

Depreciation, Provisions and Reserves

CBSE · Class 11 · Accountancy — exam notes

Fixed assets lose usefulness over time, and depreciation is the systematic way of spreading an asset's cost across the years it is used, so that profit and the balance sheet stay truthful. This chapter covers how depreciation is measured (Straight Line and Written Down Value methods), how it is recorded in the books, how assets are disposed of, and how businesses set aside money through provisions and reserves to meet future needs and stay financially sound.

Key terms & definitions

Depreciation

The permanent, continuous and gradual fall in the book value of a fixed (tangible) asset caused by use, wear and tear, passage of time or obsolescence; it is a systematic allocation of the asset's cost to each accounting period, not a valuation of the asset.

Depreciable Amount (Cost of an asset for depreciation)

The historical cost of the asset (purchase price plus all expenses needed to bring it into working condition, such as freight, installation and legal charges) minus its estimated scrap/residual value. This is the total amount to be written off over the asset's life.

Scrap Value / Residual Value / Salvage Value

The estimated amount expected to be realised from selling an asset (or its parts) at the end of its useful life, after deducting any cost of disposal.

Useful Life

The estimated period (in years or units of output) over which a fixed asset is expected to be usable by the business, which may be shorter than its physical life because of obsolescence or planned replacement.

Obsolescence

Loss of an asset's usefulness because of new technology, change in demand, better alternatives or legal restrictions, even though the asset may still be physically usable.

Depletion

The fall in the value of natural/wasting assets such as mines, oil wells and quarries as the resource is physically extracted; conceptually similar to depreciation but applied to natural resources.

Amortisation

The writing-off of the cost of intangible assets such as goodwill, patents, copyrights and trademarks over their useful life, equivalent to depreciation for intangible assets.

Straight Line Method (SLM)

A method that charges an equal (fixed) amount of depreciation every year, calculated as $(\text{Cost} - \text{Scrap Value}) / \text{Useful Life}$; also called the Fixed Instalment or Original Cost Method because the rate is applied to original cost.

Written Down Value Method (WDV)

A method that charges depreciation at a fixed percentage on the opening book value (written down value) of the asset each year, so the rupee amount of depreciation falls year after year; also called the Diminishing/Reducing Balance Method.

Provision for Depreciation Account (Accumulated Depreciation)

A contra-asset account that collects (accumulates) all depreciation charged on an asset over the years; using it keeps the asset at original cost in the books while the accumulated depreciation is shown as a deduction from that cost in the balance sheet.

Provision

An amount charged against profit (a debit to the Profit and Loss Account) and set aside to meet a known liability or an expected loss whose amount cannot be determined with accuracy, e.g. provision for depreciation, provision for doubtful debts. It is created whether or not there are profits.

Reserve

An amount of profit appropriated (set aside out of profits via the Profit and Loss Appropriation Account) to strengthen the financial position or meet future needs; it is created only when there are profits and is shown on the liabilities side under Reserves and Surplus.

Revenue Reserve

A reserve created out of revenue (trading) profits that are normally available for distribution as dividend, e.g. General Reserve, Dividend Equalisation Reserve, Workmen Compensation Fund.

Capital Reserve

A reserve created out of capital profits (profits not earned in the normal course of business) that is not normally available for dividend, e.g. profit on sale of fixed assets, premium on issue of shares, profit on revaluation of assets.

Secret Reserve

A reserve that exists but is not disclosed in the balance sheet (the firm appears weaker than it really is), created by undervaluing assets or overstating liabilities; permitted only for banking, insurance and financial companies, not for ordinary companies.

Meaning and Features of Depreciation

- Depreciation is the gradual and permanent decrease in the book value of a fixed tangible asset due to use, wear and tear, efflux (passage) of time or obsolescence.
- It is a non-cash expense: recording it does not involve any outflow of cash, because the cash already left the business when the asset was purchased.
- It applies only to fixed/tangible assets (machinery, building, furniture, vehicles), not to current assets and not to land (land has unlimited life and normally is not depreciated).
- It is a process of cost allocation (spreading cost over useful life), not a process of valuation of the asset at market price.
- It is continuous (charged every year) and gradual (a part of the cost is written off each period).

