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PARADIGM SHIFT OF APPROACHES WITH REGARD TO TREATMENT OF CHANGE IN METHOD OF DEPRECIATION: A THEORITICAL FRAMEWORK

Kushal Dey
Research Scholar
Ph.D., Session: 2018-23
St Xavier's College (Autonomous), Kolkata
and
Part-time (Guest) Lecturer,
St Xavier's College (Autonomous), Kolkata;
Heramba Chandra College (South City College)
University of Calcutta

ABSTRACT

Depreciation is calculated in financial accounting by regulated criteria as determined by relevant Accounting Standards and Company Law. India's attempt to move towards global parity in financial reporting is being brought about with the implementation of Ind-AS and amendments to existing laws. Among many, one area where a transition in approach was observed post adoption of Ind-AS was the treatment of change in method of depreciation. This research paper is an attempt to address the same.

Key Words: Prospective effect, Retrospective effect, Accounting policy, Accounting estimate, Accounting Standard, IFRS.

INTRODUCTION

With Ind-AS becoming a reality, India has opened a new chapter in its accounting reforms initiative thereby taking a huge step forward towards achieving full convergence with the globally accepted IFRS (International Financial Reporting Standards) in the future. Not only have these IFRS converged standards filled up significant gaps that existed in the Indian GAAP (Generally Accepted Accounting Principles) but also paved a way to considerably enhance the transparency, quality and international comparability of financial reporting in Indian companies. However, the gradual phasing and conversion to Ind-AS has not proved to be a hassle-free job as Ind-AS' are significantly different from the prevailing Indian GAAP.

OBJECTIVES

- To show the shift in accounting for change in method of depreciation.
- To show the reason for change in shift of accounting for change in method of depreciation.
- To show the reform in Indian GAAP for depreciation as a step to converge with the globally accepted IFRS.

METHODOLOGY

The main objective of this paper is to show the shift in change in method of depreciation. So, a conceptual research has been done to show the shift in method of change in depreciation and for this a thorough study has been done on AS6, AS10, AS5, Ind-AS16.

REVIEW OF LITERATURE

Rode (2012) made a study on "IFRS vs Indian GAAP- some key differences". This study talks about the difference between IFRS and Indian GAAP and the effects of IFRS on Indian accounting standards.[1].

"A Study on Implementation and Benefits of International Financial Reporting Standards –IFRS in India**"** was undertaken by Suddapally and Tazeem (2018). This study focuses on the benefits to industries, investors in India in adopting IFRS.[2].

RESEARCH GAP

No particular study has shown how an adoption of IND-AS has an effect over the Indian GAAP, specially with respect to change in the method of depreciation and how this change has been brought in the AS.

CHANGE IN METHOD OF DEPRECIATION

Among the various areas which exhibited disparity, one area worth noting would be the approach towards the treatment of change in method of depreciation. As we know, a variety of depreciation methods can be used to allocate the depreciable amount of an asset over its useful life. Among others, these methods include the Straight Line Value Method, the Diminishing Value Method & the Units of Production Method. An enterprise selects the method of depreciation that most closely reflects the expected pattern of consumption of future economic benefits embodied in an asset. Although this selected method is expected to be applied consistently from period to period, situations may arise where the method needs to be changed to a different one. Such situations may be due to a change in the expected pattern of consumption of future economic benefits; which in turn would be reflected in a better manner in the financial statements with a new method of depreciation. Withal, such a change should be accounted for.

TREATMENT: IND AS vs. INDIAN GAAP

For the larger part of its accounting history, Indian enterprises had been following the method of retrospective re-calculation of depreciation for circumstances where a change in method of depreciation was involved. This was in line with the principles of AS-6 [*Depreciation Accounting*] which required retrospective re-computation of depreciation with the new method adopted from the date of the asset coming into use. The justification for treating this change with retrospective effect underlay in the concept that 'a change in method' was viewed as 'a change in accounting policy'. Accordingly, its effect was required to be quantified and disclosed in the financial statements by virtue of AS-1 [*Disclosure of Accounting Policies*] and AS- 5 [*Net Profit or Loss for the Period, Prior Period Items and changes in Accounting Policies*]

However, accounting for change in method of depreciation underwent a paradigm shift from the F.Y 2016-17 due to the adoption of Ind-AS and amendments made by the Ministry of Corporate

Affairs (MCA), vide notification no. *G.S.R. 364 (E)* dated *30-03-2016*. The notification was specifically applicable for all companies which were not included in the roadmap of Ind-AS from F.Y 2016-17. By virtue of this notification, AS-6 stood withdrawn & the existing AS-10 [*Property, Plant & Equipment*] had been replaced by a Revised AS-10 which incorporated accounting principles for both fixed assets & depreciation. Unlike the withdrawn AS-6, the Revised AS-10 treated 'a change in method of depreciation' as 'a change in accounting estimate'. Hence, complying with the requirements of AS-5 there would be no requirement for a retrospective recalculation but rather 'the change in method' being 'a change in estimate' would be treated with **a prospective effect**.

