Depreciation, Provisions and Reserves

Depreciation- Meaning, Reasons and Requirement

Objectives

After going through this lesson, you shall be able to understand the following concepts.

- Concept of Depreciation
- Causes of Depreciation
- Need for Providing Depreciation

Introduction

We know that a sole proprietor commences business with capital in the form of various assets and liabilities. The assets can be in form of fixed assets (or long-term assets) and current assets. Both the type of assets are acquired to carry out various business activities. Fixed assets are used for the production of various goods and services whereas, current assets are consumed for production of various goods and services of a business. Fixed assets are used continuously in the daily business operations. Therefore, with the passage of time and their consistent use in the business their value may decrease due to normal wear and tear. This decrease or *fall in the value of the fixed assets is termed as Depreciation*. In this lesson, our basic focus will be on the reduction in the value of fixed assets and its various causes.

Reduction in the value of fixed assets associated with their continuous use in the business is regarded as Depreciation. Depreciation is a permanent decrease in the value of fixed asset. All the fixed assets, except land, have specific useful life in the business. Generally, the total cost of an asset is spread over its useful life in the business and this allocation of cost is regarded as Depreciation. Thus, it can be said that depreciation is an ***allocation of cost of an asset*** over its useful life and is ***not a valuation process of the asset***.

It should be noted that generally no depreciation is provided on land. This is because land is assumed to have an infinite life in the business.
According to William Pickles, '*Depreciation is the permanent and continuing diminution in the quality, quantity or value of an asset*'.
In the words of J.R. Batliboi, '*It is a matter of common knowledge that all fixed assets such as plant, machinery, building, furniture, etc. gradually diminish in value as they get older and become worn out by constant use in the business*'.
According to the Matching Concept, Depreciation is considered as an expense only to the extent of the decrease in the value of the asset during an accounting period. In other words, it refers to value of fixed asset consumed in the production process during an accounting period.

As depreciation is a reduction or loss in the value of fixed assets, therefore, it is charged

from the revenues earned by a business. It is charged by recording it on the Debit side of the Profit and Loss Account.

Features of Depreciation

The following are the various features of depreciation.

i. It is a fall in the book value of fixed assets.

ii. It occurs due to normal wear and tear or obsolescence of technology during its use in the business.

iii. It does not affect the market value of fixed asset. It only reduces the book value of the asset.

iv. The decrease in the value of fixed asset is permanent in nature.

v. It is an allocation of the cost of asset over its effective life.

vi. It is charged only on the Tangible fixed assets. Tangible fixed assets are those which can be seen or touched such as Building, Machinery, Furniture, etc.

vii. It is a non-cash expense of a business which does not involve any outflow of cash.

Causes of Depreciation

1. ***Continuous Use-*** The continuous use of the fixed assets in the business operations leads to reduction in their value due to the natural factors such as sun light, rain, gas, etc. Therefore, it can be said that depreciation occurs due to the normal wear and tear and constant use of the fixed assets in the business.

2. ***Expiry of Useful Life-*** All the fixed assets (except land) have only some specific life for which they are useful in the business. With the passage of time there is always a fall in the value of fixed assets irrespective of the fact whether they are used or not. This fall in the value can be due to the natural forces such as rain, weather, etc.

3. ***Obsolescence-*** Due to the fast technological innovations and inventions, the existing assets may get outdated. In such cases, the old assets are needed to be replaced by new technologically sophisticated assets. This leads to the obsolescence of fixed assets which need to be replaced even if their useful life has not expired.

4. ***Expiration of Legal Rights-*** If an asset is acquired for a specific period of time, then, whether the asset is put to use or not, its value becomes zero at the end of its useful life. For example, if a building is acquired at a cost of Rs 1,00,000 for 10 years on

lease, then each year its value depreciates by $1/10^{th}$ of its gross value and at the end of 10^{th} year, the value of the building will be zero in the books.

5. ***Accidents-*** An asset may lose its value or get damaged due to some mishaps such as fire, accident, theft or a natural calamity. Loss due to an accident is permanent in nature, in the sense, that such assets cannot be used further in the business as they have been permanently destroyed by the accident.

6. ***Permanent Reduction in the Market Value-*** Generally, the fluctuations in the market price of the fixed assets is not recorded in the Books of accounts. However, if the fall in market price is permanent, then it is recorded in the books because it leads to a fall in the value of fixed assets.

Need for Providing Depreciation

The following are the various reasons due to which there arises a need for providing depreciation.

1. ***To Determine True Net Profit or Net Loss-*** Correct profit or loss can be ascertained only when all the expenses and losses incurred during an accounting period for earning revenues are charged to Profit and Loss Account. Assets are used in various business operations for earning revenues and therefore, its cost should be charged in the form of depreciation from the Profit and Loss Account. Therefore, if depreciation is not charged, then the net result shown by the Profit and Loss Account would not reveal the true profit or loss.

2. ***To Reveal True and Fair View of Financial Position-*** If depreciation is not charged in the books, then assets would be shown at higher value than their actual value in the Balance Sheet. Consequently, the Balance Sheet fails to reflect the true and fair view of the Financial Position of a business at the end of an accounting period.

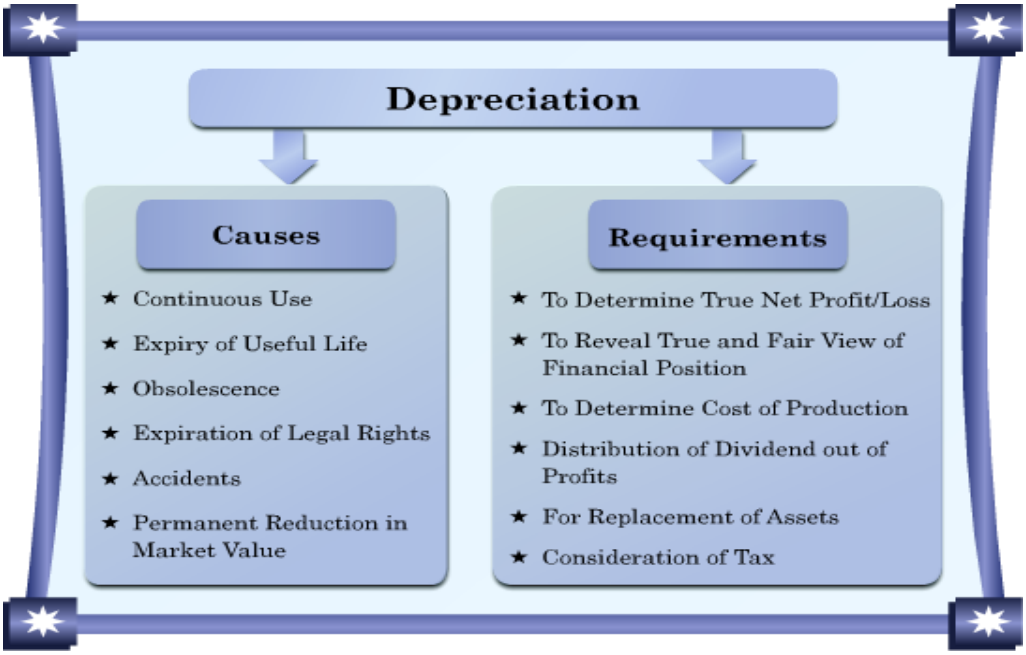
3. ***To Determine Cost of Production-*** Depreciation on Plant and Machinery and on other assets, which are engaged in production, is included in the cost of production. Cost of production is a basis for determining the selling price of products in the market. Therefore, if depreciation is not provided, then the cost of production is underestimated, which will lead to the low sale price in the market and thus leads to the lower profits.

4. ***Distribution of Dividend Out of Profit-*** In case depreciation is not charged from the revenues, the profit shown by the Profit and Loss Account will be more than actual. This may lead to the distribution of more profits as dividend out of capital instead of retaining the profit in the business. This will in turn lead to the flight of scarce capital out of the business.

5. ***For Replacement of Assets-*** Unlike other expenses, depreciation is not a cash expense, rather it is a non-cash transaction. So, the amount of depreciation charged

will be retained in the business. This amount, in the future can be used for replacement of fixed assets after its useful life.

6. ***Consideration of Tax-*** When depreciation is charged, Profit and Loss Account will disclose lesser profit as compared to when depreciation is not charged. This depicts the reduced profits and thus the business will be liable for lesser tax amount.



Other Terminologies related to Depreciation

- ***Depletion-*** This term refers to the reduction in availability of natural resources due to extraction, mining and quarrying. It helps to ascertain the reduction in product reserves of natural resources. In other words, it refers to the amount of natural resources used or consumed during an accounting period.

- ***Obsolescence-*** This term refers to the loss in the capital value of the existing fixed assets that is not physically worn out. This reduction in the value takes place due to the advancement and appreciation of technology, scientific innovations and inventions, change in fashion, adoption of cost efficient production techniques, etc.

- ***Amortisation-*** This term refers to the reduction in the value of intangible assets over its useful life. Intangible assets are those assets which do not have physical existence such as, Goodwill, Copyrights, Patents, etc. It measures the amount of intangible assets used during an accounting period.

Determinants of Depreciation & Methods of Recording

Objectives
After going through this lesson, you shall be able to understand the following concepts.

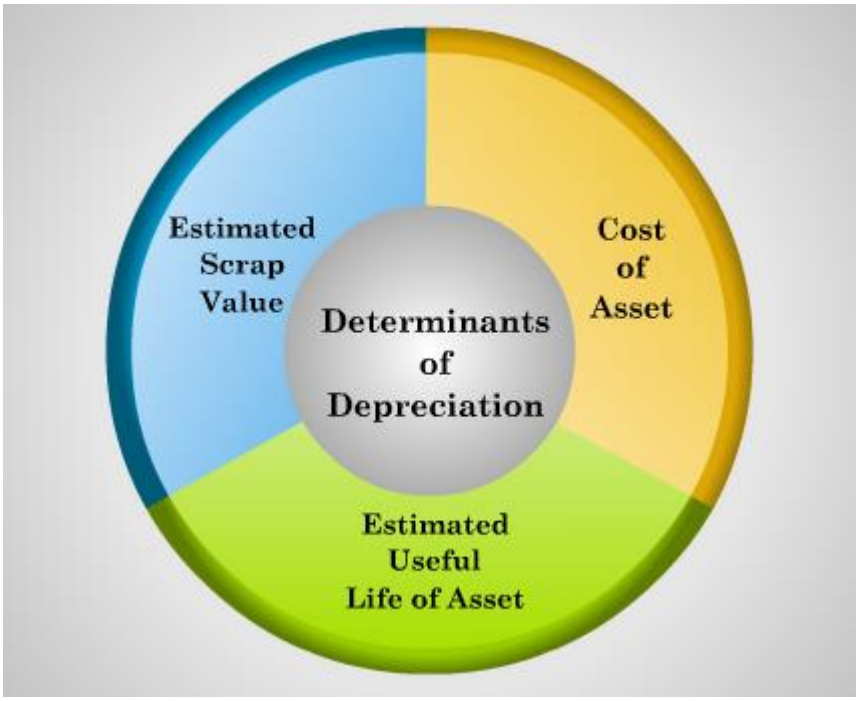
- Determinants of Depreciation
- Recording of Depreciation

Determinants of Depreciation
We know depreciation is the fall in the value of fixed assets that are used in the business operations. The calculation of the exact amount of depreciation is a troublesome process. It is generally based on estimations. However, efforts are made that estimated depreciation calculated is precise and exact. The given below are some factors that helps in determining the actual amount of depreciation.

1. ***Cost of Asset-*** For the purpose of calculating the amount of depreciation, the total cost of asset should be considered. All the expenses incurred in relation to acquiring, installing and construction of an asset and bringing the asset into usable condition are included in the total cost of the asset. Some of the examples of such costs are freight, installation cost, transit insurance cost, etc. An important point to be noted here is that the cost of asset never includes the financial charges such as interest on loan taken to purchase the fixed assets, etc.

2. ***Estimated Useful Life of Asset-*** Another factor determining the amount of depreciation is estimated useful life of the asset. The useful life of assets may be in terms of number of months, years, hours, units, etc. Every asset has its useful life other than its physical life. An asset may have a physical existence but may not be able to perform its functions. For instance, if machinery is purchased for carrying out business operations whose useful life is 10 years. But, it is expected to last only for 6 years. In such a case, the estimated useful life of the machinery will be considered only for 6 years and not 10 years.

3. ***Estimated Scrap Value-*** Scrap value is residual value or salvage value that is expected to be realised from the sale of the asset at the end of its expected useful life. Before providing the depreciation, the scrap value should be deducted from the cost of the asset. This net value of the assets i.e. difference of cost of assets and scrap value is considered as base for charging depreciation. Algebraically, it can be written as-
   Amount to be Written-off = Cost of Asset – Scrap Value
   For example, Furniture is acquired at cost of Rs 2,00,000 with its effective life of 10 years. After 10 years, furniture is expected to realise Rs 20,000. In this case, the cost of asset that should be considered for charging depreciation is Rs 1,80,000 (2,00,000 – 20,000). That is, the cost after deducting its scrap value.



4. ***Legal Provisions:*** Law has prescribed guidelines for the method of charging depreciation and rate at which it is to be charged. A business entity must refer to them to avoid any confusion at later stages.

Treatment of GST Paid to a Vendor

When a business firm purchases a machine and GST is to be paid, it will be debited to Input GST Account. This is because a firm can obtain benefit from it in the form of Input tax credit and can adjust it against the GST received on sale i.e. Output GST.

Example: Keshav Ltd. purchased machinery on 1st November, 2018 for Rs. 8, 00,000 plus CGST and SGST @ 9% each. He paid Rs. 15,000 as freight and Rs. 20,000 as loading/unloading charges to bring the machine to the plant. He incurred Rs. 10,000 as installation charges on the same. Pass Journal entries. Also, show your workings clearly.

Answer:

Working Notes:

1) Amount to be paid to the vendor:

	Rs.
Cost of Machine	8,00,000
Add: CGST @9%	72,000
SGST @9%	72,000
	9, 44,000

2) Amount debited to Machinery Account:

	Rs.
Cost of Machine	**8,00,000**
Add: Freight	**15,000**
Loading/Unloading Charges	**20,000**
Installation	**10,000**
Charges	
	8,45,000

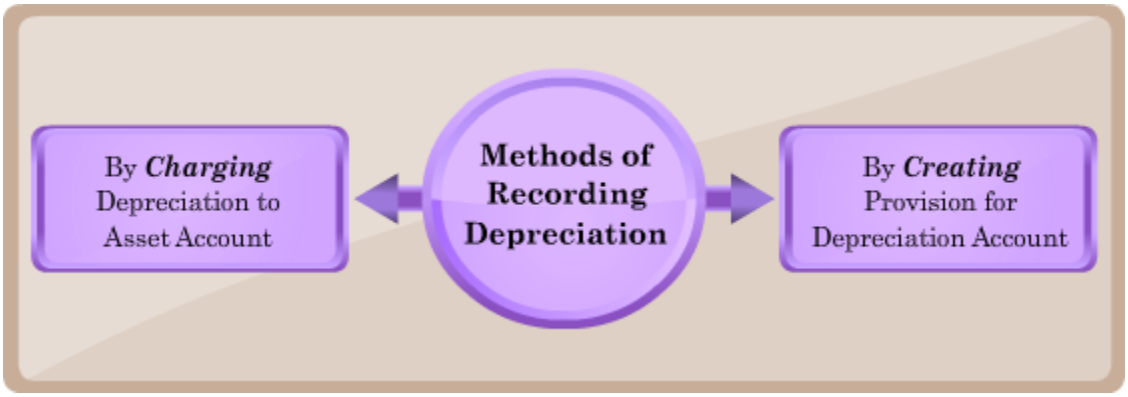
Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
2018	Machinery A/c	Dr.		8,00,000	
Nov.1	Input CGST A/c	Dr.		72,000	
	Input SGST A/c	Dr.		72,000	
	To Cash A/c				9,44,000
	(Being Machinery Purchased)				
	Machinery A/c	Dr.		45,000	
	To Cash A/c				45,000
	(Being freight, installation and loading/unloading charges paid)				

Note: Whenever a new machine is purchased any expenses paid until it becomes operational is to be added to the cost of the machine.

Recording of Depreciation

Depreciation, being the loss on the value of fixed asset, is considered as an expense for a business. It should be properly recorded in the books of accounts in order to determine the correct figure of profit or loss. There are two methods for recording depreciation in the books. These are:

1. By Charging Depreciation to Asset Account
2. By Creating Provision for Depreciation Account



1. ***By Charging Depreciation to Asset Account***

Under this method, depreciation is directly credited to the asset account. In short, depreciation is straight forwardly charged on the value of the assets. The asset on which the depreciation is charged is shown in the Balance Sheet at its depreciated value. Thus, under this method, the original cost of an asset and the total amount of depreciation cannot be determined from the Balance Sheet, as the Asset appears at its written down value. The following are the Journal entries recorded under this method.

Journal Entries

JE-1	***On Purchase of Asset***	
	Asset A/c To Cash/Bank A/c (Asset purchased)	Dr.
JE-2	***For Charging Depreciation on Asset***	
	Depreciation A/c To Asset A/c (Depreciation charged on asset)	Dr.
JE-3	***For transferring Depreciation to Profit and Loss Account***	
	Profit and Loss A/c To Depreciation A/c (Amount of depreciation transferred to profit and loss account)	Dr.
JE-4	***On Sale of Asset***	
	Cash/Bank A/c To Asset A/c (Asset sold)	Dr.

JE-5	***In Case of Profit on Sale***
	Asset A/c Dr. To Profit and Loss A/c (Profit on sale of asset)
JE-6	***In Case of Loss on Sale***
	Profit and Loss A/c Dr. To Asset A/c (Loss on sale of asset)

The given below is the format of Asset Account prepared under this method.

Asset Account

Dr. **Cr.**

Date	**Particulars**	**Amount (Rs)**	**Date**	**Particulars**	**Amount (Rs)**
	Balance b/d (In case opening balance is given) Bank A/c (Purchase of Asset- ***JE 1***) Profit and Loss A/c (Profit on Sale- ***JE-5***)**			Bank A/c (Sale of Asset- ***JE-4***) Profit and Loss A/c (Loss on Sale- ***JE-6***)** Depreciation A/c (Depreciation charged- ***JE-2***) Balance c/d (Closing Balance)	

Note- Either Profit or Loss on Sale would appear at one time.

2. ***By Creating Provision for Depreciation Account***

Under this method, depreciation is not directly credited to the Assets Account. In fact, under this, a separate account, namely, Provision for Depreciation Account is prepared for crediting depreciation. Provision for depreciation is also known as Accumulated Depreciation. As depreciation is not credited to the Asset Account, so, in this case, asset always appears at its original cost. That is, at the end of the year, asset is shown at its original cost in the Balance Sheet and total depreciation on such asset up to the date of Balance Sheet is shown as Provision for Depreciation Account. This provision can be shown either on the Assets Side as a deduction from the original cost of concerned asset or it can be separately shown on the Liabilities Side of the Balance Sheet. In the normal practice, it is

usually shown as a deduction from the original cost of the asset. The following are the Journal entries recorded under this method.

