

# audit

## FINANCIAR

Anul XIV, nr. 139 - 7/2016

7/2016

- Reglementarea, contabilitatea și auditul depozitelor bancare
- Regulation, accounting and audit of bank deposits



- **Sistemul de raportare integrată: un nou instrument de creștere a responsabilității asumate în cazul entităților din sectorul public**

- **Politici și practici contabile aplicabile pentru deprecierea activelor generatoare de alte fluxuri decât cele de trezorerie**

- **Managementul prin bugete. Întocmirea și lansarea bugetului de vânzări al întreprinderii**

- **The integrated reporting system: a new accountability enhancement tool for public sector entities**

- **Accounting policies and practices applicable for the impairment of assets that generate income other than cash flows**

- **Performance management through budgets. Drafting and launching the company's sales budget**

**Adevărul contabil și asigurarea acestuia la entitățile din Republica Moldova**

**Accounting truth and its assurance in entities from the Republic of Moldova**

# Sumar / Content

**audit**  
**FINANCIAR**

7/2016

Tudor OPRÎȘOR, Adriana TIRON-TUDOR,  
Cristina Silvia NISTOR

- *The integrated reporting system: a new accountability enhancement tool for public sector entities* [Click here!](#).....749

Marinela Daniela MANEA

- *Accounting policies and practices applicable for the impairment of assets that generate income other than cash flows* [Click here!](#).....763

Viorel ȚURCANU, Irina GOLOCIALOVA

- *Accounting truth and its assurance in entities from the Republic of Moldova* [Click here!](#).....771

Marioara AVRAM, Veronel AVRAM

- *Considerations regarding the regulation, accounting and audit of bank deposits* [Click here!](#).....783

Adriana Mihaela IONESCU, Cristina Elena BÎGÎOI

- *Performance management through budgets. Drafting and launching the company's sales budget* [Click here!](#).....791

Revistă lunară editată de  
**Camera Auditorilor Financieri  
din România**

Str. Sirenelor nr. 67-69, sector 5,  
București, OP 5, CP 83

Director științific:  
prof. univ. dr. **Pavel NĂSTASE**

Director editorial:  
prof. univ. dr. **Mădălina DUMITRU**

Secretar de redacție:  
**Cristina RADU**

Prezentare grafică și tehnoredactare:  
**Nicolae LOGIN**

*Colegiul editorial științific și colectivul  
redacțional nu își asumă  
responsabilitatea pentru conținutul  
articolelor publicate în revistă.*

Indexare în B.D.I.:

Academic Keys;

Cabell's;

Deutsche Zentralbibliothek für  
Wirtschaftswissenschaften;

DOAJ;

Ebsco;

ERIH PLUS;

Global Impact Factor;

Google Scholar;

ProQuest;

Research Papers in Economics  
(RePEc);

SCIPIO;

Ulrich's

Marcă înregistrată la OSIM,  
sub nr. M2010 07387

Telefon: (021) 410.74.43 interior 120;

Fax: (021) 410.03.48;

E-mail: [revista@cafr.ro](mailto:revista@cafr.ro);

<http://revista.cafr.ro>;

ISSN: 1583-5812,

ISSN on-line: 1844-8801

Tipar: Universal Color SA,  
Str. Victoriei, Complex Fortuna-Parter,

Pitești, jud. Argeș,

tel.: +40 248 215 788

e-mail: [universal@universalcolor.ro](mailto:universal@universalcolor.ro)

## Scientific Editorial Board

- Dinu AIRINEI, Ph. D. – "Al. I. Cuza" University, Iași  
Veronel AVRAM – Craiova University  
Yuriy BILAN – Szczecin University, Poland  
Sorin BRICIU – "1 Decembrie 1918" University, Alba Iulia  
Ovidiu BUNGET – Universitatea de Vest din Timișoara  
Alain BURLAUD – The National Conservatory of Arts and Crafts, Paris  
Tatiana DĂNESCU – "Petru Maior" University, Târgu Mureș  
Lilia GRIGOROI – Academy of Economic Studies of Moldova, Chișinău  
Raluca-Gina GUȘE – Bucharest University of Economic Studies  
David HILLIER – Leeds University Business School, United Kingdom  
Allan HODGSON – University of Queensland, Australia  
Emil HOROMNEA – "Alexandru Ioan Cuza" University, Iași  
Robin JARVIS – Brunel University, United Kingdom  
Maria MANOLESCU – Bucharest University of Economic Studies  
Dumitru MATIȘ – "Babeș-Bolyai" University, Cluj-Napoca  
Ion MIHĂILESCU – "Constantin Brâncoveanu" University, Pitești  
Ana MÔRARIU – Bucharest University of Economic Studies  
Mirela PĂUNESCU – Bucharest University of Economic Studies  
Irimie Emil POPA – "Babeș-Bolyai" University, Cluj-Napoca  
Vasile RĂILEANU – Bucharest University of Economic Studies  
Ion STANCU – Bucharest University of Economic Studies  
Donna STREET – Dayton University, USA  
Ioan TALPOȘ – West University, Timișoara  
Alexandru TUGUI – "Alexandru Ioan Cuza" University, Iași  
Eugeniu TÎRLEA – Bucharest University of Economic Studies  
Iulian VĂCĂREL – Member of the Romanian Academy

All rights of this edition are reserved to the Chamber of Financial Auditors of Romania (CAFR). Reproduction, even partially, on any support, and the sale are prohibited without prior consent of the CAFR, being subjects to the stipulations of the copyright law.

### Important for Authors!

**The articles** are submitted to the editor by e-mail at: revista@cafr.ro, compulsory in MS Office Word format, in black-and-white.

**The authors** are kindly requested to comply with the following:

- the language the article is drafted in is English
- the optimal size of the article is: 7-10 pages with 2000 signs/page, spaces included;
- the article must mention the title, the research methodology used, authors' contributions, the imperfect on the accounting profession and the references;
- an Abstract is compulsory, which must be written at the 3rd person plural, presenting the subject of the research, the main problems and authors' contributions;
- 4-5 key words;
- JEL Classifications.

**Tables and graphs** are developed in black and white whit up to six shades of gray and sent also separately, if they were elaborated in MS Office Excel.

**The review** of the articles is performed by members of the Scientific Assessment Council of the „Audit Financiar” Journal, by means of the „double-blind review” method, that is, the reviewers do not know the names of the authors, nor the authors know the names of the reviewers.

Assessment criteria for articles: innovative input, topicality, importance and relevance for the subject matter; the quality of the research methodology; clarity and pertinence of the presentation and argumentation; the relevance of the bibliographic sources used; contribution made to the research in the area.

The resolution of the Scientific Assessment Council of the journal can be: acceptance; acceptance with revisions; rejection. The results of the assessments are communicated to the authors and only the articles approved by the Scientific Assessment Council are published.

**More details** can be found on our website www.revista.cafr.ro, sections „Reviews” and „Manuscripts”.

**audit**  
**FINANCIAR**

7/2016

Monthly Journal published by the  
**Chamber of Financial Auditors  
of Romania**

67-69 Sirenelor Street, District 5,  
zip code 050855, Bucharest, OP 5,  
CP 83

Scientific Director:

Professor **Pavel NĂSTASE**, Ph.D.

Editorial Director:

Professor **Mădălina DUMITRU** Ph.D.

Editorial Assistant:

**Cristina RADU**

DTP: **Nicolae LOGIN**

*The Scientific Editorial Board and  
the editorial technical team shall  
take no responsibility for the content  
of the articles published in the  
journal.*

International Databases:

Academic Keys;

Cabell's;

Deutsche Zentralbibliothek für  
Wirtschaftswissenschaften;

DOAJ;

Ebsco;

ERIH PLUS;

Global Impact Factor;

Google Scholar;

ProQuest;

Research Papers in Economics  
(RePEc);

SCIPPIO;

Ulrich's

OSIM Trademark no. M2010 07387

**Chamber of Financial Auditors  
of Romania**

Phone: (021) 410.74.43 extension 120;

Fax: (021) 410.03.48;

E-mail: revista@cafr.ro;

http: revista.cafr.ro;

ISSN: 1583-5812

ISSN on-line: 1844-8801

Printing: Universal Color SA,  
Str. Victoriei, Complex Fortuna-  
Parter, Pitești, jud. Argeș,  
tel: +40 248 215 788

e-mail: universal@universalcolor.ro

---

# The integrated reporting system: a new accountability enhancement tool for public sector entities

---

Tudor OPRÎȘOR,  
Babeș-Bolyai University of Cluj-Napoca,  
E-mail: tudor.oprisor@econ.ubbcluj.ro

Adriana TIRON-TUDOR,  
Babeș-Bolyai University of Cluj-Napoca,  
E-mail: adriana.tiron@ubbcluj.ro

Cristina Silvia NISTOR,  
Babeș-Bolyai University of Cluj-Napoca,  
E-mail: cristina.nistor@econ.ubbcluj.ro

## Abstract

*In the recent years, integrated reporting has made progress towards becoming an efficient communication instrument that would bring an active contribution to the financial stability and sustainability of the economic environment. This paper employs mainly a documentary research approach and aims to track one of the main prerequisites leading towards new trends in public sector reporting – the concept of “public accountability”, and pinpoint the existing evidence which supports the perspective of adopting an integrated reporting system for public entities. Also, the authors emphasize the reaction from practitioners to the idea of “integrated reporting for the public sector” and analyse the front-running application of hybrid forms of reporting (e.g. City of Warsaw Integrated Sustainability Report), as well as the profile of the “Integrated Reporting – Public Sector Pioneer Network.”. Findings show that integrated reporting is gaining momentum towards application in the case of public sector entities, but advancements are rather slow. Due to the scarcity of data from reporting practice regarding integrated reports in the public sector (as the Pioneer Network is currently under development), which makes it difficult to construct an empirical study with actual evidence, the authors use extrapolation and knowledge transference from existing proof of hybrid forms of reporting.*

**Keywords:** Integrated reporting, public sector, accountability, integrated thinking.

**JEL Classification:** M41.

### To cite this article:

Oprîșor, T., Tiron-Tudor, A. and Nistor, C.S. (2016), The integrated reporting system: a new accountability enhancement tool for public sector entities, *Audit Financiar*, vol. XIV, no. 7(139)/2016, pp. 749-762, DOI: 10.20869/AUDITF/2016/139/749

### To link to this article:

<http://dx.doi.org/10.20869/AUDITF/2016/139/749>

## Introduction

Disclosure enhancement requirements are always causing “mutations” in the reporting systems, as organizations from all sectors are attempting to fulfil the information needs of their stakeholders and mitigate potential conflicts of interest between different categories of information users. One natural outcome of these so-called “mutations” is the integrated reporting system (<IR>), which is a way of an efficient communication on the holistic view of an organization’s activity (including both financial and non-financial dimensions).

The concept gained traction as the main governing body – the International Integrated Reporting Council (IIRC) – undertook a lot of effort to promote it and provide guidance and delineations so that its implementation would be eased. Thus, the Consultation Draft for the Conceptual Framework was issued in April 2013 (IIRC, 2013a), with a refined proposal for all the principles, fundamental concepts and content elements for an integrated report. In December 2013, the IIRC issued the final version of the Conceptual Framework (IIRC, 2013b), which embedded the feedback received through the comment letters from various stakeholders (reporting entities, professional organizations, standard setters, auditors, academics etc.).

Also, simultaneous initiatives have been launched to provide further guidance on <IR>. In this respect, professional organizations have been involved in this process. Their contribution to the development of the framework is seen in the form of the <IR> Background Papers and they approach specific topics, such as the business model (CIMA, IFAC and PwC, 2013); the capitals (ACCA and NBA, 2013); the connectivity of information principle (WICI, 2013); materiality (AICPA, 2013).

According to the <IR> Conceptual Framework (paragraph 1.1), “*an integrated report is a concise communication about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term*” (IIRC, 2013b). This generally-accepted definition represents the main ground for the integration process within an organization (regarding financial and non-financial elements), as well as the planned outputs resulting from predefined procedures. Furthermore, the definition outlines the

elements of “architecture” of an integrated reporting system, therefore intending to facilitate a better understanding of the processes which take place within an entity, as well as the results of the reporting entity’s activity.

While this system was designed to be implemented by companies, new developments have emerged leading it towards other sectors (such as the public and not-for-profit sectors), but without clear and distinct delineations to this extent. Moreover, to some degree, the idea of implementing <IR> in the public and not-for-profit sector was met with reluctance by a part of the practitioners, mostly by advocates of the <IR> design for the private sector. However, the professional organizations and standard setters – through the comment letters submitted in the consultation process – emphasized development directions towards the public sector and rallied behind the idea that <IR> would have good implementation perspectives for these entities (thus creating and promoting initiatives, such as the <IR> Public Sector Pioneer Network).

The primary objective of this paper is to identify the prerequisites for public “integrated thinking” and to argue for applying integrated reporting for the public sector as a useful accountability-enhancing tool, as well as a disclosure instrument for the impact of the entities’ activity.

Accordingly, our research questions to which we attempt to provide answers are the following:

1. *Is integrated reporting a suitable reporting system for public sector entities?*
2. *Can integrated reporting enhance accountability for public sector entities?*

In the way this paper is constructed, the main contribution would be towards a better understanding of the prerequisites of <IR> in the context of public sector implementation. Furthermore, this would concur to enabling <IR> as an efficient communication tool between the reporting entities (as stewards of public resources) and the users of accounting information (among which are accounting professionals, including auditors). Auditing <IR> is, in itself, a controversial and well-debated topic. Any increase in the level of understanding regarding the delineations and the (possibly) adjusted <IR> model for public sector entities is highly relevant in terms of research value.

## 1. Research methodology

To accomplish our research objective, we turn towards the literature and analyse what the frontrunners from this research field have done. We develop a brief review of the relevant literature and evidence from practice to gain a better level of knowledge on how integrated reporting has evolved and what future directions there are for its development. In this respect, we reveal that our research is on a documentary level and our research methods are the review, the argumentative structure and content analysis.

Most of the papers and reports that we found and used in our literature review regarding integrated reporting are targeted towards the implementation of <IR> in the private sector, as this is the benchmark and the primary example of good practice. Therefore, we undertook a breakdown of the integrated reporting construct and attempted to identify the prerequisites for its implementation in the public sector (so that we could create an argument for the development of <IR> as an accountability tool in public sector entities).

Consequently, we select public accountability as a link between the sectors and a way of transferring the know-how in the case of public sector adoption of <IR>. We attempt to identify key delineations (in terms of definition, taxonomy, evolution over time and embedment in reporting systems), links to precursor models based on integrated thinking (such as sustainability reporting, which relies on the triple bottom line) and, ultimately, inference in the <IR> model (based on the mentioned taxonomy).

Also, we study the architecture of the <IR> Framework and question how the key dimensions could be addressed for the public sector entities. In our assumption, in the case of public sector entities, instances of public accountability exist on every layer of the <IR> model (both on a static view – when addressing resource allocation and on a dynamic view – when discussing value creation). After all, the IIRC clearly states within the Framework that one of their aims is “to enhance accountability and stewardship for the broad base of capitals [...] and promote understanding of their interdependencies” (IIRC, 2013b: p. 2).

Last, but not least, we emphasize the existing cases and projects in development for <IR> in the public sector. Although their number is not that high, these cases are

the practical manifestations of the (tentative) implementation process started by the IIRC and its collaborators. Research and discussions in this direction are gaining traction, and we expect to see an intensification of the initiatives leading towards <IR> in the public sector.

Being publicly accountable is an inherent trait of public servants (and, by extension, of public sector organizations). Therefore, we frame our motivation for considering <IR> as an accountability tool in the context of practical communication needs. As the public sector has a broader range of stakeholders (and a part of them do not have a high degree of economic literacy), many of them do not necessarily need *more* disclosure, but an *efficient* one (and by “efficient” we mean a form of reporting where the users can understand from a concise communication as many aspects as possible regarding the use of resources and the impact of the organization’s activity).

Clearly, <IR> could have many implications in the case of public sector entities other than safeguarding accountability and it can be linked to different principles and theories which were also a basis for precursor forms of reporting. Having said that, we consider public accountability as an intrinsic attribute of public sector entities which leads to the need for reporting system restructuring towards <IR> (said otherwise, into a model that would comprise as many elements of public resource use in an intelligible and comprehensive manner).

## 2. Theoretical insights on the concept of public accountability: a prerequisite for integrated reporting

Even if it generates many debates in the literature, accountability – as a concept – still presents significant problems of interpretation. Generally speaking, accountability indicates “*the aptitude of subjects (accountee or steward) to account for their actions, and for their actions in relation to another person or group of people (accountor or principal)*”. Therefore, the key conceptual delineation revolves around the agency theory, respectively: there is a relationship between a subject, who acts in the interest of another, and towards whom he has some form of obligation to make himself

accountable (Stewart, 1984, cited by Bartocci and Picciaia, 2013: p. 192).

To provide a better understanding of the delineations regarding accountability, Patton (1992) conducted a comprehensive study concerning the concept of accountability. He mainly focused on the link between the idea of accountability and the governmental financial reporting, presenting the approach of the GASB from the United States of America (which states that “[g]overnment financial reporting should provide information to assist users in (a) assessing accountability and (b) making economic, social and political decisions [...]”). Nevertheless, many other inherent issues and limitations are prone to appear, such as the inconsistent meaning of “accountability” – as a term; the complications brought to the cost-benefit analysis of information; the hindrance in assuring the provision of sufficient information in a single report for all users; the existence of “*non-accounting-based means of achieving accountability*”.

In Patton’s (1992) view, “*accountability reporting in complex environments with many dimensions of accountability (for instance, legal, political, financial, etc.) would imply eclectic reports that include both financial data and a variety of other forms of information*”. These dimensions can be addressed separately, as Burrit (2012) does with environmental performance accountability, or even more interesting, all together. This would constitute the essential ground of having a report which encompasses disclosures for most (if not all) of the capitals of an organization.

In itself, accountability has become a trending principle. It has even been included in the “*Seven Principles of Public Life*” (alongside selflessness, integrity, objectivity, openness, honesty and leadership), issued by the Nolan Committee from the UK. Also, the South African Public Service Commission considers the systematic building and incremental development of both capacity and capability as core enablers of public service. In other words, an accreditation system for public service managers is highly recommended to ensure that appointees have the required set of skills and experience for their work (Raga and Taylor, 2005).

Mashaw (2006, p. 118) develops a framework proposal starting with a taxonomy formed from six lines of inquiry which – in his opinion – constitute the layers of an accountability regime: “*who, to whom, about what, through what processes, by what standards and with*

*what effect*”. This taxonomy allows the careful dimensional analysis of any reporting system, especially one with a holistic approach, such as <IR>, and identify all the key actors and informational flows in-depth.

We notice that, over time, stakeholders have become increasingly demanding concerning the quality of the governing process, transparency and accountability of public sector organizations. Hence, <IR> is a tool able to provide an accurate level of insight into how the reporting entity is governed and which are the sources of information in the decision-making process, respectively how management structures are held accountable for performance (KPMG, 2012).

The principle of stakeholder engagement (which is also an essential element in the <IR> construct) is also viewed as a fundamental accountability mechanism, mandating organizations to involve their stakeholders in identifying, comprehending and responding to sustainability concerns as well as to issue reports, and provide explanations and answers to stakeholders regarding their decisions, actions and performance (AccountAbility, 2011: p. 6, cited by Steyn and de Beer, 2012: p. 61).

The concept of <IR> – i.e. disclosing financial and nonfinancial information about governance, performance and risk management in a holistic manner within the same document - is perceived as a necessary, forward-looking upgrade of sustainability reporting. These <IR> guidelines have been argued to support the information needs of long-term investors (favoured to, but not excluding other groups of interested parties), by showing the broader and longer-term social and environmental consequences of decision-making. <IR> puts strategic financial and non-financial information at the same level of importance for performance disclosure and stakeholder accountability (Synergiz, 2014).

Returning our focus on precursor reporting models of publicly accountable entities, we identify studies connected to sustainability reporting on the development processes of KPIs (key performance indicators) used for measuring sustainability performances and the way in which they are employed in the planning and decision-making processes (Adams and Frost, 2008). We also find studies on the reasons for generating sustainability reports (using the semi-structured interview on a sample of entities well-known for “good reporting practices” from the Australian public sector) (Farneti and Guthrie, 2009). Concurring findings on the Australian public sector

entities are also achieved using a different methodology (i.e. mail survey) (Williams, Wilmhurst and Clift, 2011), whereas other studies present cases for other countries, such as Italy (Montesinos et al., 2013) or Spain (Quiles, Navarro-Galera and Ortiz-Rodriguez, 2013), revealing the GRI guidelines as prevalent for sustainability reporting, as well as significant developments for transparency increment (as a mean to discharge accountability), requiring public administrations to inform citizens about their activities.

The emphasis on the emerging social dimension leads to a structural change from a “vertical” construct to “horizontal” relations between parties engaged in accountability relationships. Moreover, we notice the existence of intermediate bodies which allow communication and interaction between citizens and public administrations. In this sense, power is not contained into one pole, rather it is more widespread, and relations are implicitly more balanced (Bovens 2005; cited by Bartocci and Picciaia, 2013: 194). This leads to a “flattening” and downward enlargement in relations, introducing a horizontal dimension of accountability.

Nowadays, many organizations focus on increasing the availability of information to improve management and provide external accountability. Programs and activities are required to lend themselves to target actual measures. However, one particular area of confusion is the lack of clarity regarding the status of local governments as local administrators of a national performance framework and standards, as opposed to being responsible for local leadership implying accountability in which performance measurement is of paramount importance. The original driver for implementing performance reporting was a desire for accountability enhancement (most of all, for services provided). Recent findings indicate that there is indeed reason to express optimism about the capacity of performance reporting systems to enable accountability and effectiveness in government entities, but the complexity of the process is very high, and it is not as immediate as many advocates would suggest (Cunningham and Harris, 2005).

