Basics (Understanding and Analysis) of Depreciation under Schedule II of Companies Act, 2013:

The Companies Bill 2011 was introduced in Parliament in December 2011 and was referred to the Parliamentary Standing Committee on Finance for its review and suggestions.
Based on its Recommendations and suggestions, amendments were made to the Companies Bill 2011.
Then it was introduced as Companies Bill 2012 and was passed by the Lok Sabha in December 2012.
Companies Bill 2012 was passed by Rajya Sabha On August 08, 2013 as Companies Bill, 2013.
And finally, On August 29, 2013, Bill 2013 Received assent from president and Companies Bill, 2013 becomes Companies Act, 2013.

The Companies Act, 2013 has brought in extensive changes with the objective to ensure and seek transparency and establish better corporate governance practices.

This article is based on Understanding, Impact and Analysis of Deprecation provision which is in Schedule II of Companies Act, 2013. I hope that you will find this publication useful in understanding Deprecation provision of the Companies Act, 2013.

1. Key point for Depreciation under Schedule II of Companies Act, 2013 (Act 2013):

1) The depreciation needs to be provided based upon the useful life as specified in Schedule II of companies Act, 2013.
2) In the Schedule II of companies Act, 2013, useful life of Plant and Machinery bifurcated into General Plant and Machinery and Special Plant and Machinery (Industry in Specific like glass manufacturing industries, Telecommunications industries, Refining industries, power generation and distribution industries, steel manufacturing industries etc)
3) Defined its residual value cap. Ordinarily, the residual value of an asset is often insignificant but it should generally be not more than 5% of the original cost of the asset.

Accounting Standard 6:

As per Para 13 of Accounting Standard 6, The statute governing an enterprise may provide the basis for computation of the depreciation. For example, the Companies Act, 1956,(now to say the companies Act, 2013) lays down the rates of (now to say Useful life for) 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 (now any change in useful life of asset which is not as per Schedule II then justification should be given)

2. Analysis and interpretation of Deprecation under Schedule II of Companies Act, 2013

1) Schedule II – PART 'A' of the Companies Act 2013,

- **Depreciation** is the systematic allocation of the depreciable amount of an asset over its useful life.
- **The depreciable amount** of an asset is the cost of an asset or other amount substituted for cost, less its residual value.
- **The useful life** of an asset 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.
- For the purpose of this Schedule, the term **depreciation includes amortisation.**
- Without prejudice to the foregoing provisions of above paragraph —

(i) The useful life of an asset shall not be longer than the useful life specified in Part 'C'and the residual value of an asset shall not be more than five per cent. of the original cost ofthe asset:

Provided that where a company uses a useful life or residual value of the asset which is different from the above limits, justification for the difference shall be disclosed in its financial statement.

(ii) For intangible assets……..

2) Schedule II – PART 'B' of the Companies Act 2013
The useful life or residual value of any specific asset, **as notified for accounting purposes by a Regulatory Authority constituted under an Act of Parliament or by the Central Government** shall be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of this Schedule.

3) No separate depreciation rate is prescribed for intangible assets. The same will be governed by notified AS.

4) In Schedule XIV of Companies Act, 1956 for the assets used in double shift or triple shift, **shift wise different rates are prescribed,** whereas in Schedule II of Companies Act, 2013 it specifies that 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 shall be calculated on the basis of 100% for that period. **No additional deprecation** for the assets in respect of which no extra shift depreciation is permitted and the same is indicated by NESD in Part C.

Let us understand it with the following comparable table which is derived Useful life of assets if it is used for Double and triple shift and comparison with Companies Act, 1956:

Asset	Shift	Companies Act, 1956			Companies Act, 2013	
		WDV	SLM	Useful Life derived based on Rate of Depreciation	Increase in depreciation	Useful Life
Plant and machinery	Single	13.91 %	4.75 %	20 Years	-	15 Years
Plant and machinery	Double	20.87 %	7.42 %	12 Years	50 %	10 Years
Plant and machinery	Triple	27.82 %	10.34 %	9 Years	100 %	7.5 Years

5) There is no specific requirement to charge 100% depreciation on assets whose actual cost does not exceed **₹ 5 thousand,** so any assets irrespective of value should be categorized based on Schedule II and depreciated based on Useful life of assets. However, Para 12 of Accounting Standard 6 says that 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.

6) Where during any financial year, any addition has been made or sold, discarded, demolished or destroyed, the depreciation on such assets shall be calculated on pro rata basis.

7) The following **information shall also be disclosed** in the accounts, namely:—
   a. **depreciation methods used**; and
   b. the **useful lives of the assets** for computing depreciation, if they are different from the life specified in the Schedule

8) Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value. Ordinarily, the **residual value of an asset** is often insignificant but it should generally be not more than 5% of the original cost of the asset.

