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Comparative Study on Depreciation Trends Through Exploring Variants And Current Effects

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Abstract **The purpose of the study was to aware about the common aspects of Depreciation in relation to current scenario. Depreciation is an accounting method of allocating the cost of a tangible or physical asset over its useful life or life expectancy. Depreciation represents how much of an asset's value has been used up. Depreciating assets helps companies earn revenue from an asset while expensing a portion of its cost each year the asset is in use. Businesses can depreciate long-term assets for both tax and accounting purposes. It is mandatory under companies act as it is compulsory to charge depreciation in profit and loss account in companies act 2013.**

Keywords —Accounting, Assets, Depreciation, Double Declining Balance, Straight line method and written down value method.

I. Introduction

Depreciation is probably the most discussed and disputed topic in accounting. The term depreciation is derived from the Latin words “De”(meaning down) and “Pretium” (meaning Price) and in popular everyday usage simply means a decline in value. Depreciation is an accounting convention that allows a company to write off an asset's value over a period of time, commonly the asset's useful life. Assets such as machinery and equipment are expensive. Instead of realizing the entire cost of the asset in year one, depreciating the asset allows companies to spread out that cost and generate revenue from it. Depreciation is used to account for declines in the carrying value over time. Carrying value represents the difference between the original cost and the accumulated depreciation of the years. Each company might set its own threshold amounts for when to begin depreciating a fixed asset–or property, plant, and equipment. For example, a small company may set a rupees 10000 threshold, over which it depreciates an asset. On the other hand, a larger company may set a rupees 50,000 threshold, under which all purchases are expensed immediately.

For tax purposes, the IRS publishes depreciation schedules detailing the number of years an asset can be depreciated, based on various asset classes.

The entire cash outlay might be paid initially when an asset is purchased, but the expense is recorded incrementally for financial reporting purposes because assets provide a benefit to the company over a lengthy period of time. Therefore, depreciation is considered a non-cash charge since it doesn't represent an actual cash outflow. However, the depreciation charges still reduce a company's earnings, which is helpful for tax purposes.

The matching principle under generally accepted accounting principles (GAAP) is an accrual accounting concept that dictates that expenses must be matched to the same period in which the related revenue is generated. Depreciation helps to tie the cost of an asset with the benefit of its use over time. In other words, each year, the asset is put to use and generates revenue, the incremental expense associated with using up the asset is also recorded.

The total amount that's depreciated each year, represented as a percentage, is called the depreciation rate.

II. Trending Depreciation

The causes of deprecation are clearly spelt out as part of the definition of depreciation in the accounting standard 6 i.e. Wear and tear due to use or passage of time, Expiration of legal rights, Obsolescence, Abnormal factors.

1. Wear and tear due to use or passage of time means deterioration, and the consequent diminution in an assets value, arising from its use in business operations for earning revenue. It reduces the asset’s technical capacities to serve the purpose for, Which it has been meant.

2. Expiration of legal rights certain categories of assets lose their value after the agreement governing their use in business comes to an end after the expiry of pre-determined period. Example of such assets are patents, copyright, leases, etc.

3. Obsolescence is another factor leading to depreciation of fixed asset in ordinary language, Obsolescence implies to

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an existing asset becoming out of date on account of the availability of better type of asset. It arises from the factors like technological advancement, legal or other description.

4. Abnormal factors decline in the usefulness of the asset may be caused by abnormal factors such as accidents due to fire, earthquake, flood, etc. Accidental loss is permanent but continuing or gradual. For example, A car which has been repaired after an accident will not fetch the same price in the market even if it has not been used.

III. Conceptualization of Depreciation

Depreciation is an accounting method of allocating the cost of a tangible or physical asset over its useful life or life expectancy. Depreciation represents how much of an asset's value has been used up. Depreciating assets helps companies earn revenue from an asset while expensing a portion of its cost each year the asset is in use. If not taken into account, it can greatly affect profits. Businesses can depreciate long-term assets for both tax and accounting purposes. For example, companies can take a tax deduction for the cost of the asset, meaning it reduces taxable income. However, the Internal Revenue Service (IRS) states that when depreciating assets, companies must spread the cost out over time. The IRS also has rules fog when companies can take a deduction.

