Contents

Guidance Note on Accounting for Depreciation in Companies

[Foot Note: This Guidance Note also applies to various non-corporate entities to the extent it may be relevant though it has been issued specifically for companies.]

Introduction

P1.

- The Council of the ICAI has issued AS 6 on 'Depreciation Accounting'.
- This standard lays down general principles of accounting for depreciation applicable to all entities.
- As such, the **Standard** is **applicable** to companies also in matters **where there are no specific requirements under the Companies Act.**
- AS 6 also provides that the statute governing an enterprise may provide the basis for computation of depreciation.
  - In such a situation, the requirements of the statute have to be complied with.
  - Thus, in case of companies, **section 205 and 350 of the Companies Act, 1956**, which govern provisions regarding
    - charge of **depreciation** for the purpose of payment of **dividends** and
    - computation of **managerial remuneration**, respectively, provide the basis for computation of depreciation.
- The Companies (Amendment) Act, 1988, has amended section 350,
  - as a consequence to which rates of depreciation prescribed in Income-tax Act, 1961, and the Rules made thereunder are no more relevant
  - as the aforesaid section now provides that the rates of depreciation applicable would be those prescribed in **Schedule XIV**, which has been inserted in the Act.
  - This GN on Accounting for Depreciation in Companies is issued by the Research Committee in the context of the aforesaid sections of the Act as well as the Accounting Standard.

P2. The Council of the Institute and its various committees have issued, from time to time, various **pronouncements** on the subject of accounting for depreciation, in particular reference to the corporate sector, which are listed below:

(a) GN on Provision for Depreciation
[published in Compendium of GNs, Vol.I (2nd Edition)]

(b) Statement On Provision for Depreciation in Respect of Extra or Multiple Shift Allowance
[Published in Compendium of Statements and Standards on Accounting, 1st Edition]

(c) Statement on Changes in the Mode Of Charging Depreciation in Accounts
[Published as an Appendix in the Guide to Company Audit]

(d) Guidance Note on Accounting for Depreciation Consequent to Changes in Rates of Depreciation [Published in Compendium of Guidance Notes, Vol. II, 1st Edition]

This Guidance Note comes into effect in respect of accounting periods commencing on or after 1st April, 1980. Accordingly, the above Guidance Notes/Statements stand withdrawn from that date.

Methods of Charging Depreciation

P3. Section **205** of the Companies Act, 1956, prescribes the methods of charging depreciation. The relevant extracts thereof are as follows:

"(2) ... depreciation shall be provided either-

(a) to the extent specified in section 350; or

(b) in respect of each item of depreciable asset,
- → **for such an amount as is arrived at by dividing 95% of the original cost thereof**
- → **to the company by the specified period in respect of such asset; or**

(c) on any other basis approved by the CG
- → **which has the effect of writing off by way of depreciation**
- → **95% of the original cost to the company**
- → **of each such depreciable asset**
- → **on the expiry of the specified period; or**

(d) as regards any other depreciable asset
- → **for which no rate of depreciation has been laid down by this Act or rules made thereunder,**
- → **on such basis as may be approved by the Central Government**
  - **by the general order published in the Official Gazette or**
  - **by any special order in any particular case:**

Provided that where depreciation is provided for in the, manner laid down in clause (b) or clause (c), [i.e. 95%]
- → **then, in the event of the depreciable asset being sold, discarded, demolished or destroyed**
- → **the written down value thereof at the end of the financial year in which the asset is sold, discarded, demolished or destroyed,**
- → **shall be written off in accordance with the proviso to section 350.**

....

(5) '**Specified period**' in respect of any depreciable asset shall mean

- → the **number of years at the end** of which
- → at least **95% of the original cost** of the asset to the company will have been provided for by way of depreciation
- → if depreciation were to be calculated as per provisions of **section 350.**"

P4.

- → Note No. 5(i) to Schedule XIV requires that **depreciation method(s) used** by the company shall be disclosed.
- → Part II of Schedule VI requires that if **no provision** is made for depreciation,
    - the **fact** that no provision has been made should be stated and
    - the **quantum of arrears** of depreciation computed in accordance with section **205(2)** of the Act
- → shall be **disclosed by way of a note**.
- → The Committee is of the view that the company should also disclose the **method(s) by which the arrears of depreciation** have been computed.

