

## PROVISIONS AND ACCRUED LIABILITIES IN THE LIGHT OF THE POLISH BALANCE LAW AND INTERNATIONAL ACCOUNTING STANDARDS

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Розмір резервів підприємства є однією з основних категорій виміру фінансового стану та рентабельності. Їх формування повинно відповідати принципу достовірної й об'єктивної оцінки підприємства. Розглянуто сутність резервів, подано їх класифікацію. Докладно окреслено резерви і реструктуризацію та поточні розрахунки. Метою є також порівняння резервів у польському законодавстві та в Міжнародних стандартах фінансової звітності № 37.

Provisions in accounting are one of basic categories of measurement of the financial situation and profitability. Creating them must be in accordance with the principle of accurate and reliable image of the enterprise. In the article the essence of provisions and their classification was described. In detail provisions were discussed to provisions for restructuring and accruals. The purpose of the article is to present provisions in perspective of the Polish balance law and IAS 37.

**Introduction.** The provided information through the accounting system must be credible, accurate and reliable. Only then will financial reports be reflecting material and financial situation of enterprises in accordance with superior principles of accounting. Central principle irrespective of domestic legal provisions must deliver accurate and reliable image of enterprise clearly, without polishing or obscuring information. In result different situations causing uncertainty are accompanying actions of economic entities which influence the book (accounting) image of the enterprise. However, there are categories burdened with uncertainty which are nevertheless possible to assess in credible way provisions and accruals are among these categories. Creating provisions is securing against risk and uncertainty, but only in such case when this uncertainty and risk bring unpredictable burden to enterprise<sup>46</sup>. 4th Directive of EEC of 25 July 1978<sup>47</sup> is describing principles of creating protections. Polish balance law of 29 September 1994 didn't define provisions in the present shape, their definition was determined in the law of 9 November on amendments to the Accountancy Act. Next amendment to a bill (2002) caused narrowing the scope of provisions to liabilities the date of maturity of which or the amount aren't certain what was in accordance with IAS 37, provisions, contingent liabilities and contingent assets (article 10).

Portraying provisions in the Polish balance and international law is a purpose of the this article. The Accountancy Act and the IAS 37 are pointing at the definition of provisions, creating, recognizing and presenting them in the financial report whereas detailed principles of creating provisions, including accruals are left in guise of an economic unit.

**The essence, classification and the duty of creating provisions by economic entities.** Comprehension of notion provision (provisions) comes from French word provisions, from Latin *reservo* indicating a form of reservation or providing and so the meaning is also present as such in accounting<sup>48</sup>. Executive acts to the Accountancy Act (called farther A-ACT) they are defining the term of provisions for the majority of entities alike excluding banks, insurance companies and other financial institutions. Provisions there are created upon estimated sizes of future liabilities connected with their activity in last periods.

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<sup>46</sup> IAS 1 Presentation of financial statements.

<sup>47</sup> ECC Directive on annual financial reports of some kinds of partnerships, art. 20.

<sup>48</sup> Orzeszko T., Pojęcie i rodzaje rezerw w świetle przepisów z zakresu rachunkowości w Polsce po 1990 r., Zeszyty Teoretyczne Rachunkowości, Numer Specjalny, tom 13 (69), Stowarzyszenie Księgowych w Polsce, s. 189

A-Act provides that it is possible to create provisions for predicted additional costs and caused losses with the impairment or loss of the ability to continue activity. In that case provisions is debited in capital from the updated valuation if continuation isn't justified. It is possible to create them when activity is being carried out on assumption that activity will be continued. Creating capital provisions for subsidiaries as a result of the consolidation of financial reports.

In every case of assessing provisions there are expectations of economic benefits. It's necessary to create provisions based on past events or experience taking into account when that particular moment, a legal or customary obligation triggering off incurring the expense in the future. Creating provisions for so-called general operating risk is not possible.

