

PROVISIONS ACCOUNTANCY FOR PENSIONS AND SIMILAR LIABILITIES

MIHAELA COSMINA PETRE
CONSTANTIN BRANCOVEANU UNIVERSITY, PITESTI
FACULTY OF MANAGEMENT MARKETING IN ECONOMIC BUSINESS
16-18 RUBINELOR STREET, BRAILA, ROMANIA
nita_mihaela_c@yahoo.com

Abstract:

The foundation of accountancy provisions is based on IAS 37 „Provisions, Contingent Liabilities and Contingent Assets” and on „European Accountancy Regulations” approved by OMFP no.3055/2009. The main problems regarding the provisions normalization and reglementation by using the mentioned sources of accountancy law refer to: provisions definition and delimitation, their acknowledgement, evaluation, modification and accounting.

Pension provisions refer to the amount to be paid by the entity after the employees retirement. The provisions value is established by the specialists in the field. For determining their value there must be taken into account the age, length of service and staff rotation within the entity. Pension provisions are acknowledged on the length of service remained up to the pension time, when they are certain to be paid for a predictable period of time.

Key words: *employee benefits, actuarial assumptions, IAS 19, provisions for pensions*

JEL classification: *M41 - Accounting*

In accordance with 3055/2009 order, the provisions are meant to cover the debts whose nature is clearly defined and which are likely to be at the date of balance or are certain to exist, but which are unlikely as to the value or date of their use.

Provisions are not used to adjust the value of assets.

Provisions cannot exceed the amount which is necessary to redempt a current liability at the balance date.

A provision is a debt with exigibility or uncertain value.

- Acknowledgement

A provision will be acknowledged only when:

- an entity has a current liability generated by a previous event;
- it is likely that a resource output will be necessary to honour the respective liability, and
- a credible estimation of the liability value can be achieved.

If these terms are not attained, a provision is not acknowledged.

- Difference from other liabilities

Provisions can be distinguished from other liabilities such as credit liabilities or engaged expenditures but which are not paid due to uncertainty factor as regards exigibility or the value of prospective expenditures necessary to extinguish a liability.

Unlike these:

- a) credit liabilities are obligations to pay goods or services which were received from or sent to suppliers and which were invoiced or whose payment was officially agreed upon with the suppliers; and
- b) the engaged expenditures are payment liabilities for goods and services which were received from or sent to suppliers but which haven't yet been paid, invoiced or officially agreed upon their payment with suppliers, including wages to employees (e.g. the amount for the paid leave).

Although sometimes it is necessary an estimation of these values or an exigibility of these debts, the element of uncertainty is generally much lower as regards provisions.

The entities commitments are usually presented as part of the liabilities resulting from commercial credits or from other activities, while provisions are separately reported.

In order to understand the present regulation:

- a) a legal obligation is an obligation resulting from:
 - a contract (explicitely or implicitely)
 - legislation; or
 - another legal effect;
- b) an implicate obligation (e.g. the obligation in which an entity engages to make compensatory payments to the dissnissed staff) is an obligation which results from the actions of an entity in case that:
 - by establishing some previous practices, by the company written policy or a clear declaration, the entity indicates its partners that it assumes some responsibilities; and
 - as a result, the entity induced its partners the idea of honouring those responsibilities.

There will not be acknowledged provisions for losses resulting from exploitation.

There will be acknowledged as provisions only those liabilities generated by previous events which are free from the entity prospective actions (e.g. the way of activity development in future). Examples of such liabilities are the fines or cost for eliminating the negative effects caused to environment, punished by law, both generating resources output which incorporate economic benefits, no matter the future entity actions. Similarly, an entity acknowledges a provision for the closing costs of an oil equipment, on condition that the respective entity seeks remedy for the already made damages.

Unlike this situation, an entity may intend or need, due to commercial pressures or to legal requirements, to make expenditures to be able to act in a certain way (e.g. by installing fume filters for a certain type of factory).

As the entity may avoid further expenses by different actions, such as by modifying the factory process, it does not have a current liability as regards the prospective expenditures and therefore it will not acknowledge any provision.