Therefore, accountability has been the focus of many studies, and it remains a very complex concept, which is not yet fully understood. Moreover, public accountability has come under scrutiny as the new trends in reporting are reaching the public sector. For integrated reporting, this is particularly interesting because regardless of the

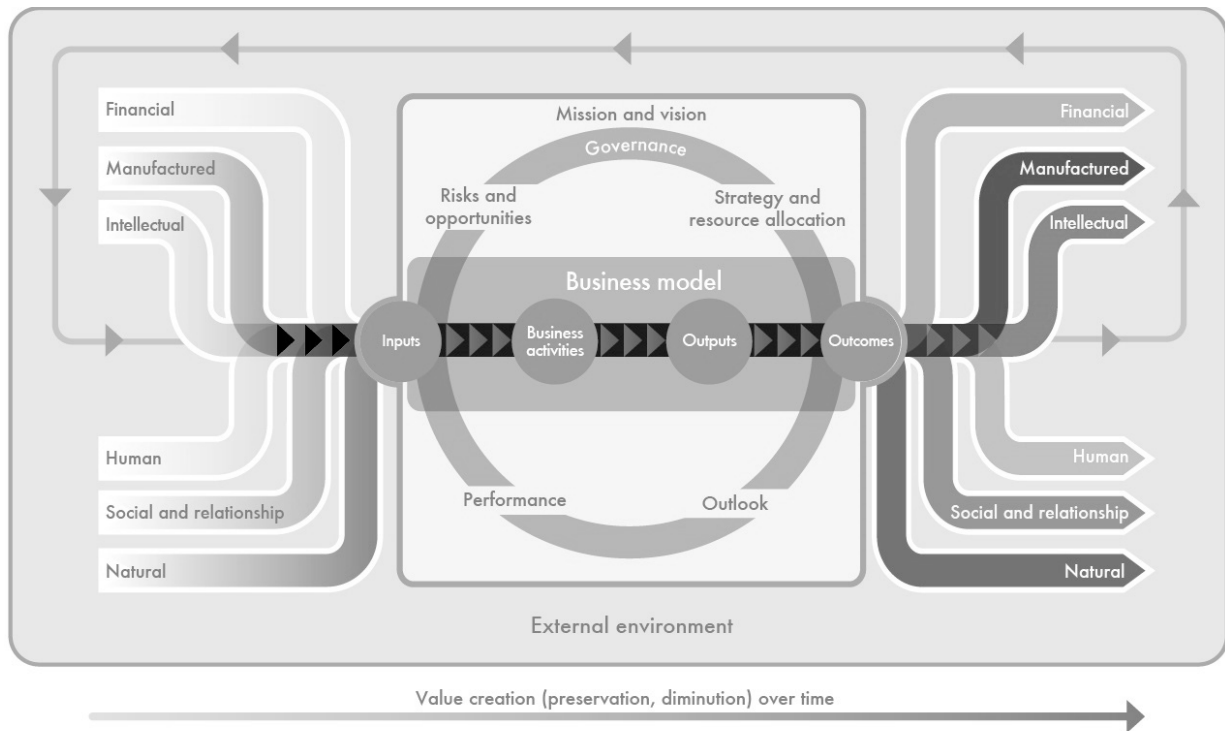
different levels of complexity, both private and public sector entities have public accountability through their actions. Thus, this concept remains a fundamental principle for public sector entities and should be taken into account when restructuring the reporting system as it may serve as an instrument of know-how transference for <IR>.

### 3. The integrated reporting framework for public sector entities: requirements and challenges

The <IR> Framework – whether in its draft form or the final version – has come under significant scrutiny and discussion regarding its construct (Loska, 2011; Reuter and Messner, 2015). The primary focus of the debates is to assess a level of understanding regarding the political dimension of standard-setting in the context of <IR> and to reveal different concerns (for instance, the scope of <IR> audience; issues of materiality and the relationship between <IR> and other existing reporting frameworks; assurance provision etc.).

Indeed, integrated reporting is a concept that was primarily designed for the private sector. However, the basic design of an integrated report can be applied to public sector entities as well (see paragraph 1.4 from the IIRC Framework) and is not as restrictive as the phrasing in the Framework appears to be. For instance, if we look at the value creation process through <IR> (see Fig. 1), we can notice that it is based on flows and elements that are similar in the public sector (such as capitals, activities, inputs, outputs, outcomes). Concepts such as value preservation and capital maintenance would suit well in the case of public sector entities, which function as stewards for public goods. However, to understand this dichotomy, we need to analyse the concept of public value – how it is defined (Moore, 1995); how it works in the context of new public management (O’Flynn, 2007; Alford and Hughes, 2008); where is it framed in the governance systems (Stoker, 2006). Moreover, there are many dimensions which are embedded in the case of value creation (for instance: we analyse that a public sector entity can create value for the public, but can it create value for itself?).

**Figure 1. The value creation process presented in the IIRC Framework**



Source: IIRC, 2013a: p. 7.

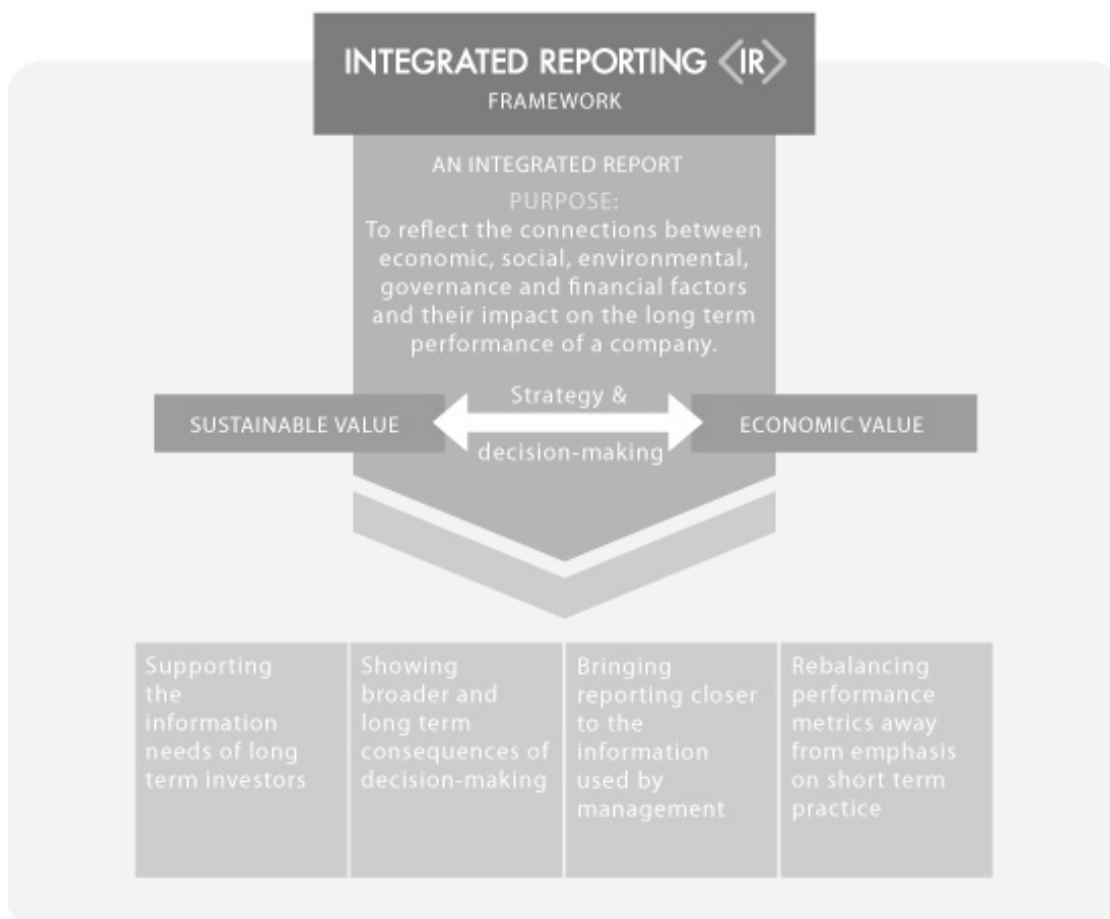
Also, the content elements and the principles of <IR> are not restrictive towards public sector entities, as there is also strategic planning (e.g. public institutions' master plans for 5-7 years), connectivity of information (both horizontally – between agencies on the same level, and vertically – between agencies on different levels), as well as stakeholder inclusiveness.

For implementation in the public sector, we need to question and break down this model in order to analyse whether it is appropriate for the public sector in its current form (with accurate testing for each piece) or it requires certain adjustments (e.g. more/fewer capitals; address resource limitations; insert political dimension in the model). Also, the principles are paramount for the public sector as well (e.g. we need to address what is material for such a report in the public sector; how can conciseness be achieved in mitigation with materiality; which are the stakeholders which need to be engaged).

The strategies and decisions which are disclosed in the <IR> should lead to the creation (preservation) of economic and/or sustainable value (with a balance between the two – see Figure 2). Also, it should provide support for the information needs of taxpayers – which are the public sector “shareholders” (although this is rarely crossed in practice) and broaden the timeframe for decision-making. Curiously enough, these stakeholders are not the primary users of the reports in the public sector, but the people who work there are.

Considering all the constituting elements of <IR>, we emphasize the fact that, by using Mashaw's taxonomy, we can distinguish this reporting system as an accountability enabler. The only questionable dimension remains connected to the set of standards by which the organization prepares the reports (at this point, the only official guideline document is the Framework).

**Figure 2. The main objectives of <IR>**



Source: <http://blog.aicpa.org/2011/07/integrated-framework-in-the-professions-future.html>

All these elements support the fact that, although the two sectors – private and public – are different concerning characteristics, the adoption of integrated reporting is suitable to the same extent. The main focus should come on the fact that the Conceptual Framework should be adapted so that it holds account of the key features and different insights of the public sector, as well. This desiderate is possible and very well supported by public sector professional organizations and standard setters (mainly the ones that actively contributed to the improvement of the Framework in the consultation process from 2013).

#### 4. Creating the path towards an accountability enhancement tool for public sector entities in the shape of integrated reporting

Following recent developments regarding <IR>, we can emphasize its evolution as an independent concept. The emergence of „integrated thinking” and the metamorphosis of sustainability reporting (by endorsing an integrated approach and splitting the triple bottom line model into more layers) have provided the ground

for advancements towards a new research direction regarding <IR> (Lai, Melloni and Stacchezzini, 2014; Eccles and Saltzman, 2011; Mammatt, 2009). Early adopters of <IR> have presented a lot of interest within this field as they would have preliminary evidence regarding the institutionalization of <IR>. Specifically, they are interested in the framing of their mutations regarding of processes and structures (even though findings show that adoption of <IR> has not necessarily stimulated innovations in disclosure mechanisms) (Stubbs and Higgins, 2014; Higgins, Stubbs and Love, 2014).

The natural evolution of the reporting system was to a template outline for <IR> which would be based on “*the story of an organization’s journey towards reaching its vision*”, by the <IR> principles, its fundamental concepts, and its content elements. Moreover, <IR> is viewed as an opportunity for the reporting parts to be summed up in a single holistic construct, presenting information about the “*web of interactions and implications of financial, social, environmental, and governance-related organizational activities for stakeholders*” (Abeysekera, 2013).

Nevertheless, the implementation and use of <IR> have much more complex implications on an organization’s activity and its relationship with stakeholders than merely a way of providing a more extensive view of the (created, preserved or depleted) value and the business model. Also, <IR> is considered a significant proxy for the overall level of quality of the management (emphasizing the growing interest in intangibles and revealing the “externalities” on the environment and society). “Integrated thinking” – as a distinct concept – is seen as a mechanism to achieve “*balance between short-term imperatives and ongoing value creation*” (Churet and Eccles, 2014).

Other discussions regarding <IR> are focused on the cost-benefit analysis (taking the implementation process into account, with all its constituting elements), as well as collaboration perspectives and the outlook for all sectors in order “*to establish a global movement for sustainable actions*” (Eccles and Saltzman, 2011). This assumption would frame the implementation of <IR> in a much broader web of interactions between different stakeholders.

In close connection, many analyses and studies have been focused on the mandatory/voluntary status of <IR> in order to create added-value to reporting (Eccles,

Cheng and Saltzman, 2010), as well as emphasizing and analysing connections with principles and content elements – such as materiality (Eccles et al., 2012; Mio and Fasan, 2014), capitals (Bartolini, Santini and Silvi, 2013) or governance (Wulf, Niemoeller and Rentzsch, 2014), as well as external factors, such as the cultural system (Frías-Aceituno, Rodríguez-Ariza and García-Sánchez, 2013; Garcia-Sanchez, Rodríguez-Ariza and Frías-Aceituno, 2013).

In the recent years, the IIRC has undertaken considerable efforts to issue and facilitate the reporting practice of <IR> through guidelines for implementation. Hence, critical voices have brought up the fact that <IR> should “broaden up” and “open up” dialogue, setting the ground for an intense debate on how standardization and guideline issuance might assist or obstruct the core model of “*sustainable practices*.” Using business cases as a primary logic shows the inherent limitation of IIRC’s view and many stakeholders demand “a more pluralistic approach, as well as new accounting technologies and engagement practices” (Brown and Dillard, 2014).

Recent studies (Veltri and Silvestri, 2015; Cheng et al., 2014; Bartocci and Picciaia, 2013) highlight the key developments, examples and implementation perspectives for the <IR> in the public sector and even synthesize hybrid forms of reporting (such as “integrated popular reporting”), as a mean for safeguarding accountability and transparency (Cohen and Karatzimas, 2015). Consequently, the <IR> might be helpful at considering the organization as a whole and unitary functional system, mainly designed for creating value for a broad range of stakeholders (Vermiglio, 2012). Most of the conclusions are in line with the comments provided by the respondents in the consultation process conducted by the IIRC.

In the public sector, a good early adopter of (some form of) <IR> is the City of Warsaw, which published its first “Integrated Sustainability Report” in 2013 (and the trend is expected to continue, with the perspective of further guidance for public sector entities). Although it is not a “pure” integrated report (as the reporting entity hesitates to call it so), the “integrated sustainability report” from the City of Warsaw is a good example of a hybrid form of reporting (which is the continuing working draft towards the final product). The main reason for producing this report as a hybrid is the fact that it was issued for the year 2013 when the <IR> Framework was still in its drafting and consultation process.

Therefore, the City of Warsaw used the closest reference to <IR> in terms of guidelines: the GRI. Apparently, this report is the first ever worldwide issued under G4 guidelines. The main construct of the report is based on the three pillars of sustainability (environmental, social and economic) and it even extends the encompassment by embedding these pillars in the strategic outlook (“ongoing steps to assure strategic goals are met”). All in all, the report is 14-pages long and does an excellent job in keeping the presentation concise and material (just as the <IR> principles state). Still, the most interesting aspect of this report is the great number of KPIs used in assessing the activity of the City Administration during the year 2013, providing numbers and percentages for each instance of activity and connected to each line from the GRI Content Index (G4 Guidelines). This leads to a very accurate presentation of the City’s results and the performance of

the public servants and their activities on each pillar of sustainability, in the context of the main strategies.

This report (alongside others of its kind) represents the consolidation start of this new trend in public sector reporting. Furthermore, CIPFA and the IIRC have announced the establishment of a new international working group: Public Sector Pioneer Network. The oversight of the network is ensured by a steering group, expected to contain a mixture of participants and external organizations, with a secretariat provided by CIPFA and the IIRC. According to its leaders, “the new group will pioneer implementation of <IR> across the various different types of bodies in the public sector to demonstrate how it can be applied and share their experience with others to help improve transparency and accountability, and build trust in the public sector organizations” (CIPFA, 2014).

**Figure 3. Benefits of participation in the <IR> Public Sector Pioneer Network**



Source: <http://www.cipfa.org/policy-and-guidance/integrated-reporting-public-sector-pioneer-network>

There is also mentioned that the new pioneer network has the role in facilitating its members to share ideas and learning one from each other as they develop their own approach to integrated

reporting. This international working group is expected to function during two reporting cycles 2014/2015. This is intensely promoted by all the founding organizations, but although these initiatives

are supported, the first reports are significantly delayed in terms of timeframe.

A CIMA report from 2015 shows that the advancements with the Public Sector Pioneer Network are slow. Until the time the report was published, merely seven reporting entities were included as good <IR> implementers, and most of them are state-owned enterprises (which, from a sectoral point of view are at the borderline between private and public, but manifest public accountability nevertheless). We expect the number of these reporting entities to rise as the Network is actively expanding and working to address all the challenges for public sector implementation.

On a discursive note, we find that the leaders of this Pioneer Network (through the voice of Bertrand Badré, Group Chief Financial Officer at the World Bank Group, acting as a founding participant) have a rather interesting assessment on how these organizations view integrated reporting in the public sector. The statement (which can be found on the promoting flyer) emphasizes that “[p]ublic sector entities are some of the largest, if not the largest, reporting entities in the world, so the transparency of their financial information is of importance to us all. Integrated Reporting would enable governments and their stakeholders to gain a better understanding of resources available and help them to manage these more effectively” (CIPFA, 2014).

First of all, it is clear that transparency is an issue for public sector entities, and it needs to be addressed (and integrated reporting is seen by the Pioneer Network’s drivers as a solution to increase it). Also, the emphasis on financial information is evident, and it leads us to think that the capital providers are not all equally important (the financial capital still gains most of the attention from the preparers). Governments are explicitly mentioned as primary users of these reports (all the other stakeholders being left in one general category). Last, but not least, it is presumed that these reports will be used as management tools, which would improve the way public sector organizations are run. It remains to be seen if the reporting entities run these coordinates in the same understanding.

To this point, it is clear that public sector entities are mandated to work in the public interest and are held publicly accountable for their use of resources, actions and impact of their activity. Thus, an important underlying assumption is that these entities should constantly attempt to reduce information asymmetry and

increase transparency. Many theorists and practitioners see <IR> as a mean to put in effect this assumption and the trend leads towards this system (whether it evolves naturally – like it is the case of City of Warsaw; or the implementation as part of an interconnected web of stakeholders – like it is the case of the Network itself).

## Conclusions

Integrated reporting has come across great support in the recent years, as most of the professional organizations, standard setters, academics and early-adopters actively collaborate in finding better ways of achieving its goals and ensuring proper implementation. However, the <IR> concept itself is not really a brand new territory, but it looks like a re-emergence of precursor reporting formats – only with an approach from a different angle (“the integrated thinking”).

On a conceptual level, integrated reporting applies to entities from all sectors (private, public and non-governmental); however, the phrasing and the primary design of the Conceptual Framework target this reporting system towards the private sector. This is in no way a restriction to the possible implementation in the public sector, as the Framework can be adapted and, furthermore, professional organizations actively work (in collaboration) to drive the public sector towards <IR>. Therefore, we conclude that <IR> is indeed suitable for the public sector (having considered the initiatives and views from theorists and practitioners) and could have many implications (among which is also accountability enhancement).

Through our study, we also reveal the main features of the concept of “accountability” in order to understand how this could work as a prerequisite for <IR>. We found many studies that approach different delineations and manifestations of accountability, needed to understand how this trait is perceived in the context of public interest and public services. Using these delineations and taxonomy, we find a match of the dimensions of public accountability with the core construct of <IR>, thus enabling the reporting system as an accountability tool for public sector entities (allowing users to understand and judge the most important aspects of an organization’s activity).

The benefits of <IR> seem to be widely acknowledged and, despite the inherent level of reluctance and negativity, the system is gathering interest from various

reporting entities (whether or not they are involved in official initiatives, such as the Public Sector Pioneer Network). Thus is the case of the City of Warsaw, which drafted its own “Integrated Sustainability Report” for the year 2013 (by GRI guidelines, but inherently following the key traits of <IR>).

The research is ongoing, but we point out key developments and the perspective of developing a new tool for public accountability enhancement (in the form of integrated reporting). The momentum is building, and the evidence is growing that this is a desired reporting system for public sector entities. The main challenges are in terms of guidelines issuance (considering the differences between the sectors and the fact that <IR> was originally drafted for the private sector) and support for this process from the main “actors” (reporting entities, professional organizations, standard setters).

Fortunately, the second aspect is on a positive trend as these entities have indeed shown interest towards this

direction and are actively working on solutions to drive <IR> towards the public sector.

The main limitation of this research is that it approaches all the concepts at a documentary level (emphasizing the core assumptions for applying integrated reporting in the public sector). The existing data needed to construct an empirical study is really scarce, and the one that does count is connected solely to the private sector. However, as an outlook, we will drive our research forward-looking and link our efforts to the main initiatives of the professional organizations and standard setters to implement <IR> in the public sector (through the Public Sector Pioneer Network).

### Acknowledgement

This work was supported by a grant of the Romanian National Authority for Scientific Research and Innovation, CNCS – UEFISCDI, project number PN-II-RU-TE-2014-4-0265.

