Introduction:

A Discussion of the depreciation, prevision for bad debt and stock valuation, and an explanation of each single point happened in them concerned with the accounting will be examined in this assignment.

Depreciation methods:

Depreciation is generally computed using one of the following methods:

1. strait line
2. units of activity
3. declining balance

Each method is acceptable under generally accepted accounting principles. The objective is to select the method that best measure the asset's contribution to revenue over its useful life. Depreciation affects the balance sheet through accumulated depreciation and income statement through depreciation expense.

Strait line method:

Depreciation is the same for each year of the asset's useful life, in order to compute the depreciation expense its necessary to determine the depreciable cost which is the cost of asset less its salvage value then divided by the assets useful life to determine depreciation expense. The book value in the end of the useful life is equal the salvage value. If the asset purchased during the year it is necessary to prorate the annual depreciation for the proportion of time used.

Units of activity:

Instead of expressing the life as time period, useful life is expressed in terms of the total units of production or use expected from the asset. In this method production can be measured in terms of units of output, working hours and driven miles. To use this method, the total units of activity for the entire useful life are divided into depreciable cost to determine the depreciation cost per unit. The depreciation cost applied to the units of activity to determine the annual depreciation. This method is difficult to make a reasonable estimate activity. It used by large companies because its results in the best matching of expenses with revenues.

Declining balance:

Produce a decreasing annual depreciation expense over the useful life of the asset it's computed by multiplying the book value at the begging of the year by declining balance depreciation rate. The depreciation rate remains constant from year to year but the book value decline each year. The book value in the first year is the cost of the asset, because the acc-depreciation at the begging of the asset useful life is zero. The depreciation stops when book value equal salvage value. The declining balance produce higher depreciation expense in the early years than in the later years and it matches with the higher benefits receive in these years, lower depreciation expense recognised in later years when the assets contribution to revenue is less. When an asset purchasing during a year its necessary to prorate the declining balance depreciation in the first year on time basis.

Depletion:

The process of allocating the cost of natural resources to an expense in a systematic manner over the resources useful life, and its computed by the strait line method. The total cost of the natural resources minus salvage value is divided by the number of units estimated to be in the resources, the result is depletion cost per unit and then multiplied by the number of units extracted and sold, and this is the depletion cost. The depletion expense is reported as a part of the cost of production the product. Accumulated depletion, a contra asset account is deducted from the cost of natural resources in the balance sheet. Sometimes natural resources extracted in one accounting period will not be sold until a later period; in this case depletion is not expensed until the resource is sold. The amount is not sold is recorded in the current asset section as an inventory.

Depreciation prevision will reduce cash; ear mark apart of the firm's cash must each year equal the amount of depreciation or invest that cash outside the business. While depreciation does not directly provide funds, it has indirect affect on the cash off a limited company. A limited company cannot distribute dividends to its shareholders in exes of its profit. To actually pay the dividends the company must have cash. Depreciation, reduce the profit available and restricts the maximum dividend.

Prevision for bad debt:

Uncollectible accents receivable, it is affected the balance sheet and income statement. Such loses are considered a normal and necessary risk of doing business on a credit basis. In fact, from management point of view, a reasonable amount of uncollectible account is evidence of a sound credit policy. When bad debts are abnormally low, the company may be losing profitable business by following a credit policy that is too strict; two methods are used by accountant for uncollectible account: the allowance method and the direct off method.

Allowance method:

Is required for financial reporting purpose when bad debts are material in amount.

1. Uncollectible accounts are estimated and the expense for the uncollectible account is matched against sales in the same accounting period in which the sales occurred.
2. Estimated uncollectible are debited to bad debt expense and credited to allowance for doubtful account at the end of each period.
3. actual uncollectible are debited to allowance for doubtful accounts and credited to accounts receivables

Bad debt expense is reported in the income statement as an operating expense. Allowance for doubtful account is a contra asset account that shows the claims on customers that are expected to become uncollectible in the future. A contra account is used instead of a direct credit to account receivable because we do not know which customer will not pay. Allowance for doubtful account is not closed at the end of the fiscal year; it is deducted from account receivable in the current asset section of the balance sheet.

