European Journal of Accounting, Finance & Business

Volume **VIII**/2018 ISSN 2344-102X
Issue (XVIII) / **October** 2018 ISSN-L 2344-102X

RECOGNITION AND MEASUREMENT OF PROVISIONS IN THE ACCOUNTING OF PUBLIC INSTITUTIONS ACCORDING TO NATIONAL AND INTERNATIONAL LAW

Lecturer Marian SOCOLIUC*
”Ștefan cel Mare” University of Suceava, Universității Street, no. 13, Suceava, Romania

Abstract
This paper aims to delimit the conditions for recognition and the assessment of provisions in the accounting of public institutions in Romania in the context of the last legislative amendments of the Order of the Minister of Public Finance no. 1917/2005, imposed by the implementation of the international public sector accounting standards (IPSAS) in the Romanian accounting. The paper also analyses the differences in the accounting legislation between provisions and debts, as well as the peculiarities of the recognition and evaluation of provisions.

Keyword: provisions, recognition, assessment, IPSAS.

JEL Classification: H83, M41

I. Introduction

According to the national accounting regulations (O.M.FP No. 1917/2005, as subsequently amended and supplemented), the provision is a debt with an uncertain chargeability or value.

In terms of value, provisions cannot exceed the amounts that are “required to settle the current obligation at the balance sheet date”.

Unlike value adjustments, provisions cannot be used to correct the value of assets. Cases provisions may be made for are, for example**:**

* *Corresponding author: Marian SOCOLIUC, E-mail: mariansocoliuc@yahoo.com*

- “Litigations, fines and penalties, compensations, damages and other uncertain debts”;
- “Expenses related to the service during the guarantee period and other expenses related to the guarantee for the clients”;
- Restructuring, social benefits.

A public institution shall recognize a provision only when the following conditions are met simultaneously (Rădescu, 2016):

Table 1- Conditions for provisons recognitions

Conditions for provisions recognition	Description of conditions	Observations
1.The institution has “a current obligation generated by a previous event”	Although national accounting regulations do not explicitly disclose a set of collateral concepts for provisions, we consider that the following additions are required in the International Public Sector Accounting Standards (IPSAS) and IPSAS 19, “Provisions, contingent liabilities and contingent assets”, respectively. **Thus, the current obligation is a legal or implicit obligation.** **The legal obligation** is the obligation resulting from a contract (explicitly or implicitly), from the law or from the effect of the law. **Implied obligation** is the obligation arising from the shares of an entity / institution if: ✓ “by establishing an earlier practice, through the written policy of the entity or by a sufficiently specific statement, the institution has indicated to its partners that it assumes certain responsibilities”; and ✓ “as a result, the institution has induced the partners he idea that they will honour those responsibilities”. In cases where the existence of the current obligation is questionable, it is considered that an earlier statement generates “a current obligation if, taking into account all the evidence available, it is more likely that there is a current reporting obligation on the reporting date”. Although, in general, the existence of an obligation of a public institution implies the existence of another party (the one the obligation manifests itself with), knowledge of the identity of this party is not mandatory given the objective of the public sector to meet the expectations of the public, the community.	*Therefore, public institutions will recognize in the accounting as provisions only the liabilities generated by previous events that are independent of their future actions.*

European Journal of Accounting, Finance & Business

Volume **VIII**/2018 ISSN 2344-102X
Issue (XVIII) / **October** 2018 ISSN-L 2344-102X

Table 1- *Cont.*

Conditions for provisions recognition	Description of conditions	*Observations*
	In public institutions, events that do not immediately generate an obligation may occur, but subsequently, as a result of legislative changes or actions taken by them, and which imply an implicit obligation. If a new proposed law is at the stage of discussing certain points, the legal obligation will only be generated when it is certain that the law will be promulgated according to the project. **The previous event** is an event that binds. To be considered an event binding the institution, it must not have any realistic alternatives to settle the obligation arising from the occurrence of the event. Such a situation arises when the "settlement of the obligation can be imposed by law or in the case of an implied obligation, when the event instigates to the partners the idea that the institution will honour its obligation".	
2. It is likely that an outflow of resources will be required to honour that obligation	According to IPSAS 19 "Provisions, contingent debts and contingent assets", an outflow of resources is considered probable if the chances of occurrence of that event are greater than the probability of non-occurrence. If there is no probable existence of a current obligation, the institution presents a contingent debt, unless an outflow of resources incorporating economic benefits or possible services is unlikely. Where there are several similar obligations, the probability of an outflow of resources being required to settle the obligation is determined by considering the class of obligations as a whole. If, in the case of an obligation, the probability of resource outflow is low, it may be probable that an outflow of resources is required for the settlement of the class of obligations as a whole.	

European Journal of Accounting, Finance & Business

Volume **VIII**/2018 ISSN 2344-102X
Issue (XVIII) / **October** 2018 ISSN-L 2344-102X

Table 1- *Cont.*

3. A credible estimate of the amount of the obligation can be made		If the aforementioned conditions 1, 2, and 3 are not met, the public institution will **not** recognize a provision.

