

A STUDY ON DEPRECIATION OF ASSETS UNDER THE COMPANIES ACT, 2013

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ABSTRACT

Depreciation is the normal wear & tear of Fixed Asset which is usually charged to Profit & loss Account. Depreciation is generally charged annually. The Companies Act 2013 does not prescribe the Rate of Depreciation as stipulated under Income Tax Act 1956. The Useful lives of the Fixed Assets are specified in Schedule II of Companies Act, 2013. The enterprises have to calculate the depreciation as the rate mentioned in the Schedule II. In this article the author discussed about the new rules and regulation for calculating the depreciation with regard to tangible and intangible assets.

Key Words: -Cost, Residual value, Shift, Useful life

1. INTRODUCTION

The sixty years old legislation has been replaced by The Companies Act, 2013. There a lot many amendments in the new companies act as compared to old act. One of such key changes is related to regulations governing depreciation provisions. AS 6 – Depreciation Accounting Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, passage of time or obsolescence through technology and market changes Depreciation is allocated so as to charge changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life accounting period during the expected useful life of the asset. Depreciation includes amortization of assets whose useful life is predetermined.. With the introduction of Companies Act, 2013 methods for calculating depreciation have changed. Schedule XIV has been replaced with Schedule II for depreciation calculation. The Ministry of Company Affairs vide general circular 08/2014, has clarified that the provisions of Schedule II have brought into force from 1st April 2014. The assets are grouped as i) Intangible assets and ii) Tangible assets.

What is meant by Intangible assets:

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. The provisions of Accounting Standard (AS) 26 shall apply for the amortisation of intangible assets. Schedule XIV of the earlier Companies Act have not suggested the method for amortisation. It deals only with the depreciation of tangible assets except for amortisation of intangible assets (Toll Roads) created under “Build, Operate and Transfer” or any other form of Public Private Partnership’s.

Depreciation on Intangible assets:

The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use. As the future economic benefits embodied in an intangible asset are consumed over time, the carrying amount of the asset is reduced to reflect that consumption. This is achieved by systematic allocation of the cost of the asset, less any residual value, as an expense over the asset's useful life. Amortisation is recognised whether or not there has been an increase in, for example, the asset's fair value or recoverable amount. Many factors need to be considered in determining the useful life of an intangible asset including:

- the expected usage of the asset by the enterprise and whether the typical product life cycles for the asset and public information estimates of useful lives of similar types of assets that are used in a similar way;
- technical, technological or other types of obsolescence;
- the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the company's ability and intent to reach such a level;

- the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases;

whether the useful life of the asset is dependent on the useful life of other assets of the enterprise.

Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life will be short. Estimates of the useful life of an intangible asset generally become less reliable as the length of the useful life increases. This Standard adopts a presumption that the useful life of intangible assets is unlikely to exceed ten years. If control over the future economic benefits from an intangible asset is the useful life of the intangible asset should not exceed the period of the achieved through legal rights that have been granted for a finite period, legal rights unless:

a) the legal rights are renewable; and (b) renewal is virtually certain.

Illustration 1:

An enterprise has purchased an exclusive right to generate hydroelectric power for fifty years. The costs of generating hydro-electric power are much lower than the costs of obtaining power from alternative sources. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least fifty years. The enterprise amortises the right to generate power over fifty years, unless there is evidence that its useful life is shorter.

Illustration 2:

An enterprise has purchased an exclusive right to operate a toll motorway for twenty five years. There is no plan to construct alternative routes in the area served by the motorway. It is expected that this motorway will be in use for at least twenty five years. The enterprise amortises the right to operate the motorway over thirty years, unless there is evidence that its useful life is shorter.

