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IPSAS versus National Norms on Public Institutions' Own Capitals

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Abstract: In this paper I have compared international standards on accounting for the public sector and those required by national norms on public institutions' own capitals, pointing out both convergences and divergences. Last, but not the least, I have compared IPSAS 1 (applied by public institutions) with IAS 1 (applied by commercial companies).

Keywords: IPSAS, national norms, own capitals, accrual accounting, cash accounting, reference frame, residual interest, financial standing

INTRODUCTION

The reform of the Romanian accounting system circumscribes to the reform as a whole of the national economy. Therefore, as from 2003, the Ministry of Public Finance of Romania (currently the Ministry of Economy and Finance) started to introduce (first on an experimental basis) a system based on accrual accounting for public institutions, namely, a system based on accounting policies and principles generally accepted by the 4th Directive concerning annual accounts, by the 7th Directive on consolidated accounts and also by the European System of Accounts (ESA 95).

As the experiment turned out to be successful, as from 1 January 2006, all the public institutions in Romania must base their accounting on accruals according to OMFP 1917/11.12.2005. In other words, the reform of accounting for public institutions in Romania represented the passage from cash accounting to the one based on accruals, the accrual accounting, and to the implementation of IPSASs.

On international level, the International Accounting Standards were drawn up for the Public Sector (The International Public Sector Accounting Standards - IPSAS) by the Public Sector Committee (PSC), organic structure founded in 1995 within the International Federation of Accountants (IFAC). IPSAS promotes the accounting standard on "accrual" basis in most of the public administrations in Europe together with the European Commission, relying on transparency and accuracy.

Therefore this survey intends to underline the similarities but especially the differences between these two reference frames: national norms versus international norms (IPSAS) as concerns the concept of own capitals, constitutive elements etc.

Public institutions' capitals are defined by the national norms in force as a category of the financial standing, replacing the liabilities. Concretely, the national norms in force define the capitals of public institutions as a residual interest of the state or administrative-territorial units, as holders of a public institution's assets, after deduction of all debts.

Within the meaning of IPSAS 1 "Presentation of Financial Statements", there are no differences in defining own capitals, we may even say that there is identity between the two reference frames. Moreover, the international reference frame defines the own capitals and net assets based on the deductive method of determination from financial statements, as follows:

Own capitals (net assets) = Total assets – Total debts

METHODS OF RESEARCH

In accordance with the title of this paper, in order to compare national norms that are applicable to public institutions and to the IPSASs in the area of own capitals, the following must be compared:

- the national reference frame, that is **OMFP 1917/2005** as further amended and supplemented, on the one side;

and

- the international reference frame, that is **IPSAS 1** "Presentation of Financial Statements", **IPSAS 3** "Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies", **IPSAS 17** "Property, Plant and Equipment", on the other side.

As I said in the introduction, there is a convergence to identity in defining the concept of own capital, between the national reference frame and IPSAS 1 "Presentation of Financial Statements". In addition to the national reference frame, IPSAS points out that there may be both a positive and a negative value of own capitals (net assets), resulting from the residual assessment performed in the balance sheet (main component of financial statements which express the financial standing of public institutions).

As for the composition of own capitals, the national norms include:

- funds (including those with special destination);
- patrimonial earnings;
- retained earnings;
- revaluation reserve.

IPSAS 1 recommends the following composition of own capitals:

- subscribed capital represented by the assembly of contributions from owners (usually the state), corrected with the distributions made to them (for instance, the payments to the state);
- accumulated surpluses or deficits determined by comparing the income with the expenses acknowledged during the period;
- reserves presented according to the nature and purpose of the setting up;
- minority interests represented by a part of the net deficit or surplus and own capitals (net assets) that may be assigned to direct or indirect participations that are not held, through controlled entities, by the controlling entity.

The main difference between the two reference frames is given by the fact that IPSAS 1 "Presentation of Financial Statements" takes into account all the categories of entities in the public sector, both those without share capital (as a consequence of the peculiarity of setting up and operation of public institutions based on public funds) and those including "government business organizations" partly private, with private funds subscribed and paid-up on a share basis. The latter represent the social share, with financial interest in own capitals, without being found within the meaning of national norms.

