CBSE Test Paper 05

Ch-6 Depreciation Provisions and Reserves

1. 'In case of a long-term asset, repair and maintenance expenses are expected to rise in later years than in earlier year.' Which method is suitable for charging depreciation if the management does not want to increase burden on profit and loss account on account of depreciation and repair.
2. Depreciation is the result of fall in the market value of assets. Comment.
3. Depletion method for charging depreciation is used for which assets?
4. What are 'provisions'? How are they created?
5. Give any three advantages offered by straight-line method of depreciation.
6. Original cost of an asset is Rs.2,00,000 and depreciation is charged @ 10% per annum at written down value. Calculate the amount of depreciation for the next 4 years.
7. Karan Enterprises has the following balances in its books as on 31st March, 2015.

Machinery (gross value)	Rs, 6,00,000
Provision for depreciation	Rs. 2,50,000

   A machine purchased for Rs.1,00,000 on 1st November, 2010 having accumulated depreciation amounting to Rs,60,000 was sold on 1st April, 2015 for Rs.35,000. Prepare the asset disposal account
8. Vinod limited purchased a machine for Rs. 2,50,000 including installation cost on January 1, 2012. On October 1, 2014, machine was sold for Rs. 1,50,000. Depreciation was provided @ 10% p.a. on Fixed Installment method and accounts are closed on December 31, each year.
   Show the Machinery Account and Provision for Depreciation Account for the year, 2012 to 2014.
9. On 1st January, 2011 Z Ltd purchased machinery for Rs.1,20,000 and on 30th June,

2012 it acquired additional machinery at a cost of Rs. 20,000. On 31st March, 2013, one of the original machine (purchased on 1st January, 2011) which had cost of Rs.5,000 was found to have become obsolete and was sold as scrap for Rs.500. It was replaced on that date by a new machine costing Rs.8,000. Depreciation is to be charged @ 15% per annum on the basis written down value method. Accounts are closed on 31st December, each year. Show the machinery account for the first 3 years.

10. A company purchased a machine for Rs.50,000 on 1st October 2015. Another machinery costing Rs.10,000 was purchased on 1st December 2016. On 31st March 2018, the machinery purchased in 2015 was sold at a loss of Rs.5,000. The company charges depreciation at the rate of 15% p.a. on Diminishing Balance Method. Account is closed on 31st March every year. Prepare Machinery Account for 3 years.

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Answer

1. The company should charge depreciation as per written down value method. Under this method the depreciation is calculated on the opening balance of the asset.So under this method the depreciation charge declines and repair expenses increase in the later years. Hence, the total of depreciation and repair expense remains similar year after year.

2. No, depreciation is not a result of fall in the market value of fixed assets. Depreciation is the reduction of value of asset due to it's usage and lapse of period of time. Depreciation is charged on historical cost or original cost.

3. Depletion method of charging depreciation is used for the assets like mines and quarries.

4. **Provision**
   The amount set aside for the purpose of providing for any known liability or uncertain loss or expense, the amount of which cannot be ascertained with certainty is referred to as provision. For example, an entity routinely records provisions for bad debts, sales allowances, and inventory obsolescence.
   Provisions are created by ascertaining those expenses/losses which are related to the current accounting period, but the amount of which is not certain as they are not yet incurred. For example Bad debts not occurred for that firm create Provision for bad debts. Therefore, it becomes necessary to make provision for such items for ascertaining the true profit or loss according to the principle of prudence or conservatism.

5. Straight-line depreciation is the default method used to recognize the carrying amount of a fixed asset evenly over its useful life. The various advantages offered by straight-line method are as follows:

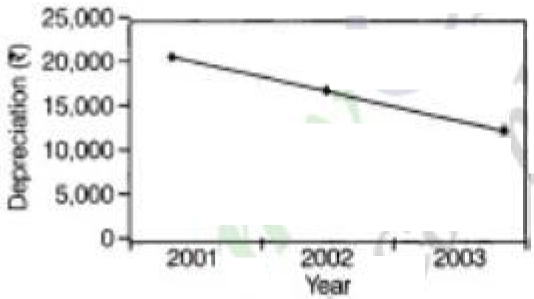
   i. It is a simple method of calculating the depreciation.
   ii. Assets can be depreciated fully or upto the scrap value over the life of the asset.

iii. Since, the depreciation amount is same every year hence, so there is a same effect on the profit and loss account every year.

