

Basis of Charging Depreciation Subsequent to Recognition of Impairment Loss

The following is brief version of an opinion given by the Expert Advisory Committee of the Institute in response to queries sent by a member. This is being published for the information of readers.

A. Facts of the Case

1 A multi-locational manufacturing company having an annual turnover of approximately Rs. 1800 crore is in operation for the last six decades. The company has adopted Accounting Standard (AS) 28, 'Impairment of Assets', issued by the Institute of Chartered Accountants of India, as part of its accounting policy, with effect from 1st April, 2004. It has identified few assets as on April 1, 2004, for carrying out impairment test as per the Standard. Following this exercise, an amount of Rs. 12 crore has been recognised as impairment loss in respect of an asset and adjusted against the opening balance of revenue reserves as on April 1, 2004. This particular asset was commissioned in September 1996, at a cost of Rs. 23 crore. Accumulated depreciation for this asset as on March 31, 2004, following the straight-line method of depreciation as per the company's accounting policy, is Rs. 9 crore. The useful life considered for the purpose of depreciation is 19 years.

2 According to the querist, as per paragraph 61 of AS 28, the accumulated impairment loss is to be adjusted against the carrying amount of the asset which will be systematically amortised over its remaining useful life. The carrying/written down value of the said asset as on April 1, 2004, is as worked out below:

| | Rs. Crore |
|--------------------------|-----------|
| Original Cost | 23 |
| Accumulated Depreciation | 9 |
| Impairment Loss | 12 |
| Adjusted Carrying Value | 2 |

3 The querist has mentioned that the carrying value of Rs. 2 crore mentioned above actually represents the recoverable amount ascertained following the requirement of AS 28. The querist has mentioned that in this specific case it represents the net selling price of the asset as ascertained by the management.

4 The accounting policy of the company so far as it relates to depreciation continues to read as follows:

"Depreciation on fixed assets is calculated on straight-line basis at rates, which are in conformity with the requirements of the Companies Act, 1956".

5 In view of the above, according to the querist, the charge for depreciation from April 2004 as per the accounting policy of the company continues to be Rs. 1.2 crore p.a. (Rs. 23 crore depreciated over 19 years) in respect of this particular asset. The implication of continuing the existing practice of charging depreciation is that the adjusted carrying value will be charged off over a period of one year and eight months. This will mean, if the existing basis of charging depreciation is followed, charge for depreciation will cease after one year and eight months in respect of this asset.

6 The querist has expressed the view that the requirement under paragraph 61 of AS 28 militates against the provisions of the Companies Act, 1956, insofar as the straight-line method of charging depreciation is con-

1. The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.

2. The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in 23 volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.

cerned. Moreover, in the view of the querist, as per paragraph 6 of AS 28, an enterprise is required to assess at each balance sheet date the status of impairment and, if necessary, estimate the recoverable amount of the relevant asset. According to the querist, there will be continuous updation of adjusted carrying value (which is nothing but recoverable amount) of the asset making enough room for accommodating depreciation charge under straight-line method. The querist has illustrated this in the Annexure to this query, with regard to the asset in question in subsequent years. According to the querist, the exercise illustrated in the Annexure goes on till the end of the useful life of the asset. Hence, in the view of the querist, providing for depreciation on straight-line method in a situation like this does not conflict with the requirement. The querist has expressed the view that the above treatment is also supported by the view of the ICAI, as mentioned in an announcement relating to Accounting Standard (AS) 11 (revised 2003) which reads as “.....where a requirement of an accounting standard is different from the applicable law, the law prevails.” Accordingly, a requirement of an accounting standard is not applicable to the extent it is in conflict with the requirement of the relevant law.

B. Query

7 The querist has sought the opinion of the Expert Advisory Committee as to whether it is correct on the part of the company to continue charging depreciation on the same basis as was followed till March 31, 2004, or change the basis of charging depreciation so that the adjusted carrying value is charged over the remaining useful life of the asset as prescribed in paragraph 61 of AS 28.

C. Points considered by the Committee

8 The Committee notes that section 205 sub-sections (2) and (5)(a) of the Companies Act, 1956, *inter alia*, provide as below:

- “(2)For the purpose of sub-section (1), 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 ninety-five per cent 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 Central Government which has the effect of writing off by way of depreciation ninety-five per cent 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 any rules made thereunder, on such basis as may be approved by the Central Government by any general order published in the Official Gazette or by any special order in any particular case”.