Journal Entries

JE-1	***On Purchase of Asset***	
	Asset A/c To Cash/Bank A/c (Asset purchased)	Dr.
JE-2	***For Charging Depreciation on Asset***	
	Depreciation A/c To Provision for Depreciation A/c (Depreciation charged on asset)	Dr.
JE-3	***For Transferring Depreciation to Profit and Loss Account***	
	Profit and Loss A/c To Depreciation A/c (Amount of depreciation transferred to profit and loss account)	Dr.
JE-4	***On Sale of Asset***	
	Cash/Bank A/c To Asset A/c (Asset sold)	Dr.
JE-5	***For Charging Depreciation on Part of Sale of Asset***	
	Provision for Depreciation A/c To Asset A/c (Depreciation on part of asset sold)	Dr.
JE-6	***In Case of Profit on Sale***	
	Asset A/c To Profit and Loss A/c (Profit on sale of asset)	Dr.
JE-7	***In Case of Loss on Sale***	
	Profit and Loss A/c To Asset A/c (Loss on sale of asset)	Dr.

The given below is the format of Asset Account and Provision for Depreciation Account prepared under this method.

Asset Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
	Balance b/d (In case opening balance is given) Bank A/c (Purchase of Asset- ***JE 1***) Profit and Loss A/c (Profit on Sale- ***JE-6***)** Balance b/d			Bank A/c (Sale of Asset- ***JE-4***) Provision for Depreciation A/c (Depreciation on part of asset- ***JE-5***) Profit and Loss A/c (Loss on Sale- ***JE-7***)** Balance c/d (Closing Balance)	

Note- Either Profit or Loss on Sale would appear at one time.

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
	Asset A/c (Depreciation on part of asset sold- ***JE-5***) Balance b/d (Closing Balance)			Balance b/d (Opening Balance) Depreciation A/c (Depreciation charged during the year- ***JE-2***)	

Distinction between Provision for Depreciation Account and Depreciation Account

Basis	Provision for Depreciation Account	Depreciation Account
1) Nature of Account	It is a permanent valuation account. Since it is prepared throughout the life of the machine. Hence, is shown in the Balance Sheet.	It is a temporary nominal account as one can always close this account by transferring to Profit and Loss Account.

		Also, one can switch to the Provision for Depreciation Account.
2) Effect on Asset	The asset will appear in the Balance Sheet at its original cost.	The asset will appear in the Balance Sheet at its written down value i.e. reduced value due to depreciation.
3) Disclosure in the Final accounts	Appears in the Balance Sheet.	Appears in the Profit and Loss Account.
4) Credit Vs. Debit Balance	It will have a credit balance.	It will have a debit balance.
5) Charged Against Asset	Not charged against asset and is shown at original cost.	Charged against asset.

Example 1: On January 01, 2011, Tutu Ltd. purchased a machinery for Rs 1,20,000 and spent Rs 30,000 immediately on its installation. Depreciation on asset is provided @ 10% p.a. The firm closes its books on December 31 every year. Pass Journal entries and prepare the necessary ledger accounts for two years if:
Case 1- Provision for Depreciation Account is not prepared
Case 2- Provision for Depreciation Account is prepared
Also show the disclosure of Machinery in the Balance Sheet in each of the above two cases.

Solution
Cost of asset for the purpose of Depreciation = 1,50,000
Annual Depreciation = 10% × 1,50,000 = Rs 15,000

Case 1- Provision for Depreciation Account is not prepared.

Journal
In the books of Tutu Ltd.

Date	Particulars		L.F.	Debit (Rs)	Credit (Rs)
2011					
Jan.01	Machinery A/c	Dr.		1,50,000	
	To Bank A/c				1,50,000
	(Machinery purchased)				
Dec. 31	Depreciation A/c	Dr.		15,000	
	To Machinery A/c				15,000
	(Depreciation charged on machinery)				
Dec. 31	Profit and Loss A/c	Dr.		15,000	
	To Depreciation A/c				15,000
	(Depreciation transferred to profit and loss account)				

2012 Dec. 31	Depreciation A/c To Machinery A/c (Depreciation charged on machinery)	Dr.		15,000	 15,000
Dec. 31	Profit and Loss A/c To Depreciation A/c (Depreciation transferred to profit and loss account)	Dr.		15,000	 15,000

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2011 Jan. 01	Bank A/c (1,20,000 + 30,000)	1,50,000	2011 Dec. 31	Depreciation A/c	15,000
			Dec. 31	Balance c/d	1,35,000
		1,50,000			1,50,000
2012 Jan. 01	Balance b/d	1,35,000	2012 Dec. 31	Depreciation A/c	15,000
			Dec. 31	Balance c/d	1,20,000
		1,35,000			1,35,000

Balance Sheet

as on December 31, 2012

Liabilities	Amount	Assets		Amount
		Machinery	1,35,000	
		Less: Depreciation	(15,000)	1,20,000

<u>Case 2</u>- Provision for Depreciation Account is prepared.

Journal

Date	Particulars		L.F.	Debit (Rs)	Credit (Rs)
2011 Jan.01	Machinery A/c To Bank A/c	Dr.		1,50,000	 1,50,000

	(Machinery purchased)				
Dec. 31	Depreciation A/c To Provision for Depreciation A/c (Depreciation charged on machinery)	Dr.		15,000	 15,000
Dec. 31	Profit and Loss A/c To Depreciation A/c (Depreciation transferred to profit and loss account)	Dr.		15,000	 15,000
2012 Dec. 31	Depreciation A/c To Provision for Depreciation A/c (Depreciation charged on machinery)	Dr.		15,000	 15,000
Dec. 31	Profit and Loss A/c To Depreciation A/c (Depreciation transferred to profit and loss account)	Dr.		15,000	 15,000

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2011 Jan. 01	Bank A/c (1,20,000 + 30,000)	1,50,000	2011 Dec. 31	Balance c/d	1,50,000
		1,50,000			1,50,000
2012 Jan. 01	Balance b/d	1,50,000	2012 Dec. 31	Balance c/d	1,50,000
		1,50,000			1,50,000

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2011 Dec. 31	Balance c/d	15,000	2011 Dec. 31	Depreciation A/c	15,000
		15,000			15,000
2012			2012		

			Jan. 01	Balance b/d	15,000
Dec. 31	Balance c/d	30,000	Dec. 31	Depreciation A/c	15,000
		30,000			30,000

Balance Sheet
as on December 31, 2012

Liabilities	Amount (Rs)	Assets		Amount (Rs)
		Machinery (Original Cost)	1,50,000	
		Less: Provision for Depreciation	(30,000)	1,20,000

Methods of Depreciation

Objectives
After going through this lesson, you shall be able to understand the following concepts.

- Methods of Depreciation
- Straight Line Method *versus* Written Down Value Method

Introduction
In the previous two lessons we have learnt the meaning of depreciation, its causes, requirement, determinants and the methods of recording it in the books of accounts. Now, in this chapter we will get familiarise with the various methods of charging depreciation on fixed assets.

Methods of Depreciation
There are various methods of calculating depreciation on fixed assets. Once the method for charging depreciation is selected and adopted, then, it should be followed consistently every year. The given below are the various methods for charging depreciation.

i. Straight Line Method
ii. Written Down Value Method
iii. Depreciation Fund Method
iv. Replacement Method
v. Annuity Method
vi. Insurance Policy Method
vii. Machine Hour Rate Method
viii. Sum of Years Digit Method
ix. Depletion Method
x. Revaluation Method

In this chapter, we will learn only first two methods of depreciation. The rest of the methods do not form part of the syllabus for Class-XI.

Straight Line Method
It is one of the most popular and easy method of charging depreciation on fixed assets. Under this method, depreciation is charged on the original cost of the asset every year, at a fixed rate of percentage. Therefore, in this case, *amount of depreciation remains the same for each of the year*. This method of depreciation is also known as Original Cost Method or Equal /Fixed Instalment Method.
Under this method, the amount to be written-off each year as depreciation is calculated by dividing the cost of the asset by its estimated useful life. It should be noted that scrap value of the asset is to be deducted from the original cost before calculating depreciation. The given below is the formula for calculating depreciation under this method.

For example, the cost of machinery purchased is Rs 4,70,000 and installation cost is Rs 30,000. The scrap value at the end of its estimated life of 10 years is expected to be Rs 50,000. In this case, the amount to be written-off each year as depreciation is calculated as follows-

Calculation of Rate of Depreciation under Straight Line Method
Rate of depreciation under this method is calculated with the help of given below formula-

Taking the above given example, the rate of depreciation in that case would be-

Advantages of Straight Line Method
The given below are the various advantages of Straight Line Method of depreciation.

1. It is a simple and easy method of calculating depreciation.

2. Under this method, asset can be completely written-off. That is, asset can be depreciated to its net scrap value or zero value.

3. As under this method, same or equal amount of depreciation is charged from the Profit and Loss Account each year, so, the burden of depreciation on the net profit remains the same.

4. It is suitable for those assets that have low repairs and maintenance costs and are used continuously in the business over a period of time.

Disadvantages of Straight Line Method
The disadvantages of Straight Line Method of depreciation are given below.

1. When the assets have been in use for a long time, it demands frequent repairs and maintenance. Thus, with the passage of time, the burden of depreciation on profit and loss account increases along with the repairs and maintenance costs of the asset.

2. Under this method, value of the asset becomes zero in the books even if the asset is still in the usable condition by the business.

3. The estimation of scrap value of the asset after a long period of say, 10 or 15 years, is a difficult task.

4. This method is not suitable for all kinds of fixed assets.

Written Down Value Method

This is another method of charging depreciation on the fixed assets. Under this method, depreciation is not charged on the original cost of the asset. It is charged at a fixed rate on the diminished or reduced value of the asset, i.e. the cost after deducting previously charged depreciation. As a result of this, with the decline in the value of asset year after year, the amount of depreciation also decreases from one year to another. This method of charging depreciation is also known as Diminishing Balance Method or Reducing Instalment Method.

For example, cost of machinery purchased is Rs 2,00,000 and rate of depreciation is 10% p.a. In this case, depreciation for the first year would be Rs 20,000 (i.e. 2,00,000 × 10%). For the second year, depreciation will be computed on the written down value of Rs 1,80,000 (i.e. 2,00,000 – 20,000). So, the amount of depreciation for the second year would be Rs 18,000 (i.e. 1,80,000 × 10%). In the similar manner, depreciation for the subsequent years can be computed by considering the written down value of machinery.

Calculation of Rate of Depreciation under Written Down Value Method

Rate of depreciation under this method is calculated with the help of formula given below -

Where,
R represents Rate of Depreciation
n represents Estimated Useful Life of the Asset
S represents Estimated Scrap Value
C represents Cost of the Asset
For example, the cost of machinery purchased is Rs 6,40,000. The scrap value at the end of its estimated life of 5 years is expected to be Rs 20,000. The rate of depreciation is calculated as-

Advantages of Written Down Value Method

The following are the advantages of written down value method of depreciation.

1. It is based on the logical assumption that asset is used more in the earlier years, so, more cost is charged in earlier years in the form of depreciation.

2. It is suitable for those assets that have high repairs and maintenance costs.

3. This method is accepted by the income tax authorities.

4. As more depreciation is charged in the earlier years, so the loss of the asset due to obsolescence of technology is reduced.

Disadvantages of Written Down Value Method

The given below are the disadvantages of written down value method of depreciation.

1. It is difficult and a time consuming process to calculate the rate of depreciation under this method.

2. The value of an asset under this method cannot be zero, thus, the asset cannot be completely written-off in the books.

3. Under this method, there arises shortage of funds for the replacement of an asset. This happens due to the fact that the amount of depreciation is retained and used in the business. Consequently, at the end of the useful life of an old asset, business finds it difficult to arrange funds for its replacement.

Distinction between Straight Line Method and Written Down Value Method

The given below are the various points of difference between the two methods of charging depreciation.

Point of Distinction	Straight Line Method	Written Down Value Method
Basis of Calculation	Calculated on the original cost of the asset.	Calculated on the written down value of the asset.
Amount of Depreciation	Remains the same throughout the effective life of the asset.	Reduces each year throughout the effective life of the asset.
Book Value of Asset	Book value becomes zero at the end of the effective life of the asset.	Book value of the asset can never become zero.
Suitability	Suitable for the assets which have lesser possibility of obsolescence and have lesser repair charges such as, Patents, Copyrights, Land and Buildings, etc.	It is suitable for assets that needs more repairs and maintenance costs and have higher possibility of obsolescence in the later years such as, Plant and Machinery, Car, etc.
Rate of Depreciation	Simple to calculate.	Difficult to calculate.

Effect of Depreciation and Repairs	The combined cost on account of repairs and depreciation is lower in initial years and higher in later years. In other words, it has *Unequal effect on Profit and Loss Account* over the life of the asset, as depreciation remains same for each year but repair cost increases in the later years.	The combined cost of two is more or less equal throughout the period. It means it has *Equal effect on Profit and Loss Account* over the life of the asset, as depreciation is high and repairs are less in the initial years but in the later years the repair cost increases and depreciation cost decreases.
Recognition under Income Tax Act	It is not recognised under the Income Tax Act.	It is recognised under the Income Tax Act.

Important Points to be noted

- **When rate of depreciation is given with the word 'per annum'**

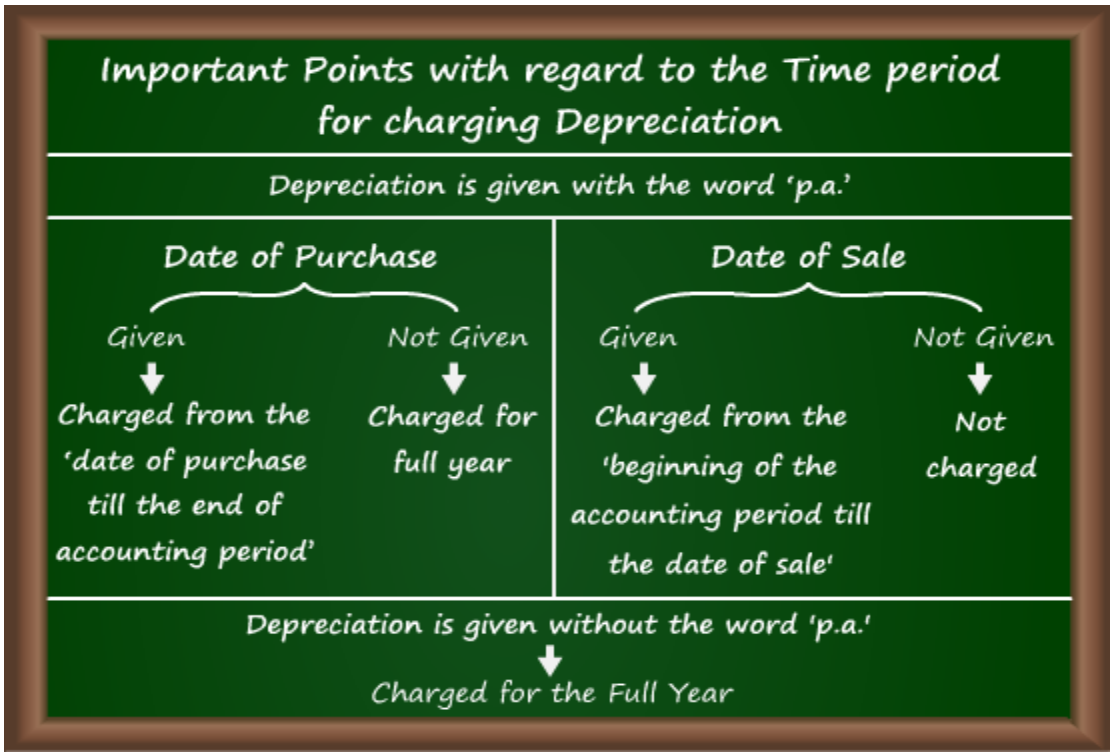
Date of Purchase	
Given	**Not Given**
Depreciation is charged for the period for which the asset is used in the business. That is, for the period from date of purchase till the end of the accounting period.	Depreciation is charged for the whole year on the assumption that asset is purchased in the beginning of the year.

Date of Sale	
Given	**Not Given**
Depreciation is charged for the period for which the asset is used in the business. That is, for the period from the beginning of the accounting period till the date of sale.	Depreciation is *not* charged on the assumption that asset is sold in the beginning of the year.

Note 1- *In case the date of purchase is given and the question clearly mentions that depreciation is to be charged for the full year, then depreciation is to be charged for the full year without considering the time factor.*
Note 2- *Similarly, in case the date of sale is given and the question clearly mentions that depreciation is to be ignored, then depreciation is not charged on the asset so sold.*

- **When rate of depreciation is *given without* the word '*per annum*'**

In case the rate of depreciation is given without the word '*per annum*', then depreciation is charged without considering the time factor. That is, depreciation on asset is charged for the full year irrespective of the date of purchase.



Straight Line Method

Objective

After going through this lesson, you shall be able to understand the Straight Line Method of charging depreciation in detail.

Straight Line Method

In the previous lesson, we learnt that it is one of the methods of charging depreciation on fixed assets. We also know that under this method, depreciation is charged on the original cost of the asset. The given below are some of the examples which will help in understanding and gaining the thorough knowledge of this method.

Example 1: On April 01, 2010, Megha Ltd. acquired a machinery costing Rs 1,65,000 on which carriage and erection charges were Rs 17,000 and Rs 28,000 respectively. The machinery was expected to realise Rs 35,000 at the end of its useful life of 7 years. Pass the necessary Journal entries in the books of Megha Ltd. for three years ending on March 31, 2013. Also, prepare Machinery Account and Depreciation on Machinery Account for three years.