According to national norms, the first constitutive element of own capitals is represented by **funds**. They represent private sources of public institutions acknowledged in the case of fixed assets for which the depreciation is not calculated (goods in the public patrimony of the state and administrative-territorial units, records of cultural and sport events, lands etc.) and also for public resources with special destination (circulating funds, reserve funds, risk funds, hospital development fund etc.) based on regulations specific to public institutions (administrative-territorial units, hospitals etc.). Considering the delimitation of public institutions' patrimony, the funds include: the fund of goods that compose the public and/or private domain of the state and/or administrative-territorial units. The goods that compose the public domain (goods of public use or interest, presented in the annex enclosed to Law no. 213/1998 on the public property and its legal status) are held and used by the state and the administrative-territorial unit, being at their disposal, inalienable, unseizable and cannot be acquired by prescription. Both the input and output of all goods in the public patrimony and only in the case of those which are not depreciable, that compose the private domain of the state and administrative-territorial units are reflected in the accounting of public institutions in Romania, in correlation with the accounts reflecting funds (100 "The fund of fixed intangible assets", 101 "The fund of goods which constitute the public domain of the state", 102 "The fund of goods which constitute the private domain of the state", 103 "The fund of goods which constitute the public domain of the administrative-territorial units" and the account 104 "The fund of goods that constitute the private domain of the administrative-territorial units" - all of them are accounts with liabilities accounting function).

According to the national norms, **the patrimonial earnings** represent the second element of own capitals, being determined as a difference between income and funding, on the one side and expenses, on the other side. Therefore, earnings can be positive (surplus) or negative (deficit). The patrimonial earnings include both the surplus/deficit from current activities and from extraordinary activities. As for the public institutions in Romania, at the beginning of each budgetary year, there is recorded the transfer of the surplus or deficit that belong to the previous year, reflected by means of the account 121 "Patrimonial earnings" (which after this operation will have a zero balance), on the retained earnings, reflected by means of the account 117 "Retained earnings".

IPSAS 3 "Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies" recommends a separate presentation in the financial statements of the income and expense elements related to the current (operational) activity, that are relevant for explaining the institution's performances in that period from the point of view of their size, nature and incidence. For instance, the separate presentation of the following situations is recommended:

- restructuring of an institution's activity and cancellation (accounting correction) of any provisions for the restructuring costs;
- settlement of disputes;
- disposal of tangible fixed assets;
- interrupted activities;
- privatisation or other cessions of long-term investments;
- reduction of inventories value to the level of the net realizable value and also the reversal of these deteriorations;
- reduction of the value of tangible fixed assets to the level of the recoverable value and also the reversal of these deteriorations;
- other cancellations of provisions.

In the same time, IPSAS 3 recommends a separate presentation of each extraordinary element (elements which are unusual, rare and significant, and which are not under the institution's influence and control). The examples of such extraordinary elements that cannot be included in the budget since they cannot be anticipated consist of:

- costs associated to a natural disaster or to disasters caused by men, such as provision of shelters for people who lose their houses after an earthquake, flood etc.;
- short-term costs associated to the supply of services for refugees when the need of such services was not foreseen in the budget at the beginning of the period (if these services are provided for a longer period, they can no longer be classified as extraordinary elements).

Comparing the two reference frames (national norms and IPSAS 3 ("Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies") we can see that both of them share the same definition, namely the patrimonial earnings represent a residual value resulting from the deduction of expenses from the income.

As for the third element of own capitals, **the retained earnings** (account 117 "Retained Earnings"), in accordance with the national norms, it appears distinctly in the balance sheet, defined as those earnings (positive or negative) whose modification was delayed for the following years. In this respect, there is a ***divergence*** between the two reference frames. Thus, IPSAS 1 "Presentation of Financial Statements" recommends to record in the balance sheet only the accumulated surplus or deficit, determined by summing to the current result the earnings made in the previous years.

The last element of own capitals, within the meaning of national norms, **the revaluation reserves** (account 105 "Revaluation Reserves") represents the differences found upon the periodical revaluation of fixed assets between the just value (revaluated value) and the historic cost (or the value before revaluation). The just value must be determined by authorized evaluators or by technical commissions. In the respect of revaluation reserves, the two reference frames (national norms and IPSAS 17 "Property, Plant and Equipment" are convergent till identity, although in the accounting of public institutions in Romania, the concept of fixed assets is used and not the one of property, plant and equipment (the notion of property, plant and equipment is specific to companies and to other economic entities in Romania).

The reference frames, IPSAS 17 and the national norms prescribe the following treatments regarding the revaluation reserves.

a. when the revaluation result is positive:
   - the difference is treated as an income compensating the expense with the decrease previously acknowledged for the same fixed asset on the previous revaluation;
   - the difference is treated as an increase of the revaluation reserve when there was no previous decrease, acknowledged as an expense related to that asset previously revaluated;

b. when the revaluation result is negative:
   - the difference is treated as an expense with the entire amount of the decrease if the revaluation reserve related to the revaluated asset is zero;
   - the difference is treated as a decrease of the revaluation reserve with the minimum value between the value of that reserve and the value of the decrease; the unpaid difference of the existing reserves is registered as an expense.

RESULTS AND DISCUSSIONS

As concerns the results, national norms use in addition to the international reference frame the concept of **result of the budgetary execution**. It is obtained by comparing net cash payments with the effective expenses, made on financing sources.

The two concepts are used by the national public accounting within the second stage of the budgetary financing (1. financing opening and 2. the proper financing) which means the consumption of budgetary credits, open or allocated.

