**Accounting Standard (AS) 10**

**UNIT-10**

**Accounting for Fixed Assets**

**Introduction1**. Financial statements disclose certain information relating to fixed assets. In many enterprises these assets are grouped into various categories, such as land, buildings, plant and machinery, vehicles, furniture and fittings, goodwill, patents, trademarks and designs. This standard deals with accounting for such fixed assets except as described in paragraphs 2 to 5 below. **2.**  This standard does not deal with the specialised aspects of accounting for fixed assets that arise under a comprehensive system reflecting the effects of changing prices but applies to financial statements prepared on historical cost basis. **3.** This standard does not deal with accounting for the following items to which special considerations apply: **(i)**  forests, plantations and similar regenerative natural resources; **(ii)**  wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources; **(iii)**  expenditure on real estate development; and **(iv)** livestock. Expenditure on individual items of fixed assets used to develop or maintain the activities covered in (i) to (iv) above, but separable from those activities, are to be accounted for in accordance with this Standard. **4.** This standard does not cover the allocation of the depreciable amount of fixed assets to future periods since this subject is dealt with in Accounting Standard 6 on ‘Depreciation Accounting’. **5.** This standard does not deal with the treatment of government grants and subsidies, and assets under leasing rights. It makes only a brief reference to the capitalisation of borrowing costs and to assets acquired in an amalgamation or merger. These subjects require more extensive consideration than can be given within this Standard. **Definitions 6.** The following terms are used in this Standard with the meanings specified: **6.1 Fixed asset** is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business. **6.2 Fair market value** is the price that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm’s length who are fully informed and are not under any compulsion to transact. **6.3 Gross book value** of a fixed asset is its historical cost or other amount substituted for historical cost in the books of account or financial statements. When this amount is shown net of accumulated depreciation, it is termed as net book value. **Explanation 7.** Fixed assets often comprise a significant portion of the total assets of an enterprise, and therefore are important in the presentation of financial position. Furthermore, the determination of whether an expenditure represents an asset or an expense can have a material. effect on an enterprise’s reported results of operations **8. Identification of Fixed Assets 8.1** The definition in paragraph 6.1 gives criteria for determining whether items are to be classified as fixed assets. Judgment is required in applying the criteria to specific circumstances or specific types of enterprises. It may be appropriate to aggregate individually insignificant items, and to apply the criteria to the aggregate value. An enterprise may decide to expense an item which could otherwise have been included as fixed asset, because the amount of the expenditure is not material. **8.2**  Stand-by equipment and servicing equipment are normally capitalised. Machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of fixed asset and their use is expected to be irregular, it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item. **8.3**  In certain circumstances, the accounting for an item of fixed asset may be improved if the total expenditure thereon is allocated to its component parts, provided they are in practice separable, and estimates are made of the useful lives of these components. For example, rather than treat an aircraft and its engines as one unit, it may be better to treat the engines as a separate unit if it is likely that their useful life is shorter than that of the aircraft as a whole . **9. Components of Cost 9.1** The cost of an item of fixed asset comprises its purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable costs are: **(i)** site preparation; **(ii)**  initial delivery and handling costs; **(iii)** installation cost, such as special foundations for plant; and **(iv)**  professional fees, for example fees of architects and engineers. The cost of a fixed asset may undergo changes subsequent to its acquisition or construction on account of exchange fluctuations, price adjustments, and changes in duties or similar factors. **9.2** Administration and other general overhead expenses are usually excluded from the cost of fixed assets because they do not relate to a specific fixed asset. However, in some circumstances, such expenses as are specifically attributable to construction of a project or to the acquisition of a fixed asset or bringing it to its working condition, may be included as part of the cost of the construction project or as a part of the cost of the fixed asset. **9.3** The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalised as an indirect element of the construction cost. However, the expenditure incurred after the plant has begun commercial production, i.e., production intended for sale or captive consumption, is not capitalised and is treated as revenue expenditure even though the contract may stipulate that the plant will not be finally taken over until after the satisfactory completion **9.4**  If the interval between the date a project is ready to commence commercial production and the date at which commercial production actually begins is prolonged, all expenses incurred during this period are charged to the profit and loss statement. However, the expenditure incurred during this period is also sometimes treated as deferred revenue expenditure to be amortised over a period not exceeding 3 to 5 years after the commence

