SCHEDULE II – DEPRECIATION

COMPANIES ACT, 2013

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Declaration of Dividend

- Section 123(1) - No Dividend except out of profits after providing depreciation in accordance with sub section(2)
- Section123(2) - Depreciation to be provided in accordance with provision Schedule II.

Accounting Standards

- Section 133 Rule 7 of The Companies (Accounts) Rules 2014 - The Accounting Standards issued by ICAI mandatory

General Circular 8/2014 dtd.04.04.2014

- Financial Statements shall be governed by Companies Act, 2013 in respect of Financial Years commencing on or after 1st April 2014.

Notification S.O.902(E) dtd.26th March 2014

- Various sections including Section 123 notified to be applicable w.e.f. 01.04.2014

Schedule II of the Companies Act, 2013

- Section 123
- Useful lives to compute Depreciation

Comparison - Schedule II of Companies Act, 2013 with Schedule XIV of Companies Act, 1956

- Prescribes indicative useful lives of various assets instead of Straight Line Method (SLM)/ Written Down Value (WDV) rates for calculating depreciation

Comparison - Schedule II of Companies Act, 2013 with Schedule XIV of Companies Act, 1956

- Useful lives prescribed for tangible assets only
- No life prescribed for intangible assets. Notified accounting standard to govern the same.[Rebuttable presumption – Life as 10 years]

Comparison - Schedule II of Companies Act, 2013 with Schedule XIV of Companies Act, 1956

- Depreciation is a systematic allocation of the depreciable amount of an asset over its useful life.
- The depreciable amount of an assets is the cost of an asset or other amount substituted for cost, less its residual value

Comparison - Schedule II of Companies Act, 2013 with Schedule XIV of Companies Act, 1956

- Useful life 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.
- [Schedule XIV of Companies Act, 1956 does not include such requirement.]

Comparison - Schedule II of Companies Act, 2013 with Schedule XIV of Companies Act, 1956

- Companies are allowed to follow different useful lives/residual value if an appropriate justification is given supported by technical advice.
- Component accounting; Useful life and Residual Value of a significant part of an asset to be determined separately

Comparison - Schedule II of Companies Act, 2013 with Schedule XIV of Companies Act, 1956

- No separate rate for double/ triple shift;
- Depreciation to be increased based on the double shift/triple shift use of the assets

Comparison - Schedule II of Companies Act, 2013 with Schedule XIV of Companies Act, 1956

- Useful lives of fixed assets prescribed under schedule II of Act different from those envisaged under Schedule XIV of the Companies Act, 1956

Comparison - Schedule II of Companies Act, 2013 with Schedule XIV of Companies Act, 1956

- Industries for which special rates are prescribed under Schedule II
- No reference to depreciation on low value asset

Importance of Depreciation

- True and Fair determination of operating results of the entity
- AS-6
- Guidance note on Accounting for Depreciation in Companies accounts
- Guidance note on some important issues arising from the amendment to Schedule XIV of the Companies Act, 1956

Depreciation

- Methods – SLM, Diminishing balance (WDV) Unit of Production
- To be applied consistently
- Change Method if expected pattern of consumption of future economic benefits change.

Depreciation

- Under AS-6 method can be changed only if –
  - Required by Statute
  - For compliance with an Accounting Standards
  - If it is considered that the change would result in a more appropriate preparation or presentation of Financial Statements

AS-6 – Definition of Depreciable Asset

- Are expected to be used during more than one accounting period; and
- Have a limited useful life; and
- Are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.

Definition of Depreciation Schedule II

- Systematic allocation of depreciable amount over its useful life.
- Depreciable amount = cost of assets [or other amount substituted] – Residual Value.
- Useful life = Period over which Asset is expected to be available for use or number of production units.
- Depreciation includes amortization.

Revaluation of Assets

- ICAI Guidance Note on Treatment of Reserve created on revaluation of fixed assets – Additional depreciation can be recouped from revaluation reserve
- Schedule II – Depreciation on amount substituted for historic cost
- AS-10 – Transfer to General Reserve on retirement or disposal of revalued asset
- Transfer not through statement of Profit and Loss.

Special Provisions – Part A Para 3 – Schedule II

- Useful life and/or residual value shall not be normally different from that indicated in Part C of Schedule II
- Different useful life and/or residual value requires justification
- For intangible assets – provisions of AS-26 shall apply.

Special Provisions – Part B – Schedule II

- Useful life or residual value as notified by any Regulatory Authority under an Act of Parliament and/or Central Government to supersede Schedule II.

Life As per AS-6 & Schedule II

- AS-6 prescribes depreciation rates under the statute as minimum
- If Management estimate of useful life is shorter than Schedule II then apply higher rates
  - AS-6 life 10 Yrs - Schedule II – 12 Yrs
  - AS-6 life 12 Yrs - Schedule II – 10 Yrs

Life As per AS-6 & Schedule II

- If Management estimate of residual value is shorter than Schedule II then apply AS-6 value and if more than Schedule II then option to apply AS-6 or Sch. II
  - AS-6 residual value NIL – Sch. II - 5%
  - AS-6 residual value 10% - Sch. II – 5%
- Justification required under Schedule II only when residual value exceeds 5% of the cost.

