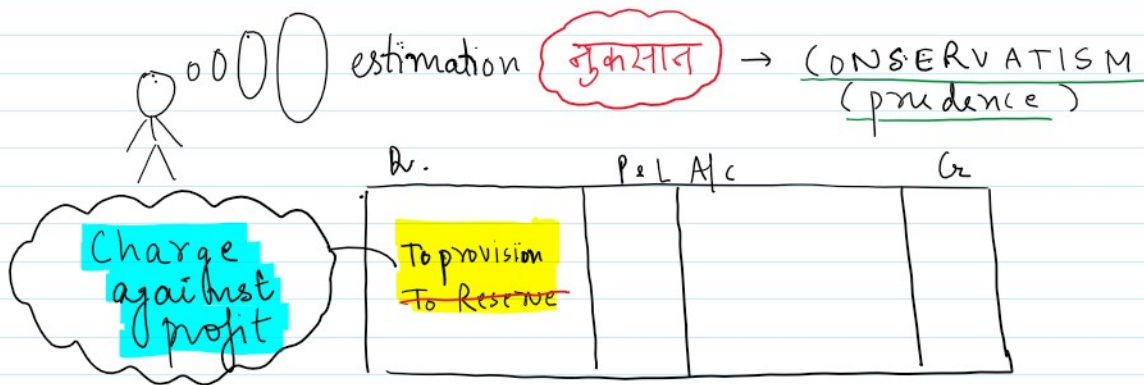


CH: Provisions and Reserves (4 Marks)

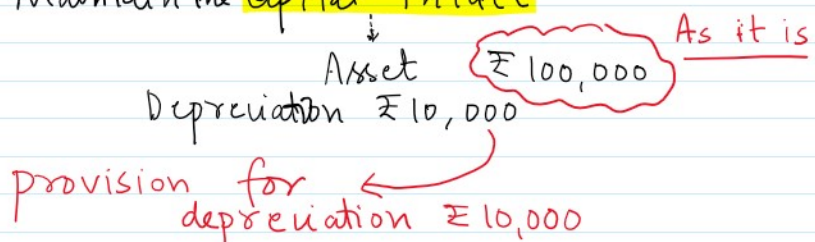
I. **PROVISIONS**

- Provision is an amount set aside, by charging it to P&L A/c, to provide for a known liability, the amount of which cannot be determined with accuracy.
- In other words, provision is a charge against profit for the purpose of providing any liability or loss.
- Eg: Provision for depreciation, provision for doubtful debts, provision for tax etc.



→ Importance of Provision

- To determine correct profit or loss
- To ascertain true and fair view of financial position
- Prudence concept is to be followed
- To maintain the capital intact



II. RESERVES

→ Reserve is the amount set aside **out of profits** for a specific purpose or to strengthen the financial position.

→ Reserve is an **APPROPRIATION of PROFITS** to strengthen the financial position of business

* The Amount of Reserve is not debited to P+L A/c. it is debited to P+L appropriation A/c

^{Imp.} * The amount of reserve when invested, then the reserve is termed as **Reserve Fund**

→ Importance of Reserve

- Expansion of business
- Improvement of financial position
- repayments of liabilities
- meeting **unforeseen contingencies**

→

Types of Reserves

Revenue Reserve

Revenue reserves are set aside out of **revenue profits** and are available for distribution as dividend

General Reserve

It is the amount set aside out of profits not for any specific purpose.

Specific Reserve

It is the amount set aside out of profits for a specific purpose.

Capital Reserve

Capital reserves are set aside out of **capital profits** and are not available for distribution as dividend.

- eg :-
- (i) Profit prior to incorporation
 - (ii) Profit on sale of fixed asset.
 - (iii) Premium on issue of shares
 - (iv) Capital Redemption

set aside out of profits not for any specific purpose

set aside out of profits for specific purpose
eg:- Workmen Compensation Reserve

of shares
(iv) Capital Redemption Reserve

* SECRET RESERVE

→ Secret reserve is a reserve the existence of which is **not disclosed**.

→ **(R)** Creation of Secret Reserve 100%

- (i) By charging excessive depreciation.
- (ii) By undervaluing stock or goodwill
- (iii) By creating excessive provision for doubtful debts
- (iv) By showing contingent liability as a real liability

→ Advantages

- It increases the working capital of the business
- Heavy losses of exceptional nature can be met without disturbing the normal business profit.

Disadvantages

- The Balance sheet will not disclose true & fair position
- It may negatively effect market value of company's share

100% ** Snapshot.	RESERVE	PROVISION
Nature	It is APPROPRIATION of profit	It is CHARGE AGAINST profit.
Purpose	It is created to strengthen financial position	It is made to meet known liability of uncertain amount.
Recording	It is debited in P&L appropriation A/c	It is debited in P&L A/c
Prudence	It is created out of	It balance maintenance

	" "	" "
Prudence	It is created out of profits	It follows prudence concept.
Presentation	It is shown under "Reserve & Surplus" heading	It is shown under "Current liabilities" heading.