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Analytical study of component Accounting, Component Depreciation and IND AS-16

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Abstract

India is known for changes and perhaps it is really needed for development and economic welfare. Changes may be in terms of introduction of new laws or amendments in existing laws and regulations but such changing conditions and environment will be beneficial for new entrants to enter in to niche area for bright prospects. Every change is not necessary beneficial and accepted by peoples of India. Mandatory implications of changes may result in negative or positive perception towards the existing systems. From this point of view study about change in depreciation accounting based on normal rates to useful life with component depreciation approach as described in IND AS 16 is important.

Introduction

In India, financial reporting plays very important role for investors in interpret and understand financial performance of different enterprises. Main reason behind the financial reporting is to provide true and fair view of financial performance of an enterprise over a period of time. Financial reporting helps management to engage in effective decision making and concentrate on company's goal and overall strategies. Moreover, it also Reveal financial health and activities of the company to its stake holders including its shareholders, potential investors, consumers and government regulators.

Now-a-days presence of foreign companies is increasing day by day and as India is land of complexity itself it will be important to understand and interpret Indian accounting system and accounting standard for them. In this direction, one step more taken by the institute of chartered accountants of India through introduction of a new system, called Indian accounting standard (IND AS) in-place of generally accepted accounting principles (GAAP) which often proved difficult for foreign companies to adhere to.

Present Accounting standard deals with Depreciation

AS-6 Depreciation Accounting the major points to be considered are:

- Depreciation is loss of value of an asset. It is measure of wearing out, consumption or other loss of value of a depreciable asset arising from use and passage of time. Is is nothing but distribution of total cost of assets over its useful life.
- Depreciable assets are-expected to be used for more than one accounting period, have a limited useful life and held for use in production of goods and services.
- This standard does not applicable to Forest, plantations, Wasting assets, minerals and natural gas, Expenditure on research and development, Goodwill, Live stock-cattle and animal husbandry.
- Depreciation is calculated with historical cost, estimated useful life and estimated scarp/residual value of depreciable assets. And depreciation methods: straight line methods (SLM)and written down value. (WDVM)

AS-10 Accounting for fixed assets the major points to be noted that,

- Asset means, held with intention of being used for purpose of producing or providing goods and service, not held for sale in the normal course of business and expected to be used for more than one accounting period.
- This standard does not applicable to, forest, plantation and similar regenerative natural resources, wasting assets like minerals, oil and natural gas, expending on real development and live stock
- Fixed assets should be shown in financial statement either at historical cost or revalued price.(R.S.Rawat,2012)

IND AS -16 Property, Plant and Equipment

Scope as stated in paragraph no. 3 of Standard: This standard does not apply to:

- Property plant and equipment classified as held for sale in accordance with IND AS 105 non-currents assets held for sale and discontinued operations;
- Biological assets related to agriculture activity (seeIND AS 41, Agriculture)
- The recognition and measurements of exploration and evaluation assets(see IND AS 106 exploration for and evaluation of mineral resource);or

- Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resourced.

Here under this study an attempt is made to put emphasis on depreciation part which is deal by this standard after introducing of IND AS 16.but before summarise format of IND AS 16 is as below. Property, plant and equipment (PPE) are tangible items that:

- Are held for the use in the production or supply of goods or services, for rental to others, or for administration purpose and
- Are expected to be used during more than one period.

Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated of proposal, if the asset were already of the age and in the condition expected at the end of its useful life. Useful life is:

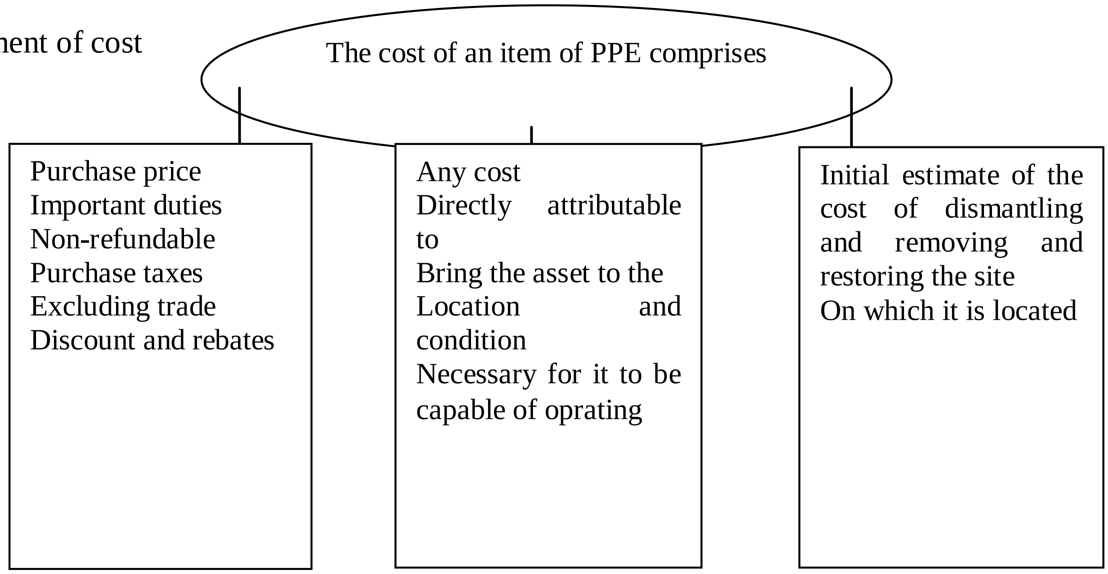
- The period over which an asset is expected to be available for use by an entity; or
- The number of production or similar units expected to be obtained from the asset by an entity.