Adoption of different methods for different types of assets

P5.

- → A company may **adopt more than one method** of depreciation.
- → Thus, it is permissible to follow different methods for different types of assets
    - provided the same methods are **consistently** adopted from year to year in accordance with Section 205(2).
- → Also, units in **different geographical locations** can follow different methods of depreciation provided the same are consistently followed.

Change in the method of providing depreciation

P6.

→ The depreciation method selected should be applied **consistently** from period to period.

→ A **change** from one method of providing depreciation to another should be made only if the adoption of the new method is

- required by **statute** or
- for compliance with an **accounting standard** or
- if it is considered that the change would result in a **more appropriate preparation or presentation** of the financial statements of the enterprise.

→ When a change in the method of depreciation is made, depreciation should be **recalculated** in accordance with the **new method from the date of the asset coming into use**. [Footnote: It is hereby clarified that the relevant portion of AS 6 on 'Depreciation Accounting', issued by the ICAI, is being revised to bring it in line with this recommendation of the GN.]

→ The **deficiency or surplus** arising from the **retrospective recomputation** of depreciation in accordance with the new method would be **adjusted** in the accounts **in the year** in which the **method** of depreciation is **changed**.

→ In case the change in the method results in **deficiency** in depreciation in respect of past years, the deficiency should be **charged to the profit and loss account**.

→ In case the change in the method results in **surplus**, it is recommended that the surplus

- be initially **transferred to the 'Appropriations'** part of the profit and loss account and
- **thence to General Reserve** through the same part of the profit and loss account.

→ Such a change should be treated as a **change in accounting policy** and its effects should be **quantified** and **disclosed**.

Relevant rates of depreciation for the purpose of preparation of accounts of a company

P7.

→ Section 205 of the Companies Act requires that **no dividend** shall be **declared or paid** by a company
- **except out of the profits** of the company
- arrived at **after providing for depreciation** as per sec 205(2)

→ This sub-section allows the company to provide for depreciation
- either in the manner specified in Section 350 of the Act
- or in the alternative manners specified in that sub-section itself.

→ Part II of Schedule VI further provides that if no provision for depreciation is made,
- the **fact** that no provision has been made shall be stated and
- the **quantum of arrears** of depreciation computed in accordance with Section 205(2) of the Act shall be disclosed by way of a note.

P8.

→ A question may arise as to whether it is obligatory on a company to provide for depreciation **only on the basis** mentioned
- in Section **205(2)**
- read with section **350** and
- Schedule **XIV** of the Act or

→ whether these bases can be considered as indicating the **minimum depreciation** which must be provided by the company,
- insofar as the **accounts** of the company are concerned and
- insofar as it is required to **exhibit a true and fair view** of the state of affairs of the company as on a given date and of the profit or loss for the year.

P9.

→ The Committee is of the view that in arriving at the rates at which depreciation should be provided the company must consider the **true commercial depreciation**,
  - i.e., the rate which is adequate to write off the asset over its normal working life.

→ If the rate so arrived at is **higher** than the rates prescribed under Schedule XIV the company should **provide** depreciation at such higher rate

→ but if the rate so arrived is **lower** than the rates prescribed in Schedule XIV, then the company should provide depreciation at the rates prescribed in Schedule XIV,
  - since these represent the **minimum rates** of depreciation to be **provided**.

→ Since the determination of commercial life of an asset is a technical matter,
  - the **decision of the Board of Directors** based on **technological evaluation** should be **accepted by the auditor**
  - **unless he has reason to believe** that such decision results in a charge which **does not represent true commercial depreciation.**

→ In case a company **adopts the higher rates** of depreciation as recommended above, the higher depreciation rates/**lower lives** of the assets must be **disclosed** as required in Note no. 5 of Schedule XIV to the Companies Act, 1956.

P10.