### REFERENCES

1. Abeysekera, I. (2013), A template for integrated reporting, *Journal of Intellectual Capital*, vol. 14, no. 2, pp. 227-245, DOI: <http://dx.doi.org/10.1108/14691931311323869>.
2. ACCA and NBA, Capitals (2013), *Background paper for <IR>*, [pdf] Available at: <http://www.theiirc.org/wp-content/uploads/2013/03/IR-Background-Paper-Capitals.pdf>, [Accessed on February 20, 2015].
3. AccountAbility (2011), *Stakeholder Engagement Standard 2011 (AA1000SES), Final Exposure Draft*, [pdf] Available at: <http://www.accountability.org/images/content/3/6/362/AA1000SES%202010%20PRINT.PDF>, [Accessed on January 20, 2015].
4. Adams, C. and Frost, G. (2008), Integrating sustainability reporting into management practices, *Accounting Forum*, vol. 32, no. 4, pp. 288-302, DOI: <http://dx.doi.org/10.1016/j.accfor.2008.05.002>.
5. AICPA (2011), *Integrated Reporting Framework in the Profession's Future*, [online] Available at: <http://blog.aicpa.org/2011/07/integrated-framework-in-the-professions-future.html>, [Accessed on January 11, 2015].
6. Alford, J. and Hughes, O. (2008), Public Value Pragmatism as the Next Phase of Public Management, *The American Review of Public Administration*, vol. 38, no. 2, pp. 130-148, DOI: <http://dx.doi.org/10.1177/0275074008314203>.
7. Bartocci, L. and Picciaia, F. (2013), Towards Integrated Reporting in the Public Sector, in *Integrated Reporting: Concepts and Cases that Redefine Corporate Accountability*, edited by Busco, C., Frigo, M.L., Quattrone, P and Riccabone, A. (eds.), Springer International Publishing Switzerland, pp. 191-204, DOI: <http://dx.doi.org/10.1007/978-3-319-02168-3>.
8. Bartolini, M., Santini, F. and Silvi, R. (2013), Performance Measurement and Capitals, in *Integrated Reporting: Concepts and Cases that Redefine Corporate Accountability*, edited by Busco, C., Frigo, M.L., Quattrone, P and Riccabone, A. (eds.), Springer International Publishing Switzerland, pp. 127-145, DOI: <http://dx.doi.org/10.1007/978-3-319-02168-3>.
9. Bovens, M. (2005), Public accountability, in *The Oxford handbook of public management*, edited by Ferlie, E., Lynne, L. and Pollitt, C. (eds.), Oxford: Oxford University Press.

10. Brown, J. and Dillard, J. (2014), Integrated reporting: On the need for broadening out and opening up, *Accounting, Auditing and Accountability Journal*, vol. 2, no. 7, pp. 1120-1156, DOI: <http://dx.doi.org/10.1108/AAAJ-04-2013-1313>.
11. Burrit, R. (2012), Environmental performance accountability: planet, people, profits, *Accounting, Auditing & Accountability Journal*, vol. 25, no. 2, pp. 370-405, DOI: <http://dx.doi.org/10.1108/09513571211198791>.
12. Cheng, M., Green, W., Conradie, P., Konishi, N. and Romi, A. (2014), The International Integrated Reporting Framework: Key Issues and Future Research Opportunities, *Journal of International Financial Management and Accounting*, vol. 25, no. 1, pp. 90-119, DOI: <http://dx.doi.org/10.1111/jifm.12015>.
13. Churet, C. and Eccles, R. (2014), Integrated Reporting, Quality of Management and Financial Performance, *Journal of Applied Corporate Finance*, vol. 26, no. 1, 2014, pp. 56-64, DOI: <http://dx.doi.org/10.1111/jacf.12054>.
14. CIMA (2015), *Integrated Reporting in the Public Sector*, [pdf] Available at: [http://www.cimaglobal.com/Documents/Thought\\_leadership\\_docs/reporting/IR-Public-Sector.pdf](http://www.cimaglobal.com/Documents/Thought_leadership_docs/reporting/IR-Public-Sector.pdf), [Accessed on March 13, 2016].
15. CIMA, IFAC, PricewaterhouseCoopers (2013), *Business Model. Background paper for <IR>*, [pdf] Available at: [http://www.theiirc.org/wp-content/uploads/2013/03/Business\\_Model.pdf](http://www.theiirc.org/wp-content/uploads/2013/03/Business_Model.pdf), [Accessed on February 20, 2015].
16. CIPFA (2014), *Integrated Reporting: public sector pioneer network*, available online: <http://www.cipfa.org/policy-and-guidance/articles/integrated-reporting-public-sector-pioneer-network>, [Accessed on June 01, 2014].
17. City of Warsaw (2013), *Integrated Sustainability Report*, [pdf] Available at: [http://www.um.warszawa.pl/sites/default/files/warsaw\\_g4\\_integrated\\_sustainability\\_report\\_2013.pdf](http://www.um.warszawa.pl/sites/default/files/warsaw_g4_integrated_sustainability_report_2013.pdf), [Accessed on February 20, 2015].
18. Cohen, S. and Karatzimas, S. (2015), Tracing the future of reporting in the public sector: introducing integrated popular reporting, *International Journal of Public Sector Management*, vol. 28, no. 6, pp. 449-460, DOI: <http://dx.doi.org/10.2139/ssrn.2524807>.
19. Cunningham, G.R. and Harris, J.E (2005), Toward a Theory of Performance Reporting to Achieve Public Sector Accountability: A Field Study, *Public Budgeting and Finance*, vol. 25, no. 2, pp. 15-42, DOI: 10.1111/j.0275-1100.2005.00359.x.
20. Eccles, R., Cheng, B. and Saltzman, D. (eds.) (2010), *The Landscape of Integrated Reporting Reflections and Next Steps*, Cambridge: Harvard Business School.
21. Eccles, R. and Saltzman, D. (2011), Achieving Sustainability through Integrated Reporting, *Stanford Social Innovation Review*, vol. 9, no. 3, pp. 55-61, [pdf] Available at: [http://people.hbs.edu/reccles/2011SU\\_Features\\_EcclesSaltzman.pdf](http://people.hbs.edu/reccles/2011SU_Features_EcclesSaltzman.pdf), [Accessed on March 08, 2014].
22. Eccles, R., Krzus, M., Rogers, J. and Serafeim, G. (2012), The Need for Sector-Specific Materiality and Sustainability Reporting Standards, *Journal of Applied Corporate Finance*, vol. 24, no. 2, pp. 8-14, DOI: 10.1111/j.1745-6622.2012.00380.x.
23. Farneti, F. and Guthrie, J. (2009), Sustainability Reporting by Australian Public Sector Organizations: Why they Report, *Accounting Forum*, vol. 33, no. 2, pp. 89-98, DOI:10.1016/j.accfor.2009.04.002.
24. Frías-Aceituno, J.V., Rodríguez-Ariza, L. and García-Sánchez, I.M. (2013), Is integrated reporting determined by a country's legal system? An exploratory study, *Journal of Cleaner Production*, vol. 44, pp. 45-55, DOI:10.1016/j.jclepro.2012.12.006.
25. Garcia-Sanchez, I. M., Rodriguez-Ariza, L. and Frias-Aceituno, J.V. (2013), The cultural system and integrated reporting, *International Business Review*, vol. 22, no. 5, pp. 828-838, DOI:10.1016/j.ibusrev.2013.01.007.
26. Higgins, C, Stubbs, W. and Love, T. (2014), Walking the talk(s): Organisational narratives of integrated reporting, *Accounting, Auditing & Accountability Journal*, vol. 27, no. 7, pp. 1090-1119, DOI: <http://dx.doi.org/10.1108/AAAJ-04-2013-1303>.
27. IIRC (2013a), *The Consultation Draft of the International <IR> Framework*, [pdf] Available at: <http://integratedreporting.org/wp-content/uploads/2013/03/Consultation-Draft-of-the->

- InternationalIRFramework.pdf , [Accessed on June 13, 2016].
28. IIRC (2013b), *The International <IR> Framework*, [pdf] Available at: <http://www.theiirc.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf>, [Accessed on March 06, 2014].
  29. KPMG (2012), *Integrated Reporting: Performance insight through Better Business Reporting*, [pdf] Available at: <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/road-to-integrated-reporting.pdf> [Accessed on March 10, 2014].
  30. Lai, A., Melloni, G. and Stacchezzini, R. (2014), *Corporate Sustainable Development: is 'Integrated Reporting' a Legitimation Strategy?*, *Business Strategy and the Environment*, vol. 25, no. 3, pp. 165-177, DOI: <http://dx.doi.org/10.1002/bse.1863>.
  31. Loska, T. (2011), *Integrated Reporting: Towards a Framework for a Sustainable International Corporate Reporting*, Master's Thesis, [online] Available at: <http://www.grin.com/en/e-book/184164/integrated-reporting-towards-a-framework-for-a-sustainable-international>, [Accessed on June 13, 2016].
  32. Mammatt, J. (2009), *Integrated Sustainability Reporting and Assurance*, *CIS Corporate Governance Conference*, 2009, pp. 1-6, [pdf] Available at: <http://licsa.co.za/documents/speakerPres/JayneMammatt/MammattIntegratedSustainabilityReportingandAssurance.pdf> [Accessed on March 08, 2014].
  33. Mashaw, J. L. (2006), *Accountability and institutional design: some thoughts on the grammar of governance*, in *Public Accountability: Designs, Dilemmas and Experiences*, edited by Dowdle, M.W., Cambridge: Cambridge University Press, pp. 115-156.
  34. Mio, C. and Fasan, M. (2013), *The determinants of materiality disclosure in integrated corporate reporting*, *Working papers series*, no. 2014/9, Universita Ca' Foscari, Venezia, [pdf] Available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2443929](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2443929), DOI: <http://dx.doi.org/10.2139/ssrn.2443929> [Accessed on June 13, 2016].
  35. Montesinos, V., Brusca, I., Manes Rossi, F. and Aversano, N. (2013), *Sustainability Reporting in Local Governments. A Comparison between Italy and Spain*, *CIGAR Conference Proceedings*.
  36. Moore, M. (1995), *Creating Public Value: Strategic Management in Government*, Cambridge: Harvard University Press.
  37. O'Flynn, J. (2007), *From New Public Management to Public Value: Paradigmatic Change and Managerial Implications*, *The Australian Journal of Public Administration*, vol. 66, no. 3, pp. 353-366, DOI: [10.1111/j.1467-8500.2007.00545.x](https://doi.org/10.1111/j.1467-8500.2007.00545.x).
  38. Quiles, F.J.A., Navarro-Galera, A. and Ortiz-Rodriguez, D. (2013), *The disclosure of information about sustainability at the regional governments and influencing factors: the case of Spain*, *EAA Doctoral Colloquium*.
  39. Patton, J.M. (1992), *Accountability and Governmental Financial Reporting*, *Financial Accountability and Management*, vol. 8, no. 3, pp. 165-180, DOI: [10.1111/j.1468-0408.1992.tb00436.x](https://doi.org/10.1111/j.1468-0408.1992.tb00436.x).
  40. Raga, K. and Taylor, D. (2005), *Impact of Accountability and Ethics on Public Service Delivery: A South African Perspective*, *Public Manager*, [pdf] Available at: [http://www.aspaonline.org/global/V34N2\\_ImpactOfAccountability\\_Taylor.pdf](http://www.aspaonline.org/global/V34N2_ImpactOfAccountability_Taylor.pdf), [Accessed on February 20, 2015].
  41. Reuter, M. and Messner, M. (2015), *Lobbying on the integrated reporting framework: An analysis of comment letters to the 2011 DP of the IIRC*, *Accounting, Auditing & Accountability Journal*, vol. 28, no. 3, pp. 365-402, DOI: <http://dx.doi.org/10.1108/AAAJ-03-2013-1289>.
  42. Stewart, J.D. (1984), *The role of information in public accountability*, in *Issues in Public Sector Accounting*, edited by Hopwood, A., Tomkins, C., Oxford: Phillip Allen Publishing, pp. 13-34.
  43. Steyn, B. and de Beer, E. (2012), *Strategic role of public relations in the process of 'integrated reporting' - An exploratory study*, *Sinergie, rivista di studi e ricerche*, vol. 88, pp. 53-72, DOI: <http://dx.doi.org/10.7433/679>.
  44. Stoker, G. (2006), *Public Value Management. A New Narrative for Networked Governance?*, *American Review of Public Administration*, vol. 36, no. 1, pp. 41-57, DOI: <http://dx.doi.org/10.1177/0275074005282583>.
  45. Stubbs, W. and Higgins, C. (2014), *Integrated Reporting and internal mechanisms of change*,

- Accounting, Auditing & Accountability Journal*, vol. 27, no. 7, pp. 1068-1089, DOI: <http://dx.doi.org/10.1108/AAAJ-03-2013-1279>.
46. Synergiz (2014), *What Natural Capital Disclosure for Integrated Reporting?*, [pdf] Available at: [http://www.acts-net.org/images/Pubs/Working\\_Papers/What-Natural-Capital-disclosure-for-integrated-reporting-Synergiz-ACTS-2014.pdf](http://www.acts-net.org/images/Pubs/Working_Papers/What-Natural-Capital-disclosure-for-integrated-reporting-Synergiz-ACTS-2014.pdf), [Accessed on February 20, 2015].
  47. Veltri, S. and Silvestri, A. (2015), The Free State University integrated reporting: a critical consideration, *Journal of Intellectual Capital*, vol. 16, no. 2, pp. 443-462, DOI: <http://dx.doi.org/10.1108/JIC-06-2014-0077>.
  48. Vermiglio, C. (2012), Integrated reporting for Italian local governments. Background for debate, *Financial Reporting Workshop*, Naples, [pdf] Available at: <http://www.frworkshop.com/napoli/eng/papers/Vermiglio.pdf>, [Accessed on June 13, 2016].
  49. WICI (2013), *Connectivity. Background paper for <IR>*, [pdf] Available at: <http://www.theiirc.org/wp-content/uploads/2013/07/IR-Background-Paper-Connectivity.pdf>, [Accessed on February 20, 2015].
  50. Williams, B., Wilmhurst, T. and Clift, R. (2011), Sustainability reporting by local government in Australia: Current and future prospects, *Accounting Forum*, vol. 35, no. 3, pp. 176-186, DOI: doi: 10.1016/j.accfor.2011.06.004.
  51. Wulf, I., Niemoeller, J. and Rentzsch, N. (2014), Development toward integrated reporting, and its impact on corporate governance: a two-dimensional approach to accounting with reference to the German two-tier system, *Journal of Management Control*, vol. 25, no. 2, pp. 135-164, DOI: <http://dx.doi.org/10.1007/s00187-014-0200-z>.

---

# Accounting policies and practices applicable for the impairment of assets that generate income other than cash flows

---

Marinela – Daniela MANEA,  
Valahia University, Târgoviște,  
E-mail: m\_manea7@yahoo.com

## Abstract

*Starting with 2005, at an European level, the European Commission alongside the International Federation of Accountants (IFAC) promoted the implementation of accrual accounting within the public sector and, by default, the shift from cash accounting to accrual accounting, as well as the development of financial statements based on the International Public Sector Accounting Standards (IPSAS). IPSAS' starting point were the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The requests of the IPSAS Standard 21 "Impairment of Non-Cash-Generating Assets" were drawn up in accordance with this policy. The differentiated practices that can be applied to the public sector in relation to the private sector have led us to the analysis of the solutions suggested by IPSAS 21 precisely to understand and further study the concepts and mechanisms of the depreciation of assets that generate income other than cash flows. Without neglecting the reality of the Romanian accounting practice within the public sector, we will gradually go through the steps of measuring and recognizing the depreciation losses associated with the assets that generate income other than cash flows, owned by the public entities.*

**Keywords:** Public sector, non-cash-generating assets, depreciation loss, recoverable value.

**JEL Classification:** H83.

### To cite this article:

Manea, M.D. (2016), Accounting policies and practices applicable for the impairment of assets that generate income other than cash flows, *Audit Financiar*, vol. XIV, no. 7(139)/2016, pp. 763-770, DOI: 10.20869/AUDITF/2016/139/763

### To link to this article:

<http://dx.doi.org/10.20869/AUDITF/2016/139/763>

## Introduction

The international financial community recognizes the need for convergence towards a single set of accounting standards IFRS – IPSAS that would provide a common basis for reporting in all countries, with implications on cost reduction as accountants, financial analysts, investors and regulators would no longer need or reconcile or transpose the financial statements from a set of standards to a different set of standards. In terms of Romanian public sector entities' financial reporting, the traditional approach (Tiron-Tudor, 2012) was centred on the budget as a main component of the set of financial statements, compliance with rules and regulations being based on cash accounting principles. In recent decades, to face the continuously changing economic environment, institutions have made the transition to accrual accounting, which ensures transparency, accountability, comparability of data and reports, detailed information on costs useful in facilitating the resources-focused management, while improving the entities' effectiveness and efficiency. It also provides a meaningful assessment of responsibilities pertaining to all the resources managed by the public institution.

Accrual accounting (EC, COM\_2013\_114 final) is the only information system generally accepted that offers a complete and reliable picture of the economic and financial situation and performance of public administrations, showing a complete picture of an entity's assets and liabilities, revenues and expenses for the period to which the accounts refer to, and at the time the accounts are closed. Being more relevant in economic terms than cash accounting, the current accounting framework for tax monitoring in the EU, SEC 95, is accrual-based. In addition, for budgetary monitoring, lately it was registered a transition to the harmonized European Standards for Public Sector Accounting (EPSAS) due to the need to report complete and comparable fiscal information between EU Member States.

### 1. State of the art in the field of assets' impairment

Before the harmonization with International Financial Reporting Standards (IFRS), in Romanian accounting it was considered necessary to assess property items at four points in time, namely: recognition, inventory, end-

of-year and derecognition. Value depreciation was resolved using the structures of depreciation/amortization and provisions. To measure the reversible impairment, according to Romanian accounting standards, the focus was on measuring values during the annual inventory.

Valuation of assets (Ristea et al., 2004) during the annual inventory emphasized, especially in practice, the quantitative rather than the qualitative side. During the annual inventory, fixed assets were each measured at their actual or useful value, called the inventory value and determined based on the assets' utility within the entity, their physical condition and the market price. The International Financial Reporting Standards deal differently with the issue of impairment; the term deprival value was induced, with a different meaning than the one commonly used in Romanian practice. It was deemed necessary to recognize an item in the financial statements at an amount that does not exceed its recoverable amount obtained from its use or from trading it on an active market. This is because, in practice, in many European jurisdictions, although there were statutory obligations to compare the assets' carrying amount to their market value, these requirements were not applied rigorously. Furthermore, some jurisdictions, particularly those following the British legal tradition, did not require the disclosure of impairment, unless it occurred on a permanent and long-term basis.

The more rigorous approach of the IFRSs reflects the fact that regulatory authorities have become aware that this was a field neglected by financial reporting. Thus, on the balance sheet date, in accordance with international requirements, the carrying value of fixed assets must be compared with its fair value and value-in-use. If the higher amount of these future values is less than the carrying amount, the difference is recognized as an impairment loss.

The concept of value depreciation was assimilated by the International Public Sector Accounting Standards Board within the International Federation of Accountants (IFAC) from the IFRS practice especially for ensuring a better and more reliable image of an asset's value, on the balance sheet date in the financial statements of public entities. The IPSAS 21 "Impairment of Non-Cash-Generating Assets" provides all the procedures that can be applied to the assets of a public entity with non-cash-generating assets in order to ensure the recognition of potential impairment losses. Therefore, on the balance

sheet date, in compliance with international provisions, the carrying amount of the fixed asset is compared with its fair value and useful value. If the highest of these value is lower than the carrying amount, than an impairment can be identified for the difference between them.

Applying the impairment test is not done randomly and does not involve all the assets of a public entity. It is considered necessary that the public entity tests for impairment when there are *indications that an asset might be impaired*. Also, the requirement that potential impairments be determined for all assets at each balance sheet date is not compulsory, as this would imply indeed a very laborious activity for many public entities. It is, rather, about *the existence of conditions that might suggest an increased risk of impairment to be assessed*. Thus, on the balance sheet date it is necessary to identify those assets that, under the considered conditions, might be impaired. The existence of conditions, or indications, do not necessarily imply an impairment, though the entity will need to analyse the recoverable amount of those respective assets.

Since the impairment test is a complex and very costly process for some entities, when measuring the recoverable value, one will implement **the concept of materiality**. If within the previous years for the asset under analysis there was established a *recoverable value significantly higher than the net carrying amount, and for the elapsed time the indications that the asset has lost its value do not consist in events that lead to the reduction of the difference, then it is not necessary to reassess the recoverable value*.

Example: The local council X owns a building constructed in 1983 meant as an *office building*. In 2013, the building had a fair value, net of selling costs of 75,000 RON, useful value estimated based on the depreciated replacement cost of 80,000 RON, while the net accounting value was 60,000 RON. Since the recoverable value is higher than the accounting value by 20,000 RON, and within the following two years there were no events to lead to the idea that the asset could have registered significant changes of market value, or the useful value, respectively, at the end of the budget year 2015, it is not necessary to reassess the recoverable value of the building.

## 2. Research methodology

In the process of Romania's accession to the EU, to fulfil the commitments of convergence and implementation of the *acquis communautaire*, the Romanian accounting standard-setters initiated a public accounting reform so that the national legal framework was enriched over time by the implementation of new accounting regulations. To simplify, the public sector accounting regulations were harmonized with those of the private sector in terms of chart of accounts and the structure and content of the financial statements, but the reform process is far from complete. In this context, our intention to identify the extent to which Romanian accounting standard-setters assimilated into national legislation the provisions of IPSAS 21 *Impairment of non-cash-generating assets* generated questions such as: Are the public authorities in Romania prepared to implement IPSAS? Are professional accountants working in Romanian public institutions familiar with concepts such as non-cash-generating assets, the recoverable service amount, fair value etc.?

To answer the above-listed questions we conducted a normative research showing gradually the steps for the measurement and recognition of impairment losses on assets non-cash-generating assets according to IPSAS 21 and the possibility of adopting a common language between the standard and Romanian law.

## 3. Identifying the non-cash-generating assets from the public sector which can be depreciated

When identifying the depreciated assets, the standard requires a set of potential depreciation indications and suggests that these represent a minimum list of factors that will be taken into account. The entity could identify other depreciation factors besides the ones provided by the standard, as the list is not comprehensive. On a first analysis, one will take into account the signals, the impairment criteria grouped into **external criteria** and **internal criteria**.

The external criteria or indications are mainly the result of ruptures within the technological environment, with a negative impact on the assets' utility into service, on the decrease of utility level as a consequence of new assets

appearing on the market, which perform better, or significant long-term changes that emerged within the legal environment or in the governmental policy with adverse effects on the entity. The internal indications are generated by the wear and tear, or by the decrease of the level of services expected to be provided by the asset, changes that show up in its usage, or a long-term decrease of the request for the assets' services, respectively, with a negative impact on the entity etc. Internal indications refer to all the internal information that leads to the idea that, in the future, the asset's performance will decrease. Out of the two categories of information sources, the external criteria or resources that are outside the entity have an important share and require special attention, since they cannot be influenced by the entity or by its management.