**10. Self-constructed Fixed Assets 10.1** In arriving at the gross book value of self-constructed fixed assets, the same principles apply as those described in paragraphs 9.1 to 9.5. Included in the gross book value are costs of construction that relate directly to the specific asset and costs that are attributable to the construction activity in general and can be allocated to the specific asset. Any internal profits are eliminated in arriving at such costs. **11. Non-monetary Consideration 11.1** When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may be appropriate to consider also the fair market value of the asset acquired if this is more clearly evident. An alternative accounting treatment (It *may be noted that this paragraph relates to “all expenses” incurred during the period. This expenditure would also include borrowing costs incurred during the said period. Since Accounting Standard (AS) 16, Borrowing Costs, specifically deals with the treatment of borrowing costs, the treatment provided by AS 16 would prevail over the provisions in this respect contained in this paragraph as these provisions are general in nature and apply to “all expenses”.)* that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, is to record the asset acquired at the net book value of the asset given up; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration. **11.2** When a fixed asset is acquired in exchange for shares or other securities in the enterprise, it is usually recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident. **12. Improvements and Repairs 12.1**  Frequently, it is difficult to determine whether subsequent expenditure related to fixed asset represents improvements that ought to be added to the gross book value or repairs that ought to be charged to the profit and loss statement. Only expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity. **12.2**  The cost of an addition or extension to an existing asset which is of a capital nature and which becomes an integral part of the existing asset is usually added to its gross book value. Any addition or extension, which has a separate identity and is capable of being used after the existing asset is disposed of, is accounted for separately. **13. Amount Substituted for Historical Cost 13.1** Sometimes financial statements that are otherwise prepared on a historical cost basis include part or all of fixed assets at a valuation in substitution for historical costs and depreciation is calculated accordingly. Such financial statements are to be distinguished from financial statements prepared on a basis intended to reflect comprehensively the effects of **13.2** A commonly accepted and preferred method of restating fixed assets is by appraisal, normally undertaken by competent valuers. Other methods sometimes used are indexation and reference to current prices which when applied are cross checked periodically by appraisal method. **13.3** The revalued amounts of fixed assets are presented in financial statements either by restating both the gross book value and accumulated depreciation so as to give a net book value equal to the net revalued amount or by restating the net book value by adding therein the net increase on account of revaluation. An upward revaluation does not provide a basis for crediting to the profit and loss statement the accumulated depreciation existing at the date of revaluation. **13.4** Different bases of valuation are sometimes used in the same financial statements to determine the book value of the separate items within each of the categories of fixed assets or for the different categories of fixed assets. In such cases, it is necessary to disclose the gross book value included on each basis. **13.5** Selective revaluation of assets can lead to unrepresentative amounts being reported in financial statements. Accordingly, when revaluations do not cover all the assets of a given class, it is appropriate that the selection of assets to be revalued be made on a systematic basis. For example, an enterprise may revalue a whole class of assets within a unit. **13.6**  It is not appropriate for the revaluation of a class of assets to result in the net book value of that class being greater than the recoverable amount of the assets of that class. **13.7** An increase in net book value arising on revaluation of fixed assets is normally credited directly to owner’s interests under the heading of revaluation reserves and is regarded as not available for distribution. A decrease in net book value arising on revaluation of fixed assets is charged to profit and loss statement except that, to the extent that such a decrease is considered to be related to a previous increase on revaluation that is included in revaluation reserve, it is sometimes charged against that earlier increase. It sometimes happens that an increase to be recorded is a reversal of a previous decrease arising on revaluation which has been charged to profit and loss statement in which case the increase is credited to profit and loss statement to the extent that it offsets the previously recorded decrease. **14. Retirements and Disposals 14.1**  An item of fixed asset is eliminated from the financial statements on disposal. **14.2**  Items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realisable value and are shown separately in the financial statements. Any expected loss is recognised immediately in the profit and loss statement. **14.3**  In historical cost financial statements, gains or losses arising on disposal are generally recognised in the profit and loss statement. **14.4**  On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that, to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset which relates to that asset may be transferred to general reserve. **15. Valuation of Fixed Assets in Special Cases 15.1**  In the case of fixed assets acquired on hire purchase terms, although legal ownership does not vest in the enterprise, such assets are recorded at their cash value, which, if not readily available, is calculated by assuming an appropriate rate of interest. They are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof. **15.2**  Where an enterprise owns fixed assets jointly with others (otherwise than as a partner in a firm), the extent of its share in such assets, and the proportion in the original cost, accumulated depreciation and written down value are stated in the balance sheet. Alternatively, the pro rata cost of such jointly owned assets is grouped together with similar fully owned assets. Details of such jointly owned assets are indicated separately in the fixed assets register. **15.3** Where several assets are purchased for a consolidated price, the consideration is apportioned to the various assets on a fair basis as determined by competent valuers. **16. Fixed Assets of Special Types 16.1** Goodwill, in general, is recorded in the books only when some consideration in money or money’s worth has been paid for it. Whenever a business is acquired for a price (payable either in cash or in shares or otherwise) which is in excess of the value of the net assets of the business taken over, the excess is termed as ‘goodwill’. Goodwill arises from business connections, trade name or reputation of an enterprise or from other intangible benefits enjoyed by an enterprise. **16.2** As a matter of financial prudence, goodwill is written off over a period. However, many enterprises do not write off goodwill and retain it as an asset. **17. Disclosure 17.1**  Certain specific disclosures on accounting for fixed assets are already required by Accounting Standard 1 on ‘Disclosure of Accounting Policies’ and Accounting Standard 6 on ‘Depreciation Accounting’. **17.2**  Further disclosures that are sometimes made in financial statements include: **(i)** gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements; **(ii)**  expenditure incurred on account of fixed assets in the course of construction or acquisition; and **(iii)** revalued amounts substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of any indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts. **Main Principles 18.** The items determined in accordance with the definition in paragraph 6.1 of this Standard should be included under fixed assets in financial statements. **19.**  The gross book value of a fixed asset should be either historical cost or a revaluation computed in accordance with this Standard. The method of accounting for fixed assets included at historical cost is set out in paragraphs 20 to 26; the method of accounting of revalued assets **20.**  The cost of a fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use. **21.**  The cost of a self-constructed fixed asset should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset. **22.**  When a fixed asset is acquired in exchange or in part exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration. For these purposes fair market value may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident. Fixed asset acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident. **23.**  Subsequent expenditures related to an item of fixed asset should be added to its book value only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance. **24.**  Material items retired from active use and held for disposal should be stated at the lower of their net book value and net realisable value and shown separately in the financial statements. **25.**  Fixed asset should be eliminated from the financial statements on disposal or when no further benefit is expected from its use and disposal. **26.**  Losses arising from the retirement or gains or losses arising from disposal of fixed asset which is carried at cost should be recognised in the profit and loss statement. **27**. When a fixed asset is revalued in financial statements, an entire class of assets should be revalued, or the selection of assets for revaluation should be made on a systematic basis. This basis should be disclosed. **28.**  The revaluation in financial statements of a class of assets should not result in the net book value of that class being greater than the recoverable amount of assets of that class. **29.**  When a fixed asset is revalued upwards, any accumulated depreciation existing at the date of the revaluation should not be credited to the profit and loss statement. **30.**  An increase in net book value arising on revaluation of fixed assets should be credited directly to owners’ interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revaluation of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or **31.** The provisions of paragraphs 23, 24 and 25 are also applicable to fixed assets included in financial statements at a revaluation. **32.** On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value should be charged or credited to the profit and loss statement except that to the extent that such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account. **33**. Fixed assets acquired on hire purchase terms should be recorded at their cash value, which, if not readily available, should be calculated by assuming an appropriate rate of interest. They should be shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof. **34.** In the case of fixed assets owned by the enterprise jointly with others, the extent of the enterprise’s share in such assets, and the proportion of the original cost, accumulated depreciation and written down value should be stated in the balance sheet. Alternatively, the pro rata cost of such jointly owned assets may be grouped together with similar fully owned assets with an appropriate disclosure thereof. **35.** Where several fixed assets are purchased for a consolidated price, the consideration should be apportioned to the various assets on a fair basis as determined by competent valuers. **36.** Goodwill should be recorded in the books only when some consideration in money or money’s worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is in excess of the value of the net assets of the business taken over, the excess should be termed as ‘goodwill’. **Disclosure 37.** The following information should be disclosed in the financial statements: **(i)** gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements; **(ii)** expenditure incurred on account of fixed assets in the course of construction or acquisition; and **(iii)** revalued amounts substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.

