DEPRECIATION

Depreciation is the decrease in the value of asset due to usage or passage of time.

Asset: As per Accounting standard 6 assets are those

- which are expected to be used for more than one accounting period
- have a limited useful life
- Held in the business for production or supply of goods or for rental to others or for administrative purpose and not for sale.

Technically speaking depreciation is non-cash expenditure.

For some asset the term depreciation is used for some asset the term amortization is used and for some other asset the term depletion is used.

Name and nature of asset	Term used
Intangible assets - Patent, Trademark, copyright, franchise, Licence right, deferred charge, Goodwill, etc.	Amortization
Tangible asset- Plant, Building, Machinery, Tools,	Depreciation
Wasting asset - Oil-well, mineral deposit, etc.,	Depletion
Land, Inventory, cash, investments, etc.,	No depreciation

Purpose of providing depreciation:

To ascertain the true cost of production

To ascertain the true profit or loss for the year

To present true and fair value of firms assets

To provide for replacement of assets

Factors determining depreciation:

Cost of the asset – all cost incurred upto the asset put to or ready to use or any other cost which improves the capacity of the asset. If addition is made it is also considered as cost of the asset

Useful life – estimated based on various factors but the useful life is shorter than the physical life of the asset.

Residual value–amount likely to be obtained by disposal of assets at the end of its useful life

METHOD OF DEPRECIATION

Various method are adopted by the firms depends on their requirements. Some of the methods are as under:

1] Straight line method:

Under this method, equal amount of depreciation is written off every year from the asset. It is otherwise called as fixed installment method, original cost method.

Depreciation = cost – residual value/ useful life

Rate of depreciation = Depreciation/ cost of asset x 100

2] Written down value method:

This method otherwise called diminishing balance method and accepted under Income tax Act. Under this method, the annual depreciation decreases from year to year so that the burden and benefits of later years are shared by the earlier years.

The value of asset never completely extinguished under this method. Here the rate of depreciation remains the same year after year but not the amount of depreciation.

Depreciation = 1-n Residual value/cost of asset

3] Sum of years digits method:

Depreciation = cost of the asset x remaining life of the assets/ Total digits of life of assets

4] Machine hour rate method:

Depreciation = cost of asset x no of machine hours during the year/ Total machine hours during life

5] Production units' method:

Depreciation = cost of asset x production of the current year/ Total estimated production during life

6] Depletion method:

Used for wasting assets

Depreciation= cost of asset x quantity of mineral or oil extracted during year/ Total estimated quantity from the mine/oilfield/quarry during lease

7] Annuity method

8] Sinking fund method

9] Sinking fund investment method

Accounting treatment

	When provision is not created	**When provision for depreciation is created**
For Depreciation	Depreciation A/c. To Fixed asset A/.c P and L A/c. To Depreciation A/c.	Profit and loss A/c. To Prov. For Depreciation A/c.
	Depreciation amount deducted from the cost of asset every year	Provision for depreciation accumulated and not deducted from the asset every year
Disposal of asset	Disposal value – cost of asset in the book either profit or loss	(Cost of asset in the book – accumulated depreciation) – disposed value = profit or loss

Change in the method of depreciation

According to consistency concept, you have to follow methods in a consistent manner but that does not mean there is no possibility of changes. When situation/Act requires changes in the method is accepted, the ultimate idea there should be any drastic changes in the method.

When changes requires for example, changing the method of depreciation from SLM to WDV, we have to recalculate the depreciation right from the first year and if there requires any further/ additional depreciation, it should be provided during the year by debiting the profit and loss account and if the depreciation already provided is more that can be credited to the profit and loss account during the year.

Increase/ decrease in the value of assets:

The company can revalue its assets whenever required and if there is any increase or decrease in the value of the assets, then the depreciation should be recomputed according to the revalued amount.

Increase/decrease in the life of the assets:

The depreciation should be recomputed according to the revalued life of the assets.

