Depreciation

# Straight Line Method

Calculate the amount of depreciation charged each year for each of the following assets:

1. A machine that cost £50 has been estimated to last for 5 years. It is expected the machine will have no residual value.
2. A photocopier that cost £3,999 to buy. It has been estimated that it could be sold for £1,999 and it has a life expectancy of 4 years.
3. A delivery van costs £10,000 new. A firm buys it, intends to keep it for 8 years, and believes it will fetch £2,000 when they come to sell it again.
4. A factory costs £500,000 to buy. The business thinks they will have practical use of it for 5 years, before they’ll have to sell it and move into larger premises. They estimate a residual value of £750,000.
5. A business buys a lorry for £40,000. They use £10,000 cash and a £30,000 loan. They intend keeping it for 8 years before selling it for £5,000.
6. The business that bought the delivery van in question 3 smash it into a tree and write it off. This happens after having it for only 2 years.
7. Explain the impact on the Net Profits of the firm that had the delivery van referred to in questions 6, following the accident.
8. As a result of this, what advice would you give to accountants when dealing with depreciation?

# Reducing Balance Method

Calculate the yearly amount of depreciation and the Net Book Values, for each of the following assets:

1. A machine costs £60,000 and has a useful life of 4 years. It is estimated the machine will depreciate by 20% each year.
2. A company car costs £25,000. The accountants of the firm that bought the car think they’ll keep it for 3 years before trading it in for another new car. They estimate an annual depreciation rate of 25%.
3. A firm buys a printer for the office for £1,000. They think it will decrease in value by 10% each year and they aim to keep it for 3 years.
4. The firm that bought the delivery van that smashed into a tree earlier, actually used the reducing balance method, not the straight line method. They thought it was more appropriate for vehicles. They thought it would depreciate at rate of 15% per year. Calculate this for the full 8 years they thought they would keep the vehicle for initially.
5. Is the Straight Line Method better than the Reducing Balance Method when calculating the depreciation of vehicles? Use your calculation to the previous question to substantiate your answer.
6. There is a lot of guesswork and estimates used when calculating depreciation. To what extent does this provide an opportunity for accountants to ‘get creative’ with their accounting?