

FINANCIAL IMPLICATIONS ON THE BUDGETS OF ADMINISTRATIVE-TERRITORIAL UNITS IN THE CONTEXT OF DEFAULT ON ACCRUAL ACCOUNTING REQUIREMENTS

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Abstract:

Following the audit/control missions, there were registered inaccurate situations which concern the correct registration of financial and exceptional operation revenues and expenditures, based on documents attesting their way and content. Thus, in the relation between the local budget of the administrative-territorial unit and two trading companies of local interest, with regard to the granting of subventions to the two companies, there were identified certain value discrepancies between the amounts approved by the local budget, in less and those provided in the budgets of the entities under discussion. The discrepancies of the budgets mentioned above had direct consequences on the reality of financial statements of the respective partners, on their budgets and on the fiscal regimes of the local subordination entities.

Key words: accrual accounting, arrears, Public Debt, accounts payables, VAT.

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According to the provisions of Romania's Constitution and of the Regulation for Organizing and Functioning, the Romanian Court of Auditors controls the acquiring, management and use of the State's and public sectors financial resources.

Also, according to the legislation, the Court of Auditors is the only institution qualified to certify the accuracy and verity of the information of the verified execution accounts, as described by article 26 of the Law, aiming at and ensuring that:

- the audited fiscal situations are drawn by the entity in accordance with the financial reporting framework applicable in Romania, they observe the principles of legality and regularity and provide a true image of the financial state and performance related to the specific activity of the concerned entity.

Based on the Organizing and Functioning Law, „*the control function of the Court of Auditors is exerted through external public audit procedures stipulated in the specific internal audit standards, drawn in accordance with the general accepted international audit standards*”.

In accordance with the above-mentioned, we have to specify that the new audit standards used by the Court of Audit at the present time were approved by Plenum Decision no. 22 as of February 6, 2011.

Law no. 94/1992, republished, defines audit standards as „*the set of concepts, guiding principles, procedures and methods according to which the external public auditor establishes the verification stages and procedures in order to achieve the objective set*”.

Since the practical approach refers to the observance of the legal provisions regarding public accountancy by the public institutions, we believe that the following aspects have to be highlighted:

A. The legal frame regulating the public accountancy at national level

The main legal documents setting up the legal frame of the public institution's accountancy¹, at national level, are the following:

- Law no. 82/24 December 1991, on accountancy, republished, modified and completed;
- Law no. 500/11 July 2002, on public finances, modified and completed;
- Law no. 273/29 June 2006, on local public finances, modified and completed;
- The Resolution issued by the Ministry of Public Finances no. 1917/12 December 2005, for approving the methodological Norms for organizing and managing public institution's accountancy, the Chart of Accounts for public institutions and the application guidelines;
- The Resolution issued by the Ministry of Public Finances no. 3055/29 October 2009 (*updated*), for approving the Accounting Regulations harmonized with European Directives – specifically for Autonomous Public Entities, Trading Companies (nationally or locally subordinated), National Companies.

1. The public institutions' financial statements

As per the above-mentioned legal documents, the financial statements have to provide a true image of the financial state, performances, and other information as required by the legislation, on the specific operations.

The public institutions draw up quarterly and annual financial statements on the budget implementation, in accordance with the norms issued by the Ministry of Public Finances, signed by the fund manager and by the Head of the Financial and Accounting Department or by other mandated person. There might be situations where public institutions have no employee for financial and accounting position; in this case, the documents should be signed by the fund manager and by the legally authorized natural or legal persons.

The financial statements are drawn on quarterly and annual base and include:

- a) The Balance Sheet;
- b) The Profit and Loss Account;
- c) The statement on Treasury Funds;
- d) The situation regarding modifications of assets/capitals;
- e) Annexes to the financial statements including: accounting policies and explanatory notes;
- f) The Budget Execution Account.

2. The public accountancy's components

According to Law no. 82/1991, article 2, paragraph (2) and to the Decision no. 1917/12.12.2005 issued by the Ministry of Public Finances for approving the Methodological Norms on organizing and performing accounting within public institutions, the Chart of Accounts for public institutions and the application guidelines, chapter I, point 1.1., the public institutions' accountancy includes:

- a. The accounting of budgetary incomes and expenditures which reflects the collection of incomes and payment of expenditures related to the fiscal year;

¹ According to art. 2, point 30 of Law no. 500/2002, on public finances, the public institutions are defined to be „the umbrella term including the Parliament, The Presidential Administration, the Ministries, other specialised public administration bodies, other public authorities, autonomous public institutions and the subordinated institutions, regardless of their source of financing”.

