

VIDYA BHAWAN BALIKA VIDYA PITH

शक्तिउत्थानआश्रमलखीसरायबिहार

Class 11 commerce Sub. ACT Date 14.02.2021

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Depreciation, Provisions and Reserves

SECTION – II

Provisions and Reserve

7.11 Provisions

There are certain expenses/losses which are related to the current accounting period but amount of which is not known with certainty because they are not yet incurred. It is necessary to make provision for such items for ascertaining true net profit. For example, a trader who sells on credit basis knows that some of the debtors of the current period would default and would not pay or would pay only partially. It is necessary to take into account such an expected loss while calculating true and fair profit/loss according to the principle of Prudence or Conservatism. Therefore, the trader creates a *Provision for Doubtful Debts* to take care of expected loss at the time of realisation from debtors. In a similar way, Provision for repairs and renewals may also be created to provide for expected repair and renewal of the fixed assets. Examples of provisions are :

- Provision for depreciation;
- Provision for bad and doubtful debts;
- Provision for taxation;
- Provision for discount on debtors; and
- Provision for repairs and renewals.

It must be noted that the amount of provision for expense and loss is a charge against the revenue of the current period. Creation of provision ensures proper matching of revenue and expenses and hence the calculation of true profits. Provisions are created by debiting the profit and loss account. In the balance sheet, the amount of provision may be shown either:

- By way of deduction from the concerned asset on the assets side. For example, provision for doubtful debts is shown as deduction from the amount of sundry debtors and provision for depreciation as a deduction from the concerned fixed assets;
- On the liabilities side of the balance sheet alongwith current liabilities, for example provision for taxes and provision for repairs and renewals.

Additional Information

- Bad debts proved bad but not recorded amounted to Rs. 8,000
- Provision is to be maintained at 10% of debtors.

In order to create the provision for doubtful debts, the following journal entries will be recorded:

Journal

Date	Particulars	L. F.	Amount Rs.	Amount Rs.
2014 Mar. 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		8,000	8,000
Mar. 31	Profit & Loss A/c Dr. To Bad debts A/c (Bad debts debited to profit and loss account)		8,000	8,000
Mar. 31	Profit and Loss A/c Dr. To Provision for doubtful debts a/c (For creating provision for doubtful debts)		6,000 ¹	6,000 ¹

Working Notes

Provision for doubtful debts @10% of sundry debtors i.e.
Rs. 68,000 – Rs. 8000 = Rs. 60,000

$$\text{Rs. } 6000 \times \frac{10}{100} = \text{Rs. } 6000^1$$