9) **"Continuous process plant"** means a plant which is required and designed **to operate for twenty-four hours a day.**

10) **<u>Component Accounting - Note No 4 of Schedule II :</u>**

   - Useful life specified in the Schedule II to the Companies Act is for whole of the asset. Where cost of a part of the asset is significant to the 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 will be determined separately

- This paragraph talks about the 'component approach', which is in line with international practices. It requires companies to separately depreciate parts of an asset that are significant and have a useful life different from the useful life of the asset as a whole
- The component approach is already allowed in current Accounting Standard 10 – "Accounting for Fixed Assets**"** in Paragraphs 8.3, but it seems to be a choice of matter. Now it seems as per the note 4 it is mandatory in Companies Act, 2013.

11) **Unit of Production method - According to Part A of schedule II :**
- "The useful life of an asset 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".
- So, companies can also follow the Unit of Production method for the depreciation of the assets.

12) **Note No 7 Schedule II** – Vary Important provision at the date of applicability of Schedule II of Companies act, 2013

From the date of the Companies Act coming into effect, the carrying amount of the asset as on that date:

(a) Shall be depreciated over the **remaining useful life of the asset** according to the Act

(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**.

(i) Following example to get more clarity and understanding of point (a) :

Example 1: As on 1st April 2008 consider the capitalization of Plant & Machinery (for continuous plant) of ₹ 1,00,000. Also consider Schedule II of Companies Act 2013, to be applicable from 1st April 2014.

Particulars	**Companies Act, 1956**
Capitalization on 1st April 2008	1,00,000/-
Depreciation from 1st April 2008 – 31st March 2014 (Useful Life 18 years – 5.28 % SLM)	31,680/-
Balance as on 31st March 2014	68,320/-

As on date of Applicable of Schedule II:

Useful life of Plant and Machinery as per schedule II of companies Act, 2013	25 Years

Carrying Amounts as on 31st March 2014 (As per previous table)	68,320
Residual Value	5 % of 1,00,000 = 5000
Balance years	25 – 6 = 19

So, the balance years' depreciation will be

$$\text{Depreciation} = \frac{\text{Carrying Amount as on } 31^{st} \text{ March 2014 Less Residual Value}}{\text{No. of Years remaining}} = \frac{68{,}320 - 5{,}000}{19\ (25\text{-}6)}$$

Depreciation = 3,333 per year from 1st April 2014 (2014-15) till the completion of useful life

(ii) Following example to get more clarity and understanding of point (b) :

Example 2: As on 1st April 2008 consider the capitalization of Office Equipment of ₹ 1,00,000. Also consider Schedule II of Companies Act 2013, to be applicable from 1st April 2014.

Particulars	**As per Companies Act, 1956**
Capitalization on 1st April 2008	1,00,000/-
Depreciation from 1st April 2008 – 31st March 2014 (Useful Life 20 years – 13.91 % WDV)	59,289/-
Balance as on 31st March 2014	40,711/-

As per Schedule II of Companies Act, 2013 the useful life of Office Equipment is 5 years and 5 years are completed as on April 1, 2014, the remaining useful life is nil. So the balance amount after retaining the residual value to be recognized in the opening balance of retained earnings.

To be recognised in R/E on 1st April 2014	Carrying value on 31st March 2014 Less Residual Value (40,711 – 5000)
To be recognised in R/E on 1st April 2014	35,711

Following entry to be passed as on date of Applicable of Schedule II, for above adjustments in the Books of Accounts:

Date	Particulars	Debit	Credit
01.04.2014	Retained Earnings	35,711	
	Accumulated Depreciation		35,711

Let us understand the impact by following Example under applicability of Point (a) and Point (b) under point no. 15 under particular / specific situation:

Particulars	Asset A	Asset B
Original cost of the Building (Other than factory building)	58 crore	58 crore
Useful life as per companies Act, 1956	58 years	58 years
Date of Capitalisation	1st April 1985	1st April 1984
Building already used till 31st March 2014	29 years	30 years
Residual Value (5 %)	2.9 crore	2.9 crore
Building (other than factory building) carrying amount as on 31st March 2014	29 crore	28 crore
Consider Companies Act, 2013 to be effective from 1st April 2014		
Useful life as per companies Act, 2013	30 Years	30 years
Following is impact as per Note no 7 of Schedule II (as explained above):		
To be charged to P/L (Carrying amount – Residual value)	26.10 crore (29 - 2.9)	Nil
To be charges to R/E (Carrying amount – Residual value)	Nil	25.10 crore (28 - 2.9)

In above example, as on date of applicability of Schedule II of Companies Act, 2013, if very less remaining useful life is remains then it will more impact P&L. But is both the scenario, net worth will be remains same.