Need / Objectives of Charging Depreciation

- To determine correct (true) profit or loss: since the asset helps earn revenue for several years, its cost must be matched against revenue of each of those years (matching/accrual concept).
- To show the asset at its true book value in the balance sheet: if depreciation is not charged, the asset is overstated and the balance sheet does not give a true and fair view.
- To provide for replacement of the asset: charging depreciation retains funds within the business (profits are not over-distributed), helping accumulate resources for buying a new asset later.
- To comply with legal requirements: the Companies Act and Income Tax Act require depreciation to be charged before computing distributable profit and taxable income.

Causes of Depreciation

- Wear and tear by use: constant use of machines, vehicles and equipment reduces their efficiency and value.
- Effluxion (passage) of time: some assets lose value simply with the passage of time even if not used, e.g. due to weather/rust.
- Obsolescence: arrival of better technology or change in demand makes the existing asset out of date.
- Expiry of legal rights: assets like patents, leases and licences lose value as their fixed legal term runs out.
- Accident or abnormal factors: a permanent reduction in value due to fire, accident, etc. (recorded separately as a loss, distinct from normal depreciation).

Factors Affecting the Amount of Depreciation

- Cost of the asset: total acquisition cost = purchase price + freight/carriage + installation + any expense to make it ready for use.
- Estimated scrap (residual) value: the amount expected to be realised at the end of useful life.
- Estimated useful life: the number of years (or units of output) the asset is expected to serve the business.
- These three factors together fix the depreciable amount (Cost minus Scrap Value) and the annual charge; the rate of depreciation also depends on the method chosen.

Related Terms: Depletion and Amortisation

- Depreciation relates to fixed tangible assets such as plant, machinery and furniture.
- Depletion relates to natural/wasting assets such as mines, oil wells, quarries and forests, whose value falls as the resource is physically extracted.
- Amortisation relates to intangible assets such as goodwill, patents, copyrights, trademarks and licences, whose cost is written off over their useful life.
- All three share the same idea — systematically writing off the cost of a long-term asset over the period it benefits the business.

Straight Line Method (SLM)

- An equal amount of depreciation is charged every year throughout the useful life of the asset.
- Formula: $\text{Annual Depreciation} = (\text{Cost of Asset} - \text{Estimated Scrap Value}) \div \text{Useful Life (in years)}$.
- Rate of Depreciation (%) = $(\text{Annual Depreciation} \div \text{Cost of Asset}) \times 100$.
- Because the same amount is written off each year, the book value falls in a straight line and reaches exactly the scrap value at the end of useful life — full recovery of the depreciable amount is guaranteed.
- Also called the Fixed Instalment Method or Original Cost Method (depreciation is based on original cost).
- Merits: simple to understand and calculate; the asset can be written down to zero/scrap value; suitable for assets like furniture, patents and leases.
- Limitations: it ignores the fact that repair costs rise as the asset ages, so the total burden (depreciation + repairs) on the Profit and Loss Account is unequal across years; it also ignores interest on capital invested in the asset.
- Not the method required by Indian income tax law for most assets.

Written Down Value Method (WDV)

- A fixed percentage is charged on the opening book value (written down value) of the asset every year, so the rupee depreciation amount keeps decreasing year after year.
- Year 1 depreciation = Cost multiplied by Rate; Year 2 = (Cost minus Year 1 depreciation) multiplied by Rate; and so on.
- Also called the Diminishing Balance or Reducing Balance Method.
- Depreciation is high in the early years (when repair costs are low) and low in later years (when repair costs are high), so the combined burden of depreciation and repairs tends to stay roughly even across years — a key advantage.
- Required by the Income Tax Act, 1961 for most tangible fixed assets, so it is widely used in practice.
- Limitation: the book value can never become exactly zero, and over a fixed life it does not necessarily fall to the planned scrap value, because a percentage is always applied to a declining balance.
- Merits: recognised for tax; gives a fairer matching of total asset cost (depreciation + repairs) against revenue across the life of the asset.
- Limitations: the rate that exactly reduces cost to scrap value is harder to compute; like SLM it ignores interest on capital invested.

