Depreciation Interview Questions And Answers Guide.

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Depreciation Job Interview Preparation Guide.

Question # 1
Does depreciation generate funds for replacement of assets?

Answer:-

Yes, depreciation generate funds for replacement of assets. When depreciation is charged against the asset, a significant portion is taken out of the profits every year during the lifetime of the existing assets, and is retained and accumulated without being distributed to the owners as dividend. Thus at the end of the life of the existing asset, the business will have some funds to replace old asset with the new one.

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Question # 2
How are the fixed assets categorized to calculate the depreciation as per schedule XIV of Companies Act, 1956?

Answer:-

To calculate depreciation as per Schedule XIV of Companies Act, 1956 the fixed assets are categorized as below:
-Buildings-Factory Buildings as well as Administration buildings
-Plant and Machinery
-Furniture
-Vehicles
-Computer Installations

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Question # 3
What method of depreciation calculation is used to calculate the tax liability according to Income Tax Act, 1961?

Answer:-

According to Income Tax Act, 1961 Written Down Method of depreciation is used to calculate the tax liability. In this method, depreciation is charged at predetermined rate, which is calculated on the balance of cost of asset less amount of depreciation previously charged. The rate at which the depreciation will be calculated is also specified in the Income Tax Act 1961.

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Question # 4
How is depreciation calculated as per schedule XIV of Companies Act, 1956?

Answer:-

As per Schedule XIV of Companies Act, 1956 the company can calculate the depreciation by using either Straight Line Method or Written Down Value Method. The rate to calculate depreciation is also specified in Schedule XIV. If any addition has been made to any asset during the financial year, depreciation on such an asset will be calculated on pro-rata basis from the date of such addition or upto the date on which such asset has been sold.

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Question # 5
Compare: Depreciation as per Companies Act and Income Tax Act?

Answer:-

Under the Companies Act: Depreciation is computed either using the straight line method or written down value method. In straight line method the amount of depreciation is uniform for all the years where in written down method the amount of depreciation is highest in the first year and gradually decreases in the subsequent years.
Under Income Tax Act: Depreciation is computed using written down value method. Also it is charged on the block of assets and not on individual assets. The block of assets means a group of assets for which the same rate of depreciation is applicable.

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Question # 6
Explain endowment policy method of calculating depreciation?

Answer:-

This method is similar to Sinking Fund method except in this method instead of investing in securities the amount set aside is used to pay premium on an Endowment Policy. And the policy should mature on the date on which the ceases its useful life. This collected money is then used to replace the expired asset.

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Question # 7

What is sinking fund method of calculating depreciation?

Answer:-

It is also known as Depreciation fund method. Under this method a sinking fund or depreciation fund is created. Every year the profit and loss account is debited and fund account is credited with a sum, which is calculated such that the annual sum credited to the fund account which is accumulating throughout the life of the asset will be equal to the sum required to replace the old asset. The main advantage of this method is that it accumulates interest or dividends by regular investment of cash outside the business e.g.in securities to finance the replacement of the assets, which has become useless. But on the other hand this method has disadvantage also as the burden of profit and loss account goes on increasing as years pass by since the amount spent on repairs and maintenance goes on increasing due to the wear and tear of the asset and the amount of depreciation remains same.

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Question # 8

Explain renewal method to calculate depreciation?

Answer:-

In this method the full cost of the asset is charged as depreciation during the period in which the asset is renewed. No depreciation is charged in between the period. This method can be used if the asset is of small value and is renewed frequently.

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Question # 9

Explain revaluation method to calculate depreciation?

Answer:-

Under this method the fixed assets are valued at the end of each accounting period. The difference between the value at the beginning of the period and the value at the end of the period represents the depreciation value which is charged against the profit and loss account. This method is used in case of assets like loose tools, packages, Farmers' livestock etc.
Formula for Calculating:
Depreciation = Value of asset at the end â€" Value of asset at the beginning + Any new purchases

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Question # 10

Explain joint factor rate method of calculating depreciation?

Answer:-

This method is also used to calculate amount of depreciation. In this method the depreciation is provided partly at a fixed rate on time basis and partly at a variable rate on usage basis.

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Question # 11

Explain annuity method of calculating depreciation?