- Why are provisions constituted?

Provisions are constituted for such elements as:

- a) litigations, penalties, damages and other uncertain debts;
- b) expenses made during the quarantee period of service activity and other expenses regarding the quarantee to clients;

- c) reorganization activity;
- d) pensions and similar liabilities;
- e) disaffected corporeal estates and other similar actions in relation to this;
- f) taxes;
- g) premiums to be paid to the staff from profit, according to legal and contractual provisions; and
- h) other provisions.

When the time – value effect of money is significant, the provision value represents the updated value of expenses estimated to be necessary to redempt a liability. In this case, the provisions updating is made because, due to the money time- value, provisions adherent to resource output which come shortly after the balance are much more onerous than the ones adherent to resource output of the same value, but which appear later.

The provisions update is usually made by specialised staff. The update rate reflects the current estimations on the market of money time-value and of the risks salient to liabilities.

The profits resulting from the demise of assets shall not be taken into consideration when estimating a provision.

If it is estimated that some or all the expenses for a provision will be reimbursed by a third party, the reimbursement will be acknowledged only when it is certain to be received. Reimbursement shall be considered as a separate asset.

Provisions have to be revised at the date of each balance and adjusted to reflect for a liability redemption is not probable a resource output, the provision must be cancelled by income resumption.

Provisions shall be used only for the purpose for which they were initially acknowledged. Provisions are evaluated before determining the profit tax , the fiscal treatment being the one provided by fiscal legislation.

- Provisions for pensions

Pension provisions refer to the amount to be paid by the organization after the employees have left the organization. IAS 19 “ Employees benefits” calls them post engagement benefits and include pension benefits or pensions and other postengagement benefits (postengagement life assurance and postengagement medical assistance).

According to IAS 19, the postengagement benefits are established on the basis of some official or unofficial contract and are classified like that:

- Determined contribution plans.

These are postengaged benefit plans on the basis of which the organization legal or implicit obligation is limited to the value with which it contributes to the fund. As a result the value of postengaged benefits received by the employee is determined by the value of the contributions paid by the organization at which he is engaged (and perhaps by the employee , too). Hence the conclusion that the actuarial risk (the risk that the benefits may cost more than expected) and investment risk (the risk that the invested assets will not be enough to generate the expected benefits) belong to the employee.

- Determined benefit plans.

These are postengaged benefit plans on the basis of which the organization has the obligation to offer the employees when retired the agreed level of

remuneration. In that case the actuarial risk and the investment risk are in the organization charge and not in the employee's.

The main problem in case of both plans (of determined contributions and determined benefits) is the achievement of a credible estimation of benefit values given to employees for their services.

Since such estimations imply the use of actuarial techniques and a totality of hypotheses and probabilities generated by demographic variables (such as staff rotation, mortality and also financial variables (such as prospective wages rise and medical costs) their calculation (estimation) is attributed to the specialists in the field.

Including the problem to the determined benefit plans, the organization liabilities regarding determined benefits are calculated by totalizing the current service costs to the expenses with interest adherent to these services.

The cost of current services represents the update value of liabilities regarding the determined benefit which results from the employee service during the current period.

The interest expenditures represent the interest adherent to liability regarding the determined current service for the previous service.

Considering these facts, the steps to be made in order to estimate the liabilities regarding the retirement benefits (pensions)- with reference to a single employee are the following:

1. Update of the yearly wages at the end of the contract, on the basis of an interest rate, mainly the market interest rate.
2. Determination of benefits (pension) allocated for each year of activity, depending on the update value of the yearly wages and on percentage rate the organization engages to contribute to the benefits payment.
3. Determination of benefits (pension) at the end of the contract, depending on the benefits (pension) allocated to each year and on the length of service in contract.
4. Calculation of expenses with the current annual service by updating the benefits allotted to each year of service (2).
5. Calculation of expenses with annual interests by applying the rate of interest to the current service cost settled for the previous exercise (4).
6. Calculation of the total liabilities (expenditures) for each current year (4 + 5).
7. Calculation of liabilities (expenditures) accumulated at the end of each year (6+ the liabilities at the end of the previous year).

