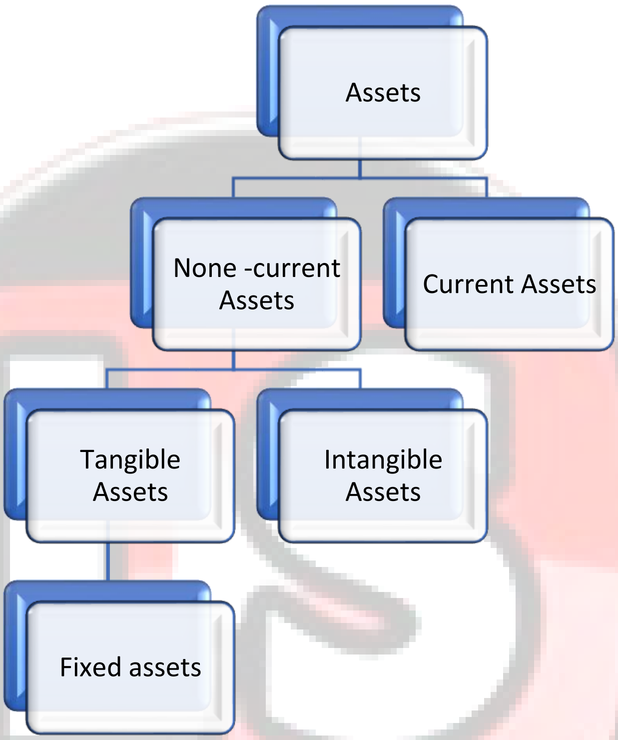
DEPRECIATION



Depreciation refers to the **decrease in the value of Fixed assets** of the company over a time period **due to use, Passage of time, and obsolescence.**

FEATURES

- Depreciation is a **non-cash expense** because it does not involve any outflow of cash.
- Depreciation is a **continuous process** of reduction in the value of the fixed assets, as every year depreciation is charged on the fixed assets
- Depreciation is a **charge against profit**. It is done because actual profit can only be ascertained
- It provides a **tax benefit to the company**, as the depreciation is adjusted to the profit before the payment of taxes

FACTORS OF DEPRECIATION

Original Cost of the asset

It is an amount **paid or incurred to acquire or produce the asset**. It includes the purchase price, taxes, transportation costs, installation expenses etc.

Useful or economic life of asset

It refers to the **estimated period** over which the asset is expected to **provide economic benefits to the owner.**

