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PECULIARITIES OF ACCOUNTING AND TAXATION OF PROVISIONS IN THE REPUBLIC OF MOLDOVA

Throughout their economic activity, businesses are exposed to various risks, which may lead to unforeseen expenses (losses). To cover such expenses/losses, companies put aside funds, i.e. provision estimates, which, in fact, are potential risk estimates, and represent one of the criteria affecting the reliability of financial reporting. The recognition and taxation of such provisions at Moldovan undertakings is governed by the National Accounting Standard (NAS) "Equity and Liabilities" [1] and by the Tax Code (TC) [2].

According to the NAS "Equity and Liabilities", provisions are liabilities that are uncertain as to the date on which they would arise or as to their amount [1, p.4]. They can be created to cover the supposed expenses (losses), namely:

- employees' benefits – company's liabilities towards its employees in terms of leave benefits, pensions, rewards for the annual business outcomes and other payments, stemming from the collective and individual labour agreements [1, p. 85^1 subpoint 1]. The amount of provisions for leave benefits shall be determined for each employee or for each category of employees based on a percentage to the payroll set by the accounting policy – when setting the provisions during the reporting period, or based on the actual number of unused vacation days – when setting the provisions as of the reporting date;
- the repair and maintenance of assets sold during the warranty period – to cover the costs for the repair and warranty service of goods sold, for the return and price reduction of goods sold and for other warranties stemming from the agreements concluded with buyers/clients [1, p. 85^1 subpoint 2]. As a rule, the amount of provision estimates is determined based on the analysis of information on warranty expenses for the previous 3–5 reporting periods and are included into sales expenses;
- taxes – to refund the differences in taxes revealed during the inspections/audits, which were started but not completed; for the taxes related to ongoing legal proceedings a company is part of, as well as for other situations, which may give rise to tax and fee liabilities, including the accrued penalties and sanctions [1, p. 85^1 subpoint 3]. The amount of such provisions shall be determined as of the reporting date, based on the estimated amounts of tax liabilities to be paid to the budget. When calculating the amount of said provisions the company may take into account the 50% discount on fines pursuant to Art 234, (2) of the TC;

other purposes – to cover the costs related to legal proceedings, environment protection, decommissioning of long-term tangible assets, company restructuring and in other cases provided for by the legislation and/or by the company leadership. Provisions for legal proceedings shall be created as of the reporting date for those claims/trials the company is likely to lose. The amount of such provisions is determined based on the assessment of the damages to be compensated, legal fees, costs to conduct technical and/or accounting expert appraisals, etc. The provisions for the decommissioning of long-term tangible assets shall be created for each unit in order to cover the costs of asset disposal. The procedure for reflecting the above-mentioned provisions in accounting depends on the period of their creation: before the transfer of long-term tangible assets into operation or during their period of use. Provisions created before the transfer of long-term tangible assets into operation are included in their initial cost, and provisions formed during their period of use are recognized as current expenses/costs.

Overall, the list of provision estimates and their creation procedure, laid down in the aforementioned National Accounting Standard, are in compliance with Directive 2013/34/EU, which provisions shall be applied to the extent they do not conflict with the financial reporting rules used by certain types of undertakings or with the rules of capital allocation, contained by other legal acts in force [3].

It is necessary to pay attention to a range of key aspects in the process of creating, writing-off, accounting and taxing the provisions, namely [4]:

- **Regulatory governance.** The regulatory acts of the Republic of Moldova comprise no special binding requirements for companies to create provisions. The need of their creation is determined individually by each company depending on its information needs, specific work conditions, the probability of unexpected costs occurrence during the upcoming reporting periods, as well as on the materiality of such expenses/costs. If the company decides to create provisions, then their list and the procedure of their creation and use shall be mirrored in the accounting policy;
- **Creation procedure**. Provisions shall be created at the expense of the primary/historical value of assets and/or of the current costs/expenses and be used only for those purposes, for which they were initially created [1, pp. 85, 86]. Hence, the provisions created to cover certain costs/expenses (e.g., to pay leave benefits), shall not be used for other purposes (for instance, to compensate the costs for the repair and maintenance of assets sold during the warranty period);
- **Appraisal and frequency of creation.** The amount of provisions can be calculated by the company's employees or by independent professionals. The specific method used to appraise various types of provisions shall be established independently by each company and mirrored in its accounting policy. Provisions can be created during the reporting

period (on a monthly/quarterly basis) or as of the reporting date. When creating provisions during the reporting period, their amount shall be revised as of the reporting date and adjusted to better mirror the current appraisal [1, p. 87]. Depending on its nature, such adjustment shall be mirrored as a regular or reversing entry, using the same account correspondence as during the creation of provisions;

- **Write-off.** The amount of unused provisions, to be used in the upcoming reporting periods (e.g., to pay the leave benefits, to cover the costs for the repair and maintenance of assets/goods sold during the warranty period), shall not be written-off as of the reporting date. Therefore, in such situations, when calculating the balance sheet indicators, the balance of accounts where provisions were recorded shall be taken into consideration. If there is no possible outflow of benefit generating funds, the provisions shall be cancelled by writing them off to current income [1, p. 88]. Such situation may occur when the company ceases to create provisions for certain purposes (e.g., to cover the costs for the decommissioning of long-term assets, for the repair and maintenance of assets sold during the warranty period) or does not fully use the provisions created for tax liabilities, legal claims, etc. [5];
- **Taxation.** No deduction of costs related with the creation of provisions shall be permitted [2, Art. 31 (2)]. The created provisions are mirrored in the Income tax statement for entrepreneurial activity, while the expenses incurred or paid at the account of provisions shall be deducted for taxation purposes during the period of their actual use. The income recognised due to the cancelation of provisions depends on the taxation method used by the company. When the general taxation method is used, such income is not subject to income tax because the expenses related to their creation were not deducted for taxation purposes [2, Art. 20 z^{17}]. When using the taxation method for small businesses, the amount of provisions written-off to income is subject to income tax as this income does not appear in the list of income exempted from taxation, referred to in Art.20 of the TC [2, Art. 54^2 (3)].

To sum up the foregoing, it is worth mentioning that despite the fact that the regulatory acts in force comprise no specific binding requirements for companies to create provisions, the need for their creation in order to reliably calculate the financial reporting indicators, is determined by [4]:

- the principle of prudence, which implies that assets and income are not to be overestimated and/or the liabilities and expenses are not to be underestimated;
- the assurance of the correspondence between income and expenses during the reporting periods;
- the accurate calculation of the net profit (net loss) for the current reporting period and the avoidance of unnecessary dividend distribution.

The lack of provisions serves as evidence that the financial results may have been distorted, and, as such, may generate financial difficulties, as well as issues in the process of auditing the company's financial statements.

References:

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