Source: The author's own processing

II. Evaluation of provisions in accounting

According to IPSAS 19 "*Provisions, contingent debts and contingent assets*", the value recognised as a provision should be the best estimate of the "expense required to settle the current obligation at the reporting date".

"The best estimate of the expense required to settle the current obligation is the amount that the institution will reasonably pay to settle the obligation at the reporting date or to transfer it to a third party at that time".

The estimation of financial results and effects is based on the way in which the management of the institution is analysed, the experience gained through similar transactions, as well as reports prepared by independent experts. Also, the elements considered include additional evidence provided by events occurring after the reporting date.

As for the uncertain elements regarding the value of the provision that will be recognised in the accounting, they are different.

Thus, if the provision involves several elements, the institution will estimate the obligation by weighing all the possible outcomes with the likelihood of each realisation.
If there is a range of possible outcomes and the individual probabilities of achievement are equal, the institution will use the midpoint of the interval. If the institution assesses a single obligation, the individual outcome may be the best estimate of the debt. However, the institution should also consider "other possible outcomes, either predominantly higher or predominantly lower than the most likely outcome".

In the process of determining the best estimate, the institution must also take into account the risks and uncertainties generated by the various circumstances. *From this perspective, the institution must apply the principle of prudence, not to overstate the incomes and the assets, respectively to not subdue the expenses and debts.*

European Journal of Accounting, Finance & Business

Volume **VIII**/2018 ISSN 2344-102X
Issue (XVIII) / **October** 2018 ISSN-L 2344-102X

Another element to be taken into account in estimating the provision value is "the significant time-value effect of money". Thus, the amount of the provision will be the amount of estimated expenses required to settle the obligation.

If the provision is updated over a certain number of years, the actual value of the provision will increase each year as the provision approaches the estimated settlement date. The discount rates used by the institution shall reflect the current cash-based payment assessments of the money and the specific risk of the debt.

With regard to the impact of future events on the amounts required to settle an obligation, these will be accounted for in the provision value if there is sufficient evidence of those events taking place.

As regards the change and use of provisions, they should be reviewed at each annual financial report and adjusted to reflect the best current estimate. If, for the settlement of an obligation, an outflow of resources is" no longer probable or the outflow of resources has taken place", the provision has to be cancelled by resuming income. Provisions will be used by public institutions only for the purpose for which they were initially recognized in the accounting.

III. Differentation between provisions and debts

The differences between provisions and debts are presented as it follows (see Table 2):

Table 2 - Differentiation between provisions and debts

Provisions versus commercial debts	**Provisions versus contingent debts**
The fundamental particularity that differentiates provisions and trade debts is the uncertainty over time positioning or the value of future expenditure required to settle the debt. Compared to provisions, trade debts represent obligations to pay for goods/services received by the institution on an invoice basis from suppliers/dispatched by suppliers or whose payment has been formally established with suppliers.	IPSAS 19 "Provisions, contingent debts, contingent assets" defines contingent liability as: • "a possible obligation arising from past events whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events that cannot be wholly under the control of the entity"; or • "current obligation generated by past events but not recognized because: - it is unlikely that resources will be required to incorporate economic benefits or possible services to settle this obligation; or

European Journal of Accounting, Finance & Business

Volume **VIII**/2018 ISSN 2344-102X
Issue (XVIII) / **October** 2018 ISSN-L 2344-102X

Table 2- *Cont.*

Provisions versus commercial debts	Provisions versus contingent debts
	- the value of the obligation cannot be evaluated sufficiently reliably". Although at first glance, contingent provisions and debts interfere in terms of time positioning or of the value of future expenditure required to settle the debt, a thorough analysis of these reflects that **contingent liabilities are unrecognizable in contrast to contingencies accounting as debts because**: they are possible but must be confirmed by the entity; or they are "current obligations that do not meet the recognition criteria".