The duty of establishing provisions is resulting from legal norms of the domestic legislation, the agreement or different laws<sup>49</sup>. According to superior principle of accounting of carefulnesses, the amount of provisions should not be inflated or lowered. The amount of the estimated provisions should result from adopted methods of the estimate, also from statistical methods. Amounts of provisions considering the expenditure and their financial effects should be determined diligently. Accomplishing the estimate can in special cases be commissioned to independent actuary. However, the method of calculations of amounts of provisions should be in documentation of the subject. According to IAS 37, the amount of the estimate is found credible if in harmony with rational premises it was established of the amount, which individual would have to pay paying for liability on the balance day or to pay the third party taking over paying for liability on the same date<sup>50</sup>.

Economic subjects have also a duty of creating provisions for losses from economic transactions in the course, including provisions for given guarantees, guarantees, credit operations, legal effects of judicial proceedings under way, to pension schemes and derivative services.

Provisions being a subject of regulations – of the Polish balance law, the Directive of the European Union and IAS is an instrument of the balance politics in every case. Estimating provisions is having an influence on the image of the financial report of economic units<sup>51</sup>.

Provisions are being presented in liabilities of balance sheet as:

1. Provisions of the deferred income tax
2. Provisions to pension schemes and similar services
  - long-term,
  - short-term
3. Remaining provisions
  - long-term
  - short-term.

Provisions of the income tax from the title deferred, requiring the payment in the future, in the connection with positive transitory differences are for these subjects, of which the annual financial report is subject to examining and announcing (art.64). If, however, the annual financial report of the individual isn't coming under the duty of the examination and announcing<sup>52</sup> the individual can resign from establishing provisions from the title deferred tax<sup>53</sup>. For creating these provisions are not obliged sole traders and partnerships taxed according to personal income tax.

The provisions for pension schemes and similar services is indicating the magnitude of the created provisions on account of justified accruals to workers' services. The duty of assessing services is resulting

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<sup>49</sup> Jankowska M., Wybrane aspekty tworzenia rezerw i biernych rozliczeń międzyokresowych kosztów w świetle prac nad krajowym standardem rachunkowości „Rezerwy, zobowiązania warunkowe i aktywa warunkowe” [w:] Standardy rachunkowości wobec wyzwań współczesnej gospodarki pr. zb. pod red. Messnera Z., tom II Analiza standardów rachunkowości, s.161

<sup>50</sup> Gierusz B., Rezerwy na zobowiązania. Komentarz do ustawy o rachunkowości, ODDK, Gdańsk 2002, s. 383

<sup>51</sup> Provisions – principles of creating and estimating them are different in the Anglo-Saxon model of accounting and the Germanic model. In the first case provisions constitute the integral part of liabilities (regarded as the allocation of costs). In the second case provisions are a peculiar variety of liabilities and simultaneously with instrument protecting risks against adverse effects, too: Orzeszko T., Orzeszko T., Pojęcie i rodzaje rezerw w świetle przepisów z zakresu rachunkowości w Polsce po 1990 r., Zeszyty Teoretyczne Rachunkowości, Numer Specjalny, tom 13 (69), Stowarzyszenie Księgowych w Polsce, s. 189.

<sup>52</sup> art. 64 ust 1 Polish Accountancy Act.

<sup>53</sup> art. 37 ust. 10 Polish Accountancy Act.

from the collective agreement or job agreements<sup>54</sup>. So these provisions is embracing amounts due to workers (law enforceable), essential for the result of business unit. Provisions are located in category to jubilee awards in IAS 19 (Employee benefits) provisions from this title are called different long-term workers' services). The provisions from the title of pension services as well as jubilee awards is being established for the day balance toting up provisions concerning individual workers or their homogeneous groups.

Remained provisions are sure liabilities or highly probable, not mentioned in the above categories. They are treated as accruals of costs or provisions for certain or highly probable future liabilities concerning financial transactions, non financial operations and the events non connected with the general risk of business activity.

In literature of accounting there are many different divisions of provisions in the arrangement of balance, among others: capital provisions, for loss of value, to costs, to liabilities and losses<sup>55</sup>.