What is meant by Tangible Assets:

Cash, equipment, machinery, plant, property anything that has long-term physical existence or is acquired for use in the operations of the business and not for sale to customers. In the balance sheet of the business, such assets are listed under the heading 'Plant and equipment' or 'Plant, property, and equipment.' Tangible assets, unlike intangible assets, can be destroyed by fire, hurricane, or other disasters or accidents. However, they can be used as collateral to raise loans, and can be more readily sold to raise cash in emergencies

The Formula to calculate depreciation is

$$\text{Depreciation} = \frac{\text{Cost of Asset} - \text{Residual value}}{\text{Useful Life}}$$

The Useful Life of the Fixed Assets is given below. The Residual value can must not be more than 5% of the Cost of the Asset. The Depreciation can be applied on Straight line method or Reducing Balance Method. If any Addition or Deletion is made to Fixed Asset then Depreciation is to be calculated on prorata basis.

How to calculate Extra Shift Depreciation?

The Calculation of the extra depreciation for double shift working and for triple shift working should be made separately in the proportion which the number of days for which the concern worked double shift or triple shift as the case may be, bears to the normal number of working days during the year.

- In the case of Seasonal Factory or concern, the number of days on which the factory or concern actually worked during the year or 180 days, whichever is greater.
- In any other cases the number of days on which the factory or concern actually worked during the year or 240 days, whichever is greater.

Extra Depreciation for double shift working should be the difference between the depreciation for double shift working and the depreciation for single shift working, adjusted in proportion which the number of days for which the concern worked double shift bears to the normal working days during the year. The extra shift depreciation so calculated has to be added to the depreciation for single shift working to arrive at the total depreciation for double shift working.

Formula for arriving the depreciation

Depreciation for Single Shift working + (Depreciation for Double/triple Shift working - Depreciation For single Shift Working) x (Number of days worked double or triple shift / normal working days during the year)

Applicability of useful life provision:

i. Prescribed class of companies:

In companies whose financial statements are required to comply with the prescribed as under Companies Act 2013, the useful lives should normally be in accordance with the Schedule and, if a prescribed company uses a different useful life, it should give a justified disclose.

ii. Government companies:

In these companies useful life or residual value of any specified asset, as notified by the relevant Regulatory Authority shall be applied in calculating the depreciation, irrespective of the requirements of this Schedule.

iii. Other Companies:

In these companies, the useful life of an asset shall not be longer than the useful life and the residual value shall not be higher than as prescribed in Part C.

Useful Life of Tangible Fixed Assets:

Nature of assets	Useful Life
I. Buildings [NESD]	
(a) Buildings (other than factory buildings) RCC Frame Structure	60 Years
(b) Buildings (other than factory buildings) other than RCC Frame Structure	30 years
(c) Factory buildings	30 years
(d) Fences, wells, tube wells	5 Years
(e) Others (including temporary structure, etc.)	3 Years
II. Bridges, culverts, bunders, etc. [NESD]	30 years
III. Roads [NESD]	
(a) Carpeted roads	
(i) Carpeted Roads-RCC	10 Years
(ii) Carpeted Roads-other than RCC	5 Years
(b) Non-carpeted roads	3 Years
IV. Plant and Machinery	
<u>(i) General rate applicable to plant and machinery not covered under special plant and machinery</u>	
(a) Plant and Machinery other than continuous process plant not covered under specific industries	15 Years
(b) continuous process plant for which no special rate has been prescribed under (ii) below [NESD]	8 Years
<u>(ii) Special Plant and Machinery</u>	

(a) Plant and Machinery related to production and exhibition of Motion Picture Films	
1. Cinematograph films—Machinery used in the production and exhibition of cinematograph films, recording and reproducing equipments, developing machines, printing machines, editing machines, synchronizers and studio lights except bulbs	13 Years
2. Projecting equipment for exhibition of films	13 Years
(b) Plant and Machinery used in glass manufacturing	
1. Plant and Machinery except direct fire glass melting furnaces — Recuperative and regenerative glass melting furnaces	13 Years
2. Plant and Machinery except direct fire glass melting furnaces — Moulds [NESD]	8 Years
3. Float Glass Melting Furnaces [NESD]	10 Years
(c) Plant and Machinery used in mines and quarries— Portable underground machinery and earth moving machinery used in open cast mining [NESD]	8 Years
(d) Plant and Machinery used in Telecommunications [NESD]	
1. Towers	18 Years
2. Telecom transceivers, switching centres, transmission and other network equipment	13 Years
3. Telecom—Ducts, Cables and optical fibre	13 Years
4. Satellites	13 Years
(e) Plant and Machinery used in exploration, production and refining oil and gas [NESD]	
1. Refineries	25 Years
2. Oil and gas assets (including wells), processing plant and facilities	25 Years
3. Petrochemical Plant	25 Years
4. Storage tanks and related equipment	25 Years
5. Pipelines	30 Years
6. Drilling Rig	8 Years
7. Field operations (above ground) Portable boilers, drilling tools, well-head tanks, etc.	8 Years

