**Depreciation**

Companies purchase equipment to produce income. These assets benefit future periods, and the cost of the asset must be rationally and systematically expensed against future revenues. The rational and systematic allocation of the cost of equipment to expense is called depreciation. It is not a determination of value or impairment of the asset but an allocation of expense. Depreciation expense is found on the Income Stmt and is the debit in the AJE. The corresponding Balance Sheet account credited is not the asset. Assets are shown on the Balance Sheet at the purchase price amount to provide readers of the Financial Stmts with information on the amount spent by the company on its infrastructure. No, rather an account called “Accumulated Depreciation” is credited. Accumulated depreciation is associated with each class of asset and is considered a contra asset account. It is contra to the asset and is shown on the balance sheet along with the asset.



Book value of an asset is the historical cost of the asset minus accumulated depreciation.

The AJE for depreciation is determined by several factors:

1. Cost of the asset
2. Salvage value of the asset
3. Useful life of the asset

To calculate depreciation (We will only learn straight line depreciation in this chapter. Later in the semester, we will learn other depreciation methods).



We will always use monthly depreciation because the calculation can accommodate monthly, yearly and partial year calculations. The trick is to look at the time period that has elapsed since the Financial Stmts were prepared last to determine how many months of depreciation expense is warranted. If one month, the AJE:

Depreciation Expense (I/S) 375

Accumulated Depreciation (B/S) 375

**All projects use straight line depreciation.**