Solution

Journal

Date	Particulars		L.F.	Debit Amount (Rs)	Credit Amount (Rs)
2010					
Apr. 01	Machinery A/c (1,65,000 + 17,000 + 28,000)	Dr.		2,10,000	
	To Bank A/c				2,10,000
	(Machinery purchased)				
2011					
Mar. 31	Depreciation A/c (***WN1***)	Dr.		25,000	
	To Machinery A/c				25,000
	(Depreciation charged on machinery)				
Mar. 31	Profit and Loss A/c	Dr.		25,000	
	To Depreciation A/c				25,000
	(Depreciation transferred to Profit and Loss Account)				
2012					
Mar. 31	Depreciation A/c	Dr.		25,000	
	To Machinery A/c				25,000
	(Depreciation charged on machinery)				
Mar. 31	Profit and Loss A/c	Dr.		25,000	
	To Depreciation A/c				25,000
	(Depreciation transferred to Profit and Loss Account)				
2013					
Mar. 31	Depreciation A/c	Dr.		25,000	
	To Machinery A/c				25,000
	(Depreciation charged on machinery)				
Mar. 31	Profit and Loss A/c	Dr.		25,000	
	To Depreciation A/c				25,000
	(Depreciation transferred to Profit and Loss Account)				

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2010			2011		
Apr. 01	Bank A/c	2,10,000	Mar. 31	Depreciation A/c	25,000
			Mar. 31	Balance c/d	1,85,000
		2,10,000			2,10,000

2011			2012		
Apr. 01	Balance b/d	1,85,000	Mar. 31	Depreciation A/c	25,000
			Mar. 31	Balance c/d	1,60,000
		1,85,000			1,85,000
2012			2013		
Apr. 01	Balance b/d	1,60,000	Mar. 31	Depreciation A/c	25,000
			Mar. 31	Balance c/d	1,35,000
		1,60,000			1,60,000

Depreciation on Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2011			2011		
Mar. 31	Machinery A/c	25,000	Mar. 31	Profit and Loss A/c	25,000
		25,000			25,000
2012			2012		
Mar. 31	Machinery A/c	25,000	Mar. 31	Profit and Loss A/c	25,000
		25,000			25,000
2013			2013		
Mar. 31	Machinery A/c	25,000	Mar. 31	Profit and Loss A/c	25,000
		25,000			25,000

Working Note:

WN1- *Calculation of Depreciation*

$$\text{Annual Depreciation} = \frac{\text{Original Cost of Asset} - \text{Estimated Scrap Value}}{\text{Estimated Useful Life}}$$

$$= \frac{(1,65,000 + 17,000 + 28,000) - 35,000}{7} = \text{Rs } 25,000$$

Example 2: Furniture costing Rs 2,40,000 was purchased on January 01, 2009 and Rs 25,000 was paid for its cartage. Depreciation is charged at 12% p.a. by Straight Line Method. Assuming the books are closed on December 31 each year, prepare Furniture Account and Depreciation for four years.

Solution

Furniture Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount

		(Rs)			(Rs)
2009			2009		
Jan. 01	Bank A/c (2,40,000 + 25,000)	2,65,000	Dec. 31	Depreciation A/c (2,65,000 × 12%)	31,800
			Dec. 31	Balance c/d	2,33,200
		2,65,000			2,65,000
2010			2010		
Jan. 01	Balance b/d	2,33,200	Dec. 31	Depreciation A/c (2,65,000 × 12%)	31,800
			Dec. 31	Balance c/d	2,01,400
		2,33,200			2,33,200
2011			2011		
Jan. 01	Balance b/d	2,01,400	Dec. 31	Depreciation A/c (2,65,000 × 12%)	31,800
			Dec. 31	Balance c/d	1,69,600
		2,01,400			2,01,400
2012			2012		
Jan. 01	Balance b/d	1,69,600	Dec. 31	Depreciation A/c (2,65,000 × 12%)	31,800
			Dec. 31	Balance c/d	1,37,800
		1,69,600			1,69,600

Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2009			2009		
Dec. 31	Furniture A/c	31,800	Dec. 31	Profit and Loss A/c	31,800
		31,800			31,800
2010			2010		
Dec. 31	Furniture A/c	31,800	Dec. 31	Profit and Loss A/c	31,800
		31,800			31,800
2011			2011		
Dec. 31	Furniture A/c	31,800	Dec. 31	Profit and Loss A/c	31,800
		31,800			31,800
2012			2012		
Dec. 31	Furniture A/c	31,800	Dec. 31	Profit and Loss A/c	31,800
		31,800			31,800

Example 3: On January 01, 2010, a plant costing Rs 68,000 was purchased and Rs 12,000 was spent on its installation. It was expected to realise Rs 15,000 at the end of its effective life of 13 years. On April 01, 2011, another plant costing Rs 95,000 was acquired and Rs 8,000 was spent for its freight. The estimated life of this plant was 9 years at the end of which it is expected to realise Rs 13,000. On July 01, 2012, a new plant was purchased for Rs 50,000 the residual value of which after effective life of 10 years will be Rs 5,000. Prepare a Machinery Account from 2010 to 2012 on the assumption that accounts are closed on December 31 each year.

Solution

Plant Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010			2010			
Jan. 01	Bank A/c (P1) (68,000 + 12,000)	80,000	Dec. 31	Depreciation A/c (P1)		5,000
			Dec. 31	Balance c/d		75,000
		80,000				80,000
2011			2011			
Jan. 01	Balance b/d	75,000	Dec. 31	Depreciation A/c		
Apr. 01	Bank A/c (P2) (95,000 + 8,000)	1,03,000		P1	5,000	
				P2 (*for 9 months*)	7,500	12,500
			Dec. 31	Balance c/d		
				P1	70,000	
				P2	95,500	1,65,500
		1,78,000				1,78,000
2012			2012			
Jan. 01	Balance b/d		Dec. 31	Depreciation A/c		
	P1 70,000			P1	5,000	
	P2 95,500	1,65,500		P2	10,000	
Jul. 01	Bank A/c (P3)	50,000		P3 *(for 6 months)*	2,250	17,250
			Dec. 31	Balance c/d		
				P1	65,000	
				P2	85,500	
				P3	47,750	1,98,250
		2,15,500				2,15,500

Working Notes: *Calculation of Depreciation on Plant*

Example 4: On January 01, 2010, a machinery was purchased for Rs 4,00,000. Another second hand machinery costing Rs 1,25,000 was purchased on April 01, 2011 and Rs 25,000 was paid for its installation. Depreciation is charged @ 5% p.a. on the original cost basis.
Prepare Machinery Account for three years, assuming that books are closed on December 31 each year.

Solution

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010			2010			
Jan. 01	Bank A/c (M1)	4,00,000	Dec. 31	Depreciation A/c (M1)		20,000
			Dec. 31	Balance c/d		3,80,000
		4,00,000				4,00,000
2011			2011			
Jan. 01	Balance b/d	3,80,000	Dec. 31	Depreciation A/c		
Apr. 01	Bank A/c (M2)	1,50,000		M1	20,000	
				M2 (*for 9 months*)	5,625	25,625
			Dec. 31	Balance c/d		
				M1	3,60,000	
				M2	1,44,375	5,04,375
		5,30,000				5,30,000
2012			2012			
Jan. 01	Balance b/d		Dec. 31	Depreciation A/c		
	M1 3,60,000			M1	20,000	
	M2 1,44,375	5,04,375		M2	7,500	27,500
			Dec. 31	Balance c/d		
				M1	3,40,000	
				M2	1,36,875	4,76,875
		5,04,375				5,04,375

Working Notes: *Calculation of Depreciation*

Example 5: Max Ltd. bought a truck for Rs 4,50,000 on July 01, 2010. During the year 2012, on October 01, the truck was sold for Rs 2,15,000. Depreciation is charged at 20% p.a. on original cost basis. Prepare Truck Account and Depreciation Account assuming the books are closed on December 31 every year. Also pass the necessary Journal entries.

Solution

Journal

Date	Particulars		L.F.	Debit Amount (Rs)	Credit Amount (Rs)
2010					
Jul. 01	Truck A/c	Dr.		4,50,000	
	To Bank A/c				4,50,000
	(Truck purchased)				
Dec. 31	Depreciation A/c (***WN1***)	Dr.		45,000	
	To Truck A/c				45,000
	(Depreciation charged for 6 months)				
Dec. 31	Profit and Loss A/c	Dr.		45,000	
	To Depreciation A/c				45,000
	(Depreciation transferred to Profit and Loss Account)				
2011					
Dec. 31	Depreciation A/c (***WN1***)	Dr.		90,000	
	To Truck A/c				90,000
	(Depreciation charged on truck)				
Dec. 31	Profit and Loss A/c	Dr.		90,000	
	To Depreciation A/c				90,000
	(Depreciation transferred to Profit and Loss Account)				
2012					
Oct. 01	Depreciation A/c	Dr.		67,500	
	To Truck A/c				67,500
	(Depreciation charged for 9 months)				
Oct. 01	Bank A/c	Dr.		2,15,000	
	To Truck A/c				2,15,000
	(Truck sold)				
Oct. 01	Profit and Loss A/c (***WN2***)	Dr.		32,500	
	To Truck A/c				32,500
	(Loss on sale of truck)				
Dec. 31	Profit and Loss A/c (***WN1***)	Dr.		67,500	
	To Depreciation A/c				67,500

	(Depreciation transferred to Profit and Loss Account)			

Truck Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2010			2010		
Jul. 01	Bank A/c	4,50,000	Dec. 31	Depreciation A/c (*for 6 months*)	45,000
			Dec. 31	Balance c/d	4,05,000
		4,50,000			4,50,000
2011			2011		
Jan. 01	Balance b/d	4,05,000	Dec. 31	Depreciation A/c	90,000
			Dec. 31	Balance c/d	3,15,000
		4,05,000			4,05,000
2012			2012		
Jan. 01	Balance b/d	3,15,000	Oct. 01	Depreciation A/c (*for 9 months*)	67,500
			Oct. 01	Bank A/c (*sale of truck*)	2,15,000
			Oct. 01	Profit and Loss A/c (*Loss on sale*)	32,500
		3,15,000			3,15,000

Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2010			2010		
Dec. 31	Truck A/c	45,000	Dec. 31	Profit and Loss A/c	45,000
		45,000			45,000
2011			2011		
Dec. 31	Truck A/c	90,000	Dec. 31	Profit and Loss A/c	90,000
		90,000			90,000
2012			2012		
Dec. 31	Truck A/c	67,500	Dec. 31	Profit and Loss A/c	67,500
		67,500			67,500

Working Notes:

WN1- *Calculation of Depreciation*

WN2- *Calculation of Profit or Loss on Sale*

Particulars	Amount
Value of Truck as on Jan. 01, 2012	3,15,000
Less: Depreciation for 9 months	(67,500)
Value of Truck as on Oct. 01, 2012	2,47,500
Less: Sale Value	(2,15,000)
Loss on Sale	**32,500**

Example 6: On January 01, 2010, a machinery was purchased for Rs 9,00,000. During the same year, on May 31, 2010, an additional second-hand machinery was also purchased for Rs 6,30,000. On September 01, 2012, second-hand machinery purchased on May 31 goes out of order and sold for Rs 4,20,000. On the same date, a new machinery was acquired for Rs 3,50,000. Depreciation charged at 15% p.a. on Equal Instalment Method.
Record the necessary Journal entries in the books and also prepare the Machinery Account. The books are closed on 31st December every year.

Solution

Journal

Date	Particulars	L.F.	Debit Amount (Rs)	Credit Amount (Rs)
2010				
Jan. 01	Machinery A/c Dr.		9,00,000	
	To Bank A/c			9,00,000
	(Machinery purchased)			
May 31	Machinery A/c Dr.		6,30,000	
	To Bank A/c			6,30,000
	(Another second-hand machinery purchased)			
Dec. 31	Depreciation A/c Dr.		1,90,125	
	To Machinery A/c			1,90,125
	(Depreciation charged on machinery)			
Dec. 31	Profit and Loss A/c Dr.		1,90,125	
	To Depreciation A/c			1,90,125
	(Depreciation transferred to Profit and Loss Account)			
2011				

Dec. 31	Depreciation A/c To Machinery A/c (Depreciation charged on machinery)	Dr.		2,29,500	 2,29,500
Dec. 31	Profit and Loss A/c To Depreciation A/c (Depreciation transferred to Profit and Loss Account)	Dr.		2,29,500	 2,29,500
2012 Sept. 01	Depreciation A/c To Machinery A/c (Depreciation charged on machinery sold)	Dr.		63,000	 63,000
Sept. 01	Bank A/c To Machinery A/c (Machinery sold)	Dr.		4,20,000	 4,20,000
Sept. 01	Machinery A/c To Profit and Loss A/c (Profit on sale of machinery)	Dr.		2,625	 2,625
Sept. 01	Machinery A/c To Bank A/c (Purchase of new machinery)	Dr.		3,50,000	 3,50,000
Dec. 31	Depreciation A/c To Machinery A/c (Depreciation charged on machinery)	Dr.		1,52,500	 1,52,500
Dec. 31	Profit and Loss A/c (63,000 + 1,52,500) To Depreciation A/c (Depreciation transferred to Profit and Loss Account)	Dr.		2,15,500	 2,15,500

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010			2010			
Jan. 01	Bank A/c (M1)	9,00,000	Dec. 31	Depreciation on-		
May 31	Bank A/c (M2)	6,30,000		M1	1,35,000	
				M2 (*for 7 months*)	55,125	1,90,125
			Dec. 31	Balance c/d		

					M1	7,65,000	
					M2	5,74,875	13,39,875
			15,30,000				15,30,000
2011				2011			
Jan. 01	Balance b/d			Dec. 31	Depreciation on-		
	M1	7,65,000			M1	1,35,000	
	M2	5,74,875	13,39,875		M2	94,500	2,29,500
				Dec. 31	Balance c/d		
					M1	6,30,000	
					M2	4,80,375	11,10,375
			13,39,875				13,39,875
2012				2012			
Jan. 01	Balance b/d			Sep. 01	Depreciation A/c (*On M2 for 8 months*)		63,000
	M1	6,30,000		Sep. 01	Bank A/c (*Sale of M2*)		4,20,000
	M2	4,80,375	11,10,375	Dec. 31	Depreciation on		
Sept. 01	Profit and Loss A/c (*Profit*)		2,625		M1	1,35,000	
Sept. 01	Bank A/c (M3)		3,50,000		M3 (*for 4 months*)	17,500	1,52,500
				Dec. 31	Balance c/d		
					M1 (6,30,000 – 1,35,000)	4,95,000	
					M3 (3,50,000 – 17,500)	3,32,500	8,27,500
			14,63,000				**14,63,000**

Working Notes: *Calculation of Profit or Loss on Sale*

Particulars	**Amount (Rs)**
Value of M2 as on Jan. 01, 2012	4,80,375
Less: Depreciation for 8 months	(63,000)
Value of M2 as on Sept. 01, 2012	4,17,375
Less: Sale Value	(4,20,000)
Profit on Sale	**2,625**

Example 7: Hema Ltd. purchased furniture for Rs. 3, 00,000 plus CGST and SGST @ 6% each on 1st April, 2016. Additional furniture was purchased for Rs. 50,000 plus IGST @ 12% by cheque on 1st October, 2017. Depreciation is charged @ 15% p.a. by the Straight Line Method. Accounts are closed on 31st March every year. Pass necessary journal entries for the years ended 31st March, 2017, 2018 and 2019 and show Machinery Account and Machinery in the Balance Sheet.

Answer: **In the Books of Hema Ltd.**

Journal

Date	Particulars		L.F.	Dr.(Rs.)	Cr.(Rs.)
2016 Apr. 1	Furniture A/c Input CGST A/c Input SGST A/c To Cash/ Bank A/c (Being furniture purchased plus CGST and SGST paid)	Dr.		3,00,000 18,000 18,000	 3,36,000
2017 Mar. 31	Depreciation A/c To Furniture A/c (Being depreciation charged on Furniture)	Dr.		45,000	 45,000
Mar.31	Profit & Loss A/c To Depreciation A/c (Being depreciation transferred to Profit & Loss Account)	Dr.		45,000	 45,000
2017 Oct.1	Furniture A/c Input IGST A/c To Bank A/c (Being inter-state purchase of furniture)	Dr.		50,000 6,000	 56,000
2018 Mar.31	Depreciation A/c To Furniture A/c (Being depreciation charged on Furniture)	Dr.		48,750	 48,750
Mar.31	Profit & Loss A/c To Depreciation A/c (Being depreciation transferred to Profit & Loss Account)	Dr.		48,750	 48,750
2019 Mar.31	Depreciation A/c To Furniture A/c (Being depreciation charged on Furniture)	Dr.		52,500	 52,500
Mar.31	Profit & Loss A/c To Depreciation A/c (Being depreciation transferred to Profit & Loss Account)	Dr.		52,500	 52,500

Note: GST paid is not added to the cost of furniture since it is to be set off against GST collected

Dr. **Furniture A/c** **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2016				2017			
Apr. 1	To Cash/ Bank A/c		3,00,000	Mar.31	By Depreciation A/c		45,000
				Mar.31	By Balance c/d		2,55,000
			3,00,000				3,00,000
2017				2018			
Apr. 1	To Balance b/d		2,55,000	Mar.31	By Depreciation A/c		48,750
Oct. 1	To Bank A/c		50,000	Mar.31	By Balance c/d		2,56,250
					Furniture 1 2,10,000		
					Furniture 2 46,250		
			3,05,000				3,05,000
2018				2019			
Apr. 1	To balance b/d		2,56,250	Mar.31	By Depreciation A/c		52,500
					Furniture 1 45,000		
					Furniture 2 7,500		
				Mar.31	By Balance c/d		2,03,750
					Furniture 1 1,65,000		
					Furniture 2 38,750		
			2,56,250				2,56,250

Dr. **Depreciation A/c** **Cr.**

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2017				2017			
Mar.31	To Furniture A/c		45,000	Mar.31	By Profit & Loss A/c		45,000
			45,000				45,000
2018				2018			
Mar.31	To Furniture A/c		48,750	Mar.31	By Profit & Loss A/c		48,750
			48,750				48,750
2019				2019			
Mar.31	To Furniture A/c		52,500	Mar.31	By Profit & Loss A/c		52,500

			52,500				52,500

Written Down Value Method

Objective

After going through this lesson, you shall be able to understand the Written Down Value Method of charging depreciation.

Written Down Value Method
As against the Straight Line Method, under this method, depreciation is charged on the book value or diminished value of the asset. The given below are some examples which will help you to understand this method of depreciation in a better way.

Example 1**:** On January 01, 2009 a machinery was acquired for Rs 11,00,000 on which erection and freight was paid Rs 23,000 and Rs 27,000 respectively. The estimated scrap value at the end of its effective life was expected to be Rs 32,000. Depreciation is provided at 10% p.a. on Written Down Value Method. Pass the necessary Journal entries in the books and also show Machinery Account and Depreciation Account for four years. The books are closed on December 31 each year.

