

Chapter 17 Provisions and Reserves

Question 1

Define Provisions. Mention three main importance of creating a provision?

Answer: The term 'Provisions' refers to the amount retained or written off by the way of providing for depreciation, renewals and diminution in the value of assets.

The three main importance of provision are.

1. To establish the authentic net profit of a firm
2. To determine the true financial status of a company
3. To predict future losses in the future

Question 2

Mention the differences between the Provisions and Reserves.

Answer:

Provisions	Reserves
The amount retained or written off by the way of providing for depreciation, renewals and diminution in the value of assets	Reserves refer to the amount that is set aside out of profits and other surpluses to meet future uncertainties. In other words, a reserve is meant for meeting any sort of an unknown liability or losses in the future.
It is created by crediting to Profit and Loss a/c.	It is not created by debiting to Profit and Loss a/c; but, via Profit and Loss Appropriation a/c.
It cannot be used for allocation as dividends among the shareholders.	It can be used for allocation as dividends among the shareholders.

Question 3

Distinguish between provision and reserve on the following basis.

(i) Basic Nature (ii) Purpose (iii) Effect on taxable profits (iv) Presentation in Balance Sheet (v) Elements of Compulsion (vi) Use of payment of dividend

Answer:

Basis	Provision	Reserve
Basic Nature	The Provision provides future liability	Reserve is formed after evaluating net profit.
Purpose	To understand liabilities and expected losses	Increase in capital employed
Effect on taxable profits	Not required	Profit is important to create reserves, apart for a few types of reserves.

Presentation in the Balance Sheet	In terms of assets it is displayed as a debit from that particular asset, while for liability, it is displayed on the liabilities side.	Displayed on the liabilities side.
Elements of Compulsion	Yes, according to the GAAP	It is optional except that reserves which are obligatory.
Use of payment of dividend	The dividend is never paid from provisions.	The dividend can be paid out of reserves.

Question 4

Differentiate between provision and reserve on the following basis.

(i) Appropriate or charge (ii) Financial position (iii) Distribution

Answer:

Basis	Provision	Reserve
Appropriate or charge	Provision is charged for a determined expense	Reserve is charged with profit for a particular purpose
Financial position	Charged against profit	Appropriate for profit
Distribution	It cannot be shifted for distribution to General Reserve	It can be distributed as dividends if it is not utilized for a period of time

Question 5

Give five examples of capital reserves

Answer: The five examples of capital reserves are.

1. Profit on the redemption of debentures
2. Profit on the purchase of an operating business
3. Profit on fixed assets sale
4. Profit from the reissue of forfeited share

Question 6

Distinguish between revenue and capital reserve

Answer:

Basis	Revenue Reserve	Capital Reserve
Creation Source	It is formed out of revenue profit which is obtained from regular business activities or operations.	It is built from the capital profit, which is not obtained from normal business activities.
Utilization	It is utilised for the dividend.	It cannot be utilised for a dividend.

Purpose	It is used for increasing the financial status of the firm.	It is created to fulfil the capital losses
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Question 7

Define capital reserve.

Answer: A reserve created from the firm's profit generated from its non-operating activities for a particular period of time is defined as capital reserves.

Very Short Answer Question

Question 1

Give a few examples of provision.

Answer: Few examples of provision are

- Provision for Taxation
- Provision for bad and doubtful debts
- Provision for depreciation of assets
- Provision for discount on debtors

Question 2

Define Reserves.

Answer: Reserves refer to the amount that is set aside out of profits and other surpluses to meet future uncertainties. In other words, a reserve is meant for meeting any sort of an unknown liability or losses in the future.

Question 3

Give two examples of reserves.

Answer: The two examples of reserves are.

- Dividend Equalization Reserve
- Debenture Redemption Reserves
- Contingency Reserves
- Capital Redemption Reserves

Question 4

What is dividend equalisation reserve?

Answer: A reserve generated to support a stable rate of dividend is known as dividend equalisation reserve.

Question 5

What is the workmen compensation fund?

Answer: The workmen compensation fund is generated to dispense compensation payable to workers if any accident or unknow event occurs.

Question 6

Mention two example of the specific reserve.

Answer: The two example of specific reserves are dividend equalisation reserve and workmen compensation fund

Question 7

Give one difference between general and specific reserve.

Answer: The one difference between general and specific reserve is.

- Any reserve which is not generated for any particular purpose is defined as a general reserve. Whereas, a reserve generated for a specific purpose is defined as a specific reserve.

Question 8

Name the reserve that can be used in the distribution of dividend.

Answer: The reserve that can be used in the distribution of dividend is revenue reserve

Question 9

Where will you transfer profit on the sale of a fixed asset?

Answer: The profit on the sale of a fixed asset is defined as capital profit. So, it will be transferred to capital reserve. Stay tuned to BYJU'S for more DK Goel solutions, question papers, sample papers, syllabus and Commerce notifications.