Provisions are also being classified in division to balance and non balance<sup>56</sup>. Non balance, called open provisions, value of assets of perms and corrections of value of rotational assets. Figure 1 drawing presents ranking of balance provisions.

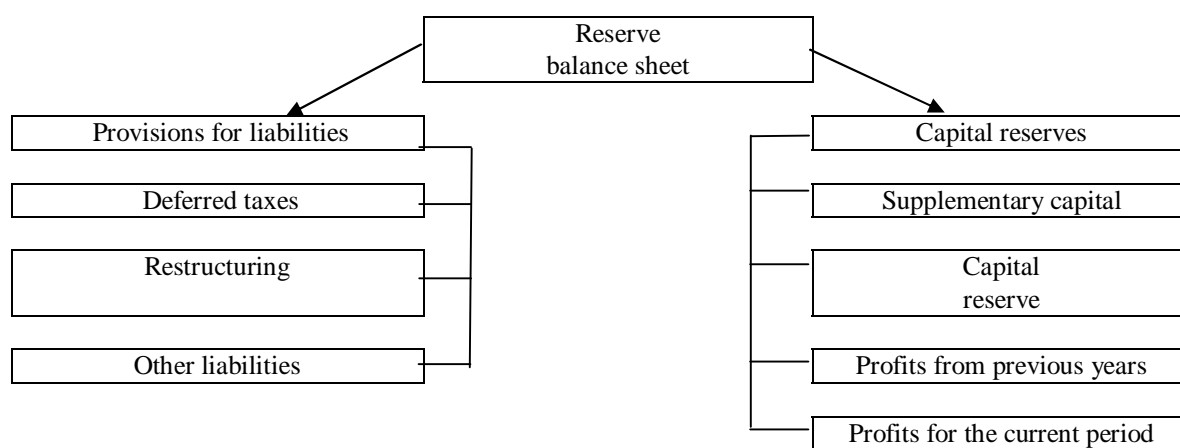


Fig. 1. Classification of balance sheet reserves

Source: own study based on Gmytrasiewicz M, A. Karmańska, *Rachunkowość finansowa, Difin, Warszawa 2002*.

Balance provisions are making the source of financing for assets allotted to provisions for closely determined purposes. They leave a lasting mark in balance sheet and accounting books. These provisions are called general<sup>57</sup> on account of the fact that there are laws created in harmony with applying regulations as well as in the statute of enterprises, moreover they are documented.

On account of the period of the realization, in which the benefit will become smaller, provisions are being classified for short-term and long-term (short-term provisions will become liabilities in the sequence of 12 months from the balance day, long-term provisions will become liabilities in the period above 12 months).

Another criterion of division of provisions is their type. According to this criterion provisions are being singled out as resulting from the restructuring, from regulations of the income tax in the scope of services for workers, from the deferred tax title or from the title of financial instruments and remaining provisions.

On account of the kind of burdened activity, it is possible to single out those burdening remaining operating activity, financial activity and burdening the financial gross result. So-called financial effect is a

<sup>54</sup> art. 39 ust. 2 Polish Accountancy Act.

<sup>55</sup> Poniatowska L., *Rezerwy w świetle znowelizowanego prawa rachunkowości*, [w:] Gierusz J., Jerzemowska M., Martyniuk T., (red.) *Rachunkowość wobec procesów globalizacji*, Uniwersytet Gdański, Gdańsk 2002 r., s. 481.

<sup>56</sup> M. Gmytrasiewicz, A. Karmańska, *Rachunkowość finansowa, Difin, Warszawa 2002 r.*, s. 398-399.

