

Method of Depreciation as Per Requirements of the Companies Act, 2013

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

A. Facts of the Case

1. The querist has stated that Schedule II to the Companies Act, 2013 defines the depreciable value and the useful life of the asset and by dividing the depreciable value of the asset with the useful life of the asset, the rate is calculated at which depreciation is to be charged on any depreciable asset and this appears to be straight line method. However, Accounting Standard (AS) 6, 'Depreciation Accounting', provides that the depreciation can be charged either on the basis of straight line method (SLM) or written down value (WDV) method. The Schedule II is not clear whether a company can apply the WDV method for charging depreciation.
2. The querist has further stated that the company (X) has two production units (A and B) located at different places. Till financial year 2013-14, Unit A was using the straight line method (SLM) for charging depreciation whereas Unit B was using the written down value method (WDV) for charging depreciation as per the specific rates provided in Schedule XIV to the erstwhile Companies Act, 1956.
3. According to the querist, with the enactment of the Companies Act, 2013, Schedule II provides for the concept of useful life of the asset instead of specific depreciation rates as provided under Schedule XIV to the erstwhile Companies Act, 1956, for straight line method and written down value method.

B. Query

4. In the above background, the querist has sought the opinion of the Expert Advisory Committee on the following issues:
 - (i) Whether Schedule II of the Companies Act, 2013 prescribes only straight line method for charging depreciation or any other method for charging depreciation can also be used.

- (ii) Whether Unit A can continue to charge depreciation following straight line method and Unit B continue to charge depreciation following written down value method for charging depreciation for the year 2014-15 as per Schedule II to the Companies Act, 2013, or both units will have to adopt same method for charging depreciation.

C. Points considered by the Committee

5. The Committee notes from the Facts of the Case that the issues raised in the query relate to methods of charging depreciation as per the requirements of Schedule II and whether different method of depreciation can be adopted by the company for two units. The Committee has, therefore, considered only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, calculation of depreciation rate, determination of useful life of the assets, etc.
6. With regard to methods of depreciation, the Committee further notes the following provisions of Schedule II to the Companies Act, 2013 and Accounting Standard (AS) 6, 'Depreciation Accounting' notified under the Companies (Accounting Standards) Rules, 2006:

Schedule II

"1. 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."

"Notes

3. The following information shall also be disclosed in the accounts, namely:—

- (i) depreciation methods used; and
- (ii) the useful lives of the assets for computing depreciation, if they are different from the life specified in the Schedule.”

AS 6

“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.”

“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.”

“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 straight line 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.”

“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. ...”

7. The Committee notes that section 123 of the Companies Act, 2013, requires that “depreciation shall be provided in accordance with the provisions of Schedule II” and, as compared to Schedule XIV to the Companies Act, 1956, Schedule II does not specify any method of depreciation but only provides the indicative useful life of the assets. Accordingly, the Committee notes that neither section 123 nor Schedule II of the Companies Act, 2013, specifically lay down the methods of depreciation. The Committee further notes that, although the methods of depreciation have not been specified, Schedule II requires depreciation *methods* used to be disclosed in financial statements. Thus, the Committee is of the view that any appropriate method of depreciation, such as, SLM, WDV and Unit of Production (UoP) can be used considering the useful life of the assets and other requirements of Schedule II to the Companies Act, 2013 and AS 6.
8. The Committee further notes from the requirements of Schedule II and AS 6 that the basic purpose of charging depreciation is to allocate depreciable amount of an asset over its useful life so as to reflect a true and fair view of the financial statements. The Committee notes that the Guidance Note on Accounting for Depreciation in Companies, issued by the Institute of Chartered Accountants of India, provides in paragraph 9 that “in arriving at the rates at which depreciation should be provided the company must consider the true commercial depreciation, i.e., the rate which is adequate to write off the asset over its normal working life”. Accordingly, the Committee is of the view that selection of most appropriate method of depreciation is a matter of judgement by the management considering various factors, such as, type of asset, the nature of the use of such

asset and circumstances prevailing in the business, to allocate the depreciable amount of an asset over its useful life. Further, since depreciation is a measure of wearing out, consumption or other loss of value of a depreciable asset, the depreciation method selected should reflect such wearing out, consumption or loss of value of asset over its useful life appropriately and adequately. As per AS 6, methods normally used are Straight Line Method (SLM) /Wirtten Down Value Method (WDV). However, the selection of a method depends upon the facts and circumstances of the case and therefore, the company should select the most appropriate method based on various factors, as discussed above.

9. With regard to the issue as to whether different methods of depreciation can be adopted by the company for two units, the Committee notes the following requirements of the Guidance Note on Accounting for Depreciation in Companies, issued by the Institute of Chartered Accountants of India:

“Adoption of different methods for different types of assets

5. A company may adopt more than one method of depreciation. Thus, it is permissible to follow different methods for different types of assets provided the same methods are consistently adopted from year to year in accordance with Section 205(2). Also, units in different geographical locations can follow different methods of depreciation provided the same are consistently followed.”

From the above, the Committee is of the view that although the Guidance Note permits units in different geographical locations to follow different methods of depreciation, the requirements of the Guidance Note should be read alongwith the requirements of Schedule II and AS 6. Accordingly, the Committee is of the view that the method of depreciation selected for the units at two different locations can be different if the methods selected reflect differences in wearing out, consumption or other loss of value of a depreciable asset over its useful life considering the requirements of Schedule II and AS 6, as discussed in paragraph 8 above. If there is no difference in wearing out, consumption or other loss of value of an asset in different units at different

geographical locations, the company cannot use different methods of depreciation for the asset.

D. Opinion

10. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 4 above:
- (i) Apart from SLM, other methods of depreciation, such as, WDV can also be used considering the requirements of Schedule II to the Companies Act, 2013 and AS 6, as mentioned in paragraph 7 above.
 - (ii) The company can follow different methods of depreciation for an asset in different units at different geographical locations only if the depreciation methods selected for such asset(s) reflect differences in the wearing out, consumption or other loss of value of such asset(s) over its useful life, as discussed in paragraphs 8 and 9 above.

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 Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on June 3, 2015. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty four volumes. A CD of Compendium of Opinions containing thirty four volume has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.in .