**Fixed assets are depreciated, which is an important part of accounting for fixed assets, are explained below**:

**Depreciation:** Depreciation is the decrease in value of a tangible asset or assets over time

Depreciation is an accounting term used to rectify the cost of tangible assets with the decrease in value over their useful life (from normal use, wear and tear, or just the passage of time). It is reported as an expense on the income statement (usually as "depreciation" though often lumped together with amortization or sometimes in an overarching category like "other"). However, since it is a non-cash expense, depreciation is never actually paid for (no cash changes hands) and, as such, is added back to the total cash from operating activities on the cash flow statement. Thus, depreciation actually *increases* a company's free cash flow while decreasing earnings.

There are different methods of depreciating assets and each will provide different values for the asset over time. As such, there is some controversy over how companies choose to depreciate their assets, as different methods will provide different values. Some common methods of depreciation include straight-line depreciation, declining balance depreciation, and unadjusted depreciation. Regardless of what method of depreciation is chosen by the company, the total value of depreciation over the asset's lifetime will be the same. That is, the different methods simply provide different schedules for depreciation.

It should be noted that depreciation is *not* the spreading of an asset's cost over a period of time, but rather as a means of accounting for the item's decrease in value following initial purchase. The purchase of the item itself is calculated as an expense on the income statement at the time of purchase.

**Following are the causes of Depreciation:**  
-Wear and Tear due to regular use of the asset  
-Deterioration occurs with the passage of time, whether the asset is in use or not  
-Damages done to the assets due to an accident like fire, mishandling etc.  
-Depletion of Asset  
-Obsolescence i.e. due to new technology in use, new inventions, innovations etc.

**The need of depreciation account?**

According to the matching principle of accounting, the costs incurred in the accounting year should be matched with the revenue or income earned during the same accounting year. Thus, it is necessary to spread the cost of fixed asset less scrap or realizable value after the useful life of the fixed asset is over and this process of ascertain the same is called depreciation accounting. Thus, depreciation account is needed for mainly two purposes: To ascertain due profits and to cost i.e book represent the value of the fixed asset at its unexpired value of the asset less depreciation.

**Methods of Depreciation**

There are many methods of calculation of depreciation. No one apply on the all assets, because, different assets have different nature and according to management policy and effect of laws specially tax laws, different methods are used for providing depreciation. There are 10 methods of calculation of depreciation. Out of which some are the most important and it should be learned.  
  
**1st Method of providing depreciation**  
  
***Fixed installment method***   
  
Fixed installment method is that method, in which we calculate fixed rate of depreciation and then with this rate we deduct every year from fixed asset.   
  
**--------------------------Original cost of asset - scrape value of asset**  
**Depreciation =     \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_  
-------------------------Effective working life of asset**  
  
For example Suhail purchased an asset of $ 20000 and he can use it for 4 years and after four year its scrape value will be $ 4000 . Calculate depreciation with fixed installment method  
Depreciation = 20000- 4000/4 = $ 4000  
Rate of depreciation = 4000/20000X 100 = 20%  
every year we provide $ 4000 and deduct from original cost of fixed asset. So its other name is original cost method or straight line method of providing depreciation.