<sup>57</sup> In contrast to general provisions there are so-called quiet reserves, however their scope is an individual trademark of every enterprise, although norms have an impact on the possibility of their address in the evaluation of assets and liabilities (also accountings resulting from the policy). For example, the rising of quiet provisions is involving the asset pricing and of income below their actual value.

different criterion of identity. Provisions can be debited into costs, that is: remained operating costs, financial costs and burdens from the income tax title. Here it is possible also to single out balance provisions making own capital smaller and increasing assets. Next criteria of provisions is criterion of identity (provisions priced with actuarial method and priced with remaining methods) and criterion on account of the tax effect (tax and non tax provisions).

**Specificity of provisions for restructuring.** Companies which are continuing activity are creating provisions for future liabilities caused by restructuring, if it is resulting from different regulations or the company is under an obligation to performing it or in effect of binding agreements in this matter and plans of restructuring permit in the credible way to assess value of these liabilities.

The Accountancy Act isn't specifying what one should understand under term restructuring. It stated that provisions for restructuring is being created when on the basis of separate regulations the company has the duty of performing it or binding agreements were signed in this matter and plans permit the restructuring in the credible way to assess future value of liabilities. IAS 37 more precisely is pinning this notion down. IAS 37 states that the restructuring of activity is a planned, announced and controlled programme by the executive committee which is changing in the essential way:

- a) the scope of activity carried out by an economic unit or
- b) the way this activity is being carried out.

So restructuring comes down to sale or the ending of operation in one of the fields of activity, closing premises where activity was carried out and moving core economic action to a different country or region, the change in structure, or fundamental reorganization which has essential influence on character and the purpose of activity of an economic unit. The restructuring is burdened with considerable risk and uncertainty, so it requires measurement of risk and creating provisions.

IAS 37 is pointing that costs of the restructuring should be recognized only when the following criteria are met:

- the firm has the formal plan of the restructuring,
- there are justified expectations of parties which the plan concerns that the firm would carry restructuring action by beginning implementing the plan or announcing main elements of the plan to these parties.

Provisions for restructuring are protecting an economic unit against losses and costs in the course of correction of the financial result in the initial stage of establishing it.

**Accruals as the special form of provisions.** Accruals are a specific form of provisions since they are being established for services closely defined, rather than to the risk of their occurrence. Interrelation of accruals and provisions are presented in Figure 2.

Accounting for costs in the time is resulting mainly from the principle telling to the adequacy that for assuring the adequacy of gross receipts and of costs bound with them to assets or liabilities of the given month one should rate costs or gross receipts concerning next periods and costs for this month which not yet were carried. Therefore, individuals should make accruals to the height for the current month of services closely tied to liabilities and likely costs the amount of which or the date of rising of the obligation from their title are not known. From the definition of accruals liabilities falling for the current period so the title of settlements should fulfil conditions contained in the definition. accruals are cost in memorial recognition based on the estimate and making the cost of basic, operational activity. Effect of taking them (financial effect) are also determining the future expense and liabilities.

Applying passive settlements is being caused by probable liability in the reporting period and this liability are resulting in the particular:

1. from obliging services made for the individual by contractors of the company if the amount is possible to estimate in the credible way,
2. from the duty of the workmanship, connected with activity in progress, future services to unknown persons, of which it is possible to estimate the amount even though the date of liability isn't still known, including from the title repair guarantee and of the guarantee behind sold products of long-term use.

