Expenses

Revenue expenses.

No Physical assets came in existance

We will get services against this expenses

Revenue exp.

Benefit of such service received in same year of expenses

eg:- Rent, Insurance, electricity, salary, telephone charges etc

Charged against Revenue of the respective year

Deferred Revenue expenditure

Benefit of such expenses is received in > 1 year

eg:- u/w commission, Heavy advertisement expenses during Product / Business launch, Floatation Cost on issue of Shares & Debentures

we will deferred and amortised / carry Forward to balance sheet & charge to P&L in Installment.

Capital expenditure

Against this expenses some assets came in existence. Benefit > 1 Financial year

eg: - Building, Machine, Car software, Furniture, Patent

Life

Limited:

T Building

T Machine,

T Furniture

T Vehicle

intang Goodwill

Unlimited:

- Land
- trademark

Non-depreciable assets

Tangible Assets

Intengible Assets

Depreciable assets

Amortisation

Depreciation / Amortisation will be charged on such assets during its useful economic life.

AS: 10 Property plant and equipment

definition

1. Assets of Business
2. Primarily held to be used in Business: in the process of Production, administration, selling & Distribution or using For Rendering of services
3. Useful economic life is > 1 year.

Cost of car : 27 Lakhs

Realisable value : 12 Lakhs

value depreciated :- 15 Lakhs

Wrong

Car a/c

Year				
1	to Bank	27	by bal c/d	27
2	to Bal b/d	27	by bal c/d	27
3	to Bal b/d	27	by bal c/d	27
4	to Bal b/d	27	By Bank	15
			By P&L	12

charged to P&L of 4th year

Matching Concept Break

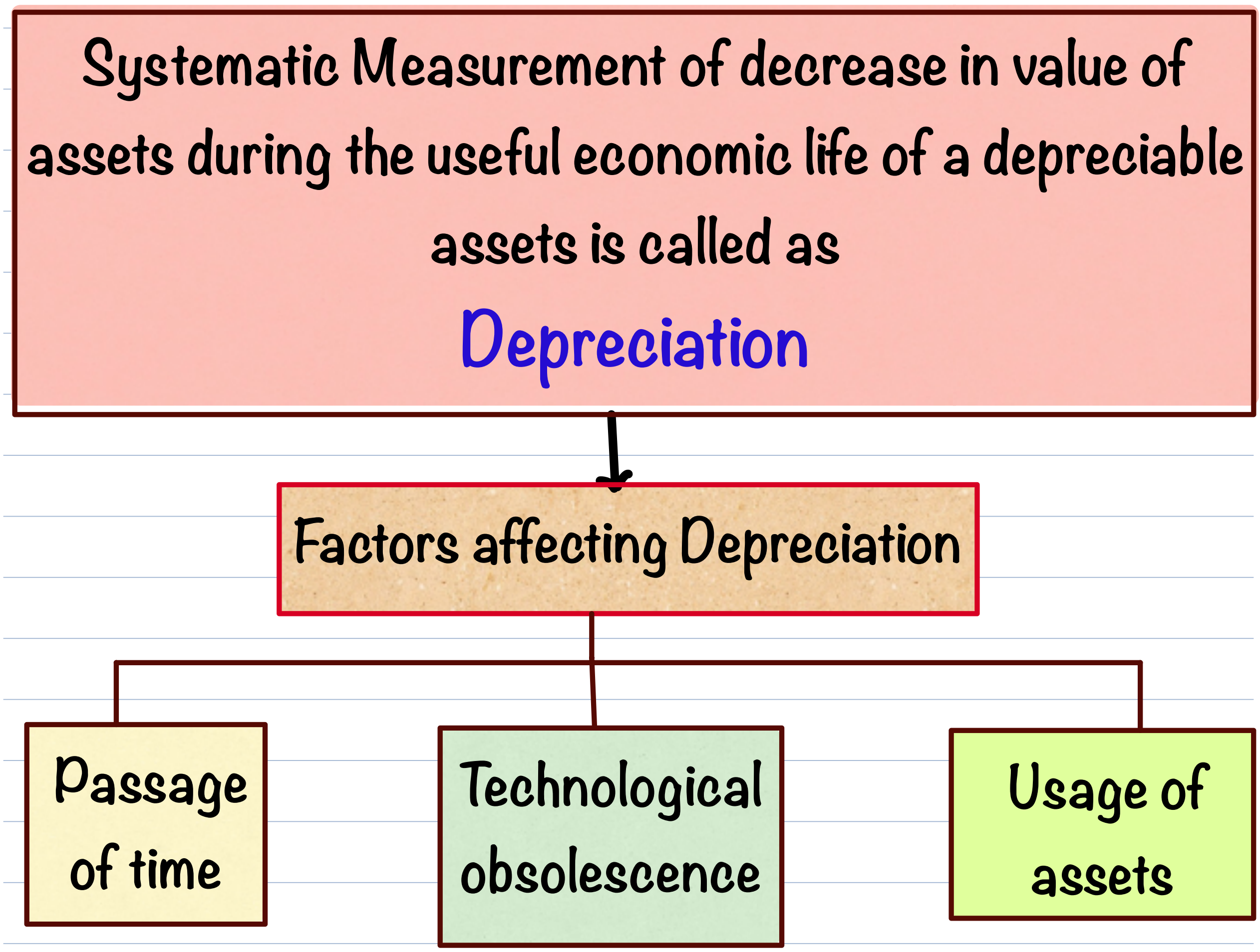
Since we took benefit of assets during its useful life so distribution of cost must be also divided in useful economic life

