Depreciation within the double-entry system

Recording depreciation

Fixed assets accounts are always kept for showing assets at cost price. This adheres to the Historic Cost accounting concept. As a result, the depreciation is shown in a separate 'provision for depreciation' account.

Example 1

B Swifts financial year ends on 31st December. A machine is purchased for 2,000 pounds cash on the 1st January. It is to be depreciated at the rate of 20 per cent using the reducing balance method.

Cash Account (20X6)

Dr		Pounds			Pounds Cr
			1.1.X6	Machine	2,000

Machinery Account (20X6)

Dr		Pounds			Pounds Cr
1.1.X6	Cash	2,000	31.12.X6	Bal. c/d	2,000
		2,000			**2,000**
1.1.X7	Bal. b/d	2,000			

Provision for Depreciation Account (20X6)

Dr		Pounds			Pounds Cr
31.12.6	Bal. c/d	400	31.12.6	Profit & Loss	400
		400			**400**
			1.1.X7	Bal. b/d	400

B Swift

Dr **Trading and Profit and Loss Account for the year ended the 31.12.X6** Cr

	Pounds		Pounds
Opening Stock	300	Sales	6,700
	4,260	Closing Stock	550
	4,560		
Gross Profit bal. c/d	2,690		
	7,250		**7,250**
Wages	520	Gross Profit bal. b/d	2,690
Lighting and heating	190		
Provision for Depreciation	400		
Rent	240		
General expenses	70		
Carriage inwards	110		
Net Profit bal. c/d	1,160		
	2,690		**2,690**
Capital	1,160	Net Profit bal. b/d	1,160

The provision for depreciation has been debited as an expense.

The provision for depreciation has reduced the Profit by 400 pounds.

Remember depreciation is a provision estimated by accountants. No actual money leaves the business.

B Swift's Balance Sheet (extract) as at 31st December 20X6

	Pounds	Pounds	Pounds
Fixed Assets	Cost	Depreciation	Net Book Value
Machinery	2,000	400	1,600

Machinery Account (20X7)

Dr		Pounds			Cr Pounds
1.1.X7	Bal. b/d	2,000	31.12.X7	Bal. c/d	2,000
		2,000			**2,000**
1.1.X8	Bal. b/d	2,000			

Provision for Depreciation Account (20X7)

Dr		Pounds			Cr Pounds
			1.1.X7	Bal. b/d	400
31.12.7	Bal. c/d	720	31.12.7	Profit & Loss	320
		720			**720**
			1.1.X8	Bal. b/d	720

B Swift

Trading and Profit and Loss Account for the year ended the 31.12.X7

Dr	Pounds		Cr Pounds
Opening Stock	XXX	Sales	XXX
		Closing Stock	XXX
Gross Profit bal. c/d	XXX		XXX
Wages	XXX	Gross Profit bal. b/d	XXX
Lighting and heating	XXX		
Provision for Depreciation	**320**		
Rent	XXX		
General expenses	XXX		
Carriage inwards	XXX		
Net Profit bal. c/d	XXX		
	XXX		**XXX**
Capital	XXX	Net Profit bal. b/d	XXX

B Swift's Balance Sheet (extract) as at 31st December 20X7

	Pounds	Pounds	Pounds
Fixed Assets	Cost	Depreciation	Net Book Value
Machinery	2,000	720	1,280

Example 2

GTC Ltd. run a business where the financial year runs from the 1st July to the 30th June in the following calendar year. A motor lorry is bought on the 1st July 20X7 for $8,000. Another motor lorry is bought on the 1ST July 20X8 for $11,000. Each lorry is expected to be in use for five years, and the disposal value of the first lorry is expected to be $500 and the second lorry is expected to have a disposal value of $1,000. The method of depreciation to be used on motor lorrys is the straight line method of depreciation.

a) Year One →1st July 20X7 - 30 June 20X8

Cash Account (20X7-20X8)

Dr					Cr
		$			$
			1.7.X7	Motor Vehicle	8,000

Motor Vehicle Account (20X7-20X8)

Dr					Cr
		$			$
1.7.X7	Cash	8,000	30.6.X8	Bal. c/d	8,000
		8,000			**8,000**
1.7.X8	Bal. b/d	8,000			

Provision for Depreciation Account (20X7-20X8)

Dr					Cr
		$			$
30.6.X8	Bal. c/d	1,500	30.6.X8	Profit & Loss	1,500
		1,500			**1,500**
			1.7.X8	Bal. b/d	1,500

GTC

Dr Trading and Profit and Loss Account for the year ended the 30.6.X8 Cr

	$		$
Opening Stock	XXX	Sales	XXX
		Closing Stock	XXX
Gross Profit bal. c/d	XXX		
	XXX		XXX
Wages	XXX	Gross Profit bal. b/d	XXX
Lighting and heating	XXX		
Provision for Depreciation	**1,500**		
Rent	XXX		
General expenses	XXX		
Carriage inwards	XXX		
Net Profit bal. c/d	XXX		
	XXX		**XXX**
Capital	XXX	Net Profit bal. b/d	XXX

GTC's Balance Sheet (extract) as at 30th June 20X8

	$	$	$
Fixed Assets	Cost	Depreciation	Net Book Value
Motor Vehicles	8,000	1,500	6,500

b) Year two →1st July 20X8 - 30th June 20X9

Dr Cash Account (20X8-20X9) Cr

		$			$
			1.7.X8	Motor Vehicle	11,000

Dr Motor Vehicle Account (20X8-19X9) Cr

		$			$
1.7.X8	Bal. b/d	8,000			
1.7.X8	Cash	11,000	30.6.X9	Bal. c/d	19,000
		19,000			**19,000**
1.7.X9	Bal. b/d	19,000			

Dr Provision for Depreciation Account (20X8-20X9) Cr

		$			$
			1.7.X8	Bal. b/d	1,500
30.6.X9	Bal. c/d	**5,000**	30.6.X9	Profit & Loss	3,500
		5,000			**5,000**
			1.7.99	Bal. b/d	5,000

GTC

Trading and Profit and Loss Account for the year ended the 30.6.X9

Dr	$		Cr $
Opening Stock	XXX	Sales	XXX
		Closing Stock	XXX
Gross Profit bal. c/d	XXX		XXX
Wages	XXX	Gross Profit bal. b/d	XXX
Lighting and heating	XXX		
Provision for Depreciation	**3,500**		
Rent	XXX		
General expenses	XXX		
Carriage inwards	XXX		
Net Profit bal. c/d	XXX		
	XXX		**XXX**
Capital	XXX	Net Profit bal. b/d	XXX

This $3,500 is made up of a combination of depreciation for two vehicles: Vehicle 1 - $1,500
Vehicle 2 - $2,000

The provision for depreciation for this year is $3,500 only.

GTC's Balance Sheet (extract) as at 30th June 20X9

	$	$	$
Fixed Assets	Cost	Depreciation	Net Book Value
Motor Vehicles	19,000	5,000	14,000

This $19,000 is a combination of both vehicles - 1 → Cost $8,000
2 → Cost $11,000

This depreciation figure is a combination of depreciation from Year 1 & 2: Yr. 1 → $1,500
Yr. 2 → $3,500