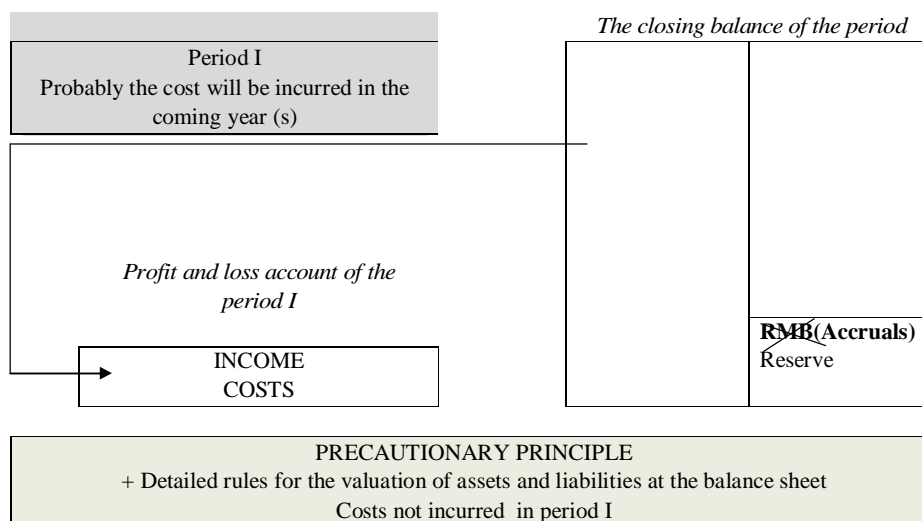


Figure 2. Accruals and provisions

Source: E. Walińska, *Zasady ujmowania rozliczeń międzyokresowych biernych w sprawozdaniu finansowym – propozycje zmian, Zeszyty Teoretyczne Rachunkowości, tom 35 (91) Stowarzyszenie Księgowych w Polsce, Rada Naukowa, Warszawa 2006 r., s. 187*

Every title of passive settlements must create the probable liability resulting from services of determined credibly will cause using already possessed or future assets of the firm, in harmony with the definition of liabilities from the Accountancy Act.

accruals refer in the particular to the title from:

- of costs of redeemed contracts for the firm for which the seller wasn't obliged to invoices before the balance day, and it is possible credibly to assess value of fulfilled services,
- of costs of warranty repairs, the customer complaint and guarantees concerning sold products of long-term use,
- of costs of removing mining damages and the rehabilitation of vandalised soil by the business activity,
- of payments of holiday remunerations, the bonus, jubilee awards,
- of making long-term agreements still not-finished for favours, in it building, if costs entered in the books of sold favours are higher than costs really incurred<sup>58</sup>.

Accruals are causing estimating current costs of activity but aren't estimating the future risk of economic subject connected with liabilities. As a rule they are being established with the big accuracy and future expense is 100% out, opposite to provisions which are burdened greater uncertainty.

Deductions of accruals can come appropriately to the passage of time or the size of services, costs with taking character into consideration accounted and with preserving the principle of the carefulness. Choice about the way of settlements should be taken hold in the politics bookkeepings, whereas principles of establishing them are resulting from recognised commercial customs.

From a point of view of A-Act regulations individual titles of settlements can be created only under the condition that it is possible in the rational way to estimate the amount of costs connected with each of these titles. Provisions to costs of next periods are being established of the amount resulting from the preliminary calculation, in the amount for the current reporting period. In case of creating the provisions to services on account of the customer complaint, for assessing value norms of the defectiveness or statistical data can be a base. Provisions to costs of warranty repairs are being created as a rule as a percentage sale value, individually for individual products for the year a given product was sold.

To sum up, although accruals are special form of provisions, there are certain differences between

<sup>58</sup> Accruals of costs and constitute also obligations of the entity reflecting the value of performed benefits under the terms of the agreement for the unit which aren't liable to a duty of issuing an invoice before the balance sheet day, however the individual can into the credible way estimate them: Fołta T., Godlewska J., Bilans 2005, Infor, Warsaw 2005, p. 232.

these notions. A caused event is a cause of settlements, whereas in the case of provisions the agreement is giving rise to burdens, the event for which the provisions are being created will appear in the future. A cost accruals, whereas in case of provisions predicted cost is recognised in the current period. The amount of settlements is based on relatively accurate estimates, whereas in the case of provisions this estimate is approximated<sup>59</sup>.

**Differences in recognizing provisions the Accountancy Act and IAS 37.** The issue of provisions is present in both Polish and international regulations, however, with certain differences. Differences refer to defining notions of responsibility, IAS defines creating provisions more precisely than A-Act. IAS 37 is precisely pinning down, opposite to A-Act, obliging event, i.e. event which creates legal or custom duty so that an economic unit has no possibility of not fulfilling this obligation<sup>60</sup>.

