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**For – LNMU B. Com part -1 , Hons paper -1 Financial
Accounting **Unit-4** *Accounting for Reserves, provisions
and Surplus***



Easy to Understand the concept

Ques- Distinguish between Provisions and Reserves.

Ans- following are the Distinguish between Provisions and Reserves :

Basis of Difference	Provisions	Reserve
(i) Meaning	It is created to meet a known liability.	It is created to meet an unknown liability.
(ii) Investment	It is not invested outside the business.	It may be invested outside the business.
(iii) Distribution	It cannot be distributed as divided among shareholders.	It can be distributed as dividends among shareholders.
(iv) Charge	It is debited to the profit and loss account.	It is debited to the profit and loss appropriation account.

Ques- Define Revenue Reserves.

Ans. Revenue reserves are created out of revenue profits which are available for Distribution as dividend. The main object of creation of revenue reserve is to Strengthen the financial position and meeting the unforeseen contingencies or Some specific purpose.

It is of two types:

(i) General Reserve.

(ii) Specific Reserve.

(i) General Reserve: It is the amount set aside out of profits for no specific Purpose. It is created for meeting unforeseen losses. It is voluntary for, a business Enterprise to maintain general reserve.

(ii) Specific Reserve: It is created for a specific purpose and can be utilized Only for that purpose. For example, Dividend Equalization Reserve, Reserve for Replacement of Asset.

Ques-Define Capital Reserve.

Ans- Capital reserves are created out of capital profits and are normally not available For distribution as cash dividend. Business enterprise earns normal profits as well As capital profits from many sources. Reserves created out of such capital profits Are known as capital reserves.

Examples of capital reserves are:

- (i) Profit on the revaluation of fixed assets and liabilities.***
- (ii) Profit on sale of fixed assets.***
- (iii) Profit on redemption of debentures.***
- (iv) Profit from the reissue of forfeited shares.***
- (v) Profit prior to incorporation.***
- (vi) Premiums received on issue of shares or debentures.***

Generally these reserves cannot be utilized for distribution of dividends to Shareholders. However, some capital reserves can be utilized to distribute Dividends subject to fulfillment of certain conditions laid down by Companies Act.

Ques- Define Secret Reserves. How it is created?

Ans- A secret reserve is one, the amount of which is not disclosed in the balance sheet.

It is also called a „Hidden Reserve “. Such reserves are created by showing the Assets at a lower amount and liabilities at a higher amount. When secret reserve Exist, the actual position of the firm may be much better or worse than what is Disclosed by the balance sheet. Secret reserves are allowed in concerns like Banking companies, insurance companies, public utility companies etc.

The methods of creating secrete reserve are:

(i) Under valuation of closing stock.

(ii) Showing a contingent liability as an actual liability.

(iii) Creation of excessive provision for bad debts.

(iv) Charging excessive depreciation.

(v) Charging capital expenditure to the profit and loss account.

(vi) Inclusion of fictitious assets.