

DEPRECIATION

Depreciation is a term used in accounting, economics and finance to spread the cost of an asset over the span of several years.

In simple words we can say that depreciation is the reduction in the value of an asset due to usage, passage of time, wear and tear, technological outdateding or obsolescence, depletion or other such factors.

In accounting, depreciation is a term used to describe any method of attributing the historical or purchase cost of an asset across its useful life, roughly corresponding to normal wear and tear. Depreciation in accounting is often mistakenly seen as a basis for recognizing impairment of an asset, but unexpected changes in value, where seen as significant enough to account for, are handled through write-downs or similar techniques which adjust the book value of the asset to reflect its current value. Therefore, it is important to recognize that depreciation when used as a technical accounting term is the allocation of the historical cost of an asset across time periods when the asset is employed to generate revenues. This process of cost allocation has little or no direct relationship to the market value or current selling price of the asset, it is simply the recognition that a portion of the asset's cost (the portion that will never be recuperated through re-sale or disposal of the asset) was "used up" in the generation of revenues for that time period.



The use of depreciation affects the financial statements. The recording of depreciation will cause an expense to be recognized, thereby lowering stated profits on the income statement, while the net value of the asset (the portion of the historical cost of the asset that remains to provide future value to the company) will decline on the Balance Sheet.

Depreciation and its related concept, amortization (generally, the depreciation of intangible assets), are non-cash expenses. Neither depreciation nor amortization will directly affect the cash flow of a company, as both are accounting representations of expenses attributable to a given period.

The Institute of Chartered Accountants of India has defined it as “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 depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortization of assets whose useful life is predetermined.”