**Benefits of this method**   
  
1. It is easy to calculate  
2. It shows zero value of fixed asset at the end of its life.  
3. It divides all weight of total depreciation equally in all period of life of asset.  
4. After providing depreciation, balance will shows correct value of fixed asset.   
  
**Disadvantage of this method**   
  
1. After showing zero value of expiry of fixed asset in books, but it is possible that asset is in good position. Then what provision will show in books, this method does not tell to accountant.  
2. Some assets ' value will increase after spending of time at there we cannot use this on that assets.  
3. There is no provision in this method for buying new asset after scrap of old assets.

**2nd Method of Providing Depreciation**

**Diminishing Balance Method**

**Diminishing balance method** of providing depreciation is very important from [**accounting**](http://svtuition.blogspot.com/2008/06/accounting-education.html)point of view. In this method, accountant calculates depreciation on the asset from which he deducts all previous depreciation from asset. So, every year amount of depreciation will go

down.   
Suppose we purchase a machinery at **SR 50000** and if we fix **10 %** depreciation on machinery with diminishing balance method, then first year depreciation will **SR 5000,**next year will calculate depreciation **SR 50000 - SR 5000 = SR 45000 X 10 % = SR 4500**  
Third year depreciation will apply on **SR 45000 - SR 4500 = SR 40500**  
  
So, we calculate depreciation on written down value of asset so, its other name is written down method or reducing value method.  
Now we are seeing the value of depreciation is decreasing  
  
**Ist year = SR 5000  
2nd year = SR 4500  
3rd year = SR 4050**  
 **Benefit 1.** This is also very easy method.

2. This is very scientific method and provides logic that which asset is abolish due to spending of time at that portion of depreciation is not included in asset.

3. Income tax officer prefers this method for assessment of business and professional income.  
If we buy any asset after first year, we need not to calculate depreciation from beginning.

**Disadvantages of this method**

1. In this method we also ignore interest on capital which is used for purchasing such asset.
2. All new and old assets are mixed with each other, for an auditor, it is so difficult to differ among them.
3. It is difficult to calculate optimum rate of depreciation

**Ques. What is fixed assets?**

**Ans. Fixed asset** is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.

**Ques.** What is fair market value?

**Ans. Fair market value** is the price that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm’s length who are fully informed and are not under any compulsion to transact.

**Ques.** When should goodwill be recorded in the book?

**Ans. .** Goodwill should be recorded in the books only when some consideration in money or money’s worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is in excess of the value of the net assets of the business taken over, the excess should be termed as ‘goodwill’

**Some practical problems and solutions**

Jan.01. 2010. Mr. Abdullah has purchased machinery for SR 40,000. The depreciation is provided @10% per annum on original cost at the end of every year. Prepare machinery account for four years. **(Fixed Method)**

**Solution. Machinery account**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Particulars | Amount | Date | Particulars | Amount |
| 2010  Jan.01  2011  Jan.01  2012  Jan.01  2013  Jan.01  2013  Jan.01 | To Bank a/c  To Balance b/d  To Balance b/d  To Balance b/d  To Balance b/d | 40,000  -----------40,000  -----------  36,000  -----------  36,000  32,000  -----------32,000  -----------  28,000  -----------28,000  -----------  24,000 | 2010  Dec.31  2011  Dec.31  2012  Dec.31  2013  Dec.31 | By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d | 4,000  36,000  -----------40,000  -----------  4,000  32,000  -----------36,000  -----------  4,000  28,000  -----------32,000  -----------  4,000  24,000  -----------28,000  ----------- |

2. Jan.01. 2010. Mr. Abdullah has purchased machinery for SR 40,000. The depreciation is provided @10% per annum on balance cost at the end of every year. Prepare machinery account for four years. **(Balance Method)**

