

Depreciation

Depreciation means a gradual and permanent decline in the value of a tangible fixed asset due to its use, wear and tear, obsolescence, effluxion of time, expiration of legal rights or similar other causes.

Fixed Instalment method	Diminishing Balance Method
1. Depreciation is calculated on the 'original cost' of the fixed asset.	1. Depreciation is calculated on the 'written down value' of the fixed asset.
2. The amount of depreciation remains constant in every accounting period.	2. The amount of depreciation declines in every accounting period.
3. The value of a fixed asset may get reduced to Nil/ its residual value.	3. The value of a fixed asset can never get reduced to Nil/ its residual value.
4. It is not an 'accelerated method of depreciation'.	4. It is an 'accelerated method of depreciation'.

Q. On Apr. 1, 2012, B. Sarkar & Co. bought a machine at Rs.80,000. The company had to pay Rs.5,000 as its installation charges. On July 1, 2012, another machine was bought at Rs. 1,00,000.

On June 30, 2014, the first machine was sold out for Rs.65,000, to replace a new Machine costing Rs.1,00,000.

Show the Machinery A/c as it would in the books of the company during all these three years up to Dec. 31, 2014 assuming that the books of accounts are closed Dec. 31 every year and Depreciation is to be written-off @ 10% p.a. on the original cost of these machines.

Solution**Books of B. Sarkar & Co.**

Dr.			Machinery A/c			Cr.	
Date	Particulars	₹	Date	Particulars	₹		
1.4.12	To Bank A/c [Purchase of Machinery & installation Charges: ₹80,000 + ₹5,000]	85,000	31.12.12	By Depreciation A/c [₹(85,000 × 10% × 9/12) + (1,00,000 × 10% × 6/12)]	11,375		
1.7.12	To Bank A/c [Purchase of Machinery]	1,00,000	31.12.12	By Balance c/d	1,73,625		
		1,85,000			1,85,000		
1.1.13	To Balance b/d	1,73,625	31.12.13	By Depreciation A/c [₹(85,000 × 10%) + (1,00,000 × 10%)]	18,500		
			31.12.13	By Balance c/d	1,55,125		
		1,73,625			1,73,625		

1.1.14	To Balance b/d	1,55,125	30.6.14	By Depreciation A/c	4,250
30.6.14	To Bank A/c [New Machinery Acquired]	1,00,000	30.6.14	By Bank A/c	65,000
			30.6.14	By Loss on sale of Machinery A/c [WN: 1]	875
			31.12.14	By Depreciation A/c [WN: 2]	15,000
			31.12.14	By Balance c/f	1,70,000
		2,55,125			2,55,125

WORKINGS**1. Sale of Machinery on Jun. 30, 2014 (Figs in ₹):**

Original cost on Apr. 1, 2012	85,000
Less: Depreciation for 2012 [₹85,000 × 10% × 9/12]	6,375
∴ WDV on Dec. 31, 2012/Jan. 1, 2013	78,625
Less: Depreciation for 2013 [₹85,000 × 10%]	8,500
∴ WDV on Dec. 31, 2013/Jan. 1, 2014	70,125
Less: Depreciation till June 30, 2014 [₹85,000 × 10% × 6/12]	4,250
∴ WDV on June 30, 2014	65,875
Sale Proceeds	65,000
∴ Loss on Sale: ₹(₹65,875 – ₹65,000)	875

Journal Entry:

Depreciation A/c	Dr.	4,250
Bank A/c	Dr.	65,000
Loss on sale of Mach. A/c	Dr.	875
To Machinery A/c		70,125

Annual Depreciation for 2014

Annual Depreciation is to be calculated on Machines existing on Dec. 31, 2014, as under:-

on Machinery Purchased on July 1, 2012 [₹1,00,000 × 10%]	10,000
on Machinery Purchased on June 30, 2014 [₹1,00,000 × 10% × 6/12]	5,000
∴ Annual Depreciation for 2014	15,000