

# Accounting for Fixed Assets – Impact of Schedule II of the Companies Act, 2013



*The Companies Act, 2013 is set to be implemented by the corporate sector from the financial year 2014-15. Like Section 205 of the Companies Act, 1956, Section 123 of the Companies Act, 2013 states that no dividend shall be declared unless some depreciation is provided in accordance with Schedule II of the Companies Act, 2013 (corresponding Schedule XIV of the Companies Act, 1956). Schedule II of the Companies Act, 2013 provides Useful Lives to Compute Depreciation as against Rates of Depreciation provided hitherto in the Schedule XIV of the Companies Act, 2013. The author, after duly presenting an extract of Schedule II of the Companies Act, 2013, explains and discusses the impact of these provisions of the Schedule on the accounting for fixed assets. Read on...*

Like Section 205 of the Companies Act, 1956, Section 123 of the Companies Act, 2013 states that no dividend shall be declared unless some depreciation is provided in accordance with Schedule II of the Companies Act, 2013 (corresponding schedule XIV of the Companies Act, 1956). Following is the extract of the Schedule II of the Companies Act, 2013, which provides *Useful Lives to Compute Depreciation* as against *Rates of Depreciation* provided hitherto in the Schedule XIV of the Companies Act, 2013:

## **PART 'A'**

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.

2. For the purpose of this Schedule, the term *depreciation* includes amortisation.
3. Without prejudice to the foregoing provisions of paragraph 1—
  - (i) In case of such a class of companies, as may be prescribed and whose financial statements comply with the accounting standards prescribed for such class of companies under Section 133, the useful life of an asset shall not normally be different from the useful life and the residual value shall not be different from that as indicated in Part C, provided if such a company uses a useful life or residual value which is different from the useful life or residual value indicated therein, it shall disclose the justification for the same.



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- (ii) In respect of other companies the useful life of an asset shall not be longer than the useful life and the residual value shall not be higher than that prescribed in Part C.
- (iii) For intangible assets, provisions of the Accounting Standards mentioned under sub-para (i) or (ii), as applicable, shall apply.

## PART 'B'

4. The useful life or residual value of any specific asset, as notified for accounting purposes by a regulatory authority constituted under an Act of Parliament or by the Central Government shall be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of this Schedule.

## PART 'C'

It provides useful lives of various assets under the following categories:

- I. Buildings
- II. Bridges, culverts, bunders, etc.
- III. Roads
- IV. Plant and Machinery
- V. Furniture and Fittings
- VI. Motor Vehicles
- VII. Ships
- VIII. Aircrafts or Helicopters
- IX. Railway Sidings, Locomotives, Rolling Stocks, Tramways and Railways used by concerns, Excluding railway concerns
- X. Ropeway Structures
- XI. Office Equipment
- XII. Computers and Data Processing units
- XIII. Laboratory equipment
- XIV. Electrical Installations and Equipment
- XV. Hydraulic Works, Pipelines and Sluices

Notes to Part 'C' of the Schedule II reads:

1. *Factory buildings* do not include offices, godowns, or staff quarters.

**The useful life or residual value of any specific asset, as notified for accounting purposes by a regulatory authority constituted under an Act of Parliament or by the Central Government shall be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of this Schedule.**

2. Where during any financial year, any addition has been made to any asset, or where any asset has been sold, discarded, demolished or destroyed, the depreciation on such assets shall be calculated on a *pro rata* basis from the date of such addition or, as the case may be, up to the date on which such asset has been sold, discarded, demolished or destroyed.
3. The following information shall also be disclosed in the accounts, namely—
  - (i) depreciation methods used; and
  - (ii) useful lives of the assets for computing depreciation, if they are different from the life specified in the Schedule.
4. Useful life specified in Part C of the Schedule is for whole of the asset. Where cost of a part of the asset is significant to total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of that significant part shall be determined separately.
5. Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value. Ordinarily, the residual value of an asset is often insignificant but it should generally be not more than 5% of the original cost of the asset.
6. The useful lives of assets working on shift basis have been specified in the Schedule based on their single shift working. Except for assets in respect of which no extra shift depreciation is permitted (indicated by NESD in Part C above), if an asset is used for any time during the year for double shift, the depreciation will increase by 50% for that period and in case of the triple shift the depreciation shall be calculated on the basis of 100% for that period.
7. From the date this Schedule comes into effect, the carrying amount of the asset as on that date—
  - (a) shall be depreciated over the remaining useful life of the asset as per this Schedule;
  - (b) after retaining the residual value, shall be recognised in the opening balance of retained earnings where the remaining useful life of an asset is nil.
8. *Continuous process* plant means a plant which is required and designed to operate for 24 hours a day.

