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शक्तिउत्थानआश्रमलखीसरायबिहार

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Depreciation, Provisions and Reserves

Question 6:

In case of a long term asset, repair and maintenance expenses are expected to rise in later years than in earlier year. Which method is suitable for charging depreciation if the management does not want to increase burden on profits and loss account on account of depreciation and repair.

ANSWER:

If the management does **not** want to exert undue burden on the profits due to high depreciation and repair costs in the latter years of the assets, then 'written down method' should be a preferred method to provide depreciation. This is because the cost of depreciation reduces; whereas, repair and maintenance expenses increase in the latter years. However, on the whole, it does **not** exert increasing burden on profits

Question 7:

What are the effects of depreciation on profit and loss account and balance sheet?

ANSWER:

The effects of depreciation on Profit and Loss Account are given below.

1. Depreciation increases the debit side of profit and loss account and hence reduces net profit.
2. Depreciation increases the total expenses, leading to an excess of debit over credit balance.

The effects of depreciation on Balance Sheet are given below.

1. It reduces the original cost or book value of the concerned asset.
 2. It reduces the overall balance of asset's column in the balance sheet.
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Question 8:

Distinguish between provision and reserve.

ANSWER:

Basis of Difference	Provision	Reserve
Meaning	It is created to meet the known liability.	It is created to meet unknown liability.
Nature	Provision is charged against profit.	Reserve is appropriation of the profit.
Purpose	It is created for a specific liability.	It is created for strengthening the financial position.
Mode of creation	It is created by debiting the profit and loss account.	It is created by debiting the profit and loss appropriation account.
Use for payment of dividend	It cannot be used for payment of dividends.	It can be used for payment of dividends.
Creation	Creation of provision is compulsory. It is created even if there is no profit.	Creation of reserve depends on the discretion of the management. It is created only when there is profit.

Question 9:

Give four examples each of provision and reserves.

ANSWER:

Four examples of provision are given below.

1. Provision for bad and doubtful debts

2. Provision for discount on debtors
3. Provision for depreciation
4. Provision for taxation

Four examples of reserve are given below.

1. General reserve
2. Capital reserve
3. Dividend equalisation reserve
4. Debenture redemption reserve

Question 10:

Distinguish between revenue reserve and capital reserve.

ANSWER:

Basis of Difference	Revenue Reserve	Capital Reserve
Source	It is created out of revenue profit, i.e., revenue earned from normal activities of business operations.	It is created out of capital profit, i.e., gain from other than normal activities of business operations, such as sale of fixed assets, etc.
Dividend	It can be used for dividend.	It cannot be used for dividend.
Purpose	It is created for strengthening the financial position of the business.	It is created for the purpose laid down in the Companies Act.

Question 11:

Give four examples each of revenue reserve and capital reserves.

ANSWER:

1. Four examples of revenue reserve are given below.

1. General Reserve
2. Retained Earnings
3. Dividend Equalisation Reserve
4. Debenture Redemption Reserve

2. Four examples of capital reserve are given below.

1. Issues of shares at premium
 2. Profit on issue of shares
 3. Sale of fixed assets
 4. Profit on redemption of debentures
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