Depreciation as per Companies Act, 2013

Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortization of assets whose useful life is predetermined.

'Useful life' may be considered as a period over which an asset is available for use or as the number of production or similar units expected to be obtained from the asset by the entity. The useful lives specified in Schedule II of the 2013 Act for various assets will result in their depreciation over a different period than currently applicable under Schedule XIV of the Act. For example, for an entity using Straight line method method of depreciation under the Act, useful life has been reduced for

• general plant and machinery from 21 years to 15 years;

• general furniture and fittings from 15 years to 10 year;

• computers from 6 years to 3 years;

The useful lives of assets working on shift basis have been specified in the Schedule II of the Companies Act, 2013, 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), 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 will be calculated on the basis of 100% for that period.

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'. The basic feature of the system of extra shifts is employment of a different set of workers for the period additional to the normal working hours.

Extra shift depreciation is calculated in proportion which the no. of days for which concern worked multiple shift, bears to normal no. of working days. For this purpose, the normal number of working days during the year shall be deemed to be:

<u>Normal No. of working days</u>

- In case of seasonal factory or concern, no. of days concern actually worked during the year or 180 days, whichever is greater.
- In any other case, no. of days concern actually worked during the year or 240, whichever is greater. Actual capacity of the plant & machinery utilized is not relevant for computing extra shift depreciation.

$$\text{Depreciation} = \text{Depreciation for single shift working} + (\text{Depreciation for double/triple shift working} - \text{Depreciation for single shift working}) \times \frac{\text{No. of days worked double/triple shift}}{\text{Normal working days during the year.}}$$

For Normal No. of working days, not the working days of individual plant and machinery item, but the working days for the concern as a whole should be considered for purpose of computing extra depreciation. And even the idle days on account of maintenance etc should be considered.

Component Accounting

Useful life specified in part C of Schedule II of the Companies Act, 2013, is for whole of the asset. But, if Cost of 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 should be determined separately. Thus, concept of component Accounting is Introduced. AS 16/IAS16 guide us on concept of component Accounting.

In case of prescribed class of companies, whose financial statement comply with prescribed AS u/s 133 the useful life of an asset should not normally differ from the useful life and the residual value indicated in part C. Provided if such a Company uses a useful life as resided value, different from that indicated therein, **it should disclose the justification for the same.** From the use of word "different", it seems clear that both higher & lower useful life and residual value are allowed.

Ordinarily, **residual value** of an asset is often insignificant but should generally be **not more than 5% of the original cost of asset.**

The useful life or residual value of any specific asset, as notified for accounting purpose by a **Regulatory Authority constituted under on Act of parliament or by the central Government** should be applied in calculating depreciation to be provided for such asset irrespective of the requirement of schedule II of the Companies Act, 2013.

The Concept of **Continuous process Plant** is same under both the Acts. i.e."Continuous process plant is a plant which is required and designed to operate 24 hours a day".

Where, during any F.Y., any addition has been made to any asset, or where any asset has been sold, discarded, demolished or destroyed, the depreciation on such asset should 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.

There is no specified provision in the companies Act, 13 regarding depreciation on assets with value less than rupees fine thousand. Thus, it may be inferred that the requirement of fully depreciating the assets up to **Rs. 5000**, does not in the companies Act, 2013.

Transitional Provisions

From the date schedule II 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 schedule II;
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.

Example 1

From the following information, you are required to calculate the depreciation rate and illustrate the application under the following methods:

I. Straight-line method (SLM)
II. Written Down Value method (WDV)

	(Rs in lakhs)
Cost of the machine (acquired on 1 April 2013)	Rs 30,000
Erection Charges	Rs. 3,000
Estimated useful life	10 years
Estimated Scrap Value	Rs 3,000

Solution

I. *Straight Line Method*

The asset will be capitalised at Rs 33,000 laks, being the purchase price and erection charges.

$$\text{Depreciation} = \frac{\text{Capitalised Cost} - \text{Estimated Residual Value}}{\text{Estimated Residual Value}}$$

= Rs (33,000 lakh – 3,000 lakh)/10

= Rs 3,000 lakh

Thus, the amount of depreciation would be Rs 3,000 lakh p.a.

Effective rate of depreciation = Annual Depreciation x 100/Cost of Asset

= Rs 3,000 lakh x 100/Rs 33,000 lakh

= 9.09%

II. *Written down Value method:*

Computation of depreciation rate:

Rate= 1-(Rs 3,000 lakh/ Rs 33,000 lakh) ^0.1

= 21.32%

III. *If remaining useful life is 0.*

<u>Impact</u>

a) Opening balance of retained earnings would reduce by the carrying amount.

b) No depreciation from F.Y 2013-14 onwards shall be charged to the profit and loss account, which otherwise would have been charged if Schedule II would not have come into force.