

Figure 11-2

Illustration of a Short Report. Designed for the busy reader who wants the main message quickly, this report begins with the recommendations. Then it presents the report in logical order, following a brief introduction with a comparison of three methods of depreciation for delivery trucks (the subject of the investigation). The somewhat formal style is appropriate for reports of this nature.

743 Beaux Avenue
New Orleans, LA 70118-4913

Brewington and Karnes, CPAs

5 Ws and
1 H produce
complete title

Recommendations for Depreciating Delivery Trucks

*An Analysis of Three Plans Proposed for
the Bagget Laundry Company*

Use of
three-spot title
page gives good
emphasis to
writer-reader
relationship and
balances page

April 16, 2008

Continued

•
•
•
•
•

Recommendations for Depreciating Delivery Trucks

Topic sentence—
first paragraph
designs and
transition words
give emphasis and
forward movement
to ideas.

An Analysis of Three Plans Proposed for the Bagget Laundry Company

Recommendation of Reducing Charge Method

Direct order
accounts
report
solution.

The Reducing Charge method appears to be the best method to depreciate Bagget Laundry Company delivery trucks. The relative equality of cost allocation for depreciation and maintenance over the useful life of the trucks is the prime advantage under this method. Computation of depreciation charges is relatively simple by the Reducing Charge plan but not quite so simple as computation under the second best method considered.

The second best method considered is the Straight-Line depreciation plan. It is the simplest to compute of the plans considered, and it results in yearly charges equal to those under the Reducing Charge method. The unequal cost allocation resulting from increasing maintenance costs in successive years, however, is a disadvantage that far outweighs the method's ease of computation.

Third among the plans considered is the Service Hours method. This plan is not satisfactory for depreciating delivery trucks primarily because it combines a number of undesirable features. Prime among these is the complexity and cost of computing yearly charges under the plan. Also significant is the likelihood of poor cost allocation under this plan. An additional drawback is the possibility of variations in the estimates of the service life of company trucks.

The Whats and Whys of the Problem

Authorization by President Bagget. This report on depreciation methods for delivery trucks of the Bagget Laundry Company is submitted on April 16, 2008, to Mr. Ralph P. Bagget, President of the Company. Mr. Bagget orally authorized Brewington and Karnes, Certified Public Accountants, to conduct the study on March 15, 2008.

Problem of Selecting Best Depreciation Method. Having decided to establish branch agencies, the Bagget Laundry Company has purchased delivery trucks to transport laundry back and forth from the central cleaning plant in downtown New Orleans. The Company's problem is to select from three alternatives the most advantageous method to depreciate the trucks. The three methods concerned are the Reducing Charge, Straight-Line, and Service-Hours. The trucks have an original cost of \$25,000, a five-year life, and trade-in value of \$10,000.

Continued

Preview paragraph gives sequence of body divisions and justifies it.

Use of Company Records to Solve Problem. In seeking an optimum solution to the Company's problem, we studied Company records and reviewed authoritative literature on the subject. We also applied our best judgment and our experience in analyzing the alternative methods. We based all conclusions on the generally accepted business principles in the field.

Presentation of Analysis. In the following analysis, our evaluations of the three depreciation methods appear in the order in which we rank the methods. Since these methods involve different factors, direct comparison by factors is meaningless. Thus our plan is that we evaluate each method in turn.

Marked Advantages of the Reducing Charge Method

Sometimes called Sum-of-the-Years'-Digits, the Reducing Charge method consists of applying a series of decreasing fractions over the life of the property. To determine the fraction, first compute the sum of years of use for the property. This number becomes the denominator. Then determine the position number (first, second, etc.) of the year. This number is the numerator. Then apply the resulting fractions to the depreciable values for the life of the property. In the case of the trucks, the depreciable value is \$15,000 (\$25,000 - \$10,000).

Sub-ordinate reference to graphic allows main sentence to begin interpretation.

As shown in Table I, this method results in large depreciation costs for the early years and decreasing costs in later years. But since maintenance and repair costs for trucks are higher in the later years, this method provides a relatively stable charge over the life of the property. In actual practice, however, the sums will not be as stable as illustrated, for maintenance and repair costs will vary from those used in the computation.