The net cash payments (underlined by the account 770 "Budget Financing") represent a specific concept materialized in the monetary flows performed on the account of public funds resulting from certain events or transactions with influence on the institution's assets and liabilities, namely: payments made to suppliers, wages due to personnel, social and fiscal contributions to the state budget, to the social insurance budget etc.

The effective expenses (underlined by the 6th class accounts in the account chart, but especially by those of groups 60 "Expenses related to inventories", 61 "Third party services expenses", 62 "Other third party services expenses", 63 "Other taxes, duties and similar expenses", 64 "Personnel expenses", 65 Other operating expenses" and 66 "Financial charges" represent the money equivalent of resource consumptions, reflecting the degree of use of the public funds made available to the institution through the consolidated budget, namely: inventory consumption, labour force consumption expressed by the wage rights due to the personnel, consumption of unstorable goods etc. According to IPSAS, expenses are reductions of the economic benefits registered during the accounting period as outputs or decreases of the assets value or increases of debts, which are materialized in own capital reductions, other than those resulted from allocation to shareholders.

The result of the budgetary execution at the level of public institutions in Romania does not represent an element of own capitals, its nature being purely financial-budgetary since it gives the possibility to appreciate the effective degree of use of the public funds.

In the same time, the national norms have included in the set of financial statements of public institutions "The account of budgetary execution" which contains all the operations related to the income received and the payments made. They must comply with the same structure in which they were approved in the budget. As for the income, the budgetary execution account includes: budgetary provisions, income found, income received and income to be received. As for expenses, there are necessary some information concerning: budgetary credits, budget and legal commitments, payments made, payment commitments and effective expenses.

Staying in the same sphere of results, the patrimony surplus appears when net cash payments are bigger than the effective expenses, in which case the public funds are immobilized in purchased goods that are not used. The patrimonial deficit appears in the inverse case, namely when the effective expenses overcome the net cash payments, therefore resources existing from the previous years were consumed, or obligations which were not met were created.

Coming back to the concept of capitals, compared to the accounting of companies, we can notice **the absence of the concept of permanent capitals** (long-term debts) in the case of public institutions. The motivation is represented by the impossibility of public institutions to borrow from credit institutions in compliance with the legal regulations in force (Law no. 500/2002 on public finance). On the other side, long-term borrowings are contracted or guaranteed by state and administrative-territorial units in order to ensure the financial resources of the entire hierarchically subordinated system, taking the form of a public debt, governmental or local, internal or external. Therefore, although from the point of view of the call date, long-term debts represent sources with permanent nature, still they cannot be appreciated as permanent capitals due to this peculiarity.

CONCLUSIONS

Analyzing the IPSASs (applicable to public institutions) and the IASs (applicable to commercial companies) one can draw the conclusion that there are similarities and even coincidence of names. In the same time, the IPSASs were drawn up having the IASs as a starting point, undergoing amendments (addendums or eliminations) of the concepts improper to public institutions. The main differences between the two categories of accounting standards are related to terms definitions, inclusion of additional comments from the IAS in order to make clear the applicability of standards in the public sector.

Analyzing how the patrimonial operations of self-funded public institutions are reflected compared to those of commercial companies, one can certainly state that there are major similarities between them, namely, public accounting is very close to the accounting of commercial companies (public institutions also use the account 560 "Disposal of public institutions financed entirely from own revenues" for the record of transactions from own revenues).

As for the public institutions' own capital, we can notice both convergences (to identity) and divergences between the international reference frame IPSAS and the native reference frame.

We appreciate favourably the attempt of the Romanian standards developer to elaborate norms that are tangent (even convergent) with the international norms. For instance, leaving aside the absence of public institutions that include "government business organizations" partly private, with private funds subscribed and paid-up on a share basis - peculiarity of the national economy - the convergence of national norms with IPSAS 1 "Presentation of Financial Statements" ensures the comparability of financial statements of public institutions with those in the previous periods and with the financial statements of other public institutions. Therefore the financial statements of public institutions in Romania provide convergent information (IPSAS 1 "Presentation of Financial Statements" and IAS 1 "Presentation of Financial Statements") about the financial standing (balance sheet), performance (the patrimonial earnings account), cash flow (cash flow statement), modifications of own capitals (statement of modifications of net assets/own capitals) etc., useful for a wide area of users in making decisions.

The main differences between IPSAS 1 and IAS 1 are determined by: additional comments compared to the IAS in order to make clear the applicability of standards to the accounting of institutions in the public sector, various sets of definitions of technical terms in IPSAS compared to IAS, the terminology used in certain cases by IPSAS is different from the one of IAS.

In conclusion, we think it is about time for the accounting profession in Romania to be prepared to apply a financial reporting system that is convergent and world-wide acknowledged (IPSAS).

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