SPECIFIC ACCOUNTING POLICIES ON PUBLIC INSTITUTIONS RELATED TO PROVISIONS, CONTIGENT LIABILITIES AND CONTIGENT ASSETS

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Abstract

Nowadays, the activity performed by professional accountants should be transparent and the communication process should be an efficient one so that the data transmitted is relevant and reliable. Such characteristics can become achievable only within a quality accounting referential, based on international accounting standards likely to integrate the public field particularities. The need to obtain comparable and transparent information in the public sector has determined the emergence of IPSAS standards, high quality standards with benefice consequences upon the world economy.

The purpose of the disclose study is to analyse the development of accountancy in Romania and the level of accounting harmonization and convergence with IPSAS 19 "Provisions, contingent liabilities and contingent assets". We are also focusing on performing a comparison between the main characteristics of the disclose national and international regulations, with the mention of resemblances and differences on provisions, contingent liabilities and contingent assets in order to identify the range of convergent and divergent issues.

Key words: provisions, onerous contract, contingent liability, contingent asset, appraisal

JEL Classification M41

Introduction

Public institutions accountancy as a field seems to be a domain open and receptive to changes occurring in the political, economic, social and cultural environments. Thus, the disclosed international requirements have entailed the legitimating of a common financial reporting language. This evolution considers as much as possible, the improvement and reduction of differences between national accounting regulations and practices, aiming to elaborate principles and rules of a general character likely to determine the comparability of data provided by the content of financial statements issued by the public sector, as well as to reduce the differences between accounting regulations of different countries.

This paper aims to be an analysis of the level of convergence and harmonization of national accounting rules with a view to recognizing and performing operations related to construction contracts in compliance with the international accounting standard for the public sector that is ISPAS 19 "Provisions, contingent liabilities and contingent assets".

1. Conceptual delimitations on contracts, provisions, contingent liabilities and assets

Analysing the national accounting convergence issues in comparison with international standards for the public sector, we have noticed certain "omitted" aspects in national regulations. Thus, the standard ISPAS 19 "Provisions, contingent liabilities and contingent assets" develops aspects related to both provisions and contingent liabilities and contingent assets which national accounting regulations do not refer to.

In defining and recognizing a provision there are convergences, such as:

O.M.F.P. no.1917/2005	IPSAS 19 "Provisions, contingent liabilities and contingent assets"
The provision is a liability of uncertain chargeability or amount. A provision shall be recognised only when: − an institution has a current obligation determined as a result of a past event; − an outflow of resources can be required to settle that obligation, and − a sufficiently reliable estimate of the amount of the obligation can be made. Unless such conditions are met, a provision shall not be recognised.	The provision is a liability of uncertain timing or amount. A provision shall be recognised only if the following conditions are simultaneously fulfilled: − an entity has a current obligation (legal or constructive) determined as a result of a past event; − an outflow of resources embodying economic benefits or possible services can be required to settle that obligation, and − a sufficiently reliable estimate of the amount of the obligation can be made. Unless such conditions are met, a provision shall not be

O.M.F.P. no.1917/2005	IPSAS 19 “Provisions, contingent liabilities and contingent assets”
	recognised.

The measurement of a provision occurs as such:

O.M.F.P. no.1917/2005	IPSAS 19 “Provisions, contingent liabilities and contingent assets”
The recognised amount of a provision must reconstitute the best estimate on the date of balance sheet of the expenditures necessary to settle a disclose obligation. Provisions cannot exceed from the point of value of their value the amounts which are necessary for the settlement of the disclose obligation on the date of balance sheet.	The amount recognized as a provision shall be the best estimate of the expenditure required to settle the disclose obligation at the reporting date. The best estimate of the expenditure required to settle the disclose obligation is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate. Future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur. Where the effect of the time value of money is material, the amount of a provision shall be the disclose value of the expenditures expected to be required to settle the obligation. Provisions shall not be recognized for net deficits from future operating activities.

There cannot be seen any convergence between national rules and ISPAS 19 “Provisions, contingent liabilities and contingent assets”, in the respect of contingent liabilities and contingent assets.

