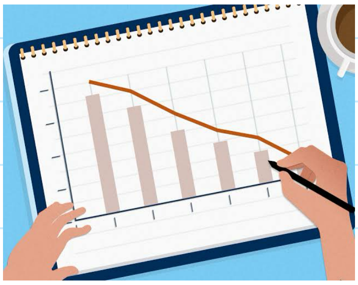
7 CHAPTER — DEPRECIATION

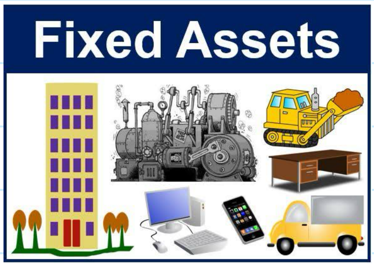
Question 1 :- What is Depriciation ?



It is the systematic distribution of depriciable amount of asset over its useful life.

we can say reduction in value of asset due to wear and tear (use), passage of time or obsolence

Question 2 :- What is a Fixed Asset ?



Asset which is used for :-

* production of goods or
* supply of services

① AMOUNT OF FIXED ASSETS

PURCHASE PRICE OF ASSET
(−) Trade Discount
Net purchase price
(+) Any tax whose refund not avail
(+) Freight / Carriage / Transport exp
(+) Installation expenses
(+) Commission expenses
(+) Loading or unloading expenses
(+) Trial Run expenses
(−) Income from Trial Run

(2) SCRAP VALUE

Estimated value we expect to realise at the end of useful life of asset.

(3) USEFUL LIFE OF ASSET

- In years
  like any building, furniture
- In Hours
  some machines like projector
- In units

(4) METHODS OF DEPRECIATION

- STRAIGHT LINE METHOD (SLM)
- REDUCING BALANCE METHOD (WDV)
- PRODUCTION UNIT METHOD
- MACHINE HOUR METHOD
- SUM OF DIGITS METHOD

(5) STRAIGHT LINE METHOD

$$\text{DEPRICIATION AMOUNT} :- \frac{\text{Cost of asset} - \text{scrap value}}{\text{Useful life of asset}}$$

This method says that charge equal dep. in each year of use of the asset or (depriciate equally)

DEPRECIATION RATE :- $\dfrac{\text{Depriciation per year}}{\text{cost of asset}} \times \dfrac{12 \text{ months}}{\text{months dep charged}}$

Important Question :-

(i) WHEN TO START CHARGING DEPRICIATION :- FROM DATE OF PURCHASE ✗
FROM DATE OF PUT TO USE ✓

(ii) WHEN TO STOP CHARGING DEPRECIATION :- When ASSET IS SOLD
When ASSET DOESN'T EXIST

(iii) Depriciation is always charged for the full year

(iv) But can it be charged for less than one year ?

Yess !! • In the year of purchase • In the year of sale

So if any asset is used for less than 12 months, then charge depriciation for less than 12 months.

6 CALCULATION OF PROFIT OR LOSS ON SALE OF ASSET

Profit or loss on sale of Asset :- Sale value of asset
(−) Book value of asset on date of sale

If sale value of asset > Book value — profit on sale of asset

If sale value of asset < BV — Loss on sale of asset

How to find out to use SLM

Question says

* use SLM method   * 10% dep on cost

7 PLANT & MACHINE A/C

Whenever you purchase plant & machine :-

Plant & m/c a/c — Dr
  To cash / Bank

When you incurr any expenses :-

Carriage exp — Dr
Freight — Dr
Tax — Dr
Comm — Dr
  To Cash / Bank

Plant & m/c —— Dr
  To carriage
  To freight
  To Tax
  To commission

When we charge depriciation :-

Depriciation — Dr
  To Plant & m/c a/c

Profit & loss a/c — Dr
  To Depriciation

Asset sold on profit :-

Bank a/c — Dr
  To plant & m/c a/c
  To profit on sale

Asset Sold on Loss :- Bank a/c — Dr
Loss on sale — Dr
To Plant & m/c

WHEN THERE IS PROVISION OF DEPRICIATION

Here we don't touch the asset account at all untill we purchase the asset or sell the asset

Buy Asset :- Plant & m/c a/c — Dr
To Bank/cash

Depriciation charged :- Depriciation a/c — Dr
To Prov. for dep

P/L a/c — Dr
To Depriciation

When machine sold :- Asset disposal — Dr
To Plant & m/c a/c
(It is recorded @ Book value)

Bank a/c — Dr
To Asset disposal a/c
(Amount received on sale)

Provision for dep — Dr
To Asset Disposal a/c
(All the accumulated dep) on that asset

PLANT & MACHINE A/c

Date	particulars	₹	Date	particulars	₹
	To Bank	xx		By Depriciation	xx
	To Carriage etc	xx		By balance c/d	xx
	To freight etc	xx			
		xxx			xxx
	To Balance b/d	xxx		By depriciation	xx
				By balance c/d	xx
		xxx			xxx

DEPRECIATION A/c

Date	particulars	₹	Date	particulars	₹
	To Plant & m/c	xx		By P/L a/c	xx
		xx			xx

HOW TO CALCULATE BOOK VALUE

Ques. let's say we purchased a machine on 1-July 20 and sold it on 1st June 24.