Bases used for allowance method:

1. Percentage of sales: basis results in a better matching of expense with revenues-an income statement. The management establishes a percentage between the amount of credit sales and expected losses from uncollectible account.

2. Percentage of receivables: basis producers the better estimate of cash realizable value-a balance sheet. The management establishes a percentage relation ship between the amount of receivables and expected losses from uncollectible account.

Direct write-off method:

The bad debt losses are not estimated and no allowance account is used. When account is determined to be uncollectible, the loss is charged to bad debt expense. Bad debt expense is often record in a period different than the revenue was recorded. Thus no attempt is made to match bad debt expense to sales revenue in the income statement or to show the cash realizable value of the account receivable in the balance sheet. Consequently, unless bad debt losses are insignificant, the direct write off method is not acceptable for financial reporting purposes.

Stock valuation:

It is the aggregate of items of tangible personal property and the stock includes

1. finished goods
2. work in progress
3. raw materials

The bases of stock valuation:

Output values:

Current selling price: the use of it is acceptable as a measure of a finished Stock valuation when there is in existence a sure market price and no substantial cost of marketing.

Net realizable value: is the amount at which it is expected that items of stock and work in progress can be disposed of without creating either profit or loss in the year of sale.

Input values:

- Historical cost:

The input value of stock is seen as the costs incurred in the Costs incurred in the past to place the stock in its present state. In a business the historical cost is the purchase prise; in a manufacturing concern the historical cost will be the purchase prise of the raw materials.

The three methods for computing the historical cost:

First in first out (FIFO):

FIFO rule is based on the assumption that the stock Acquired first will be the first to be sold. (FIFO) system represents an Approximation to normal flow of goods, and also ensures that the end stock will be valued at the most recent costs. Depending on the quickness of sale and the rate of change in the price level. The greater the time interval between buying and selling stock in a time of changing price levels, the more unrealistic the measures of profit. In business FIFO can result in unrealistic measurement of profit in time of changing prices.

Last in first out (LIFO):

This system of stock valuation assumes that the stock purchased most recently is the first to be sold, it's achieve the objective of matching the most currently available costs with current revenues. The LIFO system is often employed by business whose pricing system depends on a percentage addition to cost, but if a system adopted there is evidently much in favour of relating selling price to the most current cost. This should ensure sufficient margin of profit to cover the rising costs of replacement.

Weighted average:

It is purpose to void the problem of changing price; average costs are neutral both in respect of income measurement and balance sheet valuation. All stock acquired during a given period, is reduce to a single representative average cost.

- Current replacement cost:

Accounting makes the assumption of continuity. If a business is to continue its operations then there is a perpetual cycle of buying stock, selling it and replacing it. It follows that the cost of using an item is not what was paid for it in the past. Stock should be valued at its current replacement cost; its permits the matching of current input values with current revenues in the income statement, and also the monetary value assigned to stock at the end of the period represents current cost.

Accounting and the stock valuation:

Accounting has produced wider difference in a practice than the computation of the amount at which stock and work in progress are stated in financial accounts. Accounting practices required stock to be valued at cost or market value, whichever is the lower. The new accounting standard merely reinforces the traditional emphasis on conversation by requiring stock to be stated at cost or if lower at net realizable value, and does nothing to remove internal inconsistency. In any businesses the number of items of stock where net realizable value is below cost will almost certainly be very few, and the convention of materiality may well apply.

Although the profit for any one year my be different from the computed on other basis, the total profit over the whole life of business will, if the valuation basis is changed, the profit will be as much a function of the change in method as a change in business fortunes. if a business does elect to change the basis, then in that year profit must be ascertained on both old and new basis in order that a proper comparison can be made.

Conclusion:

There are three methods to compute the depreciation, strait line method, units of activity method and declining balance method, Depletion The process of allocating the cost of natural resources. The depreciation reduces the cash and its reducing the company profit. Prevision for bad debt: Uncollectible accents receivable, it is affected the balance sheet and income statement. Two methods are used by accountant for uncollectible account: the allowance method and the direct write off method. The stock valuation has an input and an output. There is a current selling price and net realizable value in the output but in the input is historical cost and current replacement cost. We can compute the historical cost by these three methods: First in first out (FIFO), last in first out (LIFO), and weighted average.

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