MULTIPLE CHOICE QUESTIONS

Q1] the permanent, continuing and gradual shrinkage in the book value of a fixed asset is called

A] depreciation B] appreciation C] reduction D] computation

Q2] Depreciation is charged on the

A] Market value B] Depreciable value

C] purchase value D] sale value

Q3] Depreciation is charged on

A] Continuous basis B] temporary basis

C] Daily basis D] monthly basis

Q4]Mines, quarries, oilfields and forest are example of

A]Fixed assets B] current assets

C]Wasting assets D] intangible assets

Q5] Depreciation applies to

A] Current assets B] wasting assets

C]Intangible assets D] fixed assets

Q6] Estimated sale value of the asset at the end of its economic life is known as

A]Purchase value B] market value

C] Written down value D] residual value

Q7] property, plant and machinery are conventionally shown in the balance sheet at

A] Replacement cost less accumulated depreciation

B] Market value less salvage value C] Market value less depreciation

D] Historical cost less total depreciation there of

Q8] the depreciation is charged on the assets in order to

A] Correlate the market value of an asset with its gradual decline in physical efficiency

B] Allocate the cost of an asset to the period in which services are received from the asset

C] Ensure that cash is available at the time of replacement of the asset

D] To show the asset at a decreased value in the balance sheet

Q9] which of the following method of depreciation is prescribed by the Income tax Act and are commonly used

A] Straight line method and reducing balance method

B] Depletion method and reducing balance method

C] Straight line method and annuity method

D] Production hour method and sum of years digits method

Q10] In case the depreciable assets are revalued, the provision for depreciation is based on

A] The revalued amount over the estimate of the remaining useful life of such assets

B] Market value of the assets

C] Depreciated value of the assets D] Historical cost of assets

Q11] which of the following expenses can be captialised as part of fixed assets?

1] Initial handling and delivery costs B] Installation costs

C] Site preparation cost D] Professional fees incurred

A] 2 and 3 B] 1 and 2 C] 3 and 4 d] all the above

Q12] In case the going concern assumption does not hold good for a concern, then during the preparation of financial statements, the assets must be shown in the books at

A] Historical cost B] Net realizable value

C] Cost less depreciation D] Lower of cost price or market value

Q13] For Depreciation, which accounting standard is applicable?

A] AS 1 B] AS 2 C] AS 6 D] AS 12

Q14] Plant assets are depreciated over their useful lives. Which basis of principle of accounting does this procedure reflect?

A] Historical cost B] Matching expenses with revenue

C] Consistency D] objectivity

Q15] the depreciation account is closed at the end of the year by transfer to the

A] Fixed assets account B] General Reserve Account

C] Profit and loss account D] Capital account

Q16] Appreciation in the market value of a fixed asset will be recorded in the books of account only at the time of

A] Sale of asset B] Preparing the balance sheet at the end

C] Damage of asset D] none of the above

Q17] Purchase of plant Rs.380000/-, expenses incurred for transport, installation, trial run etc.,Rs.30000/-, useful life 10 years, estimated scrap value on realization Rs.20000/-. What is the original cost of the plant?

A] Rs.390000/- B] Rs.430000/- C] Rs.380000/- D] Rs.410000/-

Q18] Rohit sold his car for Rs.150000/- incurring a loss of Rs.400000/- what is the net book value of the car sold?

A] 550000/- B] 400000/- C] 150000/- D] 250000/-

Q19] If the equipment account has a balance of Rs.25500/- and the accumulated depreciation account has a balance of Rs.14500/-, the book value of the equipment is

A] Rs.25500/- B] Rs.14500/- C] Rs.50000/- D]Rs.11000/-

Q20] the method in which the total depreciation is equally spread over the life of the asset is called?

A] Straight line method B] Reducing balance method

C]Sum of years digits method D] Sinking fund method

Q21] Wadia Garments purchased a machine for Rs.500000/- and spent Rs.50000/- on its erection. On the date of purchase it was estimated that effective life of the machine will be ten years and after ten years its scrap value will be Rs.50000/-. The amount of depreciation on Straight line method for each year will be

A] Rs.55000/- B] Rs.50000/- C] Rs.60000/- D] none

Q22] an asset is purchased for Rs.25000/- depreciation is to be provided annually according to straight line method. Useful life of the asset is 10 years and the residual value is Rs.5000/-. Rate of depreciation will be

A] 10% B] 12% C] 8% D] 15%

Q23] an asset was purchased for Rs.200000/- on which depreciation was provided @ 15% on straight line method, the written down value of the asset at the end of the second year is

A] Rs.170000/- B] Rs.30000/- C] Rs.144500/- D] Rs.140000/-

Q24] if the machinery costing Rs.18000/- is sold after 2 years for Rs.16000/- and the depreciation rate is 10% per annum on straight line method, then the profit or loss from the sale of machine is