Solution

Journal

Date	Particulars		L.F.	Debit Amount (Rs)	Credit Amount (Rs)
2009 Jan. 01	Machinery A/c (11,00,000 + 23,000 + 27,000)	Dr.		11,50,000	
	To Bank A/c				11,50,000
	(Machinery purchased)				
Dec. 31	Depreciation A/c	Dr.		1,15,000	
	To Machinery A/c				1,15,000
	(Depreciation charged on machinery)				
Dec. 31	Profit and Loss A/c	Dr.		1,15,000	
	To Depreciation A/c				1,15,000
	(Depreciation transferred to Profit and Loss Account)				

2010					
Dec. 31	Depreciation A/c	Dr.		1,03,500	
	To Machinery A/c				1,03,500
	(Depreciation charged on machinery)				
Dec. 31	Profit and Loss A/c	Dr.		1,03,500	
	To Depreciation A/c				1,03,500
	(Depreciation transferred to Profit and Loss Account)				
2011					
Dec. 31	Depreciation A/c	Dr.		93,150	
	To Machinery A/c				93,150
	(Depreciation charged on machinery)				
Dec. 31	Profit and Loss A/c	Dr.		93,150	
	To Depreciation A/c				93,150
	(Depreciation transferred to Profit and Loss Account)				
2012					
Dec. 31	Depreciation A/c	Dr.		83,835	
	To Machinery A/c				83,835
	(Depreciation charged on machinery)				
Dec. 31	Profit and Loss A/c	Dr.		83,835	
	To Depreciation A/c				83,835
	(Depreciation transferred to Profit and Loss Account)				

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2009			2009		
Jan. 01	Bank A/c	11,50,000	Dec. 31	Depreciation A/c (11,50,000 × 10%)	1,15,000
			Dec. 31	Balance c/d	10,35,000
		11,50,000			11,50,000
2010			2010		
Jan. 01	Balance b/d	10,35,000	Dec. 31	Depreciation A/c (10,35,000 × 10%)	1,03,500
			Dec. 31	Balance c/d	9,31,500
		10,35,000			10,35,000
2011			2011		

Jan. 01	Balance b/d	9,31,500	Dec. 31	Depreciation A/c (9,31,500 × 10%)	93,150
			Dec. 31	Balance c/d	8,38,350
		9,31,500			9,31,500
2012			2012		
Jan. 01	Balance b/d	8,38,350	Dec. 31	Depreciation A/c (8,38,350 × 10%)	83,835
			Dec. 31	Balance c/d	7,54,515
		8,38,350			8,38,350

Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2009			2009		
Dec. 31	Machinery A/c	1,15,000	Dec. 31	Profit and Loss A/c	1,15,000
		1,15,000			1,15,000
2010			2010		
Dec. 31	Machinery A/c	1,03,500	Dec. 31	Profit and Loss A/c	1,03,500
		1,03,500			1,03,500
2011			2011		
Dec. 31	Machinery A/c	93,150	Dec. 31	Profit and Loss A/c	93,150
		93,150			93,150
2012			2012		
Dec. 31	Machinery A/c	83,835	Dec. 31	Profit and Loss A/c	83,835
		83,835			83,835

Example 2: On January 01, 2010, the furniture account of Hemraj Ltd. showed a balance of Rs 2,70,000. In the same year, on July 01, 2010, additional furniture worth Rs 1,20,000 was purchased. On April 01, 2011 new furniture costing Rs 1,60,000 was purchased. Depreciation is provided at 15% p.a. on the Diminishing Balance Method. Prepare furniture account upto December 31, 2012, assuming that books are closed on December 31 each year.

Solution

Furniture Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010				2010			
Jan. 01	Balance b/d (F1)		2,70,000	Dec. 31	Depreciation A/c		
Jul. 01	Bank A/c (F2)		1,20,000		F1	40,500	
					F2 (*for 6 months*)	9,000	49,500
				Dec. 31	Balance c/d		
					F1	2,29,500	
					F2	1,11,000	3,40,500
			3,90,000				3,90,000
2011				2011			
Jan. 01	Balance b/d			Dec. 31	Depreciation A/c		
	F1	2,29,500			F1 (2,29,500 × 15%)	34,425	
	F2	1,11,000	3,40,500		F2 (1,11,000 × 15%)	16,650	
Apr. 01	Bank A/c (F3)		1,60,000		F3 (*for 9 months*)	18,000	69,075
				Dec. 31	Balance c/d		
					F1	1,95,075	
					F2	94,350	
					F3	1,42,000	4,31,425
			5,00,500				5,00,500
2012				2012			
Jan. 01	Balance b/d			Dec. 31	Depreciation A/c		
	F1	1,95,075			F1 (1,95,075 × 15%)	29,261	
	F2	94,350			F2 (94,350 × 15%)	14,153	
	F3	1,42,000	4,31,425		F3 (1,42,000 × 15%)	21,300	64,714
				Dec. 31	Balance c/d		
					F1	1,65,814	
					F2	80,197	
					F3	1,20,700	3,66,711
			4,31,425				4,31,425

Example 3: Shiny Ltd. acquired a machinery for Rs 2,00,000 on May 01, 2010. During the year 2012, the machinery was sold for Rs 1,06,000 on August 31. Depreciation is charged at 8% p.a. Prepare Machinery Account and Depreciation Account assuming the books are closed on December 31 every year.

Solution

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)

2010			2010		
May 01	Bank A/c	2,00,000	Dec. 31	Depreciation A/c (*for 8 months*)	10,667
			Dec. 31	Balance c/d	1,89,333
		2,00,000			2,00,000
2011			2011		
Jan. 01	Balance b/d	1,89,333	Dec. 31	Depreciation A/c (1,89,333 × 8%)	15,147
			Dec. 31	Balance c/d	1,74,186
		1,89,333			1,89,333
2012			2012		
Jan. 01	Balance b/d	1,74,186	Aug. 31	Depreciation A/c (*for 8 months*)	9,290
			Aug. 31	Bank A/c (*Sale of Machine*)	1,06,000
			Aug. 31	Profit and Loss A/c (*Loss on Sale*)	58,896
		1,74,186			1,74,186

Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2010			2010		
Dec. 31	Machinery A/c	10,667	Dec. 31	Profit and Loss A/c	10,667
		10,667			10,667
2011			2011		
Dec. 31	Machinery A/c	15,147	Dec. 31	Profit and Loss A/c	15,147
		15,147			15,147
2012			2012		
Dec. 31	Machinery A/c	9,290	Dec. 31	Profit and Loss A/c	9,290
		9,290			9,290

Working Notes: *Calculation of Profit or Loss on Sale*

Particulars	Amount
Value of Machinery as on Jan. 01, 2012	1,74,186
Less: Depreciation for 8 months	(9,290)
Value of Machinery as on Aug. 01, 2012	1,64,896
Less: Sale Value	(1,06,000)
Loss on Sale	**58,896**

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Example 4: On January 01, 2010, a machinery was purchased for Rs 4,72,000 and Rs 28,000 was paid for its carriage and installation. Another machinery costing Rs 3,60,000 was acquired on June 01, 2011. On March 01, 2012, machinery purchased on January 01, 2010 was sold for Rs 3,88,700. On the same date, new machinery costing Rs 2,50,000 was purchased and installed. Depreciation is charged at 10% p.a. on Written Down Value Method. Record the necessary Journal entries in the books and also prepare machinery account and depreciation. The books are closed on December 31 every year.

Solution

Journal

Date	Particulars		L.F.	Debit Amount (Rs)	Credit Amount (Rs)
2010 Jan. 01	Machinery A/c (4,72,000 + 28,000)	Dr.		5,00,000	
	To Bank A/c				5,00,000
	(Machinery purchased)				
Dec. 31	Depreciation A/c	Dr.		50,000	
	To Machinery A/c				50,000
	(Depreciation charged on machinery)				
Dec. 31	Profit and Loss A/c	Dr.		50,000	
	To Depreciation A/c				50,000
	(Depreciation transferred to Profit and Loss Account)				
2011 June 01	Machinery A/c	Dr.		3,60,000	
	To Bank A/c				3,60,000
	(Machinery purchased)				
Dec. 31	Depreciation A/c (45,000 + 21,000)	Dr.		66,000	
	To Machinery A/c				66,000
	(Depreciation charged on machinery)				
Dec. 31	Profit and Loss A/c	Dr.		66,000	
	To Depreciation A/c				66,000
	(Depreciation transferred to Profit and Loss Account)				
2012 Mar. 01	Depreciation A/c	Dr.		6,750	

	To Machinery A/c (Depreciation charged on machinery sold)				6,750
Mar. 01	Bank A/c	Dr.		3,88,700	
	To Machinery A/c (Machinery sold)				3,88,700
Mar. 01	Profit and Loss A/c	Dr.		9,550	
	To Machinery A/c (Loss on sale of machinery)				9,550
Mar. 01	Machinery A/c	Dr.		2,50,000	
	To Bank A/c (Purchase of new machinery)				2,50,000
Dec. 31	Depreciation A/c To Machinery A/c (Depreciation charged on machinery)	Dr.		54,733	54,733
Dec. 31	Profit and Loss A/c (54,733 + 6,750) To Depreciation A/c (Depreciation transferred to Profit and Loss Account)	Dr.		61,483	61,483

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010			2010			
Jan. 01	Bank A/c (M1)	5,00,000	Dec. 31	Depreciation A/c (M1)		50,000
			Dec. 31	Balance c/d		4,50,000
		5,00,000				5,00,000
2011			2011			
Jan. 01	Balance b/d	4,50,000	Dec. 31	Depreciation A/c		
Jun. 01	Bank A/c (M2)	3,60,000		M1	45,000	
				M2 (*for 7 months*)	21,000	66,000
			Dec. 31	Balance c/d		
				M1	4,05,000	
				M2	3,39,000	7,44,000
		8,10,000				8,10,000
2012			2012			

Jan. 01	Balance b/d		Mar. 01	Depreciation A/c (*on M1 for 2 months*)		6,750
	M1 4,05,000			Bank A/c (*Sale of M1*)		3,88,700
	M2 3,39,000	7,44,000		Profit and Loss A/c (*Loss on Sale*)		9,550
Mar. 01	Bank A/c (M3)	2,50,000	Dec.31	Depreciation on-		
				M2	33,900	
				M3	20,833	54,733
			Dec. 31	Balance c/d		
				M2	3,05,100	
				M3	2,29,167	5,34,267
		9,94,000				9,94,000

Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2010			2010		
Dec. 31	Machinery A/c	50,000	Dec. 31	Profit and Loss A/c	50,000
		50,000			50,000
2011			2011		
Dec. 31	Machinery A/c	66,000	Dec. 31	Profit and Loss A/c	66,000
		66,000			66,000
2012			2012		
Dec. 31	Machinery A/c	61,483	Dec. 31	Profit and Loss A/c	61,483
		61,483			61,483

Working Notes: *Calculation of Profit or Loss on Sale*

Particulars	Amount
Value of M1 as on Jan. 01, 2012	4,05,000
Less: Depreciation for 2 months	(6,750)
Value of M1 as on Marc. 01, 2012	3,98,250
Less: Sale Value	(3,88,700)
Loss on Sale	**9,550**

Example 5: On 1st July, 2016 Krystal Ltd. purchased machinery for Rs. 6, 00,000. On 1st October, 2018, this machinery was destroyed and Rs. 2, 50,000 was received by a cheque from the Insurance Company in full settlement on 1st January, 2019. On 1st October, 2018 additional machinery was purchased for Rs. 4, 00,000 plus IGST @12%. The company

charges depreciation @10% per annum. Prepare Machinery Account from 2016 to 2019 when books are closed on 31st March every year.

Answer:

Dr. Machinery A/c Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2016				2017			
Jul.1	To Cash/ Bank A/c		6,00,000	Mar.31	By Depreciation A/c (for 9 months)		45,000
				Mar.31	By Balance c/d		5,55,000
			6,00,000				6,00,000
2017				2018			
Apr. 1	To Balance b/d		5,55,000	Mar.31	By Depreciation A/c		55,500
				Mar.31	By Balance c/d		4,99,500
			5,55,000				5,55,000
2018				2019			
Apr. 1	To balance b/d		4,99,500	Jan.1	By Bank A/c		2,50,000
Oct.1	To Bank A/c		4,00,000	Jan.1	By Loss on sale of Machine A/c		2,24,525
				Mar.31	By Depreciation A/c		44,975
				Mar.31	By Balance c/d		3,80,000
			8,99,500				8,99,500

Dr. Depreciation A/c Cr.

Date	Particulars	J.F.	Rs.	Date	Particulars	J.F.	Rs.
2017				2017			
Mar.31	To Machinery A/c		45,000	Mar.31	By Profit & Loss A/c		45,000
			45,000				45,000
2018				2018			
Mar.31	To Machinery A/c		55,500	Mar.31	By Profit & Loss A/c		55,500
			55,500				55,500
2019				2019			
Mar.31	To Machinery A/c		44,975	Mar.31	By Profit & Loss A/c		44,975
			44,975				44,975

Working Notes:

1) Calculation of Depreciation

a) 10% of Rs.4,99,500 for 6 months (4,99,500 x 10/100 x 6/12)

b) 10% of Rs.4,00,000 for 6 months (4,00,00 x 10/100 x 6/12)

Total Depreciation

2) Calculation of Loss on Machinery due to Fire

a) Original Cost
Less: Depreciation (45,000 + 55,500 + 24,975)
Book Value on the accident date

b) Insurance Claim
Less: Book Value on the accident date

Loss on Machinery destroyed

Note: Whenever a new machine is purchased any expenses paid until it becomes operational is to be added to the cost of the machine. Hence, not included in the Rs. 4,00,000 machinery cost.

Asset Account with Provision for Depreciation Account

Objective

After going through this lesson, you shall be able to understand the preparation of Asset Account along with Provision for Depreciation Account.

Introduction
In the previous lessons, we have already learnt that depreciation can be recorded in the books either by directly charging it to the Assets Account or by preparing a separate account i.e. Provision for Depreciation Account. When depreciation is directly charged to

the assets, then depreciation so charged is shown in the Assets Account itself. This method we have already learnt in the previous lessons. Now in this lesson, we will learn how to prepare Assets Account when depreciation is recorded in a separate account i.e. in the Provision for Depreciation Account.
The given below are some examples which will help in getting the better hold over this concept.

Example 1: On January 01, 2010, furniture costing Rs 3,00,000 was purchased. On July, 01, 2011 additional furniture costing Rs 1,70,000 was purchased and Rs 10,000 was paid for its carriage. Depreciation was charged @ 5% p.a. on Straight Line Method.
Prepare necessary ledger accounts for the period from 2010 to 2012, if Provision for Depreciation Account is maintained for recording depreciation. Also pass the necessary Journal entries. Assume that books are closed on December 31 each year.

Solution

Journal

Date	Particulars		L.F.	Debit (Rs)	Credit (Rs)
2010					
Jan. 01	Furniture A/c	Dr.		3,00,000	
	To Bank A/c				3,00,000
	(Furniture purchased)				
Dec. 31	Depreciation A/c	Dr.		15,000	
	To Provision for Depreciation A/c				15,000
	(Depreciation charged on furniture)				
Dec. 31	Profit and Loss A/c	Dr.		15,000	
	To Depreciation A/c				15,000
	(Depreciation transferred to Profit and Loss Account)				
2011					
Jul. 01	Furniture A/c (1,70,000 + 10,000)	Dr.		1,80,000	
	To Bank A/c				1,80,000
	(Furniture purchased)				
Dec. 31	Depreciation A/c	Dr.		19,500	
	To Provision for Depreciation A/c				19,500
	(Depreciation charged on furniture)				
Dec. 31	Profit and Loss A/c	Dr.		19,500	
	To Depreciation A/c				19,500
	(Depreciation transferred to Profit and Loss Account)				
2012					

Dec. 31	Depreciation A/c To Provision for Depreciation A/c (Depreciation charged on furniture)	Dr.		24,000	 24,000
Dec. 31	Profit and Loss A/c To Depreciation A/c (Depreciation transferred to Profit and Loss Account)	Dr.		24,000	 24,000

Furniture Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010				2010			
Jan. 01	Bank A/c (F1)		3,00,000	Dec. 31	Balance c/d		3,00,000
			3,00,000				3,00,000
2011				2011			
Jan. 01	Balance b/d		3,00,000	Dec. 31	Balance c/d		
Jul. 01	Bank A/c (F2)		1,80,000		F1	3,00,000	
					F2	1,80,000	4,80,000
			4,80,000				4,80,000
2012				2012			
Jan. 01	Balance b/d		4,80,000	Dec. 31	Balance c/d		
	F1	3,00,000			F1	3,00,000	
	F2	1,80,000			F2	1,80,000	4,80,000
			4,80,000				4,80,000

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010			2010			
Dec. 31	Balance c/d	15,000	Dec. 31	Depreciation A/c (F1)		15,000
		15,000				15,000
2011			2011			
			Jan. 01	Balance b/d		15,000
Dec. 31	Balance c/d	34,500	Dec. 31	Depreciation on-		
				F1	15,000	
				F2 (*for 6 months*)	4,500	19,500
		34,500				34,500
2012			2012			

			Jan. 01	Balance b/d		34,500
Dec. 31	Balance c/d	58,500	Dec. 31	Depreciation on-		
				F1	15,000	
				F2	9,000	24,000
		58,500				58,500

Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2010 Dec. 31	Provision for Depreciation A/c	15,000	2010 Dec. 31	Profit and Loss A/c	15,000
		15,000			15,000
2011 Dec. 31	Provision for Depreciation A/c	19,500	2011 Dec. 31	Profit and Loss A/c	19,500
		19,500			19,500
2012 Dec. 31	Provision for Depreciation A/c	24,000	2012 Dec. 31	Profit and Loss A/c	24,000
		24,000			24,000

Example 2: Totu Ltd., acquired machinery for Rs 10,00,000 on January 01, 2010. In the same year, on April 01, 2010, new machinery costing Rs 6,00,000 was purchased. On October, 2011 another machinery costing Rs 8,00,000 was purchased. Depreciation is provided @ 10% p.a. on Diminishing Balance Method. Prepare Machinery Account and Provision for Depreciation Account up to December 31, 2012, assuming that books are closed on December 31 each year.

