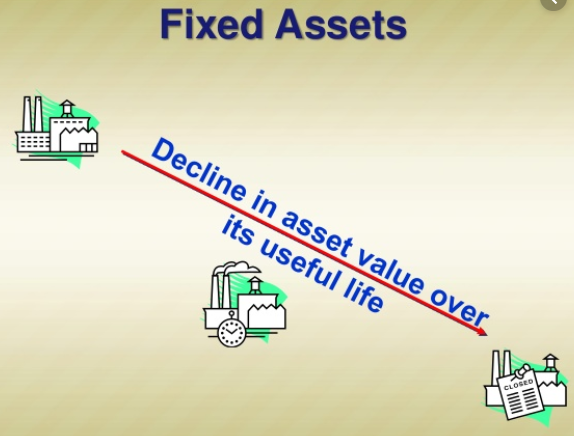
Note

The process of "expensing off" the cost of a fixed asset as it is "used up" over the time it is used is **depreciation.**



For example, suppose the dumbbells that Core Fitness bought when they set up the gym need to be replaced after 5 years. We would say the useful life of the dumbbells is 5 years.

A transaction for depreciation occurs at the end of each accounting period during the asset’s useful life. It involves a debit to Depreciation Expense for the amount of the cost expired.

For example if the dumbbells cost $5,000 and depreciated at $1,000 per year for 5 years, then each year there would be a $1,000 *Depreciation Expense.*

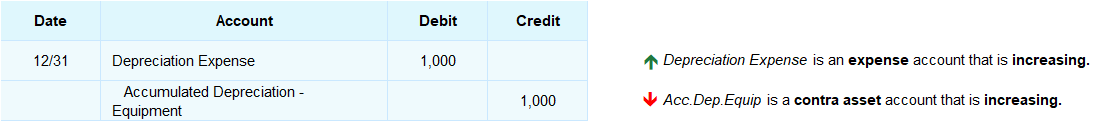
Rather than crediting the asset account directly to reduce its value, a substitute account is used. That way the ledger balance of the fixed asset always remains at its full cost (such as $5,000 for the dumbbells).

Note

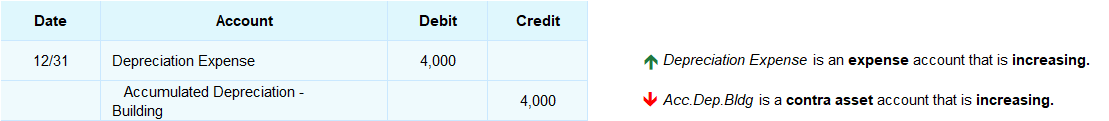
*For fixed assets, the account credited to record depreciation is* Accumulated Depreciation*. This is called a* ***contra asset account*** *and is intentionally the opposite of the normal balance for an asset – it has a credit balance in the ledger. The debit balance of the asset account minus the credit balance of its associated* Accumulated Depreciation *contra account equals the asset’s book value, or its current value to the business.*

Transactions #1 and #2 show the end-of-period entries that expense off some of the cost of a fixed asset.

1. Assume the dumbbells depreciate at a rate of $1,000 per year.



2.  Assume Core Fitness’ new building depreciates at a rate of $4,000 per year



## Interactive Exercise 12 – Depreciation transaction on account

Instructions:  Journalize the following transaction.

***Instructions*:**  Journalize the following transaction.

A company records annual depreciation on its equipment of $800.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |
| **Date** | **Account** |  | **Debit** | **Credit** |  |
| 12/31 |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |

*[Hint:* An expense account is increasing. A contra asset account is also increasing.]

*[ANSWER KEY]*

A company records annual depreciation on its equipment of $800.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |
| **Date** | **Account** |  | **Debit** | **Credit** |  |
| 12/31 | Depreciation Expense |  | 800 |  |  |
|  | Accumulated Depreciation – Equipment |  |  | 800 |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |

## Test Your Understanding

A company purchased its building on January 1, 2016 for $200,000. It depreciates at a rate of $10,000 per year. What is the book value of the building on December 31, 2019?  
  
                                        $ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

*[Correct Answer: $160,000]*