Answer:-

In this method, the purchase of an asset is considered an investment of capital on which a certain rate of interest is earned. The cost of the asset and the interest are written down annually by equal instalments until the book value of the asset is reduced to nil. The annual charge by way of depreciation is found out from the annuity tables. The annual charge for depreciation will be credited to asset account and debited to depreciation account while the interest will be debited to asset account and credited to interest account. The disadvantage of this method is that it is a complicated method to charge depreciation. Secondly, the burden on Profit and Loss account goes on increasing with the passage of time and the amount of interest goes on diminishing as years pass by. Thus this method is best suited to those assets which require considerable investment and don't require frequent additions.

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Question # 12

Explain production unit method to calculate depreciation?

Answer:-

Production Unit Method is also a method of calculating depreciation. According to this method, rate of depreciation is predetermined at per unit, which is calculated on the basis of total number of units produced during the life of the asset. This method gives more importance to the usage factor. Higher the number of units produced, higher will be the amount of depreciation and vice versa.
Formula to calculate:
Rate of Depreciation per unit = (Cost of machine â€" Estimated Scrap Value) / Estimated number of units produced

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Question # 13

Explain Written Down Value (Reducing Balance) method to calculate depreciation. What are the benefits of this method?

Answer:-

In Written Down Value Method, the rate of depreciation is predetermined. This is done by deducting the amount of depreciation charged before from the balance of cost of asset (Cost of Asset-Estimated Scrap Value). In simple words, in the first year the amount of depreciation charged is high and it gradually starts decreasing

during the subsequent years.
Formula to calculate:
Depreciation = 1-
N= number of years
R= Residual/Scrap Value
C=Cost of the asset
The main benefit of this method is that it recognises this fact that in the initial phase of an asset, costs of maintenance, repairs etc. are less which goes on increasing with the progressing life of the asset. Thus, by charging higher amount of depreciation in the initial years and gradually decreasing the amount of depreciation counterbalance both the lower amount of repairs and maintenance cost in the initial years and the gradual increase later on. It can be noted here that the written down value can never be zero.

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Question # 14

Explain straight line method to calculate depreciation. What are it advantages and limitations?

Answer:-

It is the simplest and most often used technique. The components used to calculate Straight Line Method are:
-Cost of Asset
-Estimated Scrap vale-is the value of the asset at the end of life of the asset
-Estimated life of Asset
Formula to calculate:
Depreciation = (Cost of Asset-Estimated Scrap Vale)/Estimated life of Asset in years
The main advantage of this method is that an equal amount of depreciation is charged every year throughout the life of the Asset which makes the calculation of depreciation easy.
But the limitation of this method is that the amount of depreciation charged on the asset in the later years is high due to the reduced value of the asset.

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Question # 15

List various methods for calculating depreciation?

Answer:-

Methods for calculating depreciation are:
-Straight Line Method
-Written Down Value(Reducing Balance)Method
-Production Unit Method
-Production Hour Method
-Joint Factor Rate Method
-Revaluation Method
-Renewal Method

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Question # 16

What is the effect of depreciation of assets on profits received by owners?

Answer:-

Depreciation forms a part of cost which is used for arriving at correct estimation of profits, which then is distributed to the owners of the business in the form of dividend. Addition of depreciation to the cost reduces the amount of distributable profits. By maintaining a depreciation account a part of the distributable profit is retained in the business as a reserve which is used to purchase new machinery or for other purposes in the future which reduces the profits or dividends received by the owners.

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Question # 17

What is the need of depreciation account?

Answer:-

According to the matching principle of accounting, the costs incurred in the accounting year should be matched with the revenue or income earned during the same accounting year. Thus, it is necessary to spread the cost of fixed asset less scrap or realizable value after the useful life of the fixed asset is over and this process of ascertain the same is called depreciation accounting. Thus, depreciation account is needed for mainly two purposes:
To ascertain due profits and to represent the value of the fixed asset at its unexpired cost i.e book value of the asset less depreciation.

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Question # 18

Do you know What is depreciation? What are the causes of depreciation? Is it a cost? Why?

Answer:-

Depreciation is a permanent, gradual and continuous reduction in the book value of the fixed asset. Except Land all the fixed assets e.g. Car, Machinery, Furniture etc depreciates in value making the asset useless after the end of a certain period.
Following are the causes of Depreciation:
-Wear and Tear due to regular use of the asset
-Deterioration occurs with the passage of time, whether the asset is in use or not
-Damages done to the assets due to an accident like fire, mishandling etc.
-Depletion of Asset
-Obsolescence i.e. due to new technology in use, new inventions, innovations etc.
Yes, depreciation is a cost. It is a historical cost, which is charged against profits of the organisation reducing the profitability. It is a non-cash cost as it is never paid or incurred in cash.

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