ie. in 4 years on some logical basis

Depreciable Cost of assets is required to be depreciated in useful economic life.

So we will charge depreci. on depreciable Assets during its useful economic Life.

WHAT



CAUSES OF DEPRECIATION

The main causes of depreciation include the following:

1. **Physical wear and tear** — When the fixed assets are put to use, the value of such assets may decrease. Such decrease in the value of assets is said to be due to physical wear and tear.
2. **With the passage of time** — When the assets are exposed to the forces of nature like weather, winds, rains, etc. the value of such assets may decrease even if they are not put to any use.
3. **Changes in economic environment** — The value of an asset may decrease due to decrease in the demand of the asset. The demand of the asset may decrease due to technological changes, changes in the habits of consumers etc.
4. **Expiration of legal rights** — When the use of an asset (e g., Patents, Leases) is governed by the time bound arrangement, the value of such assets may decrease with the passage of time.

NEED FOR CHARGING DEPRECIATION

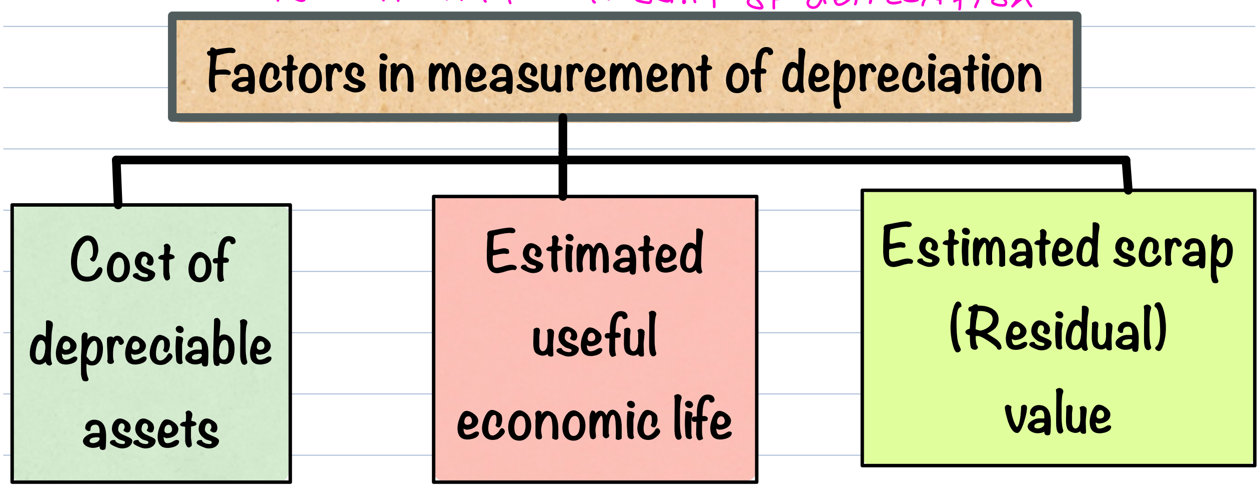
The need for charging depreciation in accounting records arises due to any one or more of the following objectives to be achieved:

P&C

1. **To ascertain True Financial Performance** — For proper matching of costs with revenues, it is necessary to charge the depreciation (cost) against income (revenue) in each accounting period. Unless the depreciation is charged against income, the financial performance would be overstated. As a result the Income Statement would not present a true and fair view of the financial performance of an accounting entity.
2. **To present True and Fair view of the Financial Position** — For presenting, a true and fair view of the financial position, it is necessary to charge the depreciation. If the depreciation is not charged, the unexpired cost of the asset concerned would be overstated. As a result, the Position Statement (i.e., the Balance Sheet) would not present a true and fair view of the financial position of an accounting entity.
3. **To ascertain the True Cost of Production** — For ascertaining the cost of production, it is necessary to charge depreciation as an item of cost of production. If the depreciation on fixed assets is not charged, the cost records, would not present a true and fair view of the cost of production.
4. **To comply with Legal Requirements** — In case of companies, it is compulsory to charge depreciation on fixed assets before it declares dividend [Sec. 205(1) of The Companies Act, 2013],
5. **To accumulate Funds for Replacement of Assets** — A portion of profits is set aside in the form of depreciation and accumulated each year to provide a definite amount at a certain future date for the specific purpose of replacement of the asset at the end of its useful life.

Further depreciation is a non-cash expense and unlike other normal expenditure (e.g. wages, rent, etc.) does not result in any cash outflow. Further depreciation by itself does not create funds it merely draws attention to the fact that out of gross revenue receipts, a certain amount should be retained for replacement of assets used for carrying on operation which is achieved by charging depreciation that reduces the distributable profits.

To calculate amount of depreciation



Cost of Depreciable Assets:- (AS-10 PPE)

Cost of an Item of PPE

- Includes
  - Purchase Price
    - Invoice Price
    - -) trade discount or Rebate
    - + Non refundable taxes.
    - - Govt. Grants / subsid.
    - xxx
  - Any Directly Attributable Costs
    - *
  - Decommissioning, Restoration and similar Liabilities
    - #
- Excludes
  - Costs of opening a new facility or business (Such as, Inauguration costs)
  - Costs of introducing a new product or service (including costs of advertising and promotional activities)
  - Costs of conducting business in a new location or with a new class of customer (including costs of staff training)
  - Administration and other general overhead costs

Money outlay or it's equivalent for acquiring assets:		XX
(Invoice value of assets acquired)		
Less:	trade discount/ rebates	(XX)
Add:	Non refundable taxes on purchases	XX
Add:	Directly attributable costs	XX
	i.) Expenses to bring the assets eg. freight, transit insurance, toll tax, loading & unloading exp. etc	
	ii.) Installation of PPE site preparation, material used, wages paid, architect fee	
	iii.) cost of testing, whether the assets is functioning properly, after deducting the net proceeds from selling any item produced while bringing the assets to that location and condition such as sample production while testing equipment.	
	iv) professional fee - direct as well as apportioned.	
Add:	Decommissioning, restoration and similar liabilities	XX
		xxx

Thus all the expenses which are necessary for asset to bring it in condition and location of desired used will become part of cost of the asset. However, following expenses should not become part of cost of asset:

(a) costs of opening new facility or business, such as inauguration costs;

(b) cost of introducing new product or service (for example cost of advertisement or promotional activities).

(c) cost of conducting business in a new location or with a new class of customer (including cost of staff training); and

(d) administration and other general overhead costs.

Once an asset has been brought to its intended condition and location of use, no cost should recognized as part of cost of the asset unless there is major repair or addition which increases the useful life of the asset or improves the production capacity of the asset. Accordingly, cost incurred while and item is capable of operating in intended manner but it is not yet put to use or is used at less than full capacity should not be capitalized as part of cost of the asset. Similarly, cost of relocation of an asset should not be capitalized.

Any additions made to a particular item of property, plant and equipment after it is initially put to use are depreciated over the remaining useful life of the asset. Any addition or extension which has a separate identity and is capable of being used after the existing asset is disposed of, is accounted for separately. Therefore, it is important to maintain an asset register capturing asset wise details of cost, rate of depreciation, date of capitalization etc. All these details need to be captured for any additions to existing assets as well. In the absence of the adequate information, it will be very difficult to compute depreciation expense year on year. Also, at the time of disposal or discard of a particular asset, it will not be possible to compute gain or loss on such disposal/discard.