- b. The accounting of the State Treasury;
- c. General accounting based on the principle of determining the rights and duties, reflecting the evolution of the financial and patrimony situation and the surplus or deficit of the patrimony;
- d. Accounting for assessing the costs of approved programs, which will be developed based on procedures and methods according to the implementation of general accounting as per the principle of determining the rights and duties.

The accrual accounting is defined as an „*accounting technique according to which the institutions determine their revenues from the moment of obtaining them and charge the expenditures upon the profit/loss of the period during which such expenditures occurred, without regards to the specific date of the cashing in or payments*”²

The information provided by the public accountancy to credit release authorities concern the following:

- income and expenditure budget execution;
- assets under management;
- budget outturn;
- patrimonial result.

B. Generally accepted accountancy principles

The evaluation of annual financial statements items is made according to general accountancy principles, in conformity with the accrual accounting:

- business continuity principle;
- permanent principle methods;
- precautionary principle;
- accrual based accounting principle;
- principle of separate valuation of assets and liabilities;
- intangibility principle;
- non-balancing principle;
- principle of comparability of information;
- materiality principle (significance threshold);
- Principle of economic on juridical prevailing (substance over form principle).

Deviations from the general principles presented above can be achieved in exceptional cases. Such deviations must be presented in explanatory notes, together with the determining reasons and an evaluation of their effect on the value of assets, debts, financial position and patrimonial result.

C. Identification of situations regarding the negative effect on budgetary execution as result of default on accrual accounting principles

Following the audit/control missions, there were registered inaccurate situations which concern the correct registration of financial and exceptional operation revenues and expenditures, based on documents attesting their way and content.

Thus, in the relation between the local budget of the administrative-territorial unit and two trading companies of local interest, with regard to the granting of subventions to the two companies, there were identified certain value discrepancies

² International Federation of Accountants (IFAC) (2002), Transition to the Accrual Basis of Accounting: Guidance for Government Entities, New York: IFAC Public Sector Committee

between the amounts approved by the local budget, in less and those provided in the budgets of the entities under discussion.

The discrepancies of the budgets mentioned above had direct consequences on the reality of financial statements of the respective partners, on their budgets and on the fiscal regimes of the local subordination entities.

The disturbances in question reveal that:

- the local budget of the administrative-territorial unit was based without fully taking into consideration the financial needs (subsidies) of the two companies;
- the budget construction of the local subordination companies did not observe the limits set by the local general budget.

Although the budgets of the two trading companies are approved by the Local Council of the administrative-territorial unit, as per the regulations given this does not return on the general local budget in the sense of identifying the funding resource of the expenditures approved in the budget of the two companies.

A consequence of the budgetary discrepancies and of the breach of accrual accounting principles in the execution of the local budget was there the lack of proceedings to the recording of tax documents issued by the two companies in the financial accounting and settlement, they cannot be traced in the debt account of the administrative-territorial unit.

The unequivocal result of the above mentioned situation is the violation of the provisions of the Resolution issued by the Ministry of Public Finances no. 1917/2005, for approving the Methodological Norms for the organization and management of public institution's accountancy, respectively the accrued accounting principle: *"The effects of the transactions and of other events are acknowledged when the transactions and the events are being produced and not as the cash or its equivalent is collected or paid and they are registered in the accounting records and reported in the financial statements of the reporting periods.*

The financial statements prepared on the base of this principle provide information not only on passed transactions and events which determined receivables and payments but also on future resources, future payment obligations, respectively.

This principle is based on the independence of the exercise according to which all income and all expenses relate to the exercise referred, without taking into consideration the date of the revenue collection, respectively the date of the expenditure payment".

