# Fixed Assets Accounting (A Theoretical Framework)

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**ABSTRACT**

Fixed assets accounting is an indispensable content in entities' accounting activities. Fixed assets accounting provides information relating to fixed assets changes; depreciation and repairing in order to make decisions of investment, selling, disposal and repairing for upgrading fixed assets. However, for subjective and objective reasons, fixed assets accounting in entities still makes certain errors. These errors exert impact on entities' internal management as well as control, inspection and auditing of state organs. This article discusses common errors in fixed assets accounting in entities and puts forward the correlative solutions.

**Keywords:** Fixed assets accounting, accounting entities, depreciation, amortization, useful life, assets block,

**Meaning of assets**

An asset is anything that will probably bring future economic benefit. In looking at assets, the focus will be on long lived tangible assets, sometimes referred to as fixed assets or property, plant, and equipment.

**Fixed assets**

Assets are classified into two categories: tangible and intangible. Tangible assets are assets that one can touch, hold, or feel. Typically called fixed assets in accounting literature, tangible assets are the physical things that a business uses in the production of goods and services. They constitute the production facilities, buildings, equipment, and vehicles. These operational assets of a business include furniture, computers, and similar items not used up within a year. Intangible assets are primarily financing items: stocks, bonds, mortgages, etc.

**Accounting of Fixed assets**

Fixed assets accounting is a systematic mathematical process of allocating the cost of an assets over the various accounting periods in which it is estimated that the assets will earn revenue. The valuation of fixed assets accounting in recent year is making a provision for charging the value of fixed assets during its useful life of assets because of replacement. A fixed assets is purchased for long term used in the business to earn profit in this processes it is consumed gradually and its loss, its value i.e. effectiveness. This decrease in its value should be, therefore debited to profit and loss account, before net profit is arrived at. Just it is to say that the consumption capital investment in fixed assets like the cost of material and labour must be recovered from the revenue earned every year with the help of such assets during the useful life time of individual fixed assets.

They include land and improvements, buildings, machinery, furniture, vehicles, and other equipment which the district intends to hold or continue to use over a long period of time. "Fixed" indicates the intent for long-term use, not the immobility of an asset. Fixed assets are reported on the financial statements as "capital assets."Fixed assets acquired with governmental funds are accounted for as capital expenditures and coded in the 700expenditure object series. Assets associated with governmental funds that are received through donation are considered fixed assets even though they are not recorded as capital expenditures. Fixed assets acquired with proprietary or fiduciary funds that are recorded as asset.

**Depreciation**

Depreciation is the loss in value or service life of fixed assets because of wear and tear through use, lapse of time, inadequacy or obsolescence. Accounting for depreciation means recording an asset's gradual loss in value as depreciation expense over the useful life of the asset's when purchased (capitalized).

**Methods of depreciation**

- **Straight Line Method:** In this method, depreciation is calculated by dividing the cost of the asset minus scrap value by the effective life of the asset. The amount of depreciation, remains fixed over the whole life of the asset. This method is simple and works well when an asset has a fixed life as in the case of lease etc. But, charge to profit and loss is not equal because of repairs. It is a known fact that repairs would increase when the asset becomes older. Moreover, the income tax authorities, in India, do not recognize this method. The greatest disadvantage with this method is non-availability of ready funds for replacement of asset as depreciation amount is invested in the business of the firm.
- **Diminishing Balance Method:** Under this method, depreciation is charged at a fixed rate on the opening balance of the asset, every year. As the opening balance of the asset decreases year after year, the depreciation amount also reduces in value, year after year. However, repairs would increase, with the age of the asset. Over a period, the total amount of depreciation and repairs would be more or less uniform. In consequence, this method gives an equal charge to the profit and loss account and is also recognized by the income tax authorities in India. But, in case of addition or sale, tedious calculations are involved. Moreover, it does not provide any fund for the replacement of the asset, similar to straight-line method. Diminishing Balance Method is also known as **'Written down Value Method'.**
- **Annuity Method:** This method charges depreciation on the assumption that fixed rate of interest is charged on the asset, treating the fixed asset as an investment. The first two methods — Straight Line Method and Diminishing Balance Method — ignore interest aspect. The annuity method takes into account the interest lost on the acquisition of an asset. The amount to be written off as depreciation is calculated from the annuity table. The depreciation will be different according to the rate of interest and according to the period over which the asset is to be written off. Charge (burden) on the profit and loss account in the form of depreciation and interest would be more in the annuity method compared to Straight Line Method as well as Diminishing Balance Method.
- **Depreciation Fund Method:** Funds are needed for replacement of the fixed asset. As and when the fixed asset is required to be replaced with a new asset, all the above three methods do not provide ready funds for replacing the asset. Non-availability of ready funds is the greatest handicap in respect of all the above methods. Depreciation Fund Method provides the advantage of ready funds for replacing the asset, as and when needed. Depreciation Fund Method is also known as **'Sinking Fund Method'.**