→ This view is supported by the Department of Company Affairs and it has clarified that "the rates as contained in **Schedule XIV** should be viewed as the **minimum rates**, and,
  - therefore, a company will **not be permitted** to charge depreciation at **rates lower** than those specified in the Schedule in relation to assets purchased after the date of applicability of the Schedule.

→ If, however, on the basis of **bona fide technological evaluation**, **higher rates** of depreciation are **justified**, they may be provided with **proper disclosure** by way of a note forming part of annual accounts[3].

P11.

(nearly outdated para- any asset in Sch XIV with life of 28 yrs or more-check)

→ The Committee is, however, of the view that in respect of assets existing on the date of Schedule XIV coming into force,
  - and where the company is following the Circular of the Department of Company Affairs bearing No.1/86, dated 21st May, 1986,
  - whereby depreciation under straight line method was worked out based on depreciation rates in force under Income tax Act, 1961 and Rules made thereunder at the time of the acquisition of the asset,
  - it would be permissible to the company to follow Circular no. 1/86, dated 21st May, 1986.

→ An appropriate note will be required to be given in this regard.

P12.

→ Schedule XIV requires that where the concern has worked extra shift,
  - **the multiple or extra shift depreciation** will have to be provided on the plant and machinery, wherever applicable.

→ In this regard, various units/departments/mills/factories should be taken as **separate concerns**.

→ In cases where depreciation has **not been provided** in respect of extra or multiple shift allowance,
  - it will be necessary for the auditor to **qualify** his **report** accordingly.

→ An example of the qualification is given below:

"Depreciation in respect of extra or multiple shift allowance amounting to rupees …………. has not been provided which is contrary to the provisions of Schedule XIV to the Companies Act.

This has resulted in the profit being overstated by Rs ……….. and plant and machinery overstated by Rs ………….."

P13.

- → It has been argued that the **SLM rates** (corresponding to the WDV rates as per Schecule XIV) **can be different** than those prescribed under Schedule XIV, provided the company continues to **determine** the rates as provided **u/s 205.**
- → For instance, against the SLM rate of 11.31 (triple shift rate for general plant and machinery) prescribed in Schedule XIV, a company can charge depreciation at the rate of 10.56%.
  - o It may be mentioned that the rate of 11.31% has been determined on the basis of 8 years and 6 months or so of specified period whereas 10.56% is arrived at if 95% of the cost of the asset is divided by 9 years.
  - o It is argued that for calculating the SLM rates **complete years** have to be taken into account whereas the rates under Schedule XIV also take into account **fractions of years**.

P14. The Committee is of the view that a company should provide SLM instead of holding the contention that **fractions of years** can be ignored. This view is supported by Department of Company Affairs, as per its Circular No. 2/89, dated March 7, 1989.

Applicability of the rates prescribed in Schedule XIV to assets existing on the date on which Schedule XIV came into force.

P15. Applicability of the **rates** prescribed in Schedule XIV to existing assets would depend upon whether the company has been charging depreciation on its assets as per the **written down value method or the straight line method.**

P16. Where a company has been following the written down value method of depreciation in respect of its assets, the **WDV rates** prescribed in Schedule XIV should be applied to the written down value as at the end of the previous financial year as per the books of the company.

P17. Where a company has been following the **straight line basis** of depreciation in respect of its assets the position prevailing at present is discussed hereunder.

P18. In January, 1985, the Department of Company Affairs issued a **circular** dated 10.1. 1985 (enclosed as **Annexure II**). In this Circular, the Government **recognised the need for recalculating the specified period consequent to changes in the income tax rates.** For determining depreciation consequent upon changes in the income tax rates it recommended the following method:-

(i) As far as **recomputation of specified period** is concerned, the specified period be recomputed by **applying to the original cost**, the revised rate of depreciation as prescribed under **Income-tax Rules.**

(ii) As far as charge of depreciation is concerned depreciation be charged by allocating the written down value as per books over the **remaining part of the recomputed specified period**.

P19.

→ The Department of Company Affairs issued another **Circular** (No. 1/86 dated 21st May, 1986, enclosed as **Annexure III**) wherein it re-examined its earlier circular of 1985.

