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Anthology : The Research

Research Paper on Accounting Called Depreciation

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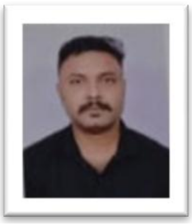

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Abstract

This study tries to Explore the Significance of Depreciation on fixed asset, When are used many of years in Accounting period asset held by an corporate sector for any type of production or service. Under the Standard Accounting Practice (SSAP)12,Depreciation is gradually Decrease in the value of fixed asset, By regular use of asset and loss of value of fixed asset or any type of market changes policies and due to modern technology. This situation may rise due to physical Deterioration, fall in value of fixed asset, replacement of asset, and change in economical environment or by expiry of time. So Accountant applies various methods for calculation the value of Depreciation on fixed asset. Such as Straight Line method, Diminishing Balance Method, Sinking Method, Revaluation and Annuity Method etc .The Consequential effect Determine the Financial Statement Include Profit and loss and Financial Position (Balance sheet) of an Organization.

Keywords: Depreciation, Measuring profitability, Regular use, value of Machinery, Rate, Estimated life, Scrap value,

Introduction

Depreciation is term is used in accounting, does not mean the physical deterioration of an asset, neither does depreciation mean the decrease in market value of a fixed asset over a period of time. Depreciation means the measures of the exhaustion of the useful life of an asset owing to use or obsolescence during a given period .it is the expired cost of fixed asset during an accounting period. The term use cover two things 1) it is not only include the wear and tear of an asset but also the exhaustion of the material in the case of wasting asset such as mimes 11) it is as much concerned with effusion of time in the case of an asset as lease, for which there is limit of ownership. According to R.N Carter, “Depreciation is the gradual and permanent decrease in the value of an asset from any cause.”

Features of Depreciation

1. The term depreciation is used only related to tangible fixed asset like building, plant and machinery, furniture etc.
2. Depreciation decreases on the book value of asset not on the market value.
3. Depreciation charged on permanent basis. Once the depreciation is charged, it reduces the book value of the asset permanently.
4. Depreciation is charged on a continue basis. once the depreciation is charged, it must be charged on regular basis in the succeeding period also.
5. The charge of depreciation will decrease the value of asset gradually

Causes of Depreciation

Due to Accident

If an asset may an occurs accident automatically its value will be reduced after depreciation.

Due to Depletion

There are some asset like Coal mines, Oil wells any other minerals mines etc where value will decrease after regular extraction of minerals or coal and oil wells .at one stage its value would be zero when nothing is left there.

Due to constant use

Due to constant and regular use of fixed asset is a cause of decreasing in the value of fixed asset. So due regular use its value will start reduced.

Due to change in economic Conditions

Due to change in habits and taste of consumer and if natural resource changes may bring fall in price of goods and services.

Materials and method

The present study subjective and descriptive in nature .The data is collected from various such as research articles, publication magazines text books and authenticated websites.

Objective of the Study

Ascertainment true profit and loss

Depreciation being a loss, will certainly affect the business profit, therefore, to arrive at the true profit or loss, depreciation must be provided for and recorded .In balance sheet asset must be shown at their true values .this is not possible unless deprecation is deducted from the values of this asset. Some asset used the business, need replacement after the expiry of their service life. by providing depreciation a part of the profit of the business is kept in the business which can be used for purpose of new asset on the old fixed asset becoming useless and correct cost of production cannot be calculated unless deprecation is properly provided and accounted for as an item of cost of production beside that is required to be made for calculating correct profit for tax purpose and for computation of tax liability, otherwise more income tax will be paid on account of excess profit.

Factor determines the amount of Depreciation

Total cost of asset

The cost of asset includes the invoice price of the asset , less any trade discount plus all cost essentials to bring the asset e.g. freight, carriage, insurance in transit installation charges.etc

Estimated useful life of an asset

This is represented by numbers of years of the estimated serviceable life span of an asset. If an asset is expected to last for 15 years before completely losing its usefulness for business operation, its life is taken to be 15 years. This may be calculated in terms of month, hours, and units of output of other operative measures such as kilometers in case of taxi or truck.

Estimated scarp value of asset

The term scrap value means the residual or break up or salvage value which is estimated to be realized on account of the sale of the asset at the end of its useful life.

Example

If a machine is bought for Rs 3000 are spent on its freight Rs 2000 for its Installation .It is estimated by the expert that its working life will be 10 years and at that time residual value will be Rs 2500. In such case depreciation will be calculated as follows:

Cost of the asset= Rs 50,000 +Rs 3000+Rs 55,000

Working life of an asset ---- 10 years

Scrap value of an asset Rs 2500

It means Rs 52500(Rs 55000-Rs 2500) will be written off in the time span of 10 Years i.e., Rs 5250 every year as Depreciation.