Solution

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010			2010			
Jan. 01	Bank A/c (M1)	10,00,000	Dec. 31	Balance c/d		
Apr. 01	Bank A/c (M2)	6,00,000		M1	10,00,000	
				M2	6,00,000	16,00,000
		16,00,000				16,00,000

2011			2011		
Jan. 01	Balance b/d		Dec. 31	Balance c/d	
	M1 10,00,000			M1 10,00,000	
	M2 6,00,000	16,00,000		M2 6,00,000	
Oct. 01	Bank A/c (M3)	8,00,000		M3 8,00,000	24,00,000
		24,00,000			24,00,000
2012			2012		
Jan. 01	Balance b/d		Dec. 31	Balance c/d	
	M1 10,00,000			M1 10,00,000	
	M2 6,00,000			M2 6,00,000	
	M3 8,00,000	24,00,000		M3 8,00,000	24,00,000
		24,00,000			24,00,000

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010			2010			
Dec. 31	Balance c/d	1,45,000	Dec. 31	Depreciation on-		
				M1	1,00,000	
				M2 (*for 9 months*)	45,000	1,45,000
		1,45,000				1,45,000
2011			2011			
			Jan. 01	Balance b/d		1,45,000
Dec. 31	Balance c/d	3,10,500	Dec. 31	Depreciation on-		
				M1	90,000	
				M2	55,500	
				M3 (*for 3 months*)	20,000	1,65,500
		3,10,500				3,10,500
2012			2012			
			Jan. 01	Balance b/d		3,10,500
			Dec. 31	Depreciation on-		
Dec. 31	Balance c/d	5,19,450		M1	81,000	
				M2	49,950	
				M3	78,000	2,08,950
		5,19,450				5,19,450

Example 3: On January, 01, 2010, Saini Ltd. bought machinery for Rs 5,40,000 and spent Rs 1,35,000 for its overhauling. On July 01, 2011 it has purchased another second-hand machinery for Rs 2,80,000. On August 30, 2012 the machinery purchased on January 01,

2010 became obsolete and disposed-off for Rs 3,98,000. On the same date, it has purchased new machinery costing Rs 4,60,000. Depreciation is charged at 15% p.a. on Fixed Installment Method. Prepare necessary ledger accounts assuming that books are closed on December 31 every year, if:

Case i- Provision for Depreciation Account is not maintained

Case ii- Provision for Depreciation Account is maintained

Solution

Case i- *When Provision for Depreciation Account is not maintained*

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010			2010			
Jan. 01	Bank A/c (M1) (5,40,000 + 1,35,000)	6,75,000	Dec. 31	Depreciation A/c (M1)		1,01,250
			Dec. 31	Balance c/d		5,73,750
		6,75,000				6,75,000
2011			2011			
Jan. 01	Balance b/d	5,73,750	Dec. 31	Depreciation A/c		
Jul. 01	Bank A/c (M2)	2,80,000		M1	1,01,250	
				M2 (*for 6 months*)	21,000	1,22,250
			Dec. 31	Balance c/d		
				M1	4,72,500	
				M2	2,59,000	7,31,500
		8,53,750				8,53,750
2012			2012			
Jan. 01	Balance b/d		Aug.30	Depreciation A/c (*on M1 for 8 months*)		67,500
	M1 4,72,500			Bank A/c (*Sale of M1*)		3,98,000
	M2 2,59,000	7,31,500		Profit and Loss A/c (*Loss on Sale*)		7,000
Aug.30	Bank A/c (M3)	4,60,000	Dec. 31	Depreciation on-		
				M2	42,000	
				M3 (*for 4 months*)	23,000	65,000
			Dec. 31	Balance c/d		

				M2	2,17,000	
				M3	4,37,000	6,54,000
		11,91,500				11,91,500

Working Notes: *Calculation of Profit or Loss on Sale*

Particulars	Amount
Value of M1 as on Jan. 01, 2012	4,72,500
Less: Depreciation for 8 months	(67,500)
Value of M1 as on Aug. 30, 2012	4,05,000
Less: Sale Value	(3,98,000)
Loss on Sale	**7,000**

Case ii- *When Provision for Depreciation Account is maintained*

Machinery Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010				2010			
Jan. 01	Bank A/c (M1)		6,75,000	Dec. 31	Balance c/d		6,75,000
			6,75,000				6,75,000
2011				2011			
Jan. 01	Balance b/d		6,75,000	Dec. 31	Balance c/d		
Jul. 01	Bank A/c (M2)		2,80,000		M1	6,75,000	
					M2	2,80,000	9,55,000
			9,55,000				9,55,000
2012				2012			
Jan. 01	Balance b/d			Aug. 30	Provision for Depreciation A/c		2,70,000
	M1	6,75,000		Aug. 30	Bank A/c (*Sale of M1*)		3,98,000
	M2	2,80,000	9,55,000	Aug. 30	Profit and Loss A/c (*Loss on Sale*)		7,000
Aug. 30	Bank A/c (M3)		4,60,000	Dec. 31	Balance c/d		
					M2	2,80,000	
					M3	4,60,000	7,40,000
			14,15,000				14,15,000

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010 Dec. 31	Balance c/d		1,01,250	2010 Dec. 31	Depreciation A/c (M1)		1,01,250
			1,01,250				1,01,250
2011				2011 Jan. 01	Balance b/d		1,01,250
Dec. 31	Balance c/d			Dec. 31	Depreciation on-		
	M1	2,02,500			M1	1,01,250	
	M2	21,000	2,23,500		M2	21,000	1,22,250
			2,23,500				2,23,500
2012 Aug. 30	Machinery A/c (2,02,500 + 67,500)		2,70,000	2012 Jan. 01	Balance b/d		
	(Transfer to Machinery A/c)				M1	2,02,500	
					M2	21,000	2,23,500
				Dec. 31	Depreciation on M1 (*for 8 months*)		67,500
Dec. 31	Balance c/d			Dec. 31	Depreciation on-		
	M2 (21,000 + 42,000)	63,000			M2	42,000	
	M3	23,000	86,000		M3	23,000	65,000
			3,56,000				3,56,000

Example 4: On January 01, 2012, Jindal Ltd. has a balance of Rs 11,60,000 in its Plant Account and Rs 4,49,500 in its Provision for Depreciation Account. On March 31, 2012, a plant costing Rs 1,74,000 that was purchased on January 01, 2009 becomes outdated and auctioned for Rs 90,000. On the same date, a new plant costing Rs 46,400 was purchased. Depreciation is charged @ 15% p.a. on original cost method. The firm closes its books on December 31 each year.
Prepare Plant Account, Provision for Depreciation Account and Depreciation Account for the year 2012.

Solution

Plant Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)

2012			2012		
Jan. 01	Balance b/d	11,60,000	Mar. 31	Provision for Depreciation A/c	84,825
Mar. 31	Profit and Loss A/c (*Profit*)	825	Mar. 31	Bank A/c	90,000
Mar. 31	Bank A/c	46,400	Dec. 31	Balance c/d (11,60,000 – 1,74,000 + 46,400)	10,32,400
		12,07,225			12,07,225

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2012			2012		
Mar. 31	Plant A/c	84,825	Jan. 01	Balance b/d	4,49,500
			Mar. 31	Depreciation (*on plant sold*)	6,525
Dec. 31	Balance c/d	5,24,320	Dec.31	Depreciation on-	
				(9,86,000 × 15%)	1,47,900
				(46,400 × 15% × 9/12)	5,220
		6,09,145			6,09,145

Working Notes:

WN1: *Calculation of Depreciation on Plant Sold*

Original Cost of Plant Sold = Rs 1,74,000
Depreciation for full year=1,74,000×15100=26,100Depreciation for 3 months=1,74,000×1
5100×312=6,525Depreciation for full year=1,74,000×15100=26,100Depreciation for 3 mo
nths=1,74,000×15100×312=6,525

WN2: *Calculation of Profit or Loss on Sale*

Particulars	Amount
Value of Plant as on January 01, 2009	1,74,000
Less: Depreciation (26,100 + 26,100 + 26,100 + 6,525)	(84,825)
Value of Plant as on March 31, 2012	89,175
Less: Sale Value	(90,000)
Profit on Sale	**825**

Example 5: The following balances are appearing in the books of Shaina Ltd., as on 1st April, 2019:

Machinery Account = Rs. 10,00,000

Provision for Depreciation Account = Rs. 4, 00,000

On 1st October, 2019, a machinery which was purchased on 1st April, 2015 for Rs. 5,00,000 was sold for Rs. 2,20,000 plus CGST and SGST @6% each. The firm is charging depreciation @ 10% p.a. on Original Cost Method and closes its books on 31st March every year. You are required to prepare Machinery Account and Provision for Depreciation Account for the year 2019-20. Also, pass Journal entry for the sale of machinery.

Answer:

Dr. Machinery A/c Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2019			2019		
Apr.1	To Balance b/d	10,00,000	Oct.1	By Bank A/c	2,20,000
			Oct. 1	By Provision for Depreciation A/c	2,25,000
			Oct. 1	By Loss on Sale of Machinery A/c (Profit & Loss A/c) (WN1)	55,000
			2020		
			Mar.31	By Balance c/d	5,00,000
		10,00,000			**10,00,000**

Dr. Provision For Depreciation A/c Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2019			2019		
Oct.1	To Machinery A/c (WN1)	2,25,000	Apr.1	By Balance b/d	4,00,000
2020			Oct. 1	By Depreciation A/c	25,000
Mar.31	To Balance c/d	2,50,000		(on machine sold for 4 months)	
			2020		
			Mar.31	By Depreciation A/c (WN2)	50,000
		4,75,000			**4,75,000**

Journal Entry on Sale of Machinery

Date	Particulars		L.F.	Dr.(Rs.)	Cr.(Rs.)
	Bank A/c	Dr.		2,46,400	
	Provision for Depreciation A/c	Dr.		2,25,000	
	Loss on Sale of Machinery A/c	Dr.		55,000	
	To Machinery A/c				5,00,000
	To Output CGST A/c				13,200
	To Output SGST A/c				13,200
	(Being the machinery sold and loss on sale of machinery transferred to Profit and Loss Account)				

Note: *GST received on sale of the machinery is not be added to the sale proceeds.*

Working Notes:

1) Computation of Profit/Loss on sale of Machinery

Particulars	Rs.
Cost of Machinery (As on 1st April,2015)	5,00,000
Less: Provision For Depreciation (50,000+50,000+50,000+50,000+25,000)	2,25,000
Book Value as on 1st October, 2019	2,75,000
Less: Sale Proceeds	2,20,000
Loss on Sale of Machinery	55,000

2) Depreciation to be charged as on 31st March, 2020:

On Balance Machinery (i.e.10,00,000-5,00,000)@10%

Asset Disposal Account

Objective

After going through this lesson, you shall be able to understand the concept of Asset Disposal Account.

Introduction

Till now we learnt the preparation of Assets Account, Depreciation Account and Provision for Depreciation Account. Now, in this lesson we will learn the preparation of Asset Disposal Account.

Asset Disposal Account

It is an account that is prepared to record the sale of an asset. Till now, we have studied that all the transactions related to the purchase and sale of an asset is recorded in the Asset Account itself. But, when the Asset Disposal Account is prepared, we record all the transactions related to sale of an asset in the Asset Disposal Account. The basic motive of preparing this account is to directly ascertain the profit or loss on the sale of the asset. In other words, this account depicts the complete and clear view of all the transactions related to sale of the assets. The Journal entries for recording the sale of asset in the Assets Disposal Account depends on the following two methods of recording depreciation in the books.

1. When Provision for Depreciation Account is not maintained

2. When Provision for Depreciation Account is maintained

1. *When Provision for Depreciation Account is not maintained*

The given below are the Journal entries for maintaining the Asset Disposal Account under this method.

JE-1	***For transferring the Book Value of Asset Sold (as on the Date of Sale) to Asset Disposal Account***		
	Asset Disposal A/c To Asset A/c (Book value of asset sold transferred to asset disposal account)	Dr.	With the Book Value of Asset Sold
JE-2	***For Sale of Asset***		
	Cash/Bank A/c To Asset Disposal A/c (Asset sold)	Dr.	With the Sale Value of Asset
JE-3	***In Case of Profit on Sale***		
	Asset Disposal A/c To Profit and Loss A/c (Profit on sale of asset)	Dr.	With the Amount of Profit on Sale

JE-4	***In Case of Loss on Sale***	
	Profit and Loss A/c Dr. To Asset Disposal A/c (Loss on sale of asset)	With the Amount of Loss on Sale

The given below is the format of Asset Disposal Account prepared under this method.

Asset Disposal Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
	Asset A/c # (Book value of asset sold - ***JE-1***) Profit and Loss A/c** (Profit on sale of asset - ***JE-3***)			Bank/Cash A/c (Sale of asset - ***JE-2***) Profit and Loss A/c** (Loss on sale of asset - ***JE-4***)	

Note- Either Profit or Loss on Sale will appear at one time.
 # Only the Book Value of that asset will be recorded in this account which is sold during the year.

Example 1: Nancy Ltd. has a balance of Rs 1,00,000 in its furniture account. During the year, it sold the entire furniture for Rs 86,000. Record the necessary Journal entries in the books and prepare furniture disposal account.

Solution

Journal

Date	Particulars	L.F.	Debit (Rs)	Credit (Rs)
	Furniture Disposal A/c Dr.		1,00,000	
	To Furniture A/c			1,00,000
	(Book value of furniture transferred to Furniture Disposal Account)			
	Bank A/c Dr.		86,000	
	To Furniture Disposal A/c			86,000

	(Furniture sold) Profit and Loss A/c To Furniture Disposal A/c (Loss on sale of furniture)	Dr.		14,000	14,000

Furniture Disposal Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
	Furniture A/c	1,00,000		Bank A/c (*Sale*) Profit and Loss A/c (*Loss on Sale*)	86,000 14,000
		1,00,000			1,00,000

2. ***When Provision for Depreciation Account is maintained***

The Journal entries and Asset Disposal Account for the sale of asset under this method are given below.

JE-1	***For transferring the Original Cost of Asset Sold to Asset Disposal Account***		
	Asset Disposal A/c To Asset A/c (Books value of asset sold transferred to asset disposal account)	Dr.	With the Original Cost of an Asset Sold
JE-2	***For transferring Provision for Depreciation of Asset Sold to Asset Disposal Account***		
	Provision for Depreciation A/c To Asset Disposal A/c (Provision for depreciation transferred to asset disposal account)	Dr.	With the Provision for Depreciation on Asset Sold
JE-3	***For Sale of Asset***		
	Cash/Bank A/c To Asset Disposal A/c (Asset sold)	Dr.	With the Sale Value of Asset

JE-4	***In Case of Profit on Sale***		
	Asset Disposal A/c To Profit and Loss A/c (Profit on sale of asset)	Dr.	With the Amount of Profit on Sale
JE-5	***In Case of Loss on Sale***		
	Profit and Loss A/c To Asset Disposal A/c (Loss on sale of asset)	Dr.	With the Amount of Loss on Sale

The given below is the format of Asset Disposal Account prepared under this method.

Asset Disposal Account

Dr. **Cr.**

Date	**Particulars**	**Amount (Rs)**	**Date**	**Particulars**	**Amount (Rs)**
	Asset A/c# (Book value of asset sold- ***JE-1***) Profit and Loss A/c** (Profit on sale of asset-***JE-4***)			Provision for Depreciation A/c (Accumulated depreciation on asset sold- ***JE-2***) Bank/Cash A/c (Sale of asset-***JE-3***) Profit and Loss A/c** (Loss on sale of asset- ***JE-5***)	

****Note- Either Profit or Loss on Sale will appear at one time.***
 # Only the Book Value of that asset will be recorded in this account which is sold during the year.

***Example 2*:** The following balances appeared in the books of Khemu Ltd.

Machinery A/c	3,00,000
Provision for Depreciation A/c	1,20,000

Machinery purchased for Rs 90,000 on which accumulated depreciation amounted to Rs 25,000 was sold during the year for Rs 70,000. Pass the necessary Journal entries in the books and also prepare Machinery Disposal Account.

Solution

Journal

Date	Particulars		L.F.	Debit (Rs)	Credit (Rs)
	Machinery Disposal A/c	Dr.		90,000	
	To Machinery A/c				90,000
	(Original cost of machinery sold transferred to machinery disposal account)				
	Provision for Depreciation A/c	Dr.		25,000	
	To Machinery Disposal A/c				25,000
	(Provision for depreciation transferred to machinery disposal account)				
	Bank A/c	Dr.		70,000	
	To Machinery Disposal A/c				70,000
	(Machinery sold)				
	Machinery Disposal A/c	Dr.		5,000	
	To Profit and Loss A/c				5,000
	(Profit on sale of furniture)				

Machinery Disposal Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
	Machinery A/c	90,000		Provision for Depreciation A/c	25,000
	Profit and Loss A/c (*Profit on Sale*)	5,000		Bank A/c (*Sale*)	70,000
		95,000			95,000

***Example 3*:** On January 01, 2010, a company acquired plant costing Rs 25,00,000. During the same year, on July 01, an additional plant costing Rs 6,50,000 was purchased and Rs 50,000 was paid for its installation. On April 01, 2012, plant purchased on July 01, 2010 became obsolete and disposed-off for Rs 4,92,000. On the same date, a new plant costing Rs 10,00,000 was purchased. Depreciation is provided @ 15% p.a. on Straight Line Method.

Prepare Plant Account and Plant Disposal Account provided the company closes its books on 31 December every year, if:

Case i**-** Provision for Depreciation Account is not maintained
Case ii**-** Provision for Depreciation Account is maintained

Solution
Case i- When Provision for Depreciation Account is not maintained

Plant Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010				2010			
Jan. 01	Bank A/c (P1)		25,00,000	Dec. 31	Depreciation on-		
Jul. 01	Bank A/c (P2)		7,00,000		P1	3,75,000	
					P2 (*for 6 months*)	52,500	4,27,500
					Balance c/d		
					P1	21,25,000	
					P2	6,47,500	27,72,500
			32,00,000				32,00,000
2011							
Jan.01	Balance b/d			Dec. 31	Depreciation on-		
	P1	21,25,000			P1	3,75,000	
	P2	6,47,500	27,72,500		P2	1,05,000	4,80,000
					Balance c/d		
					P1	17,50,000	
					P2	5,42,500	22,92,500
			27,72,500				27,72,500
2012							
Jan. 01	Balance b/d			2012			
	P1	17,50,000		Apr. 01	Depreciation (*on P2 for 3 months*)		26,250
	P2	5,42,500	22,92,500	Apr. 01	Plant Disposal A/c (***WN1****)		5,16,250
Apr. 01	Bank A/c (P3)		10,00,000	Dec. 31	Depreciation on-		
					P1	3,75,000	
					P3 (*for 9 months*)	1,12,500	4,87,500
					Balance c/d		
					P1	13,75,000	
					P3	8,87,500	22,62,500
			32,92,500				32,92,500

Plant Disposal Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2012 Apr. 01	Plant A/c	5,16,250	2012 Apr. 01	Bank A/c (*Sale*)	4,92,000
			Apr. 01	Profit and Loss A/c (*Loss on Sale*)	24,250
		5,16,250			5,16,250

Working Notes:

WN1: *Calculation of Profit or Loss on Sale*

Particulars	Amount
Value of Plant (P2) as on Jan. 01, 2012	5,42,500
Less: Depreciation for 3 months	(26,250)
Value of Plant as on Apr. 01, 2012*	**5,16,250**
Less: Sale Value	(4,92,000)
Loss on Sale	**24,250**

Case ii- When Provision for Depreciation Account is maintained

Plant Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010				2010			
Jan. 01	Bank A/c (P1)		25,00,000	Dec. 31	Balance c/d		
Jul. 01	Bank A/c (P2)		7,00,000		P1	25,00,000	
					P2	7,00,000	32,00,000
			32,00,000				32,00,000
2011				2011			
Jan. 01	Balance b/d		32,00,000	Dec. 31	Balance c/d		
	P1	25,00,000			P1	25,00,000	
	P2	7,00,000	32,00,000		P2	7,00,000	32,00,000

		32,00,000				32,00,000
2012			2012			
Jan. 01	Balance b/d		Apr. 01	Plant Disposal A/c (P2)		7,00,000
	P1 25,00,000		Dec. 31	Balance c/d		
	P2 7,00,000	32,00,000		P1	25,00,000	
Apr. 01	Bank A/c (P3)	10,00,000		P3	10,00,000	35,00,000
		42,00,000				42,00,000

