Ensuring financial statement accuracy through adjusting the value of reserves in construction organizations

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Abstract. This paper substantiates the need to create reserves for reducing the value of material assets in construction organizations in order to comply with the requirements for the reliability of financial statements. The issue of creating reserves is considered from the standpoint of the features of the construction organization activities. The necessity of creating such reserves for construction organizations conducting warehouse accounting is proved.

Subject of the study: features of accounting for inventories in construction organizations and their reflection in the financial statements in accordance with the principles of reliability.

Objectives: to justify the need to create reserves for reducing the cost of inventories in construction organizations.

Materials and methods: the question of creating reserves is considered from the point of view of the requirements of Russian accounting standards and international standards in relation to the valuation of stocks in a warehouse.

Results: the reasons for creating reserves for reducing the value of material assets are formulated, the features of stock accounting in construction organizations are studied.

Conclusions: the degree of reliability of the financial statements significantly increases when reflecting the value of inventories in the balance sheet in a net assessment, taking into account reserves for reducing the value of material assets.

1. Introduction
The creation of reserves for reducing the value of material assets is not a mandatory requirement in Russian accounting. However, the adjustment of stock value achieved through reserves allows reflecting the balance of reserves at the reporting date at the most real value in the reporting. Such an approach is necessary to implement the requirement of reliability of financial statements, which is fundamental both in Russian and in international accounting. In the organizations of the construction field of activity, there are certain features in relation to inventory accounting, which is primarily caused by the object-based accounting of work, their cyclical nature and other factors. Materials that are not used up during the construction process, as a rule, not always can be used at other sites and
remain in the warehouse. In accounting, material balances are recorded at actual cost, which is reflected in the balance sheet and can significantly increase the value of assets. Thus, unadjusted value of inventories may lead to unreliable reflection of financial statements.

2. Literature review
The reliability requirement for the preparation of financial statements is established both in Russian regulatory acts (Federal Law “On Accounting” (hereinafter referred to as the Law) and federal accounting standards) and in international standards. In accordance with the Law, the reliability requirement is formulated: “The accounting (financial) statements must give a reliable idea of the financial position of the organization at the reporting date, the financial result of its activities and cash flow for the reporting period, which is necessary for users of these reports to make economic decisions” [1]. International Standard (IAS) 1 “Presentation of financial statements” states that “A fair presentation requires a fair reflection of the effects of transactions, other events and conditions in accordance with the definitions and criteria for recognizing assets, liabilities, income and expenses” [2].

The reliability of the reporting is ensured by the correct reflection of the value of assets according to the rules of Russian and international standards. Reporting indicators are confirmed by the results of the inventory and the results of revaluation in the case of fixed assets. Inventories are classified as current assets, and their value is accounted for according to certain rules.

In accordance with the requirements of RAS 5/01 “Accounting for inventories”, materials, including construction materials, are reflected in the balance sheet at the actual cost of purchase, which often does not correspond to their real value during long-term storage. [3] Such a situation leads to overstatement of balance sheet assets and to distortion of accounting information, which violates the principle of reliability. To prevent the reflection of false information in the statements when it is impossible to change the book value of materials, the adjustment of the balance indicators is achieved through the creation of reserves.

To calculate the reserve, the difference between the current market cost and the actual cost of materials is determined. In case of a positive result, a reserve is created. This approach to adjustment, when the actual cost does not change, but is reflected in the balance sheet net of reserve, is practiced in Russian accounting.

From the standpoint of international standards, the requirement for the reliability of accounting information is one of the main ones. For inventories that are losing their market value, IFRS IAS 2 “Inventories” prescribes the need to assess inventories “at the lower of cost or net possible selling price” [2]. Thus, unlike RAS 5/01, IFRS IAS 2 “Inventories” ensures compliance with the accuracy requirement by adjusting directly the book value.

Despite the differences in Russian and international standards in assessing the value of depreciated materials, reserves allow reflecting reliable value in the balance sheet, since creating a reserve in a separate account for adjusting the cost does not contradict IFRS rules.

3. Materials and methods
The reasons for the creation of reserves for the depreciation of material assets (hereinafter reserves) are indicated in the guidelines for the accounting of inventories: decrease in market value; obsolescence and loss of original qualities. [5] In general, for most organizations with stocks, the creation of reserves ensures compliance with legislation on the reliability of accounting information.

The reserve for reducing the value of material assets is formed on the same account 14 due to the financial results of the organization. [4]. The formation of a reserve for reducing the value of material assets is reflected in the account for the credit of account 14 “Reserves for reducing the value of material assets” and the debit of account 91 “Other income and expenses”. In the next reporting period, as the material assets for which the reserve is created are written off, the reserved amount is restored: the account has a record on the debit of account 14 “Reserves for reducing the value of material assets” and the credit of account 91 “Other income and expenses”. A similar record is made
when the market value of material assets increases, for which the corresponding reserves were previously created. Analytical accounting for account 14 “Reserves for reducing the value of material assets” is maintained for each reserve. [4].

Thus, in the balance sheet, the adjustment of indicators for material assets accounts (10, 41, 43) is carried out by including data on two accounts in one line. Since the counter account 14 adjusts the property of the organization, it is contractual, i.e. it allows reflecting the materials in the “net assessment”. The balance of account 14 is not separately reflected in the balance sheet, but is presented together with data on the balance of that account, for the regulation of which this account is used.

