

CHAPTER 14

PROVISIONS AND RESERVES

❖ Provisions

Provisions are the amounts which are set off against profit or surplus to meet the known liabilities but the amount of these liabilities cannot be determined with certainty.

Examples of Provisions:

Provision for taxation

Provision for depreciation

Provision for doubtful debts

Provision for discount on debtors, etc.

❖ Reserves

Reserves are the amounts shown in the liabilities side of the Balance Sheet that are set off out of the profit or surplus. These reserves can be used for distribution of dividend, meeting contingent liabilities, investment outside the business and investment within the business to expand and strengthen the business.

❖ Accounting Treatment

Provisions		Reserves	
Profit and Loss A/c	Dr.	Profit and Loss Or Profit	
To Provision forA/c		and Loss Appropriation A/c	Dr.
(Provision made for)		To Reserve forA/c	
		(Amount transferred to	
		Reserve)	

❖ Types of Reserves:

• *Capital Reserves*

These reserves are made out of capital profit, for example, profit on sale of machinery transferred to capital reserve account.

- ***Revenue Reserves***

These reserves are made out of revenue profit. There are two types of reserves, namely:

- *General Reserves*

These reserves are made out of revenue profit for general purpose.

- Specific Reserves

These reserves are made out of revenue profit for specific purpose, for example, Dividend Equalisation Reserve, Debenture Redemption Reserve, Capital Redemption Reserve, etc.

❖ **Difference between Provision and Reserves**

Point of Difference	Provision	Reserves
Source	It is made against profit	It is made out of profit
Conditions	It can be made even if the firm incurs loss	It is made only if the firm earns profit, after deducting all expenses and losses
Purpose	These are specific, i.e. can be used only for specific purpose.	These can be both specific as well as general
Liabilities	These are made to meet the known liabilities but the amount of these liabilities cannot be determined with certainty.	These are used for meeting contingent liabilities.