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010				2010			
Dec. 31	Balance c/d			Dec. 31	Depreciation on-		
	P1	3,75,000			P1	3,75,000	
	P2	52,500	4,27,500		P2	52,500	4,27,500
			4,27,500				4,27,500
2011				2011			
Dec. 31	Balance c/d			Jan. 01	Balance b/d		
	P1	7,50,000			P1	3,75,000	
	P2	1,57,500	9,07,500		P2	52,500	4,27,500
				Dec. 31	Depreciation on-		
					P1	3,75,000	
					P2	1,05,000	4,80,000
			9,07,500				9,07,500
2012				2012			
Apr. 01	Plant Disposal A/c (P2) (1,57,500 + 26,250)		1,83,750	Jan. 01	Balance b/d		
Dec. 31	Balance c/d				P1	7,50,000	
	P1	11,25,000			P2	1,57,500	9,07,500
	P3	1,12,500	12,37,500	Apr. 01	Depreciation on P2 (*for 3 months*)		26,250
				Dec. 31	Depreciation :		
					P1	3,75,000	
					P3 (*for 9 months*)	1,12,500	4,87,500
			14,21,250				14,21,250

Plant Disposal Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2012 Apr. 01	Plant A/c	7,00,000	2012 Apr. 01	Provision for Depreciation A/c	1,83,750
			Apr. 01	Bank A/c (*Sale*)	4,92,000
			Apr. 01	Profit and Loss A/c (*Loss on Sale*)	24,250
		7,00,000			7,00,000

Example 4: On January 01, 2010, a company acquired a motor car for Rs 10,00,000. During the same year, on April 01, a new motor car was purchased for Rs 6,50,000. On May 01, 2012, motor car purchased on April 01, 2010 met an accident and was damaged and sold for Rs 5,42,000. On the same date, a second-hand motor car was purchased for Rs 3,30,000. Depreciation is provided at 10% p.a. on Diminishing Balance Method. Prepare Motor Car Account and Motor Car Disposal Account, if:

Case i- Provision for Depreciation Account is not maintained

Case ii- Provision for Depreciation Account is maintained

Solution

Case i- When Provision for Depreciation Account is not maintained

Motor Car Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010				2010			
Jan. 01	Bank A/c (M1)		10,00,000	Dec. 31	Depreciation on-		
Apr. 01	Bank A/c (M2)		6,50,000		M1	1,00,000	
					M2 (*for 9 months*)	48,750	1,48,750
					Balance c/d		
					M1	9,00,000	
					M2	6,01,250	15,01,250
			16,50,000				16,50,000
2011				2011			
Jan.01	Balance b/d			Dec. 31	Depreciation on-		
	M1	9,00,000			M1	90,000	
	M2	6,01,250	15,01,250		M2	60,125	1,50,125

			Dec. 31	Balance c/d		
				M1	8,10,000	
				M2	5,41,125	13,51,125
		15,01,250				15,01,250
2012						
Jan. 01	Balance b/d		2012			
	M1 8,10,000		May 01	Depreciation (*on M2 for 4 months*)		18,038
	M2 5,41,125	13,51,125	May 01	Motor Car Disposal A/c (***WN1****)		5,23,087
May 01	Bank A/c (M3)	3,30,000	Dec. 31	Depreciation on-		
				M1	81,000	
				M3 (*for 8 months*)	22,000	1,03,000
				Balance c/d		
				M1	7,29,000	
				M3	3,08,000	10,37,000
		16,81,125				16,81,125

Motor Car Disposal Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2012			2012		
May 01	Motor Car A/c	5,23,087	May 01	Bank A/c (*Sale*)	5,42,000
May 01	Profit and Loss A/c (*Profit on Sale*)	18,913			
		5,42,000			5,42,000

Working Notes:

WN1: *Calculation of Profit or Loss on Sale*

Particulars	Amount
Value of Plant (M2) as on Jan. 01, 2012	5,41,125
Less: Depreciation for 4 months	(18,038)
Value of Motor Car as on May 01, 2012*	**5,23,087**
Less: Sale Value	(5,42,000)
Profit on Sale	**18,913**

<u>Case ii</u>- When Provision for Depreciation Account is maintained

Motor Car Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010				2010			
Jan. 01	Bank A/c (M1)		10,00,000	Dec. 31	Balance c/d		
Apr. 01	Bank A/c (M2)		6,50,000		M1	10,00,000	
					M2	6,50,000	16,50,000
			16,50,000				16,50,000
2011				2011			
Jan. 01	Balance b/d			Dec. 31	Balance c/d		
	M1	10,00,000			M1	10,00,000	
	M2	6,50,000	16,50,000		M2	6,50,000	16,50,000
			16,50,000				16,50,000
2012				2012			
Jan. 01	Balance b/d			May. 01	Motor Car Disposal A/c (M2)		6,50,000
	M1	10,00,000		Dec. 31	Balance c/d		
	M2	6,50,000	16,50,000		M1	10,00,000	
Apr. 01	Bank A/c (M3)		3,30,000		M3	3,30,000	13,30,000
			19,80,000				19,80,000

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars		Amount (Rs)	Date	Particulars		Amount (Rs)
2010				2010			
Dec. 31	Balance c/d			Dec. 31	Depreciation on-		
	M1	1,00,000			M1	1,00,000	
	M2	48,750	1,48,750		M2 (*for 9 months*)	48,750	1,48,750
			1,48,750				1,48,750
2011				2011			
Dec. 31	Balance c/d			Jan. 01	Balance b/d		

	M1	1,90,000			M1	1,00,000	
	M2	1,08,875	2,98,875		M2	48,750	1,48,750
				Dec. 31	Depreciation on-		
					M1	90,000	
					M2	60,125	1,50,125
			2,98,875				2,98,875
2012				2012			
Apr.	Motor Car Disposal A/c (M2)			Jan. 01	Balance b/d		
01	(1,08,875 + 18,038)		1,26,913				
Dec. 31	Balance c/d				M1	1,90,000	
	M1	2,71,000			M2	1,08,875	2,98,875
	M3	22,000	2,93,000	Apr.01	Depreciation on M2 (*for 4 months*)		18,038
				Dec. 31	Depreciation		
					M1	81,000	
					M3 (*for 8 months*)	22,000	1,21,038
			4,19,913				4,19,913

Motor Car Disposal Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2012			2012		
May 01	Motor Car A/c	6,50,000	May 01	Provision for Depreciation A/c	1,26,913
May 01	Profit and Loss A/c (*Profit on Sale*)	18,913	May 01	Bank A/c (*Sale*)	5,42,000
		6,68,913			6,68,913

Comprehensive Examples

Objective

In the previous lessons, we have learnt the various concepts and aspects of depreciation along with numerical examples. Now, in this lesson, we will be dealing with some more comprehensive examples that will help you to further enhance your knowledge on the concept of depreciation.

Example 1: On April 01, 2010, Janvi Ltd. has balance of Rs 9,50,000 in its Machinery Account. On October 01, 2010 it purchased a second-hand machinery for Rs 2,20,000 and paid Rs 25,000 for brokerage and Rs 55,000 for its overhauling. On December 31, 2011, machinery purchased on October 01, 2010 was disposed-off at a loss of Rs 18,700 due its

bad working condition. In the next year on July, 01, 2012, a new machinery costing Rs 5,00,000 was purchased. Depreciation is charged @ 10% p.a. on the Diminishing Balance Method. The Books are closed on March 31 each year. Record the necessary Journal entries in the books and prepare Machinery Account and Depreciation Account.

Solution

Journal

Date	Particulars		L.F.	Debit (Rs)	Credit (Rs)
2010-11					
Oct. 01	Machinery A/c (2,20,000 + 25,000 + 55,000)	Dr.		3,00,000	
	To Bank A/c				3,00,000
	(Machinery purchased)				
Mar. 31	Depreciation A/c	Dr.		1,10,000	
	To Machinery A/c				1,10,000
	(Depreciation charged on machinery)				
				1,10,000	
Mar. 31	Profit and Loss A/c	Dr.			1,10,000
	To Depreciation A/c				
	(Depreciation transferred to profit and loss account)				
2011-12					
Dec. 31	Bank A/c	Dr.		2,44,925	
	To Machinery A/c				2,44,925
	(Machinery sold)				
Dec. 31	Profit and Loss A/c	Dr.		18,700	
	To Machinery A/c				18,700
	(Loss on sale of machinery)				
Mar. 31	Depreciation A/c (21,375 + 85,500)	Dr.		1,06,875	
	To Machinery A/c				1,06,875
	(Depreciation charged on machinery)				
Mar. 31	Profit and Loss A/c	Dr.		1,06,875	
	To Depreciation A/c				1,06,875
	(Depreciation transferred to Profit and Loss Account)				
2012-13					
Jul. 01	Machinery A/c	Dr.		5,00,000	
	To Bank A/c				5,00,000
	(Machinery purchased)				
Mar. 31	Depreciation A/c (76,950 + 37,500)	Dr.		1,14,450	

	To Machinery A/c (Depreciation charged on machinery)				1,14,450
Mar. 31	Profit and Loss A/c (76,950 + 37,500)	Dr.		1,14,450	
	To Depreciation A/c (Depreciation transferred to Profit and Loss Account)				1,14,450

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010-11			2010-11			
Apr. 01	Balance b/d (M1)	9,50,000	Mar. 31	Depreciation on-		
Oct. 01	Bank A/c (M2)	3,00,000		M1	95,000	
				M2 (*for 6 months*)	15,000	1,10,000
			Mar. 31	Balance c/d		
				M1	8,55,000	
				M2	2,85,000	11,40,000
		12,50,000				12,50,000
2011-12			2011-12			
Apr. 01	Balance b/d		Dec. 31	Depreciation A/c (*on M2 for 9 months*)		21,375
	M1 8,55,000		Dec. 31	Profit and Loss A/c (*Loss on sale*)		18,700
	M2 2,85,000	11,40,000	Dec. 31	Bank A/c (*Sale of M2- **WN***)		2,44,925
			Mar. 31	Depreciation (M1)		85,500
			Mar. 31	Balance c/d (M1)		7,69,500
		11,40,000				11,40,000
2012-13			2012-13			
Apr. 01	Balance b/d (M1)	7,69,500	Mar. 31	Depreciation on-		
July. 01	Bank A/c (M3)	5,00,000		M1	76,950	
				M3 (*for 9 months*)	37,500	1,14,450
			Mar. 31	Balance c/d		
				M1	6,92,550	
				M3	4,62,500	11,55,050
		12,69,500				12,69,500

Working Notes: *Calculation of Sale Value of M2*

Particulars	Amount (Rs)
Value of M2 as on April 01, 2011	2,85,000
Less: Depreciation for 9 months	(21,375)
Value of M2 as on December 31, 2011	2,63,625
Less: Loss on Sale	(18,700)
Sale Value	**2,44,925**

Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2010-11			2010-11		
Mar. 31	Machinery A/c	1,10,000	Mar. 31	Profit and Loss A/c	1,10,000
		1,10,000			1,10,000
2011-12			2011-12		
Mar. 31	Machinery A/c	1,06,875	Mar. 31	Profit and Loss A/c	1,06,875
		1,06,875			1,06,875
2012-13			2012-13		
Mar. 31	Machinery A/c	1,14,450	Mar. 31	Profit and Loss A/c	1,14,450
		1,14,450			1,14,450

Example 2: A company bought a new furniture costing Rs 2,50,000 on April 01, 2009. On September 01, 2011, the company sold 1/5th of its furniture for Rs 21,300 due to damage. During the year 2012, on July 01, additional furniture costing Rs 80,000 was purchased and Rs 5,000 was paid for its cartage. Depreciation is charged @10% p.a. on Written Down Value Method. Prepare Furniture account for the period from 2009 to 2012. The books are closed on December 31 every year.

Solution

Furniture Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2009			2009		
Jan. 01	Bank A/c (F1)	2,50,000	Dec. 31	Depreciation A/c (*for 9 months*)	18,750
			Dec. 31	Balance c/d	2,31,250
		2,50,000			2,50,000

2010			2010			
Jan. 01	Balance b/d	2,31,250	Dec. 31	Depreciation A/c		23,125
			Dec. 31	Balance c/d		2,08,125
		2,31,250				2,31,250
2011			2011			
Jan. 01	Balance b/d	2,08,125	Sept. 01	Depreciation A/c (***WN***)*		2,775
			Sept. 01	Bank A/c (*Sale*)		21,300
			Sept. 01	Profit and Loss A/c (*Loss on sale*)		17,550
			Dec. 31	Depreciation (***WN***)**		16,650
			Dec. 31	Balance c/d		1,49,850
		2,08,125				2,08,125
2012			2012			
Jan. 01	Balance b/d	1,49,850	Dec. 31	Depreciation on-		
Jul. 01	Bank A/c (F2)	85,000		F1	14,985	
				F2 (*for 6 months*)	4,250	19,235
			Dec. 31	Balance c/d		
				F1	1,34,865	
				F2	80,750	2,15,615
		2,34,850				2,34,850

Working Notes:
Calculation of Depreciation on Furniture Sold

Particulars	**Amount (Rs)**
Value of 1/5th of Furniture Sold on Jan. 01 2011	
(1/5th of 2,08,125)	41,625
Less: Depreciation for 8 months (from Jan.01 to Sept. 01)	(2,775)*
Value as on Sept. 01, 2011	38,850
Less: Sale Value	(21,300)
Loss on Sale	**17,550**

Value of Remaining Furniture as on Jan. 01, 2011 = 2,08,125 – 41,625 = 1,66,500
Depreciation on remaining furniture for full year = 1,66,500 × 10% = 16,650**
∴ Value of Furniture as on Dec. 31, 2011 = 1,66,500 – 16,650 = Rs 1,49,850

Example 3: On January 01, 2012, the machinery account of Nitika Ltd. showed a balance of Rs 1,11,870 (original cost Rs 1,62,690). On April 01, 2012, a new machinery was acquired for Rs 49,500. On September 30, 2012, an old machinery, which was purchased at a cost of Rs 51,100 on March 01, 2010 was sold for Rs 30,360. The company has a policy to charge

full year's depreciation on all the purchases made during the year and avoid depreciation on the sale of machinery during the year. Depreciation is charged @ 15% p.a. on Straight Line Method. Prepare Machinery Account for the year ending December 31, 2012.

Solution

Machinery Account

Dr. **Cr.**

Date	**Particulars**	**Amount (Rs)**	**Date**	**Particulars**		**Amount (Rs)**
2012			2012			
Jan. 01	Balance b/d (M1)	1,11,870	Sept. 30	Bank A/c (*Sale of machinery*)		30,360
Apr. 01	Bank A/c (*Purchase*-M2)	49,500	Sept. 30	Profit and Loss A/c (*Loss on sale*)		5,410
			Dec. 31	Depreciation A/c		
				M1	16,739	
				M2	7,425	24,164
			Dec. 31	Balance c/d		
				M1 (1,11,870 – 35,770 – 16,739)	59,361	
				M2 (49,500 – 7,425)	42,075	1,01,436
		1,61,370				1,61,370

Working Notes: ***WN1***: *Calculation of Profit or Loss on Sale*

Particulars	**Amount (Rs)**
Cost of Machinery as on March 01, 2010	51,100
Less: Depreciation* (*for 2010*)	(7,665)
Value as on January 01, 2011	43,435
Less: Depreciation (*for 2011*)	(7,665)
Value as on January 01, 2012	35,770
Less: Depreciation (*for 2012*)	Nil*
	35,770
Less: Sale Value	(30,360)
Loss on Sale	**5,410**

****Note***- The company is following the policy of charging full year's depreciation on machinery purchased at any time during the year and ignoring the depreciation on the machinery sold at any time during the year. Therefore, depreciation for the year 2010 is

charged for the full year on Rs 51,100. Similarly, by following this policy, when this machinery is sold during the year 2012, no depreciation is charged.

WN2: *Calculation of Depreciation on Remaining Machines*

Depreciation on Existing Machine

Particulars	Amount (Rs)
Original Cost of Machinery as on January 01, 2010	1,62,690
Less: Original Cost of Machinery Sold	(51,100)
Original Cost of remaining machine	1,11,590
∴ Depreciation on remaining machine @ 15%	16,739

Depreciation on Machinery Purchased

Particulars	Amount (Rs)
Original Cost of Machinery purchased on April 01, 2012	49,500
∴ Depreciation @ 15% for full year	7,425

Example 4: On January 01, 2010, Mate Ltd. purchased 6 trucks for Rs 1,50,000 each. On November 30, 2011, the company sold its 2 trucks for Rs 1,90,000 and on the same day, a new truck was purchased for Rs 2,40,000. On July 01, 2012, another truck which was purchased on January 01, 2010 met with an accident and was destroyed. The amount of Rs 35,000 were recovered from the insurance company in full settlement. On the same date, second-hand truck was purchased for Rs 1,75,000. Depreciation is charged @ 20% p.a. on Fixed Instalment Method and books are closed on December 31 every year. You are required to prepare:

i. Truck Account
ii. Provision for Depreciation Account and
iii. Depreciation Account

Solution

Truck Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2010 Jan. 01	Bank A/c (1,50,000 × 6)	9,00,000	2010 Dec. 31	Balance c/d	9,00,000

		9,00,000			9,00,000
2011			2011		
Jan. 01	Balance b/d	9,00,000	Nov. 30	Provision for Depreciation A/c (***WN1***)	1,15,000
Nov. 30	Profit and Loss A/c (*Profit on sale*)	5,000	Nov. 30	Bank A/c (*Sale*)	1,90,000
Nov. 30	Bank A/c (*Purchase*)	2,40,000	Dec. 31	Balance c/d	8,40,000
		11,45,000			11,45,000
2012			2012		
Jan. 01	Balance b/d	8,40,000	Jul. 01	Provision for Depreciation A/c (***WN3***)	75,000
Jul. 01	Bank A/c	1,75,000	Jul. 01	Bank A/c (Amount received from Insurance Co.)	35,000
			Jul. 01	Profit and Loss A/c (*Loss-* ***WN4***)	40,000
			Dec. 31	Balance c/d	8,65,000
		10,15,000			10,15,000

Provision Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars		Amount (Rs)
2010			2010			
Dec. 31	Balance c/d	1,80,000	Dec. 31	Depreciation A/c (9,00,000 × 20%)		1,80,000
		1,80,000				1,80,000
2011			2011			
Nov. 30	Truck A/c (***WN1***)	1,15,000	Jan. 01	Balance b/d		1,80,000
Dec. 31	Balance c/d	2,44,000	Nov. 30	Depreciation A/c (*on 2 trucks for 11 months*)		55,000
			Dec. 31	Depreciation-		
				On 6,00,000	1,20,000	
				On 2,40,000 (*for 1 month*)	4,000	1,24,000
		3,55,000				3,59,000
2012			2012			
Jul. 01	Truck A/c (***WN3***)	75,000	Jan. 01	Balance b/d		2,44,000
Dec. 31	Balance c/d	2,91,500	Jul. 01	Depreciation A/c (20 % on 1,50,000 for 6 months)		15,000
			Dec. 31	Depreciation-		
				On 4,50,000	90,000	
				On 1,75,000 (*for 6 months*)	17,500	1,07,500
		3,66,500				3,66,500

Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2010			2010		
Dec. 31	Provision for Depreciation A/c	1,80,000	Dec. 31	Profit and Loss A/c	1,80,000
		1,80,000			1,80,000
2011			2011		
Dec. 31	Provision for Depreciation A/c	1,79,000	Dec. 31	Profit and Loss A/c (55,000 + 1,24,000)	1,79,000
		1,79,000			1,79,000
2012			2012		
Dec. 31	Provision for Depreciation A/c	1,22,500	Dec. 31	Profit and Loss A/c (15,000 + 1,07,500)	1,22,500
		1,22,500			1,22,500

Working Notes:

WN1: 2 Trucks purchased for Rs 3,00,000 (i.e.1,50,000 × 2) on January 01, 2010 has been sold on November 30, 2011. Therefore, depreciation on 2 trucks for 1 year and 11 months i.e. Rs 1,15,000 [60,000 (for 2010) + 55,000 (for 2011)] is credited to Truck Account by making a debit to Provision for Depreciation Account.