→ The Department accordingly expressed its view that "**once the 'specified period' was determined at the time of purchase** of an asset in accordance with the procedure laid down under **Section 205(5) read with Section 350** of the Companies Act with reference to the rates of depreciation under the Income-tax Act at that time and the amount of depreciation fixed under section 205(2)(b) of the Companies Act, the same **need not be changed subsequently consequent on changes in the rates of depreciation in the Income-tax Act**."

→ The Circular further stated that it was therefore "open to the companies to provide for depreciation under clause (b) of Section 205(2) of the Companies Act on the basis of rates of depreciation prescribed under Income tax Act and in force at the time of acquisition/purchase of the asset."

P20. In its Circular No. 2/89 dated March 7, 1989, the Department has reiterated that the companies which follow Circular No. 1/86 "may, therefore, **continue to charge depreciation at the old SLM rates in respect of the already acquired assets** against which depreciation has been provided in earlier years on SLM basis."

P21. The Committee is of the view that where a company is following the straight line method of depreciation in respect of its **assets existing on the date of Schedule XIV coming into force**, it would be **permissible to apply** the relevant **SLM rates** prescribed in the said **Schedule on the original cost** of the assets **from the year of the change of rates**.

P22. The Committee is accordingly of the view that where a company has been following straight line method of depreciation in respect of its assets existing on the date of Schedule XIV coming into force, the following alternative bases may be adopted for computing the depreciation charge:

(a) Where a company follows the manner of charging depreciation recommended by the Department of Company Affairs in its **Circular No. 1/85**, it has to **change its depreciation rates** as follows :

(i) The **specified period** should be **recomputed** by applying to the original cost, the revised rate as prescribed in Schedule XIV;

(ii) **depreciation charge** should be calculated by allocating the **unamortized value** as per the books of account over the **remaining part of the recomputed specified period**.

(b) A company which follows the **Circular No. 1/86**, can **continue to charge depreciation on straight line basis at old rates** in respect of assets existing on the date on which the new provisions relating to depreciation came into force.

(c) SLM rates prescribed in **Schedule XIV** can be straightaway **applied to the original cost of all the assets** including the existing assets from the year of change of the rates.

P23. A company which **changes the rates of depreciation** should make an **appropriate disclosure** in its accounts pertaining to the year in which the change is made.

Pro-rata depreciation

P24.

→ **Note no. 4 in Schedule XIV** to the Companies Act, 1956, prescribes that

- "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".

→ The Committee is of the view that a company may **group additions and disposals in appropriate time period(s)**, e.g., 15 days, a month, a quarter etc., for the purpose of charging *pro rata* depreciation in respect of additions and disposals of its assets **keeping in view the materiality** of the amounts involved.

P25.

→ Where the **financial year** of a company is **more/less than 12 months**, a question may arise as to whether the rates of depreciation prescribed in Schedule XIV

- are to be applied **proportionately** to the duration of the financial year of the company or
- the said rates are to be applied as **flat rates** irrespective of the duration of the financial year.

→ It may be argued that since **secs 205 and 350**, **are in relation to the financial year,** the rates prescribed in Schedule XIV are applicable in respect of the financial year of the company, irrespective of its duration.

→ The Committee is, however, of the opinion that in **view of the true and fair consideration** of preparation of accounts, the rates of depreciation as per Schedule XIV **should be applied proportionately taking into consideration the duration of the financial year.**

Depreciation on low value items

P26.

- → Prior to the enforcement of the Companies (Amendment) Act, 1988, many companies used to follow the practice of **writing off low value items** in the year of acquisition, since such a write off was **permitted under the Income-tax Act**.
- → The **limit** for such a write off was **Rs. 5,000/-.** Schedule XIV is, however, silent on this aspect.
- → The Committee is of the view that the **concept of materiality** should be kept in mind while deciding the amounts to be written off in this regard.
  - For instance, in **small companies**, the total write off on this basis may be a substantial figure, it may not, therefore, be proper to charge 100% depreciation on low value items.
  - However, in **large companies**, where the value of assets is very high, it may be proper to charge 100% depreciation on low value items keeping in view the concept of materiality.
- → The Committee recommends that the **accounting policy followed** by the company in this regard should be **disclosed appropriately** in the accounts.