A contingent liability is [IFAC, p. 582]:

a. A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
b. A disclose obligation that arises from past events, but is not recognized because:
   - It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
   - The amount of the obligation cannot be measured with sufficient reliability

An entity shall not recognise a contingent liability. In case the entity has a liability commonly engage with other parties, this one is considered a contingent liability.

Contingent liabilities are continuously assessed for determining whether there has appeared an outflow of resources embodying economic benefits or possible services, as if such probability occurs a provision shall be recognised in the financial statements for the period of time when the adjustment of the probability on the outflow of resources occurred (for example, in case of a violation of a legal provision on the environment protection, it is not certain whether the environment was affected or not. In case it becomes clear that the environment was affected and that certain remedies are necessary, and then the entity shall recognise a provision, as the outflow of economic benefits becomes now probable).

ISPAS 19 “Provisions, contingent liabilities and contingent assets” makes the difference between provisions and contingent liabilities as follows:

a. All provisions are contingent because they are uncertain in timing or amount. Provisions are recognized as liabilities (assuming that a reliable estimate can be made) because they are disclose obligations and it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations; and
b. Contingent liabilities are not recognized as liabilities because they are either:
   - possible obligations, as it has yet to be confirmed whether the entity has a disclose obligation that could lead to an outflow of resources embodying economic benefits or service potential; or
   - disclose obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation can not be made).

A contingent asset is a possible asset as a result of past events and whose existence shall be confirmed only by the emergence or non-emergence of one or more uncertain future events which cannot be entirely under the control of the entity [IFAC, 2009 p.582].

Contingent assets usually arise from unplanned or other unexpected events that are not wholly within the control of the entity, and give rise to the possibility of an inflow of economic benefits or service potential to the entity (for example the emergence of a claim subject to a legal outcome whose conclusion is still uncertain).

Contingent assets are not recognized in financial statements, since this may result in the recognition of revenue that may never be realized. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits or service potential will arise and the asset's value can be measured reliably, the asset and the related revenue are recognized in the financial statements of the period in which the change occurs. If an inflow of economic benefits or service potential has become probable, an entity discloses the contingent asset.

Provisions in compliance with the national accounting provisions under O.M.F.P. no.1917/2005 are elements of permanent sources for the institution of uncertain chargeability or amount and which occur as a result of applying the principle of prudence. They are meant for financing risks and expenditures that past and disclose events make possible, public institutions being able to make provisions for issues such as: litigation, fines, penalties, damages, damages and other doubtful debts, provisions for warranty's to customers, including work service, provisions for decommissioning of tangible fixed assets, provisions for restructuring other provisions

According to international accounting standards for the public sector, provisions can be recognised in the following situations [Ţenovici, C.O., 2013, p. 87]:

Event	**Disclose obligation determined by a past obligating event**	**Outflows of resources necessary for the settlement of obligation**	**Recognition means**
Warranty's granted	The obligating event is the selling of the product with a warranty period, a fact which gives rise to a legal obligation.	The outflows of resources are probable for the warranty as a whole.	A provision is recognised for the best estimate of the restoration costs for the products sold before the reporting date.
The promulgation of a law on the existence of a contaminated geographical area.	The obligating event is the contamination of a geographical area and the promulgation of law requiring decontamination.	Outflows of resources are probable.	A provision is recognised for the best estimate of the decontamination costs.
The contamination of a geographical area and its implicit decontamination.	The obligating event is the contamination of a geographical area and the implicit obligation is the decontamination of such area.	Outflows of resources are probable.	A provision is recognised for the best estimate of the decontamination costs.
Gravel quarries exploitations	The obligating event is the construction of buildings in the exploitation area and the obligation to restore the area.	Outflows of resources are probable.	A provision is recognised for the best estimate of demolition and restoration costs.
Applying reimbursement policy	The obligating event is the selling of products, a fact which gives rise to an implicit obligation as the entity has caused buyers to expect reimbursement.	It is probable that a part of the sold product to be returned for reimbursement.	A provision is recognised for the best estimate of the reimbursement costs.
The outsourcing of a business division and the implementation is done before the reporting date	The obligating event is the transmission of decisions to the employees, a fact which give rise to an implicit obligation, as it determines them to expect the division activities to be outsourced.	Outflows of resources are probable.	A provision is recognised for the best estimate of the costs determined by the oursourcing of the division's activities..
The existence of an onerous contract. *	The obligating event is the signing of an onerous contract which gives rise to a legal obligation.	Outflows of resources are probable.	A provision is recognised for the best estimate of the unavoidable payments as a result of the onerous contract.
Granting a unique warranty	The obligating event is the granting of a unique	Outflows of resources are probable.	A provision is recognised for the best estimate of the

