Depreciation Class 11 Notes

What is Depreciation?

With time, any asset tends to deteriorate and lose its original value to wear and tear. The acquired asset is thus known to be depreciated when the monetary value is reduced due to wear and tear, time, and daily usage.

Methods for Calculating Depreciation

While studying depreciation class 11, you will study two types of methods for calculating depreciation. As we are discussing the theory of depreciation, provisions and reserve, we will be looking briefly into the definition of the two methods of calculating depreciation. Students are advised to thoroughly practice the practical part of this section as it is one of the most important parts of the chapter. The two main methods that are used to calculate depreciation are:

- **Straight-line Method**: Original cost of the asset is taken as the basis for the calculation of depreciation
- **Written Down Value Method:** The reduced value or the book value is taken as the depreciation and is different for every year

Why is Depreciation Needed?

As you go on with the chapter and analyse what depreciation is, it is vital to understand its importance in Accountkeeping. After a due period of time, every form of organisation is required to evaluate the depreciated value of its product and goods. Mentioned below are the important points mentioned in depreciation class 11 explaining the importance of depreciation:

- **To provide an unbiased view of financial statements and not have inflated values reflected in financial statements.** The assets' value in the market decreases with time. So, not keeping a tab on that in the books as well would be necessary to provide an accurate picture of profits or losses.
- **For keeping money with the organization and not taking it away from the business**. This is likely to happen when the profit is overestimated and is sent as dividends.
- **To even out the profit and reflect true value** keeping in consideration the production cost that comes with the deterioration in the value of an asset. This would ensure that the original value of the asset is not counted as the only expense.
- **For replacing the old machinery with a new one** by accumulating the charges for depreciation and using those when needed.

- **To avoid paying extra to the government in tax**. The business will have to pay extra tax unnecessarily in lieu of the wrong calculation of profit if depreciation is not accounted for. Thus, it is important to ensure scope to avoid any additional taxes.

Causes of Depreciation

As mentioned above, revising the profit and loss and calculating depreciation is necessary. But what are the factors that lead to the depreciation of a product? The below enlisted key points from depreciation class 11 will assist you in understanding the common causes of depreciation:

- Wear and tear with regular use is likely to happen when you use an asset regularly. It will corrode with time and use or will become slower and, thus making it less productive and this would also reduce its value.
- Many times, machinery is likely to go obsolete with time as newer inventions step in the market for better value and return. With a better bargain, these new machines will attract more business.
- In accounting terms, an asset may also depreciate when it becomes useless after its full tenure is served, according to the legal expiry that it has. Its implications could be anywhere from having to make heavy repairs or disposing of the asset altogether.
- An accident may also permanently reduce or damage the value of an asset completely.

Factors Affecting Depreciation

As per the depreciation chapter for class 11, here are a few factors that affect the depreciation of an asset:

- **Cost of Asset:** Depreciation is directly proportional.
- **Estimated Useful Life:** Determines the division of depreciation proportionately.
- **Estimated Scrap Value:** Identifies the net residual value and its direct correlation.

Provisions and Reserves

It is important to estimate and keep aside a certain amount when there is some expected expenditure for an asset or liability in the future. If the expenditure is recurring, you can use it as it is but you can keep a certain amount preserved for the future so that in case there is a need, you can prevent your profits from being disturbed and use the said amount instead. Hence, this is how depreciation class 11 introduces these topics:

Provisions

These are kept for an unforeseen circumstance that is likely to occur with a liability. Provision is an expense, according to GAAP. e.g. Provision for Depreciation.

Reserves

This is an amount set aside as a liability against the intention to buy an asset, pay bonuses, etc. These are often allocated for specific purposes and appear as shareholders' equity.

Difference Between Provisions and Reserves

Here are the key points of difference between Provisions and Reserves which you must know while studying Depreciation Class 11:

Basis	***Provision***	***Reserve***
Meaning	Maintained for a known liability	Maintained for an unknown liability
Nature	It is charged against profit	Appropriation of profit
Creation	Debiting P&L Account	Debiting P&L Appropriation Account
Need for Creation	If there is almost no profit in the business	Only if the business is reaping profits
Purpose	Specific Liability	Fortification of Business
Dividend Payment	Not used for dividend payments	Can be utilized for dividend payments as well

Revenue Reserve and Capital Reserve

As explained in depreciation class 11, there are two types of reserves, revenue, and capital, on the basis of the investment. They solve the basic functions under revenue, and capital like an expenditure does and to give you a clear understanding of the kind of reserves there can be. Tabulated below is a detailed overview elucidating the differences between the two:

Basis	**Revenue Reserve**	**Capital Reserve**
Source	Daily operations	Profit from assets sold
Purpose	Business financial position is solidified	Long time projects can be financed, or capital expenses can be written off
Dividend	Can be paid as a dividend	Cannot be paid as a dividend

General Reserve and Specific Reserve

On the basis of the purpose that it is supposed to be solved, reserves can be general or specific. In the accountancy syllabus for depreciation class 11, you will learn about how some reserves are kept for future use without defining the purpose of the same. Let us understand the vital differences between general and specific reserves.

Basis	**General Reserve**	**Specific Reserve**
Meaning	Created without a specific purpose in mind	Created with a specific purpose in mind
Usage	Flexible with being utilized wherever the business deems necessary	For the specification that has been kept in mind during the creation
Example	Fund reserve	DRR (debenture redemption reserve)