Review of Accounting concept of Depreciation

International Accounting standards 8 (Accounting Policies, changes in accounting estimates and error) made overwhelming assertion on the on the conceptualization of depreciation and method of presentation in the financial statement. The assertion of IAS 8 notwithstanding, many accountant are yet to decide whether depreciation should be conceived as accounting policy or as accounting estimates .each of these conception has different effect on the entities performance presentation .this section of paper will focus on reviewing the purpose, method and different professional conception of depreciation.

Method of providing depreciation

Straight line method

Under this method a fixed and equal amount to be charged as depreciation every year during the life time of the asset .The depreciation can calculated by deducting its scrap value from its cost price and then dividing such resulting figure by the estimated working life of the asset it is based on assumption of equal usages of an asset over different years of its useful life. The amount of annually charged as depreciatio0n is to reduced the original cost of asset to zero or its scrap value ,as the case may be, at the end of its working life. This method is also known as installment method ,straight line method and original cost method .Annual depreciation is charge is the historical cost divided by the numbers of years of the asset less scrap value, shown below

Diminishing Balance method

Under this method, depreciation is charged on the book value of the asset each year. In other words, the amount of depreciation is calculated as fixed percentage of the diminishing value of the asset standing in the books at the beginning of the year. The amount of depreciation goes on decreasing every year. For example if the cost of an asset is Rs 10000 and the rate of depreciation is 10% the amount of depreciation to be charge d in the first year will be a sum of Rs 1000. In the second year, Depreciation Rs 900 will be charged at 10% on the book value of the asset i.e. 9000 (10000-1000)*10/100. Similarly in third year, Depreciation Rs 810 will be charged on diminishing value i.e. Rs 8100(Rs 9000-rs900)*10/100 and so on. This method is also known as reducing installment method or written down value method.

Annuity Method

The amount spent on the purchase of an asset has an opportunity cost I e if that amount had been invested in some other form, it would have earned interest at certain rate. The fixed installment and the diminishing balance METHOD IGNORE SUCH COST. Generally depreciation does not take such loss of interest into account. But in some cases it is considered desirable to include it. For example when some property taken on lease we have to pay a lump sum amount at the initial stage and then a nominal amount as rent every year. The amount paid at initial stage is sort of advance payment of rent. It is treated as the cost of lease and written off during the lease period by way of providing depreciation .In such the situation the loss of interest on advance payment must also be treated as a part of the cost of using the asset. The method by which the interest is also included in the amount of depreciation is known as annuity method.

The depreciation will be different according to the rate of interest and according to the period over which asset is to be written off. In other words the amount of interest varies from year to year. The installment of depreciation is uniform. The fixed amount of depreciation as well as the rate of depreciation is so adjusted that end of the working life of the asset, its book value is reduced to zero or to its break up value, if any. It often happens that owing to a fraction of paisa being neglected three often arises a slight difference at the end of last year and it is therefore adjusted in the last installment.

Revaluation Method

Writing about revaluation method of depreciation nature and asset may not permit an informed Judgment to apply either straight line or accelerated method. When the amount of physical detritions is uncertain and difficult to ascertain and coupled with improper valuation may result to arbitrariness like live stock depreciation. Other may include farmer's stools, engineering tools, contractor equipment. This method becomes apparent when obsolescence, passage of time and change in technology are the significant deprecation factor

Sinking Fund Method

Depreciation fund method Under this method cash may not be available when the time of replacement comes because the amount of depreciation is retained in the business itself in the form of asset which cannot be readily sold. Under this method a fund is created to provide a definite amount at ascertain future date for specific purpose of replacement of the asset at the end of its useful life. Depreciation fund is also known as sinking fund method. This method implies that the amount written off as depreciation should be kept aside and invested.

Accounting Treatment for Providing Depreciation

For asset Purchased

Asset A/C Dr.
To Cash/Bank A/C

For Depreciation Charged

Depreciation A/c Dr.
To Asset A/c

For transferring Depreciation to Profit and loss A/c

Profit and loss A/c Dr.
To Depreciation A/C

Conclusions and Recommendations

The enigma of depreciation and Depreciable asset and its application in financial reporting, exacerbate the current thinking in current practice. Because it lacks exactitude method, determination and assessment ,tax authority disallows depreciation as an allowable expenses and replace it with capital allowances other reason postulated by tax authority for disallowing depreciation expenses included in financial statement i9s more of subjective decision. Parties to the financial statement may be overwhelmed distress because of the high or low reported profit which must have been influenced by the method and rate of depreciation. The Blanked financial statements or window dressing financial report may not be the truth and fairness of profit and loss account and the balance sheet.

The assumption that depreciation is valuation technique and asset replacement in business is incorrect .The inflationary trend has actually proved the above assumption incorrect. The price of asset yesterday changes as tronomically that the accumulated depreciation cannot replace its value in today's or tomorrow's market.

Recommendation

This review that depreciation should be used with caution, especially when the anticipated economic useful lives of the asset is short lived by new technology or passage of time, thereby making it extremely difficult to recover or replace the net book value of the asset .It is also recommended that a persistent and constant policy to be adopted in the choice of depreciation method so that the firm's performance overtime can be objectively analyzed and positional

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