Useful life of depreciable assets:

'Useful Life' is either (i) the period over which a depreciable asset is expected to be used by the enterprise or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise. Determination of the useful life is a matter of estimation and is normally based on various factors including experience with similar type of assets. Several other factors like estimated working hours, production capacity, repairs and renewals, etc. are also taken into consideration on demanding situation.

Now useful life is not only based on time, rather it will be based on usage , Hours or output, depends on how life of an asset will be measured.

Residual value or scrap value of depreciable assets:

Determination of the residual value is normally a difficult matter. If such value is considered as insignificant, it is normally regarded as nil. On the other hand, if the residual value is likely to be significant, it is estimated at the time of acquisition/ installation, or at the time of subsequent revaluation of asset.

Cost of assets is historical (actual) whereas useful life and residual value is estimated one.

All the components can change during its useful life, as per AS-10 PPE, all the enterprises are required to review all the above factors at each year end.

METHODS OF RECORDING DEPRECIATION

There are two methods of recording Depreciation as follows:

1. By Charging to Asset Account. & maintain FA as WDV.
2. By Creating Provision for Depreciation/Accumulated Depreciation Account. & assets a/c is to be maintained at cost.

   Let us discuss these methods one by one.

RECORDING OF DEPRECIATION BY CHARGING TO ASSET ACCOUNT METHOD

1. Under this method of recording depreciation, depreciation is directly credited to the 'Respective Asset Account'.
2. Respective Asset Account appears at its Book Value (i.e., Original Cost less depreciation till date).
3. The various journal entries which are passed under this method are summarised as follows:

C : 10 ERV: 2 UEL : 5 Dep. P/A 1.6

Recording of depreciation by charging depreciation in provision for depreciation account:

we will not credit fixed assets a/c with the amount of depreciation, rather we credit the same in Provision for Depreciation a/c or accumulated depreciation a/c

entry :-	Depreciation a/c	dr.	X	
	To Prov. For dep. a/c	Cr		X
	or			
	To accumulate depreciation a/c.	Cr.		X

when the assets is sold / disposed off, we will Close fixed assets account & transfer the historical cost to Disposal of FA a/c, Accumulate depreciation charged on respective fixed assets will be transferred From Provision For depreciation a/c & transferred to Disposal of FA a/c.

Loss on sales of FA a/c Dr 0.60 L
to FA Cr 0.60 L

Entry:-	Provision For dep. a/c	Dr.	xx	
	to Disposal of FA a/c.	Cr.		xx

Credit Disposal of FA a/c with the amount realised From sales of assets or by Realising Residual Value / scrap. value:

to FA

entry:-

Cash / Bank a/c	Dr.	X	
To Disposal of FA a/c	Cr.		X

Now balance disposal of fixed assets accounts and recognise profit or loss on disposal of fixed assets.

i.) If there is a loss (dr > cr)	ii.) If there is a profit (cr > dr)
loss on sale of FA a/c dr X	Disposal of fixed assets a/c dr X
To Disposal of fixed assets a/c	To profit on sale of FA a/c. Cr X

Disposal of fixed assets account

To fixed assets a/c (Historical cost)	X	By Accumulate dep. a/c	X
		By cash a/c	X
To profit on sales of FA a/c	X		
		By loss on sales of fixed assets a/c	X

Cost of FA : 100 lakhs
Depr. p/a : 20 lakhs
Econ. useful life : 5 years
Assets sold at begining of 4th year : ??

Fixed Assets (Hist. Cost)

1st to Bank	100	by Bal c/d	100
To Bal b/d	100	By Bal c/d	100
3rd to Bal b/d	100	by Bal c/d	100
to Bal b/d	100	by Assets disposal	100

Depreciation a/c (Nominal)

1st

Prov. For Dep. a/c

to Bal c/d	20	by deprec.	20
to bal c/d	40	By Bal b/d	20
		by Deprec	20
to Bal c/d	60	by bal b/d	40
		by Depr. a/c	20
to Assets Disposal	60	by Bal b/d	60

	Note				
P.P.E	?				