**Changing of depreciation**

- As per company act. 2013
  Schedule II to the Companies Act, 2013 requires depreciating the asset over its useful life unlike Schedule XIV of the Companies Act, 1956 which specifies minimum rates of depreciation to be

provided by a company. Normally, prescribed companies who have to follow the accounting standard prescribed under the new act should depreciate the asset over the useful life as prescribed under the act but there is no compulsion. They can use shorter life to depreciate the asset but the same should be disclosed along with the reason of using such shorter life period in "Notes to Account". Other companies can also depreciate the asset over shorter useful life, but note that useful life cannot exceed the life as prescribed under the act.

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 amortization.
3. Without prejudice to the foregoing provisions of paragraph 1,i. 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. 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, the provisions of the Accounting Standards mentioned under sub-para (i) or (ii), as applicable, shall apply.
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.

- **Notes**

1. "Factory buildings" does not include offices, godowns, and staff quarters.
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. The useful life 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—

i. Shall be depreciated over the remaining useful life of the asset as per this Schedule;
ii. 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.

8. ''Continuous process plant'' means a plant which is required and designed to operate for twenty-four hours a day.

**Analysis**

Firstly let us understand the concepts related to depreciation:

i. Useful Life: life over which asset can be used subject to maximum as specified in the act.
ii. Depreciable Amount: Cost of Asset – Residual Value
iii. Residual Value: Generally not more than 5% of original cost (Note 5 of Schedule II)
iv. Carrying Amount: Not defined in the act. AS-28 defines carrying amount as the amount at which an asset is recognized in the Balance Sheet after deducting any accumulated Depreciation (amortization) and accumulated impairment losses thereon".

- As per income tax act.

Depreciation is allowable as expense in Income Tax Act, 1961 on basis of block of assets on Written Down Value (WDV) method. Depreciation on Straight Line Method (SLM) is not allowed.

Block of assets means group of assets falling within a class of assets for which same rate of depreciation is prescribed.

| S No. | Asset Class | Asset Type | Rate of Depreciation |
|---|---|---|---|
| 1. | Building | Residential buildings except hotels and boarding houses | 5% |
| 2. | Building | Hotels and boarding houses | 10% |
| 3. | Building | Purely temporary erections such as wooden structures | 100% |
| 4. | Furniture | Furniture – Any furniture / fittings including electrical fittings and air conditioners | 10% |
| 5. | Plant & Machinery | Motor car, motor cycle, bike, scooter other than those used in a business of running them on hire, Mobile phone | 15% |
| 6. | Plant & Machinery | Motor buses/taxies/lorries used in a business of running them on hire | 30% |
| 7. | Plant & Machinery | Computers, Laptops, computer software, Printer, Scanner, UPS and other peripheral devices | 60% |
| 8. | Plant & Machinery | Books owned by assessee, carrying on profession being annual publications | 100% |

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| 9. | Plant & Machinery | Books owned by assessee, carrying on profession not being annual publications | 60% |
| 10. | Plant & Machinery | Books owned by assessee, carrying on business in running lending libraries | 100% |
| 11. | Intangible Assets | Know how, patents, copyright, trademark, license, franchise or any other business or commercial rights of similar nature | 25% |

**Conclusion:**

The theoretical framework describes that problem which arises here is that note 7 of Schedule II of the act says the asset is to be depreciated over its carrying amount but AS-28 doesn't give any reference of residual value. So, on which value the asset is to be depreciated WDV or WDV less residual value?

Many of the articles & notes we have gone through say carrying amount is WDV of the asset. Residual value is not to be considered again while calculating depreciation under the new act i.e. (SLM method)

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