![Accounting for inventories in the balance sheet](image)

**Figure 1.** Comparison of accounting for inventories in the balance sheet according to the International standards and the Russian regulatory acts.

In the construction field, the issue of creating reserves is very relevant. Object-based accounting in construction with a completed cycle is an important factor affecting the reflection of all costs, including material ones. RAS 2/2008 “Accounting for construction contracts” contains a requirement that the accounting of income, expenses and financial results should be carried out separately for each of the executed contracts. In respect of inventories, object-based cost accounting, characteristic for construction organizations, implies their targeted purchase and use for specific purposes without further storage. The individuality of the objects and the completed cycle of their creation causes a one-time write-off of materials for the costs of a particular construction and the practical impossibility of using them at other objects.

4. Results of the study

The balances of unused materials are reflected in account 10 “Materials” at the actual cost and fall into the balance sheet asset at the end of the reporting period. Further use of such materials is possible:

- at other construction sites (if they comply with construction requirements);
- as a secondary raw material;
- during warranty repair of the facility;
- implementation;
- retirement (writing off) due to loss of quality.
The share of materials used within the organization is small, since the purchase of materials is carried out for a specific facility. In cases where there is a balance of such materials at the reporting date, an adjustment to their value is necessary.

Selling unused materials in construction companies has certain difficulties. Unlike trading companies, where goods, due to their purpose, should not “lie too long” in the warehouse, unused materials that remain on the balance sheet of the construction organization are used (or sold) extremely slowly. Due to its specificity, a construction organization does not have full-fledged opportunities for selling unnecessary stocks, like a trade organization. The reason for creating a reserve in accordance with RAS 5/01 in this case is a decrease in market value. It is also possible to be guided by IFRS 2, where the change in the cost of inventories can be carried out with an increase in the cost of bringing to the final state of a product or an increase in the cost of selling.

In order to comply with the principle of reliability, for construction organizations, the question of creating a reserve for reducing the cost of material assets in relation to unused construction materials should be decided immediately after completion of work and commissioning of the object to the customer. The creation of a reserve by the construction organization is necessary not only after a long period, when the materials are really depreciated, but at the end of the current reporting year, since this is necessary to comply with the principle of reliability. The question of estimating the reserve in the absence of a decrease in market value can be resolved based on the provisions of IFRS 2, i.e. an estimate is made at the net selling price, which should be understood as the expected selling price of each unit of goods, reduced by expected sales costs. This decision does not contradict RAS 5/01 and IFRS 2, and should be recorded in the Accounting policies of the organization.

Besides, the question of creating reserves affects not only the requirement of reliability, but also the principle of prudence, which should be ensured by the accounting policy of the organization in accordance with RAS 1/2008. In Russian accounting, this principle sounds like “a greater willingness to recognize in accounting expenses and liabilities than possible incomes and assets, avoiding the creation of hidden reserves” [6]. The reserve affects the financial performance of the organization. When creating a reserve for reducing the value of material assets, it is possible to reduce profits, and when writing off - an increase. This issue is quite serious in both financial and tax accounting, and requires the development of the most accurate approach to determining market value (in accordance with RAS 5/01) or the net possible selling price (in accordance with IFRS 2). Russian accounting legislation does not contain specific guidance regarding the determination of market value. For the purpose of creating a reserve, one can use the statement of position on the accounting statement: “The current market value means the amount of cash that can be obtained as a result of the sale of these assets”. [5] However, when calculating the cost of inventories at the net possible price, an organization can use IFRS 2: “The estimated assessments of the possible net sale price are based on the most reliable evidence of the amount available from the sale of reserves at the time of such assessments” [2]. In any case, it is necessary to use information about the market value of similar materials in the region at the valuation date with an indication of an information source.

Since the creation of a reserve is provided only for a part of inventories that have lost their original qualities or their market value has decreased, it is necessary to restructure inventory accounting to adequately reflect the value of inventories with and without reserves. One way to separately account for such stocks is to create a separate sub-account to account 10 “Materials”, for example, “Materials with reduced cost” and transfer to it all the reserves for which the reserve has been created. Such an approach will reduce the possibility of error in future write-offs of stocks, since the reserve must also be written off (account 14).

Another approach is based on the use of automated accounting capabilities and involves the creation of a virtual warehouse “Materials and reserves”. Material accounting remains on the accounts (and sub-accounts) of the purchase, and when creating a reserve for such stocks, they are “transferred” in the program to a separate virtual warehouse. This approach is convenient when accounting for materials in various sub-accounts and has advantages in analytical accounting, in particular, in the formation of operational information for both financial and managerial accounting.
The selected method of accounting for materials on synthetic and analytical accounts, as well as the organization’s policy of creating reserves for reducing the value of material assets, should be prescribed in the Accounting Policy and be used unchanged throughout the year.

5. Conclusions
Creating a reserve for reducing the value of material assets in relation to materials purchased but not used up after completion of construction work will allow construction organizations to comply with the reliability requirement in the financial statements.

In the case of accounting for materials with the use of reserves, it is necessary to organize their separate accounting for correct writing-off both from account 10 “Materials” and from account 14 “Reserve for reducing the value of material assets” when selling or using them in future activities of the organization.

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