Moreover, Para 61 of Ind-AS 16 [*Property, Plant and Equipment*] states that a change in method of depreciation shall be accounted as a change in an accounting estimate in accordance with Ind-AS 8 [*Accounting Policies, Changes in Accounting Estimates and Errors*]. Hence, the revised AS 10 was substantially aligned with Ind-AS 16 which treated a change in method of depreciation on similar lines.

CONCEPTUAL EXPLANATION

The thing which is mainly to be seen why previously it was considered a policy and now a estimate is the reason that when previously the method of depreciation was taken into consideration as per Para 12, AS 6 it was based on some important factors like:-

- Type of the asset
- The nature of the use of such asset
- Circumstances prevailing in the business

So all these factors were dependent on the conditions that were prevailing from before, so it was regarded as policy

Para 62 of AS 10 states that the depreciation method should be such that it shows the future economic benefit of the asset which the company expects to consume .It also states that if there is change in expectation of the future economic benefit of the asset, then the method of deprecation should be changed.

So earlier what was a practise is now an estimate (a future estimate).

Para 21 of AS 5 states that an estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments. So the change in method of depreciation now comes as new information and hence is a change in accounting estimate.

It also states that sometimes, it is difficult to distinguish between a change in an accounting policy and a change in an accounting estimate. In such cases, the change is treated as a change in an accounting estimate, with appropriate disclosure.

This new approach is clearly in sync with the concept that the depreciation method is an estimation of the consumption of the utility in the asset. The definition of 'change in an accounting estimate' as per IAS 8 [*Accounting Policies, Changes in Accounting Estimates and Errors*] further validates this new approach of providing a prospective effect:

"A change in accounting estimate is <u>an adjustment of the carrying amount of an asset or liability</u>, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors"

We can rightly say that depreciation is an adjustment of the carrying amount of asset over its useful life and hence a change in method of depreciation would be a change in accounting estimate. Moreover, with regard to depreciation, a change in accounting policy would occur only if the entity changes its policy whether to depreciate the asset or not.

To conclude, this paradigm shift can be demonstrated with a numerical example:

Company A buys machinery on 1/04/2014 for Rs.60000. The company was using written down value method for depreciation. On 1/04/2017 the company changed its method of depreciation from WDV to Straight line method of depreciation and the amount of depreciation charged changed from 10 % p.a. to 15%p.a.

In the books of Company A

Machinery A/C

Dr. Cr.

Date	Particulars	Amount(in Rs.)	Date	Particulars	Amount(in Rs.)
1/04/2014	To Bank a/c	60000	31/3/2015	By depreciation a/c	6000
				By bal c/d	54000
		60000			60000
1/04/2015	To bal b/d	54000	31/3/2016	By depreciation a/c	5400
				By bal c/d	48600
		54000			54000
1/04/2016	To bal b/d	48600	31/3/2017	By depreciation a/c	4860
				By bal c/d	43740
		48600			48600
1/04/2017	To bal b/d	43740	31/3/2018	By depreciation a/c	9000
				By bal c/d	34740
		43740			43740

Depreciation A/C

Dr. Cr.

Date	Particulars	Amount(in Rs.)	Date	Particulars	Amount(in Rs.)
1/04/2014	To Machinery	6000	31/3/2015	By P/L a/c	6000
		6000			6000
1/04/2015	To Machinery	5400	31/3/2016	By P/L a/c	5400
		5400			5400

1/04/2016	To Machinery	4860	31/3/2017	By P/L a/c	4860
		4860			4860
1/04/2017	To Machinery	9000	31/3/2018	By P/L a/c	9000
		9000			9000

It is observed that if the company treated a change in method with retrospective effect which was earlier considered when change in method of depreciation was considered as a change in accounting policy, the company could have debited its P/L a/c for the year ended 31/3/2018 by Rs. 19740 (9000+10740), thus by changing simply the method of depreciation , the company could have changed its net income by a larger margin (here it could have decreased it) , but now as per AS 10 which considered a change in method of depreciation is a change in accounting estimate , therefore it has a prospective effect i.e. on the current period and the future period in which it is going to affect and the company can charge only Rs. 9000 to its P/L a/c.

Conclusion

The change in method of depreciation is a new change that has been accommodated to make the presentation of the financial statement more transparent and to give a true and fair view. It is one important step of convergence of Indian GAAP with IFRS.

References

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