Accounting Standard (AS) 6
(revised 1994)

Depreciation Accounting

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Accounting Standard (AS) 6*

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Depreciation Accounting

(This Accounting Standard includes paragraphs 20-29 set in ***bold italic*** *type and paragraphs 1-19 set in plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the Preface to the Statements of Accounting Standards[1].)*

The following is the text of the revised Accounting Standard (AS) 6, 'Depreciation Accounting', issued by the Council of the Institute of Chartered Accountants of India.

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* Accounting Standard (AS) 6, *Depreciation Accounting*, was issued by the Institute in November 1982. Subsequently, in the context of insertion of Schedule XIV in the Companies Act in 1988, the Institute brought out a Guidance Note on Accounting for Depreciation in Companies which came into effect in respect of accounting periods commencing on or after 1st April, 1989. The Guidance Note differed from AS 6 in respect of accounting treatment of (a) change in the method of depreciation, and (b) change in the rates of depreciation. It was clarified in the Guidance Note, with regard to the matter at (a), that AS 6 would be revised to bring it in line with the recommendations of the Guidance Note.

Based on the recommendations of the Accounting Standards Board, the Council of the Institute at its 168th meeting, held on May 26-29, 1994, decided to bring AS 6 in line with the Guidance Note in respect of both of the aforementioned matters. Accordingly, it was decided to modify paragraphs 11, 15, 22 and 24 and delete paragraph 19 of AS 6. Also, in the context of delinking of rates of depreciation under the Companies Act from those under the Income-tax Act/Rules by the Companies (Amendment) Act, 1988, the Council decided to suitably modify paragraph 13 of AS 6. An announcement to this effect was published in the August 1994 issue of *The Chartered Accountant* (pp. 218-219).

AS 6 is mandatory in respect of accounts for periods commencing on or after 1.4.1995. Reference may be made to the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium for a detailed discussion on the implications of the mandatory status of an accounting standard. From the date of Accounting Standard (AS) 26, 'Intangible Assets', becoming mandatory for the concerned enterprises, this Standard stands withdrawn insofar as it relates to the amortisation (depreciation) of intangible assets (See AS 26).

[1] Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

Introduction

1. This Statement deals with depreciation accounting and applies to all depreciable assets, except the following items to which special considerations apply:—

(i) forests, plantations and similar regenerative natural resources;

(ii) wasting assets including expenditure on the exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources;

(iii) expenditure on research and development;

(iv) goodwill;

(v) live stock.

This statement also does not apply to land unless it has a limited useful life for the enterprise.

2. Different accounting policies for depreciation are adopted by different enterprises. Disclosure of accounting policies for depreciation followed by an enterprise is necessary to appreciate the view presented in the financial statements of the enterprise.

Definitions

3. The following terms are used in this Statement with the meanings specified:

3.1 *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 amortisation of assets whose useful life is predetermined.

3.2 *Depreciable assets* are assets which

(i) are expected to be used during more than one accounting period; and

(ii) have a limited useful life; and

(iii) 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.

3.3 *Useful life* is either (i) the period over which a depreciable asset is expected to be used by the enterprise; or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.

3.4 *Depreciable amount* of a depreciable asset is its historical cost, or other amount substituted for historical cost[2] in the financial statements, less the estimated residual value.

Explanation

4. Depreciation has a significant effect in determining and presenting the financial position and results of operations of an enterprise. Depreciation is charged in each accounting period by reference to the extent of the depreciable amount, irrespective of an increase in the market value of the assets.

5. Assessment of depreciation and the amount to be charged in respect thereof in an accounting period are usually based on the following three factors:

(i) historical cost or other amount substituted for the historical cost of the depreciable asset when the asset has been revalued;

(ii) expected useful life of the depreciable asset; and

(iii) estimated residual value of the depreciable asset.

6. Historical cost of a depreciable asset represents its money outlay or its equivalent in connection with its acquisition, installation and commissioning as well as for additions to or improvement thereof. The historical cost of a depreciable asset may undergo subsequent changes arising as a result of increase or decrease in long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors.

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[2] This statement does not deal with the treatment of the revaluation difference which may arise when historical costs are substituted by revaluations.

7. The useful life of a depreciable asset is shorter than its physical life and is:

(i) pre-determined by legal or contractual limits, such as the expiry dates of related leases;

(ii) directly governed by extraction or consumption;

(iii) dependent on the extent of use and physical deterioration on account of wear and tear which again depends on operational factors, such as, the number of shifts for which the asset is to be used, repair and maintenance policy of the enterprise etc.; and

(iv) reduced by obsolescence arising from such factors as:

(a) technological changes;

(b) improvement in production methods;

(c) change in market demand for the product or service output of the asset; or

(d) legal or other restrictions.

8. Determination of the useful life of a depreciable asset is a matter of estimation and is normally based on various factors including experience with similar types of assets. Such estimation is more difficult for an asset using new technology or used in the production of a new product or in the provision of a new service but is nevertheless required on some reasonable basis.