Romanian legislation, harmonized with IPSAS standards, by the Order of the Minister of Public Finance no. 1917/2005 as subsequently amended, does not distinguish between internal and external indications of impairment, but merely lists them in paragraph 1.2.6.

*Impairment losses of fixed assets*, as: physical deterioration, termination of the demand/need for services provided by a fixed asset, decision to terminate the construction of the asset, asset performance lower than that originally envisaged, changes in technology or legislation. It is not the only situation in which Romanian standard-setters do not approach in detail some of the issues treated and exemplified by the international standard in a rigorous manner.

The possibility provided by IPSAS 21 to choose, in establishing the recoverable value, between two values, is not random. It is considered that the entity can recover the value of its assets through use or capitalization on the market. Nevertheless, the measurement of the two values is a complex process, very costly for some of the entities, based on estimations that belong to the management and have a strong subjective charge, which also reflects on the certainty and credibility of the obtained data.

#### 4. Measuring a recoverable service amount. Certainties and uncertainties

Implementing the impairment test to fixed assets for which, at the end of the reporting period, there are clues

of a potential value loss involves measuring the recoverable service amount. According to the standards, an entity has two evident possibilities of recovering the value of its assets: by capitalizing them on an active market or by using it (as a result of ample debates, which concluded that both the hypothesis encountered on the market and the entities' own modelling do not ensure a complete accuracy; this is why they opted between the maximum of the two aggregates, in compliance with the probable behavior of the management).

*As a rule, it is easier to determine the fair value minus the selling costs than the value-in-use.* From the definition provided by the standard, the fair value minus the selling costs is the value which can be obtained by willingly selling an asset within a transaction that takes place in objective conditions between the interested parties that are fully informed, from which the concession costs are deduced. Since it is measured on the market, where the seller's offer meets the buyer's offer, the estimation of fair value minus the concession costs is, most of the time, certainly carried out for the entity. The objective of the entity is to identify the fair value on the market of the fixed asset from which it can subtract the costs related to taking it out of use. In the economies characterized by the existence of specialized markets for assets, there will be no significant difficulties since the fair value is relatively easy to estimate for the entity. However, despite the fact that the IFRS/IPSAS frequently use notions like fair value and active market, the reality of the Romanian economy proves that, for the majority of the assets, there are no active markets where this aggregate could be assessed.

However, it is possible to determine the fair value minus the selling costs even if the asset is not traded on an active market. Under these circumstances, the entity will analyse the information it has related to potential past transactions, with similar assets, for which they know the selling prices on the market; likewise, if there are offers made for similar assets and the prices reach approximately close values, they can make an estimation of the net fair value.

*Without the intention of drawing a conclusion, in many cases, the notion of fair value only knows a single reality: the market value. This, however, only represents one of the ways of measuring the fair value, the one which ensures the most objectivity since it is based on*

information outside the entity, which cannot be, under any circumstances, influenced by it.

Using an assessment technique constitutes an alternative method of measuring value, when there is no price established on the market. The following two approaches can be encountered:

- the first one is the *analogy method* which involves resorting to the market value of a similar asset that presents identical or at least similar characteristics with the asset that is being analysed;
- the second approach implies capitalizing an asset using the *modelling technique*. The method of establishing the value of an asset through analogy or similarity is, from a theoretical point of view, valid, however, in practice, this is difficult to realize, to the extent that the notion of *similar characteristics* is, most of the times, difficult to establish and prove.

Although there is no equivalent in IPSAS for IFRS 13 *Fair value measurement*, according to the established policy of convergence between IPSAS and IFRS, fair value should be estimated in a manner that is consistent with IFRS.

Instead, Romanian law considers that fair value is determined only on the basis of assessments made by professional valuers, members of a professional body in the field. The different approaches in the provisions of IPSAS and Romanian regulations in the field have generated many gaps in the national accounting practice in terms of information held by professional accountants, who will not engage in modelling fair value as long as the standard-setter does not encourage such behaviour, creating an applicability void related to the provisions of IPSAS in the Romanian territory.

However, returning to the measurement of a recoverable service amount according to IPSAS, sometimes it is impossible to determine the fair value minus the selling costs “because of the absence of a basis for a credible estimation of the sum that could be obtained from selling the asset within a transaction carried out in objective conditions between interested and fully informed parties.” Under these circumstances, it is mandatory to measure the value in use, which implies estimations based, in the majority of the cases, on subjective values. Additionally, since its size is different for each entity, due to the uniqueness of its models, it has a higher degree of subjectivity and is, likewise, more difficult to validate.

IPSAS 21 states that a non-cash-generating asset’s value-in-use is the discounted value of the **potential remaining service** of the asset. The standard provides additional guidance on the following three methods to estimate the potential service remained:

- the net replacement cost approach,
- the restoration cost approach,
- the service units approach.

The cost approach, specific to the valuation standards (ANEVAR, 2015, IE 2, 2012) and endorsed by the provisions of IPSAS would require minimum valuation knowledge on the part of Romanian professional accountants, as well as significant interpretation and estimates. In addition, the technique of modelling the replacement/restoration cost of the service potential of a non-monetary asset is impractical and outside the reach of practitioners in the Romanian public sector, encased between rigid regulations and the lack of vision and commitment with regard to accounting creativity.

## 5. Recognition and measurement regarding impairment losses from depreciation for non-cash-generating assets

### 5.1. The impairment loss in the IPSAS 21 version

The purpose of implementing the impairment test and measuring the recoverable service amount is to identify potential impairment losses for the asset that is being analysed and **recognizing** it within financial statements. In the **measurement** of an impairment loss, it is measured the gap between the net carrying amount, which is higher, and the recoverable service amount, which is lower, by following the provisions of paragraph 52 from IPSAS 21 *Impairment of non-cash-generating assets* according to which “if, and only if, the recoverable service amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable service amount. That reduction is an impairment loss”.

Example: In the case of a medical equipment with a gross carrying amount of 100,000 RON, accumulated depreciation of 30,000 RON, for which various

hypothesis were analysed regarding the value-in-use, respectively the fair value minus the selling costs; in Table 1 are outlined the consequences of the necessity

(or lack thereof) to recognize an impairment loss, as it follows:

Table 1. The impairment losses - various hypothesis		
Hypotheses	Impairment	The asset's value in the balance sheet
<b>Hypothesis 1</b>		
Net fair value = 80,000 Net fair value > Net carrying amount	The asset is not impaired	70,000
<b>Hypothesis 2</b>		
Net fair value = 60,000 Value-in-use = 65,000 Recoverable value = 65,000	5,000 RON impairment	65,000
<b>Hypothesis 3</b>		
Net fair value = 60,000 Value-in-use = 50,000 Recoverable value = 60,000	10,000 RON impairment	60,000
<b>Hypothesis 4</b>		
Net fair value = 60,000 Value-in-use = 75,000 Recoverable value = 75,000	The asset is not impaired	70,000

Source: Author's processing

The impairment loss thus measured will be recognized according to paragraph 50 of IPSAS 21 "an impairment loss shall be recognized immediately in surplus or deficit". IPSAS 21 stresses, in paragraphs 54 and 69, the necessity of recognizing the impairment loss by debiting an expenses account and by disposing of the impairment loss through crediting a revenues account. However, there is no strict specification regarding the corresponding accounts, but it is mandatory that the **asset's carrying amount be adjusted**.

Example: A public health institution owns a specialized equipment purchased in the year N for the price of 50,000 RON. The equipment was estimated to have a useful life of 10 years. For the period N – N+5, based on internal reports written by the entity, the value-in-use is measured at 16,500 RON. At the end of the year N+5, based on the current market conditions and on some indications according to which the asset might be impaired, a fair value net of selling costs of 18,000 RON was estimated. Applying the impairment test, at the end of the year N+5, the situation is as follows:

Net fair value  $50,000 - [(50,000/10 \text{ years}) \times 6] = 20,000$  RON;

Fair value minus selling costs = 18,000 RON;

Value-in-use = 16,500 RON.

Recoverable service amount = 18,000 RON.

Since the net carrying amount is higher than the recoverable service amount, an impairment loss of 2,000 RON for the equipment is recognized, according to the IPSAS provisions, by the direct adjustment of the assets account, as it follows:

Asset impairment expenses	=	Plant and machinery, motor vehicles, animals and plantations	2,000 (1)
---------------------------	---	--	-----------

The method of adjusting the asset's value partially renounces, for the impaired assets, at the historical cost as a measurement basis. The above-mentioned example used the technique of recording the impairment directly by adjusting the asset's value, by crediting the appropriate asset account. **Applying the impairment test is made, according to IPSAS, at the moment in which the entity decides if it is advisable to maintain its assets in accounting at a historical cost or if the measurement basis needs to change.**

The Romanian practice, however, uses the structure of *impairment adjustments* for recognizing the temporary losses of value, using amending accounts for outlining the impairment, while the assets are maintained at cost in the financial statements. *However, regardless of the method used for registering the loss, the balance sheet value of the impaired asset is the same, and recognizing the value loss through amending adjustments accounts for impairment does not fully suit the reasoning for the recognition and reversal of these accounting structures.* Moreover, recognizing impairment through adjustment accounts involves, in case of a potential sale of the asset, to ignore the corresponding sales earnings and the effect of reversing the impairment.

After the recognition of an impairment loss *“the depreciation/amortization charge for the asset shall be adjusted in future to allocate the asset’s revised carrying amount less its residual value (if any), on a systematic basis over its remaining useful life”* (IPSAS 21, para. 57).

The main consequence of recognizing the impairment loss of an asset is, according to IPSAS, **changing by adjustment the depreciation/amortization of future years, starting from the recoverable value as a new carrying amount recognized in the financial statements for the respective asset.** The depreciable base will now become the recoverable value, which will be allotted for the remaining useful life; similarly, adjusting depreciation/amortization will be carried out if it is necessary to reverse a previously recognized impairment.

## 5.2. Approaching impairment loss according to the current Romanian regulations

The Romanian accounting system recognizes impairment losses as temporary value adjustments. *The moment of recognizing an impairment loss is the end of the budgetary year.* At this time, the *asset’s net carrying amount* (the carrying value less the depreciation/amortization and the cumulated impairment adjustments) is compared with the *inventory value*, resulted from the inventory process.

Focusing on the inventory value, since it is the result of modelling certain parameters such as: *the usefulness of the respective assets for the entity, their condition, and the market price, respectively*, the obtained aggregate can be considered similar to the recoverable service amount from international practice, which is, ultimately,

an indication of both market value and value-in-use, according to the IPSAS regulations.

In this way, for the assets that show *reversible negative differences* between the inventory value and the net carrying amount, we carry out an adjustment for impairment or loss of value, **diminishing the asset’s value by using the amending adjustment accounts.** If the international accounting practice recognizes the impairment loss through directly by adjusting the assets accounts, according to the Romanian standard-setters the depreciated assets is registered at cost, while amending adjustment accounts are used.

Example: A public institution owns a building for which the following information is known: cost 320,000 RON, accumulated depreciation 120,000 RON, inventory value established at the end of the budgetary year N 175,000 RON.

At the suggestion of the inventory commission, the public institution will recognize a n impairment adjustment for the building in the amount of 25,000 RON as it follows:

$$\begin{array}{l} \text{Operational} \\ \text{expenses regarding} \\ \text{the impairment} \\ \text{losses for non-} \\ \text{current assets} \end{array} = \begin{array}{l} \text{Impairment of} \\ \text{buildings} \end{array} \quad \begin{array}{l} 25,000 \\ (2) \end{array}$$

If, subsequent to recording of a value adjustment, an additional impairment for the respective asset is noticed, it is mandatory to increase the adjustment. Even though the Romanian regulations do not thoroughly follow the provisions of the international normalizers (IPSAS), using amending accounts for adjusting the elements of temporarily impaired assets and not the direct adjustment of the corresponding assets’ accounts, the result is finally the same, **the adjustment of the asset that is considered to be impaired.**

## Conclusions

Any accounting system, no matter how efficient, modern, or convergent with the applicable international accounting standards, will always be perfectible, even if only because of the fact that the economy, on a national and international level, is continuously transforming, subject to new trends and processes, forced to set new

priorities and to answer new challenges that are more and more avant-gardist.

In terms of reflecting the true and fair view, Romanian public accounting will follow the approach initiated at EU level to harmonize national legislation up to a convergence point with the accounting regulations and techniques/treatments proposed by the international standard-setter. This is because we would have a quality accounting referential and a precise framework, in the absence of which there is no competitiveness. In addition, in terms of better tax and budgetary European integration, only a single set of public sector accounting standards for all Member States would allow national budgetary decisions taken to be assessed at EU level. However, this approach requires significant human and financial resources allocations, difficult to implement in

the current precarious conditions of the Romanian public sector.

The issue of reversible impairment of non-cash-generating assets held by public entities involves the use of methods and discounting techniques specific to valuation specialists, the consistent application of professional judgment, modelling and accounting estimates etc., with which Romanian professional accountants are not yet familiar. However, the need to provide relevant information for decision-making will require to align their behavior with the existing international practices. The budgetary impact will be substantial because this approach involves major investments in employee training and equipping the public sector entities with integrated information systems. The ultimate goal is that Romanian regulations comply with the IPSAS standards.

## REFERENCES

1. International Valuation Standards Council (2015), *Standardele de evaluare*, Bucharest: ANEVAR.
2. European Commission (2013), *Report from the Commission to the Council and the European Parliament towards Implementing Harmonised Public Sector Accounting Standards in Member States. The Suitability of IPSAS for the Member States* (COM\_2013\_114 final), Bruxelles: EC, [pdf] Available at: <http://eur-lex.europa.eu/procedure/EN/202448>, [Accessed on June 12, 2016].
3. IPSASB (2013), *Manualul de Norme Internaționale de Contabilitate pentru Sectorul Public*, Bucharest: Editura CECCAR.
4. IFAC, *IPSAS 21 Impairment of non-cash-generating assets*, [pdf] Available at: <https://www.ifac.org/system/files/publications/files/ipsas-21-impairme.pdf> [Accessed on June 12, 2016].
5. IASB (2011), *IFRS 13 Fair Value Measurements*, London: IFRS Foundation.
6. International Valuation Standards Council (2012), *Îndrumar pentru evaluare 2 - Abordarea prin cost pentru activele corporale*, Bucharest: IROVAL.
7. Ristea, M., Dumitru, C.G., Păunescu, M. and Gușe, G.R. (2004), *Ghid pentru înțelegerea și aplicarea Standardelor Internaționale de Contabilitate – IAS 36*, Bucharest: Editura CECCAR.
8. Tiron-Tudor, A. (2012), *Îmbunătățirea calității raportărilor financiare ale entităților din sectorul public prin aplicarea IPSAS*, *Curierul Național*, [online] Available at: <http://www.curierulnational.ro/Specializat/2012-05-03/Imbunatatirea+calitatii+raportarilor+financiare+ale+entitatilor+din+sectorul+public+prin+aplicarea+IPSAS>, [Accessed on June 12, 2016].
9. Ministerul Finanțelor Publice, OMFP 1917/2005 pentru aprobarea Normelor metodologice privind organizarea și conducerea contabilității instituțiilor publice, Planul de conturi pentru instituțiile publice și instrucțiunile de aplicare a acestuia, cu modificările și completările ulterioare, Official Journal no. 1186/December 29, 2005.
10. [www.ipsasb.org](http://www.ipsasb.org)
11. [www.epsas.eu](http://www.epsas.eu)

---

# Accounting truth and its assurance in entities from the Republic of Moldova

---

**Viorel ȚURCANU**

Academy of Economic Studies of Moldova,  
E-mail: vturcanu@mail.ru

**Irina GOLOCIALOVA,**

Academy of Economic Studies of Moldova,  
E-mail: monomah5@yandex.ru

## Abstract

*The multiple users will not be able to make correct decisions, unless the information provided by accounting is exact and transparent. Otherwise we cannot state that it communicates the accounting truth with regard to the activity of a company. The accounting truth is determined by several factors, like the accounting technique, the principles and the qualitative characteristics, the accounting normalization and the audit.*

*The objective of the study is to provide a general analysis of these factors, as well as to investigate the manner in which these support the assurance of the accounting truth in the Republic of Moldova (RM) in the context of the IFRS concept of true and fair view, also relying on practical examples from the banking system.*

*The results of the study show that the accounting truth in RM entities is ensured to a large extent, due to the positive impact of these factors. At the same time, there is still room for improvement in theoretical matters of accounting and financial reporting, as well as for the development of the accounting legal framework, with the purpose of expanding the financial analysis potential of the disclosed information.*

*The situation of the banking system shows that, if no adequate attention is paid to the operative and strategic analysis of the financial position and results, including based on audit, economically destructive phenomena can take place, both at entity-level, and at country-level.*

**Keywords:** Accounting truth, accounting technique, qualitative characteristics, normalisation, audit control.

**JEL Classification:** M 41; M 11; G21.

### To cite this article:

Țurcanu, V. and Golocialova, I. (2016), Accounting truth and its assurance in entities from the Republic of Moldova, *Audit Financiar*, vol. XIV, no. 7(139)/2016, pp. 771-782, DOI: 10.20869/AUDITF/2016/139/771

### To link to this article:

<http://dx.doi.org/10.20869/AUDITF/2016/139/771>

## Introduction

At the current stage, the financial information plays a significant role in the management of the entity, as valuable decisions are made to a large extent based on data provided by accounting. At the same time, it is equally important that the disclosed data are fair. Out of these reasons, British researchers developed the financial reporting concept called in Romanian „reprezentare exactă” and in English “true and fair view”. The first component of the phrase has a quantitative and formalised orientation, while the second one – a psychological, ethical and moral, i.e. a non-formalised orientation (Gray, Coenberg and Cordon, 1993).

The concept is also recommended by the EU Directive 2013/34/EU, from June 26<sup>th</sup> 2013, translated in the Romanian version with the French inspired „image fidèle” (Colasse, 1997). As such, art. 4(3), states that “the annual financial statements shall give a true and fair view of the [...] financial position and profit or loss” (Directive 2013/34/EU). At the same time, we notice that the meaning of the true and fair view in the sense of the Directive is not quite the same with the meaning of the concept in IFRS, as paragraph (22) of the Directive emphasizes the fact that “the recognition and measurement of some items in financial statements are based on estimates, judgments and models rather than exact depictions”. This is natural, as the concept does not imply the existence of rules and requirements in the preparation of financial reporting.

After examining the meaning of the above mentioned concept, we consider that its core and role are better described in Romania by the phrase “accounting truth” (Ro. „adevărul contabil”) (Colasse, 2009), employed in the present paper. The Romanian Lexicon defines the truth as “that which reflects the reality, what exists or happened in reality”, which makes the truth (Ro. „adevărul”) a wider notion than the true and fair view (Ro. „reprezentarea exactă”).

The truth about the entity, as provided by accounting, is disclosed in the financial statements, prepared based on data regarding economic events during the disclosure period, and confirmed by the auditors. As such, interested users are sure that the information provided is veridical and the decisions based on this information are correct. Basically, a piece of information is veridical if it allows users to identify a concrete object or event from the economic life of the entity. It is however more

complicated when knowledge on the overall object of accounting becomes necessary - the activity of the entity and the way in which the entity assures the true and fair view. For this, accounting models the processes of the entity, based on symbols; it observes the qualitative characteristics of the financial information; it applies the established accounting rules. The Conceptual Framework for Financial Reporting (The Conceptual Framework, 2010), emphasises the fact that, in order to deliver a true and fair view, a description must observe three characteristics: it must be complete, neutral and free of error.

Obviously, perfection can seldom be reached, but the accounting truth is grounded by principles which allow us to believe that the disclosed information describes the reality of the economic events, at the level of the entity. In this context, we need to mention the fact that maximizing the quality of the information should be the main objective of accounting.

Yet, the information disclosed in the entity’s financial reporting can be considered veridical only if its truthfulness is confirmed by an audit firm, when auditing becomes an important factor in assuring the accounting truth.

The analysis of the accounting status in RM shows several organizational and methodological disorders, hindering the realization of the accounting truth in different entities, though accounting complies with the IFRS. The scandal of the one-billion USD theft from three banks makes us question the quality of the banking system management, including its accounting and audit efficiency.

## 1. Literature review

The concept of the True and Fair View – TFV was first presented by the IASB Conceptual Framework and the EU Directives. Subsequently it was introduced – directly or indirectly – in the accounting regulations of several countries. However, before the concept has officially been adopted, several debates took place between the supporters and the critics of this idea. One of the TFV supporters is the British researcher Alexander D., who claimed that the financial reporting prepared based on the prudence principle (the Teleological Interpretation concept – TI) provides a less relevant information from the standpoint of the opportunity of future success, than the TFV concept. This conclusion came as a result of

several studies on profit calculation (Alexander, Britton and Iorisen, 2005).

An opposite standpoint is issued by the researchers Livne and McNichols (2009), who performed a comparative analysis of different companies, with the purpose of detecting the accounting role of TFV and TI. In their opinion, TFV led to the possibility of concealing both the level of the entity's activity, and its financial results. The divergent application of this concept in accounting also led to the occurrence of international financial scandals, like the one of Enron. The authors' general conclusion is that the TFV problem regards mainly the disclosure of profit-related information, as well as the decisions made based on it by users, especially by managers.

The TFV idea was intensely criticized by Walton (1993), according to whom "the theory and practice of financial accounting are full of odd notions, curious inconsistencies and improbable ways of approaching problems, but surely the single most bizarre notion is the British true and fair view". He considers that, in order for this notion to obtain a real meaning, it must consider the legal component of the information disclosure, as: from the standpoint of the financial disclosure practice, TFV has no meaning; the independence from the accounting rules increases the responsibility of those preparing the financial statements; accounting relies on general principles.