WN2: *Calculation of Profit or Loss on Sale*

Particulars	Amount (Rs)
Value of 2 Trucks Sold as on Jan. 01, 2010 (1,50,000 × 2)	3,00,000
Less: Depreciation for 1 year 11 months (60,000 + 55,000)	(1,15,000)
Value of 2 Trucks on Nov. 30, 2011	1,85,000
Less: Sale Value	(1,90,000)
Profit on Sale	**5,000**

WN3: One Truck purchased for Rs 1,50,000 on January 01, 2010 met with an accident on July 01, 2012. It was used for 2 years and 6 months, therefore, depreciation for this period is Rs 75,000 (30,000 + 30,000 + 15,000) which has been credited to Truck Account by making a debit to Provision for Depreciation Account.

WN4: *Calculation of Profit or Loss on Destruction Due to Accident*

Particulars	Amount (Rs)
Value of 1 Truck as on Jan. 01, 2010	1,50,000
Less: Depreciation for 2 years 6 months (30,000 + 30,000 + 15,000)	(75,000)
Value of 1 Truck as on July 01, 2012	75,000

Less: Amount recovered from Insurance Company	(35,000)
Loss on Destruction	**40,000**

Example 5: On April 01, 2009 machinery was purchased for Rs 12,00,000. During the year 2012, a part machinery costing Rs 2,50,000 was damaged and disposed-off for Rs 1,13,000. Depreciation is charged @ 15% p.a. on Diminishing Balance Method. Draw up Machinery Account assuming books are closed on March 31 every year.

Solution

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2009-10			2009-10		
Apr. 01	Bank A/c	12,00,000	Mar. 31	Depreciation A/c	1,80,000
			Mar. 31	Balance c/d	10,20,000
		12,00,000			12,00,000
2010-11			2010-11		
Apr. 01	Balance b/d	10,20,000	Mar. 31	Depreciation A/c	1,53,000
			Mar. 31	Balance c/d	8,67,000
		10,20,000			10,20,000
2011-12			2011-12		
Apr. 01	Balance b/d	8,67,000	Mar. 31	Depreciation A/c	1,30,050
			Mar. 31	Balance c/d	7,36,950
		8,67,000			8,67,000
2012-13			2012-13		
Apr. 01	Balance b/d	7,36,950		Bank A/c	1,13,000
				Profit and Loss A/c (Loss- ***WN1***)	40,531
			Mar. 31	Depreciation A/c (***WN2***)	87,513
			Mar. 31	Balance c/d	4,95,906
		7,36,950			7,36,950

Working Notes:

WN1- *Calculation of Profit or Loss on Sale of Part of Machinery*

Particulars	Amount (Rs)
Cost of Part Machinery Sold as on Apr. 01, 2009	2,50,000
Less: Depreciation @ 15 % for 2009-10	(37,500)
Value as on Apr. 01, 2010	2,12,500

Less: Depreciation @ 15 % for 2010-11	(31,875)
Value as on Apr. 01, 2011	1,80,625
Less: Depreciation @ 15 % for 2011-12	(27,094)
Value as on Apr. 01, 2012	1,53,531*
Less: Sale Value	(1,13,000)
Loss on Sale	**40,531**

Note: *As the date of sale of part of machinery is not given, so, it has been assumed that it is sold in the beginning of the year.*

WN2- *Calculation of Depreciation on Remaining Machinery for 2012-13*

Particulars	**Amount (Rs)**
Book Value of Machinery as on Apr. 01, 2012	7,36,950
Less: Book Value of Part Machinery sold as on Apr. 01, 2012*	(1,53,531)
	5,83,419
∴ Depreciation @ 15% (5,83,419 × 15%)	87,513

Remaining Value of Machinery at the end of the year = 5,83,419 – 87,513 = **4,95,906**

Example 6: Jayant Ltd. bought furniture for Rs 3,00,000 on April 01, 2009. It has purchased additional furniture for Rs 1,70,000 on July 01, 2010 and for Rs 2,00,000 on February 01, 2012. On April 01, 2012 a part of furniture purchased for Rs 1,10,000 on January 01, 2009 was sold for Rs 90,000. On the same date, new furniture costing Rs 2,50,000 was purchased. Depreciation is charged at 10% on Reducing Balance Method. The firm closes its books on March 31, every year. Prepare Machinery Account for the period from 2009 to 2012.

Solution

Furniture Account

Dr. **Cr.**

Date	**Particulars**	**Amount (Rs)**	**Date**	**Particulars**	**Amount (Rs)**
2009-10			2009-10		
Apr. 01	Bank A/c (F1)	3,00,000	Mar. 31	Depreciation A/c (F1)	30,000
			Mar. 31	Balance c/d	2,70,000
		3,00,000			3,00,000
2010-11			2010-11		

Apr. 01	Balance b/d		2,70,000	Mar. 31	Depreciation on-		
Jul. 01	Bank A/c (F2)		1,70,000		F1	27,000	
					F2	17,000	44,000
				Mar. 31	Balance c/d		
					F1	2,43,000	
					F2	1,53,000	3,96,000
			4,40,000				4,40,000
2011-12				2011-12			
Apr. 01	Balance b/d			Mar. 31	Depreciation on-		
	F1	2,43,000			F1	24,300	
	F2	1,53,000	3,96,000		F2	15,300	
Feb. 01	Bank A/c (F3)		2,00,000		F3	20,000	59,600
				Mar. 31	Balance c/d		
					F1	2,18,700	
					F2	1,37,700	
					F3	1,80,000	5,36,400
			5,96,000				5,96,000
2012-13				2012-13			
Apr. 01	Balance b/d			Apr. 01	Bank A/c		90,000
	F1	2,18,700		Mar. 31	Depreciation on-		
	F2	1,37,700			F1 (***WN2***)	13,851	
	F3	1,80,000	5,36,400		F2	13,770	
Apr. 01	Profit and Loss A/c (Profit- ***WN1***)		9,810		F3	18,000	
Apr. 01	Bank A/c (F4)		2,50,000		F4	25,000	70,621
				Mar. 31	Balance c/d-		
					F1(***WN2***)	1,24,659	
					F2	1,23,930	
					F3	1,62,000	
					F4	2,25,000	6,35,589
			7,96,210				7,96,210

Note: *The rate of depreciation is given without the words '**per annum (p.a.)**'. Therefore, depreciation on furniture is charged for the full year irrespective of the time factor*.

Working Notes:

WN1- *Calculation of Profit or Loss on Sale of Part of Machinery*

Particulars	**Amount (Rs)**
Cost of Part Furniture Sold as on Apr. 01, 2009	1,10,000

Less: Depreciation @ 10% for 2009-10	(11,000)
Value as on Apr. 01, 2010	99,000
Less: Depreciation @ 10% for 2010-11	(9,900)
Value as on Apr. 01, 2011	89,100
Less: Depreciation @ 10% for 2011-12	(8,910)
Value as on Apr. 01, 2012	80,190*
Less: Sale Value	(90,000)
Profit on Sale	**9,810**

WN2- *Calculation of Depreciation on Remaining Furniture (F1) for 2012-13*

Particulars	Amount (Rs)
Book Value of Furniture (F1) as on Apr. 01, 2012	2,18,700
Less: Book Value of Part Furniture Sold as on Apr. 01, 2012*	(80,190)
	1,38,510
∴ Depreciation @ 10%	13,851

Remaining Value of Furniture (F1) at the end of the year 1,38,510 – 13,851 = **1,24,659**

Example 7: The following balances appeared in the books of Santa Ltd. as on January 01, 2012.

Machinery A/c	15,00,000
Provision for Depreciation A/c	3,48,000

A part of machinery purchased on January 01, 2010 for Rs 3,00,000 was sold for Rs 1,80,000 on July, 01, 2012. Depreciation is charged @ 20% p.a. on written Down Value Method. Prepare Machinery Account, Provision for Depreciation Account and Machinery Disposal Account for the year ended December 31.

Solution

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2012			2012		
Jan. 01	Balance b/d	15,00,000	Jul. 01	Machinery Disposal A/c	3,00,000
			Dec. 31	Balance c/d	12,00,000

		15,00,000			15,00,000

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2012			2012		
Jul. 01	Machinery Disposal A/c (***WN2***)	1,27,200	Jan. 01	Balance b/d	3,48,000
Dec. 31	Balance c/d	4,32,000	Jul. 01	Depreciation A/c (***WN1*****)	19,200
			Dec. 31	Depreciation A/c (***WN3***)	1,92,000
		5,59,200			5,59,200

Machinery Disposal Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2012			2012		
Jul. 01	Machinery A/c	3,00,000	Jul. 01	Provision for Depreciation A/c (***WN2***)	1,27,200
Jul. 01	Profit and Loss A/c	7,200	Jul. 01	Bank A/c	1,80,000
		3,07,200			3,07,200

Working Notes:

WN1- *Calculation of Profit or Loss on Sale of Part of Machinery*

Particulars	Amount (Rs)
Cost of Part Machinery Sold as on Jan. 01, 2010	3,00,000
Less: Depreciation @ 20% for 2010	(60,000)
Value as on Jan. 01, 2011	2,40,000
Less: Depreciation @ 20% for 2011	(48,000)
Value as on Jan. 01, 2012	1,92,000
Less: Depreciation @ 20% for 2012 (*for 6 months*)**	(19,200)
Value as on Jul. 01, 2012	1,72,800
Less: Sale Value	(1,80,000)
Profit on Sale	**7,200**

WN2- *Calculation of Accumulated Depreciation on Machinery Sold*

Accumulate Depreciation = 60,000 + 48,000 + 19,200 = 1,27,200

WN3- *Calculation of Depreciation on Remaining Machinery*

Particulars	Amount (Rs)
Remaining Value of Machinery (15,00,000 – 3,00,000)	12,00,000
Less: Accumulated Depreciation (3,48,000 + 19,200 – 1,27,200)	(2,40,000)
	9,60,000
Depreciation @ 20%	1,92,000

Example 8 (With GST): On April 01, 2017, Janvi Ltd. has balance of Rs 9,50,000 in its Machinery Account. On October 01, 2017 it purchased another machinery for Rs 3,00,000 plus CGST @6% and SGST @6% . On March 31, 2018, machinery purchased on October 01, 2017 was disposed–off at a loss of Rs 18,700 due its bad working condition charging CGST and SGST @6% each. In the next year on July, 01, 2018, a new machinery costing Rs 5,00,000 was purchased. Depreciation is charged @ 10% p.a. on the Diminishing Balance Method. The Books are closed on March 31 each year. Record the necessary Journal entries in the books and prepare Machinery Account, Depreciation Account, Input CGST Account, Input SGST Account, Output CGST Account and Output SGST Account for the 2 years 2017–18 and 2018–19.

Solution

Journal of Janvi Ltd.

Date	Particulars		L.F.	Debit Amount (Rs)	Credit Amount (Rs)
2017					
Oct. 01	Machinery A/c	Dr.		3,00,000	
	Input CGST A/c	Dr.		18,000	
	Input SGST A/c	Dr.		18,000	
	To Bank A/c				3,36,000
	(2nd Machinery purchased)				
2018					
Mar. 31	Depreciation A/c (95,000 M1 + 15,000M2)	Dr.		1,10,000	
	To Machinery A/c				1,10,000
	(Depreciation provided on M1 and M2 @10% p.a.)				
Mar. 31	Profit and Loss A/c	Dr.		1,10,000	
	To Depreciation A/c				1,10,000
	(Depreciation charged to profit and loss account)				

Mar.31	Bank A/c	Dr.		2,98,256	
	To Machinery A/c				2,66,300
	To Output CGST A/c	Dr.			15,978
	To Output SGST A/c				15,978
	(Machinery 2 sold)				
Mar.31	Profit and Loss A/c	Dr.		18,700	
	To Machinery A/c				18,700
	(Loss on sale of machinery 2)				
2018					
Jul. 01	Machinery A/c	Dr.		5,00,000	
	Input CGST A/c	Dr.		30,000	
	Input SGST A/c	Dr.		30,000	
	To Bank A/c				5,60,000
	(3rd Machinery purchased)				
2019					
Mar. 31	Depreciation A/c (85,500 M1+37,500M3)	Dr.		1,23,000	
	To Machinery A/c				1,23,000
	(Depreciation provided on M1 and M2 @10% p.a.)				
Mar. 31	Profit and Loss A/c	Dr.		1,23,000	
	To Depreciation A/c				1,23,000
	(Depreciation transferred to profit and loss account)				

Ledger
Depreciation Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2018 Mar. 31	Machinery A/c	1,10,000	2018 Mar. 31	Profit and Loss A/c	1,10,000
		1,10,000			1,10,000
2019 Mar. 31	Machinery A/c	1,23,000	2019 Mar. 31	Profit and Loss A/c	1,23,000
		1,23,000			1,23,000

Machinery Account

Dr. **Cr.**

Date	Particulars	Amount	Date	Particulars	Amount

		(Rs)				(Rs)
2017			2018			
Apr. 01	Balance b/d (M1)	9,50,000	Mar. 31	Depreciation on–		
Oct. 01	Bank A/c (M2)	3,00,000		M1	95,000	
				M2 (*for 6 months*)	15,000	1,10,000
			Mar. 31	Balance c/d		
				M1	8,55,000	
				M2	2,85,000	11,40,000
		12,50,000				12,50,000
2018			2018			
Apr. 01	Balance b/d		Mar. 31	Profit and Loss A/c (*Loss on sale*)		18,700
	M1 8,55,000		Mar.31	Bank A/c (*Sale of M2*– ***WN***)		2,66,300
	M2 2,85,000	11,40,000	2019			
July 1	Bank A/c (M3)	5,00,000	Mar. 31	Depreciation on–		
				M1	85,500	
				M3 (*for 9 months*)	37,500	1,23,000
			Mar. 31	Balance c/d		
				M1	7,69,500	
				M3	4,62,500	12,32,000
		16,40,000				16,40,000

Input CGST Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2017			2018		
Oct. 1	Bank A/c	18,000	Mar. 31	Output CGST A/c	15,978
			Mar. 31	Balance c/d	2,022
		1,10,000			1,10,000
2018			2019		
Apr.1	Balance b/d	2,022	Mar. 31	Balance c/d	32,022
July 1	Bank A/c	30,000			
		32,022			32,022

Input SGST Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2017 Oct. 1	Bank A/c	18,000	2018 Mar. 31	Output SGST A/c	15,978
			Mar. 31	Balance c/d	2,022
		18,000			18,000
2018 Apr. 1	Balance b/d	2,022	2019 Mar. 31	Balance c/d	32,022
July 1	Bank A/c	30,000			
		32,022			32,022

Output CGST Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2018 Mar. 31	Input GGST A/c	15,978	2018 Mar. 31	Bank A/c	15,978

Output SGST Account

Dr. **Cr.**

Date	Particulars	Amount (Rs)	Date	Particulars	Amount (Rs)
2018 Mar. 31	Input SGST A/c	15,978	2018 Mar. 31	Bank A/c	15,978

Working Note: Calculation of Sale Value of M2

Particulars	Amount (Rs)
Value of M2 as on Oct.1, 2017	3,00,000
Less: Depreciation up to 31st Mar., 2018	15,000
Value of M2 as on December 31, 2011	2,85,000

Less: Loss on Sale	18,700
Sale Value	**2,66,300**

Provisions & Reserves - Meaning and Accounting Treatment

Objectives

After going through this lesson, you shall be able to understand the following concepts.

- Meaning of Provision
- Meaning of Reserves
- Distinction between Provisions and Reserves

Provision

Every business organisation is exposed to some common known expenses or losses the exact amount of which in the future period is unknown such as depreciation on fixed assets, payment of tax liability, default in payment by customers, etc. For the purpose of meeting such expenses or losses a business may keep aside a certain amount every year. The amount that is kept aside from the profits of an enterprise to meet the future 'known' liabilities is known as *provision*. It is created only for those liabilities, the amount of which cannot be ascertained precisely and accurately beforehand. Therefore, if a provision is created for a liability whose amount is already known cannot be considered as a provision rather, it would be considered as a liability for the business. From this it is clear that there lies a difference between a provision and a liability as the former is to provide for a future known liability whose amount is difficult to be determined while the latter is in itself a future known liability whose amount is already known. *For example*, provision created for a tax liability of Rs 10,000 to be paid in the month of December is a liability and not a provision. This is because, here, the amount of liability is already known, therefore provision cannot be created for this liability.

This creation of provision is truly based on the intuitions and past experiences of a business. In other words, it is created on an estimated basis based on the past performances. The unascertained liabilities in the form of provisions are kept aside which helps a business to sustain from the future unexpected losses.

Provision is considered as an expense of a business which is charged from the profits by debiting it to the Profit and Loss Account.

The underlying principle behind creation of provision is accounting principle of Conservatism which state that '*provide for all anticipated expenses or losses but do not provide for anticipated incomes or gains*'. It should be noted that creation of provision is compulsory even if the business does not have profits. The main rationale for making provisions is to provide cushion to the future business performance against the uncertain and unforeseen losses that may arise from the past transactions. The creation of provision helps in determining the true profits or losses during an accounting period.

As per Penguin Dictionary of Commerce '*A provision is the amount written off or retained by*

way of providing depreciation, renewals or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy'.

The following are few examples of provisions.

i. Provision for Doubtful Debts
ii. Provision for Discount on Debtors
iii. Provision for Taxation
iv. Provision for Depreciation
v. Provision for Repairs and Renewals

Accounting Treatment
The amount of provisions is charged against profits by debiting it to the Profit and Loss Account. It is charged in the accounting period in which such provision is created. We know that provision is compulsorily to be create therefore, it has to be created by the business even in case of losses. The following is the Journal entry for creating provision.