**Solution Machinery account**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Particulars | Amount | Date | Particulars | Amount |
| 2010  Jan.01  2011  Jan.01  2012  Jan.01  2013  Jan.01  2013  Jan.01 | To Bank a/c  To Balance b/d  To Balance b/d  To Balance b/d  To Balance b/d | 40,000  -----------40,000  -----------  36,000  -----------  36,000  32,400  -----------32,400  -----------  29,160  -----------29,160  -----------  29,160 | 2010  Dec.31  2011  Dec.31  2012  Dec.31  2013  Dec.31 | By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d | 4,000  36,000  -----------40,000  -----------  3,600  32,400  -----------36,000  -----------  3,240  29,160  -----------32,400  -----------  2,916  26,244  -----------  29,160  ----------- |

3 A plant was purchased 0n Jan.01 2010 for SR 50,000 and carriage charges was paid SR 10,000.The depreciation is provided@10% per annum at end of each year. Prepare plant a/c for four years by **balance method.**

**Solution Plant account**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Particulars | Amount | Date | Particulars | Amount |
| 2010  Jan.01  2011  Jan.01  2012  Jan.01  2013  Jan.01  2013  Jan.01 | To Bank a/c  To Bank a/c (carriage)  To Balance b/d  To Balance b/d  To Balance b/d  To Balance b/d | 50,000  10,000  -----------60,000  -----------  54,000  -----------  54,000  48,600  48,600  -----------  43,740  43,740  -----------  39,366 | 2010  Dec.31  2011  Dec.31  2012  Dec.31  2013  Dec.31 | By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d | 6,000  54,000  -----------60,000  -----------  5,400  48,600 -----------54,000  -----------  4,860  43,740  ---------  48,600  -----------  4,374  39,366  -----------  43,740  ---------- |

4. A plant was purchased 0n Jan.01 2010 for SR 50,000 and carriage charges was paid SR 10,000.The depreciation is provided@10% per annum at end of each year. Prepare plant a/c for four years by **fixed method.**

**Solution Plant account**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Particulars | Amount | Date | Particulars | Amount |
| 2010  Jan.01  2011  Jan.01  2012  Jan.01  2013  Jan.01  2013  Jan.01 | To Bank a/c  To Bank a/c (carriage)  To Balance b/d  To Balance b/d  To Balance b/d  To Balance b/d | 50,000  10,000  -----------60,000  -----------  54,000  -----------  54,000  48,000  48,000  -----------  42,000  42,000  -----------  36,000 | 2010  Dec.31  2011  Dec.31  2012  Dec.31  2013  Dec.31 | By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d | 6,000  54,000  -----------60,000  -----------  6,000  48,000 -----------54,000  -----------  6,000  42,000  ---------  48,000  -----------  6,000  36,000  -----------  42,000  ---------- |

**5.** Mr.Shadab Ahmad has purchased a building for SR 44,000 on Jan.01 2007. Its estimated life is 10 years after which it will fetch only SR 4,000. Prepare building account for 3 years only.

**Solution.** Depreciation per annum = Price of building –Residual value/ no. of estimated life of asset.

44,000 -4,000 /10= 4000

**Building Account**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Particulars | Amount | Date | Particulars | Amount |
| 2007  Jan.01  2008  Jan.01  2009  Jan.01  2010  Jan.01 | To Bank a/c  To Balance b/d  To Balance b/d  To Balance b/d | 44,000  -----------44,,000  -----------  40,000  -----------  40,000  36,000  36,000  -----------  32,000 | 2007  Dec.31  2008  Dec.31  2009  Dec.31 | By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d  By Depreciation a/c  By Balance c/d | 4,000  40,,000  -----------44,000  -----------  4,000  36,000 -----------40,000  -----------  4,000  32,000  ---------  36,000  ----------- |

**Ques**. What is depreciation?

**Ans.** **Depreciation** is a non-cash expense that reduces the value of assets gradually over a period of time due to many reasons. When it's stated that depreciation is "non-cash," it means that depreciation is taken as an accounting entry, and that the amount of cash held by the business is not affected. Business assets that can be depreciated include equipment, machinery, technology and computers, office furniture, buildings and improvements to buildings, leasehold improvements, and business vehicles. Land cannot be depreciated because it appreciates instead of depreciating.