To Prov. For depr.	20	by P&L a/c	20
2nd to Prov. For dep	20	by P&L a/c	20
to Prov. For dep.	20	by P&L a/c	20

Note:- x

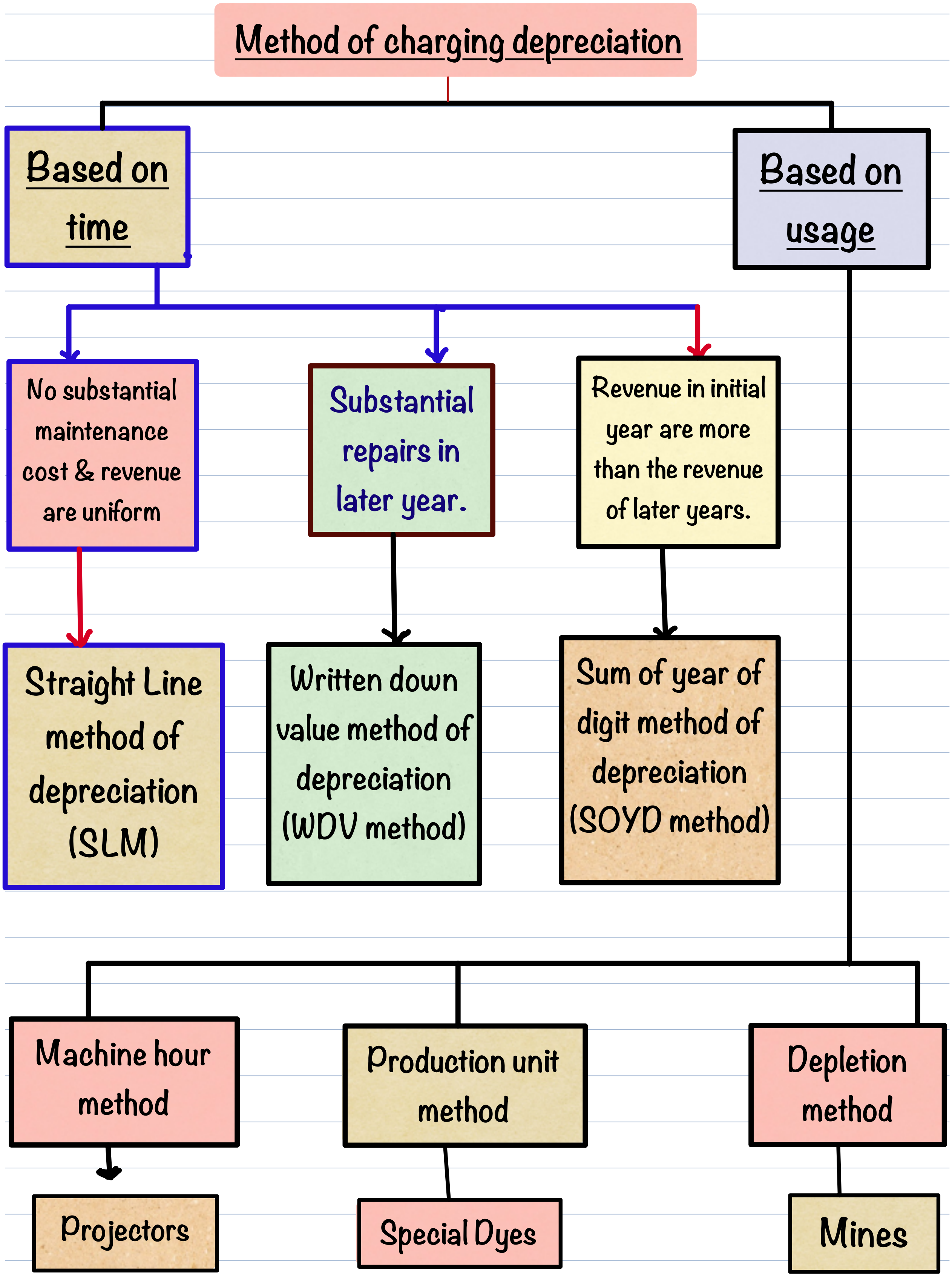
PPE:	I	II	III	IV
Clo. Histor. Cost	100	100	100	75
(-) Clo. accum. Dep.	20	40	60	60
Clo. WDV	80	60	40	15

Assets Disposal a/c

to FA a/c	100	by Prov. For Depr. a/c	60
		By Bank	22
		By Loss on sale of FA	18
	100		100

B/S	I	II	III
Fixed assets.	80	60	40

Hist. cost	100	100	100
(-) Accum. deprec.	20	40	60


Method of charging depreciation
Based on time
Based on usage
No substantial maintenance cost & revenue are uniform
Substantial repairs in later year.
Revenue in initial year are more than the revenue of later years.
Straight Line method of depreciation (SLM)
Written down value method of depreciation (WDV method)
Sum of year of digit method of depreciation (SOYD method)
Machine hour method
Production unit method
Depletion method
Projectors
Special Dyes
Mines