A] Rs.1600/ profit B] Rs.1600 loss

C] Rs.3600/- profit D] Rs.3600 loss

Q25] the portion of the acquisition cost of the asset, yet to be allocated is known as

A] Written down value B] Accumulated value

C] Realisable value d] Salvage value

Q26] Arun limited purchased a machine on 01/01/10 for Rs.120000/-. Installation expenses were Rs.10000/-. On 01/07/2013, expenses for repairs were incurred to the extent of Rs.2000/-. Depreciation is provided @ 10% p.a. under WDV method. Depreciation for the 4th year

A] Rs.25000/- B] Rs.13000/- C] Rs.10530/- D] Rs.9477/-

Q27] H Limited purchased a machinery on 01/04/2000 for Rs.325000/-. It is estimated that the machinery will have a useful life of 5 years after which it will have a salvage value of Rs.25000/-. If the company follows sum of the years digits method of depreciation, the amount of depreciation charged during the year 2004-05

A] Rs.100000/- B] Rs.80000/- C] Rs.60000/- D] Rs.20000/-

Q 28] Depreciable amount of the machinery is Rs.11 lakh. The machine is expected to produce 30 lakh units in its 10 year life and expected distribution of production units is as follows:- 1-3 year 5 lakh units each year

4-6 3 lakh unit each year 7-10 year 1.5 lakh units each year

Annual depreciation for 1-3 year, using production units' method will be

A] Rs.110000/- B] Rs.55000/- C] Rs.65000/- D] Rs.183333/-

Q29]A machine purchased on 1st April 2004 for Rs.10000/- is showing a balance of Rs.6000/- as on 01st April 2006 when depreciation is charged on SLM method. Now the company wants to switch over to WDV method charging depreciation @ 20%. The amount of excess/short depreciation of last two years will be

A] Excess depreciation of Rs. 400/- B] short depreciation of Rs. 400/-

C] Excess depreciation of Rs.1600/- D] short depreciation of Rs.1600/-

Q30] A machine costing Rs.770000/- purchased on 01/01/2000 is having a useful life of 7 years with Rs.70000/- as residual value is depreciated at SLM method. After the end of third year, the machine was revalued and its value is increased to Rs. 970000/-. Now determine the amount of depreciation for the fourth year.

A] Rs.70000/- B] Rs.225000/- C] Rs.138571/- D]Rs.128571/-

On 31st December every year, depreciation is charged at 10% p.a. on cost price. The machinery account is as under:

Machinery Account

Date	Particulars	Amount	Date	Particulars	Amount
01/01/05	To B b/d [M1]	15000	01/10/05	By Depre. A/c.	1500
01/01/05	To Bank A/c.[M2]	45000	01/10/05	By Bank A/c.[M1]	12250
01/04/05	To Bank A/c.[M3]	16000	01/10/05	By P & L A/c. [M1]	?
			31/12/05	By Depre. A/c.	?
			31/12/05	By B c/d.	?
		76000			**76000**

Q31] On sale of Machine 1 on 01/10/2005, the entry against profit and loss account will be

A] Loss of Rs.1250/- B] Profit of Rs.13500/-

C] Profit of Rs.1250/- D] Profit of Rs. 2750/-

Q32] The amount of depreciation provided on 31/12/2005 is

A] Rs.7600/- B] Rs.5700/- C] Rs.6100/- D] Rs.7500/-

Q33] The balance c/d on 31/12/2005 is

A] Rs.55300/- B] Rs.55500/- C] Rs.54750/- D] Rs.56750/-

Q34] A machine costing Rs.770000/- purchased on 01/01/2000 is having a useful life of 7 years with Rs.70000/- as residual value is depreciated at SLM method. After the end of third year, the machine was revalued and its life is increased to 10 years. Now determine the amount of depreciation for the fourth year.

A] Rs.100000/- B] Rs.70000/- C] Rs.138571/- D] Rs.128571/-

1] A	2] B	3] A	4] C	5] D	6] D	7] D	8] B	9] A	10] A
11] D	12] B	13] C	14] B	15] C	16] A	17] D	18] A	19] C	20] A
21] B	22] C	23] D	24] A	25] A	26] D	27] D	28] D	29] A	30] B
31] A	32] B	33] A	34] A						