These provisions of the Schedule II of the

**Another issue which arises is, if companies are now mandatorily required to assess the useful life and provide for depreciation according to such useful life even if the useful life is different from that provided in Schedule II of the Companies Act.**

Companies Act would have greater impact on accounting for fixed assets which are discussed hereinafter.

### Determination of Useful Life

Section 205 read with Section 350 of the Companies Act, 1956 prescribes that depreciation will be charged at the rates as per Schedule XIV of the Companies Act. Para 13 of AS 6 'Depreciation Accounting' further states:

*13. The statute governing an enterprise may provide the basis for computation of the depreciation. For example, the Companies Act, 1956 lays down the rates of depreciation in respect of various assets. Where the management's estimate of the useful life of an asset of the enterprise is shorter than that envisaged under the provisions of the relevant statute, the depreciation provision is appropriately computed by applying a higher rate. If the management's estimate of the useful life of the asset is longer than that envisaged under the statute, depreciation rate lower than that envisaged by the statute can be applied only in accordance with requirements of the statute.*

Thus, under the Companies Act, 1956, the rates prescribed were minimum rates for charging depreciation on fixed assets. However, in the Companies Act, 2013, para 3(i) of Part A of the Schedule II provides that in case of such class of companies, as may be prescribed and whose financial statements comply with the accounting standards prescribed for such class of companies under Section 133 the useful life of an asset shall not normally be different from the useful life and the residual value shall not be different from that as indicated in Part C, provided that if such a company uses a useful life or residual value which is different from the useful life or residual value indicated therein, it shall disclose the justification for the same.

These provisions in Schedule II give an option (whether it is an option or mandatory, discussed

later) to a certain class of companies to use different useful life which may be higher or lower useful life than provided in the Schedule II. Accordingly, these certain classes of companies can now even apply lower rate of depreciation provided they disclose the justification for the same in the financial statements.

Another issue which arises is if companies are now mandatorily required to assess the useful life and provide for depreciation according to such useful life even if the useful life is different from that provided in Schedule II of the Companies Act. One view which comes to mind is that it is an option given to companies to use different useful life as the Schedule II provides *the useful life of an asset shall not normally be different from the useful life and the residual value shall not be different from that as indicated in Part C, provided that if such a company uses a useful life or residual value which is different from the useful life or residual value indicated therein, it shall disclose the justification for the same.* It nowhere mandates the companies to use different useful life. However, the following reasons support the view that, for certain classes of companies, it would be mandatory to assess the useful life of fixed assets and charge depreciation accordingly:

- a. General instructions for the preparation of Balance Sheet and Statement of Profit & Loss as given in the Schedule III of Companies Act, 2013 requires that where compliance with the requirements of the Act including Accounting Standards as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head or sub-head or any changes, *inter se*, in the financial statements or statements forming part thereof, the same shall be made and the requirements of this Schedule shall stand modified accordingly. Thus para 13 of AS 6 *Depreciation Accounting* is mandatorily required to be followed. Since Schedule II of the Companies Act, 2013 gives an option to charge depreciation using different useful life for certain class of companies, this option is mandatorily required to be followed in view of para 13 of AS 6 read with general instructions given in Schedule III of the Companies Act, 2013.
- b. Para 8.3 of AS 10 Accounting for Fixed Assets states:

*In certain circumstances, the accounting for an item of fixed asset may be improved if the total expenditure thereon is allocated to its component parts, provided they are in practice separable, and estimates are made of the useful lives of these components. For example, rather than treat an aircraft and its engine as one unit, it may be better to treat the engine as a separate unit if it is likely that their useful life is shorter than that of the aircraft as a whole.*

In the era of the Companies Act, 1956, this paragraph was not mandatorily followed by the companies. However, now note 4 to Part C of the Schedule as reproduced above mandates that where cost of a part of the asset is significant to total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of that significant part shall be determined separately. This requirement is not optional. Hence to follow this requirement of Companies Act, 2013, the companies necessarily require identifying those components, which have significant cost and determine their useful life separately.

- c. As per Schedule II, Part C, useful life of Plant & Machinery other than the continuous process plant not covered under specific industries, is 15 years on single shift basis. Thus, if a company has used the Plant & Machinery on triple shift basis, the useful life of such assets would be 7.5 years only as the note 6 to Part C of Schedule II as reproduced above requires that

in case the asset is used for triple shift, the depreciation shall be calculated on the basis of 100% for that period. Note 7 (b) to Part C of the Schedule II as reproduced above requires that from the date this Schedule comes into effect, the carrying amount of the asset as on that date after retaining the residual value, shall be recognised in the opening balance of the retained earnings where the remaining useful life of an asset is nil. In many companies' a situation would arise where they have used the asset for more than 7.5 to 15 years on single/double/triple shift basis. Hence, as per the Schedule II, their remaining useful life as on the commencement of the Schedule II may remain nil. However, if such a company is falling in the class of companies as prescribed it would not be judicious to consider the useful life as given in Schedule II as there is an option with these companies to determine different useful life. Thus, it would be mandatory for those companies to use different useful life which will be higher than the useful life as given in Schedule II. A similar situation may arise for other assets too.