6.

Year	Depreciation Amount	Written Down Value (Year-end)
Ist Year	$2,00,000 \times \frac{10}{100}$ = Rs.20,000	2,00,000-20,000=1,80,000
IInd Year	$1,80,000 \times \frac{10}{100}$ = Rs.18,000	1,80,000-18,000=1,62,000
IIIrd Year	$1,62,000 \times \frac{10}{100}$ = Rs.16,200	1,62,000-16,200=1,45,800
IVth Year	$1,45,800 \times \frac{10}{100}$ = Rs.14,580	1,45,800-14,580=1,31,220

This method is based upon the assumption that the benefit accruing to business from assets keeps on diminishing as the asset becomes old. This is due to the reason that a predetermined percentage is applied to a gradually shrinking balance on the asset account every year. Thus, large amount of depreciation is recovered in the earlier years then in later year. Even after becoming the asset obsolete or scrap, under this method. The book value of the asset can never be zero. Graph of the depreciation charged and year of charge slopes downward as year after year amount of depreciation is reduced.



Under the written down value method, the rate of depreciation is computed by using the following formula :

$$R = \left[1 - \sqrt[n]{\frac{S}{C}}\right] \times 100$$

where R=Rate of depreciation

n=Expected useful life

S=Scrap value

C=Cost of an asset

7.

Dr	Machinery Disposal Account						Cr
Date	Particulars	J.F.	Amt (Rs.)	Date	Particulars	J.F.	Amt (Rs.)
2015				2015			
Apr 01	To Machinery A/c		1,00,000	Apr 01	By Provision for Depreciation A/c		60,000
				Apr 01	By Bank A/c [sale price]		35,000
				Apr 01	By Profit and Loss A/c (Loss on sale) [working note]		5,000
			1,00,000				**1,00,000**

Dr	Machinery Account						Cr
Date	**Particulars**	**J.F.**	**Amt (Rs.)**	**Date**	**Particulars**	**J.F.**	**Amt (Rs.)**
2015				2015			
Apr 01	To Balance b/d		6,00,000	Apr 01	By Machine Disposal A/c		1,00,000
				2016			
				Mar 31	By Balance c/d		5,00,000
			6,00,000				**6,00,000**

Working Note :

Computation of loss on sale of machinery	
Original cost of the asset being sold	1,00,000
(-) Accumulated depreciation	(60,000)
Book value on the date of sale	40,000
Sales value realised	(35,000)
Loss on sale	**5,000**

Entry when the Original cost of asset sold is transferred to Asset Disposal Account :

Asset Disposal Account (Dr

To Asset A/c

Entry when amount of depreciation provided on asset is transferred :

Provision for Depreciation A/c (Dr)

To Asset Disposal A/c

8. **Machinery Account**

Date	Particulars	J.F	(Rs.)	Date	Particulars	J.F.	(Rs.)
2012				2012			
Jan 1	To Bank A/c		2,50,000	Dec 31	By Balance c/d		2,50,000
			2,50,000				**2,50,000**
2013				2013			
Jan 1	To Balance b/d		2,50,000	Dec 31	By Balance c/d		2,50,000
			2,50,000				**2,50,000**
2014				2014			

Apr 1	To Balance b/d		2,50,000	Oct 1	By Provision for Dep. A/c		68,750
				Oct 1	By Bank A/c (sale amount)		1,50,000
				Oct 1	By Profit & Loss A/c (Balancing Figure)		31,250
			2,50,000				**2,50,000**

Provision for Depreciation Account

Date	Particulars	J.F	(Rs.)	Date	Particulars	J.F.	(Rs.)
2012				2012			
Dec 31	To Balance c/d		25,000	Dec 31	By Depreciation A/c		25,000
			25,000				**25,000**
2013				2013			
Dec 31	To Balance c/d		50,000	Jan 1	By Balance b/d		25,000
				Dec 31	By Depreciation A/c		25,000
			50,000				**50,000**
2014				2014			
Oct 1	To Machinery A/c		68,750	Jan 1	By Balance b/d		50,000
				Oct 1	By Depreciation A/c		18,750
			68,750				**68,750**

Notes :

- If asset is used for part of the year, then depreciation will be calculated on time basis.
- When Provision for Depreciation Account is maintained the amount of depreciation to be provided in a particular year is debited to Profit & Loss Account and corresponding credit is given to Provision for Depreciation

Account. The Asset account appears in books at its original value and Provision for Depreciation Account appears on the liability side.In case of asset sold, the provision for depreciation transferred to Asset Account.