Source: The author's own processing

IV. Particularities regarding the recognition of provisions in accounting

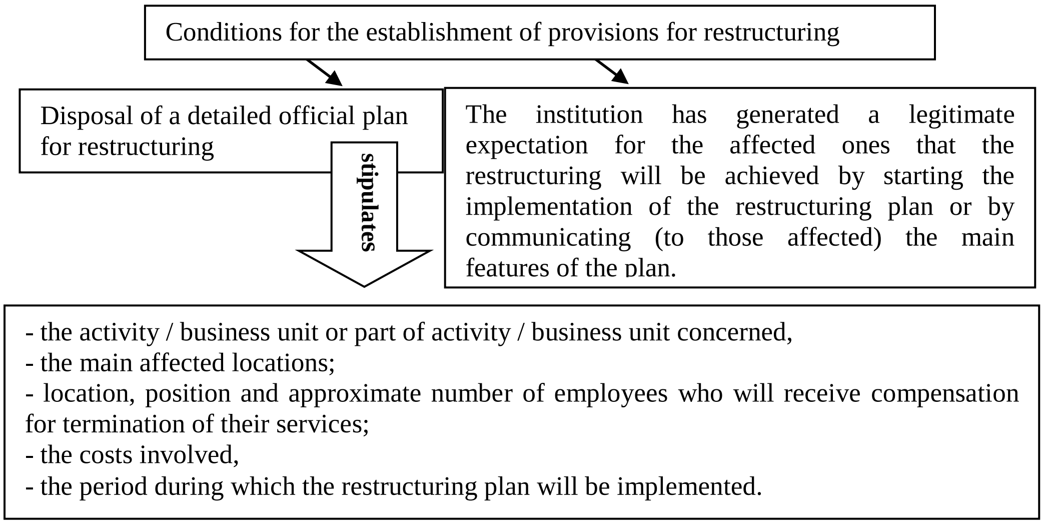
The aspects regarding the provisions are not fully and explicitly presented in O.M.F.P. no. 1.917 / 2005, as amended and supplemented. An example of this is the provisions for restructuring that are detailed in IPSAS 19 "*Provisions, contingent debts and contingent assets"*. According to IPSAS 19, a "restructuring is a planned and controlled management program" that significantly changes: either the field of activities of an entity;either the manner in which those activities are carried out. Restructuring can take place at the level of the entire government, at the portfolio level or at the ministry or agency level.

The events for which restructuring provisions may be made are as follows:

- "conclusion or cession of an activity or service";
- "closure of a branch or cessation of activities of a government agency in a specific location or region or relocation of activities from one region to another";
- "modifications of the management structure; for example, the removal of a senior management or executive service";
- "fundamental reorganizations that have a significant effect on the nature and the main object of the entity's activities".

Restructuring provisions are made only under the following conditions shown in the figure 1:

Figure 1 - Conditions for the establishment of provisions for restructuring



Source: own elaboration

The ways in which a government or public institution proves that the *implementation of the restructuring plan* has begun may be the following:

- public announcement of the main features of the restructuring plan;
- sale or transfer of assets;
- notification of the intention to cancel the leasing or leasing contracts
- establishing alternative commitments for service customers

For a plan to be sufficient to generate an implied obligation when it is communicated to the affected person, implementation is planned to begin as soon as possible and be completed within a timeframe where the significant change to the plan to be unlikely.

If the restructuring is expected to start over a longer period of time or it will be unjustifiably long, it is unlikely that the plan will cause other parties to reasonably expect that" the government or individual entity is currently engaged to carry out the restructuring because the timeframe allows the government or entity to modify their plans".

Volume **VIII**/2018 ISSN 2344-102X
Issue (XVIII) / **October** 2018 ISSN-L 2344-102X

"A restructuring decision taken by the management or the management body before the reporting date does not imply an implicit obligation on the reporting date unless, before that date, the entity":

- "started the implementation of the restructuring plan"; or
- "has announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to cause them to reasonably expect the entity to carry out the restructuring".

However, there are also cases where an implied obligation can arise from correlating the management's decision to restructure with other past events.

An example of this is the negotiation with employees' representatives on termination benefits / buyers for the sale or transfer of an activity unit - which can be completed only with the approval of the management body or board of directors.

It should be noted that a restructuring provision should only include direct restructuring costs, that is, those that are necessarily generated by the restructuring process and not related to the on-going activities of the entity.

Expenditures that do not include a provision for restructuring are those related to re-qualification or relocation of "permanent staff, marketing or investment costs in new distribution systems and network".

V. Conclusions

From the above, we can emphasize that it is of a particular importance to verify the criteria for the cumulative recognition of provisions in the accounting of public institutions, and especially their assessment way. Public institutions will recognise in accounting as provisions only liabilities arising from previous events that are independent of their future actions. Unless the recognition criteria are met, then the provisions will be evaluated and recorded in the accounting. In the process of assessing provisions, public institutions must apply the principle of prudence, not to overstate the incomes and assets, respectively not to subdue the expenses and debts.

References

Books

1. Colectiv Rentrop & Straton. (2017). *Consilier - Contabilitatea pentru instituții publice*. Ghid practic, Rentrop&Straton.

Volume **VIII**/2018 ISSN 2344-102X
Issue (XVIII) / **October** 2018 ISSN-L 2344-102X

2. Rădescu, N. (2016). *Consilier - Contabilitatea pentru instituții publice*. Ghid practic, Rentrop&Straton.

Legislation

3. OMFP 1917/2005 on the approval of the Methodological Norms regarding the organization and management of the accounting of public institutions, the plan of accounts for public institutions and the instructions for its implementation, updated 2019.
4. IPSASB. (2016). *Manualul de Norme Internaţionale de Contabilitate pentru Sectorul Public,* CECCAR, Bucharest.
5. IPSAS International Accounting Standards for the Public Sector. (2009). *IPSAS 19 – Privileges, liabilities and contingent assets,* CECCAR., Bucharest.

Internet source

6. International Public Sector Accounting Standards Board. Retrieved November 5, 2018 from: https://www.ifac.org/system/files/publications/files/ipsas-19-provisions-c.pdf.