SLM versus WDV — Key Differences

- Base of charge: SLM charges on original cost (fixed amount each year); WDV charges on reducing book value (falling amount each year).
- Annual amount: equal every year under SLM; highest in year 1 and decreasing thereafter under WDV.
- Book value at end of life: reaches exactly scrap value under SLM; never becomes zero and may not equal scrap value under WDV.
- Burden on Profit and Loss Account: depreciation + repairs is uneven under SLM (rises with age); roughly even under WDV.
- Suitability: SLM suits assets with steady use and low repairs (furniture, patents, leases); WDV suits assets with heavy early use and rising repairs (plant, machinery, vehicles).
- Legal recognition: WDV is recognised by the Income Tax Act for most assets; SLM is permitted for accounting but not the tax default.

Methods of Recording Depreciation in the Books

- Method 1 — Charging depreciation to the Asset Account (no separate provision account): depreciation is credited directly to the asset account each year, so the asset account shows the reduced (written down) value; the balance sheet shows the asset at this net book value.
- Entry under Method 1 each year: Depreciation A/c Dr., To Asset A/c. Then Profit and Loss A/c Dr., To Depreciation A/c (to transfer the expense).
- Method 2 — Creating a Provision for Depreciation Account (Accumulated Depreciation): the asset account is kept at original cost permanently, and depreciation is accumulated in a separate Provision for Depreciation Account.
- Entry under Method 2 each year: Depreciation A/c Dr., To Provision for Depreciation A/c; then Profit and Loss A/c Dr., To Depreciation A/c.
- In the balance sheet under Method 2, the asset is shown at cost and the accumulated depreciation (balance of the Provision for Depreciation Account) is deducted from it to give net book value: e.g. Machinery (cost) minus Provision for Depreciation = Net Book Value.
- Method 2 (provision account) is preferred because the original cost stays visible for audit, control and disclosure, while the total depreciation charged so far is clearly shown.

Disposal (Sale) of an Asset

- On sale of an asset, compare the sale proceeds with the book value on the date of sale to find profit or loss on sale (Profit if proceeds exceed book value; Loss if proceeds are less).
- When depreciation is charged to the Asset Account (Method 1): the asset account itself carries the written down value, and the difference between book value and sale proceeds is transferred to the Profit and Loss Account.
- When a Provision for Depreciation Account exists (Method 2): open an 'Asset Disposal Account'. Debit it with the original cost of the asset sold; credit it with the accumulated depreciation on that asset (transferred from the Provision for Depreciation A/c) and with the sale proceeds; the balancing figure is the profit or loss on sale, transferred to the Profit and Loss Account.
- First charge depreciation up to the date of sale on the asset being sold, then carry out the disposal calculation.
- Profit on sale of a fixed asset is a capital profit (often taken to capital reserve); loss on sale is charged to the Profit and Loss Account.

Provisions

- A provision is an amount set aside, by charging against profit, to meet a known liability or an anticipated loss whose amount cannot be measured precisely.
- It is created by debiting the Profit and Loss Account (an expense/charge), so it reduces profit; it is created whether the business earns profit or incurs a loss.
- Common examples: Provision for Depreciation, Provision for Doubtful Debts (bad debts), Provision for Discount on Debtors, Provision for Taxation, Provision for Repairs and Renewals.
- Presentation: a provision for a specific asset (e.g. provision for doubtful debts, provision for depreciation) is shown as a deduction from that asset; a provision for a liability (e.g. provision for taxation) may be shown on the liabilities side.
- Purpose: to ensure profit is not overstated and that the business is prepared for the known/expected obligation.

