

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

❖ **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. |