

Class- 11th
Subject- Account
Chapter- 7

Depreciation, provisions and reserves

Q. Explain the meaning of depreciation with their characteristics?

Ans- The word depreciation is derived from the Latin word depretium. It is combination of two words De + pretium. De means decline and pretium means price. Depreciation is to decrease in the value of fixed or capital assets.

Characteristics:-

1. charge on fixed assets.
2. permanent fall
3. continuous process
4. non cash expenditure
5. effect on result

Q. What are the reasons for arising depreciation?

Ans-1. due to normal use of the assets, the assets deteriorate physically, which results in a reduction in their value.

2. some assets have fixed time period. The values of such assets decrease with the passage of time.

3. the old assets become useless and expensive due to the arrival of new and better machines in the market, so the value of old machine declined due to this reason.

4. sometimes a machine may be destroyed due to any reason such as fire flood earthquake etc. which cause full or partial decrease in the value of assets.?

Q. What are the objectives of depreciation

Ans-1. Ascertaining cost of production

2. ascertaining net profit and loss
3. presentation of correct financial position
4. replacement of assets
5. restriction on distribution of dividend
6. tax planning
7. legal compulsion
8. stability in capital

Q. What are the factors determining the amount of depreciation?

Ans-1. Total cost of an asset does not include only the purchasing price of an asset but it also includes the transportation charge and installation charge.

2. Useful life of an asset is estimated economic or commercial life of an asset. Physical life is not important for this purpose. To calculate useful life, it is kept in mind that how many periods the asset can be used in the business to earn profit with proper repair and maintenance charges.

3. it is also known as the Residual value, break up value of an asset, which is estimated to be realised on account of the sale of the asset at the end of its useful life. The difference between cost of the asset and its Residual value is termed as depreciable cost of the asset.

Q. Explain fixed installment method with their characteristics?

Ans- In fixed installment method, a fixed percentage of the original cost of the assets is written off every year from the profit and loss account or statement of profit and loss, hence the amount of depreciation remains the same every year.

characteristics:--

1. in this method depreciation is charged on the original cost of the assets.
2. calculation of depreciation is easy in this method.
3. the amount of depreciation is same every year.
4. the cost of the assets is written off up to zero or up to scrap value.
5. this method is suitable for short term life or less expensive assets, such as furniture.

Q. Explain diminishing balance method with their characteristics?

Ans- Under this method depreciation is charged on the book value of the assets every year. In the purchasing year, depreciation is calculated on the original cost of the assets thereafter in the following years depreciation is calculated on the opening balance of the assets every year. This process goes on till the end of life time of an asset.

characteristics:--

1. under this method, depreciation is calculated on book value or opening balance of an asset every year.
2. the amount of depreciation keeps on reducing year after year.
3. the amount of depreciation is an even every year
4. percentage or rate of depreciation remains constant.
5. this method is approved by Income Tax authorities for tax assessment, hence it is a scientific method.

Q. Explain the meaning, characteristics and objective of provision?

Ans- when some liabilities and losses are anticipated but the amount of which is not known accurately, so it is necessary to make provisions. If the great amount of 8 can be known then it becomes a liability not a provisions. At the time of preparing final account, a certain amount of provision must be kept aside whether the firm earns any profit or not, so that accurate net profit of each year can be ascertained. the provisions are usually created by debiting the profit and loss account in balance sheet they are is deducted on the Asset side from concerning assets or shown on the liabilities side. the amount of provision cannot be used for other purpose than that is made.

characteristics:--

1. create out of profits
2. create for expected contingencies
3. estimation of liability
4. used only for instructed objectives
5. charge against profit
6. legal compulsion
7. determine actual position of assets
8. amount of provision not for investment

Objectives or importance of provision:--

1. Ascertain true profit or loss

2. Arrangement for future losses
3. Arrangement for replacement of assets
4. Determine true and fair value of assets
5. Uniform charge on income statement

Q. Explain the meaning of Reserve with their characteristics and objectives?

Ans- Reserve means appropriation of a part of profit which is saved out of undistributed profit and other surpluses for future contingency or uncertainties.

characteristics:-

1. Reserve are created out of net profit or divisible profit. As such the Reserve are also known as undistributed profit or retained earning.
2. It is created for strengthening the financial position of the business and for meeting and an anticipated condition in the future.
3. It is the appropriation of profit but not a charge against profit it is also known as accumulated profit.
4. If the Reserve are invested out of the business is known as reserve fund.

objectives of Reserve:--

1. If adequate provision are created for all anticipated expenses and losses, then the balance sheet will show true and fair financial position of the business.
2. Reserve is an appropriation of profit or profits are ploughed back in to the business which may be used as a source of finance.
3. Creation of provision increases working capital of business.
4. Reserve are specially created for an anticipated or abnormal process and may contingent liability that can arise in future.

Q. Explain secret reserve with their objectives?

Ans- Secret reserve is that reserve which is not known in the balance sheet. Due to this, financial position of the business is better than that position which is shown by the balance sheet.

objectives of secret reserve:-

1. Create a strong financial position
2. Provide financial stability
3. To increase working capital
4. To increase financial soundness
5. Reduction in competition.