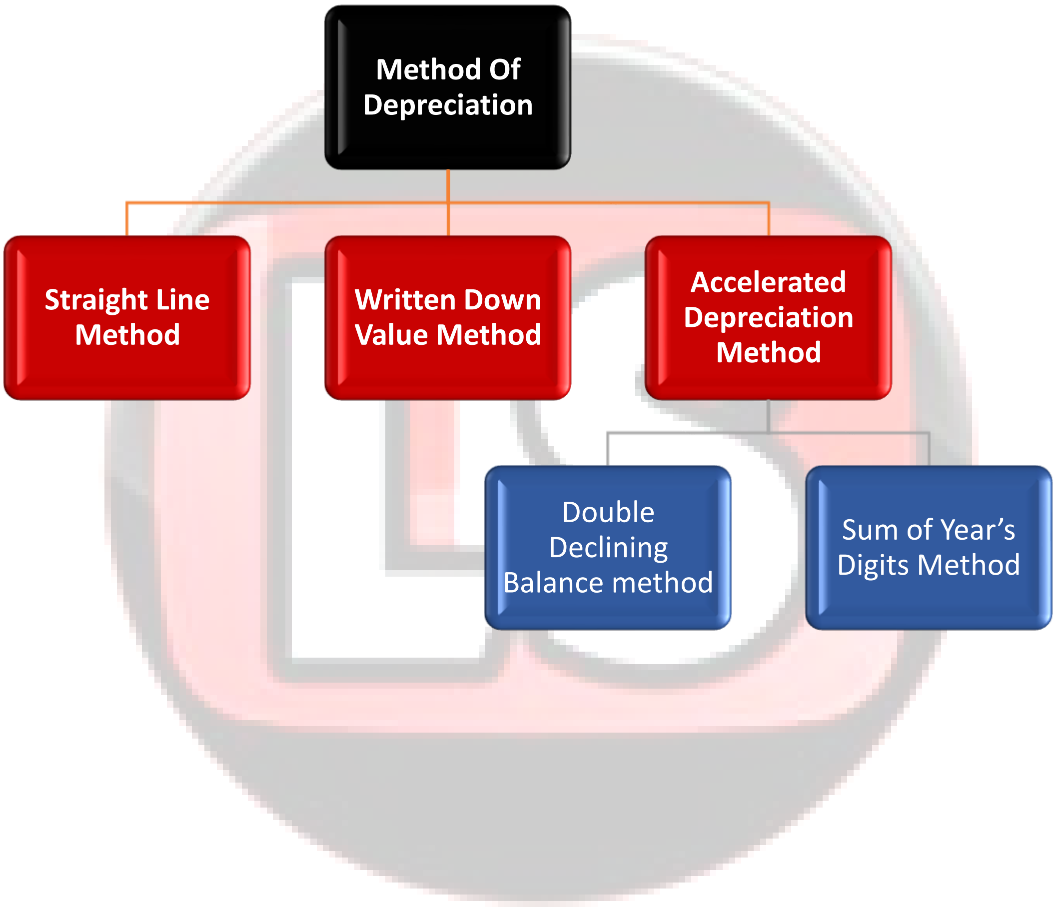
Residual or scrap value

It is the **expected value of the asset** at the end of its Useful or economic life of asset.

Legal provisions

Legal provisions may **exist regarding the depreciation of certain assets**, particularly when it comes to **tax regulations or accounting standards.**

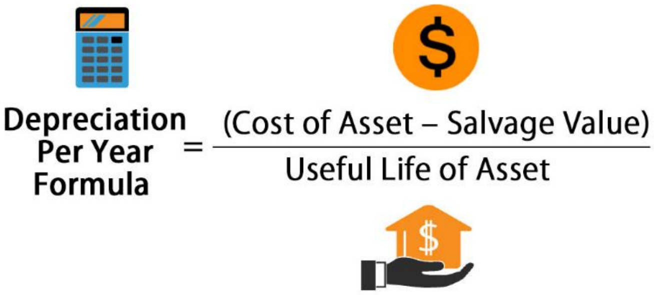
METHODS OF CHARGING DEPRECIATION



STRAIGHT LINE METHOD/FIXED INSTALMENT METHOD

- This method assumes that the asset will **lose an equal amount of value each year.**
- Depreciation is calculated every year **on the depreciable value of asset.**
- Amount of **depreciation is constant every year**.

Depreciable Value=Cost of the Asset−Residual Value



The original cost of the machinery is Rs.3 lac. depreciation is calculated at Straight Line Method (SLM) and the life of machine is 4 years. The total amount of depreciation shall be After 3 years and Book value of asset.

Solution

Depreciation per year = $\frac{Original\ Cost - Scrap\ value}{Uselife\ life\ asset}$, $=$

a) 250000 , 70000
b) 225000 , 75000
c) 300000 ,80000
d) 150000 , 90000

The original cost of the machinery is 3.5 lakh. Depreciation is calculated at Straight Line Method (SLM) and scrap value is 50000 the

life of machine is 4 years. The amount of depreciation shall be After 3 years and Book value of asset.

Solution

Depreciation per year = $\frac{Original\ Cost - Scrap\ value}{Uselife\ life\ asset}$

a) 250000, 170000
b) 225000, 125000
c) 300000 ,180000
d) 150000, 190000

WRITTEN DOWN VALUE/DIMINISHING VALUE METHOD

- Deprecation is calculated every year **on written down value of asset**. **deprecation keeps on decreasing** year after year.
- **More depreciation** tends to **occur earlier in the asset's l**ife.

Annual Depreciation = Written Down Value X Percentage rate

A firm purchased machinery for Rs.2.5 lac. it is to be depreciated by 10% at written down value method. What will be the total amount of depreciation after 3rd year ?

