

5.10 | Prudence concept

- Prudence concept and its relevance
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- Application of the concept in preparing financial statements

Prudence concept

The prudence concept contributes to the preparation of the financial statements to show the operating results, financial position, and cash flow of the accounting entity in the best manner.

Examples for the concept

The list below shows situations that this concept can be applied in:

- Making a provision for doubtful debts
- Making a provision for depreciation
- Recording a reduction in the value of stocks
- Making a provision for workmen's compensation

Application of the concept

The adjusting entries to the above adjustments is as follows:

- | | | |
|---------------------------------|----------|---|
| 1. Doubtful debts a/c | - Debit | } Making a provision for the first time |
| Provision for doubtful debts | - Credit | |
| 2. Doubtful debts a/c | - Debit | } Adjustment for increase in the provision for doubtful debts |
| Provision for doubtful debts | - Credit | |
| 3. Provision for doubtful debts | - Debit | } Adjustment for decrease in the provision for doubtful debts |
| Doubtful debts a/c | - Credit | |
| 4. Bad & doubtful debts a/c | - Debit | } Adjustment for bad and doubtful debts |
| Provision for doubtful debts | - Credit | |