7. REVALUATION OF PROPERTY, PLANT AND EQUIPMENT

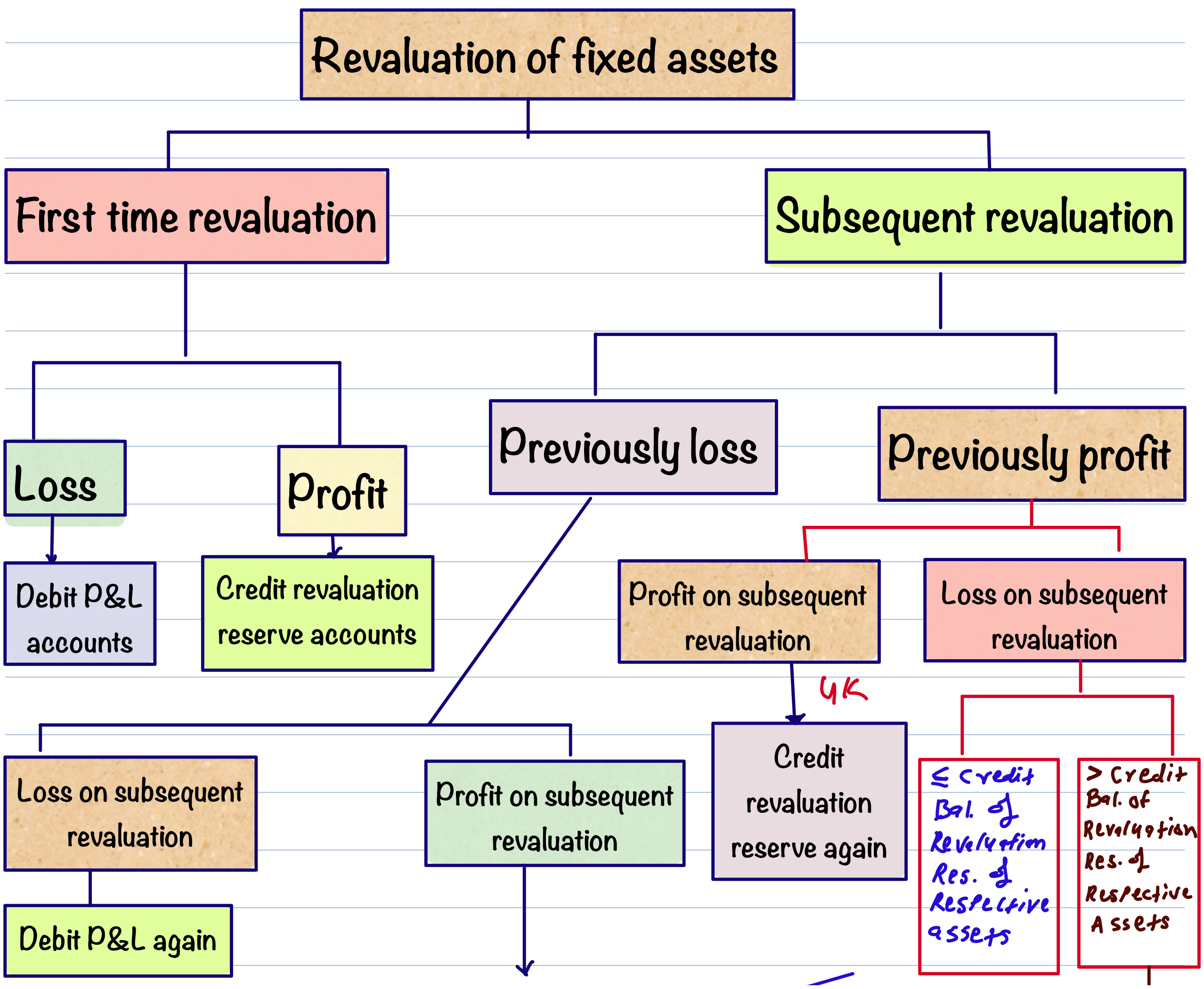
After recognizing an asset initially, the asset whose fair value could be reliably measured should be carried at the revalued amount, being the fair value at revaluation date and reduced by successively accumulated depreciation and successive accumulated impairment losses (permanent decline in value) (if any).