9. Any addition or extension to an existing asset which is of a capital nature and which becomes an integral part of the existing asset is depreciated over the remaining useful life of that asset. As a practical measure, however, depreciation is sometimes provided on such addition or extension at the rate which is applied to an existing asset. Any addition or extension which retains a separate identity and is capable of being used after the existing asset is disposed of, is depreciated independently on the basis of an estimate of its own useful life.

10. Determination of residual value of an asset is normally a difficult matter. If such value is considered as insignificant, it is normally regarded as nil. On

the contrary, if the residual value is likely to be significant, it is estimated at the time of acquisition/installation, or at the time of subsequent revaluation of the asset. One of the bases for determining the residual value would be the realisable value of similar assets which have reached the end of their useful lives and have operated under conditions similar to those in which the asset will be used.

11. The quantum of depreciation to be provided in an accounting period involves the exercise of judgement by management in the light of technical, commercial, accounting and legal requirements and accordingly may need periodical review. If it is considered that the original estimate of useful life of an asset requires any revision, the unamortised depreciable amount of the asset is charged to revenue over the revised remaining useful life.

12. There are several methods of allocating depreciation over the useful life of the assets. Those most commonly employed in industrial and commercial enterprises are the straightline method and the reducing balance method. The management of a business selects the most appropriate method(s) based on various important factors e.g., (i) type of asset, (ii) the nature of the use of such asset and (iii) circumstances prevailing in the business. A combination of more than one method is sometimes used. In respect of depreciable assets which do not have material value, depreciation is often allocated fully in the accounting period in which they are acquired.

13. The statute governing an enterprise may provide the basis for computation of the depreciation. For example, the Companies Act, 1956 lays down the rates of depreciation in respect of various assets. Where the management's estimate of the useful life of an asset of the enterprise is shorter than that envisaged under the provisions of the relevant statute, the depreciation provision
is appropriately computed by applying a higher rate. If the management's estimate of the useful life of the asset is longer than that envisaged under the statute, depreciation rate lower than that envisaged by the statute can be applied only in accordance with requirements of the statute.

14. Where depreciable assets are disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material, is disclosed separately.

15. The method of depreciation is applied consistently to provide comparability of the results of the operations of the enterprise from period to period. A change from one method of providing depreciation to another is 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 such a change in the method of depreciation is made, depreciation is recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method is 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 is charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus is credited to the statement of profit and loss. Such a change is treated as a change in accounting policy and its effect is quantified and disclosed.

16. Where the historical cost of an asset has undergone a change due to circumstances specified in para 6 above, the depreciation on the revised unamortised depreciable amount is provided prospectively over the residual useful life of the asset.

Disclosure

17. The depreciation methods used, the total depreciation for the period for each class of assets, the gross amount of each class of depreciable assets and the related accumulated depreciation are disclosed in the financial statements alongwith the disclosure of other accounting policies. The depreciation rates or the useful lives of the assets are disclosed only if they are different from the principal rates specified in the statute governing the enterprise.

18. In case the depreciable assets are revalued, the provision for depreciation is based on the revalued amount on the estimate of the remaining useful life of such assets. In case the revaluation has a material effect on the amount of depreciation, the same is disclosed separately in the year in which revaluation is carried out.

19. A change in the method of depreciation is treated as a change in an accounting policy and is disclosed accordingly.[3]

[3] Refer to AS 5.

Accounting Standard

20. The depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset.

21. 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 such 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. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should 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 in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

22. The useful life of a depreciable asset should be estimated after considering the following factors:

(i) expected physical wear and tear;

(ii) obsolescence;

(iii) legal or other limits on the use of the asset.

23. The useful lives of major depreciable assets or classes of depreciable assets may be reviewed periodically. Where there is a revision of the estimated useful life of an asset, the unamortised depreciable amount should be charged over the revised remaining useful life.

24. Any addition or extension which becomes an integral part of the existing asset should be depreciated over the remaining useful life of that asset. The depreciation on such addition or extension may also be

provided at the rate applied to the existing asset. Where an addition or extension retains a separate identity and is capable of being used after the existing asset is disposed of, depreciation should be provided independently on the basis of an estimate of its own useful life.

25. Where the historical cost of a depreciable asset has undergone a change due to increase or decrease in long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors, the depreciation on the revised unamortised depreciable amount should be provided prospectively over the residual useful life of the asset.

26. Where the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful lives of such assets. In case the revaluation has a material effect on the amount of depreciation, the same should be disclosed separately in the year in which revaluation is carried out.

27. If any depreciable asset is disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material, should be disclosed separately.

28. The following information should be disclosed in the financial statements:

- ***(i) the historical cost or other amount substituted for historical cost of each class of depreciable assets;***
- ***(ii) total depreciation for the period for each class of assets; and***
- ***(iii) the related accumulated depreciation.***

29. The following information should also be disclosed in the financial statements alongwith the disclosure of other accounting policies:

- ***(i) depreciation methods used; and***
- ***(ii) depreciation rates or the useful lives of the assets, if they are different from the principal rates specified in the statute governing the enterprise.***