

Allowance for Doubtful Debts: Economic Essence

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Abstract: The purpose of this article is to clarify the description of the economic essence of the doubtful debt reserve, based on studying its nature. The objectives of the research are to study regulations, scientific sources, literature, to identify and describe the nature of the reserve, to substantiate the economic essence of doubtful debt reserve. The authors use the following methods: analysis and synthesis, deduction and induction, abstraction. As a result, they clarify the description of the nature and economic essence of the reserve for doubtful debts. The research is scientifically significant as the revised description allows more fully to identify and substantiate problems of the reserve accounting and develop a set of measures to resolve them.

1 INTRODUCTION

The doubtful debt reserve is one of the most difficult accounting objects. Its recognition and reflection in accounting and disclosure in financial statements raises a large number of questions and problems.

The reason for this problem is the lack of understanding by accounting employees and the management of an economic entity, users and other people interested in information about the enterprise, the economic nature of the doubtful debt reserve. In addition, this problem is caused in Russia by the lack of desire among the accounting employees and the management to form a reserve and take the initial action to form it - to check doubtful debts.

It determines the relevance of the study and is the prerequisite for its implementation.

Theoretical basis for the study were works by Kulikova L.I., Garyncev A.G., Goshunova A.V. (Kulikova LI, Garyncev AG, Goshunova AV, 2015), Scott B. Jackson, Xiaotao Kelvin Liu (Scott B. Jackson, Xiaotao Kelvin Liu, 2010), Catherine A. Finger (Catherine A. Finger, 2010), Nizar Mohammad Alsharari, Rasha Abousamra (Nizar Mohammad Alsharari, Rasha Abousamra, 2019), Kuznetsova O.N. (Kuznetsova O.N., 2019), Alloy Silverstein (Alloy Silverstein, 2019), Hyun Ah Lee, Won Wook Choi (Hyun Ah Lee, Won Wook Choi, 2016), Goryachikh S.P. (Goryachikh S.P., 2016)

Kholkin A.V. (Kholkin A.V., 2019); and other sources, in particular, accounting textbooks by Jerry J. Weygandt, Paul D. Kimmel, Donald E. Kieso (Jerry J. Weygandt, Paul D. Kimmel, Donald E. Kieso, 2018).

Researchers define the doubtful debt reserve as a certain regulatory value formed in accounting with the aim of adjusting the amount of accounts receivable to determine the amount of receipts from debtors, which is likely to be received.

But, this definition of the economic essence of the reserve does not quite correspond to the nature of the reserve. It leads to misunderstanding of the necessity of its formation. Accounting workers and the management of economic entities are not interested in understanding the importance of this reserve as an economic indicator characterizing the enterprise management system.

Therefore, the hypothesis of the research is that the doubtful debt reserve as an accounting object and an indicator that affects the formation of data reflected in the accounting (financial) statements, is of a more complex nature than it is described in scientific sources.

The scientific novelty of the study is the clarification of the nature of the doubtful debt reserve formed in accounting and disclosed in reports.

Therefore, the purpose of this study is to clarify the description of the economic essence of the

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doubtful debt reserve on the basis of studying the nature.

This goal requires solving the following tasks:

1. To identify and describe the nature of the doubtful debt reserve based on scientific sources, accounting standards and recommendations.

2. To establish and describe the economic essence of the doubtful debt reserve based on the description of its nature.

3. To substantiate the description of the economic nature of the reserve.

An object of research is the doubtful debt reserve formed in accounting. The subject of the research is its nature and economic essence.

2 MATERIALS AND METHODS

The tasks were solved using the following methods: analysis and synthesis, deduction and induction, abstraction.

Analysis is a method that involves dividing a single object into its separate parts and examining them in the totality of connections and dependencies. The use of this method made it possible to reveal the nature of the reserve and to study its description.

Synthesis is the union of separate parts or elements into a whole. The use of this method made it possible to determine and describe the economic essence of the provision for doubtful debts.

Deduction is the formulation of an inference based on the transition from general facts and provisions to specific conclusions and generalizations, reasoning from the general to the particular. The application of this method made it possible to describe specific features and elements of the economic essence of the reserve.