(a) Revaluations must be made at adequate intervals (say yearly) for ensuring that carrying amount doesn't differ substantially from that which would be determined if fair value at end of the reporting period is used

(b) In case an item of PPE is revalued, whole class of such PPE to which such asset belongs should be revalued

(c) In case the carrying amount of an asset increases due to revaluation, such increase should be credited to Revaluation Reserve / Surplus (In other comprehensive income) and should be accumulated in equity. However, such increase should be recognized in P/L statement to the extent of reversal of a previous decrease of that asset that was recognized in the P/L account.

(d) In case the carrying amount of an asset is decreased due to revaluation, such decrease should be recognized in the P/L account. However, such decrease should be debited to the Revaluation Reserve to the extent of reversal of a previous increase that was recognized in Revaluation Reserve for that asset.



8000 ↑

Profit is ≤ previously recognised loss.

Credit p&l account to the extent of revaluation losses recognised to p&l account earlier .

Fixed assets	Dr	x
To P&L account	Cr	x

12000

Profit on subsequent revaluation is > previously recognised revaluation loss.

Credit p&l account equal to previously recognised loss & then credit revaluation reserve accounts for surplus revaluation profit.

adj. from Revaluat. Reserve

Revalu. Reserve dr
to FA cr

First adj. avail. bal. of Revalu. Reserve & Debit Bal. Loss in P&L a/c

Revaluation Res.	dr	3
P&L	dr	3
to FA	cr	6

Revaluation of PPE

First time Revaluation

WDV > Fair Value
20L > 18L

Revalu. LOSS : 2 Lakh

Charge to P&L a/c

P&L a/c	dr	2L
to P.P.E. a/c		2L

Naya Depr.
ab is Nayi Value Par Calculate Hoga.

WDV < Fair value
18L < 20L

Revalu. Profit : 2L

increase the value of PPE.
But Profit is unrealised So we cannot Distribute Such Profit.
So we can't trans. such Profit to P&L a/c,
Revaluation Profit will be transf. to "Revaluation Reserve"

PPE a/c	dr	2L
to Revalu. Reserve a/c		2L

Subsequent revaluation of same assets

treatment of Subseq. revalu. Depends on Previous revalu.

Loss

Subsequent

Loss → "Same treatment"

Profit

≤ Previous Loss (Recovery Mono) → Credit P&L a/c

> Previous Loss → Previ. Loss ke equal amount ko P&L main credit karo aur uske upar jo Profit hua hai usko Revaluation Reserve main credit karo

"Profit"

Again Profit → Same treatm.
Cr. Revaluat. Reserve

this time Loss → amt. of Loss

≤ bal. of Revalu. Reserve. For the assets. → adjust entire Loss Against Revalu. Reserve

> bal. of Revalu. Reserve. For the assets. → Ist use bal. of Revalu. reserve & then Debit P&L a/c For remaining Loss:-

Revalu. Reserve a/c	dr	
P&L a/c	dr	
to P.P.E. a/c		

10
1
9
1
8
9

1 gain
(Cr. Revalu. Res)

1/4/2020 = 10 L
20-21 1 L
9 L
21-22 1 L
WDV 31/3/22 8 L
Fair value 6 L
Revalu. loss = 2 L
P&L

1/4/22 : 6 L
22-23 80k
5.20 L
23-24 0.80 L
31/3/24 4.40 WDV

9 L
1.25 L → 1 L, 25k
7.75
1.25
6.50

Fair value 3.50
4.40 − 3.50
= 0.90 L
P&L

Fair value 5.00
5.00 − 4.40
= 60k (P&L)
(≤ Previous Loss)
is Profit ko P&L main Credit
(Recovery of Loss mano)

Fair value 7 Lakh
FV − WDV
7 − 4.40
= 2.60
(> Previous Loss)
Recovery of Previous Loss 2.00 L P&L Cr
60k ye gain hai. (Cr − Reval. Res.)

6.50 WDV

again gain
Fair: 7.50
Firse 1L = Cr. Revalu. Reserve

Loss
≤ 60k
adjust Full amt. of loss from R.Res

> 60k Loss
Loss upto 60k adj. from Revalu. Res.
& Bal Rev. Loss tran. to P&L (Dr)

is assets par aaj R.Res. main = 60k ka bal pada hai