

# FINANCIAL ACCOUNTING - DEPRECIATION

[http://www.tutorialspoint.com/accounting\\_basics/financial\\_accounting\\_depreciation.htm](http://www.tutorialspoint.com/accounting_basics/financial_accounting_depreciation.htm)

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Depreciation reduces the value of assets on a residual basis. It also reduces the profits of the current year.

Depreciation indicates reduction in value of any fixed assets. Reduction in value of assets depends on the life of assets. Life of assets depends upon the usage of assets.

There are many deciding factors that ascertain the life of assets. For example, in case of a building, the deciding factor is time. In case of leased assets, the deciding factor is the lease period. For plant and machinery, the deciding factor should be production as well as time. There can be many factors, but the life of assets should be ascertained on some reasonable basis.

## Why Do We Need to Account for Depreciation?

Here is why we need to provide depreciation:

- To ascertain the true profit during a year, it is desirable to charge depreciation.
- To ascertain the true value of assets, depreciation should be charged. Without calculating the correct value of assets, we cannot ascertain the true financial position of a company.
- Instead of withdrawal of overstated profit, it is desirable to make provisions to buy new assets to replace old asset. The accumulated value of depreciation provides additional working capital.
- Depreciation helps in ascertaining uniform profit in each accounting year.
- Depreciation allows to take the advantage of tax benefit.

## Accounting Entries Related to Assets and Depreciation

Let us see the accounting entries related to assets and depreciation:

S.No.	Particulars	Journal Entries
1	Purchase of Fixed Assets	Asset A/c Dr. To Bank A/c
2	Expenses on purchase of Fixed Assets	Related Asset A/c Dr. To Cash/Bank A/c
3	For Providing depreciation	Depreciation A/c Dr. To Assets A/c

4	Transfer of depreciation to Profit & Loss a/c		
		Profit & Loss A/c	Dr.
		To Depreciation A/c	
5	Sale of Assets		
		Bank A/c	Dr.
		To Assets A/c	

$$\text{Depreciation} = \frac{\text{Cost of Assets} - \text{Scrap Value of Assets}}{\text{Estimated Life of Assets}}$$

## Method of Depreciation

Depreciation can be calculated using any of the following methods, however the most popular methods remain *a* Straight Line Method and *b* Written Down Value Method.

- Straight Line Method
- Written Down Value Method
- Annuity Method
- Insurance Policy Method
- Machine Hour Rate Method
- Depletion Method
- Revaluation Method
- Depreciation Fund Method

## Format

### DEPRECIATION CHART

Desc.	Opening Value	Addition during the year	Sale	Balance	Rate of Depreciation	Value of Depreciation	Closing Value
1	2	3	4	5	6	7	8
				2 + 3 - 4			5 - 7

## Format of ledger accounts

### ASSET ACCOUNT

Date	Particulars	L.F.	Amt	Date	Particulars	L.F.	Amt
25-06-13	To Bank		xxx	31-03-2014	By Depreciation		xx
					By Balance c/d		xx

<b>Total</b>		<b>xxx</b>	<b>Total</b>		<b>xxx</b>
01-04-2014	To Balance	xx	By Depreciation	xx	

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