9.

Dr	Machinery Account						Cr
Date	**Particulars**	**JF**	**Amt (Rs.)**	**Date**	**Particulars**	**JF**	**Amt (Rs.)**
2011				2011			
Jan 1	To Bank A/c (i)		1,20,000	Dec 31	By Depreciation A/c		18,000
				Dec 31	By Balance c/d		1,02,000
			1,20,000				**1,20,000**
2012				2012			
Jan 1	To Balance b/d		1,02,000	Dec 31	By Depreciation A/c(15,300+1500)		16,800
Jun 30	To Bank A/c (ii)		20,000	Dec 31	By Balance c/d(86,700+18,500)		1,05,200
			1,22,000				**1,22,000**
2013				2013			
Jan 1	To Balance b/d (86,700+18,500)		1,05,200	Mar 31	By Bank A/c (Sale)		500
Mar 31	To Bank A/c		8,000	Mar 31	By Depreciation A/c (WN1)		135
				Mar 31	By Profit and Loss A/c (Loss) (WN 1)		2,977
				Dec 31	By Depreciation A/c (WN2)		16,138

				Dec 31	By Balance c/d		93,450
			1,13,200				**1,13,200**
2014							
Jan 1	To Balance b/d		93,450				

Working Note

1. **Calculation of Loss on Sale of Machinery**

Cost of machinery sold (1st January, 2011)	5,000
(-) Depreciation for 2011 (Rs. 5,000 × 15/100)	750
Book value of machinery (1st January, 2012)	4,250
(-) Depreciation for 2012 (Rs.4,250 × 15/100)	638
Book value of machinery (1st January, 2013)	3,612
(-)Depreciation upto 31st March, 2013 (Rs.3,612 × 15/100 × 3/12)	135
Book value of machinery sold (31st March, 2013)	3,477
(-) Sale proceeds	500
Loss on sale machinery	2,977

2. **Calculation of Depreciation after Sale of Machinery**

Book value of machinery (1st January, 2013)	1,05,200
(-)Book value of machinery sold (1st January,2013) (WN1)	3,612
Remaining machinery	1,01,500
Depreciation on remaining machinery Rs.1,01,588 × 15/100=	15,238
(+)Depreciation on machinery purchased during the year	900
(Rs.8,000 × 15/100 × 9/12) Total	16,138

In accounting terms, depreciation is defined as the reduction of recorded cost of a fixed asset in a systematic manner until the value of the asset becomes zero or negligible. As in this question what we have done we have just recorded the depreciation in machinery A/c, if the question asks than one can also prepare Depreciation A/c, Provision for Depreciation A/c, etc.. for easy & better understanding the calculation of balances.

10. **MACHINERY ACCOUNT**

Dr.							**Cr.**
Date	**Particulars**	**J.F.**	**Rs.**	**Date**	**Particulars**	**J.F.**	**Rs.**
01.10.15	To Bank A/c		50,000	31.03.16	By Depreciation A/c		3,750
					By Balance c/d		46,250
			50,000				**50,000**
01.04.16	To Balance b/d		46,250	31.03.17	By Depreciation A/c (W.N.)		7,438
01.12.16	To Bank A/c		10,000		By Balance C/d		48,812
			56,250				**56,250**
01.04.17	To Balance b/d		48,812	31.03.18	By Depreciation A/c (W.N.)		7,322
					By Cash A/c (W.N.)		28,415
					By P/L A/c		5,000
					By Balance c/d		8,075
			48,812				**48,812**
01.04.18	To Balance b/d		8,075				

Working Notes:

Particulars			Total

	Machine I	Machine II	
Cost	50,000		50,000
Less : Depreciation for 2015-16 @ 15%	-3,750		3,750
W.D.V.	46,250	10,000	56,250
Less : Depreciation for 2016-17 @ 15%	-6,938	-500	7,438
W.D.V.	39,312	9,500	48,812
Less : Depreciation for 2017-18 @ 15%	-5,897	-1,425	7,322
W.D.V.	33,415	8,075	
Less: Loss on sale	-5,000		
Sale Value	28,415		

Depreciation is calculated by Diminishing value method so it is calculated on balance value of asset or written down value of asset not on the cost of the asset.