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Research Paper Management

Accounting for Depreciation of Tangible Assets And Compliance With Schedule XIV of Companies Act of 1956 - A Case Study

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ABSTRACT

Every business unit is legally responsible to account the usage of its fixed assets every year in such a way that its diminished value is reflected. This is done by subjecting the fixed assets to depreciation. In India Schedule XIV of the Companies Act of 1956 provides for the rates of depreciation to be charged while preparing the financial statements. The study aims to examine how a company arrives at the depreciation to be charged on fixed assets and checks whether the company complies with the depreciation rates as specified under Schedule XIV of The Companies Act of 1956. In case of any deviation, the paper attempts to identify reasons for such deviation. For this, a case of a well established enterprise that offers a broad range of products and systems is studied. The study reveals that the depreciation rates implemented by the company are within the statutory framework.

KEYWORDS Companies Act, Compliance, Depreciation Rates, Net Book Value, Schedule XIV

INTRODUCTION

A financial statement of a company includes a brief summary of fixed assets. Fixed assets are categorized as land, building, plant and machinery, vehicles, furniture and fittings, patents, goodwill, trademark and designs. Such fixed assets often constitute a major portion of the total assets of the company. They are held with the intention of being used for the purpose of producing goods or services and not held for trade in the normal course of business.

Fixed assets are generally subject to depreciation. Depreciation is the diminution in the historical value of an asset due to usage. As a rule, it is spread over the economic life of an asset. Depreciation is a subject that accountants have paid little attention till recent years. The attitude was "depreciation cannot be determined accurately anyway, so why bother?". However this attitude has undergone change and today depreciation is being treated as a significant item in arriving at the net profits of the company. The company's act of 1956 provides for the treatment of depreciation. Schedule XIV of the companies act mentions the chargeable rates of depreciation. Depreciation as per the schedule should be charged in each accounting period irrespective of the appreciation in its market price.

LITERATURE REVIEW

According to Accounting Standard VI, Depreciable assets are assets which:

- Are expected to be used during more than one accounting period; and
- Have a limited useful life; and
- Are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.

Useful life is either:

- The period over which a depreciable asset is expected to be used by the enterprise; or
- The number of production or similar units expected to be obtained from the use of the asset by the enterprise

The quantum of depreciation to be provided in an accounting period involves the exercise of judgment by management in the light of technical, commercial, accounting and legal requirements and accordingly may need periodical review. (mca.gov.in).

Indian GAAP, AS-6 suggests two methods of depreciation

- Straight Line Method (SLM) - Under this method, the cost of the asset is equally spread over its life time by dividing the difference between an assets cost and its expected salvage value by the number of years it is expected to be used.
- Written Down Value Method (WDVM) - Under this method, a fixed percentage of depreciation is calculated upon the original cost of the asset in the first year and in the subsequent years fixed percentage of depreciation is calculated on the written down value of the asset over the expected useful life of the asset.

STATEMENT OF THE PROBLEM

Schedule XIV of Companies Act of 1956 provides for the rates of depreciation to be charged while preparing the financial statements. But whether companies comply with the statutory depreciation rates? If yes, what is the procedure adopted by an enterprise in arriving at its depreciation rates that abide by the statute?

OBJECTIVES

- To study the procedure adopted in arriving at depreciation on fixed assets by an enterprise
- To understand the depreciation rates mentioned in Schedule XIV of Companies Act and Compare it with the depreciation rates followed by the enterprise to check for compliance.

RESEARCH METHODOLOGY

The topic is arrived at by studying the case of a well established organization. Information is derived from secondary sources like company manual, published reports and few related websites. Also, further information is gained through direct interaction with the finance head and other officials in the corporate finance department.

Initially the study examines the procedure adopted by the company in arriving at the Net Book Value of the asset every year and lately compares the depreciation rates prescribed under schedule XIV of the Companies Act of 1956 with that of the rates followed by the company.

CASE STUDY

For the study, let us consider the case of a well-established enterprise that offers an extensive range of products and systems. The study is based on the data collected from Fixed Assets Register (FAR) as on March 2013 maintained by Property Accounting Team (PAT). FAR contains details such as Asset No, Asset Description, Installation date, Useful life, Remaining life, Purchase price, Accumulated Depreciation, Net book value, Asset Category, Department number, Department description.