Induction is the process of obtaining logical conclusions based on the transition from particular provisions to the general. The use of this method made it possible to generalize and formulate a general conclusion about the economic essence of the reserve.

Abstraction is a mental selection, isolation of some elements from a certain set and separating them from other elements of a given set. It is used to separate unnecessary, irrelevant, unusual features when describing the nature of the reserve.

3 RESULTS AND DISCUSSION

When solving the tasks, the authors have obtained the following results:

1. described the nature of the provision for doubtful debts;

2. determined the economic essence of the doubtful debt reserve, which is different from its essence given in the literature;

3. gave the substantiation of the description of the economic nature of the reserve.

Investigating the nature of the doubtful debt reserve, it is necessary to study provisions of accounting standards, recommendations, regulations and literary sources.

The provisions of the IAS were investigated as standards and prescriptions (regulations).

The works of the above authors were studied as literary sources.

Literary sources define the doubtful debt reserve as a kind of regulatory value created for adjusting the amount of accounts receivable, due to the need to reflect in the accounting (financial) statements the amount which, with a high degree of probability, the debtor will fulfill its obligation fully and on time. It is considered the nature and essence of the debt reserve.

This position cannot be considered complete, since it does not describe the nature of the reserve in the following aspects.

1. The reserve is a virtual value. This conclusion is made due to the fact that the reserve is an accounting object, its formation is not associated with the real movement of resources and real economic processes. All operations carried out with the reserve exist only in the system of accounting accounts and cannot exist independently.

2. A reserve is an opinion expressed in monetary form that any obligation to an economic entity will not be fulfilled by its debtor fully within the specified time period, which will lead to economic losses in the future. However, based on the requirement of prudence, these losses are recognized as expenses and reduce the financial result when the enterprise obtains obvious and sufficient evidence that in the future the debtor will not fulfill its obligations fully and on time. Opinion has no material form, it is not associated with the emergence of a duty. Therefore, it cannot really exist.

3. The reserve has a dual nature, it fully corresponds to the application of the double entry method. The dual nature of the reserve is manifested in the following. On the one hand, this is a value used to adjust accounts receivable, to determine and reflect in the accounting (financial) statements the amounts actually receivable from debtors. On the other hand, this is a value that characterizes possible financial losses, including lost profits, arising as a result of the wrong choice of counterparties, their failure to fulfill

their obligations, and shortcomings in claims. This characterizes the risk management system.

4. The need to form a reserve is due to the requirements of regulatory enactments governing accounting, to ensure the reliability and reality of the data in the accounting (financial) statements. That is, the requirements for the formation of a reserve, as a rule, are normatively fixed and do not aim to somehow distort the actual state of affairs. Therefore, the management of an economic entity may have no incentive to ensure the organization of a reliable reflection in the accounting of the reserve. Moreover, there is a motive for refusing to form a reserve due to compliance with the requirement of rationality of accounting.

5. The value of the reserve has not been determined in terms of the risk management system.

Considering the nature of the reserve from the standpoint of risk management, it is necessary to explain the following.

Entrepreneurship is based on risk. One of the significant risks is the risk of default by the debtor of his obligations under the contract, legislation, and customs. Of course, there are various mechanisms to reduce the negative effects of the debtor's failure to fulfill his obligations, but for their application it is necessary to create appropriate conditions, without them the application of these mechanisms is not possible. Therefore, the simplest and most effective is the implementation of a set of measures aimed to prevent the occurrence of the situation, when adverse consequences are possible. It presupposes the creation of a risk management system and ensuring its effective functioning. Therefore, the creation of a risk management system, in terms of managing accounts receivable, is a prerequisite for preventing the negative consequences of default by debtors, their default or bankruptcy.

Any management system, including the risk management system, must function effectively. Therefore, the key point in the functioning of the management system is the assessment and control of efficiency. Control is possible if there is a quantitatively measurable indicator. The value of the created reserve for doubtful debts should be used as an indicator.