“(5)For the purposes of this section –

- (a) “specified period” in respect of any depreciable asset shall mean the number of years at the end of which at least ninety-five per cent of the original cost of that asset to the company will have been provided for by way of depreciation if depreciation were to be calculated in accordance with the provisions of section 350”.

9 The Committee also notes that section 350 of the Companies Act, 1956, requires, *inter alia*, as follows: “The amount of depreciation to be deducted in pursuance of clause (k) of sub-section (4) of section 349 shall be the amount of depreciation on 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”.

10 The Committee further notes that Part III, ‘Interpretation’, of Schedule VI to the Companies Act 1956, states in paragraph 7(1)(a) as below:

“The expression ‘provision’ shall, subject to sub-clause (2) of this clause, mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy”.

11 The Committee also notes paragraph 61 of AS

28, which requires as below:

“61. After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset’s revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.”

12 The Committee notes from the definition of the term ‘provision’ as reproduced above that apart from depreciation, the law recognises that there can be a diminution in the value of assets which can be by way of a write off. The Committee is of the view that impairment of assets is nothing but a write off of the nature of diminution in the value of a fixed asset. On a harmonious reading of the definition of the term ‘provision’ as given in Part III of Schedule VI with the requirements under sections 205 and 350 of the Act, the Committee is of the view that the requirement of the law is that the carrying amount of the asset after adjusting the diminution/impairment in its value, has to be charged off over the remaining life, i.e., the specified period, as determined in accordance with the requirements of the Act. The Committee is further of the view that in order to do so it would be necessary to revise the rate of depreciation. The Committee is, therefore, of the view that the requirements of paragraph 61 of AS 28 are not in conflict with the relevant provisions of the Companies Act, 1956.

13 The Committee notes that paragraph 94 of AS 28, which relates to reversal of impairment loss, requires as below:

“94. An enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset.”

14 On the basis of the above, the Committee is of the view that impairment loss can be reversed only under the situations contemplated in AS 28 and not with the objective of adjustment of depreciation amount as suggested by the querist in paragraph 6 above. In any case, as stated in paragraph 12, there is no need for such an adjustment.

15 The Committee further notes that Schedule XIV to the Companies Act, 1956, requires, *inter alia*, that depreciation rates or the useful lives of the assets should be disclosed in the accounts if they are different from the principal rates specified in the Schedule (Note 5).

D. Opinion

16 On the basis of the above, the Committee is of the opinion that it is not correct on the part of the company to continue charging depreciation on the same basis as was followed in March 2004. The depreciation should be charged over the remaining useful life of the asset as prescribed in paragraph 61 of AS 28, with appropriate disclosure in respect of the rate of depreciation having been changed in view of the requirements of AS 28. ■

ELECTRONIC FURNISHING OF RETURN OF INCOME SCHEME, 2004

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The Income Tax Department (ITD) has launched a new scheme for improving interface with the taxpayers. This scheme titled “Electronic Furnishing of Return of Income Scheme, 2004” enables authorized intermediaries to electronically file Income-tax returns on behalf of the taxpayers. This scheme is available to any taxpayer who is assessed or assessable to tax at any of the 60 cities specified by ITD.

Under this scheme an eligible person, **at his option**, may furnish his return of income which he is required to furnish under sub-section (1) of section 139 of the Act for the assessment year 2004-05 and any subsequent year, through the above-mentioned authorized intermediaries.

These entities that are authorized to file Income Tax returns in electronic form on behalf of taxpayers are called e-Return Intermediaries. e-Return Intermediaries are appointed by ITD. Chartered Accountants in practice with prescribed experience and infrastructure are eligible to be appointed as e-intermediaries.

NSDL has been appointed as the Registrar for processing applications for registration as e-Return Intermediary by eligible entities. NSDL has setup a web-based facility for online registration of e-Return Intermediaries.

Members are requested to come forward and register themselves as e-return intermediaries and make the Scheme a grand success. This would help them to develop an electronic interface with the Income tax department. Details are available at www.tin-nsdl.com and www.incometaxindia.gov.in.