Chapter -15 Provision and Reserves

Meaning of provision:

1. Provision is an estimated amount set aside to meet an uncertain loss or expense in future.
2. Provision differs from liability to the extent that provision is an estimated amount where liability is determined amount .For example, wages of Rs50,000 payable for the month of March is a liability.
3. Provision is charge against profit and loss Account .

Objectives of Provisions :

1. The objective of provision are to account all expenses and losses.
2. Where the amount of liability , expenses and losses are not ascertained or determined , they are estimated and accounted by making provisions.

Features of Provision:

1. It is an amount set a side out of income or profits .It is a retention of profit , made temporarily , for a specific purpose.
2. The purpose , for which a provision is created , is to meet.

   (a) An anticipated loss which has occurred but the amount is not ascertained , or

   (b) A known depletion or diminution in the value of an asset, or

   (c) a liability which has been known to have arisen.
3. The exact amount of anticipated loss or the depletion in the value of an asset or the liability is not ascertained.
4. It is a charge to Profit and loss account.

Importance of provision :

1. Provision is an amount set a side out of current earning considered necessary to provide for all losses .
2. Provision is made to retain future operating performance undisturbed by losses.
3. Provision is made following the prudence concept of accounting which holds “provide for all anticipated expenses and losses but do not provide for anticipated incomes.
4. Any loss or depletion in the value of an asset or any liability as may not have been provided against income or profit would effectively erode the capital of a business. Creation of Provision is an attempt to maintain the capital of business intact.

RESERVE

Meaning and Concept :

1. Reserve are the amount set aside out of profits. It is an appropriation of profits to strengthen the financial position of the business.
2. Reserve are not set aside to meet a liability or depreciation in the value of asset but is set aside to meet known or unknown Contingency that may arise in future. Examples are General Reserve, Reserve for expansion, Reserve for equalization of dividends etc.

Importance of Reserve : Creation of Reserve enables the enterprises to sail through difficult financial period in the future. The purpose of reserve can be :

(i) Expansion of Business

(ii) improvement of financial position

(iii) Redemption of liabilities

(iv) Meeting unforeseen contingencies

(v) Making dividends uniform from year to year and

(vi) Meeting legal requirements such as Debentures Redemption Reserve required b income tax law.

Types of Reserves :Reserve are generally classified into :

1. Revenue Reserves 2. Capital Reserves

1. Revenue Reserve are set a side out of revenue profits which are available for distribution as dividend. It can be classified into:

(a) General Reserve : It is the amount set aside out of profits not for any specific purpose. It is available for any future contingency or expansion of business. Such reserves are strengthen the financial position of the business. Examples is General Resreve.

(b) Specific Reserve :