged off to Profit and Loss account where the remaining useful life of an asset is nil.

- Hence the company will have to reassess the useful life of its existing fixed assets in accordance with Schedule II.

Transitional Provision

Case D :-

A company acquired a building and other than RCC Frame Structure at a cost of Rs. 10 crores. The company was depreciating the building according to Schedule XIV SLM rate, i.e., 1.63 per cent (rate computed assuming useful life to be approximately 60 years). Now, in April 2014, Schedule II of the Companies Act, 2013 became effective, useful life specified in which is 30 years.

Explain how the transitional provision effect will be accounted for,

A. If the building is acquired on 1st April, 2000.

B. If the building is acquired on 1st April, 1980.

Solution:

A. Transition effect in case the building is acquired on 1st April, 2000

Depreciation charged till FY 2013-14,
i.e., depreciation on SLM for 14years

Rs. 10 crores*1.63%*14yrs = **Rs. 2,28,20,000**

Carrying Value as on 1st April, 2014 = 10,00,00,000 – 2,28,20,000 = 7,71,80,000

- The carrying value as on 1st April, 2014 will be depreciated over the remaining useful life of the asset as per Schedule II of the Companies Act, 2013.
- The remaining useful life as per new Schedule is (30-14) 16 years. Accordingly, depreciable amount of Rs. 7,71,80,000 will be depreciated over 16 years.
- So, annual depreciation to be charged to Profit and loss account from FY 2014- 15 onwards would be Rs. 7,71,80,000/16yrs, i.e., Rs. 48,23,750.

Solution:

B. Transition effect in case the building is acquired on 1st April, 1980

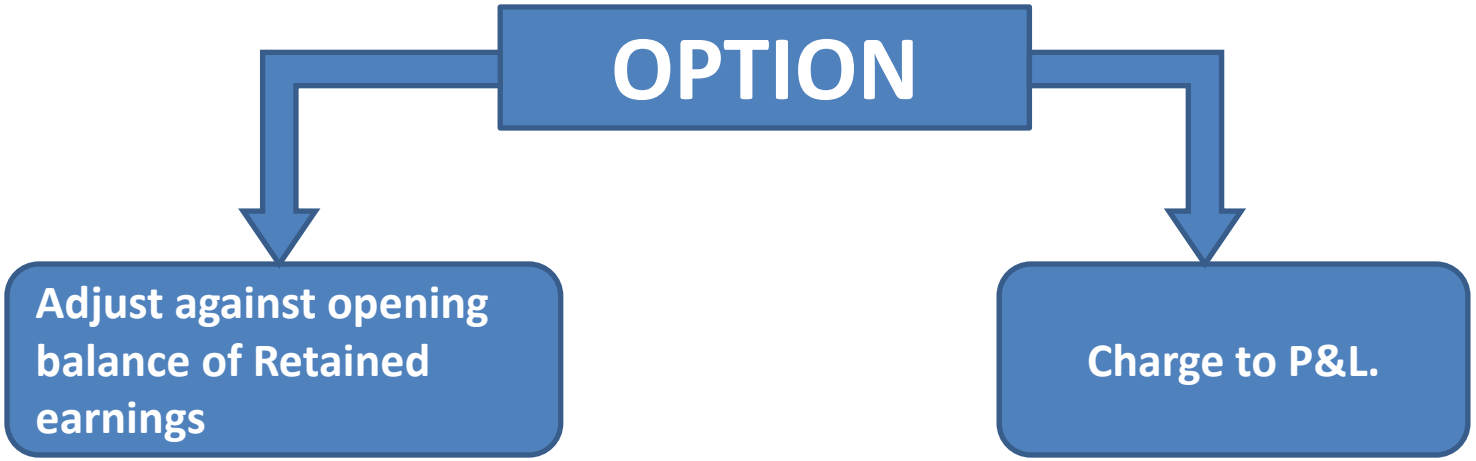
If the building would have been purchased on 1st April, 1980, then as on 1st April, 2014, useful life of 30 years as per new Schedule has already expired.

Depreciation charged till FY 2013-14,

i.e., depreciation on SLM for 34years

Rs. 10 crores*1.63%*34yrs = **Rs. 5,54,20,000**

Carrying Value as on 1st April, 2014 = 10,00,00,000 – 5,54,20,000 = 4,45,80,000



THANK YOU

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