Computation of managerial remuneration -- whether SLM rates given in Schedule can be used

P27.

- → The Department of Company Affairs, as per its circular no. 3\19\88 CL V, dated April 13, 1989, has stated that
- → "For the purpose of **determining net profits** of any financial year the amount of depreciation required to be deducted in pursuance of **Section 349(4)(k) read with Section 350** shall be the amount calculated as per the **written down value method** at the **rate** specified in **Schedule XIV**, on the assets as shown by the books of the Company at the end of the relevant financial year".
- → The Committee is of the opinion that the language of Section 350 as it stands at present **does not permit the use of the Straight Line Method.**

→ The aforesaid section makes reference to 'written down value of the assets' indicating thereby that **<u>for the purposes of computation of managerial remuneration, only the WDV method can be used</u>** as the SLM rates, by definition, are applicable only to the original cost of the assets and not to the WDV of the assets.

Charging of depreciation in case of revaluation of assets

P28.

→ A question may arise, as to whether the **additional depreciation provision** required in consequence of revaluation of fixed assets can be **adjusted against "Revaluation Reserve"** which is created by a company by transferring the difference between the revalued figure and the book value of the fixed assets.

→ Depreciation is required to be provided with reference to the total value of the fixed assets as appearing in the accounts after revaluation.

→ However, for certain **statutory purposes** e.g., dividends, managerial remuneration etc., **only depreciation relatable to the historical cost** of the fixed assets is to be provided **out of the current profits** of the company.

→ In the circumstance, the additional depreciation relatable to revaluation may be adjusted against "Revaluation Reserve" by transfer to Profit and Loss Account.

→ In other words, as per the requirements of Part II of Schedule VI to the Companies Act, the company will have to provide the depreciation **on the total book value** of the fixed assets (**including the increased amount as a result of revaluation**) **in the Profit and Loss Account** of the relevant period, and **thereafter** the company can **transfer** an **amount equivalent to the additional depreciation from the Revaluation Reserve**.

→ Such **transfer** from Revaluation Reserve should be **shown in the Profit and Loss Account separately** and an **appropriate note** by way of **disclosure** would be **desirable**.

→ Such a disclosure would appear to be in consonance with the **requirement of Part I of Schedule VI** to the Companies Act, prescribing **disclosure of write-up in the value of fixed asset for the <u>first five years after revaluation</u>**.

P29.

→ If a company has transferred the difference between the revalued figure and the book value of fixed assets to the "Revaluation Reserve" and
  - has charged the **additional depreciation** related thereto to its **Profit and Loss Account**,
  - it is possible to transfer an **amount equivalent to accumulated additional depreciation** from the **revaluation reserve to the Profit and Loss Account or to the General Reserve** provided suitable **disclosure** is made in the accounts as recommended in this guidance note.

P30.

→ The **Revaluation Reserve is not available for payment of dividends**.
→ This view is also supported by the Companies (Declaration of Dividend out of Reserves) Rules, 1975.
→ Similarly, **accumulated losses or arrears of depreciation should not be set off against Revaluation Reserve.**
→ However, the revaluation reserve **can be utilised for adjustment of the additional depreciation** on the increased amount due to revaluation from year to year or on the retirement of relevant fixed assets (as discussed in paragraphs 28 and 29 above respectively).

P31.

→ The **revaluation** of fixed assets is normally done in order to **bring into books the replacement cost** of such assets.
→ This is a healthy trend as it recognises the importance of retaining sufficient funds through additional depreciation in the business for replacement of fixed assets.
→ As such, it will be **prudent not to charge the additional depreciation against revaluation reserve**, though the charge of additional depreciation against revaluation reserve is not prohibited as discussed in paragraphs 28 and 29 above.
→ The practice of not charging the additional depreciation against revaluation reserve would also give a **more realistic appraisal of the company's operations in an inflationary situation.**

ANNEXURE I
[Footnote: Circular No. 2/89, dated March 7, 1989 (Annexure I)]

Circular No.2/89
No.1/17/87-CL.V

Government of India
Ministry of Industry
Department of Company Affairs
Shastri Bhavan, 5th Floor, 'A' Wing
Dr. R. P. Road
New Delhi-1, the 7.3.1989

To

All Chambers of Commerce & Industry.