Reserves

- A reserve is an appropriation of profit — an amount set aside out of profits (through the Profit and Loss Appropriation Account) to strengthen the financial position or meet future contingencies.
- It is created only when there are profits, and it is shown on the liabilities side of the balance sheet under 'Reserves and Surplus'.
- Creating a reserve does not meet any present known liability; it builds up the firm's general financial strength or is earmarked for a future purpose.
- Reserves increase working capital and can help equalise dividends, finance expansion, or meet unforeseen losses.
- Types: Revenue Reserves and Capital Reserves; Revenue Reserves are further divided into General Reserves and Specific Reserves.

Types of Reserves

- Revenue Reserve: created out of revenue (trading) profits available for dividend, e.g. General Reserve, Dividend Equalisation Reserve, Workmen Compensation Fund, Investment Fluctuation Fund.
- Capital Reserve: created out of capital profits not earned in normal operations, e.g. premium on issue of shares/debentures, profit on sale of fixed assets, profit on revaluation of assets, profit prior to incorporation; not normally available for dividend.
- General Reserve (Free Reserve): set aside without any specific purpose, to strengthen the overall financial position and meet any future need.
- Specific Reserve: created for a particular, named purpose, e.g. Dividend Equalisation Reserve, Debenture Redemption Reserve, Workmen Compensation Fund.
- Secret (Hidden) Reserve: a reserve that is not disclosed in the balance sheet, making the firm look financially weaker than it actually is; created by understating assets or overstating liabilities; allowed only for banking, insurance and financial companies, not for ordinary trading companies.

Capital Reserve versus Revenue Reserve

- Source: capital reserve comes from capital profits (e.g. premium on shares, profit on sale of fixed assets); revenue reserve comes from normal trading/revenue profits.
- Availability for dividend: capital reserve is normally NOT available for dividend; revenue reserve is generally available for dividend.
- Purpose: capital reserve is used to meet capital losses or for purposes specified by law; revenue reserve is used to strengthen finances, equalise dividends or fund expansion.
- Both are shown under 'Reserves and Surplus' on the liabilities side, but they arise from different kinds of profit.

Provision versus Reserve — Key Differences

- Nature: a provision is a CHARGE against profit (it is an expense that reduces profit); a reserve is an APPROPRIATION of profit (a division of profit already earned).
- Purpose: a provision meets a known liability or an anticipated/expected loss; a reserve strengthens the general financial position or meets a future/unknown contingency.
- Creation when no profit: a provision must be created even if there is a loss; a reserve is created only when there are profits.
- Effect on profit: a provision reduces net profit; a reserve is set aside from net profit after it has been computed.
- Disclosure/use: a provision is generally meant for the specific purpose for which it is created and cannot be freely used for dividend; a general reserve can usually be used for dividend distribution.
- Presentation: a provision against an asset is shown as a deduction from that asset (or as a liability if against a liability); a reserve is always shown on the liabilities side under Reserves and Surplus.