The existence of the inaccuracies presented also leads to the breach in the execution of the local budget of the provisions of Law 273/2006, on local public finances, modified and completed by Government Emergency Ordinance no. 47/01.09.2012, for modifying and completing certain norms and regulating certain fiscal-budgetary measures, in the sense that *"credit release authorities of the local budgets of administrative-territorial units/subdivisions which register arrears have the obligation to diminish, on a monthly base, their volume by at least 5%, calculated to balance the previous month".* In our case, the mentioned provision has not been respected and the consequence on the local budget was that *"the directors of county public finances authorities stopped the supply with both share rates deducted from the income tax and with amounts deducted from certain revenues of the state budget meant for balancing the local budgets".*

At the same time, given that the debts towards the two companies of local subordination have been accepted, but not registered and paid by the administrative-territorial unit (as determined by the fact that these debts represent taxable income of economic operators and are taxed according to the tax legislation), their default of payment generates a cash gap at company level, having as consequence the delayed

fulfillment of tax obligations to the state budget and implicitly generating accessories and additional amounts that lead to unjustified financial pressure on the local budget – without taking into account the financial costs arising from financing the companies ‘cash gap by means of credits with final effect on the local budget that also has as funding source payments from the net profit of the local subordination trading companies.

To conclude on the above presented, the following issues are to draw:

- 1. local budgeting of the administrative-territorial and of the two local subordination companies have not kept financial and budgetary equilibrium conditions, which resulted in accumulation of arrears;*
- 2. the failure to report arrears as an element of the budget;*
- 3. violation of accrual accounting.*

Also, by cumulatively breaching the accounting principles, respectively by breach of the accrual accounting principle as well as of the obligation to chronologically and systematically register all operations, they have proceeded to an “*embellishment*” of the real situation of arrears – debts with payment maturities exceeding 90 days – which, within the meaning of the law on local public finances³, has practically determined the administrative-territorial unit to find itself in a situation of financial crisis with all the implications of this state.

The above mentioned situation could be avoided by compelling the entities with commercial activities which interact with public institutions to declare by means of Form 394 “*Informative Declaration on Delivery/Supply and Purchases Made on National Territory*” the deliveries / supplies and purchase made on the national territory towards persons not registered for VAT purposes, or by introducing an exception in this respect in the case of transactions with public institutions and performed on their tax IDs which are not assigned the RO tax code (not registered for VAT).

In order to draw the reports mentioned, it is necessary to modify the legal framework in the sense presented, namely the provisions of the **Resolution issued by the Ministry of Public Finances no.3.596/19 December 2011**, regarding the declaration on delivery/supply and purchases made on national territory by persons registered for VAT purposes and to approve the model and content of the “*Informative Declaration on Delivery/Supply and Purchases Made on National Territory*” by persons registered for VAT purposes, either by eliminating the restriction „...towards/from other taxable persons registered for VAT purposes in Romania” – art. 1 -, or by introducing the exception from the general rule for economic transactions undertaken by public institutions.

In addition to those presented and as an effect of non-accrual accounting principles, we show that, considering the provisions of art. 2 in Law no. 273/2006 – modified by the provisions of Government Emergency Ordinance no. 47/1st of September 2012 amending and supplementing certain laws and regulations on budget and fiscal measures, according to which the arrears are defined as overdue payments older than 90 days, calculated from the due date, as well as the provisions of art. 62 in the Law of local public finances with reference to the Public Debt (which provides that local government debt instruments also include accounts payables) – it proves necessary to introduce the arrears when calculating the enrollment of the total debt limit under 30% of the arithmetic average of their income, defined and calculated at art. 63, of the same law.

The introduction of arrears in determining the total level of indebtedness of public entities is needed in order to recognize the debt of credit provider (given that

³ Law no. 273/29.06.2006, art.74, paragraph (1): The administrative-territorial unit is considered in financial crisis if it is in one of the following situations:

a) unpaid payment obligations, liquid and matured, older than 90 days and greater than 15% of the annual budget;
b) non-payment of wages stipulated in the income and expenditure for a period exceeding 90 days from the due date.

arrears are treated as credit provider) and to present the real image of public debt by increasing the level of indebtedness of administrative-territorial units/subdivisions with these loans from third parties, past due date, that must be covered in the same income that ensures their contracting new loans or providing guarantees. In other words, arrears effect is to reduce liquidity and solvency entities applied for loans, or offers warranties, indicators that are used by public institutions reporting requirements, but are vital for an economic entity which operates on the principles of economy, efficiency and effectiveness.

For these reasons and based on the practical experience at the Court of Auditors, the amount of the arrears is often masked by the very failure to chronologically and systematically register the institutions' obligations to third parties.

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