

DEPRECIATION

1. Depreciation: Meaning

- Decrease in the value/utility of an asset
- Due to
 - i. Wear & Tear
 - ii. Exhaustion of subject matter
 - iii. Effluxion of time
 - iv. Obsolescence

2. Objectives of Providing Depreciation

- a. Correct Measurement of Income
- b. Replacement of an asset

3. Depreciation is a **charge against profit and not appropriation**. It should be provided whether there is profit/loss for an enterprise

4. Accounting Treatment:

Alternative: 1

Profit & Loss a/c Dr. xxxx
 To Provision for Depreciation a/c xxxx

Alternative: 2

- 1. Depreciation a/c Dr. xxxx
 To Asset a/c xxxx
- 2. Profit & Loss a/c Dr. xxxx
 To Depreciation a/c xxxx

5. Methods of Providing Depreciation

a. STRAIGHT LINE METHOD

- Equal amount is written off during the working life of the asset
- At the end of the working/useful life, value/cost becomes zero
- Examples: Leases, patents, copyrights etc.

Formulae:

- i) Amount of Depreciation = [Cost of Asset – Scrap Value] / Useful life of the asset
- ii) Depreciation Rate = [Amount of Depreciation/Cost of Asset] x 100

b. REDUCING BALANCE METHOD

- Fixed percentage is written off every year
- Value at the end of the life will be charged to revenue
- Examples: Plant, Furniture etc.

Formulae:

Rate of Depreciation = $1 - \text{nth root of } [\text{Residual Value/Cost of Asset}] \times 100$

c. SUM OF YEARS OF DIGITS METHOD

- This is a variation of Reducing Balance method. This method is not yet in vogue in India

Formulae:

Depreciable Amount =

$$[\text{Cost of the Asset} - \text{Scrap Value}] \times \frac{\text{Number of years remaining} \text{ [Including current year]}}{\text{Total of all digits of life of the Asset}}$$

Note: For finding out total of all digits of life of the asset, $n(n+1)/2$ formula can be used.

d. ANNUITY METHOD:

Depreciation = Annuity value for 'n' years @ "r" rate of interest

e. MACHINE HOURS METHOD

Formulae:

- Depreciation rate/hour = $[\text{Cost of Asset} - \text{Scrap Value}] / \text{Total Estimated Hours}$
- Depreciation = Hours in the year $\times$ Rate/-hour

f. PRODUCTION UNITS METHOD:

Formulae:

- Depreciation rate/unit = $[\text{Cost of Asset} - \text{Scrap Value}] / \text{Total Estimated Production}$
- Depreciation = No of units produced in the year $\times$ Rate/-unit

g. DEPLETION METHOD:

- Example: Mines, Quarries etc

Formulae:

- a. Depreciation rate/unit = [Cost of Asset]/Total Estimated Quantity
- b. Depreciation = Quantity Extracted x Rate/-unit

h. SINKING FUND METHOD

6. Profit/Loss on sale/disposal of Depreciable assets

Transfer to Profit & Loss a/c

7. Change in the method of Depreciation

- It is a change in accounting policy
- Retrospective effect should be given
- Profit/Loss due to excess/short depreciation [as change is made] is transferred to Profit & Loss a/c in the year of change
- Change is made only if
 - a. Law requires
 - b. It is considered to be more appropriate to do while preparing & presenting financial statements

8. Revision in estimated useful life of depreciable assets

- Depreciable assets are such assets which are:
 - a. Used for more than one accounting period
 - b. Having a limited useful life
 - c. Which can be used in production/supply of goods/services
- If there is any revision in estimated life, the unamortized depreciable amount should be charged to asset over the revised remaining estimated useful life of the asset

9. Revaluation of Depreciable Assets:

- When depreciable asset is revalued, the depreciation should be charged on the revalued amount on basis of the remaining estimated useful life of the asset