

**ISSUES REGARDING**  
**DEPRECIATION AS PER**  
**SCHEDULE II OF**  
**COMPANIES ACT, 2013**

# Depreciation – Mandatory?

## Issue 1

Whether depreciation is compulsorily to be provided under Companies Act, 2013

Ans :

Sec.123 - No Dividend except out of profit after providing depreciation in accordance with schedule II.

Sec.133 Rule 7 of the Companies (Accounts) Rules 2014- Accounting Standards issued by ICAI mandatory

# Depreciation – Useful Life

## Issue 2

Whether two companies in the same group and in the same business can have different useful life of asset.

Ans : Yes.

Depreciation is a systematic allocation of the depreciable amount of an asset over its useful life.

Useful Life is the period over which an asset is expected to be available for use by an entity, or the number of production expected to be obtained from the asset by the entity

# Depreciation – Useful Life

## Issue 3

What are the factors for deciding useful life of a tangible asset.

Ans :

- i. Expected usage based on capacity or physical output
- ii. Expected physical wear and tear – based on shifts and repairs maintenance programme

Contd....

# Depreciation – Useful Life

## Issue 3

What are the factors for deciding useful life of a tangible asset.

Ans : Contd..

- iii. Technical or commercial obsolescence or market demand or changes in selling price
- iv. Legal or similar limits (Leases)
- v. Management intention

# Depreciation – Useful Life

## Issue 4

What are the factors for deciding useful life of an intangible asset.

Ans :

Amendment to Schedule II allows company to use revenue based amortization for BOT assets.

For other intangible assets, AS-26 will apply where amortization period depends on rebuttable presumption of life not exceeding 10 years and yearly amortization will depend upon pattern of consumption of economic benefits of an assets.

# Depreciation – Review of Useful Life

## Issue 5

Whether adjustment for review of useful life is an extra ordinary item or a prior period item?

Ans :

Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

Contd..



# Depreciation – Review of Useful Life

## Issue 5

Whether adjustment for review of useful life is an extra ordinary item or a prior period item?

Ans : Contd...

Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.

Therefore, review of useful life is neither an Extra Ordinary item or a Prior period item.



# Depreciation – Useful Life

## Issue 6

Useful life in case of renewable option

Ans :

If the renewal of a lease is possible only by mutual consent then the asset needs to be depreciated over the original lease period.

If the renewal of a lease is to be decided by the lessee i.e. the Management, then the Management's intention to renew can be considered for determining total period of lease.

# Depreciation – Revaluation

## Issue 7

Whether depreciation on revalued asset can be set off against revaluation reserve

Ans : No.

Schedule II requires depreciation to be provided on the historical cost or the amount substituted for it.

The Guidance Note on treatment of reserve created on revaluation of fixed assets allowed such a treatment. This is withdrawn by revised AS-10 which recommend direct transfer of Revaluation of reserve to general reserve.

# Depreciation – Continuation of old Rates

## Issue 8

If company does not follow Schedule II and continues 1956 Act depreciation rates

Ans :

Schedule II of Companies Act, 2013 prescribed useful life of assets as against rates of depreciation in Schedule VI under Companies Act, 1956. The rate of depreciation converted for useful life does not give the same rates under both Schedules.

Qualification required for violation of accounting standards.

# Depreciation – Component Accounting

## Issue 9

If company does not follow component accounting

Ans :

Violation of Companies Act only if the dividend is declared u/s 123.

Violation of revised AS-10 whenever applicable

# Depreciation – Revision of Rates

## Issue 10

How often depreciation rates/useful life is required to be reviewed

Ans :

Para 23 of AS-6 says that, 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 unamortized depreciable amount should be charged over the revised remaining useful life.

Contd..

# Depreciation – Revision of Rates

## Issue 10

How often depreciation rates/useful life is required to be reviewed

Ans : Contd..

Para 21 of AS-5 says that, an estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

Contd...



# Depreciation – Revision of Rates

## Issue 10

How often depreciation rates/useful life is required to be reviewed

Ans : Contd..

AS-10(Revised) Para 53 – The residual value and the useful life of an asset should be reviewed at least at each financial year end



# Depreciation – Small Assets Write-off

## Issue 11

100% write off of amounts less than stated limit.

Ans :

Not allowed either under Companies Act, Schedule II nor under Accounting Standards. But will not be commented if the amount is insignificant, as accounting standards apply only to material amounts.

# Depreciation – Change in Method of Depreciation

## Issue 12

Can I change method of Depreciation under Companies Act 2013 freely like useful life

Ans :

No. Under AS-6 method can be changed only if -

- i. Required by Statute
- ii. For compliance with an Accounting Standards
- iii. If it is considered that the change would result in a more appropriate preparation or presentation of Financial Statement.

Contd....

# Depreciation – Change in Method of Depreciation

## Issue 12

Can I change method of Depreciation under Companies Act 2013 freely like useful life

Ans : Contd.

AS-10 (Revised) Para 63 states that depreciation method should be reviewed at least at each Financial Year end and if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Change should be accounted for as change in accounting estimate in accordance with AS-5

# Depreciation – Impact of Changes

## Issue 13

What is the impact of change in the method of accounting v/s change in the useful life.

Ans :

Change in the method of accounting will have adjustment for depreciation amount to the profit & Loss account of the year of change

Change in useful life will have prospective effect.

# Depreciation – Residual Value

## Issue 14

What is the importance of percentage of residual value ?

Ans :

Under WDV method, lower the percentage of residual value higher will be the rate of depreciation in the first year.

# Depreciation – Residual Value

## Issue 15

How to calculate the depreciation, if management estimate of residual value is higher than prescribed in Schedule II.

Ans :

Option to follow either with appropriate explanation for deviation by management.

For residual value less than 5% no disclosure is necessary.

# Depreciation – Residual Value

## Issue 16

Residual value taken as NIL – What is auditor's responsibility

Ans :

Auditor should review the method followed by management for estimation of residual value, whether it is taken as NIL or otherwise.



# Depreciation–Component Accounting

## Issue 17

Whether component accounting is prospective.

Ans :

No. Component accounting is required for entire block of assets and not only for new assets acquired. In this sense, it is retrospective.

# Depreciation – Different Rates

## Issue 18

Can the company have different rates of depreciation for individual assets within the same class? What about addition on different dates in the same year for same class ?

Ans :

Yes. Depending on the estimation of useful life within the same class the rate of depreciation will change.

The same principal will apply for addition on different dates in the same year for same class.

# Thank you.