

EXPOSURE DRAFT
CAS -16
COST ACCOUNTING STANDARD ON DEPRECIATION AND AMORTISATION

The following is the Exposure draft of the Cost Accounting Standard (CAS-16) on “DEPRECIATION AND AMORTISATION”. In this Standard, the standard portions have been set in ***bold italic*** type. These are to be read in the context of the background material which has been set in normal type.

1. Introduction

This standard deals with the principles and methods of classification, measurement and assignment of Depreciation and Amortisation for determination of the cost of product or service, and the presentation and disclosure in cost statements.

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Depreciation and Amortisation with reasonable accuracy.

3. Scope

This standard shall be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Depreciation and Amortisation, including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified:-

4.1 Amortisation: Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

It refers to expensing the acquisition cost minus the residual value of intangible assets such as Patents and Trademarks or Copyrights in a systematic manner over their estimated useful economic life so as to reflect their consumption in the production of goods and services.

4.2 *Asset: The terms Asset, Fixed Asset and Intangible Asset will have the same meaning as in the Accounting Standards notified by the Central Government under the Companies (Accounting Standards) Rules, 2006.*

An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise. It may be acquired for safety or environmental reasons. The acquisition of such asset may not provide future economic benefits directly but may be necessary for an entity to obtain the future economic benefits from other assets. Such items also qualify for recognition as assets.

An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.

4.3 *Cost Object: This includes a product, service, cost centre, activity, sub-activity, project, contract, customer or distribution channel or any other unit in relation to which costs are ascertained.*

4.4 *Depreciation: 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 estimated useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined.*

4.5 *Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less the estimated residual value.*

4.6 *Depreciable fixed and Intangible assets are assets which:*

(i) are expected to be used during more than one accounting period;

(ii) have a limited useful life; and

(iii) 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.

Land is not a depreciable asset as it does not have a defined useful life.

4.7 *Residual (salvage) value:* Residual value is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

4.8 Useful life of asset is either

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

5. Principles of Measurement

5.1 *Depreciation and Amortisation shall be measured based on the depreciable amount and the useful life.*

The residual value of an intangible asset shall be assumed to be zero unless:

- (a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
- (b) there is an active market for the asset and:
 - I. residual value can be determined by reference to that market; and
 - II. it is probable that such a market will exist at the end of the asset's useful life.
 - III. The residual value of a fixed asset shall be considered as zero if the entity is unable to estimate the same with reasonable accuracy.

The minimum amount of depreciation to be provided shall not be less than the amount calculated as per principles and methods as prescribed by any law or regulations applicable to the entity and followed by it.

5.2 *In case of regulated industry the amount of depreciation shall be the same as prescribed by the concerned regulator*

The residual value of an intangible asset shall be assumed to be zero unless:

- (a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
- (b) there is an active market for the asset and:
 - (i) residual value can be determined by reference to that market; and
 - (ii) it is probable that such a market will exist at the end of the asset's useful life.

5.3 *While estimating the useful life of a depreciable asset, consideration shall be given to the following factors:*

- (a) Expected physical wear and tear;***
- (b) Obsolescence; and***
- (c) Legal or other limits on the use of the asset.***

5.4 *The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset.*

If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.

The useful life of an intangible asset, in any situation, shall not exceed 10 years from the date it is available for use.

5.5 *Depreciation shall be considered from the time when a depreciable asset is first put into use.*

An asset which is used only when the need arises but is always held ready for use. Example: fire extinguisher, stand by generator, safety equipment shall be considered to be an asset in use. Depreciable assets will be considered to be put into use when commercial production of goods and services commences.

Depreciation on an asset which is temporarily retired from production of goods and services shall be considered as abnormal cost for the period when the asset is not in use.

5.6 *Depreciation of any addition or extension to an existing depreciable asset which becomes an integral part of that asset shall be the remaining useful life of that asset.*

5.7 *Depreciation of any addition or extension to an existing depreciable asset which retains a separate identity and is capable of being used after the expiry of the useful life of that asset shall be based on the estimated useful life of that addition or extension.*

5.8 *The method of depreciation used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.*

5.9 *An entity can use any of the methods of depreciation to assign depreciable amount of an asset on a systematic basis over its useful life.*

For example:

- a) Straight-line method;*
- b) Diminishing balance method; and*
- c) Units of production method.*

5.10 *The method of amortisation of intangible asset shall reflect the pattern in which the economic benefits accrue to entity.*

5.11 *The methods and rates of depreciation applied shall be reviewed at least annually and, if there has been a change in the expected pattern of consumption or loss of future economic benefits, the method applied shall be changed to reflect the changed pattern.*

5.12 *Spares purchased specifically for a particular asset, or class of assets, and which would become redundant if that asset or class of asset was retired or use of that asset was discontinued, shall form part of that asset. The depreciable amount of such spares shall be allocated over the useful life of the asset.*

5.13 *Depreciation for small value items shall be @100% if these are written off in the period in which they were purchased for the preparation and presentation of Financial Statements.*

5.14 *Cumulative depreciation charged against any individual item of fixed asset shall not exceed original cost of the asset, net of residual value.*

5.15 *Where depreciation for an addition of an asset is measured on the basis of the number of days for which the asset was used for the preparation and presentation of financial statements, depreciation of the asset for assigning to cost of object shall be measured in relation to the period, the asset actually utilized.*

6. Assignment of Costs

6.1 *Depreciation shall be traced to the cost object to the extent economically feasible.*

6.2 *Where the depreciation is not directly traceable to cost object, it shall be assigned based on either of the following two principles:*

- i. Cause and effect - cause is a process or operation or activity and effect is the incurrence of cost.*
- ii. Benefits received– depreciation is to be apportioned to the various cost objects in proportion to the benefits received by them.*

6.3 *The impact of higher depreciation due to revaluation of assets shall not be assigned to cost object.*

7. Presentation

Depreciation and Amortisation, if material, shall be presented in the cost statement as a separate item of cost.

8. Disclosures

8.1 *The cost statement shall disclose the following:-*

- 1. The basis of distribution of Depreciation and Amortisation to the cost objects.*
- 2. Any credits / recoveries relating to Depreciation and Amortisation.*
- 3. Higher cost of depreciation due to revaluation of assets.*

8.2 *Disclosure shall be made only where material, significant and quantifiable.*

8.3 *Disclosures shall be made in the body of the cost statement or as a foot note or in a separate schedule.*

8.4 *Any change in the cost accounting principles and methods applied for the measurement and assignment of Depreciation and Amortisation during the period covered by the cost statement which has a material effect on Depreciation and Amortisation shall be disclosed. Where the effect of such change is not ascertainable wholly or partly, the fact shall be indicated.*