One topic of the debates was the older fundamental principles overriding the TFV, adopted not long ago in the Conceptual Framework and IAS 1. To this effect, several authors (Alexander and Jermakowicz, 2006; Alexander and Eberhartinger, 2009) state that these conceptions should not come into conflict, considering that both have the same objective – to meet the demand of the financial statements users for veridical information. At the same time, as the TFV is widely recommended in the Anglo-Saxon system, characterised by a higher liberalism in accounting, the concept should be adapted in the countries of the continental Europe, that rely on stricter accounting and financial reporting rules. In this context, following question should find an answer: *What is the concept of the true and fair view – a fundamental request or a fundamental principle in the preparation of the financial report?* The answer is obvious: this concept does not incorporate any rules regarding the preparation of the financial statements; it implies the observance of principles assuring the true and fair view.

Like any other element, it is interesting to describe the true and fair view concept in its evolution (Vladu, Mătiş and Salas, 2012). The performed investigations showed that TFV: is considered a feature of the general conception of preparing the financial report; it lies in "the solving space of the conflict between the principles and the numerous accounting rules". However, with no clear definition, the TFV is only a trend, that can be compared to the American one – "the fair presentation", based on certain principles and with a different meaning.

The above mentioned issues show that:

- The TFV concept requires a legal confirmation, or else it will remain at the level of an idea;
- If, together with the prudence principle, the accounting judgment is applied, any event can be completely and truly disclosed, based on the TFV concept;
- TFV is a valuable concept of the accounting and financial reporting system, which must be investigated hereafter.

Some researchers (Covaliov, 2012) argued that the TFV concept should be applied for financial leasing agreements. In this context, it was ascertained that, as accounting and financial reporting are not merely a control instrument, but a connection meaning of business relationships, the understanding of the concept's core and its adequate application gives users the opportunity to assess financial statements as an information source of strategic value. Hence, the TFV concept allows the development of the "art" of wording legal regulations and supports the achievement of objectives.

Besides the concept of true and fair view, a particular role is played by the concept of capital maintenance. The core of this concept is that the profit calculation for the reporting period is performed by considering the time value of money and the inflation processes. Yet, as economical decision-making requires the disclosure of information on the dynamics of the capital changes based on different factors, with regard both to the capital paid by the shareholders and the capital accumulated during operation, this requirement led to the alteration of the balance sheet concept and status within the current financial reporting system (Alexander, Britton and Iorisen, 2005). The opinion of Hicks (1946) was considered in this context,

according to whom the capital dynamics can be exactly measured only in two cases: when all components change proportionately; when the price of commodities remains unchanged. According to this concept, referred to within the IFRS as the capital maintenance concept, only that part of the net assets value which overrides the increase of the general price level is recognized as profit. The remaining part of the increased net assets is regarded as a correction, ensuring the capital maintenance.

The TFV concept is strongly linked to the resource theory, enunciated in the Conceptual Framework – a financial management concept, aiming to explain the achievement of sustainable competition, by efficiently using strategic resources (Rumelt, 1984). From the standpoint of the information disclosure in the financial report, emphasizing issues on resources leading to profit maximization is an essential task. In this context, the understanding of the mutual connections between the entity's resources, capacity and competitive priorities on the one hand, and its profitability on the other side, is a key issue. In this view, resources are not merely the material, but also the non-material, like the financial, human, technological, organizational and other ones. (Grant, 1991).

As known, in order to disclose information on a certain element, its identification and assessment are required. Therefore, Grant (1991) holds the view that, in applying this concept, researchers face the problem of identifying and disclosing the non-material resources, whereas the solution could be to calculate the value of such assets as the difference between the fair value of the company and the replacement value of all its material resources.

## 2. Research methodology

In order to perform our study, we generally identified the factors influencing the correctness of the information disclosed in the financial report. The main criterion used consisted in the current requirements of the information users, as well as the role played by a specific factor in assuring the accounting truth within the entity. Hence, we emphasized: the accounting technique, the principles and qualitative characteristics, the accounting

normalisation and the examination of the information by the auditor.

In the second stage, in order to conclude on the way in which the accounting truth is ensured, within entities located in the RM, we performed an analysis on following directions:

- the organization of the accounting technique in different types of entities;
- the adopted principles and qualitative characteristics, and their mode of operation;
- the quality and clarity of the legislative framework;
- the role of auditing in confirming the truthfulness of the data.

In the next stage, we investigated the extent to which the National Accounting Standards (NAS) comply with the IFRS, the significant deviations from these and the possibilities to improve accounting in RM.

Finally, we examined the situation of the banking system and, based on the recent dynamics of the main indicators of the Moldovan Bank of Savings (MBS), we ascertained that ignoring the control of the information on the financial position and results of the activity, including by accountants and auditors, led to significant thefts from three banks, as well as to their subsequent liquidation.

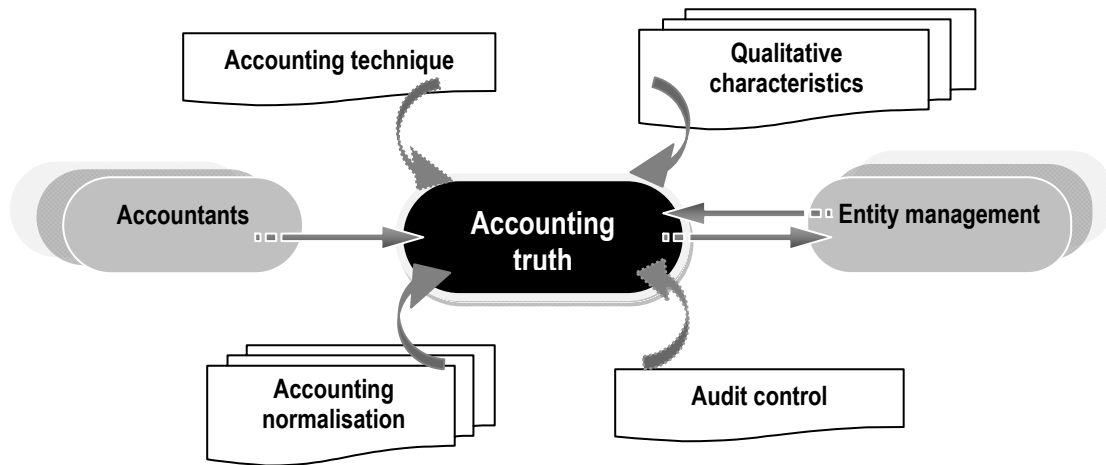
## 3. The characterisation of the factors ensuring the accounting truth

In our opinion, the accounting truth relies on several pillars, assuring its achievement (Figure 1).

Figure 1 shows that the accounting practice defined three types of "actors", who contribute to assuring the accounting truth (Colasse, 2009):

- the entity accountants and the managers, who prepare and account for the disclosed information;
- the regulators, who define the actions of the previous category; and
- the auditors, who monitor the observation of the accounting regulations.

**Figure 1. Factors assuring the accounting truth**



Source: Authors' processing, 2016.

The following paragraphs will detail the above mentioned.

**Factor 1 – the accounting technique.** In order to manage the activity, any entity needs information. The provision of financial information is the task of the accounting which, by means of its specific methods and procedures, models this process in connection with the economic magnitude of the entity's operations.

Like any other science, the accounting crossed several *paradigms*. One of these was the transition, at the end of the Middle Ages, from the single-entry to the *double-entry bookkeeping*, presented, as known, by Luca Paciolo. This accounting system allows, based on symbols/accounts, the modelling of any type of company – simple or modern. Consequently, the double-entry bookkeeping has successfully been fulfilling the information and control function for over five centuries.

Yet the double-entry bookkeeping, as the main instrument of the accounting technique, has continuously been updated through accounts that are being changed based on the introduction of new accounting elements and economic operations. More exactly, the double-entry bookkeeping, by modelling the activity of the entity, provides the necessary data on its position, performance and financial result, disclosed in the financial report – the main information source of the economic decision-making. Though the double-entry bookkeeping allows only a limited economic analysis,

the observation of its rules will largely ensure the accounting truth in any entity, as it definitely permits the examination of the correctness of the booked transactions.

**Factor 2 – the principles and the qualitative characteristics.** A particular place in the preparation and disclosure of financial information is taken by the accounting principles and the qualitative characteristics of the financial information. The accounting principles involve the universal approach of practical tasks and provide the basis of accounting.

In preparing financial statements, the accountant must primarily be guided by a natural and highly important, though unofficial principle – “the entity principle”, applied based on legal, financial or economic criteria. Its core idea is that accountants must define a border between the entity and its environment and distinguish it from its owners. This isolation comes mainly from legal criteria, as the entity is seen as a legal person, with its own rights and obligations. Applying “the entity principle” can be a delicate and sometimes essential matter, “turning the company into an accounting structure more or less dependent on the intervention and intention of its managers” (Colasse, 2009).

The content and the application method of the principles and qualitative characteristics are clearly enunciated in the General framework and examined in detail in literature (Țurcanu and Golocialova, 2015). We mention

however that the method of accounting and disclosing the information in the financial report depends to a large extent on the application (or not) of the substance over form principle, while the qualitative characteristics contribute, without any doubt, to assuring the accounting truth in the entity.

**Factor 3 – the accounting normalisation.** A decision-related role in assuring the accounting truth is played by the accounting normalisation. This statement can be explained by the fact that financial information will be trusted primarily if it has been prepared based on rules, issued by specific institutions. Today, we no longer doubt the necessity of accounting regulations; yet, the issue of the regulation degree is still debated. A high number of rules hinders the development of accounting, while an excessive room for professional judgment can lead to negative consequences. The Enron case proves it once more.

Should we analyse the core and the role of the accounting normalisation, we shall find that it fulfils the following functions:

- it helps producing the necessary financial information;
- it provides the disclosed information with reliance;
- it assures the verification of the financial information, both through internal and through external control;
- it permits the settling of conflicts between contractual parties;
- it facilitates the spatial and temporal collation of data, disclosed in financial statements complying with the same regulations.

According to several researchers, a set of regulations constitute the accounting law (Richard, 2000). Such an approach is reasonable, as the accounting provisions included in specific regulations create unique requirements in the field of accounting, on state level.

**Factor 4 – the audit control.** It is beyond debate that, irrespective of its quality, mere regulations are not able to assure the trust of the users in the entity's financial statements. This trust is confirmed by independent experts – the auditors. Audit was born in the 19<sup>th</sup> century, out of the need that financial information becomes a connection between the company and its external partners. This objective was reached through the examination of the financial statements by external auditors. During the 20<sup>th</sup> century, the audit activity

passed through several changes: the elaboration of the International Standards on Auditing (ISA), the performance of the external audit based on internal control, the establishment of a new auditing form – risk auditing.

The validation of the accounting data truthfulness is based on the audit opinion. The auditor, through the audit conclusion, validates or invalidates the entity's accounting truth.

## 4. Accounting issues in the Republic of Moldova

In the RM, the double-entry bookkeeping is prescribed by the Accounting Act RM no. 113-XVI from 27.04.2007 (Accounting Act, 2007). Art. 7 of the Act stipulates that, if the accounting regulation system does not prescribe any bookkeeping method in a specific matter, then the company is allowed to design the respective method by itself.

The Accounting Act also provides for the application of two double-entry accounting systems - a complete and a simplified one. The complete system is used for large companies and the simplified system is used for small and medium-sized companies. Yet, in fact, the National Accounting Standard "*The presentation of financial statements*" (NAS, 2013) does not provide for any forms of simplified financial statements for small and medium-sized companies, though their weight in the national economy amounts to ca. 75%.

As mentioned above, the accounting principles and the qualitative characteristics are described in the General Framework, which actually is the basis for the current accounting theories. However, we regretfully observe that, among the regulations issued in the last years by the Ministry of Finance, no General Framework is to be found. This is a step back, compared to the first reform, based on which a similar local document had been prepared, i.e. the Conceptual Basis, showing that, in the RM, accounting theory issues are not approached, either by national specific journals, or officially. More, the process of standardization and regulation of the accounting procedures and the financial statements preparation cannot be completed, without the theoretical reasoning and the scientific interpretation of all the categories and instruments of this science.

We can find a brief presentation of the fundamental principles and the qualitative characteristics only in the National Accounting Standard “*The presentation of financial statements*” (NAS, 2013). Yet, practitioners also need to know the manner in which these operate. By comparing the principles and the qualitative characteristics from the NAS with the ones presented in the General Framework, we shall notice that some of these, of major significance, are overlooked: the true and fair view, the verifiability, the timeliness, while we will not find materiality associated to relevance. And not in vain, since the Moldovan accounting does not observe substance over form. While materiality involves that information is material if its omission or misstatement may influence the decisions made by users, based on financial information (The General Framework, 2010).

At the same time, the NAS does not include any conceptual notions: the performance, associated to the calculation of the profit or loss, the recognition in the financial statements, the measurement methods, i.e. essential approaches, that should guide any accountant in practice.

In addition, the General Framework clarifies the core and the application method of the capital maintenance concept and the resource theory. Hence, it is not enough that users receive certain pieces of information, it is important that this information provides the opportunity of performing reasonable economic analyses of the data, supporting a fair decision-making.

Normalisation is conducted by a specific body, which can be differently structured in each country. For example, all the members of the US Normalisation Committee are professionals. In the EU Member states, the accounting regulation institutions consist of different interested parties, necessarily with the participation of the professional bodies. Yet, the normalisation process in these countries is supervised by the state.

In RM, the accounting normalisation is more restrictive than in the EU Member States. This state of the art is confirmed by the provisions of the Accounting Act, the NAS, the General Chart of Accounts and other regulations. The accounting regulation is conducted solely by the state, as the professional body (ACAP) does not play any part in the elaboration of the regulations, though the Accounting Act prescribes that professional bodies are part of the accounting regulation structure within the Ministry of Finance. More, according to law, professional bodies have the right to elaborate

and submit for approval accounting regulation drafts (Accounting Act, 2007).

Though experts state that, following the reform, accounting complies with the IFRS, this happened directly only in public interest entities, including banks. Most entities are regulated by the NAS, which is seen as complying with the IFRS. We need to mention in this context that only 16 national standards have been elaborated; some of these include provisions of more than one IFRS, while a large part of the IFRS has not been covered by the NAS. Hence, entities often need to seek guidance in the IFRS. It was proved in literature that the impact of the financial ratios computed based on the IFRS, compared to the NAS lies between +3 and 13% (Ghedrovici et al., 2014).

However, international regulations are too complex for the ordinary accountant, which makes the application of the accounting system and the assurance of its truth in the financial statements rather difficult. Some methodological and educational guides for practitioners, for use with the local General chart of accounts have been prepared, with the aim to explain the application of IFRS (Țurcanu and Golocialova, 2015).

At the same time, we need to clarify what accounting system is implemented in RM: the continental, or the Anglo-Saxon one. The two global accounting models were properly described by French researchers (Colasse, 2009 and Richard, 2000). Their work shows that the RM accounting system, based on its organisation, is a continental one, although, from a methodological point of view, it complies with the IFRS, which are actually aligned to the Anglo-Saxon accounting system. Hence, the specific features of the accounting system in the RM are the following:

- a. The regulation through banks, as these dominate the investment and financing process of the national economy. This factor leads to multiple interested parties of the information disclosed by the entities;
- b. The prevalence of the legal over the economic reality;
- c. The multiple accounting regulations, leaving only limited room for professional judgment;
- d. The strong connection between accounting and tax; the accounting benefit is to a certain extent restrained by tax rules;
- e. The measurement at historical cost, in the context of the prudence principle, to the detriment of the fair value.

To the above specified shortages of the RM accounting system, some researchers add the following:

- The long and slow reformation of accounting (almost 20 years), due to the lack of a clear and long-termed conceptual framework (Alexander and Ghedrovici, 2013);
- The accounting reform should have been oriented towards business performance and privatisation; it requires a closer collaboration between ACAP and the governmental bodies, for the adaptation of the new accounting standards (Armitage, Neider and Shelaru);
- The IFRS and the NAS include controversial regulations; for example, with regard to the impairment of fixed assets, a comparison between non-comparable ratios should be performed (Bucur and Ioniță, 2016).

In the 2013 Report of the World Bank on the accounting and auditing quality in the RM, several methodological and organisational remarks are included, like: the lack of the General Framework, of a NAS on consolidated financial statements, the need for a revision of the Accounting Act etc. (World Bank, 2013).

In performing audit engagements, auditors in RM are guided by the Auditing Act no. 61-XVI from 16.03.2007 (the Auditing Act, 2007), while the audit methodology complies with the International Standards on Auditing (ISA). Audit is mandatory, according to law, only in large and public interest entities.

A further problem associated to audit regards the supporting documents provided for examination by the audited entity. If the entity manager manipulates these documents, the auditor should apply adequate procedures for identifying those documents which were not delivered. As a consequence, the magnitude of the underground economy would decrease. Much here depends on the ethics of the manager, the accountant and even the auditor.

## 5. Consequences of ignoring the control of financial information

As the banking system is a significant component of the national economy, as well as an extremely sensitive sector during financial crises, we should also investigate

the accounting truth and the role of auditing in this field. We need to mention that both accounting, and auditing in the banking system show significant particular features, related to the credit provision, various risks, the responsibility of the managers and of the employees in cash-based transactions, which often involve enormous amounts of money.

The recent famous scandals in the RM banking system, involving thefts of one billion US dollars from three commercial banks (The Savings Bank, The Social Bank and Unibanc), lead to multiple prosecutions, generated debates among analysts, as well as a strong dissatisfaction of the population. Currently, the guilty parties are identified and arrested, the money is sought and paid back, though no one is wondering: what kind of accounting has been practiced in these banks, what kind of auditing has been performed in the banking system, since such enormous damage was caused both to the state, and the banking system and it ended only in the liquidation of the involved banks?

In the case of the American company Enron, back in 2003, when losses amounted to trillions of dollars, economists contributing to literature also blamed it on the accounting, while the famous auditing firm Arthur Andersen, which presented a deficient opinion on the information disclosed by Enron, lost its licence and was subsequently liquidated. We may wonder, what adequate measures will be taken with regard to the theft of the century, from RM?

The irregularities in the banking system have been on the increase since 2012, when certain private shareholders or the government manipulated the majority of shares for the own benefit. This was the case of The Moldovan Savings Bank (Banca de Economii a Moldovei – BEM). Hence, up to 2013, the state held 56% of the bank's shares; the shareholding subsequently decreased to 33%, following the additional issue of shares. The bank had already started to act for the benefit of the private shareholders, with well-known consequences. In support of this fact, as well as of other proofs of the deteriorated financial position of the BEM, Table 1 summarizes the financial indicators of the bank for the years 2011, 2013, 2015.

It should be mentioned that ignoring certain theoretical positions and disclosure requirements for the financial information, as prescribed by the General Framework, can lead to serious consequences in performing the operational analysis of the entity's financial and

economic position. For example, the concept of the capital maintenance is highly significant, primarily with regard to commercial banks. According to this concept, the capital maintenance is achieved only if the amount of net assets at the end of a period is equal to or exceeds the amount at the beginning of the period. Provided that

the accountants and analysts of the BEM had continuously followed the level of this indicator, the bank would not have gone bankrupt. In 2012, compared to 2011, the amount of net assets (equity) remained unchanged, but up to the end of 2014, it lowered by 147 million lei and up to 30.06.2015, by 198 million lei.

**Table 1. Selected financial indicators of the Moldovan Savings Bank**

Indicators	MU	31.12.2011	31.12.2013	30.06.2015
Total assets	thousand lei	5,841,010	8,532,765	14,556,358
Total normative equity	thousand lei	828,209	555,032	276,570
Shareholders' equity	thousand lei	117,337	197,587	197,587
Liquid assets	thousand lei	2,618,948	5,636,926	494,810
Deposits	thousand lei	4,404,200	6,426,337	4,450,198
Credits	thousand lei	2,866,008	1,221,578	1,321,300
Profit (loss)	thousand lei	28,727	35,405	-166,843
Credit impairments	thousand lei	394,668	468,870	541,842
Adequacy of the weighted capital to risk (Minimum level 16%)	%	32.96	3.22	2.21
Equity loss	%	-	-34.51	-4.40
Share of foreign investors in the shareholders' equity	%	10.13	17.63	42.50
Bad loans /Total loans	%	31.86	58.42	79.68
Return on assets (ROA)	%	0.52	0.54	-2.31
Return on equity (ROE)	%	3.93	3.97	-47.18
Net interest income/total income	%	37.40	6.95	-6.43
Long term liquidity (Minimum level 1)	%	0.65	0.29	0.31
Current liquidity (Minimum level 20)	%	44.94	66.00	87.70

Source: Authors' processing.

The deterioration of the financial position of the three banks mentioned above shows that the financial and the internal audit in the banking system faced severe difficulties. A group of individuals was preparing, in 2013, the take-over of these banks. Between 2012-2014, the financial position of the three banks worsened, questionable credits and liabilities of 13.8 bill. lei were recorded. Yet, the losses of the state increased because, in 2014, the National Bank of Moldova granted the three banks a state aid for rehabilitation, amounting to 10 bill. lei. It is however well-known that the banks were liquidated in 2015. In commercial banks, corruption had been in place for a while: even since 2010-2011, the crediting rules were frequently broken at the MBS, with consequent losses of 244 bill. lei. At the same bank, the CFO and the depositary deputy manager stole 7 mill. US dollars. Accordingly, the missing internal and external control at MBS lead to the sudden deterioration of the

main indicators (see **Table 1**) and the bank went bankrupt. More, the weight of the bad loans in total loans reached 79.7% in 2015.

The Parliament commission, together with the American auditing firm Kroll, in charge with the investigation of the three banks, have so far presented two preliminary reports. Yet, the results of the report are classified, based on a Parliament decision, so that neither the guilty parties, nor the role played by the financial audit in this matter, have so far been made public.

