

# Chapter 12

## Harmonization of Depreciation Policy: Exploring the Practices of Bangladesh

**Afrin Rifat**

*North South University, Bangladesh*

### ABSTRACT

*The objective of this study is to examine the depreciation methods adopted by different companies listed in Dhaka Stock Exchange (DSE). Besides, the study also attempted to check the consistency in depreciation policy application and harmonization with authoritative accounting practices in the context of Bangladesh. A random sample of 120 companies across different sectors was examined to determine the depreciation method currently practiced in the country. This study revealed that declining balance of depreciation is the most commonly practiced method in most of the sample companies. Nonetheless, straight line depreciation method follows close behind. Moreover, it has been observed that only a few companies adopt both methods in the calculation of depreciation. Additionally the results also indicated a certain level of disharmony among companies within the same industry. Furthermore, it has also been observed from the research that the companies are very consistent regarding their practice of depreciation method.*

### INTRODUCTION

According to Fields et al. (2001), research on accounting practices typically addresses the fundamental issue of whether the choice of practice matters. As a result, considerable attention in the accounting literature has been devoted to the discussion of possible reasons behind the choice of depreciation policies and effects of such choices. It is therefore absolutely imperative to choose a proper depreciation method.

Depreciation is one of the most important provisions and concepts in Financial Accounting. Since decades, it has been a topic of great interest for the accounting analyzers and researchers. According to Meigs & Meigs (1999, p. 418), property, plant and equipment (which is also known as “fixed assets”) along with intangible assets constitute the long term assets obtained by a company to use in the operation of the business which is not intended for resale. The services and economic benefits provided by

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these assets are usually for a period higher than that covered by a year's financial statement (Epstein & Mirza, 1997, p. 261). As a result the cost of these assets needs to be capitalized and required to be allocated over the period during which these benefits will be received. That's why depreciation is the accounting system used in accounting, economics that attempts to allocate the cost less residual value (estimated amount expected to be obtained at the end of the useful life of the asset) if any of a fixed tangible assets or property, plant & equipment over the anticipated service life in a systematic manner (Kay & Searfoss, 1989, p. 15).

Annual charge of depreciation is considered as an essential accounting practice in every business organization. It affects net income, income tax, owners' equity and assets value. In simple words we can define depreciation as a reduction in the value of an asset due to usage, passage of time, wear and tear, technological outdateding or obsolescence, depletion, inadequacy, rot, rust, decay or other such factors.

"Depreciation Expense" which is a non cash expense charged in the statement of earnings in accordance with one of the most important accounting principles - matching principle. The matching principle states that expenses must be matched with revenues. In accounting jargon, the term Depreciation is meant to refer to the allocation of an asset's cost to the accounting periods benefited, not an attempt to value the asset. Thus, it is often said that depreciation is a process of "allocation" not "valuation" (Reynolds, 1961). As a result, depreciation does not take into account any changes in the market value (Epstein & Mirza, 2003, p. 268; Meigs, Williams, Haka, & Bettner, 2002, p.342).

A contra asset account-Accumulated Depreciation is used to record the expired amount of asset that has been perished through the usage for a specific period of time. Accumulated depreciation is subtracted from the cost of the asset to get the book value in the statement of financial position at the end of the accounting period.

According to Weygandt et al (2005), the primary causes of depreciation are physical corrosion (as a result of the use of assets and climatic condition) and obsolescence (a process of becoming out of date). Depreciation is basically a tool to determine the amount of an asset that has been consumed during a particular accounting period. Methods of calculating depreciation play a very important role in this regard.

### **Important Factors to be Considered in the Calculation of Depreciation**

There are some factors that need to be considered while calculating the amount of depreciation, regardless of the method that has been used. Those factors are:

- **Cost:** The dollar amount assigned to a particular asset; usually the ordinary and necessary amount expended to get an asset in place and in condition for its intended use (Weygandt et al., 2005).
- **Service Life:** The useful life of an asset to an enterprise, usually relating to the anticipated period of productive use of the item (Weygandt et al., 2005).
- **Salvage Value:** Also called residual value; is the amount expected to be realized at the end of an asset's service life. The anticipated sales amount at the end of the service life is the salvage or residual value.
- **Depreciable Base:** The cost minus the salvage value. Depreciable base is the amount of cost that will be allocated to the service life (Weygandt et al., 2005).
- **Book Value:** Also called net book value; refers to the balance sheet amount at a point in time that reveals the cost minus the amount of accumulated depreciation.

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