Assets: An asset is anything of monetary value owned by a person or business. Assets are classed as capital/fixed, current, tangible or intangible and expressed in terms of their cash value on financial statements. Tangible assets include money, land, buildings, investments, inventory, cars, trucks, boats, or other valuables. Intangibles such as goodwill are also considered to be assets.

Capital assets also known as Fixed assets, capital assets are those tangible physical assets acquired to carry on the business of a company with a life exceeding one year. Examples include: land, buildings, vehicles, boats, aircraft, tools, machinery, computer hardware, mobile phones, etc.

IV. Trending Variants

1. Straight-Line

Depreciating assets using the straight-line method is typically the most basic way to record depreciation. It reports equal depreciation expense each year throughout the entire useful life until the entire asset is depreciated to its salvage value.

For example, that a company buys a machine at a cost of rupess100,000. The company decides on a salvage value of rupees 20,000 and a useful life of five years. Based on these assumptions, the depreciable amount is rupees 80,000 (rupees 100,000 cost –rupees 20,000 salvage value) As a result, the depreciation rate is 20% . The depreciation rate is used in both the declining balance and double-declining balance calculations.

2. Written down value method (Declining Balance)

The declining balance method is an accelerated depreciation method. This method depreciates the machine at its straight-line depreciation percentage times its remaining depreciable amount each year. Because an asset's carrying value is higher in earlier years, the same percentage causes a larger depreciation expense amount in earlier years, declining each year.

Using the same straight-line example above, the machine costs rupees 100,000, has a salvage value of rupees 20,000, a 5-year life, and is depreciated at 20% each year, so the expense is rupees 16,000 in the first year (rupees 80,000 depreciable amount * 20%), rupees 12800 in the second year ((rupees 80,000 – rupees 20,000) * 20%), and so on.

3. Double Declining Balance (DDB)

The double-declining balance (DDB) method is another accelerated depreciation method. After taking the reciprocal of the useful life of the asset and doubling it, this rate is applied to the depreciable base, book value, for the remainder of the asset's expected life. For example, an asset with a useful life of five years would have a reciprocal value of 1/5 or 20%. Double the rate, or 40%, is applied to the asset's current book value for depreciation. Although the rate remains constant, the dollar value will decrease over time because the rate is multiplied by a smaller depreciable base each period.

4. Sum-of-the-Year's-Digits (SYD)

The sum-of-the-year's-digits (SYD) method also allows for accelerated depreciation. To start, combine all the digits of the expected life of the asset. For example, an asset with a five-year life would have a base of the sum of the digits one through five, or 1+ 2 + 3 + 4 + 5 = 15. In the first depreciation year, 5/15 of the depreciable base would be depreciated. In the second year, only 4/15 of the depreciable base would be depreciated. This continues until year five depreciates the remaining 1/15 of the base.

5. Units of Production

This method requires an estimate for the total units an asset will produce over its useful life. Depreciation expense is then calculated per year based on the number of units produced. This method also calculates depreciation expenses based on the depreciable amount.

Every industry has its own characteristics like capital structure, product differentiation and product life cycle, market structure, etc. and follows the method best suited to it.

V. Conclusion

P When an asset is purchased, it is recorded on the debit

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to increase an asset account, which then appears on the balance sheet, and a credit to reduce cash or increase accounts payable, which also appears on the balance sheet. Neither side of this journal entry affects the income statement, where revenues and expenses are recorded. In order to move the cost of the asset from the balance sheet to the income statement, depreciation is deducted, recorded on a regular basis.

It has some advantages too like: Tax Benefit as depreciation is allowed as an expense under Income tax and therefore it is important to consider it to save income tax. It is mandatory under companies act as it is compulsory to charge depreciation in profit and loss account in companies act 2013. Real profit – If it is not considered then expenditure on behalf of fixed assets is not considered and the profit may be shown as a high number especially in industries required large plant and machinery. Also, this may lead to high distribution of earnings to shareholders and thus non-availability of funds when business is in need to replace the asset.

Every industry has its own characteristics like capital structure, product differentiation and product life cycle, market structure, etc. and follows the method best suited to it.

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