

Little Flower Matriculation Higher Secondary School
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11 - Accountancy
Unit - 10 Depreciation Accounting

I. Choose the Correct Answers

1. Under straight line method, the amount of depreciation is
(a) Increasing every year (b) Decreasing every year
(c) Constant for all the years (d) Fluctuating every year
2. If the total charge of depreciation and maintenance cost are considered, the method that provides a uniform charge is
(a) Straight line method **(b) Diminishing balance method**
(c) Annuity method (d) Insurance policy method
3. Under the written down value method of depreciation, the amount of depreciation is
(a) Uniform in all the years **(b) Decreasing every year**
(c) Increasing every year (d) None of the above
4. Depreciation is caused by
(a) Lapse of time (b) Usage (c) Obsolescence **(d) a, b and c**
5. For which of the following assets, the depletion method is adopted for writing off cost of the asset?
(a) Plant and machinery **(b) Mines and quarries** (c) Buildings (d) Trademark
6. A depreciable asset may suffer obsolescence due to____
(a) Passage of time (b) Wear and tear
(c) Technological changes (d) None of the above

7. Which method shall be efficient, if repairs and maintenance cost of an asset increases as it grows older.
(a) Straight line method **(b) Reducing balance method**
(c) Sinking fund method (d) Annuity method
8. Residual value of an asset means the amount that it can fetch on sale at the ____ of its useful life.
(a) Beginning **(b) End** (c) Middle (d) None
9. Depreciation is to be calculated from the date when
(a) Asset is put to use (b) Purchase order is made
(c) Asset is received at business premises (d) Invoice of assets is received
10. If the rate of depreciation is same, then the amount of depreciation under straight line method vis-à-vis written down value method will be
(a) Equal in all years
(b) Equal in the first year but higher in subsequent years
(c) Equal in the first year but lower in subsequent years
(d) Lower in the first year but equal in subsequent years

II. Very short answer questions

1. What is meant by depreciation?

⇒ The process of allocation of the relevant cost of a fixed asset over its useful life is known as depreciation.

2. List out the various methods of depreciation.

❖ The following are the different methods of providing depreciation:

- (i) Straight line method or Fixed instalment method or Original cost method
- (ii) Written down value method or Diminishing balance method
- (iii) Sum of years of digits method
- (iv) Machine hour rate method
- (v) Depletion method
- (vi) Annuity method
- (vii) Revaluation method
- (viii) Sinking fund method
- (ix) Insurance policy method

3. Give the formula to find out the amount and rate of depreciation under straight line method of depreciation.

$$\text{Amount of depreciation per year} = \frac{\text{Original cost of the asset} - \text{Estimated scrap value}}{\text{Estimated useful life of the asset in years}}$$

$$\text{Rate of depreciation} = \frac{\text{Amount of depreciation per year}}{\text{Original cost}} \times 100$$

4. What is annuity method?

- (i) Under this method, not only the original cost of the asset but also the amount of interest on the investment is taken into account while computing depreciation.
- (ii) The idea of considering interest is that if the investment is made in any other asset instead of the relevant fixed asset, it would have earned a certain rate of interest.

5. What is sinking fund method?

- (i) This method is adopted especially when it is desired not merely to write off an asset but also to provide enough funds to replace an asset at the end of its working life.
- (ii) Under this method, the amount charged as depreciation is transferred to depreciation fund and invested outside the business.
- (iii) This method is also known as depreciation fund method.

III. Short answer questions

1. What are the objectives of providing depreciation?

- (i) To find out the true profit or loss
 - ⇒ When an asset is used for generating income for a business, the cost of the asset attributable to the use, i.e., the reduction in the book value of the asset proportionate to the benefit derived from it, should be charged against the revenue.
 - ⇒ This is to be done to find out the true cost of production and profit or loss of the business for every accounting period.

(ii) To present the true and fair view of financial position

⇒ When the depreciation is charged on fixed assets, the book value of fixed assets are reduced to that extent and the remaining value is shown in the balance sheet.