8. Loggers	8 Years
(f) Plant and Machinery used in generation, transmission and distribution of power [NESD]	
1. Thermal/ Gas/ Combined Cycle Power Generation Plant	40 Years
2. Hydro Power Generation Plant	40 Years
3. Nuclear Power Generation Plant	40 Years
4. Transmission lines, cables and other network assets	40 Years
5. Wind Power Generation Plant	22 Years
6. Electric Distribution Plant	35 Years
7. Gas Storage and Distribution Plant	30 Years
8. Water Distribution Plant including pipelines	30 Years
(g) Plant and Machinery used in manufacture of steel	
1. Sinter Plant	20 Years
2. Blast Furnace	20 Years
3. Coke ovens	20 Years
4. Rolling mill in steel plant	20 Years
5. Basic oxygen Furnace Converter	25 Years
(h) Plant and Machinery used in manufacture of non ferrous metals	
1. Metal pot line [NESD]	40 Years
2. Bauxite crushing and grinding section [NESD]	40 Years
3. Digester Section [NESD]	40 Years
4. Turbine [NESD]	40 Years
5. Equipments for Calcination [NESD]	40 Years
6. Copper Smelter [NESD]	40 Years
7. Roll Grinder	40 Years
8. Soaking Pit	30 Years
9. Annealing Furnace	30 Years
10. Rolling Mills	30 Years
11. Equipments for Scalping, Slitting , etc. [NESD]	30 Years

12. Surface Miner, Ripper Dozer, etc., used in mines	25 Years
13. Copper refining plant [NESD]	25 Years
(i) Plant and Machinery used in medical and surgical operations [NESD]	
1. Electrical Machinery, X-ray and electrotherapeutic apparatus and accessories thereto, medical, diagnostic equipments, namely, Cat-scan, Ultrasound Machines, ECG Monitors, etc.	13 Years
2. Other Equipments.	15 Years
(j) Plant and Machinery used in manufacture of pharmaceuticals and chemicals [NESD]	
1. Reactors	20 Years
2. Distillation Columns	20 Years
3. Drying equipments/Centrifuges and Decanters	20 Years
4. Vessel/storage tanks -do-	20 Years
(k) Plant and Machinery used in civil construction	
1. Concreting, Crushing, Piling Equipments and Road Making Equipments	12 Years
2. Heavy Lift Equipments—	
Cranes with capacity of more than 100 tons	20 Years
Cranes with capacity of less than 100 tons	15 Years
3. Transmission line, Tunneling Equipments [NESD]	10 Years
4. Earth-moving equipments	9 Years
5. Others including Material Handling /Pipeline/Welding Equipments [NESD]	12 Years
(l) Plant and Machinery used in salt works [NESD]	15 Years
V. Furniture and fittings [NESD]	
(i) General furniture and fittings	10 Years
(ii) Furniture and fittings used in hotels, restaurants and boarding houses, schools, colleges and other educational institutions, libraries; welfare centres; meeting halls, cinema houses; theatres and circuses; and furniture and fittings let out on hire for use on	8 Years