Table I
Depreciation and Maintenance Costs for Delivery Trucks of Bagget Laundry for 2004-2008
Using Reducing Charge Depreciation

End of Year	Depreciation	Maintenance	Sum
1	5/15 (\$15,000) = \$ 5,000	\$ 200	\$ 5,200
2	4/15 (\$15,000) = 4,000	1,000	5,000
3	3/15 (\$15,000) = 3,000	1,800	4,800
4	2/15 (\$15,000) = 2,000	2,600	4,600
5	1/15 (\$15,000) = 1,000	3,400	4,400
Totals	\$15,000	\$9,000	\$24,000

In summary, the Reducing Charge method uses the most desirable combination of factors to depreciate trucks. It equalizes periodic charges, and it is easy to compute. It is our first choice for Bagget Laundry Company.

Continued

Runner-up Position of Straight-Line Method

Incidental reference to graphic ties text and illustration together.

The Straight-Line depreciation method is easiest of all to compute. It involves merely taking the depreciable value of the trucks (\$15,000) and dividing it by the life of the trucks (5 years). The depreciation in this case is \$3,000 for each year.

As shown in Table II, however, the increase in maintenance costs in later years results in much greater periodic charges in later years. The method is not usually recommended in cases such as this.

Table II
Depreciation and Maintenance Costs for Delivery Trucks of Bagget Laundry for 2004-2008
Using Straight-Line Depreciation

End of Year	Depreciation	Maintenance	Sum
1	1/5 (\$15,000) = \$ 3,000	\$ 200	\$ 3,200
2	1/5 (\$15,000) = 3,000	1,000	4,000
3	1/5 (\$15,000) = 3,000	1,800	4,800
4	1/5 (\$15,000) = 3,000	2,600	5,600
5	1/5 (\$15,000) = 3,000	3,400	6,400
	Totals	\$15,000	\$24,000

Summary statements at section endings provide reader with time to see solution unfold.

In addition, the Straight-Line method generally is best when the properties involved are accumulated over a period of years. When this is done, the total of depreciation and maintenance costs will be about even. But Bagget Company has not purchased its trucks over a period of years. Nor is it likely to do so in the years ahead. Thus, Straight-Line depreciation will not result in equal periodic charges for maintenance and depreciation over the long run.

Poor Rank of Service-Hours Depreciation

The Service-Hours method of depreciation combines the major disadvantages of the other ways discussed. It is based on the principle that a truck is bought for the direct hours of service that it will give. The estimated number of hours that a delivery truck can be used efficiently according to automotive engineers is computed from a service total of 100,000 miles. The depreciable cost (\$15,000) for each truck is allocated pro rata according to the number of service hours used.

Completeness and detail in analysis give objectivity.

The difficulty and expense of maintaining additional records of service hours is a major disadvantage of this method. The depreciation cost for the delivery trucks under this method will fluctuate widely between the first and last years. It is reasonable to assume that as the trucks get older more time will be spent on maintenance. Consequently, the larger depreciation costs will occur in the initial years. As can be seen in Table III, the periodic

Continued

charges for depreciation and maintenance hover between the two previously discussed methods.

Table III
Depreciation and Maintenance Costs for Delivery Trucks of Bagget Laundry for 2004–2008
Using Service-Hours Depreciation

End of Year	Estimated Service Miles	Depreciation	Maintenance	Sum
1	30,000	\$ 4,500	\$ 200	\$ 4,700
2	25,000	3,750	1,000	4,750
3	20,000	3,000	1,800	4,800
4	15,000	2,250	2,600	4,850
5	10,000	1,500	3,400	4,950
	100,000	\$15,000	\$9,000	\$24,000

The periodic charge for depreciation and maintenance increases in the later years of ownership. Another difficulty encountered is the possibility of a variance between estimated service hours and the actual service hours. The wide fluctuation possible makes it impractical to use this method for depreciating the delivery truck.

The difficulty of maintaining adequate records and increasing costs in the later years are the major disadvantages of this method. Since it combines the major disadvantages of both the Reducing Charge and Straight-Line methods, it is not satisfactory for depreciating the delivery trucks.

The disadvantages of this method, together with those of the straight-line method, make the reducing charge method the best method of depreciation for Bagget's delivery trucks.

Completeness and detail in analysis give objectivity.