Though the quality of auditing practice is problematic and its effectiveness is hard to measure, the external audit can however be assessed based on the results of the accounting discipline at the audited entity and, to a certain extent, based on the efficiency of its activity. The British auditing firm Grant Thornton had been rendering services for the BEM and other Moldovan banks since 2010 and had issued unqualified opinions for five years,

during which the entity was on the fall; still, the audit is not held accountable for it. In this context, what is the audit supervision framework for? In the case of banks, significant shortages associated to the share management can be observed, even on the part of the National Bank of Moldova (Banca Națională a Moldovei – BNM).

## Conclusions

Studies reveal that the accounting from RM, as an information system and a control instrument, fulfils its functions according to the Accounting Act. By modelling the activity of the entity, through the double-entry bookkeeping and the accounts, the financial report can be prepared and suits the needs of all users. At the same time, the law should mandatorily prescribe the publication of the financial statements of all entities (except for the small ones), in order to assure the transparency of the data.

The principles and the qualitative characteristics of the financial information, which should underlie the preparation of the financial statements, are presented by the IASB General Framework (2010). However, they are missing from the accounting regulation system of RM. Hence, the theoretical quality of the local accounting is lowered. At the same time, it should be mentioned that the accounting truth is enhanced by the application of substance over form, which is however not recommended to local entities.

We ascertained that normalisation has an essential contribution to disclosing the accounting truth, it directs the behaviour of the managers and it assures the spatial and temporal comparability of data. Still, normalization cannot be absolutely faultless; managers can take advantage of its shortages and manipulate information in the preparation of the financial report. An illustration thereof was the case of the three Moldovan commercial banks, where the shareholdings were altered against the state. Yet, the regulations in RM should give accountants room for the application of the professional judgment, in order to create a true and fair view.

The accounting methodology in RM is guided by the IFRS, as well as by NAS, in compliance with the IFRS. Controversial rules, which sometimes complicate the preparation of the financial statements, can however be observed. At the same time, the NAS do not recommend

measurement methods, applied in advanced economies; some of their provisions have a tax orientation.

According to international and European regulations, no accounting information is considered reliable, unless it has been audited. Only after its fairness has been confirmed, can information serve as a basis for proper decision-making or, in other words, the accounting truth can be certified. However, auditing in RM is mandatory only in large and public interest entities.

Based on the study, instances were identified when the auditor presented an unqualified opinion on the data disclosed in the financial statements, while serious misconduct was in place in the economic and financial activity of the audited entity. This was the case of the British auditing firm “Grant Thornton”, which provided services for certain commercial banks from Moldova, including the three banks that were finally liquidated by the government, over a period of five years.

We consider that the law and jurisprudence of the RM should prescribe serious penalties for accountants who overlook fraud in the disclosure of information, as well as for auditors who issue defective reports.

Currently, the main regulations such as The Accounting Act (2007) and The Auditing Act (2007) are aligned only to international standards. However, as the RM entered into commitments associated to the Association Agreement EU-RM, through the Government Decision no. 713 from 12.10.2015 (The Government Decision, 2015), the National Action Plan for the implementation of the agreement prescribes the preparation of following documents, in the fourth quarter of 2016:

1. The Accounting Act, in compliance with the provisions of the Directive 2013/34/UE, on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings;
2. The Auditing Act, in compliance with the provisions of the Directive 2006/43/UE, on statutory audits of annual accounts and consolidated accounts.

The new acts will aim to introduce nationally relevant international standards, as well as to gradually harmonize the RM and the EU accounting and auditing regulations.

## REFERENCES

1. Alexander, D. and Eberhartinger, E. (2009), A True and Fair View in the European Union, *European Accounting Review*, vol. 18, no. 3, pp. 571-594, DOI: <http://dx.doi.org/10.1080/09638180902784405>.
2. Alexander, D. and Ghedrovici, O. (2013), Evolution of Accounting in Moldova: Some Reflections About the Importance of Historical and Cultural Factors, în Albu, C.N. și Mustățã R.V. (ed.) *Accounting in Central and Eastern Europe* (Research in Accounting in Emerging Economies, Volume 13) Emerald Group Publishing Limited, pp. 121-142, DOI: [http://dx.doi.org/10.1108/S1479-3563\(2013\)0000013010](http://dx.doi.org/10.1108/S1479-3563(2013)0000013010).
3. Alexander, D. and Jermakowicz, E. (2006), A True and Fair View of the Principles/Rules Debate, *Abacus*, vol. 42, no. 2, pp. 132-164, DOI: <http://dx.doi.org/10.1111/j.1467-6281.2006.00195.x>.
4. Alexander, D., Britton, A. and Iorisen, E. (2005), *International Financial Reporting Standards: from theory to practice*, Moscow: Vershina.
5. Armitage, J., Neider, M. and Shelaru, M. (2007), Accounting Reform in the Republic of Moldova, *International Business and Economics Research Journal*, vol. 2, no.4, pp. 92-95, DOI: <http://dx.doi.org/10.19030/iber.v2i4.3785>.
6. Bucur, V. and Ioniță, N. (2016), Prudența, provizioanele și adevărul în deprecierea activelor, în *Paradigma contabilității și auditului: realități naționale, tendințe regionale și internaționale*, Chișinău: ASEM, pp. 29-32.
7. Colasse B. (2009), *Fundamentele contabilității* (translation from French by N. Tabără), Iași: TipoMoldova.
8. Colasse, B. (1997), The French notion of the image fidele: the power of words, *European Accounting Review*, vol. 6, no. 4, pp. 681-691, DOI: <http://dx.doi.org/10.1080/09638189700000009>.
9. Covaliov, V. (2012), *True and Fair Concept in Accounting: Definition and Application*, Vestnik of St. Petersburg University, vol. 5, no. 2, pp. 3-12.
10. Directive 2013/34/EU of the European Parliament and of Council of 26 June 2013 on the annual financial statements consolidated financial statements and related reports of certain types of undertakings, [online], Available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013L0034>, [Accessed on June 12, 2016].
11. Ghedrovici, O., Mihaila, S., Erhan, L., Bîrca, A. (2014) Transition to IFRS in the Republic of Moldova: general and practical aspects, *Accounting and Management Information System*, vol. 13, no. 2, pp. 259-280.
12. Grant, R. (1991), The Resource-Based Theory of Competitive Advantage: Implications for Strategy Formation, *California Management Review*, vol. 33, no. 3, pp. 114-135, DOI: <http://dx.doi.org/10.2307/41166664>.
13. Gray, S.J., Coenenberg, A.G. and Gordon, P.D. (1993), *International group accounting: Issues in European Harmonization*, London: Routledge.
14. Hicks, J. (1946), *Value and Capital*, Oxford: Clarendon Press. ("Reprinted as Income" in Parker and Harcourt, 1969).
15. Hotărârea Guvernului nr. 713 din 12.10.2015 privind modificarea și completarea în Hotărârea Guvernului nr. 808 din 07.10.2014 cu privire la aprobarea Planului național de acțiuni pentru implementarea Acordului de Asociere Republica Moldova – Uniunea Europeană în perioada 2014-2016 [Government Decision no. 808 from 07.10.2014 on the approval of the National Action Plan for the implementation of the Association Agreement between the Republic of Moldova and the European Union, for the period 2014-2016], [online], Available at: <http://www.lex.justice.md/md/361471/>, [Accessed on June 12, 2016].
16. Legea contabilității nr. 113-XVI din 27 Aprilie 2007, cu modificările și completările ulterioare [The Accounting Act No. 113-XVI from April 27, 2007, with all subsequent completions and changes], [online], Available at: <http://www.mf.gov.md/actnorm/contabil/lawcontabil/>, [Accessed on June 12, 2016].
17. Legea privind activitatea de audit nr. 61-XVI din 16.03.2007 republicată [The Auditing Act No. 61-

- XVI from 16.03.2007, republished], [online], Available at: <http://www.mf.gov.md/actnorm/audit/1laws/>, [Accessed on June 12, 2016].
18. Livne, G. and McNichols, M. (2009), An Empirical Investigation of the True and Fair Override in the United Kingdom, *Journal of Business Finance & Accounting*, vol. 36, no. 1-2, pp. 1-30, DOI: <http://dx.doi.org/10.1111/j.1468-5957.2008.02112.x>.
  19. Ministerul Finanțelor al Republicii Moldova, Cadrul general conceptual pentru raportarea financiară [The Conceptual Framework for Financial Reporting], [online] Available at: <http://www.mf.gov.md/actnorm/contabil/standartraport/> [Accessed on June 12, 2016].
  20. Ordinul Ministerului Finanțelor 109 din 19.12.2008 privind accesarea și publicarea Standardelor Internaționale de Rapoarte Financiară [The Order of the Ministry of Finance No. 109 from 19.12.2008 on the access to and publishing of the International Financial Reporting Standards], [online], Available at: <http://www.mf.gov.md/actnorm/contabil/standartraport/>, [Accessed on June 12, 2016].
  21. Richard, J. (2000), *Accounting: Theory and Practice*, Moscow: Financy and statistica.
  22. Rumelt, R.P. (1984), *Towards a Strategic Theory of the Firm, Competence Strategic Management*, Lamb, R.B. (ed.) Englewood Cliffs, Nj: Prentice Hall, pp.556-570.
  23. Standardele Internaționale de Raportare Financiară (SIRF) [The International Financial Reporting Standards], [online], Available at: <http://www.mf.gov.md/actnorm/contabil/standartraport/>, [Accessed on June 12, 2016].
  24. Standardele Naționale de Contabilitate, aprobate prin Ordinul Ministerului Finanțelor nr. 118 din 06.08.2013 [The National Accounting Standards, approved by Order of the Ministry of Finance No. 118 from 06.08.2013], [online], Available at: <http://www.mf.gov.md/actnorm/contabil/standartnew/>, [Accessed on June 12, 2016].
  25. The magazine „Logos Press”, for the years 2011, 2013, 2015: information on banking activities, [online], Available at: <http://www.logos.press.md/> [Accessed on June 12, 2016].
  26. Țurcanu, V. and Golocialova I. (2015), *Raportarea financiară conform standardelor internaționale*, Chișinău: ACAP.
  27. Vladu, A.B., Mățiș, D. and Salas, O.A. (2012), True and Fair View and Creative Accounting Conceptual Delimitations Based on Papineau's Tree Methodology, *Annales Universitatis Apulensis Series Economica*, vol. 14, no. 1, pp. 104-115.
  28. Walton, P. (1993), Introduction: The True and Fair View in British Accounting, *European Accounting Review*, vol. 2, no. 1, pp. 49-58, DOI: <http://dx.doi.org/10.1080/09638189300000003>.
  29. World Bank (2013) *Report on the Observance of Standards and Codes on Accounting and Auditing - Moldova*, [pdf] Available at: [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/09/27/000333037\\_20130927110449/Rendered/PDF/ACS41110ROSC0E0ox0379834B00PUBLIC0.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/09/27/000333037_20130927110449/Rendered/PDF/ACS41110ROSC0E0ox0379834B00PUBLIC0.pdf), [Accessed on June 14, 2016].

---

# Considerations regarding the regulation, accounting and audit of bank deposits

---

Marioara AVRAM,  
University of Craiova,  
E-mail: marioaraavram@yahoo.com

Veronel AVRAM,  
University of Craiova,  
E-mail: veronelavram@yahoo.com

## Abstract

*Bank deposits have been known even since the Antiquity. From the legal perspective, the bank deposit was always covered with due care and received the deserved attention, while regulations generally reflected the current views, from the legal, economic, social, cultural and religious perspectives. The new Civil Code, applicable in Romania starting from October 1<sup>st</sup> 2011, brings a new element within article 2191. The fund deposit, a change that is situated against the millennial regulations of the deposit contract, when it specifies that "Subsequent to the constitution of a fund deposit at a credit institution, it gains propriety over the deposited amounts of money". Even since the Antiquity, the Roman jurists have caught the economic and judicial nature of the unregulated deposit contracts that emphasized the depository's obligations. The religious obscurantism of the Middle Ages did not allow the differentiation between the deposit contract and the loan contract as passive operations meant to attract the financial resources of the bank. Nowadays, the confusion still exists and fuels the financial instability. Even since the emergence of accounting as a science, the bank deposit has been seen as a financial asset for the depositor and a debt for the banker. The accuracy of the accounting information regarding the bank deposits is validated and confirmed through the internal and/or external auditing procedures.*

**Keywords:** Bank deposit, unregulated deposit, loan contract – mutuum, fractional reserves.

**JEL Classification:** M41, M42, M 48.

### To cite this article:

Avram, M. and Avram, V. (2016), Considerations regarding the regulation, accounting and audit of bank deposits, *Audit Financiar*, vol. XIV, no. 7(139)/2016, pp. 783-790, DOI: 10.20869/AUDITF/2016/139/783

### To link to this article:

<http://dx.doi.org/10.20869/AUDITF/2016/139/783>

## 1. Methodological approach

From the methodological perspective, we intend to follow the bank deposit in terms of the legal rules over a long period of time, starting from the Antiquity, through the Middle Ages and the modern times, until the present.

The investigated timeframe and the area of regulations regarding the bank deposit allow us to have a complex vision regarding the quality of the regulations, their effects on the business environment and the methods through which it is reflected in accounting. Through this approach, we consider that we are able to bring to the specialists' attention, the financial auditors' and that of the academic environment, significant elements to start a public debate meant to correct the inconsistencies that exist within the regulation of the bank deposit according to the new Civil Code.

## 2. Historical benchmarks

Even since the Antiquity, the public used the banks trustfully, by providing them with different amounts of money in two main ways:

- Unregulated money deposits and
- Loan contracts – mutuum.

The two methods are different both from the perspective of the economic content and from the perspective of the legal form.

**The loan contract** assumes that at the same moment the bank receives the money, the ownership of the money amounts is transferred to the banker, who in turn will be responsible to repay the money – tantundem at the date of maturity, as well as the corresponding interest for the period in which he gave up on the present money in order to enjoy the future money.

**The unregulated money deposit** does not involve the transfer of ownership rights from the depositor to the banker; the banker is mandated to ensure the depositors' access to the quantitative and qualitative equivalent of the original deposit. "Classic Roman jurists have discovered and analysed the universal legal principles that rule the unregulated deposit of money... moreover, these principles have been later found in the medieval legal codes of different European states, including Spain, in spite of the serious economic and financial regress that has been associated with the fall of the Roman Empire and the beginning of the Middle

Ages" (Huerta de Soto, 2010, p. 69). Moreover, the religious obscurantism was added. Starting from the interdiction of the interest loan, it has determined changes in the legal doctrine in the form of transferring the loan contract – mutuum, forbidden by the religious rules, into a "depositum confessatum", which apparently was a deposit, but in fact it was an interest-generating loan for the depositor.

The confusion between the unregulated money deposit and the loan contract has created, within the Anglo-Saxon system (common law), by the way of precedent, the possibility that the unregulated deposit be interpreted in a different way depending on the nature of the goods. Thus, if the grains depositors have fraudulently acted when they used the deposited grains to their benefits, bankers that used the clients' money deposits were not accused of fraud. This discrepancy has determined Murray Rothbard to ask himself, not just in the rhetorical manner "Why was the law regarding the grain deposits... oriented in the exact opposite direction, although the circumstances – of depositing fungible goods – were identical? ...was it the fact that bankers have carried out more extended lobby activities than the farmers?" (Huerta de Soto, 2010, p. 154).

When mentioning the money deposit, The Romanian Civil Code in 1865, article 1604 (2) specifies that "A money deposit, when the depositor, according to art. 1602 has made use of it, must be returned with the same coins it was made, both in the case of their value's growth or decrease" (Cercel, 2008, p. 225). The possibility that the banker uses the deposited amounts of money is acknowledged, under the condition that he respects the provisions of article 1602 "He cannot use the deposited good without the express or tacit permission of the depositor" (Cercel, 2008, p. 225). This leads to the transformation of the deposit contract in a veritable loan contract, especially if we are dealing with a term deposit with nominal interest that has been indicated or determined. These aspects have been retained by the judicial courts such as the Oradea Mare Court, which in Sentence no. 3723 of October 31<sup>st</sup>, 1924 states that "The contract, commonly known as a deposit, between a bank and the depositor of an amount of money, through which the bank has the right to use the deposited amount while paying a certain percentage to the depositor, being mandated to repay the depositor the same type, quality and quantity of currency, is really a loan. Both the ownership of the money and the risks are

transmitted to the one that receives the money, which is mandated to return the whole deposited amount on demand". From this perspective, the new Civil Code furthers the confusion when it calls a deposit a loan through which the bank "gains ownership over the deposited amounts of money and is mandated to return the same amount, of the same currency, on the agreed date of maturity or, depending on the case, upon the depositor's request, meeting the period of notice agreed by the parties, or, in its absence, the customary period" (New Civil Code, 2011, p. 451).

### 3. The economic content of the bank deposit contract

From the economic perspective, bank deposits represent a well-known mean through which savings are made, as a premise of economic development through investments. According to the data presented by the National Bank of Romania (Banca Națională a României – BNR, 2015) in 2015 bank savings in Romania have increased by 9 percentage points, respectively with 11,7 billion RON as compared to 2014. The growing trend of

the economy is also manifesting in the first part of 2016 (BNR, 2016).

Through the Government Order (G.O.) no. 99/2006 regarding the credit institutions and the capital adequacy, approved and modified through Law 227/2007, among the allowed activities of credit institutions are included attracting deposits and other reimbursable funds. From the commercial perspective, bank deposits are banking products. Banking products, through their nature, are part of a wider category of financial products and are different both from the tangible and intangible products from the real economy. Banking products can also take a tangible form (deposit certificates, savings certificates), but more often take an intangible form such as account entries, the evidence of their existence being proved by the entries and documents.

The lifecycle of banking products is generally long, deposits and credits being known ever since the Antiquity. The duration of a banking product can spread from one day (overnight deposits and credits), to several months, a year or even several decades (real estate loans). The common elements of banking products are displayed in **Table 1**.

No.	Element	Description
1	The principal	An amount of money representing either a bank receivable in the case of assets, or a bank obligation, in the case of liabilities.
2	The term	The duration of the contractual agreement that stands at the basis of the banking product, which can be: determined, in the case of the term products, undetermined, in the case of the visible products, or conditioned, in the case of collateral deposits.
3	The interest	Expenditure element for the bank in the case of liabilities or operating income in the case of assets. The interest can be fixed or variable.
4	The collateral	Warranties made either by the debtor, by third parties for the banking assets, or for the banking liabilities a deposits warranty scheme within the banking system.
5	The monetary unit	Banking products are denominated in a certain monetary unit, in the national currency or another currency, respectively.
6	The distribution	Can be made through short channels (bank - client) or long channels (by using the services of third parties that can be brokers, leasing companies, non-banking financial companies)
7	Commissions and associated charges	A series of commissions and charges can be attached to banking products.

Source: Authors' processing of Avram and Avram, 2007

The economic content of the bank deposit contract is different depending on the type of the contract, but there are generally three types of deposits:

- Demand deposits;
- Fixed-term deposits;
- Collateral deposits.

Starting from the principle of „*ubi lex non distinguit nec nos distinguere debemus*” we notice that, as formulated in the new Civil Code, it is applicable to different economic realities, as follows:

- The demand deposit mandates the bank to return, at any moment, the amounts of money that the depositor deposited. “This variety of the contract totally excludes the idea of a loan granted by the client to the bank” (Turcu, 1994, p. 200).
- The fixed term deposit, having set a maturity date and a contracted nominal interest, can be easily considered a loan granted to the bank;
- The collateral deposit made to ensure a credit given by the bank is, within the regulation of the new Civil Code, in the situation when a created warranty enters “the bank’s ownership” alongside the money deposit. From an economic perspective, however, it is the case of mutual loans.

The ceasing of the deposit account contract remains an unsolved issue of the new Civil Code, according to which banks can become perpetual owners for the amounts that are not required by the depositors. For the fixed-term deposit with automatic extension or for the demand deposits, we can practically talk about an undetermined period. For the fixed-term deposits, without automatic extension, it is customary to either transfer the amounts into demand deposits, or pay the amounts into the current account. Collateral deposits can remain the same after the repayment of the loans, just as many mortgages are not closed when the obligations are repaid.

In our opinion, it is incorrect that the legislative authorities give banks the ownership right to the money that has not been requested by the clients. For example, “in the French legal system, a deposit account which has not been active for 10 years is closed and the bank transfers the money to a deposits and consignments house, under the client’s name and ownership. After a period of three decades, the amount is transferred to the state’s ownership, through adverse possession/acquisitive prescription” (Turcu, 1994, p. 223). Starting with January 1<sup>st</sup>, 2016, the provisions of the French Civil Code were extended, when the Eckert Law no. 617/2014 was passed, from the bank deposits to the inactive bank accounts; therefore, if a client ceased any relation with the bank, after 10 years of inactivity, has all his accounts closed. The amounts are

deposited to the Deposits and Consignments House (DCH) for a period of 20 years, and afterwards are then taken over by the state if the clients or their successors do not contact the DCH in time.

## 4. The accounting recognition of bank deposits

The International Financial Reporting Standards (IFRS) also include the International Accounting Standard (IAS 30) *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* (IASB, 2005) which states the fact that the deposits attracted by banks are located in the liabilities side of the balance sheet as debts, as follows:

- Deposits in other banks;
- Other deposits on the financial market;
- Attracted deposits;
- Deposit certificates;
- Promissory notes and other liabilities attested by documents;
- Other borrowed funds.

IAS 30 underlines the fact that liabilities are grouped by their nature and are ranked based on their liquidity. The period from the date of the balance sheet until the date of the contractual maturity is of the outmost importance, even if, in practice, some deposits can be withdrawn at any moment, on demand, and others can be maintained for longer periods, by capitalizing the interest and the automatic extension of the deposit contract.

Deposits made at the credit institutions are emphasized using some accounts, such as:

- 132 Deposits of the credit institutions
- 253 Clients’ deposit accounts
- 254 Deposit certificates, savings certificates and librettos.

