

Depreciating Assets - Look at Multiple Shift, CPP and Component Accounting!

Posted Apr 08, 2021



Rajat Mohan

Senior Partner, AMRG & Associates



The most acknowledged and familiar term “Depreciation” is used all across the business which relates to Property, Plant, and Equipment that lose value on account of usage. Depreciation is a charge towards utilisation of buildings, plant & machinery, furniture & fixtures, etc. The concept of Depreciation is also applicable to intangible assets like a business or commercial rights, patents, trademarks, goodwill, etc. called amortization of assets.

Commencing ahead, to avail depreciation allowance the three conditions need to be fulfilled that (i) an asset must be owned and (ii) used for the business of the assessee also (iii) it is probable that future economic benefits associated with the item will flow to the enterprise

As per the [Companies Act, 2013 \(Schedule II\)](#) the useful life of the asset shall not be different from the useful life of that particular asset as specified in Part C. Also, the residual value of an asset shall not be more than five percent of the original cost of the asset. Provided that where a company uses a useful life different from what is specified in Part C or uses a residual value different from the limit specified above, there is a need to justify on this behalf duly supported by technical advice in the financial statements regarding the deviation.

Rolling towards the uncommon term Continuous Process Plant (CPP) and Multiple Shift Depreciation (MSD). Here, we will elucidate the deep down points of these terms lucidly.

A **Continuous process plant** means a plant that is required and designed to operate for twentyfour hours a day. The words “required and designed to operate twenty-four hours a day” are very significant and should be interpreted regarding the inherent technical nature of the plant, i.e., the technical design of a CPP is such that there is a demand to run it continuously for twenty-four hours a day. If it is not so run, there are significant shutdown and/or start-up costs which leads to some damage to the plant itself, significant energy loss, and spoilage of the materials-in process.

The plants whose technical design is not such that they have to be operated twenty-four hours a day though may work twenty-four hours a day, e.g., a textile weaving mill. In such cases, depreciation to be charged would be based on estimated useful life.

It is noted that Schedule XIV, inter alia, specified the general rates of 15.28% under the Written Down Value method (WDV) and 5.33% under Straight Line Method (SLM) of depreciation for CPP and Schedule II indicates useful life of 25 years for CPP. The mentioned rates of depreciation & useful life are for those assets for which special rates have not been prescribed in Schedule II. For certain of the cases where special rates prescribed are listed below.

Cinematograph Films-Machinery	13 Years
Plant and Machinery used in Telecommunications	18 Years
Refineries	25 Years

Now going forward to **Multiple Shift Depreciation**, the useful lives of assets working on a shift basis have been described in the Schedule based on their single shift working. Moreover, if an asset is used for any time during the year for a double shift depreciation will increase by 50% for that period and in the case of the triple shift, the depreciation shall be calculated based on 100% for that period.

Coming towards the exception of Multiple Shift Depreciation are Continuous Process Plants and the assets which have been marked as NESD. Those assets for which the useful life has been estimated on a single shift basis at the beginning of the year the concept of extra shift depreciation applies only to that assets.

Regarding the determination of the useful life of the assets for depreciation, meaning thereby “The useful life of an asset is an accounting estimate of the number of years it is likely to remain in service for cost-effective revenue generation.” It is normally based on various factors including experience with similar types of assets and it is a matter of estimation. The useful life of a depreciable asset should be determined based on some factors such as expected physical wear and tear, obsolescence, and legal or other limits on that particular asset.

Now we understand another concept of Depreciation I.e. **Component-Based Depreciation**. Under this method of depreciation, each major or material component of the Property, Plant and Equipment is depreciated separately because different components of a very large asset may have different useful lives and different salvage values. By applying a composite rate of depreciation to the whole asset might not fairly reflect the periodic allocation of the asset's cost to different periods. Hence, it is appropriate to break down the asset cost into different components as far as practical and treat each component as a sub-asset with its depreciation estimates.

There is a huge difference between Component depreciation and Unit depreciation. In unit depreciation (unlike Component depreciation), depreciation is calculated on a single rate for one particular tangible fixed asset.

It is also not similar to group depreciation (or composite depreciation). Under Group depreciation, depreciation is calculated on the weighted average rate for a particular class of similar Property, Plant, and Equipment.

The advantage of this method is that It is the most accurate. Further, treating each component as a separate asset of sub-asset allows accurate accounting if the component is replaced before the 'main' asset is emeritus. Opposing to above, the drawback is that significant calculations are needed both at the time of acquisition of an asset (in allocating the cost to different components) and at the end of each reporting period.

Conclusion:

Take the time to analyse the type of Property, Plant, and Equipment that your organization owns and how the assets are used in your organization. This will allow you to choose fixed asset depreciation methods that are appropriate for each asset and are capable of giving you accurate and cost-effective insights in the way of uniformly, consistently, and accurately, without relying on error-prone manual calculations. It will give your organization a new fixed asset depreciation entry to your accounting records and then calculate depreciation rates automatically, based on the depreciation method of your choice.

Disclaimer:

The information contained herein is intended solely for the use of the subscriber, user or other entity who is named in this document, and others authorised to generate/ receive/ use it. If you are using our Services on behalf of a business, that business accepts these terms. It will hold harmless and indemnify Taxsutra and its affiliates, officers, agents, and employees from any claim, suit or action arising from or related to the use of the Services or violation of these terms, including any liability or expense arising from claims, losses, damages, suits, judgments, litigation costs and attorneys-fees. If you are an unintended recipient of this document, please notify us immediately [by email](#) and then delete it from your system. Any action based on content in this document shall be at the sole risk, responsibility and liability of the individual or other entity taking such action. The contents of this document shall not, under any circumstance, be construed as any kind of professional advice or opinion and we expressly disclaim any and all liability for any harm, loss or damage, including without limitation, indirect, consequential, special, incidental or punitive damages resulting from or caused due to your reliance and actions/ inactions on the basis of this content. Contents of Disclaimer document [available here](#) is an integral part of this disclosure.