Formulas & formats

- Cost of Asset (for depreciation) = Purchase Price + Freight/Carriage + Installation + other expenses to make it ready for use.
- Depreciable Amount = Cost of Asset – Estimated Scrap (Residual) Value.
- Straight Line Method: Annual Depreciation = (Cost – Scrap Value) ÷ Useful Life (years).
- Rate of Depreciation under SLM (%) = (Annual Depreciation ÷ Cost of Asset) × 100.
- Written Down Value Method: Depreciation for a year = Opening Book Value × Rate%; Closing Book Value = Opening Book Value – Depreciation for that year.
- WORKED EXAMPLE (both methods): Machine cost ₹10,00,000 on 1 April 2024; scrap value ₹1,00,000; useful life 5 years; rate 20% p.a. SLM: Annual Depreciation = (10,00,000 – 1,00,000) ÷ 5 = ₹1,80,000 every year (book value falls 10,00,000 → 8,20,000 → 6,40,000 → 4,60,000 → 2,80,000 → 1,00,000 at end of year 5, exactly scrap value). WDV at 20%: Year 1 = 10,00,000 × 20% = ₹2,00,000 (BV 8,00,000); Year 2 = 8,00,000 × 20% = ₹1,60,000 (BV 6,40,000); Year 3 = 6,40,000 × 20% = ₹1,28,000 (BV 5,12,000) – note the charge falls each year and the book value never quite reaches scrap value.
- JOURNAL – charging depreciation (Method 1, to Asset A/c): (1) Depreciation A/c Dr. / To Asset A/c; (2) Profit & Loss A/c Dr. / To Depreciation A/c.
- JOURNAL – charging depreciation (Method 2, Provision for Depreciation A/c): (1) Depreciation A/c Dr. / To Provision for Depreciation A/c; (2) Profit & Loss A/c Dr. / To Depreciation A/c.
- BALANCE SHEET FORMAT (Method 2): Machinery (at cost) ₹X less Provision for Depreciation (accumulated) ₹Y = Net Book Value ₹(X – Y).
- JOURNAL – sale of asset using Asset Disposal A/c (Method 2): (a) Asset Disposal A/c Dr. / To Asset A/c (cost of asset sold); (b) Provision for Depreciation A/c Dr. / To Asset Disposal A/c (accumulated depreciation on that asset); (c) Bank A/c Dr. / To Asset Disposal A/c (sale proceeds); (d) for PROFIT: Asset Disposal A/c Dr. / To Profit & Loss A/c, or for LOSS: Profit & Loss A/c Dr. / To Asset Disposal A/c.
- PROVISION vs RESERVE (one-line): Provision = charge against profit for a known liability/expected loss; Reserve = appropriation of profit to strengthen finances / meet future needs.
- Profit/Loss on Sale = Sale Proceeds – Book Value on date of sale (positive = profit/capital profit; negative = loss to P&L).

Important questions & model answers

1 mark Define depreciation and state any two of its features.

- Depreciation is the permanent, gradual and continuous fall in the book value of a fixed tangible asset due to use, wear and tear, passage of time or obsolescence.
- Two features: (i) it is a non-cash expense (no cash outflow on recording it); (ii) it is a process of cost allocation over useful life, not valuation of the asset.

1 mark Why is depreciation called a 'non-cash' expense?

- Because charging depreciation does not involve any outflow of cash on that date.
- The cash had already left the business when the asset was purchased; the year-end entry only debits Depreciation and credits the asset / Provision for Depreciation account, with no cash account involved.

3 marks State the formula for depreciation under the Straight Line Method and explain why the book value reaches scrap value at the end of useful life.

- Annual Depreciation (SLM) = $(\text{Cost of Asset} - \text{Scrap Value}) \div \text{Useful Life}$.
- An equal amount (the depreciable amount divided by the number of years) is written off every year.
- Over the full life, the total depreciation charged equals exactly $(\text{Cost} - \text{Scrap Value})$, so the book value falls in a straight line and ends precisely at the scrap value, giving full recovery of the depreciable amount.

3 marks Distinguish between the Straight Line Method and the Written Down Value Method of depreciation (any three points).

- Base: SLM charges depreciation on original cost (equal amount each year); WDV charges a fixed percentage on the reducing book value (falling amount each year).
- Annual amount: under SLM it is constant; under WDV it is highest in year one and decreases every year thereafter.
- End-of-life value: under SLM the book value reaches exactly the scrap value; under WDV the book value never becomes zero and may not reach the planned scrap value.
- (Extra) Legal recognition: WDV is the method recognised by the Income Tax Act for most assets; SLM is allowed for accounting purposes.