All these accounts develop into second degree synthetic accounts for deposits made in national and foreign currencies, for each currency listed by the BNR. They have a liabilities accounting function and their balance reflects the obligation of the crediting institution towards the depositors. For each group of accounts, there are provided “Attached liabilities” accounts in order to record

the interest calculated and owed by credit institutions, based on the existing deposit contracts. The analytical accounting is kept separately for each depositor, using a unique identification code.

When a deposit is made with a credit institution, in the bank's assets, one registers an increase of an item such as a financial asset that can be cash, current account, correspondent account or current account at the Central Bank. In the bank's liabilities (passive), one registers an increase of the bank's liabilities towards the depositors in one of the following accounts: demand deposits, fixed-term deposits, collateral deposits.

The most common example is represented by the cash deposit at the bank's cashier desk made to open a fixed-term deposit, reflected in accounting as it follows:

101 Cash = 2532 Fixed-term deposits

When one asks for the repayment of the registered sums in the deposit account, in the assets of the credit institution, a financial asset decreases, and in the liabilities/passive, the bank's liabilities towards the depositors decrease. The most common example is that of cash withdrawal made the depositors from the bank's cashier desk.

2532 Fixed term deposits = 101 Cash

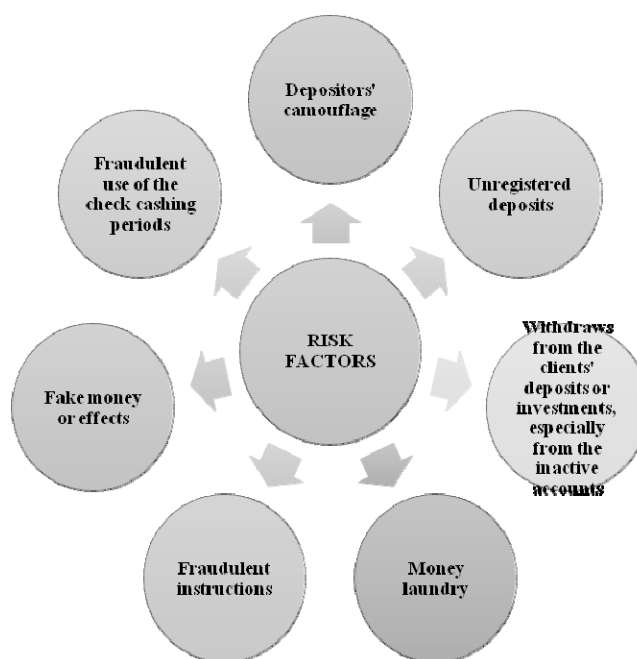
When the client does not ask to be repaid and there is no provision in terms of automatic extension of the deposit on a similar period of time, the value of the deposit is transferred into the current account opened by the client at the bank unit.

2532 Fixed term deposits = 2511 Current accounts

## 5. Audit procedures applicable to bank deposits

International Standards on Auditing (ISA) start from the significance of the prudential aspect of the banking surveillance authorities' role: "the key objective of the prudential surveillance is to maintain the stability and trust in the financial system, thus reducing the risk of loss for deponents and other creditors" (International Auditing Practice Statement – IAPS 1004, 2007, p. 706). The acceptance of deposits, which is a core activity for each authorized banking entity, can be accompanied by a series of *fraud risk factors* (IAPS, 2007, pp.807-808) of which the management and the other employees are aware of, as presented in Figure 1.

**Figure 1. Banking deposits fraud risk factors**



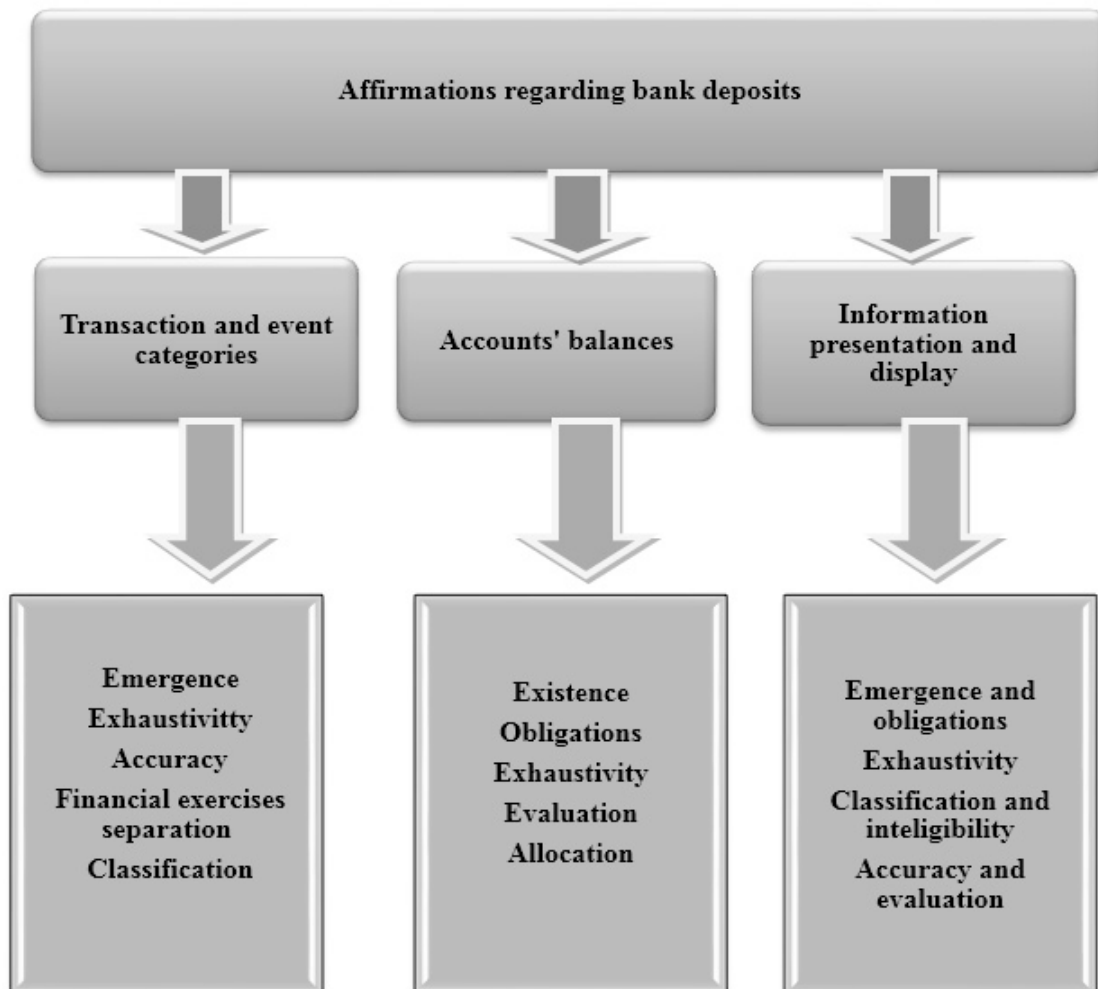
Source: Authors' processing after IAPS 1006, Appendix 1, 2006

In response to the fraud risk factors reported to the depositing cycle, financial auditors are mandated to obtain adequate and sufficient evidence by managing some baseline procedures regarding the bank's control environment and the consistency of due diligence procedures for clients and origin of the amounts deposited in the bank.

Specific procedures regarding bank deposits include analytical and conformation procedures of the average balances with interest expenditures in order to appreciate the acceptability degree of the correlation between the level of the registered deposits and the

interest trend on the specific market. The auditor pursues meeting the regulation norms and the relevant accounting principles, the potential economic dependence on certain depositors and a concentration of the maturity dates that might influence the solvability indicators in the foreseeable future. The auditor must use assertions regarding the bank deposits, displayed in **Figure 2**, and informational descriptions that are sufficiently detailed, for the purpose of evaluating the emergence risk regarding significant misstatements, and designing the potential additional auditing procedures.

**Figure 2. Assertions regarding bank deposits**



Source: Authors'– own processing after IAPS 1006, <http://www.bis.org/publ/bcbs06a.pdf>

## 6. Long and short term consequences

The new Civil Code did not consider the extensive doctrinary debates concerning the bank deposit contract and settled a subject on which specialists have not yet reached a common perspective by “assuming the governmental responsibility” and without consulting the civil society or the professionals.

The new Civil Code supports the illusion that the amounts deposited in a bank give it the ownership right on the deposited amounts, which will determine the bank to place these funds to gain profit. Meanwhile, the funds are at the same time available to the public, which trusts that the bank will meet its obligations “of returning the same amount of money, of the same currency, on the agreed term or, depending on the case, at any moment when the depositor asks, by meeting the notice period agreed upon by the parties or, in its absence, by the custom” (Noul Cod Civil, 2011, p. 351).

There is a wide literature that criticizes the uncontrolled expansion of the credit and the fractional reserves banking systems. The fractional reserves promoted by central banks through the policy of the minimal mandatory reserves are considered a “must have” ingredient of financial crises, whose causes are found in the uncontrolled expansion of the credit. “The profound cause is the artificial expansion of the credit and the currency offer which a banking system with a central bank and fractional reserves inevitably produces” (Cerna, 2014, p. 169).

Internationally, the debate is old and there is an entire series of opinions according to which “...it is probable that there is an extreme economic instability in every financial system where the same funds are used at the same time for investments in industry or trade and as cash reserves of individuals. Our financial structure has been mostly built on the illusion that the funds can be available and invested at the same time – and this observation is applied in the case of our savings banks (and, to a lower extent, in the case of other financial institutions), like in the case of commercial banks, that offer demand deposits” (Simons, 1948, p. 320).

There is a dangerous illusion which was never absent from the history of financial crises, stock exchange and banking crashes, which, according to Hayek’s profound observations, acts every time when “a universal law

principle is violated, either by a systemic coercion of the state, or by privileges, governmental advantages granted to groups or individuals” (Huerta de Soto, 2010, p. 197).

## Conclusions

Bank deposits, as a means of mobilizing temporarily available savings, are at the base of the capital circuit and the renewal of the productive means through investments. The carefully regulated legal framework can contribute to the advancement of social progress reflected in the increase of public trust in banking services and products. A regulation that emphasizes “the fatal arrogance” of the authorities, by ignoring the millennial values of the human civilization, can open the way to some undesired secondary effects. Credit institutions, specialized in financial brokerage, have a vast social responsibility, their real capital being the public’s trust in the integrity of the placements made by the bank for the amounts attracted from third parties. Corporate governance of credit institutions must ensure, at the same time, both the banking secret and the transparency of decisions reflected in the observance of the IFRS and the creation of a control environment suitable for the banking performance according to a well-known set of good practices.

The provisions of the new Civil Code regarding the bank deposits (art 2191) adopted through the mechanism of assuming governmental responsibility legislates the dangerous illusion according to which the amounts deposited in the bank can be, at the same time, both under the ownership of the bank, and available to the public. It is a regulation opposite to the millennial legal tradition in force, and opposite to the provisions of the Romanian Civil Code issued 150 years ago. It is time that, through the involvement of the academic environment, specialists, accounting professionals, civil society in general, a debate be initiated on this subject and generate a legal text that emphasizes the economic reality of the rights and obligations that originate in the bank deposit contract.

Last but not least, a regulation is needed for the situation of inactive accounts, starting from the example of the French regulation, so that the unclaimed amounts would not remain under the perpetual ownership of the bank, as it currently happens. The new regulation should present a clear procedure for the identification of inactive

accounts, followed by the registration of the amounts for a period of time established by law and, in the end, to be transferred as income to the state budget under the

mechanism of adverse possession/acquisitive prescription.

## REFERENCES

1. Avram, V. și Avram, C.D. (2007), *Marketing financiar bancar*, Craiova: Editura Universitaria.
2. BNR (2015), Raport asupra stabilității financiare – 2015, [pdf] Disponibil la: <http://www.bnr.ro/PublicationDocuments.aspx?icid=6711>, [Accesat pe 13 iunie 2016].
3. BNR (2016), Buletin lunar (secțiune statistică) 4/2016, [online] Disponibil la: <http://www.bnr.ro/Publicatii-periodice-204.aspx>, [Accesat pe 13 iunie 2016].
4. Caisse d'Epargne (n.d.), *Comptes bancaires inactifs et contrats d'assurance vie en déshérence*, [online] Disponibil la: <http://www.caisse-epargne.fr/particuliers/comptes-inactifs-et-desherence.aspx>, [Accesat pe 13 iunie 2016].
5. Cercel, S. (2008), *Codul Civil și legile conexe*, București: Editura C. H. Beck.
6. Cerna, S. (2014), *Politica Monetară*, București: Editura Academiei Române.
7. Huerta de Soto, J. (2010) *Moneda, creditul bancar și ciclurile economice*, Iași: Editura Universității A. I. Cuza.
8. IFAC (2001), *International Auditing Practice Statement 1004 The Relationship between Banking Supervisors and Banks' External Auditors*, [pdf] Disponibil la: <http://www.ifac.org/system/files/downloads/b005-2010-iaasb-handbook-iaps-1004.pdf>, [Accesat pe 13 iunie 2016].
9. IFAC (2001), *International Auditing Practice Statement 1006 Audits of the Financial Statements of Banks*[pdf] Disponibil la: <http://www.ifac.org/system/files/downloads/b006-2010-iaasb-handbook-iaps-1006.pdf>, [Accesat pe 13 iunie 2016].
10. International Auditing Practices Committee – IAPC (1990), *The Audit of International Commercial Banks*, [pdf] Disponibil la: <http://www.bis.org/publ/bcbs06a.pdf>, [Accesat pe 13 iunie 2016].
11. Legea nr. 227/2007 pentru aprobarea Ordonanței de urgență a Guvernului nr. 99/2006 privind instituțiile de credit și adecvarea capitalului, Monitorul Oficial nr. 480 din 18 iulie 2007
12. Legea 287/2009 privind Noul Cod Civil, republicată în Monitorul Oficial nr. 505/2011.
13. Simons, H.C. (1948), *Economic Policy for a Free Society*, Chicago: University of Chicago Press.
14. Turcu, I. (1994), *Operațiuni și contracte bancare*, București: Editura Lumina Lex.

---

# Performance management through budgets. Drafting and launching the company's sales budget

---

*Adriana Mihaela IONESCU,*  
University Politehnica of Bucharest,  
E-mail: [amihaela.ionescu@gmail.com](mailto:amihaela.ionescu@gmail.com)

*Cristina Elena BÎGIOI,*  
University Politehnica of Bucharest,  
E-mail: [cristinaedumitru@gmail.com](mailto:cristinaedumitru@gmail.com)

## Abstract

*In the economic activities enterprises set goals which, if achieved, enable performance improvement. In this regard, it becomes necessary to develop forecasts mentioned in budgets, which are used as tools for enterprise performance management. Creating an effective budget system, closely related to the medium and long-term plans of the company, is the key to profitable economic activity, which allows to find the right path to achieving the proposed objective and to promptly detect any obstacles. The budget is thus a strategy to improve performance by achieving better productivity, more efficient money spending, and to motivate employees to fulfil the budgetary provisions.*

*In the process of budgeting, the starting point is the sales budget, based on the sales program to which the company aims. Within it, the quantity, the selling price and the projected turnover are broken down into different time periods. Preparing a budget of marketing expenditures constitutes a logical consequence of the commercial activity as defined in the sales budget, thus allowing the establishment of the costs for the sale of the company's products and the commercial margin.*

**Keywords:** Forecast, performance, sales budget, turnover, costs.

**JEL Classification:** M11, M41.

### To cite this article:

Ionescu, A.M. and Bigioi, C.E. (2016), Performance management through budgets. Drafting and launching the company's sales budget, *Audit Financiar*, vol. XIV, no. 7(139)/2016, pp. 791-801, DOI: 10.20869/AUDITF/2016/139/791

### To link to this article:

<http://dx.doi.org/10.20869/AUDITF/2016/139/791>

## Introduction

In the current economic climate, companies are concerned with the efficient management of resources and use for this purpose the budgets, as tools for financial management, both at the level of their main activities, as well as for the entire enterprise. Economic activities of companies are permanently enrolled in the relationship of balance between revenues and expenses that requires a complex analysis, because their interaction takes the form of enterprise performance. Venkatraman and Ramanujam (1986) showed that the performance is a recurring theme in all management areas, including managerial accounting.

The strategic objectives of the company are set by managers, according to the general economic forecasts and to the predictions that characterize the industry in which the company operates, the company's priorities and resources, the relationships between management and employees. These long-term plans are defined at the level of each financial year in short-term plans called budgets. Managers' performance is considered achieved by meeting the budgetary targets (Anthony and Govindarajan, 2007).

The budgets entered the world of management theory and practice as a tool for forecasting the revenues and restraining the expenditures. The ensemble of forecasts on company performance and its financial position represents the consolidated budget, formed by modelling operational budgets. Between the budgets developed by a company there is a close connection. Viewed in their entirety, the budgets must form a coherent image. Therefore, the sales budget is not just an exercise designed to estimate future sales quantities or values, it also implies a series of measures taken by the company to achieve its strategic objectives.

## 1. Literature review

The theme addressed in our study was the subject of much research and debate (Veran, 1990; Bouquin, 1992; Villeseque, 2003; Sullivan and Sheffrin, 2003; Sponem and Lambert, 2010).

Budget is the most well-known management tool of the first half of the twentieth century (Weber and Linder, 2005). The budgeting practice emerged in the 1920s almost simultaneously in the US, France and Germany, and in 1930 the International Conference in Geneva

established the budget as the first performance monitoring tool for large industrial enterprises (Johnson and Kaplan, 1987). Subsequently, especially after the Second World War, the budget became an instrument used by most enterprises. Since the '50s, the primary objective of enterprises' activity was profit maximization, which could only be achieved by planning and achieving the planned objectives. In addition, the economic environment characterized by stability and economic growth, has created favourable conditions for the generalization of the budgeting practice .

The evolution in time of budget process is significant and shows the various roles of the budget as a management tool. Anthony (1988, p. 17) defines it as "a plan for the next year, generally expressed in monetary terms". While some see the budget as an instrument to improve the organization's performance (classical approach), others consider it an organizational legitimacy tool or a disciplinary tool. Mui Yee, Wong Sek Khin and Ismail (2016) studied the direct and indirect relationship between the decision-making process and the organization's operational performance. Organizations should maximize efficiency and effectiveness in the process of budgetary control in order to maintain competitive advantages. Owning an adequate budgetary control enables companies to improve their managerial attitude and performance and provides useful information to solve financial challenges.

According to Anthony (1988), the criteria to assess the managers' actions are effectiveness and efficiency. The role of the budget in achieving effectiveness and efficiency is important, because they allow the conversion of long-term programs in short-term action projects, ensure budgetary control, coordinate the decision-making process and ensure the convergence of the enterprise's strategic objectives.

## 2. Research methodology

Overall, this study aims to improve knowledge in the field of managerial accounting, the expected contribution being both theoretical and practical, by showing the detailed process of budgeting the sales of an enterprise.

The purpose of the research is the presentation of budgeting as a source of growth for the enterprise's performance, by studying the relationship between sales budget and decision-making process, showing how the budget supports achieving organizational performance.

In this context, the first research objective is to describe the sales budget in terms of functions, methodology development and liaison with business strategy. To achieve this objective, the qualitative research methodology was used; several scientific papers in the literature were analysed.

The second objective of this paper is to extend the research through a quantitative approach which aims to present the methodology employed for sales budgeting in the case of hypothetical enterprise, which is applicable to real organizational systems. In this regard, we conducted a quantitative research, using the case study as a research tool. Through this model we aim to place the budget process, and consequently the sales budget, within the scope of management control.

In the last part of the paper we created the premises for future research on the methodology for marketing budgeting by presenting the importance of forecasting marketing expenditure, in line with the sales budget.

The research results can be included in an integrated model for management decision support. Furthermore, research should be expanded through a quantitative approach to the budgetary control of sales, which will highlight the variances between the forecasted and real turnover and the necessary corrective measures.

### 3. Methodology for preparing sales budget

In the process of budgeting the starting point is the *sales budget*, as the basis on which entire budgeting process depends, because all the activities of a company are dependent on its sales and anticipated earnings. In addition to the sales budget, there is drafted the budget of marketing expenses, which shows in detail the expenses related to the promotion of the products, the distribution costs and the expenses related to after-sales services provided by the company.

The overall size of the enterprise's sales budget can be influenced by the business goals of the company (turnover, target market and market share), the trade policies of the company (products, customers, pricing and discounts policies) and by the general business situation.

A sales budget is a financial plan for sales of goods and services of a company. It serves as a guide for the company in terms of sales objectives and targets at the strategic level (overall turnover), operational (for the sales department) and individual (for each salesperson).

There are two stages in budgeting sales:

1. forecasting of sales (quantitative and value) and marketing expenses; and
2. breakdown of annual budgetary provisions for shorter periods (quarters, months), by products or groups of products, geographical area, responsible trading etc., namely into different budgets that facilitate regular monitoring of the annual forecasts.

The sales budget is correlated with the production budget, and both budgets determine the parameters of all other budgets. At the time of preparation, the sales and the marketing expenses budget are interconnected: if the manufacturing capacity is insufficient to produce all goods whose sale is possible, the initial forecast of sales should be reduced, or the manufacturing capacity should be developed; if, on the contrary, the possibilities offered by the sales market are insufficient to use the full manufacturing capacity, the working time should be reduced or must part of the equipment should be released from use.

#### 3.1. Sales forecasting

Sales forecasting is the most important activity, reflected in studies and research regarding the detection of potential market outlets, to which the company may have access, and the market share that it intends to conquer.