**Ques.**What are the causes of depreciation?

**Ans.** **Following are the causes of Depreciation:**  
-Wear and Tear due to regular use of the asset  
-Deterioration occurs with the passage of time, whether the asset is in use or not  
-Damages done to the assets due to an accident like fire, mishandling etc.  
-Depletion of Asset  
-Obsolescence i.e. due to new technology in use, new inventions, innovations etc.

**Ques.** Explain the need of depreciation.

**Ans.** According to the matching principle of accounting, the costs incurred in the accounting year should be matched with the revenue or income earned during the same accounting year. Thus, it is necessary to spread the cost of fixed asset less scrap or realizable value after the useful life of the fixed asset is over and this process of ascertain the same is called depreciation accounting. Thus, depreciation account is needed for mainly two purposes: To ascertain due profits and to cost i.e book represent the value of the fixed asset at its unexpired value of the asset less depreciation.

Ques.What are the benefits of fixed method of depreciation?

**Ans. 1.** It is easy to calculate  
**2.** It shows zero value of fixed asset at the end of its life.  
**3.** It divides all weight of total depreciation equally in all period of life of asset.  
**4.** After providing depreciation, balance will shows correct value of fixed asset.

Ques. Explain the disadvantages of fixed method.

**Ans.** **Disadvantage of fixed method**   
  
1. After showing zero value of expiry of fixed asset in books, but it is possible that asset is in good position. Then what provision will show in books, this method does not tell to accountant.  
2. Some assets ' value will increase after spending of time at there we cannot use this on that assets.  
3. There is no provision in this method for buying new asset after scrap of old assets.

**Ques**. Write the benefits of balance method.

Ans.**Benefit 1.** This is also very easy method.

**2.** This is very scientific method and provides logic that which asset is abolish due to spending of time at that portion of depreciation is not included in asset.

**3.** Income tax officer prefers this method for assessment of business and professional income.  
If we buy any asset after first year, we need not to calculate depreciation from beginning.

Ques.What are the disadvantages of balance method?

**Ans.** **Disadvantages of balance method**

**1**.In this method we also ignore interest on capital which is used for purchasing such asset.

**2.**All new and old assets are mixed with each other, for an auditor, it is so difficult to differ among them.

**3.**It is difficult to calculate optimum rate of depreciation.

**Exercise**

1. Mr. Black has purchased furniture for SR 1,00,000 on Jan.01 2000.

The depreciation is provided @5% per annum on fixed method.

Prepare furniture account for five years.

1. Mr. White has purchased a car for SR 1,00,000 on Jan.01 2000.

The depreciation is provided @5% per annum on balance method.

Prepare car account for five years.

1. Mr. Green has purchased a machinery for SR 1,00,000 on Jan.01 2000.and paid SR I0,000 As carriage and SR 5,000 as repair charge.

The depreciation is provided @5% per annum on balance method.

Prepare machinery account for four years.

1. Mr. Yellow has purchased a truck for SR 90,000 on Jan.01 2004 and paid SR 15,000 as repair charge. The depreciation is provided @5% per annum on original cost.

Prepare truck account for four years.

1. Mr. Red bought a plant for SR 6, 00,000 on April 1st 2008. Its estimated life is 8 years and residual value is 1, 00,000. Prepare

Plant account for five years.

1. Mr. Pink bought a plant for SR 6, 00,000 on April 1st 2008. Its estimated life is 8 years and residual value is 1, 00,000 and he purchased another plant on July 1st 2009 for 3, 75,000. Its estimated life is 10 years and residual value is 25,000. Prepare

Plant account for five years.

1. Mr. Orange bought a plant for SR 6, 00,000 on April 1st 2008. and he purchased another plant on July 1st 2009 for 3,75,000. Prepare plant account for five years by fixed method and balance method

Taking the rate of depreciation 6% per annum.