4 marks A machine is purchased for ₹2,00,000 with an estimated scrap value of ₹20,000 and a useful life of 4 years. Calculate the annual depreciation and the rate of depreciation under the Straight Line Method, and pass the journal entry for the first year's depreciation (using a Provision for Depreciation Account).

- Depreciable amount = $\text{Cost} - \text{Scrap} = 2,00,000 - 20,000 = ₹1,80,000$.
- Annual Depreciation (SLM) = $1,80,000 \div 4 = ₹45,000$ per year.
- Rate of Depreciation = $(45,000 \div 2,00,000) \times 100 = 22.5\%$ per annum.
- Journal: Depreciation A/c Dr. ₹45,000 / To Provision for Depreciation A/c ₹45,000 (being depreciation charged).
- Transfer: Profit & Loss A/c Dr. ₹45,000 / To Depreciation A/c ₹45,000 (being depreciation transferred to P&L).

4 marks Differentiate between a provision and a reserve (any four points).

- Nature: a provision is a charge against profit (an expense reducing profit); a reserve is an appropriation of profit (set aside out of profit already earned).
- Purpose: a provision is made to meet a known liability or an anticipated loss; a reserve is created to strengthen the financial position or meet a future/unknown contingency.
- When no profit: a provision must be created even if the business makes a loss; a reserve is created only when there are profits.
- Use and presentation: a provision is meant for the specific purpose it is created for (a provision against an asset is deducted from that asset); a general reserve can usually be used for dividends and is shown under 'Reserves and Surplus' on the liabilities side.

4 marks Explain capital reserve and revenue reserve with one example each, and state which is normally available for dividend.

- Revenue reserve is created out of normal trading (revenue) profits and is generally available for dividend; example — General Reserve (also Dividend Equalisation Reserve).
- Capital reserve is created out of capital profits not earned in the ordinary course of business and is normally NOT available for dividend; example — premium on issue of shares, or profit on sale of a fixed asset.
- Both appear on the liabilities side under 'Reserves and Surplus', but they differ in their source of profit and in their availability for dividend.
- Conclusion: revenue reserve is normally available for dividend; capital reserve is normally not.

4 marks On 1 April 2022 a firm bought machinery for ₹5,00,000. Depreciation is charged at 10% per annum on the Written Down Value method, and the firm closes its books on 31 March each year. Show the depreciation and the closing book value for the first three years.

- Year 1 (2022-23): Depreciation = $5,00,000 \times 10\% = ₹50,000$; Closing Book Value = $5,00,000 - 50,000 = ₹4,50,000$.
- Year 2 (2023-24): Depreciation = $4,50,000 \times 10\% = ₹45,000$; Closing Book Value = $4,50,000 - 45,000 = ₹4,05,000$.
- Year 3 (2024-25): Depreciation = $4,05,000 \times 10\% = ₹40,500$; Closing Book Value = $4,05,000 - 40,500 = ₹3,64,500$.
- Note: the depreciation amount falls each year ($50,000 \rightarrow 45,000 \rightarrow 40,500$) because the fixed 10% rate is applied to a declining book value, which is the defining feature of WDV.

6 marks Explain the two methods of recording depreciation in the books and state which one is generally preferred and why.

- Method 1 — depreciation charged to the Asset Account: each year Depreciation A/c is debited and the Asset A/c is credited, so the asset account itself shows the reduced (written down) value; the balance sheet shows the asset at this net value.
- Entries (Method 1): Depreciation A/c Dr. / To Asset A/c, then Profit & Loss A/c Dr. / To Depreciation A/c.
- Method 2 — Provision for Depreciation (Accumulated Depreciation) Account: the asset account stays at original cost; depreciation is accumulated in a separate provision account.
- Entries (Method 2): Depreciation A/c Dr. / To Provision for Depreciation A/c, then Profit & Loss A/c Dr. / To Depreciation A/c.
- Balance sheet (Method 2): the asset is shown at cost less the accumulated depreciation (balance of the provision account) to give net book value.
- Method 2 is generally preferred because the original cost of the asset remains visible in the books and balance sheet while the total depreciation charged so far is clearly shown, which is better for audit, control and disclosure.