the occasion of marriages and similar functions.	
VI. Motor Vehicles [NESD]	
1. Motor cycles, scooters and other mopeds	10 Years
2. Motor buses, motor lorries, motor cars and motor taxies used in a business of running them on hire	6 Years
3. Motor buses, motor lorries and motor cars other than those used in a business of running them on hire	8 Years
4. Motor tractors, harvesting combines and heavy vehicles	
5. Electrically operated vehicles including battery powered or fuel cell powered vehicles	8 Years
VII. Ships [NESD]	
1. Ocean-going ships	
(i) Bulk Carriers and liner vessels	25 Years
(ii) Crude tankers, product carriers and easy chemical carriers with or without conventional tank coatings.	20 Years
(iii) Chemicals and Acid Carriers:	
(a) With Stainless steel tanks	25 Years
(b) With other tanks	20 Years
(iv) Liquified gas carriers	30 Years
(v) Conventional large passenger vessels which are used for cruise purpose also	30 Years
(vi) Coastal service ships of all categories	30 Years
(vii) Offshore supply and support vessels	20 Years
(viii) Catamarans and other high speed passenger for ships or boats	20 Years
(ix) Drill ships	25 Years
(x) Hovercrafts	15 Years
(xi) Fishing vessels with wooden hull	10 Years
(xii) Dredgers, tugs, barges, survey launches and other similar ships used mainly for dredging purposes	14 Years
2. Vessels ordinarily operating on inland waters—	
(i) Speed boats	13 Years

(ii) Other vessels	28 Years
VIII. Aircrafts or Helicopters [NESD]	20 Years
IX. Railways sidings, locomotives, rolling stocks, tramways and railways used by concerns, excluding railway concerns [NESD]	15 Years
X. Ropeway structures [NESD]	15 Years
XI. Office equipment [NESD]	5 Years
XII. Computers and data processing units [NESD]	
(i) Servers and networks	6 Years
(ii) End user devices, such as, desktops, laptops, etc.	3 Years
XIII. Laboratory equipment [NESD]	
(i) General laboratory equipment	10 Years
(ii) Laboratory equipments used in educational institutions	5 Years
XIV. Electrical Installations and Equipment [NESD]	10 years
XV. Hydraulic works, pipelines and sluices [NESD]	15 Year

For Example:

X Ltd Purchased a Ship of Rs.40 Crore which Comprises Engine of Rs. 37Crore and Structure and others for Rs.3Crore.The residual value and useful life would be Rs. 7crore and Rs. 1crore respectively. The Useful Life of an asset is 30years.

Ship	Allocated Cost (Rs.)	Residual Value	Useful Life
Engine	37 Crore	7 Crore	10 Year
Others	3 Crore	1 Crore	20 Year

As per Companies Act 1956 Annual Depreciation of the Ship= $(22\text{Crore}/30) = 0.73\text{Crore}$ As per Companies Act 2013

Ship	Depreciable Amount (Rs.)	Useful Life	Depreciation
Engine	37 Crore – 7 Crore= 30 Crore	10 year	3 Crore
Others	3 Crore- 1 Crore=2 Crore	20 Years	10 Lakh
	Total		3.10 Crore

When at the end of respective useful lives of the component, the components will be replaced, the replacement cost should be capitalized and the existing carrying value, if any, should be decapitalised.

2.CONCLUSION

The useful life for plant and machinery was 21 years as per the rate prescribed by Schedule XIV of the Companies Act 1956, whereas it has come down to 15 years in the Schedule II of the Companies Act, 2013. However the companies have been given more freedom to adopt more number of useful life with proper justification. In Financial Service Sectors generally, the Companies have major part of their assets in the form of office equipment, computers, servers and furniture. The useful life has come down in the new Schedule II and may have negative impact. In the case of leasing company which lease out manufacturing plant and machinery it may have negative impact on their profits as the useful life period has come down in the new Schedule II. Infrastructure Industries like power, oil and gas may have

positive impact as they have flexibility in estimating (after proper justification) the useful life of the plant and machinery even more than 21 years which have been prescribed in the earlier Schedule XIV. The impact of new schedule II has different impacts in various industries. Generally, it may have negative impact on profitability unless they opt to use higher useful life for assets after justification.

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