

7. DEPRECIATION

Q.1. Answer in one sentence only:

1) What is Depreciation?

Ans. Depreciation means shrinkage in the value of an asset due to factors like wear and tear, passage of time or obsolescence, etc.

2) Why depreciation is charged?

Ans. Depreciation is charged to find out true amount of profit or loss in particular accounting period and to arrive at true value of the asset.

3) What is 'Scrap Value' of an asset?

Ans. The net amount which is expected to be realised on the final disposal of a fixed asset is called 'Scrap Value' or 'Residual Value'.

4) Why depreciation is charged even in the year of loss?

Ans. Unless depreciation is charged, true amount of profit and loss cannot be ascertained properly and we cannot make provision for the replacement of asset therefore depreciation is charged even in the year of loss.

5) Which account is credited when depreciation is charged?

Ans. Relevant asset account is credited when depreciation is charged.

6) Where is the profit or loss on sale of asset is transferred?

Ans. Profit or loss on sale of asset is to be transferred to 'Profit and Loss A/c'.

7) To which account balance of Depreciation A/c is transferred?

Ans. Balance of Depreciation A/c is to be transferred to 'Profit and Loss A/c'.

8) What is the formula to calculate depreciation by straight line method?

Ans. Formula to calculate depreciation by straight line method is as follows:

$$\text{Depreciation (p.a)} = \frac{\text{Original Cost} - \text{Scrap Value}}{\text{Estimated Life of the Asset (In Years)}}$$

9) What is Fixed Instalment Method?

Ans. The method in which depreciation is charged at a specific rate on the original cost of the asset every year, so as to reduce the asset account to nil or to its scrap value at the end of its estimated life is known as Fixed Instalment Method.

10) Which account is debited when expenses are paid on installation of machinery?

Ans. Machinery account is to be debited when expenses are paid on installation of machinery.

Q. 2. Give the word/term or phrase for each of the following statement.

Statement	Ans.
(1) A continuous, gradual and permanent reduction in the value of a fixed asset.	Depreciation
(2) The expenditure incurred for purchase, installation charges etc. of an asset.	Cost of asset
(3) The amount that a fixed asset is expected to realise on its disposal.	Scrap value
(4) The period for which the asset remains in working condition.	Life period of asset
(5) The method of depreciation in which the total depreciation is equally spread over the life of the asset.	Fixed Instalment method
(6) The method of depreciation in which the rate of depreciation is fixed but the amount of depreciation reduces every year.	Reducing balance method
(7) The type of asset on which de-recitation is charged.	Fixed asset
(8) Expenses incurred for fixation of the new asset to bring it in working condition.	Installation charges

(9) Excess of selling price of fixed asset over its Written down Value.	Profit on sale of asset
(10) Method of depreciation that cannot reach to zero value.	Reducing/ Diminishing balance method

Q.3. select the most appropriate answers from the alternatives given below and write the sentence.

- 1) Decrease in the value of fixed assets is known as **depreciation**.
- 2) Depreciation is charged only on **fixed** assets.
- 3) The amount spent on installation of new machinery is a **capital** expenditure.
- 4) The amount that a fixed asset is expected to realise on its disposal is known as **scrap value**.
- 5) The amount of depreciation reduces year after year under **written Down Value Method**.
- 6) The amount of depreciation remains constant every year under **Straight Line Method**.
- 7) The balance of depreciation account is transferred to **Profit & Loss A/c**.

Q.4. State whether the following statements are True or False with reasons.

- 1) Depreciation is charged on fixed assets.

Ans. This statement is True.

To find out actual profit or loss of business and to make provision for the replacement of asset. depreciation is charged on fixed assets.

- 2) Depredation increases the value of the asset.

Ans. This statement is False.

Depreciation means a continuous, gradual and permanent reduction in the value of fixed assets, so we can say that depreciation decreases the value of the asset.

3) Balance of depreciation account is transferred to Profit & Loss Alc.

Ans. This statement is True.

Depreciation is a non-cash expense for the business, every income or expense account is to be transferred to profit & loss A/c. to ascertain the actual profit or loss of the business. Therefore balance of depreciation account is transferred to Profit and Loss A/c.

4) The Profit or Loss on sale of fixed asset is ascertained only after charging depreciation.

Ans. This statement is True.

Unless depreciation is charged to the revenues, the exact amount of profit or loss of business cannot be ascertained properly. Therefore, the profit or loss on sale of fixed asset is ascertained only after charging depreciation.

5) Wages paid for installation of machinery are debited to wages A/c.

Ans. This statement is False.

Wages paid for installation of machinery is nothing but part of cost of machinery only, Therefore, it is to be debited to Machinery A/c. only.

6) It is not necessary to depreciate an asset if it is not in use.

Ans. This statement is False.

Depreciation is charged as an element of cost. If an asset is not in use, even though its value reduces due to passage of time. Therefore, we can say that it is compulsory to depreciate an asset, if it is not in use.

7) Depreciation is charged on current assets only.

Ans. This statement is False.

Depreciation is charged on fixed asset only because it is necessary to apportioned the cost over a number of years during the useful life of an asset and there is no question of useful life for current asset.

8) Depreciation need not be charged when business is making losses.

Ans. This statement is False.

Depreciation is an element of cost which is to be calculated/charged irrespective of profit or loss of the business. Also, to find actual profit or loss of the business, it is compulsory to calculate depreciation.

Q. 5. Complete the following sentence.

1) Depreciation is charged on fixed asset.

2) Wages paid for Installation/fixation of machinery is debited to machinery account.

3) Under reducing balance system, the amount of depreciation changes every year.

$$4) \text{ Depreciation} = \frac{\text{Cost of Asset Less x Scrap value}}{\text{Estimated Working Life of the Asset}}$$

5) Gradual and permanent decrease in the value of an asset is known as depreciation.

6) In Fixed Instalment System, the amount of depreciation is constant every year.

7) The amount spent on installation of machinery is a capital expenditure.

8) Scrap value is the value which an asset realises at the end of its useful life.

9) Depreciation Account is nominal account.

10) Depreciation is derived from a Latin word depreciation.

Q.6. Do you agree or disagree with the following statements.

1) Depreciation is non-cash expense.

Ans. **Agree.**

2) Under written down value method, the depreciation curve slopes parallel to 'X' axis.

Ans. **Disagree.**

3) The rate of depreciation depends upon the life of fixed asset.

Ans. **Agree.**

4) The terminal value of asset never affects the annual amount of depreciation.

Ans. **Disagree.**

5) By charging depreciation on fixed assets ascertainment of true and fair financial position is possible.

Ans. **Agree.**

Q.7. Correct the following statement and rewrite the statement.

1) Residual value of an asset increases the amount of annual depreciation.

Ans. Residual value of an asset decreases the amount of annual depreciation.

2) Depreciation is calculated on all assets.

Ans. Depreciation is calculated on fixed assets only.

3) Under written down value method depreciation is calculated on original cost of an asset.

Ans. Under fixed instalment method, depreciation is calculated on original cost of an asset.

4) Depreciation provided on asset is debited to asset account.

Ans. Depreciation provided on asset is debited to depreciation account.

5) Profit on sale of asset is credited to asset account.

Ans. Profit on sale of asset is credited to Profit & Loss A/c.