## Classification of Assets

If the line items of fixed assets as given in the Schedule II of Companies Act, 2013 and Schedule XIV of the Companies Act, 1956 are compared, one may note that various assets are now required to be classified differently under the new Companies Act. A few of the illustrations are:

### Illustration 1

Nature of assets under Companies Act, 2013	Useful Life	Depreciation rate Companies Act, 2013	Depreciation rate Companies Act, 1956	Nature of assets under Companies Act, 1956
		<b>Single Shift</b>	<b>Single Shift</b>	
<b>I. Buildings [NESD]</b>				
(a) Buildings (other than factory buildings) RCC Frame Structure	60 Years	1.67%	1.63%	Buildings (other than factory buildings)(NESD)
(b) Buildings (other than factory buildings) other than RCC Frame Structure	30 Years	3.33%	1.63%	Buildings (other than factory buildings)(NESD)
(c) Factory buildings	30 Years	3.33%	3.34%	Factory Buildings



Nature of assets under Companies Act, 2013	Useful Life	Depreciation rate Companies Act, 2013	Depreciation rate Companies Act, 1956	Nature of assets under Companies Act, 1956
		<b>Single Shift</b>	<b>Single Shift</b>	
(d) Fences, wells, tube wells	5 Years	20%	1.63%	As per note 1: "buildings" include roads, bridges, culverts, wells, and tubewells. Further, as per Note 2 "factory buildings" does not include offices, godowns, officers and employees' quarters, roads, bridges, culverts, wells and tube wells.
(e) Others (including temporary structure, etc.)	3 Years	33.33%	100%	Purely temporary erections such as wooden structures
<b>II. Bridges, culverts, bunders, etc. [NESD]</b>	30 Years	3.33%	1.63%	As per note 1: "buildings" include roads, bridges, culverts, wells, and tube wells. Further, as per Note 2 "factory buildings" does not include offices, godowns, officers and employees' quarters, roads, bridges, culverts, wells and tube wells.
<b>III. Roads [NESD]</b>				
(a) Carpeted roads				
(i) Carpeted Roads-RCC	10 Years	10%	1.63%	Included in definition of building as per Note 1 & 2 to schedule XIV.
(ii) Carpeted Roads-other than RCC	5 Years	20%	1.63%	Included in definition of building as per Note 1 & 2 to schedule XIV.
(b) Non-carpeted roads	3 Years	33.33%	1.63%	Included in definition of building as per Note 1 & 2 to schedule XIV.

**Note:** Straight Line Method rates are compared. For the purpose of Companies Act, 2013, it is assumed that residual value is Nil.

There are various implications of the above changes done in the Schedule II as compared to the Schedule XIV which are:

- Buildings (other than factory buildings) are now required to be classified under two categories *i.e.*, RCC Frame Structure and other than RCC frame structure. Under the Companies Act, 1956 both these categories of buildings were required to be depreciated at same rate of 1.63%. However, now the useful life of both the categories is different. Hence, a different rate would apply. Further a detailed exercise is required to be made by the Companies to identify buildings with RCC Frame
- In terms of Companies Act, 1956, fences, wells, tube wells *etc.*, were part of building and depreciated accordingly at 1.63%. In the Schedule II of the Companies Act 2013, a separate useful life of 5 years for these assets is prescribed. Accordingly, the depreciation rate comes at 20%. Hence, if fences, wells and tube wells are constructed five years before, any balance lying on account of such assets has to be recognised in retained earnings. Similarly for bridges, culverts

and bunders, the useful life is now 30 years and therefore the same has to be depreciated at 3.33% as against 1.63% as the same was part of buildings as per Companies Act, 1956.

- c. In terms of the Companies Act, 1956, fences, wells, tube wells, etc., were part of building and depreciated accordingly at 1.63%. In the Schedule II of the Companies Act, 2013, roads

are to be classified as *Carpeted Roads and Other than Carpeted Roads*. Carpeted roads are to be further classified into RCC and other than RCC. Based on their category, their useful life is 10 years, 5 years and 3 years as against 1.63% as per the Companies Act, 1956. Accordingly, depreciation accounting as to roads will undergo change.