Subject: Clarification on the provisions relating to depreciation the Companies Act, 1956, as amended by the Companies (Amendment) Act, 1988.

Dear Sirs,

This Department has been receiving queries from different quarters on the subject mentioned above, from time to time, and, accordingly, the following clarifications are issued:-

(1) Date on which the new provisions relating to depreciation become effective:

The Companies (Amendment) Act, 1988 specifically provides that **Schedule XIV** shall be deemed to have come into force on **2-4-1987.** The amended provisions of Section 205 and 350 of the Act have come into force on **15-6-1988** by virtue of the notification issued by this Department. A question, therefore, arises whether depreciation can be charged on assets on the basis of the rates provided in Schedule XIV for accounting year ending between 2nd April, 1987 and 14th June, 1988.

In view of the intention of the legislature behind the amendments in sections 205 and 350 of the Act, the amended provisions have come into force **w.e.f 2-4-1987.**

(2) Recomputation of specified period:

It is stated that in 1986, the Department had issued a circular stating that **specified period once determined may not be recomputed.** Accordingly, the Department has advised the companies that it was open for them not to recompute the specified period even when there is change in the rates of depreciation later on (as against the position of the Department's earlier circular of 1985 on the subject). It is argued that as far as the existing assets are concerned, the companies can follow either of the two circulars. An option under the 1986 circular would thus be available to the companies as at present not recomputing the specified period where the Straight Line Method is used. In other words, where a company decides to follow the 1986 circular, assets on which SLM depreciation was being charged can continue to be depreciated at old SLM rates.

In view of this Department's Circular No. 1 of 1986 (No. 1/1/86 CL.V), dated 21.5.1986, specified period once determined may not be recomputed. **The companies which follow this circular may, therefore, continue to charge depreciation at the old SLM rates in respect of the already acquired assets against which depreciation has been provided in earlier years on SLM basis.**

(3) Can higher rates of depreciation be charged?

It is stated that Schedule XIV clearly states that a company should **disclose** depreciation rates **if they are different** from the principal rates specified in Schedule. On this basis, it is suggested that a company can charge depreciation at rates which are lower or higher than those specified in Schedule XIV.

It may be clarified that the rates as contained in **Schedule XIV** should be **viewed as the minimum rates**, and, therefore, a company shall **not** be **permitted** to charge depreciation at rates **lower** than those specified in the Schedule in relation to assets purchased after the date of applicability of the Schedule. However, if on the basis of a **bonafide technological evaluation**, **higher rates** of depreciation are **justified**, they may be provided with **proper disclosure** by way of a note forming part of annual accounts.

(4) Can SLM rates be different than those specified under Schedule XIV?

It is stated that SLM rates (corresponding to the WDV rates as per Schedule XIV) **can be different** than those prescribed under Schedule XIV **provided a company continues to determine** the **rates** as provided **under Section 205**.

Thus, against the SLM rates prescribed under Schedule XIV of 11.31% (triple shift rate for general plant and machinery), a company can charge depreciation at the rate of 10.56%. It may be mentioned that the rate of 11.31% has been determined on the basis of 8 years and 6 months or so of specified period whereas if 95% is divided by 9 years, the corresponding SLM rate comes to 10.56%. The argument is that for calculating the SLM rates complete years have to be taken into account whereas the rates under Schedule XIV also take into account fractions of years.

It is clarified that a company must necessarily provide SLM depreciation on the rates prescribed under Schedule XIV and the **interpretation that fractions of years cannot be taken into account is not correct.**

Yours faithfully,
U. P. Mathur
Director

ANNEXURE II

Circular No.1/85
No.1/1/85 CL.V No.15/50/84-CL.VI

Government of India
Ministry of Industry and Company Affairs
Department of Company Affairs, New Delhi-1,
dated the 10.1.1985

To

All the Chambers of Commerce

Subject: Determination of Depreciation under Section 205(2)(b) of the Companies Act, 1956 consequent upon changes in the Income tax Rates introduced by Finance Act, 1983.

