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DEPRECIATION ACCOUNTING PROCEDURES

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ABSTRACT

Depreciation under income tax act is the decline in the real value of a tangible asset because of consumption,wear and tear or obsolescence. The concept of depreciation is used for the purpose of writing off the cost of an asset against profit over its life. Depreciation under income tax act is charged against income and there are different methods of calculating it like straight line method or written down value method. The income tax act recognizes WDV method of depreciating asset except for undertaking engaged in generation or generation and distribution of power. This is the time period over which the company expects that the asset will be productive. Past its useful life, it is no longer cost-effective to continue operating the asset, so it is expected that the company will dispose of it. Depreciation is recognized over the useful life of an asset. When a company eventually disposes of an asset, it may be able to sell it for some reduced amount, which is the salvage value. Depreciation is calculated expected to be quite small, then it is generally ignored for the purpose of calculating depreciation

KEY WORDS: *Income Tax Act, Written Down value Method,Salvage value, Straight line Method,*

INTRODUCTIONS

The term depreciation is derived from the Latin words do (down) and premium (price). In everday life, the term 'depreciation' denotes the decrease in the value of any asset. The depreciation accounting is mainly based on the concept of income.The concept of income is matching of revenues with expenses. The goods purchased are frequently matched through immediate sale or within a year. The crux of the concept of income is that the expenses are to be matched against the revenues. The ultimate aim of matching is done in order to determine the volume of profit or loss of the transaction. If the assets are nothing but long term assests procured by the enterprise should be matched against the revenues of them. The matching of expenditure of the assets incurred by the firm at the time of purchase against the revenues is the hard core task of the firm. Why it is being considered as a cumbersome task in matching? The benefits/revenues of the fixed assets expected to accrue for many number of years but not within a year. The initial investment on the assets at the time of purchase should be matched against the revenue pattern of the same year after year in order to find out the profitability of the long term investment. To have an effective matching against the revenues on every year, the amount of purchase has to be stretched. The stretching of expenses into many years is known as depreciation.

Definitons:

According to 'Account in Standard-6' depreciation may be defined as A measure of the wearing out, consumptions or other loss of value of depreciable assets arising form use; effluxion of time or obsolescene through technology and market changes. Depreciation is allowed so as change a fair proportion of the depreciable amount in each accounting period during the expected useful life of assets. Depreciation includes amortization of assets whose useful life is predetermined.

According to spicer and pegler, depreciation may be defined as a measure of the exhaustion of the effective life of an asset from any cause during a given period.

RESEARCH METHODOLOGY

This is study is mainly based on the secondary data.These data are collected from various websites,journals and newspaper artilcles. This study is descriptive & conceptual in nature.

USEFUL LIVES AND SALVAGE VALUES

The useful life of the asset and its salvage value is important for calculation the depreciaton. An estimate of a longer useful life reduces the depreciation and hence, increase the net income. A higher amount of the slavage value also decrease the depreciation and raises net income.

EFFECT OF DEPRECIATION METHODS ON NET INCOME

The three methods of depreciation affect pre-tax income, tax expense and other elements in different ways.The accelerated methods of depreciation cause the pre-tax income, income tax expenses,net income and profit margins to be lower in the initial years and higher in the later life of the asset, as compared to that of straight-line depreciation method.

However, the values of depreciation, taxes, pre-tax income,net income and profit margin over the entire reporting period are not affected by the method chosen for depreciation.

CHOICE OF METHOD

U.S. GAAP allows a company to use different methods of depreciation for reporting in financial statements and for reporting for tax purposes. However, this may not be the case in many countries. Most companies in the US prefer straight line depreciation method for financial reporting purposes. For reporting for taxes, they use a type of accelerated depreciation known as Modified Accelerated Cost Recovery System(MACRS). This method helps in reducing taxable income and the taxes to be paid in the initial years of the asset life. Thus , the payment of a portion of taxes is deferred until the later part of the asset's life.

In this case, where companies use straight-line method for financial reporting and an accelerated method for tax payments,the tax expense in the income statement is not changed. It causes an addition to the company's deferred tax liablility in the form of the difference between the tax expense and the taxes payable in the initial years. Later,the depreciation expense for tax purposes reduces then the depreciation expenses on the income statement. This causes the deferred tax liability to reduce by the excess of income taxes payable above the tax expense.