Recognition criteria state in paragraph no.7 :The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

- It is probable that future economic benefits associated with the item will flow to the entity; and
- The cost of the item can be measured reliably.

As per paragraph no.9 of IND AS 16,no unit of measured is provided by this standard for recognition .that means what can be constitutes as an item of property, plant and equipment is matter of judgment and may be different from case to case. Measurement for recognition: An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.

Element of cost



Measurement after recognition: As per this standard, entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property.

- Cost model: after recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.
- Revaluation model: after recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliable shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. revaluation shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. If there is market based evidence and if there is no market based evidence.

❖ Further revaluation is called for when the fair value of a revalued asset differs materially from its carrying amount.

- Proportionate changes require to match carrying amount after revaluation with the revalued amount and net amount of increase in carrying amount after revaluation

De-recognition: The carrying amount of an item of PPE shall be De-recognize when: It is dispose off or When no future economic benefits are expected from its use or disposal.

Component Accounting: Reference sections:123(2) and schedule II of the companies ACT, 2013

PART –A: 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.

PART-B: 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. From the date this schedule comes into effect, the carrying amount of the asset as on that date:

- Shall be depreciated over the remaining useful life of the asset as per this schedule;
- After retaining the residual value, shall be recognized in the opening balance of retained earnings where the remaining useful life of an asset is nil.

PART-C: It shows the useful lives of various tangible assets.

Component depreciation:

Recently component accounting was in much debate and has become part of Indian rules and regulations by taking place in companies ACT 2013 and IND AS. The component approach is already allowed under current AS 10.under AS 10,there seems to be a choice in this matter where by, the companies ACT, 2013 requires application of component accounting mandatorily when relevant and material.

We can understand impact of component depreciation with the help of following example. Assume Megh airlines purchases an airplane for Rs. 20,00,000/- on April 2010.The airplane going to be use for 20 years and .residual value is ignored for easy understanding. Megh airlines uses the straight line method of depreciation for its airplanes.

Suppose SLM is use by Megh Airline then,

$$\text{Depreciation} = \frac{\text{capitalised cost} - \text{estimated residual value}}{\text{Estimated useful life}}$$

Depreciation=$\frac{20,00,000 - Nil}{20\ years}$

= Rs. 1,00,000

Now let's assume, Megh airlines identifies the following components, Amounts and useful lives as shown below,

Components	Component Amount	Component useful life
Airframe	Rs. 24,00,000	20 years
Engine	Rs. 12,00,000	8 years
Other components	Rs. 4,00,000	5 years

Components	Component Amount	Component useful life	Component Depreciation
Airframe	Rs.24,00,000	20 years	Rs. 1,20,000
Engine	Rs. 12,00,000	8 years	Rs. 1,50,000
Other components	Rs.4,00,000	5 years	Rs. 80,000
Total	Rs. 40,00,000		Rs. 3,50,000

Depreciation amount increase by Rs. 1,50,000/-,

We can see that depreciation amount as per component as per component approach will increase by Rs. 1,50,000/- and this will result into: Extra depreciation charged to profit and loss account, increase in Non-cash expenditure and helpful to reduce taxable income.

Analysis and interpretation:

- Adoption of component approach will bring companies a step closer towards international practices.
- The objective behind the component approach is not to break or split assets into parts but to split only material/significant component.
- Under IND AS 16,companies will be under mandatory obligation to use concept of useful lives of asset for depreciation.
- The residual value, useful life and depreciation method of an asset must be reviewed at least each financial year-end and if there has been significant change in the expected pattern of consumption to reflect the change in the expected pattern of

consumption of the future economic benefits embodied in asset,than companies can change method of depreciation to reflect the change pattern.

- Standard require companies to choose either the cost model or the revaluation model or the revaluation model as its accounting policy and to apply that policy to entire class of property, plant and equipment (PPE).
- Depreciation on revaluation of asset can be debited to income statement without routing through revaluation reserve.
- In IND AS 16, revaluation reserve can be directly transferred to retained earnings on de-recognition and such reserve is transferred to income statement on de-recognition in AS 6.
- In IND AS 16,change in depreciation method or useful life will be treated as change in depreciation method will be treated as change in accounting policy having retrospective effect on financial statement.

IND AS 16 and schedule II of the companies Act, 2013 provided a freedom to companies to made estimate for useful life based on their estimates and experience. Even companies can also estimate more useful life than as prescribed by schedule II subject to disclose sufficient justification for the same. It means estimate of useful life can be made by internal or external specialist as this standard is silent on this aspect. Depreciation can be charge until assets carrying amount is more than its residual value.

Conclusion:

Because of mandatory requirement by MCA for useful life and introduction of IND AS 16,companies will be in a position to recover the invested capital asset or fixed Asset by gradual sale of asset over years during which output or services received from it.In another way, this component approach, and component depreciation will be beneficial and welcome by companies which are heavy capital intensive. And this standard will be helpful them to spread large expenditure i.e. purchase price of capital asset or fixed asset over a fixed period to match revenue received from it.

Preparation, presentation and communication of high quality of financials statement are the concern of all the users because ultimately this statement will play important role such that can be relied upon to take decisions. However after adoption of component accounting and depreciation will impact a lot on transparency of financial statement. Main objective of financial reporting is to present, communication and educate the users, mainly the investors and potential investors about the financial performance and position of a company in order to assist them in taking investment and other financial decisions and this can be achieved by step taken by The Ministry of corporate affairs.

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