JAIIB

Accounting & Financial Management for Bankers

Module A : Chapter 6

Methods of Depreciation

www.courses.edutap.co.in hello@edutap.co.in +91 8146207241

STRAIGHT LINE METHOD

$$Depreciation\ Value = \frac{Cost\ Price\ of\ Asset\ - Scrap\ Value}{(Estimated\ years\ of\ Useful\ life)}$$

- AKA Fixed Cost Method or Fixed Percentage on Original Cost Method.
- Constant value (or fixed percentage of original cost) is deducted every year from book value of asset.
- Relevant when asset is expected to give consistent performance over time.

Company A buys a piece of equipment for ₹10,500. The equipment has an expected life of 10 years and a salvage value of ₹500. Calculate the depreciation.

DIMINISHING VALUE METHOD

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$$Depreciation\,Value = Percentage\ Rate\ \times Book\,Value\ of\ Asset$$

- AKA Written Down Value (WDV) method.
- Fixed percentage of residual balance or book value (known as Depreciation rate) is deducted every year from book value of asset.
- Relevant when asset is expected to give better performance is initial years, thus higher depreciation is charged in initial years.

Company A buys a piece of equipment for ₹10,000. The company decides to charge a 10% depreciation rate for the equipment under the WDV method. Calculate the depreciation for the first three years.

UNITS OF PRODUCTION METHOD

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$$\boldsymbol{Depreciation\ Value} = \frac{\boldsymbol{Actual\ production\ during\ the\ period\ \times Total\ depreciable\ amount\ of\ asset}}{\boldsymbol{Total\ Expected\ Production\ during\ the\ period}}$$

- It is a usage based method.
- Useful life of asset is measured in terms of production output which the asset is expected to produce in its lifetime.
- Relevant for assets which depreciate in proportion to their use.

Company A buys a pen production machine which can manufacture 10 lakh pens before it is scrapped. Purchase price of machine is ₹1 lakh while the scrap value is ₹10,000. During the first year, 2 lakh pens are produced by the machine. What will be the depreciation amount in the first year?

SUM OF YEARS'S DIGITS METHOD

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$$Depreciation\ Value\ in\ n^{th}\ year = \frac{Number\ of\ Useful\ Years\ - n + 1}{Sum\ of\ All\ Years\ in\ Useful\ Life}$$

- This method is used to calculate depreciation of an asset that assumes higher depreciation charge and greater tax benefit in the early years of the asset's life.

Company A buys a computer for ₹5000 for a useful life of 3 years, after which it can be resold for ₹200. Calculate the depreciation for all three years using 'Sum of Years' Digits method'.

LET’S SOLVE!

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A company purchases a machine for ₹50,000. The machine has an estimated useful life of 10 years and a salvage value of ₹5,000. Calculate the annual depreciation expense using the straight-line method.

Thank You

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+91 8146207241

hello@edutap.co.in

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