

Week 3 - DQ 1

What is the purpose of depreciation?

Does the book value of a fixed asset (cost minus accumulated depreciation) communicate to a user what the asset is worth? Explain why or why not.

Should the financial statements reflect the value of fixed assets? Explain why or why not.

Response#1 According to Chapter 11 of our text, depreciation is the accounting process of allocating the cost of tangible assets to expense in a systematic and rational manner to those periods expected to benefit from the use of the asset. In other words, depreciation occurs when a company writes off the cost of long-lived assets over several periods. I do not believe that the book value of a fixed asset communicates to a user what the asset is worth. I think this way because Chapter 11 states that the value of the asset may fluctuate between the time the asset is purchased and the time it is sold. The book also states that attempts to measure value changes have not been accepted because values are difficult to measure objectively. Financial statements should reflect the value of the asset because financial report users will want to know what the asset is worth.

Response #2 The purpose of depreciation is to allocate the cost of a useful asset over the asset's useful life to the revenues that are earned while using the asset. The book value of a fixed asset (cost minus accumulated depreciation) does not communicate to a user what the asset is worth. The book value is the price paid for the asset minus the depreciation of the asset which is an estimate. The financial statements should reflect the value of fixed assets because investors would want to know what the asset is worth.

Response #3 The purpose of depreciation is to match the cost of a productive asset (that has a useful life of more than a year) to the revenues earned from using the asset. The book value (cost of an asset – accumulated depreciation) of a fixed asset does not correctly communicate to a user what the asset is worth because when taking accumulated depreciation from the cost of an asset, you are just doing an estimate. Yes, the financial statements should reflect the value of fixed assets because users such as investors and others are interested in knowing how much the asset is worth.

Response #4 The purpose of depreciation is to matched expenses to revenues. If an asset has a useful life of 5 years, then an organization would want to recognize the expense of the asset over those 5 years. The book value may or may not communicate to a user what the asset is worth. Sometimes the market value of an asset can be much higher or much lower than the book value, depending on the asset. Computers and other machinery can lose value quite quickly, while other equipment can hold value.

Financial statements should reflect the book value of asset and not the market value.