Value on date of purchase
(–) Depriciation for 9 months only
Book value on 31st-3-21 or 1st-4-21
(–) Depriciation for 12 months
Book value on 31st-3-22 or 1st-4-22
(–) Depriciation for 12 months
Book value on 31st-3-23 or 1st-4-23
(–) Depriciation for 2 months only
Book value on 31st-5-23 or 1st-6-23

PLANT & MACHINE A/c

Date	particulars	₹	Date	particulars	₹
	To Bank	xx		By balance c/d	xx
	To Carriage etc	xx			
	To Freight etc	xx			
		xxx			xxx
	To Balance b/d	xxx		By Asset disposal	xx
		xxx			xxx

DEPRECIATION A/c

Date	particulars	₹	Date	particulars	₹
	To prov. for dep	xx		By P/L a/c	xx
		xx			xx

PROVISION FOR DEP A/c

Date	particulars	₹	Date	particulars	₹
	To balance c/d	xx		By dep	xx
		xx			xx
	To balance c/d	xx		By balance b/d	xx
				By dep	xx
		xx			xx

ASSET DISPOSAL A/c

Date	particulars	₹	Date	particulars	₹
	To plant & m/c	xx		By Bank	xx
	To gain on sale	xx		By Prov for dep	xx
				By loss on sale	xx
		xxx			xxx

⑧ WRITTEN DOWN VALUE METHOD

We have a simple rate of depriciation and all we need to do is apply that rate of depriciation to the " written down value " or " book value " of each year

$$\text{DEPRICIATION AMOUNT} = \text{BOOK VALUE} \times \text{Rate of dep} \times \frac{\text{month Used}}{12}$$

Only difference between SLM & WDV is that

In SLM :- each year dep is same or we can say depriciation is charged on same amount

In WDV :- each year dep changes because dep. is charged on different book value of each year.

⑨ MACHINE HOUR METHOD

$$\text{DEPRECIATION AMOUNT} = \frac{\text{COST} - \text{SCRAP VALUE}}{\text{TOTAL HOURS WORKED}} \times \text{HOURS WORKED FOR YEAR}$$

⑩ PRODUCTION UNIT METHOD

$$\text{DEPRICIATION AMOUNT} = \frac{\text{COST} - \text{SCRAP VALUE}}{\text{TOTAL UNITS PRODUCED}} \times \text{UNITS PRODUCED FOR YEAR}$$

11 DEPLETION METHOD

DEPRICIATION AMOUNT = $\frac{\text{COST} - \text{SCRAP VALUE}}{\text{TOTAL EXTRACTION ALLOWED}}$ × EXTRACTION DONE FOR THE YEAR

12 WHEN THERE HAPPENS SOME CHANGES

- CHANGE IN METHOD OF DEPRECIATION
- CHANGE IN LIFE OF ASSET
- CHANGE IN SCRAP VALUE OF ASSET

Step 1 :- Just calculate Book value of asset on date of changes using old estimates

Step 2 :- After that date use new estimates, calculate new depriciation rate and go on.

13 AMORTISATION

Simply reffered to as depriciation of Intangible assets. All the concepts are same as depriciation.

Depriciation :- Fall in value of Tangible Assets

Amortisation :- Fall in value of Intangible Assets

(14) REVALUATION OF ASSET

At some fixed intervals plant & m/c must be compared with market value at that time just to check that the book value of asset is in line with market value.

Now, if on comparison there can be three scenarios :-

(i) Book value almost equal to market value
No changes required

(ii) Book value > Market value
Reduce the value of asset

(iii) Book value < Market Value
Increase the value of asset

IF BOOK VALUE OF ASSET IS TO BE INCREASED

If it is FIRST TIME INCREASE	If it is SUBSEQUENT/ SECOND TIME INCREASE
• Credit to Revaluation Reserve a/c	• First adjust with any fall in asset earlier recorded in P/L a/c • Then credit remaining to Revaluation Reserve a/c

IF BOOK VALUE OF ASSET IS TO BE DECREASED

If it is FIRST TIME DECREASE	If it is SUBSEQUENT/ SECOND TIME DECREASE
• Debit to Profit and Loss a/c	• First adjust with any rise in asset earlier recorded in Revaluation Reserve a/c • Remaining to P/L A/c