⇒ The balance represents the value of benefit that is yet to be derived from them.

(iii) To facilitate replacement of fixed assets

⇒ When the depreciation is debited to profit and loss account, an equal amount is either retained in the business or invested outside the business.

⇒ When the useful life of an asset comes to an end, a new asset can be purchased by using the resources available in the business.

(iv) To avail tax benefits

⇒ As per the Indian Income Tax Act, while computing tax on business income, depreciation is deductible from income.

2. What are the causes for depreciation?

(i) Wear and tear

⇒ The normal use of a tangible asset results in physical deterioration which is called wear and tear.

⇒ When there is wear and tear, the value of the asset decreases proportionately.

(ii) Efflux of time

⇒ Certain assets whether used or not become potentially less useful with the passage of time.

(iii) Obsolescence

⇒ It is a reduction in the value of assets as a result of the availability of updated alternative assets.

⇒ This happens due to new inventions and innovations. Though the original asset is in a usable condition, it is not preferred by the users and it loses its value.

(v) Lack of maintenance

⇒ A good maintenance will naturally increase the life of the asset. When there is no proper maintenance, there is a possibility of more depreciation.

3. State the advantages and limitations of straight line method of depreciation.

Merits:

- (a) Simple and easy to understand
 - ⇒ Computation of depreciation under this method is very simple and is easy to understand.
- (b) Equality of depreciation burden
 - ⇒ Under this method, equal amount of depreciation is debited to the profit and loss account each year.
- (c) Assets can be completely written off
 - ⇒ Under this method, the book value of an asset can be reduced to zero if there is no scrap value or to the scrap value at the end of its useful life.

Limitations:

- (a) Ignores the actual use of the asset
 - ⇒ Under this method, a fixed amount of depreciation is provided on each asset by applying the predetermined rate of depreciation on its original cost.
- (b) Ignores the interest factor
 - ⇒ This method does not take into account the loss of interest on the amount invested in the asset.
- (d) Difficulty in the determination of scrap value
 - ⇒ It may be quite difficult to assess the true scrap value of the asset after a long period say 10 or 15 years after the date of its installation.

4. State the advantages and limitations of written down value method of depreciation.

Merits:

- (a) Equal charge against income
 - ⇒ In the initial years depreciation is high and repair charges are low.
 - ⇒ When the asset becomes older, the amount of depreciation charged is less but repair charges are high.
- (b) Logical method
 - ⇒ In the earlier years, when the asset is more productive, high depreciation is charged.

- ⇒ In the later years when the asset becomes less productive, the depreciation charge is less.

Limitations:

(a) Assets cannot be completely written off

- ⇒ Under this method, the value of an asset even if it becomes obsolete and useless, cannot be reduced to zero and some balance would continue in the asset account.

(b) Ignores the interest factor

- ⇒ This method does not take into account the loss of interest on the amount invested in the asset.
- ⇒ The amount would have earned interest, had it been invested outside the business is not considered.

(c) Difficulty in determining the rate of depreciation

- ⇒ Under this method, the rate of providing depreciation cannot be easily determined.
- ⇒ The rate is generally kept higher because it takes very long time to write off an asset down to its scrap value.

5. Distinguish between straight line method and written down value method of providing depreciation.

Point of difference	Straight line method	Written down value method
1. Basis of calculation	Depreciation is calculated on the original cost of the asset for all the years.	Depreciation is calculated on the written down value of the asset year after year.
2. Amount of depreciation	The amount of depreciation is the same for all the years.	The amount of depreciation goes on decreasing year after year.
3. Book value of the asset at the end of its life	The book value of the asset becomes zero when there is no scrap value or is equal to its scrap value at the end of its life.	The book value of the asset never becomes zero.

4. Computation of rate of Depreciation	It is easy to calculate the rate of depreciation.	It is very difficult to calculate the rate of depreciation.
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Thank You

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