The important thing to note is that the total depreciation over the life of an asset is same in all the depreciation methods. The only thing that varies because of the different methods is the pattern of the depreciation expense and the taxable income.

CAUSES OF DEPRECIATION

The main causes of depreciation are as follows

i) Effluxion of time
ii) Wear and tear
iii) Tension and pressure
iv) Obsolescene i.e.,machinery rendered out of date by later invention.
v) Physical factors i.e.,evaporation, dampness, floods excessive hear etc.
vi) Superfluity i.e., not required due to change in production plans.
vii) Exhaustion
viii) Depletion and
ix) Fall in market prices

RATIONALE FOR CHARGING DEPRECIATION

a) To keep intact the capital invested: this is accompanied by retaining the amount of depreciation charge in the profit and loss account in the business.
b) To ascertain the true cost of production: as the value of fixed assets depletes gradually by consumption during the process of production, it is necessary that such consumption of value be charged in the account for determination of the true cost of production and mechanism of providing depreciation does this.
c) To determine the profit or loss for the year: depreciation being an expanse represented by the loss in the value of fixed asset arising due to use.
d) To present a true and fair value of firms assets in balance sheet on going concern basis.
e) To provide for replacement of the fixed assets: as the amount of depreciation charged in the profit and loss account retained in the

business, it goes on accumulating and eventually provides funds, for replacement of fixed assets when their useful life is over.

f) To company with legal requirements: as per the requirements of sec-205 and 350 of the companies act and part II of schedule of VI of the Indian companies act, depreciation on fixed assets needs to be provided in the account.

NEED FOR PROVIDING DEPRECIATION ON HUMAN BODY

Like other assets depreciation should be provided on human body which is employed in business. To earn revenue, to increase production and productivity human body is required to work hard, take risk and live under various mental pressures and physical tensions. This process emerges the need of depreciation of human body. Gradually all parts of human body starts to depreciate due to more tension and more exertion.

Application of money measurement concept: at this stage, if we take money measurement concept into consideration,it will be clear from this concept that business only records those activities and transactions which will be measured in terms of money. Here, it is necessary to point out that the efficiency of human body cannot be measured in terms of money. Therefore, it is not recorded. Until depreciation and repairs are not considered to be part of Human Resource Accounting, this branch of accounting will remain incomplete.

Entiltlement for charging depreciation:A business man is entitled for depreciation on assets if he employs machinery or plant, if the same is not employed, he will not be entitled to provide depreciation. Human body is more complicated and sophisticated as compared to manmade machinery or plant actually, plant and machinery is replaceable, repairable and can be overhauled but human body is neither replaceable nor repairable. If it is damaged it will remain damaged for whole life.

Creating depreciation fund for human body: like other expenditures depreciation is not a visible expenditure, gradually amount of depreciation becomes ‘Depreciation-Fund’ and that fund is helpful in replacement or repurchasing of machinery or plant. Human body is indeed the asset for the concern and if the depreciation is provided on the same it will take the shape of ‘depreciation fund’which will be helpful in increasing the efficiency of human body. Suppose, the man is ill or any part of his body is temporarily disable then this ‘Depreciation-Fund’ should be utilized to cure and make him again efficient.

CONTRADICTION BETWEEN INCOME TAX ACT AND INDIAN COMPANIES ACT

It is interesting to state here that income tax law does not permit for charging depreciation on human body and also it does not categorize human body as ‘Plant or Machinery”. The word plant ‘defined in sec-43 of Income tax act that plant includes ships, vehicles,books scientific apparatus and surgical equipment’s

For the purpose of this Act ‘Animals’ and ‘Human body’ is not heated as plant. But as per the provisions of Indian companies Act, any ‘livestock’(which consists of animals) is shown as fixed assets in the Balancce sheet as per schedule-IV

CONCLUSION

Different methods yield different outcomes on the financial statements. An analyst needs to understand and appreciate the effects of the depreciation expenses. He should be able to differentiate between the company’s recorded depreciation expense and the economic depreciation, which is actually the real decline in the assets value over the accounting period. Such subtle observations help to uncover overstated profits.