Therefore, the economic essence of the reserve should also provide the fact that the doubtful debt reserve should be considered as a certain estimated indicator, which can help to assess the effectiveness of accounts receivable management from the standpoint of an adequate preliminary selection of the counterparty (due diligence), current work with a counterparty, the choice of forms and methods of

settlements between counterparties, the use of methods to ensure the fulfillment of obligations. Of course, this indicator is not exclusive and should be supplemented by other indicators characterizing the claim work, but the formation of these indicators should be the topic of independent scientific research.

Since this indicator characterizes the risk management system in terms of receivables, the management of an economic entity may have a motive to veil the reporting data by distorting the amount of the reserve, or completely abandoning the formation of a reserve by refusing to qualify the receivables as doubtful. Disclosing the amount of the actually required to create a reserve, the management of an economic entity unwittingly discloses an indicator of possible ineffective work to prevent doubtful and bad accounts receivable.

Considering the nature of the doubtful debt reserve, it is necessary to investigate the reason of forming the reserve. The reason can be the assumption of temporary certainty of the facts of economic life, which requires the recognition of proceeds from sales in the absence of full certainty, that is, in conditions of risk. Therefore, accounting and financial reporting do not reflect revenue in the amount of actually received assets or other benefits, but a certain amount of potential revenue that can be received, taking into account the probable risk of non-receipt.

However, based on the requirement of reality, the accounting (financial) statements should reflect the amount of obligations for which the creditor organization will be able to obtain performance without resorting to additional expenditures of time and resources. Since the adjustment of proceeds when identifying signs and recognizing receivables as doubtful is not possible, it becomes necessary to change the value of the financial result indirectly, by creating a reserve of doubtful debts. And in the balance sheet, the amount of receivables is adjusted by the amount of the created reserve.

However, it should be noted that the recognition of a debt as doubtful or hopeless does not mean the termination of the existence of the obligation itself, or the right to receive performance under this obligation. It is connected precisely with the opinion that in the current circumstances or formed conditions, the voluntary performance of the obligation by the debtor, or the implementation enforcement can be difficult and hardly possible. It also implies the need to apply an indirect adjustment to the amount of the financial result, and not a direct recalculation of both the amount of receivables and recognized revenue or other income (if the fact of occurrence and

recognition of receivables is related to the recognition of revenue or other income).

Thus, the economic essence of the doubtful debt reserve can be defined as follows. The reserve is a virtual value that has a dual nature: on the one hand, it is a value that adjusts the amount of receivables to determine the real amount receivable from debtors. On the other hand, it is the amount of possible losses, including lost profits, arising from default by debtors of their obligations. The value of the reserve as a reporting indicator for management purposes is a characteristic of the state of the risk management system in terms of the risk of default by debtors.

To substantiate the described economic nature of the reserve for doubtful debts, the authors have analyzed the reasons for the reserve formation and the role of the reserve as an estimated indicator in risk management.

4 CONCLUSIONS

The article explores and describes the nature and economic essence of the doubtful debt reserve from the standpoint of risk management of an economic entity. The authors have revealed the incompleteness of the description of the nature and essence of the reserve in normative acts and literary sources, namely:

1. The dual nature of the reserve has not been investigated.

2. It has not been underlined that the reserve is a virtual object.

3. The reserve is expressed in monetary terms, and not as a consequence of the real movement of resources.

4. Formation of the reserve in general and, in particular, in Russian accounting practice, is compliance with the requirements of regulations governing accounting, and is not conditioned by the subjective desires of the management of an economic entity. Therefore, the reserve, as an accounting object, is imposed from the outside, its reflection is an objective external established obligation.

5. The nature of the reserve is not disclosed as an indicator characterizing the risk management system from the standpoint of preventing the risk of default by debtors.

Therefore, the authors of the article have made an attempt to eliminate these shortcomings in describing the economic essence and nature of the reserve for doubtful debts.

The results of this study can be used further to identify and substantiate problems in the organization

and accounting of this object, to develop measures to solve them.

Moreover, the results of the study can be used as working hypotheses in substantiating the reasons for refusing to form a doubtful debt reserve, which can be carried out using the methods of sociological research.

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