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For – LNMU B. Com part -1 , Hons paper -1 Financial Accounting Unit-4 Accounting For Depreciation

Basic Terms of Deprecation

Easy to Understand the concept

Q.1. What is Depreciation?

Ans. The monetary value of an asset decreases over time due to use, wear and tear or obsolescence. This decrease is measured as depreciation.

According to R.N. Carter, "Depreciation is the gradual and permanent decrease in The value of an asset from any cause."

It is a continuing process because the book value is reduced either due to use or With the passage of time.

Q.2. Give two characteristics of depreciation.

Ans.

(i) Depreciation is a reduction in the book value of fixed assets.

(ii) The term depreciation is used only in respect of tangible fixed assets. The Term is not used for wasting assets such as mines.

Q.3. Give two causes of depreciation.

Ans.

(i) Constant use of asset leads to its wear and tear and thus fall in value.

(ii) Due to new inventions and improved techniques the old assets become Obsolete and may have to be discarded even if they can be put to use Physically.

Q.4. Name the various methods of providing depreciation.

Ans.

(i) Straight line method.

(ii) Written down value method.

(iii) Annuity method.

(iv) Depreciation fund method.

(v) Insurance policy method.

(vi) Revaluation method.

(vii) Depletion method.

(viii) Machine hour rate method.

Q.5. What is residual or scrap value of an asset?

Ans. Scrap value is an estimated sale value of the asset at the end of its economic life to the firm. It is also known as break-up value.

Q.6. Distinguish between Fixed Installment Method and Reducing Balance Method.

Ans. Following are the Difference between Fixed Installments Method (straight Line method) and Reducing Balance Method(Written Down Value method) :

Basis of Difference	Fixed Installment Method	Reducing Balance Method

(i) Amount of Depreciation	Equal amount of depreciation is charged every year.	The amount of depreciation decreases year after year.
(ii) Basis of calculation of deprecation	Depreciation is calculated on the original cost of a fixed asset.	Depreciation is calculated on the diminishing balance or written down value of a fixed asset.
(ii) Zero Balance	The book value of the asset can be reduced to zero.	The book value of the asset can never be reduced to zero.

Q.7.State any four needs of providing depreciation.

Ans. Needs of providing depreciation are:—

(i) For ascertaining the true profit or loss: The true profit can be ascertained Only when, depreciation have been debited to the profit and loss account.

(ii) To show a true and fair view of the financial position: If the depreciation Is not charged, the assets will be shown in the balance sheet at an amount Which is in excess of their true values.

(iii) To provide funds for replacement of assets: Depreciation though debited To profit and loss account, is not paid in cash like other expenses. Hence, The amount debited in the profit and loss account are retained in the Business and it is used for the replacement of fixed assets when its life is Over.

(iv) Compliance of legal provisions: It is necessary to charge depreciation to Comply with the provisions of the Companies Act and the Income Tax Act.

Q.8. Give two advantages and disadvantages of straight line method.

Ans. Advantages of straight line method are:

(i) ***It is a simple method of calculating depreciation.***

(ii) ***Under this method, the book value of an asset can be reduced to net scrap Value or zero value, which is not possible under other methods.***

Disadvantages of straight line method are:

(i) ***Under this method, it is quite difficult to assess the true scrap value of the Asset after a long period, say 15 or 20 years from the date of its Installation.***

(ii) ***There is no arrangement of interest on capital invested in assets in this Method.***