Event	Disclose obligation determined by a past obligating event	Outflows of resources necessary for the settlement of obligation	Recognition means
	warranty which gives rise to a legal obligation.		obligation to grant the warranty.
The existence of a litigation	Based on available evidence (generated by the existence of a litigation) there is a disclose obligation.	Outflows of resources are probable.	A provision is recognised for the best estimate of fulfilling the obligation as a result of a final decision.

* An onerous contract is a contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it. [IFAC, 2009, p.583]. If an entity has a contract that is onerous, the disclose obligation (net of recoveries) under the contract shall be recognized and measured as a provision**.**

Both national regulations in force and IPSAS 19 focus on issues concerning the reorganisation/restructuring of public institutions/public sector entities activity, such as:

Law no.329 / 5.11.2009	IPSAS 19 “Provisions, contingent liabilities and contingent assets”
According to legal regulations in force, reorganization of public institutions in Romania, is achieved due to the following events: a. Abolishing public authority or institutions, through the merger by absorption, and taking its business to another existing public authority or institution; b. Abolishing public authority or institutions, through the merger by absorption, and taking its business to a newly formed division within other authorities or public institutions; c. The abolition of authorities or public institutions, through the merger by absorption, and the foundation of a new legal entity; d. Dismantling a public authority or institution as a result of the division, and taking its activity by two or more existing entities or likely to be founded; e. The reduction of positions within public authorities or institutions; f. The change of the funding regime of authorities or public institutions, by transferring revenue received from the state budget and financing expenditures from the state budget.	The following are examples of events that may fall under the definition of restructuring: (a) Termination or disposal of an activity or service; (b) The closure of a branch office or termination of activities of a government agency in a specific location or region, or the relocation of activities from one region to another; (c) Changes in management structure, for example, eliminating a layer of management or executive service; and (d) Fundamental reorganizations that have a constructive obligation to restructure arises only if: A constructive obligation to restructure arises only when: a. an entity has a detailed formal plan for the restructuring identifying at least: − the activity/operating unit or part of an activity/operating unit concerned; − the principal locations affected; − the location, function, and approximate number of employees who will be compensated for terminating their services; − the expenditures that will be undertaken; − when the plan will be implemented; and b. has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it

IPSAS 19 stipulates that a provision for restructure can be made only if the general criteria for recognising provisions are met.

The standards also refer to the possibility of reimbursement regarding the constituted, differently from Romanian regulations which do not mention anything in this regard. Thus, in case they estimate that a part or all the expenditure needed for the settlement of a provision shall be reimbursed by a third party, the reimbursement shall be recognised only when it is certain it will be received if the entity settles its obligation. Reimbursement shall be considered as a separate asset. The value recognised through reimbursement shall not exceed the value of the provision [IFAC, 2009, p. 593].

As far as the adjustment and use of provisions are concerned, there is a convergence between national and international regulations, such as:

O.M.F.P. no.1917/2005	IPSAS 19 “Provisions, contingent liabilities and contingent assets”

O.M.F.P. no.1917/2005	IPSAS 19 “Provisions, contingent liabilities and contingent assets”
Provisions must be revised on the date of each annual balance sheet and adjusted in order to reflect the best disclose estimate. In the event that for the settlement of an obligation there is not probable an outflow of resources or the outflow of resources has just occurred, the provisions must be cancelled by recurring to incomes. The provisions shall be used only in the purpose for which it was initially recognised.	Provisions must be revised on the date of each annual balance sheet and adjusted in order to reflect the best disclose estimate. In the event that an outflow of resources embodying economic benefits and service potential is no longer possible for settling an obligation, the provisions must be reconsidered. A provision shall be used only for expenditures for which the provision was originally recognized.