COMPANY STANDARD OF CHARGING DEPRECIATION ON TANGIBLE ASSETS

Tangible Assets are stated at acquisition cost, net of accumulated depreciation and accumulated impairment losses, if any. Subsequent expenditures related to an item of fixed asset are added to its book value only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance. Items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realizable value and are shown separately in the financial statements. Any expected loss is recognized immediately in the Statement of Profit and Loss. Losses arising from the retirement of, and gains or losses arising from disposal of fixed assets which are carried at cost are recognized in the Statement of Profit and Loss.

Depreciation on fixed assets other than leasehold improvements is provided on straight line method at the following rates specified which are equal to or higher than the principal rates specified in Schedule XIV to the Companies Act, 1956

Particulars	Depreciation per annum
Building	3.34% / 5.00% / 10.00%
Vehicles	20.00%
Office Equipment	20.00%
Plant and Machinery	6.67% / 10.00%
Lease Hold Improvements	10%/ 12.5%/ 20%
Data Processing Equipment	20.00% to 33.33%
Furniture and Fixtures	6.67% / 10.00%

Table 1: Company Rate of Charging Depreciation

Assets individually costing less than Rs.5, 000 are fully depreciated in the year of addition. Leasehold improvements are amortized over the period of lease as estimated by the management. Cost of Leasehold land (including stamp duty) is amortized over the period of lease. Assets taken on finance leases are depreciated over the estimated useful life or the lease term, whichever is lower (moneycontrol,2013).

STEPS FOLLOWED FOR CALCULATING DEPRECIATION

The activity begins with extracting data from FAR. The detailed contents of FAR are as follows-

1. Asset Number: This column contains the asset number which can be thought as a unique serial number that is been assigned to every asset, in case of same asset number, a sub number is provided under every asset number and the combination of asset number and sub number makes the final asset number.
2. Asset description: This column tries to explain the asset in brief, it can contain the name of the asset, the name of the vendor, the department in which it will be utilized and other such information.
3. Installation date, use full life, remaining life: These are the columns which deal with the age of the asset, the installation date give the date on which the asset is installed, the use full life is calculated on the basis of certain fixed policy's, the difference between the two gives the remaining life of the asset.
4. Purchase price, Accumulated Depreciation, Net book value: These blocks deal with the value of the asset, the first column shows the purchase price at the time of purchase, the next block shows the total or accumulated depreciation in the value of the asset and the difference of the two shows in the net book value of the asset.
5. Asset Category: For the purpose of sorting the assets and making the calculations easy, the assets are divided into categories. This block shows different categories into which the assets are divided.
6. Department number, Department description: - These two column contain the description of the department in which the asset is be installed, each department is been provided with a unique department number and also brief description of that department.

Company follows Straight Line Method for calculating depreciation. For calculating depreciation under SLM below formulae is used:

Depreciation = (Purchase Price-Residual Value)/Useful life of the Asset

The second step involves ascertaining the Purchase Price and the life of the Assets to calculate the depreciation for each and every line item of fixed asset in FAR.

Finally, Depreciation is calculated.

Depreciation value is compared with the Net Book Value (NBV), if the calculated depreciation is more than the NBV; the depreciation amount for that asset is restricted to the NBV, as the NBV cannot be negative. If the calculated depreciation is less than NBV, then entire depreciation is provided for that asset.

The current year depreciation is added to the Accumulated Depreciation balance as at 31 March, 2012 so as to obtain total accumulated depreciation and also NBV as at 31 March, 2013.

The Fixed Assets Schedule is prepared by categorizing all the Assets in the FAR to 8 categories of Tangible Assets i.e.

- Land,
- Building,
- Plant and Machinery,
- Furniture and Fixtures,
- Vehicles,
- Office Equipment,
- Data processing Equipment,
- Leasehold improvements.

At last, Fixed Assets Schedule is prepared in the following format which is disclosed in the Annual Report of the Company.

