Depreciation of Fixed Assets

PAST EXAM QUESTIONS

Depreciation of Fixed Assets

1. Explain what is meant depreciation
2. Distinguish between straight line and reducing balancing method of depreciation (8)

2018

3. Explain why a company charges depreciation in calculating profit. (4)
4. List the factors which should be considered when determining the depreciation Policy on a particular asset. (4)

2015

5. Why does a company charge depreciation in calculating profit? (4)
6. Why would a company choose one method of depreciation over another? (4)

2013

7. Explain what is meant by depreciation.(4)
8. Why does a company charge depreciation in calculating profit? (4)

2010

9. What factors are taken into account in arriving at an annual depreciation charge? (2)

2005

2018

Explain what is meant depreciation

Deprecation is the measure of loss in value of a fixed asset over its useful economic life as a result of

1. wear and tear,
2. passage of time,
3. obsolescence and extraction.

The amount allocated in each accounting period is treated as an expense to be set against revenue in the calculation of profit. Depreciation is an example of the matching concept in practice. The value of the asset is used up in the business (its depreciable amount) is matched to those accounting periods that are expected to benefit from it.

Distinguish between straight line and reducing balancing method of depreciation

The straight line method

The straight line method is where the same amount of the cost of the asset is written off each year. It is appropriate in the case of an asset that remains in the business over a long period of time and loses value slowly, for example assets such as buildings that generate profit over many years.

Depreciation of Fixed Assets

The straight-line method involves spreading the depreciable amount evenly over the estimated useful life of the asset. Using this method, the depreciation is the same figure each year, which suggests that the asset is being used up at an even rate.

The reducing balance method

The reducing balance applies a constant percentage to the gradually carrying amount balance so that the amount of depreciation expense diminishes over the useful life of the asset. The amount written off is high in early years and reduces each year until written off. This method is appropriate in the case of an asset which loses most of its value in the years immediately after purchase e.g. vehicles, computer, equipment etc., (assets that become obsolete quickly because of changes in technology). It should be noted that relatively few businesses use the reducing balance method and, where it is used, the percentage figure is often an approximation.

2015

Explain why a company charges depreciation in calculating profit.(4)

Depreciation is an expense. Depreciation is charged so as to write off the cost of the fixed asset over its useful economic life. Failure to include depreciation in the final accounts will result in the profit being overstated and the net worth being overstated in the Balance Sheet and will not show a true and fair view (true value).

List the factors which should be considered when determining the depreciation Policy on a particular asset. (4)

The factors to be considered when accounting for depreciation are:

1. Type of asset
2. Estimated life of asset
3. Cost of asset
4. Scrap value of asset at end of life
5. Method of depreciation

2013

Why does a company charge depreciation in calculating profit? (4)

Depreciation is an expense. Failure to include depreciation in the final accounts will result in the profits being overstated and the net assets in the balance sheet will not show a true value.

Depreciation of Fixed Assets

Why would a company choose one method of depreciation over another? (4)

A method of depreciation is chosen by a company because of its policy on depreciation and ensuring that the consistency concept is applied when preparing accounts.

Straight Line Method is where the same amount of the cost of the asset is written off each year. It is appropriate in the case of an asset that remains in the business over a long period of time and loses value slowly, for example Buildings, (assets that generate profit over many years).

Reducing Balance Method is where a fixed percentage of the value of the asset is written off each year. The amount written off is high in early years and reduces each year until written off. This method is appropriate in the case of an asset which loses most of its value in the years immediately after purchase e.g. vehicles, computer, equipment etc., (assets that become obsolete quickly because of changes in technology).

The general principle of providing depreciation is based on the matching concept.

2010

Explain what is meant by depreciation.(4)

Depreciation is the measure of the wearing away or loss in value of a fixed asset as a result of wear and tear, passage of time, obsolescence or extraction

Why does a company charge depreciation in calculating profit? (4)

Depreciation is an expense. Failure to include depreciation in the final accounts will [4] result in the profits being overstated and the net assets in the balance sheet will not show a true value.

2005

What factors are taken into account in arriving at an annual depreciation charge? (2)

Factors used to determine annual depreciation charge. [2]

1. Cost of asset
2. Estimated life of asset
3. Estimated residual/scrap value of asset
4. Selection of appropriate method of depreciation