Data on provisions are disclosed in financial statements such as:

<table>
<tr><th>O.M.F.P. no.1917/2005</th><th>IPSAS 19 “Provisions, contingent liabilities and contingent assets”</th></tr>
<tr><td>
Data on provisions are included in the balance sheet of the public institution, at the beginning, respectively, at the end of the financial year, grouped according to the two current/recurrent categories.
<table>
<tr><td>B</td><td>DEBTS</td></tr>
<tr><td></td><td>NON-CURRENT DEBTS- amounts to be paid over one year</td></tr>
<tr><td>1</td><td>NON-CURRENT PAYMENT AMOUNTS (ct. 4042+269+46
out of which
Trade payables(ct. 4022+4622)</td></tr>
<tr><td>2</td><td>Long-term loans
1612+1622+1632+1642+4652+166+1672+168+169)</td></tr>
<tr><td>3</td><td>Provisions (ct 151)</td></tr>
<tr><td></td><td>TOTAL NON-CURRENT DEBTS (line 24+25+26)</td></tr>
<tr><td>1</td><td>CURRENT DEBTS – amounts to be paid over one year (line 29
out of which</td></tr>
<tr><td></td><td>Trade payables and advance payments
401+403+4041+405+408+419+4621+473+481+482+483+269)
which</td></tr>
<tr><td></td><td>Trade payables (ct. 401+403+4041+405+408+4621)</td></tr>
<tr><td></td><td>Debts with the Treasury
440+441+4423+4428+444+446+4481+4671+4672+4673+4674</td></tr>
<tr><td></td><td>Debts towards the European Community
4502+4512+452+4532+4542+4552/</td></tr>
<tr><td>2</td><td>Short-term loans – amounts to be paid within one y
5186+5191+5192+4194+5195+5196+5197+5198)</td></tr>
<tr><td>3.</td><td>Long-term loans – amounts to be paid during the current finan
(ct. 1611+1621+1631+1641+1651+1671+168+169)</td></tr>
<tr><td>4.</td><td>Personnel-related salaries and related contributio
421+423+426+427+4281+431+437+438)</td></tr>
<tr><td>5.</td><td>Other similar rights granted to other individuals (
unemployment allowances, scholarships) (ct. 422+424+429)</td></tr>
<tr><td>6.</td><td>Deferred income (ct. 472)</td></tr>
<tr><td>7.</td><td>Provisions (ct 151)</td></tr>
<tr><td></td><td>TOTAL CURRENT DEBTS (line 28+32+33+34+35+36+37)</td></tr>
<tr><td></td><td>TOTAL DEBTS (line 27+38)</td></tr>
</table>
There is no further information on the provisions disclosed under explanatory notes (annexes to financial statements).
There is no further information on contingent liabilities and contingent assets, as they are not included in the present accounting regulations.
</td><td>
For each class of provisions, an entity must disclose:
a. the accounting value at the beginning and at the end of the period;
b. additional provisions made during that period, including an increase of the existent provisions;
c. the values used (the ones which appear and were paid from the provision) during that period;
d. the increase old updated value during the period due to the effect of time and adjustments dues to the increase of discount rate.
Comparative data are not necessary.
In the event that the entity chooses to recognise in its financial statements provisions for social benefits for which it does not receive directly from its beneficiary a consideration at least equal to amount of goods and services provided, it shall submit data on such provisions such as outlined above. .
An entity shall disclose for each class of provisions:
a. a brief description on the nature of obligation and the estimate of timing of any outflow of economic benefits or service potential;
b. the level of uncertainty related to the value or timing of such outflows. In the event that the provision of adequate information is necessary, the entity shall disclose the main data concerning future events, and:
c. the value of any envisaged reimbursement as the value of all assets recognised for the mentioned reimbursement is maintained.
</td></tr>
</table>