6 marks An asset costing ₹1,00,000 (purchased 1 April 2021) is depreciated at 20% per annum on SLM. It is sold on 1 April 2024 for ₹35,000. A Provision for Depreciation Account is maintained and books close on 31 March. Calculate the profit or loss on sale and show how it is recorded.

- Annual SLM depreciation = $1,00,000 \times 20\% = ₹20,000$ per year (no scrap value given).
- Depreciation for 3 full years (2021-22, 2022-23, 2023-24) = $20,000 \times 3 = ₹60,000$ (accumulated in Provision for Depreciation A/c).
- Book value on date of sale (1 April 2024) = Cost – Accumulated Depreciation = $1,00,000 - 60,000 = ₹40,000$.
- Sale proceeds = ₹35,000, which is less than book value ₹40,000, so Loss on sale = $40,000 - 35,000 = ₹5,000$.
- Recording via Asset Disposal A/c: Asset Disposal A/c Dr. ₹1,00,000 / To Asset A/c ₹1,00,000; Provision for Depreciation A/c Dr. ₹60,000 / To Asset Disposal A/c ₹60,000; Bank A/c Dr. ₹35,000 / To Asset Disposal A/c ₹35,000.
- Loss entry: Profit & Loss A/c Dr. ₹5,000 / To Asset Disposal A/c ₹5,000 (being loss on sale transferred to P&L).

Exam tips

- Always start by finding the depreciable amount (Cost – Scrap Value) for SLM; for WDV apply the rate to the opening book value and never deduct scrap before applying the rate.
- Remember the cost of an asset includes freight, installation and other charges to make it ready for use — these are part of the amount on which depreciation is charged.
- For part-year purchases, charge depreciation only for the months the asset was used in the first year: First-year depreciation = $(\text{Annual Depreciation} \times \text{number of months used}) \div 12$.
- Before selling/disposing of an asset, first charge depreciation up to the date of sale, then compute profit or loss as Sale Proceeds – Book Value.
- State the difference between provision and reserve as 'charge vs appropriation' first — that single contrast earns the core mark; then add 'known liability vs future strengthening' and 'created even at a loss vs only out of profit'.
- In WDV, explicitly note that the book value never becomes zero and may not reach scrap value — examiners look for this limitation.
- Write narrations (e.g. 'being depreciation charged for the year') after journal entries; missing narrations can cost marks.
- Capital reserve = capital profits, NOT for dividend; revenue reserve = trading profits, available for dividend — keep this pairing ready for one-mark questions.

Quick revision

- Depreciation = permanent, gradual fall in book value of a fixed tangible asset; non-cash; cost allocation not valuation; not charged on land.
- Causes: wear and tear, passage of time, obsolescence, expiry of legal rights, accidents. Factors: cost, scrap value, useful life.
- SLM: equal amount yearly = $(\text{Cost} - \text{Scrap}) \div \text{Life}$; book value ends exactly at scrap value; simple but uneven total burden with repairs.
- WDV: fixed % on reducing book value; charge falls each year; book value never zero; required by Income Tax Act; evens out depreciation + repairs.
- Recording: Method 1 credits the asset account directly; Method 2 uses a Provision for Depreciation (Accumulated Depreciation) account and keeps the asset at cost (preferred).
- Asset sale with provision account → use Asset Disposal A/c; Profit/Loss = Sale Proceeds – Book Value; profit on sale is a capital profit.
- Provision = charge against profit for a known liability/expected loss; created even at a loss; reduces profit; deducted from related asset.
- Reserve = appropriation of profit; only when profits exist; on liabilities side under Reserves and Surplus; revenue reserve (for dividend) vs capital reserve (not for dividend); secret reserve is undisclosed (banks only).
- Related terms: depletion (natural assets), amortisation (intangible assets) — same write-off idea applied to different asset types.