Life As per AS-6 & Schedule II

- Assessment of useful life and residual value.
  - Matter of judgment
  - To be decided on case to case basis
  - Involves technical expertise and not merely an accounting exercise.
- Future price level changes (Inflation) in residual value not to be considered

Life As per AS-6 & Schedule II

- Factors determining useful life
  - Expected usage based on capacity or physical output
  - Expected physical wear and tear – based on shifts and repairs maintenance programme
  - Technical or commercial obsolescence or market demand or changes in selling price

Life As per AS-6 & Schedule II And Residual Value

- Factors determining useful life
  - Legal or similar limits [Leases]
  - Management intention
- Residual Value
  - Realizable value of similar assets
  - Normally taken as NIL

Depreciation for Intangible Assets

- Notification GSR 237(E) dtd. 31.03.2014
  - BOT, BOOT or other forms of PPP route in case of Road Projects
  - Amortization Amount = Cost of Intangible Asset X Actual Revenue for the year ÷ Projected Revenue from Intangible Asset [Till the end of concession period]

Special Provisions – Part C – Schedule II

- Useful life given instead of rates of Depreciation.
- In some cases, the rates are higher or lower than previous schedule XIV
- Has given special useful life for many Industries.

Notes

- Depreciation on additions or in case asset is sold discarded demolished or destroyed – Pro-rata basis from the date of event.

Notes

- Information to be disclosed in accounts.
  - Depreciation method used
  - Useful lives of assets only if they are different from life specified in the schedule

Notes

- Component Accounting
  - Useful life specified for whole of the Assets
  - Required for entire block of asset and not for only new assets acquired after 1st April 2014 or 1st April 2015

Notes

- Component Accounting
  - Where cost of a part is significant and useful life different – such part of asset to be depreciated separately [also in para 24 of AS-6]
  - Need to identify only material / significant components – threshold to be determined by the unit based on impact on retained earnings, current/future, profit/loss

Notes

- Component Accounting
  - Currently companies expense replacement costs
  - Now expense net carrying value of replaced part

Notes

- Component Accounting
  - Determination of costs of component
    - Break-up given by vendor
    - Break-up given by technical expert
    - Current replacement cost of component of the related asset factored in historical cost

Notes

- Depreciable Amount = Cost of Asset or Amount substituted for cost – Residual Value
- Residual Value
  - is normally insignificance
  - generally not more than 5%

Notes

- Assets working on shift basis
  - Useful lives in Part C are based on single shift working
  - For double shift depreciation to be increased by 50%
  - For triple shift depreciation to be increased by 100%
  - Some assets marked NESD

Notes

- Carrying amount to be depreciated over remaining useful life of the asset after retaining residual value.
- Transitory provision -
  - Opening carrying value MAY be transferred to retained earnings [otherwise to be debited to Profit & Loss account] where remaining useful life is NIL. [GSR 627(E) dtd.29.08.2014]
  - AS-6 life NIL – Schedule II – 10 years

Notes

- Transitory provision –
  - Example useful life – furniture fitting
  - Schedule XIV – 15 yrs – Schedule II – 10 yrs
  - Furniture purchased 8 years ago – remaining period two years
  - Furniture purchased 12 years ago
- Unit may have different rates of depreciation for individual asset within same class [due to different remaining useful life for each asset]

Notes

- WDV Calculator –

$$R = \{1 - (s/c)^{1/n}\} \times 100$$

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

Notes

- Continuous process Plant
- Plant which is REQUIRED and DESIGNED to operate for 24 hours a day
  - Distinguish from repetitive process plant [Textile Mill] or Assembly line plant [Automobile Manufacturing]
  - Shut down does not change inherent technical nature

Additional Questions -

1. Whether it is necessary to review useful life every year? [Para 23 of AS-6] [Para 21 of AS-5] [Para 51 of Ind AS-16]
2. Whether adjustment of review of useful life is an extraordinary item or prior period item?

Additional Questions -

3. Can company have a policy to fully depreciate the cost of asset below certain amount? [Materiality for threshold limit]
4. Whether additions and disposals can be grouped?
5. What is the requirement of Schedule II for year ending December 31st 2014

Additional Questions -

6. Whether transitional provision is applicable for change of method of calculating depreciation? [Change in Accounting Policy as per AS-5 – Retrospective effect]

7. Useful life in case of renewable option?

Additional Questions -

8. What is the effect of transitional provisions on differed tax and MAT in case of adjustment of WDV to reserve.

ICAI Announcement "Any expense charged directly to reserves and/or Security Premium Account should be net of tax benefit expected to arise from the admissibility of such expenses for tax purposes. Similarly, any income credited directly to a reserve account on a similar account should be net of its tax effect"

!!! Thank You !!!