#### **JAIIB**



#### **Accounting & Financial Management for Bankers**

# Module A : Chapter 6 Methods of Depreciation



#### **STRAIGHT LINE METHOD**



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

- 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



**Depreciation Value = Percentage Rate** ×**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



Actual production during the period  $\times$  Total depreciable amount of asset

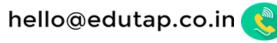
**Depreciation Value** =

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



Number of Useful Years -n+1**Depreciation Value in n^{th} year =**  $-\frac{1}{2}$ 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!**



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.









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