Solution

Depreciation expense = Written Down value X Depreciation rate

a) 67000
b) 67750
c) 50000
d) 60000

A firm purchased machinery on 1 October 2010 for Rs.2.5 lac. it is to be depreciated by 10% at written down value method. What is the written down value as on 31 December 2012?

a) 200000
b) 197718
c) 250000
d) 220000

DOUBLE DECLINING BALANCE DEPRECIATION METHOD

This method results in a **larger amount expensed in the earlier years** as opposed to the later years of an asset's useful life.

STEPS FOR CALCULATIONS

- Calculate **depreciation rate using straight line method**
- **Double** the depreciation rate
- Calculate the depreciation **at diminishing value i.e., net book value for each year.**

Original cost of a machinery is Rs.2.5 lac. depreciation is calculated at double declining method and the life of machine is 5 years. What will be the book value after 3 years?

Solution

a) 50000
b) 54000
c) 60000
d) 52000

SUM OF YEARS' DIGITS METHOD

To calculate depreciation using the **Sum of Years' Digits (SYD) method**, we first need to determine the **sum of the digits of the useful life of the asset.**

We assign a weightage to each year based on its **respective digit in the sum.**

XYZ Company purchased machinery with an original cost of ₹2,50,000. The machinery has a useful life of 5 years and no residual value. The company uses the SUM OF YEARS' DIGITS METHOD of depreciation. Calculate the annual depreciation expense and the book value of the machinery at the end of 3 year.

Solution

a) ₹2,00,000, ₹50,000
b) ₹1,90,000, ₹60,000
c) ₹2,10,000, ₹40,000
d) ₹2,25,000, ₹25,000

CAPITAL AND REVENUE EXPENDITURE

EXPENDITURE

Expenditure means **spending on something**. This can be a **payment is cash** or can also be the **exchange of some valuable item** in exchange for goods or services.

TYPES OF EXPENDITURE

Capital Expenditure

Revenue Expenditure

CAPITAL EXPENDITURE

Expenditure **involving purchase of Fixed Assets** like plant, machinery, assets, land, vehicles, patents, copy rights etc. whose benefits are received for more than one year by the firm.

FEATURES

- Expenses incurred on **acquiring, improving, or maintaining long-term assets.**
- These expenditures have a **long-term impact on the business**.
- Examples include purchasing **land, buildings, equipment, and software.**
- Capital expenditures are **recorded as assets and depreciated or amortized over time.**

REVENUE EXPENDITURE

These are expenditures which are **incurred for normal business operation by the company**, the **benefit** of which will be received in the same accounting period.

FEATURES

- Expenses incurred on **day-to-day operational activities**.
- These expenditures are necessary for the **ongoing operations and maintenance of the business**.
- Examples include employee **wages, rent, raw materials, and advertising.**
- Revenue expenditures are **fully expensed in the same accounting period.**

Difference Between Capital and Revenue Expenditure

Capital expenditure	Revenue expenditure
The amount spent is usually large.	The amount spent is relatively small.
The **purpose** is to improve or enhance business or productive or earning capacity.	The purpose is to maintain the fixed assets in good working condition.
The **benefit** is of long duration.	The benefit is of short duration.
It is **non-recurring**.	It is recurring.
It is shown in the balance sheet.	It is shown in the profit and loss account.

DEFERRED REVENUE EXPENDITURE

- The word **deferred,** which means "**Holding something back for a later time", or "postpone".**

- It is an expenditure which is **revenue in nature and incurred during an accounting period**, however, related **benefits are to be derived in multiple future accounting periods.**

CAPITAL RECEIPT

- These are receipts which **come from the issue of shares or sale of Disposal of Assets.**
- **Funds generated** from capital receipts are from **non-operating activities.**
- Capital receipts are **non-recurring in nature**. It **either creates a liability or reduces the asset**.
- It has no impact **on the income statement**, instead **the balance sheet is affected by the capital receipts**.

REVENUE RECEIPT

- Revenue Receipts are those receipts **which come from day-to-day operations** of the Company or **regular business of the company**.
- Capital receipts are **recurring in nature**. It neither creates a liability or reduces the asset.