Profit and Loss A/c	Dr.
To Provision for….A/c	
(Provision made for…)	

Disclosure of Provision in the Balance Sheet
The amount of provision in the Balance Sheet can be shown in any of the following ways-

a. It can be shown either on the Assets Side of the Balance Sheet as a *deduction* from the concerned asset. *For example*, Provision for Depreciation is shown as a *deduction* from the concerned fixed asset,

b. Or it can be shown on the Liabilities Side of the Balance Sheet. *For example*, Provision for Taxation.

Features of Provisions
The given below are some features of provision that can be derived from its above explanation.

i. It is created to meet the future known liability the exact amount of which cannot be determined.

ii. It is an estimation based on the past experiences and performances.

iii. It is compulsory to create irrespective of the fact whether there are profits or losses.

iv. It is a charge against profits and not an appropriation of profits.

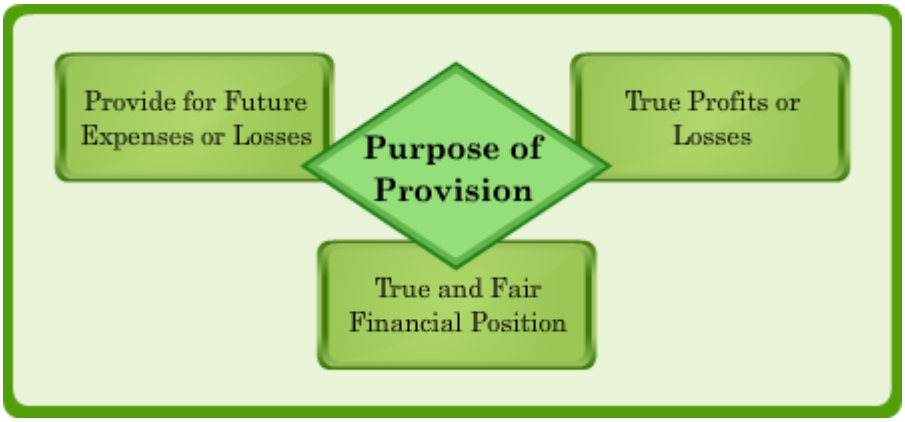
Importance of Provisions

The following are the various purposes served by creating provisions.

i. ***Provide for Future Expenses or Losses-*** Provision is the amount kept aside out of profits to meet the future expected liabilities and losses. Therefore, it helps the business in meeting the expenses or losses that are expected to take place in the near future.

ii. ***True Profits or Losses-*** The true profit or loss of a firm can be determined only when all the expenses or losses (whether they are paid/incurred or not are provided) i.e. debited to Profit and Loss Account. Provision is a charge against revenues or profits of a firm and therefore it helps in ascertaining the true profit or loss during an accounting period.

iii. ***True and Fair Financial Position-*** By creating the provisions for anticipated expenses and losses the true financial position of an organisation can be assessed at the end of an accounting period.



Reserves

The amount that is kept out of the profits of an enterprise to meet the future 'unknown' or 'unexpected' liabilities is known as reserve. The creation of reserves helps in meeting the unforeseen expenses or losses that may occur in the near future. It should be noted that

creation of reserve is not compulsory. Its creation completely depends upon the will of an enterprise. It is an appropriation of profits which is created out of the undistributed profits of the business. It helps in strengthening the financial position of the business. Besides this, the amount of reserves can also be utilised for distribution of profits among its shareholders. As creation of reserve is an appropriation of profit so, it does not reduce the profits of the firm. Therefore, the reserves are not debited to the Profit and Loss Account. Rather, it is debited to the Profit and Loss Appropriation Account. Also, the reserves created are shown on the Liabilities Side of the Balance Sheet under the head Reserves and Surplus.
Sometimes, a business may opt to invest the amount of reserve so created outside its operations. Such investment of reserve is known as ***Reserve Fund***.

In the words of William Pickles, '*Reserves means the amount set aside out of the profits and other surpluses, which are not earmarked in a way to meet any particular liability, known to exist on the date of Balance Sheet*'.
As per American Institute of Accounting views- '*The use of term reserves be limited to indicate that an undivided part of asset is being held or retained for general or specific reserve*'.

The given below are some examples of reserves.

i. General Reserve
ii. Dividend Equalisation Fund
iii. Capital Reserve
iv. Debenture Redemption Reserve
v. Workmen Compensation Fund
vi. Investment Fluctuation Fund, etc.

Features of Reserves
The following are the various features of reserves that can be derived from the above explanation.

i. It is created to meet the future uncertainties.

ii. Its creation is not compulsory.

iii. It is an appropriation of profits and not a charge against profits.

iv. It can be distributed as dividends.

Importance of Reserves
The given below are some purposes served by the creation of reserves.

i. ***Provide for Future Unexpected Liabilities-*** The amount of reserves can be utilised to meet the unexpected future losses or expenses of the business.

ii. ***Improved Financial Position-*** Reserves are basically the retention of certain portion of undistributed profits of the business. Therefore, for the purpose of expanding the business the reserves can be used as an internal source of finance.

iii. ***Improve Goodwill-*** The reputation of a business depends on the uniformity in the payment of dividends. The reserves can be utilised for the distribution as dividends to its shareholders which gives them a sense of surety and security of their investment in the business. This in turn, enhances the goodwill of the business.

iv. ***Repayment of Long-term Liabilities-*** The specific reserve can be created for the repayment of long-term liabilities. For example, for the purpose of redeeming the debentures, a business may create Debenture Redemption Reserve for making payment to its debenture-holders.

v. ***Meeting Legal Requirements-*** Sometimes the reserves may be created just to fulfill the legal requirements. For example, creation of Investment Fluctuation Fund is legally required by the Income Tax Law.

Distinction between Provisions and Reserves

Although both provisions and reserves are created to meet the future liabilities of the business, but following are some of points of dissimilarities between the two.

Point of Distinction	Provisions	Reserves
Objective	Created to meet the future known liability the amount of which cannot be determined precisely.	Created to meet the future unknown liabilities.
Appropriation v/s Charge	It is a charge against profit	It is an appropriation of profits
Aim	Created to meet the specific liability of the business in the near future	Created for strengthening the financial position of the business
Recording	Recorded on the debit side of the Profit and Loss Account	Recorded on the debit side of the Profit and Loss Appropriation Account.
Effect on Profit	The available profits of the business reduces as it is a charge against profits	It does not reduces the profit of the business as it is an appropriation of profits
Utilisation	Cannot be utilised for the purpose of distribution as profits.	Can be utilised for the purpose of distribution as profits.
Creation	It is compulsory to create even if there are no profits	It is not compulsory to create. Therefore, in cases of inadequate profits it is not created
Investment of Amount	It can never be invested outside the business	It can be invested outside the business
Disclosure in Balance Sheet	It is shown either on the Assets Side as a deduction from the concerned asset or can be shown on the Liabilities Side	It is shown on the Liabilities Side of the Balance Sheet under the head Reserves and Surplus

Reserves- Meaning and Types

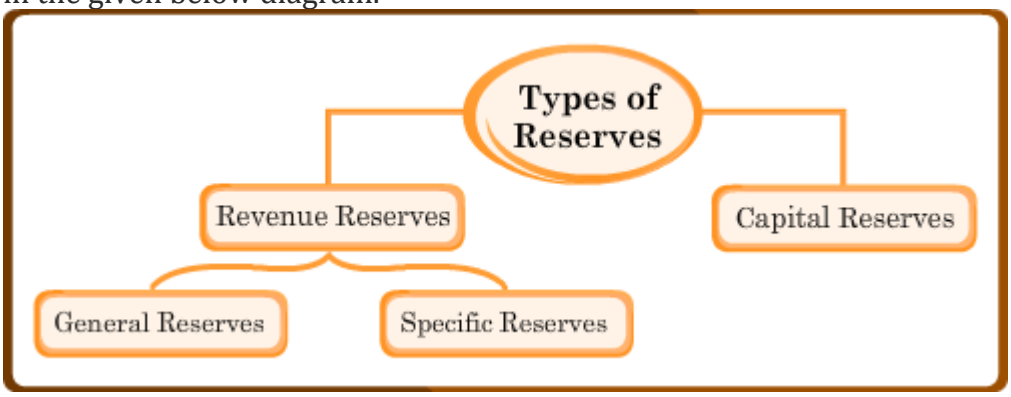
Objectives

After going through this lesson, you shall be able to understand the following concepts.

- Types of Reserves
- Distinction between Revenue Reserves and Capital Reserves
- Distinction between General Reserves and Specific Reserves
- Concept of Secret Reserves

Types of Reserves

We know that reserves are the portion of undistributed profits of a business that is kept aside to meet the future uncertainties. The reserves can be broadly bifurcated as revenue reserves and capital reserves. The revenue reserves can be further classified as general reserve and specific reserve. A clear picture of the classification of the reserves is depicted in the given below diagram.



1. Revenue Reserves

The reserves that are created out of those profits which are earned from carrying out the normal activities of a business are known as *Revenue reserves*. In other words, revenue reserves are created out of revenue profits of the firm. These reserves are created to meet the unexpected expenses or losses of the business. It helps to strengthen the financial soundness of the business. These can be utilised for distribution of dividends among the shareholders. In the words of Kohler, '*Reserves are that portion, or any thereof, of the net worth or total equity of an enterprise representing retained earnings available for withdrawal by proprietors*'. Some of the examples of Revenue reserves are Debenture Redemption Reserve, Investment Fluctuation Reserve, General Reserve, etc. The Revenue reserves can be further classified as General Reserve and Specific Reserve.

- ***General Reserves*-** These are the reserves that are created out of revenue profits without any specific purposes. In other words, these reserves are maintained to meet the future unforeseen liabilities of the business. The purposes of utilising such reserves are not specified and thus it can also be used to enhance or improve the financial position of the business. These reserves are used as per the discretion of the

management for the general purposes. The given below are some purposes for which the general reserve can be utilised.

i. To strengthen the financial position of the business.

ii. To meet unexpected expenses or losses.

iii. To provide a channel for expanding the business.

- ***Specific Reserves-*** These are the reserves that are created out of revenue profits for fulfilling the specific purposes of the business. These reserves cannot be utilised for the purposes other than specified purposes for which it has been created. For example, Debenture Redemption Reserve is a specific reserve that can be utilised for redeeming the debentures of the company. Some of the examples of specific reserves are Investment Fluctuation Fund, Workmen Compensation Fund, Dividend Equalisation Fund, Sinking Fund, Development Rebate Reserve, etc.

2. Capital Reserves

The reserves that are created out of the capital profits of a business are known as Capital reserves. Capital profits are the profits that are not earned in the normal business activities. These reserves are created out of the transactions which are capital in nature. Therefore, all the capital profits arising from the specific capital nature transactions can be termed as C*apital reserves*. The following are the some examples of capital reserves.

i. Profit on sale of fixed assets.
ii. Profit on re-issue of forfeited shares.
iii. Profit on revaluation of assets and liabilities.
iv. Premium received on issue of shares and debentures.
v. Profit on redemption of debentures.
vi. Profit prior to incorporation.

These reserves are utilised by the business for writing-off the capital losses and cannot be utilised for distribution of dividends among the shareholders.

Distinction between General Reserves and Specific Reserves

The given below are some points of distinction between general reserves and specific reserves.

Point of Distinction	General Reserves	Specific Reserve
Meaning	These are the reserves that are created without any specific purposes	These are the reserves that are created for some specific purposes

Purpose	It can be utilised for any purpose as per the discretion of the management	It is utilised only for the specified purposes for which it has been created
Examples	Reserve fund, Contingency Reserve, Retained Earnings, etc.	Investment Fluctuation Fund, Debenture Redemption Reserve, Dividend Equalisation Fund, etc.

Distinction between Revenue Reserves and Capital Reserves

The given below are some points of difference between Revenue reserves and Capital reserves.

Point of Distinction	Revenue Reserves	Capital Reserves
Creation	Created out of revenue profits that are earned in the normal business activities.	Created out of capital profits that are not earned in the normal business activities.
Distribution as Dividend	It can be utilised for distribution as dividends.	It cannot be utilised for distribution as dividends.
Aim	Created to meet the future uncertainties and enhancing the financial soundness of the business.	Created to write-off the capital losses or to meet the purpose laid down in the Companies Act.
Examples	General Reserve, Debenture Redemption Reserve, Retained Earnings, etc.	Profit on sale of fixed assets, Premium on issue of shares, Profit prior to incorporation, etc.

Meaning of Secret Reserves

Secret reserves are those reserves which exist in the business to strengthen its financial position but are not disclosed in the Balance Sheet. As these reserves are not apparent on the Balance Sheet, therefore, it is also known as Hidden Reserve or Inner Reserves. These reserves are created by showing the profit at much lower figure or by understating the assets and overstating the liabilities of the business. The presence of such reserves in the business restrains the Balance Sheet to reveal its true financial position. Due to the existence of these reserves the actual position of the business is much better than what is actually depicted by the Balance Sheet. The creation of secret reserves is not permitted by the Companies Act, 1956 except in the cases of Banking Companies and Insurance Companies.

Ways of Creating Secret Reserves
The following are the various ways through which the secret reserves may be created.

i. By undervaluation of assets.
ii. By overvaluation of liabilities and provisions.
iii. By creating excessive provision for doubtful debts.
iv. By charging excessive depreciation on the fixed assets.
v. By treating capital expenditure as revenue expenditure.
vi. By ignoring the prepaid expenses.
vii. By ignoring outstanding incomes.
viii. By treating contingent liability as an actual liability.
ix. By understating the goodwill.
x. By suppressing the sales.

Benefits of Secret Reserves
The given below are some benefits of creating secret reserves.

i. ***Financial Soundness***- Secret reserves helps in enhancing and improving the financial soundness of the business without intimating it to the shareholders and outsiders.

ii. ***Reduced Competition***- The secret reserves are created by revealing the actual profits of the business at much lower figures. This helps the management to avoid the competition in the market.

iii. ***Writing-off Unexpected Losses***- Secret reserves helps in writing-off the huge unexpected losses of the business without bringing it to the notice of the public and also without affecting the regular profits of the business.

iv. ***Regular Dividends***- In the adverse conditions of the business, when there are low profits, the secret reserves can be utilised to maintain the uniformity in the payment of dividends to its shareholders.

v. ***Prevention from Higher Income Tax***- The disclosure of reduced profits in the books leads to the reduction in the income tax liabilities.

Drawbacks of Secret Reserves
Besides various benefits of secret reserves there also exist some drawbacks. These are as follows.

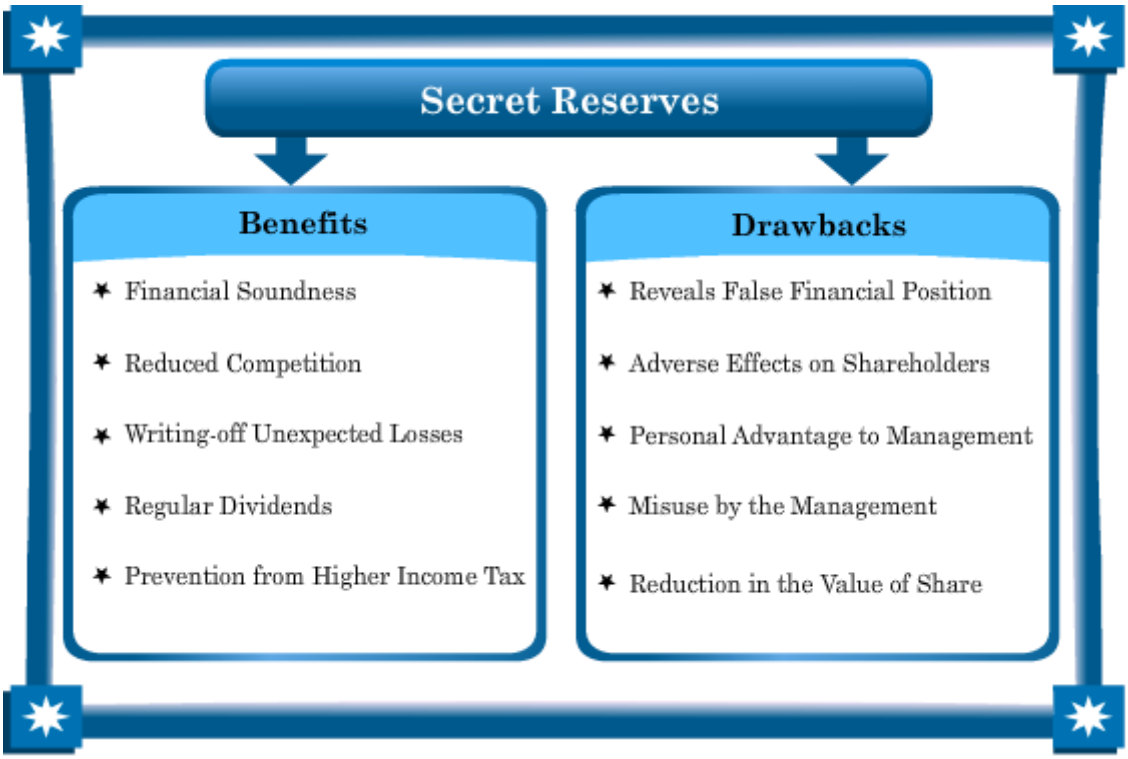
i. ***Reveals False Financial Position***- Secret reserves restrain the Profit and Loss Account from revealing the true profits and Balance Sheet from disclosing the true and fair financial position of the business.

ii. ***Adverse Effects on Shareholders***- These reserves lead to the losses to the shareholders due to the concealment of actual profits in the books. Therefore, they are not able to get their due share of actual profits.

iii. ***Personal Advantage***- The management or directors can take the undue advantages of such reserves for their personal purposes.

iv. ***Misuse by the Management***- These reserves can be utilised by the management for hiding their mistakes and fraudulent activities.

v. ***Reduction in the Value of Share***- Creation of secret reserves leads to a decline in the price of share in market.



Distinction between Provisions and Reserves

Basis of Distinction	Provisions	Reserves
1) Charge Vs. Appropriation	Charge Against Profit	Appropriation of Profit.
2) When created?	To be created whether profit is made or not.	To be created only when there is a profit.
3) Motive	To meet a known liability or contingency even if its amount cannot be determined.	To act as a buffer in case of an unknown liability.

4) Disclosure	Can be either shown on the Liability side under the head 'Other Liabilities' or deducted from the assets.	Shown on the liabilities side of the Balance Sheet under the head 'Reserves and Surplus.'
5) Disbursement	Cannot be paid as dividend and reduces net profit.	Unutilised portion can be distributed as dividend.
6) Compulsion	A must as per the GAAP.	Created out of prudence and not mandatory.
7) Examples	Provision for Depreciation, Provision for Bad Debts, etc.	General Reserve, Investment Fluctuation Reserve, etc.