Sales forecasting can be defined as the advanced establishment of sales, in both quantitative and value terms, by taking into account the limits of the company. When developed on the long-term, these forecasts allow the establishment of an investment program and a financing plan. On the short term, the sales forecasts help to develop the manufacturing program (and, accordingly, a budget of stocks of finished products or work in progress), in developing the acquisitions program and further in drawing up expenses budgets (selling, provisioning) and also the cash budget. Both in terms of operational and investment activities, sales forecasting is crucial and deserves the name "cornerstone of the budgetary construction".

The projected level of enterprise sales is established by managers on higher hierarchical levels, based on data from marketing and production sectors.

*Long and medium-term forecasting.* The issue of forecasting should be studied by taking into consideration the limits within the enterprise.

Outside the company, the limits are those imposed by the market on which the company is present. To reduce the uncertainty, certain techniques can be used. To

study the long-term trend, trend curves and long-term correlations are used, which represent methods based on extrapolation or, in other words, projecting the past into the future. The market study is based on the intentions or the present needs of consumers and determines their behaviour in future years.

Inside the company, the limits are caused by the financial constraints (financial independence), human resources (personnel matters, or recruitment problems in general), geographic (space issues, spatial planning, ecology etc.).

Representing a matter of general policy, decisions are made by the general manager, together with his collaborators (financial manager, commercial manager, technical manager etc.). Given the future limitations, the sales forecast is determined for the next years. The main limitation for the enterprise is the market, and the company must adapt as well as possible to its evolution.

The *short-term forecast* is made for a one-year period, which corresponds to a budget year and is particularly centred on the products.

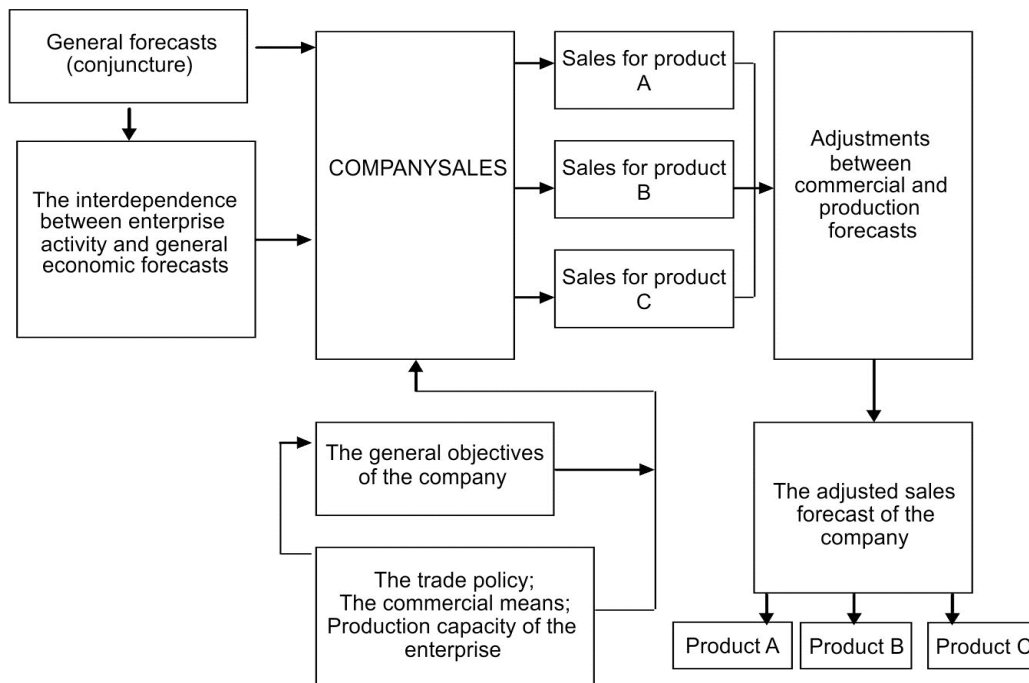
The organization may have a range of products that can change from year to year, in the sense that some products are dropped from manufacturing, due to the

unfavourable impact on the public or to the insufficient profit margin, or to the emergence of new products, as a result of technical research or commercial research conducted by the company.

Short-term forecasting work is greatly simplified for companies producing goods with a relatively long production cycle (ten-eleven months on average); the forecasting activity can be performed directly on the basis of orders received from customers.

Long-term forecasting, as well as short-term forecasting, is performed taking into account the restrictions determined both by the external environment (the market), for which there can be made economic analyses (correlation curves, trends) or commercial (market surveys, questionnaires), and by the existing limitations within the enterprise, which may vary depending on the size and nature of the enterprise's activities: commercial means (network sales, quality of the sellers, sales prices etc.), manufacturing capacity (material, equipment, workers), earnings per product (the danger that the development of a product with low profitability might pose), launching new products (the public reaction, the reaction of competition etc.), short-term development opportunities.

**Figure 1. Model on the overall situation of short-term forecast**



Source: Authors' adaptation from Gervais, 1994

The forecasting methods can be divided into: qualitative methods (determination of views); causal methods (relationships with an external variable); quantitative methods (mathematical treatment of chronological series). Qualitative methods consist of interrogating the management staff (jury opinion), the sales representatives (questionnaires), the customers (through market research) to identify their views about future sales.

### 3.2. Breakdown of annual budgetary provisions

Once established, the sales budget can vary depending on the centres of interest retained by the company, such as: the budget for a certain period of time, for sellers or for a region, budget for a product or product category, overall budget.

*The budget for a period of time.* This delimitation in time of sales targets is conditioned by the considered period and the manner in which the forecasting is performed.

The choice of the period is dictated by the needs of control of the enterprise. No enterprise would normally expect the passage of a year to verify the predictions made; on the other hand, any check has a cost, therefore conducting frequent checks is costly; thus, in practice, there must be determined a medium term, which is usually the month. When the sales program is likely to be changed frequently (due to events, competition etc.), it is indicated that the forecasting for the first quarter to be performed separately for each month, and for the next period for each quarter, in order to reduce the effort of making predictions which will be revised.

When sales are affected by seasonality, to establish the sales program, businesses rely on past experience, which they adjust to the objectives considered for the next year. Analysis of past situations can highlight a fixed seasonal structure, in the most favourable and least frequent case, which allows the extension of the previous year structure in the year under review, subject to foreseeable changes. The same analysis can show a variable seasonal pattern, which is the most common situation. In this case, the evolutions from previous years can be used as the baseline for the decisions made for the forecasting year.

*The budget for sellers or for a region.* Following comparison between the situations in each region, and

within these, each seller's effort, the company may develop a budget for different geographical regions, based on past experience and showing what is the desired objective for the future.

*The budget for products* allows the company to track and analyse sales trends for various items in the product range.

*The overall budget.* For giving a synthetic view of the program, all forecasts (per periods, regions or products) should be regrouped. This task involves some difficulties, as, for example, changes in volume-sale price or structural changes. If the price variation is uniform for all items, the correction factor is easy to apply. If the price variation is differentiated, there must be calculated a weighted correction factor. Within the overall budget, different structures (period, region, product) are compared, which generates differences during the year for a period, region or product.

## 4. Case study – the development of the sales budget

Starting from theoretical delimitations above, hereinafter we will show a practical model of budgeting sales. In this sense, we use the example of Mobilrom S.A., a company specialized in manufacturing furniture. The company has three main manufacturing sectors: Sector I - PAL, Sector II - Processing and Sector III - Assembly. Each sector consists of several workrooms where successive technological operations are run. We will consider, for example, a furniture product for the lobby, called *Andorra Wardrobe*.

### 4.1. Sales forecasting

Sales forecasting is based on **statistical methods**, which involve the extrapolation of past data for the near future. The most common methods are linear correlation method and linear adjustment method.

a. **The linear correlation method** is based on the relationship defined by the first degree function of the type  $y = a \cdot x + b$ , which underlies the calculations based on *the method of least squares*. Under this method, we can determine a relationship of dependency between the sales volume  $y$  (determined variable) that we want to predict and another variable  $x$  (determinant variable);  $a$  – the degree of variability, and  $b$  – fixed element.

In this example, using the least squares method allows to determine the degree to which the evolution of determinant variable  $x$  (*the rank of the month*) influence the evolution of the determinant variable  $y$

(*sales of the month*), by calculating a correlation coefficient  $r$ .

To determine the coefficient  $r$ , for the example chosen, there will be used the data in **Table 1**:

$x_i$	$y_i$	$(x_i - \bar{x})$	$(y_i - \bar{y})$	$(x_i - \bar{x}) (y_i - \bar{y})$	$(x_i - \bar{x})^2$	$(y_i - \bar{y})^2$
1	270	-2.5	-40	100	6.25	1,600
2	290	-1.5	-20	30	2.25	400
3	300	-0.5	-10	5	0.25	100
4	310	0.5	0	0	0.25	0
5	340	1.5	30	45	2.25	900
6	350	2.5	40	100	6.25	1,600
$\bar{x} = 3.5$	$\bar{y} = 310$	-	-	$\Sigma = 280$	$\Sigma = 17.5$	$\Sigma = 4,600$

Source: Authors' processing

Calculated by the relationship:

$$r = \frac{\sum x_i * y_i}{\sqrt{\sum x_i^2 * \sum y_i^2}} = \frac{\sum (x_i - \bar{x}) * (y_i - \bar{y})}{\sqrt{(\sum (x_i - \bar{x})^2 * (\sum (y_i - \bar{y})^2))}} \quad (1)$$

It results:

$$r = \frac{280}{\sqrt{17,5 * 4600}} \cong 0,99$$

Theoretically, the linear correlation coefficient  $r$  should be close to 1 or -1. Based on this value close to 1 ( $r \cong 0,99$ ), it is considered that the evolution of the variable  $y$  is influenced by the evolution of the variable  $x$ , and therefore, least squares method can be adopted for the forecasting of the variable  $y$  (volume sales).

The value of  $a$  will be calculated by the formula:

$$a = \frac{\sum x_i * y_i}{\sum x_i^2} = \frac{\sum (x_i - \bar{x}) * (y_i - \bar{y})}{\sum (x_i - \bar{x})^2} \quad (2)$$

$$a = 280/17,5 = 16$$

The value of  $b$  will be calculated by the formula:

$$\bar{y} = a * \bar{x} + b * b = \bar{y} - a * \bar{x} = 310 - 16 * 3,5 = 254$$

Sales forecasting for the first semester of N year is achieved using the function:

$$y = a * x + b * y_i = 16 * x_i + 254$$

Thereby, the following values are obtained, according to **Table 2**:

$X_i$ (month)	$y_i$ (Quantity-pcs.)
1	366
2	382
3	398
4	414
5	430
6	446

Source: Authors' processing

**b. Linear adjustment method.** One of the variants of this method is the forecasting of sales based on seasonality coefficients.

**b.1.** In the simplest form, seasonality coefficients corresponding to each month are determined by the ration between the average monthly sales and the average annual sales (**Table 3**), using data on quantities sold in at least two consecutive years.

**Table 3. Determination of seasonality coefficients**

Month	Sold quantity (pcs.)			Monthly average of quantities sold (pcs.)	Seasonality coefficient
	Year N-2	Year N-1	Year N		
January	286	312	350	316	7.02%
February	262	370	385	339	7.54%
March	274	375	404	351	7.80%
April	280	385	424	363	8.06%
May	293	402	487	394	8.76%
June	305	410	488	401	8.92%
Total semester 1	1,700	2,254	2,538		
Total for year	3,800	4,200	4,500		

Source: Authors' processing

We predict monthly sales schedule for the next year N+1, as shown in Table 4, by multiplying the total

amount projected for next year (5,000 pcs.) with the seasonality coefficients established.

**Table 4. Program of sales forecasting**

Month	Seasonality coefficient	Quantity predicted year N+1 (pcs.)
January	7.02%	5,000 x 7.02% = 351
February	7.54%	377
March	7.80%	390
<b>Total first quarter</b>		<b>1,118</b>
April	8.06%	403
May	8.76%	438
June	8.92%	446
<b>Total second quarter</b>		<b>1,287</b>
<b>Total first semester</b>		<b>2,405</b>
<b>Total year N+1</b>		<b>5,000</b>

Source: Authors' processing

**b.2.** In a more complex form, the seasonality coefficients are adjustments of the theoretical values obtained through a function  $y = a \cdot x + b$ , due to periodical causes which have a different influence on the two variables for

different periods of time. Thus, seasonality coefficients can be calculated either as a ratio between the achieved and forecasted quantities for the same period of the year N, or vice versa, according to Table 5:

**Table 5. Determination of seasonality coefficients**

$x_i$	$y_i$ realized N (pcs.)	$y_i$ planned N (pcs.)	Seasonality coefficient
1	2	3	4 = 2/3
1	270	270	1.00
2	290	286	1.01
3	300	302	0.99
4	310	318	0.97
5	340	334	1.01
6	350	350	1.00

Source: Authors' processing

To determine **the quantities sold forecasted for the year N+1**, the following steps shall be undertaken, whose results are listed in **Table 6**.

Steps:

- The function  $y = a \cdot x + b = 16 \cdot x + 254$  allows to determine the *theoretical projected sales volume for the year N+1* (column 2).
- By multiplying this result by seasonality factors there is obtained the *forecasted sales volume for a season* (column 4).

- In column 5 there are entered data on *sales volume increasing by a maximum accepted market share of 30%*, determined by multiplying the volume achieved for each month of the year N with 1.3.
- The sales volume forecasted (column 6) corresponding to each month and mentioned in the sales budget is the minimum amount of *forecasted sales volume* (column 4) and the *maximum permissible increase market sales volume* (column 5).

**Table 6. Program of sales forecasting**

x	Theoretical forecast of y for N+1 (pcs.)	Seasonality coefficient	y planned (pcs.)	The maximum permissible increase (pcs.)	The final forecasted quantity (pcs.)
1	2	3	4 = 2*3	5 = y planned / N * 1,3	6
1	366	1.00	366	351	351
2	382	1.01	387	377	377
3	398	0.99	395	390	390
4	414	0.97	404	403	403
5	430	1.01	438	442	438
6	446	1.00	446	455	446

Source: Authors' processing

## 4.2. Preparation of sales budget per product

The sales budget aims to forecast turnover, taking into account the sales program (amounts projected using the statistical methods presented above) and the forecast of sale prices. Final decisions lead to establishment of program sales (i.e. quantities being sold in a given period) and sales budget (quantities \* their selling prices,

values that represent useful information for production technicians, especially for financiers).

*The physical volume of sales* ( $Q_v$ ), reflected in the sales program, is determined by the production volume which is to be manufactured ( $Q_f$ ), considering of the initial stock ( $S_i$ ) and the final stock ( $S_f$ ), according to the relationship:

$$Q_v = S_i + Q_f - S_f \quad (3)$$

The volume of production which is to be manufactured is used in the production budget, and the final stock depends on the company's inventories policy (supplies budget) and the company's capacity to produce and sell.

The value of sales or Turnover (CA) reflected in the sales budget expresses the relationship between the physical volume of production intended for sale (Qv)

and its selling price (pv), according to the relationship:

$$CA = Qv * pv \quad (4)$$

The forecast for year N sales (broken down for the first semester), as entered into the sales budget, is as follows (Table 7):

**Table 7. The sales budget - Product: Andorra Wardrobe**

Month/ Year N	Forecasted quantity (pieces)	Selling price planned (lei/piece)	Turnover planned (lei)
January	351	800	280,000
February	377	800	301,600
March	390	800	312,000
April	403	800	322,400
May	438	800	350,400
June	446	800	356,800
FIRST QUARTER	2,405		1,924,000
TOTAL YEAR	5,000		4,000,000

Source: Authors' processing

## 5. Marketing expenses budget

Sales forecasting is made in conjunction with marketing expenditure forecasting as they are interrelated: marketing costs are a consequence of sales, and sales may be influenced by advertising expenses and/or costs of improving the sales network.

Preparing a marketing budget expenditures is constituted as a logical consequence of the commercial activity, as defined in the sales budget, thus allowing the establishment of the costs incurred for the sale of the company's products on the internal and external markets.

The elaboration of marketing expenses budget is approached differently by each company, depending on the characteristics of its activities and its size. Before the forecasting, the main problem is identifying the expenses that relate to the sales activity, from the wide range of expenses classified by their nature.

Thus, *marketing costs*, which are classified by their nature and highlighted in general accounting by the accounts of class 6 *Expenses accounts are transposed* in marketing expenditures by functions, which is a classification specific to managerial accounting. In

general, the budget aims to estimate the costs of the main functions involved by the marketing of products:

- administration of sales – corresponds to commercial line;
- marketing - advertising and promotion management, launching new products;
- sale - contracting customers, knowledge of needs;
- packaging - dispatch - delivery;
- after-sale services.

Subsequently, *the forecast of marketing expenses* will be achieved, as part of ante-cost calculation for determining the full costs. Marketing costs vary depending on the level of activity; so there are three types of costs:

- *Variable costs*, which are directly proportional to the volume of sales (i.e.: sales agents' commission, packaging materials, distributors' wages, transport charges etc.). The forecasting of these expenses will be made by the equation:  $y = a * x$  where  $y =$  variable expenses,  $x =$  sales and  $a =$  coefficient of proportionality of costs in relation to sales.

- *Semi-variables costs* that are partly proportional to the level of marketing activity and in part have a fixed character (for example: the phone used to sell and to resolve various administrative issues related to sales, the salaries of commercial services employees etc.). The representative equation is of the type:  $y = a \cdot x + b$ , where  $b =$  constant of proportionality, which corrects the level of sales;
- *Fixed costs*, independent on the short-term of the level of trading activity (i.e.: advertising, supervisory staff salaries, electricity, travel expenses, depreciation, professional training charges etc.). The equation that determines the level of these charges is the type:  $y = b$ .

The proportionality coefficient ( $a$ ) and the constants ( $b$ ) shall be based on data recorded in previous years on variable and fixed costs and sales.

To forecast marketing costs as realistically as possible, there is considered the causal link *between the sales activity and the costs necessary to undertake this activity*:

$$\text{Marketing expenses} = F (\text{Sales activity})$$

The forecasting of marketing expenses (advertising, promotion, business studies, launching new products etc.) can be performed according to several methods, which take into consideration: the maximum cost that the company can support, the business goals set for the next year, a percentage of sales or the costs incurred by competitors.

To determine the marketing expenditure budgeted, several *factors* will be considered: positioning of the product within its lifecycle (larger advertising costs for new products), market share, rate of acquiring customers, quality and the uniqueness of the product.

Establishing an optimal level of marketing expenditure is a difficult task, as the inter-relationship between the marketing costs and sales does not usually have an immediate effect.

*The forecast for other marketing expenditures* is based on data from previous years, extrapolated for the year for which the budget is prepared. But, because this projection of the past over the future does not eliminate the negative aspects of the past, a cost/benefit analysis should be carried out, for

removing the inefficient costs from the marketing expenditures. However, extrapolations will be updated depending on changes in the company's specific business goals and commercial policies.

Forecasting of sales and marketing expenses should be performed at the same time because they are interrelated to each other. The marketing expenses budget can be drawn up separately from the sales budget or the marketing expenses forecasts can be mentioned as a separate section at the end of the sales budget, thus allowing determination of the *commercial margin* as the difference between turnover and marketing costs.

## Conclusions

Because of the importance of sales within a company, it can be said that the sales budget affects all aspects of a business. Sales budget can be considered as the main annual budget of the company as it determines the parameters of all other annual budgets: manufacturing capacities, raw materials supply, volume and structure of the staff, strategic investment decisions etc. Preparing the sales budget can support a company to achieve its sales goals, providing at the same time a basis in determining and evaluating individual and team objectives and successes.

Preparing the sales budget is, however, a process accompanied by certain limitations. It can be a significant time consumer for the management staff and often, pending the final version of budget, it may cause conflicts between certain departments of the company. It is important that realistic goals be established in the budgeting process, with achievable indicators. This can be seen in the performance reports by comparing actual data with budgeted data.

Being convinced that budgets represent valuable guidance for the actions taken by managers, we propose as directions for our future research: the theoretical analysis and case studies for other budgets within the budgets network of the enterprise, such as investments budget, production budget, purchasing budget, treasury budget, human resources budget or administrative expenditure budget.

## REFERENCES

1. Anthony, R.N. (1988), *The management control function*, Boston: Harvard Business School Press.
2. Anthony, R.N. and Govindarajan, V. (2007), *Management Control System*, International Edition, 12th Edition, Boston: McGraw-Hill Irwin.
3. Bouquin, H. (1992), *La maîtrise des budgets dans l'entreprise*, Vanves: Edicef.
4. Gervais, M. (1994), *Contrôle de gestion par le système budgétaire*, Paris: Vuibert.
5. Johnson, H.T. and Kaplan, R.S. (1987), *Relevance lost: the rise and fall of management accounting*, Boston: Harvard Business School Press.
6. Linder, S. and Weber, J. (2005), Budgeting, better budgeting or beyond budgeting, *Journal of Cost Management*, vol. 19, no. 2, pp. 20-28.
7. Mui Yee, C., Wong Sek Khin, E. and Ismail, K. (2016), *An analysis of budgetary goals impacting organizational performance*, Audit Financiar, vol. XIV, no. 5(137)/2016, pp. 551-463, DOI: 10.20869/AUDITF/2016/137/551.
8. Sponem, S. and Lambert, C. (2010). *Pratiques budgétaires, rôles et critiques du budget. Perception des DAF et des contrôleurs de gestion*, [pdf] Available at: <https://halshs.archives-ouvertes.fr/halshs-00525987/document> [Accessed on June 12, 2016].
9. Sullivan, A. and Sheffrin, S. (2003), *Economics: Principles in action*. Upper Saddle River, New Jersey: Pearson Prentice Hall.
10. Veran, L. (1990), *Produire et vendre. Agir dans l'entreprise*, Paris: Edition Economica.
11. Villeseque, F. (2003), *Le processus budgétaire comme jeu d'interactions organisationnelles*, [pdf] Available at: <https://halshs.archives-ouvertes.fr/halshs-00582821/document>, [Accessed on June 12, 2016].

Camera Auditorilor Financiar  
*af*  
din România



6422657000013