Dear Sirs,

I am directed to say that during the year 1983, the rates of depreciation under Income-tax Act have been changed on some of the assets. As the depreciation provision in the annual accounts of the Companies Act, 1956 is related to the rates of depreciation as provided in the Income-tax Act, any change in the rates under Income-tax Act affects the provision of depreciation in the annual accounts of the companies. As a result, this Department has received several queries/representations from companies enquiring as to what procedure they should adopt for charging depreciation on straight line method on the assets purchased earlier to the change in the rates of depreciation as provided in the Income-tax Act.

2. This issue has been examined in this Department and it has been decided that under sub-section (5) of Section 205, "specified period" for providing depreciation straight line method under clause (b) of sub section (2) of Section 205 has to be recalculated on the basis of the revised rates under Income-tax Act. The companies which adopt the straight line method of depreciation should provide for the depreciation in their annual accounts on the following basis:

(a) No. of years for which asset has already been depreciated, before the change in depreciation rate

Say, 'A' years

(b) Specified period calculated at revised rates by which 95% of the original cost of asset would have depreciated on written down value method at revised rates.

Say, 'B' years

(c) Written down value of the asset in the books at the beginning of the year in which rates have been changed under I.T. Act.

Say, Rs. 'X'

(d) 5% of the original cost

Say, Rs. 'Y'

(e) Fixed instalments of depreciation to be provided each year after the rate has been changed shall be calculated as per the formula

$$\frac{X-Y}{B-A}$$

If 'A' is greater than B, then the amount (X-Y) may be provided for as depreciation in the year in which rates are changed.

3. You are requested to bring the above views of the Department to the notice of your member companies for their information and guidance.

Sooraj Kapoor
(Joint Director)

ANNEXURE III

(Circular No. 1/86)
No.1/1/86-CL.V No.15(50) 84-CL.VI

Government of India,
Ministry of Industry,
Department of Company Affairs,
Shastri Bhavan, 5th Floor, 'A' Wing
New Delhi, the 21-5-1986

To

All Chambers of Commerce etc.

Subject: Determination of depreciation under Section 205 (2) (b) of the Companies Act, 1956 consequent upon changes in Income-tax Rates introduced by Finance Act, 1983.

Dear Sirs,

I am directed to refer to this Department's Circular of even number dated 10.1.1985 on the above subject and to say that the question of providing depreciation under straight line method and the calculation of specified period, as suggested in the Circular referred to above, has been re-examined. On reconsideration, the Department is of the view that once "specified period" is determined at the time of purchase of an asset in accordance with the procedure laid down under section 205(5) read with section 350 of the Companies Act with reference to rates of depreciation under Income tax Act at that time and amount of depreciation fixed under section 205(2)(b) of the Companies Act, **the sum need not be changed subsequently consequent on changes in the rates of depreciation under Income-tax Act. It is, therefore, open to the Companies to provide for depreciation under clause (b) of Section 205(2) of the Comapnies Act on the basis of rates of depreciation prescribed under the Income-tax Act and in force at the time of acquisition of the asset.**

B. Bhavani Sankar
Joint Director (Accounts)

Section 350 in The Companies Act, 1956

350. Ascertainment of depreciation.

→ The amount of depreciation to be deducted in pursuance of clause (k) of sub- section (4) of section 349 shall be the amount calculated with reference to the written- down value of the assets as shown by the books of the company

- at the end of the financial year expiring at the commencement of this Act or immediately thereafter and
- at the end of each subsequent financial year,

at the rate specified in Schedule XIV:

→ Provided that if any asset is sold, discarded, demolished or destroyed for any reason before depreciation of such asset has been provided for in full,

- the excess, if any, of the written- down value of such asset over its sale proceeds or, as the case may be, its scrap value,
- shall be written off in the financial year in which the asset is sold, discarded, demolished or destroyed.]