## Illustration II

Nature of assets under Companies Act, 2013	Useful Life	Depreciation rate Companies Act, 2013	Depreciation rate Companies Act, 1956	Nature of assets under Companies Act 1956
		Single Shift	Single Shift	
<b>IV. Plant and Machinery</b>				
(i) General rate applicable to plant and machinery not covered under special plant and machinery				
(a) Plant and Machinery other than continuous process plant not covered under specific industries	15 Years	6.67%	4.75%	Plant and machinery (not being a ship) other than continuous process plant for which no special rate has been prescribed
(b) continuous process plant for which no special rate has been prescribed [NESD]	8 Years	12.5%	5.28%	Continuous process plant for which no special rate has been prescribed

**Note:** Straight Line Method rates are compared. For the purpose of Companies Act, 2013, it is assumed that residual value is nil. Rates for double shift and triple shift, wherever applicable, shall change as per the provisions of Schedule II of Companies Act, 2013 or Companies Act, 1956, as the case may be.

There are various implications of the above changes done in the Schedule II as compared to the Schedule XIV which are:

- The above comparison of rates as per the Companies Act, 2013 and Companies Act, 1956 shows that there has been substantial increase in rates of depreciation under the Companies Act, 2013 for general plants and machineries as well as for continuous process plant. Companies which do not have option for determining useful life higher than those prescribed in the Schedule II of the Companies Act will have to charge depreciation on general plants and machineries @ 6.67% as against 4.75% which has been applied earlier and for continuous process plant @ 12.5% as against 5.28%. Hence, in many of the companies,
- where plant and machineries have been in use for more than the useful lives as prescribed in the Schedule II of Companies Act, the remaining value has to be transferred to retained earnings.
- The identification of new categories of continuous process plant: In Schedule II, depreciation rates of plants and machineries used in various other industries as compared to the Companies Act,

**If the line items of fixed assets as given in the Schedule II of Companies Act, 2013 and Schedule XIV of the Companies Act, 1956 are compared, one may note that various assets are now required to be classified differently under the new Companies Act.**

1956 have also been specified. These other industries are telecommunications sector, power sector, steel sector, non-ferrous metal sector, pharmaceutical and chemical sector, and civil

construction sector. For an illustrative purpose the rates as prescribed for plants and machineries used in telecommunications and power sectors are discussed:

Nature of assets under Companies Act, 2013	Useful Life	Depreciation rate Companies Act, 2013	Depreciation rate Companies Act, 1956	Nature of assets under Companies Act, 1956
(d) Plant and Machinery used in Telecommunications [NESD]				
1. Towers	18 Years	5.55%	5.28%	Continuous process plant
2. Telecom transceivers, switching centres, transmission and other network equipment	13 Years	7.69%	5.28%	Continuous process plant
3. Telecom—Ducts, Cables and Optical Fibre	18 Years	5.55%	5.28%	Continuous process plant
4. Satellites	18 Years	5.55%	5.28%	Continuous process plant
(f) Plant and Machinery used in generation, transmission and distribution of power [NESD]				
1. Thermal/Gas/Combined Cycle Power Generation Plant	40 Years	2.5%	5.28%	Continuous process plant
2. Hydro Power Generation Plant	40 Years	2.5%	5.28%	Continuous process plant
3. Nuclear Power Generation Plant	40 Years	2.5%	5.28%	Continuous process plant
4. Transmission lines, cables and other network assets	40 Years	2.5%	5.28%	Continuous process plant
5. Wind Power Generation Plant	22 Years	4.54%	5.28%	Continuous process plant
6. Electric Distribution Plant	35 Years	2.85%	5.28%	Continuous process plant
7. Gas Storage and Distribution Plant	30 Years	3.33%	5.28%	Continuous process plant
8. Water Distribution Plant including pipelines	30 Years	3.33%	5.28%	Continuous process plant

It can be noted that, in many cases, the depreciation rate prescribed under the Companies Act, 2013 is even lower than what is prescribed in the Companies Act, 1956. Such assets shall be depreciated over the remaining useful life of the asset as per Schedule II in view of note 7(a) reproduced above.

## Conclusion

The implementation of the Schedule II of the Companies Act, 2013 has lots of challenges. Considering that Section 123 and Schedule II of the

Companies Act are effective from 1<sup>st</sup> April, 2014, accounting for fixed assets for the financial year 2014-15 will undergo a sea change and may have impact over the profitability of the companies. The determination of useful life and residual value of various assets will be a major task for the companies. This will require technical evaluation from experts. To complete this task, companies need to prepare themselves earliest. Of course, when challenges are there in the new Companies Act, 2013 for accounting for fixed assets, professionals need to be ready to create opportunities in these challenges. ■