In the range of the provisions relating to the restructuring, the international standard is determining in detail examples of costs which cannot be taken as provisions, on account of the fact that these costs are relating to future activity.

MSR more precisely addresses evaluation of provisions whereas in A-Act only a record is appearing that provisions are being priced in justified, credibly assessed value.

**Summary.** Regulations of the Polish Accountancy Act and IAS 37 in the scope of provisions in some cases are coinciding. For issues not covered by A-Act one should retreat to domestic standards of accounting, however in the case of their lack, to international standards. Issues of provisions and accruals are treated by A-Act very widely. In case of creating the provisions for future liabilities from the title of restructuring the Accountancy Act doesn't specify the definition of the restructuring, opposite to IAS 37, doesn't determine different notions either, e.g. of obliging event (par. 10 IAS 37). Analysis of Polish regulations concerning provisions for restructuring proves that solutions applied at making the financial report according to A-Act differ from accepted regulations in IAS.

In IAS 37 we find a distinct division of provisions and different liabilities is noticeable, these categories compared, unlike in case of A-Act.

In accordance with the A-Act in order to create the provisions, the firm must be obliged to it on the basis of legal articles or a binding agreement.

1. *IAS 1 Presentation of financial statements (polish: MSR 1 Prezentacja sprawozdań finansowych).*
2. *ECC Directive on annual financial reports of some kinds of partnerships (polish: IV Dyrektywa Rady z 25 lipca 1978 r. w sprawie rocznych sprawozdań finansowych niektórych rodzajów spółek, art. 20.*
3. *MSR 37 rezerwy, zobowiązania warunkowe i aktywa warunkowe, red. S. Sojak, Difin, Warszawa, 2007.*
4. *Walińska E., Zasady ujmowania rozliczeń międzyokresowych biernych w sprawozdaniu finansowym – propozycje zmian, Zeszyty Teoretyczne Rachunkowości, tom 35 (91) Stowarzyszenie Księgowych w Polsce, Rada Naukowa, Warszawa, 2006.*
5. *Folta T., Godlewska J., Bilans 2005, Infor, Warszawa, 2005.*
6. *Poniatowska L., Rezerwy w świetle znowelizowanego prawa rachunkowości, [w:] Gierusz J., Jerzemowska M., Martyniuk T., (red). Rachunkowość wobec procesów globalizacji, Uniwersytet Gdański, Gdańsk, 2002.*
7. *Gierusz B., Rezerwy na zobowiązania. Komentarz do ustawy o rachunkowości, ODDK, Gdańsk 2002.*
8. *Orzeszko T., Pojęcie i rodzaje rezerw w świetle przepisów z zakresu rachunkowości w Polsce po 1990 r., Zeszyty Teoretyczne Rachunkowości, Numer Specjalny, tom 13 (69), Stowarzyszenie Księgowych w Polsce.*
9. *Jankowska M., Wybrane aspekty tworzenia rezerw i biernych rozliczeń międzyokresowych kosztów w świetle prac nad krajowym standardem rachunkowości „Rezerwy, zobowiązania warunkowe i aktywa warunkowe” w: Standardy rachunkowości wobec wyzwań współczesnej gospodarki, pr. zb. pod red. Messnera Z., tom II, Analiza standardów rachunkowości.*
10. *Gmytrasiewicz M., Karmańska A., Rachunkowość finansowa, Difin, Warszawa, 2002.*

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<sup>59</sup> E. Walińska, *Zasady ujmowania rozliczeń międzyokresowych biernych w sprawozdaniu finansowym – propozycje zmian, Zeszyty Teoretyczne Rachunkowości, tom 35 (91) Stowarzyszenie Księgowych w Polsce, Rada Naukowa, Warszawa 2006 r., s. 188.*

<sup>60</sup> Exact explanation of circumstances when this obligation arises can be found in IAS 37, ed. S. Sojak, Difin, Warszawa 2007, p. 55