1954

Declining-balance depreciation; Accounting Research Bulletin, no. 44

American Institute of Certified Public Accountants. Committee on Accounting Procedure

Accounting Research BULLETINS

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Issued by the
Committee on Accounting Procedure,
American Institute of Accountants,
270 Madison Avenue, New York 16, N.Y.

October, 1954 **No. 44**

Declining-balance Depreciation

1. The declining-balance method of estimating periodic depreciation has a long history of use in England and in other countries including, to a limited extent, the United States. Interest in this method has been increased by its specific recognition for income-tax purposes in the Internal Revenue Code of 1954.

2. The declining-balance method is one of those which meets the requirements of being "systematic and rational."[1] In those cases where the expected productivity or revenue-earning power of the asset is relatively greater during the earlier years of its life, or where maintenance charges tend to increase during the later years, the declining-balance method may well provide the most satisfactory allocation of cost. The conclusions of this bulletin also apply to other methods, including the "sum-of-the-years-digits" method, which produce substantially similar results.

3. When a change to the declining-balance method is made for general accounting purposes, and depreciation is a significant factor in the determination of net income, the change in method, including the effect thereof, should be disclosed in the year in which the change is made.

4. There may be situations in which the declining-balance method is adopted for tax purposes but other appropriate methods are followed for financial accounting purposes. In such cases it may be that accounting recognition should be given to deferred income taxes. However, the committee is of the opinion that, in the ordinary situation, deferred income taxes need not be recognized in the accounts unless it is reasonably certain that the reduction in taxes during the earlier years of use of the declining-balance method for tax purposes is merely a deferment of income taxes until a relatively few years later, and then only if the amounts are clearly material.

The statement entitled "Declining-balance Depreciation" was adopted by the assenting votes of nineteen members of the committee, of whom one, Mr. Stans, assented with qualification. Mr. Burns dissented.

[1] *Accounting Terminology Bulletin* No. 1, paragraph 56.

Mr. Stans does not approve the conclusions in the last sentence of paragraph 4. He believes that the reductions in taxes in the earlier years of use in the situations described clearly represent deferments of payment until later years and that the number of years involved has no bearing on the problem. He believes that well-established accounting principles require that deferred income taxes be recognized in every case in which the amounts involved are significant.

Mr. Burns dissents because he believes that the reductions in taxes in the earlier years of use in all cases would clearly represent deferments of payment until later years and that the number of years involved has no bearing on the problem. He believes that compliance with well-established accounting principles requires that deferred income taxes be recognized in every case in which a significant amount is involved in order to avoid a misstatement of reported net income, and he believes that the bulletin should contain a definite statement to that effect.

NOTES

(See Introduction to *Accounting Research Bulletin* No. 43.)

1. Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached.

2. Opinions of the committee are not intended to be retroactive unless they contain a statement of such intention. They should not be considered applicable to the accounting for transactions arising prior to the publication of the opinions. However, the committee does not wish to discourage the revision of past accounts in an individual case if the accountant thinks it desirable in the circumstances. Opinions of the committee should be considered as applicable only to items which are material and significant in the relative circumstances.

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. Except where there is a specific statement of a different intent by the committee, its opinions and recommendations are directed primarily to business enterprises organized for profit.