2. Accounting disclosure of events and transactions on provisions

Example 1 – provisions for litigation: a public institution is involved in a law suit with a client claiming damages of 40.000 lei (Romanian currency units) under operation N. the trial will continue under operation N+1 at the end of which the final decisions will be rendered. In accordance with the final decisions, the public institution is obliged to pay damages of 48.000 lei.

a. In operation N the public institution makes the provision for damages:

6812	=	1511	40.000 lei
"Operating expenditures for provisions"		"Provisions for litigation"	

b. In operation N+1 the increase of the provision set occurs:

Provision set:	40.000 lei
Provisions needed:	48.000 lei
Provisions increase:	8.000 lei

6812	=	1511	8.000 lei
"Operating expenditures for provisions"		"Provisions for litigation"	

c. According to the final judgement on the payment of damages the previously set provisions is cancelled:

1511	=	7812	48.000 lei
"Provisions for litigation"		„Incomes from provisions"	

Example 2 – provisions for warranties granted to clients. In operation N a provision is set for warranties granted to clients for the amount of 16.000 lei (Romanian currency units). The warranty related expenditures in operation N represent 10.400 lei, out of which salaries related expenditures 6.400 lei, materials 4.000 lei. At the end of operation N the institution considers that the estimated value of repairs will be of 14.000 lei and it shall operate a corresponding decrease of provisions.

a. The provisions for warranties under operation N**:**

6812	=	1512	16.000 lei
"Operational expenditures for provisions"		"Provisions for warranties granted to clients"	

b. Recording warranty-related expenditures occurring in operation N (materials and workmanship):

602	=	302	4.000 lei
"Expenditures for consumables"		"Consumables"	
641	=	421	6.400 lei
"Expenditures for staff salary"		"Staff- outstanding salaries"	

c. Cancellation of the existent provision at the end of operation N:

provision set:	16.000 lei
provision needed:	14.000 lei
Provision cancellation:	2.000 lei

1512	=	7812	2.000 lei
"Provisions for warranties granted to clients"		„Incomes from provisions"	

Example 3 – provisions for restructure: under governmental decisions they decide on the closing of division within a governmental agency on the basis of a detailed plan related to a restructure operation. The estimated expenditures are: severance payments to redundant employees 90,000 lei, loss of guarantees made by utility providers 3,000 lei. Estimated revenue for the sale price of the building where that division is headquartered 300,000 lei. The accounting value of the building is of 750.0000 lei, with a depreciation amounting to 70%.

a. the provision for restructure (the recognition value of provision is given by the total amount of expenditures estimated for the restructure):

6812	=	1518	93.000 lei
"Operational expenditures for provisions"		"Other provisions"	

b. registration of operations determined by the actual restructure:

b1. Granting severance payments:

679	=	4621	90.000 lei
"Other expenditures"		"Lenders under one year"	

b2. Loss of warranties granted for utility providers:

663	=	267	3.000 lei
„Loss of receivables"		„Receivables"	

b3. Selling of the building headquartering the restructured division (VAT is not included for such an operation):

4611	=	791	300.000 lei
„Lenders under one year"		„Revenues from the sale of state assets"	

b4. The sold building is no longer the object of accounting registration (partially liquidated):

%	=	212	750.000 lei
		„Buildings"	

2812 „Depreciation of buildings"			525.000 lei (70% x 750.000 lei)
691 „Extraordinary expenditures from operations with fixed assets"			225.000 lei

c. cancellation of provisions at the completion of restructure action:

1518 "Other provisions"	=	7812 „Incomes from provisions"	93.000 lei

Conclusions:

The performed analysis highlights the fact that a part of IPSAS 19 standards "Provisions, contingent liabilities and contingent assets" was taken over or not taken over from national accounting rules, respectively the similar or different approach on some accounting issues. As the present international requirements have entailed the legitimating of a common financial reporting language, an aspect requesting for the necessity to introduce in the Romanian accounting regulations elements concerning contingent liabilities and assets, I consider that such a proposal can determine an improvement of accounting information quality and creditworthiness.

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