Particulars	Gross Block		Accumulated Depreciation				Net Block
	As at March31, 2012	As at March 31, 2013	As at March 31, 2012	Current Year Depreciation	Disposal	As at March 31, 2013	As at March 31, 2013
Tangible assets							
Land	45,586,145	45,586,145	Nil	Nil	Nil	Nil	45,586,145
Building	1,231,973,594	1,231,973,594	125,982,548	40,467,909	Nil	166,450,457	1,065,523,137
Plant & Machinery	20,948,700,384	2,094,870,384	672,957,997	190,579,361	Nil	863,537,358	1,231,333,026
Furniture & Fixtures	143,127,701	143,127,701	35,567,441	10,213,866	Nil	46,781,307	96,346,394

Vehicles	2,363,624	2,363,624	1,581,098	246,557	Nil	1,827,655	535,969
Office Equipment's	198,134,447	198,134,447	112,096,960	23,075,885	Nil	135,172,845	62,961,602
Data Processing Equipment's	42,651,008	42,651,008	249,700,473	10,380,012	Nil	35,350,484	7,300,524
Leasehold Improvements	188,941,333	188,941,333	105,612,347	19,118,263	Nil	124,730,611	64,210,722
Total		3,947,648,236	1,079,768,864	294,081,852	Nil	1,373,850,716	2,573,797,520

Table2: Fixed Assets Schedule

Category	Rates as per schedule under Company's Act	Rates as per FAR	Remarks
Building	3.34	3.34	Complied
		5	Complied
		10	Complied
		14.14	Complied
Vehicles	9.5	20	Complied
Office Equipment's	10.34	10.34	Complied
		20	Complied
Plant & Machinery	4.75	6.67	Complied
		10	Complied
		14.14	Complied
		20	Complied
		33.33	Complied
Lease Hold Improvements	3.34	10	Complied
		12.5	Complied
		20	Complied
Data Processing Equipment's	16.21	33.33	Complied
Furniture & Fixtures	6.63	6.67	Complied
		10	Complied

Table 3: Depreciation Rates- Comparison & Compliance (MCA,2013)

FINDINGS

The study reveals that the depreciation rates followed by the company are either equal to or greater than the rates provided as per the companies act. However, it must be noted that the rates given in the schedule is the minimum rates to be followed by the Company which was ascertained based on the life of the Fixed Asset. If the Company opines that the life of the asset is lower than provided in the Schedule XIV, the Company is allowed to follow higher rates. But, the company cannot adopt a rate that is below the rate mentioned in the schedule

LIMITATIONS

The study considers a case that focuses only on the Straight Line Method of charging depreciation and conveniently ignores the written down value method which is also a vital part of schedule XIV of Companies Act of 1956. Besides, to abridge the study, only a situation of subjecting the assets to single shift is considered. Thus, further research can choose a company for study that can focus on written down Value Method of charging depreciation and also has double and triple shift of operation.

SUMMARY & CONCLUSION

The study begins with the meaning of depreciation as per Accounting Standard VI and a brief discussion on the two major methods of charging depreciation. Further, the case of a manufacturing unit has been considered for this study. The paper discusses the steps adopted by the company for calculating depreciation and arriving at the Net Book Value of asset every year. The fixed assets category under study covers tangible assets like land, building, plant &machinery, furniture & fixtures, vehicles, office equipment, leasehold improvements and data processing equipment. The study primarily focused on the depreciation rates to be followed by every enterprise as per schedule XIV of the Companies Act of 1956.

On the basis of the comparative analysis of schedule XIV prescribed rates and the rates followed by the company, the study arrives at a conclusion that the company's rate of charging depreciation is either equal to or greater than the rates provided as per the companies act. The schedule states that the company must consider the true commercial depreciation while arriving at the depreciation rates. The true commercial depreciation is the rate that is adequate to write off the asset over its normal working life. If the rate so arrived at is higher than the rates prescribed under Schedule XIV of the company's act, the company should provide depreciation at such higher rate but if the rate so arrived is lower than the rates prescribed in Schedule XIV, then the company should provide depreciation at the rates prescribed in Schedule XIV, since these represent the minimum rates of depreciation to be provided. Thus, for every category of asset the company has complied with the statute (caalley,2013).

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