Example:

A company undertakes to pay to an employee at the conclusion of service benefits (pension) equal to 10% from the last year wages for each year of service.

The wages for the first year of employment is 30.000 lei, to rise with 4%₀ for each following year. The update rate used by the company is 5 %. The company estimates that the employee will retire over 5 years (31.12.N+4).

a) The calculation of estimated benefits (pension) entitled for the employee:

1. Update wages at the end of the year 5:
 $30.000 \text{ lei} \times (1 + 4\%)^4 = 35.096 \text{ lei}$
2. Calculation of benefits (pension) allotted to each year of service:
 $35.096 \text{ lei} \times 10\% = 3.510 \text{ lei}$
3. Calculation of benefits (pension) at the end of year 5:
 $3.510 \text{ lei} \times 5 \text{ ani} = 17.550 \text{ lei}$

b) Calculation of the company liabilities (expenses) beneficially considered:

Explanations	N	N+1	N+2	N+3	N+4
1. Benefits allotted to the current year	3.510	3.510	3.510	3.510	3.510
2. Update rate	$(1+5\%)^4$	$(1+5\%)^3$	$(1+5\%)^2$	$(1+5\%)$	-
3. Cost of the current service 1:2	2.888	3.032	3.184	3.343	3.510
4. Interest = liability at the end of the previous year x 5 %	-	144	303	501	655
5. Total expenses = 3+4	2.888	3.176	3.487	3.844	4.155
6. Liability at the end of the current year = 5+ liability at the end of the previous year	2.888	6.064	9.551	13.395	17.550

From accountancy stand point, at 31.12.N it is constituted the provision for the final liability payment of 2.888 lei by debiting 1515 account “ Provisions for pensions and similar liabilities”.

For the other 4 years up to the pension, the existing provision is yearly raised and the accounting registration is the same as 31.12. N . Therefore the existing provision will raise as follows:

- for 31.12. N+1 with the amount of 3.176 lei (6.064-2.888 lei);
- for 31.12. N+2 with the amount of 3.487 lei (9.551-6.064 lei);
- for 31.12. N+3 with the amount of 3.844 lei (13.395-9.551 lei);
- for 31.12. N+4 with the amount of 4.155 lei (17.550-13.395 lei).

In the year N+5 it is registered the payment liability of pension fond in the amount of 17.550 lei, by debiting 6458 account „ Other expenditures regarding social insurance and protection” and the crediting 4281 account „ Other liabilities with the staff”.

The payment of pension fond in the amount of 17.550 lei, is registered by debiting 4281 account „Other liabilities with the staff” and crediting 5121 account „ Bank accounts in lei”.

In the year N+5 it is cancelled the provision constituted in exercises N to N+4 in the amount of 17.550 lei by debiting 1515 account „ Provisions for pensions and other similar liabilities” and the increase of 7812 account „ Income from provisions”.

In conclusion, as a result of the example shown, the company undertakes to pay to an employee at the conclusion of his service a benefit (pension) of 17.550 lei.

- Contingent liabilities vs. provisions

A contingent liability is:

- a) a potential liability, as a result of past events, previous to the date of balance and whose existance will be confirmed only when some incert future events take place or not, and which cannot totally be under entity control; or
- b) a current liability which appeared as a result of some past events, anterior to the date of balance, but which is not acknowledged because:
 - it is uncertain that there will be necessary resource output for extinguishing some debts; or
 - the value of liability cannot be credibly evaluated.

A provision is a liability with exigibility or incert value.

Contingent liabilities are different from provisions by the fact that:

- a) provisions are admitted as liabilities (supposing that correct estimations can be achieved), as they are current liabilities at the date of balance and it is likely that resource output will be necessary for extinguishing liabilities; and
- b) contingent liabilities are not acknowledged as liabilities, because they are:
 - possible liabilities, but for which a confirmation must be made if the entity has a current liability which can generate a resource output; or
 - current liabilities which do not tally with the acknowledging criteria in the balance (as either it is not likely to be necessary a reduction of the entity resources for extinguishing the liability, or a quite credible estimation cannot be achieved for the value of liability).

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