



The duty of the Federal Government to compensate electric utilities for unmanageable costs and their disclosure on the balance sheet according to international accounting standards

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ABSTRACT

Since the issuance of OCPC 08 (Technical Guideline of the Accounting Pronouncements Committee 08), electric utility companies have had the right to be compensated by the Government in the event of non-recovery of unmanageable costs upon termination of their contracts. Indeed, the potential recognition of this obligation by the Federal Government could have a very negative effect on public accounts. Effective oversight of the recovery of these costs over the term of the contracts along with the correct accounting treatment by the Government, namely the Tax Risks Attachment of the Federal Government Balance Sheet, are crucial to the sustainable management of public accounts. This management also aims to meet the principle of publicity, established by article 37 of the Federal Constitution. This study examines the effects of demonstrating, measuring, and reporting this complex category of assets in the electric power sector and indicates potential topics of study on their management, monitoring, and control, conducted either internally by agencies of the Federal Executive Branch or externally by the Federal Court of Accounts - Brazil.

Keywords: Sectoral Financial Asset. Contra Account of Value Variation for Component A Items. Unmanageable Costs. Contingent Liability. Provisions.

INTRODUCTION

The electric power sector is a very complex economic segment. In the case of distribution companies, one of their main features is that they represent natural monopolies. This means that the operating costs of this type of activity are so high that its development by more than one company would be virtually impossible in this market. Therefore, companies in this industry require



special management of their resources, which is the reason for dividing the costs into Components *A* and *B*. The former, also known as unmanageable costs, refers to the cost of electric energy sold to end consumers, transmission costs, and corresponding charges. Component *B*, on the other hand, refers to administrative costs, such as human resources and work materials. In the latter component, companies are able to exercise much more managerial control.

For Component *A*, the main regulation is Ordinance MF/MME No. 25/2002, which determines that the utilities cannot pass on any additional electricity costs acquired in the year to the tariff pertaining to that same accounting period (year *A*). The electric utility will only be able to pass them on at the time of the next tariff adjustment (TANCINI, 2013). If they are not recovered in year $A + 1$, this difference will go on to be recovered in year $A + 2$, and so on. If this cost is not recovered by the tariff before the end of the concession agreement, the company has the right to receive this amount from the Government (Federal Government). This regulation is provided in OCPC 08, the rule approved by CVM Resolution No. 732/2014. The balance of these unmanageable costs on the balance sheet of the companies is recognized as assets by way of the Contra Account of Value Variation for Component *A* Items (CVA).

Therefore, unmanageable costs – in the form of CVA – represent a potential debt (suspensive condition) for the Federal Government, as there is no liability until the concession agreement ends. International rules for this type of situation provide specific treatments, which are recommended in NBC TSP 19 (Provisions, Contingent Liabilities, and Contingent Assets). Thus, the Provision figure arises, which are probable resource outflows from the entity to a creditor. Contingent Liabilities are on an immediately lower probability scale relative to Provisions. There is even a third level of probability of resource outflow, where there is neither acknowledgement of a provision nor mention of the potential loss in an explanatory note.

In light of these considerations, this study aims to **highlight the possible accounting treatments for the companies' right to compensation for unmanageable costs on the Federal Government Balance Sheet, pursuant to international accounting rules**. The positive and negative impacts of each situation are illustrated. This work also presents proposals for audit procedures that can contribute to more reliable measurements of these contingencies and control activities of the components, in order to mitigate the Federal Government's chances of bearing large financial expenses in the future, which could harm the sustainability of public accounts.

METHODOLOGY

With regard to its approach, this study is classified as a qualitative research. According to Deslauriers (1991 apud GERHARDT; SILVEIRA, 2009, p. 32), in this type of study, the purpose of the sample is to “produce in-depth and illustrative information; whether small or big, what matters is that it is able to produce new information.” As for its nature, this work is identified as applied research since its purpose is to apply the findings in practice. This study's objectives categorize it as descriptive research since, according to Perovano (2014 apud SILVA, 2016, p. 2), it is concerned with how “a system, method, process, or operational reality is structured and functions,” where first the variables and then the results are analyzed. As for its procedures, this work is classified as a case study.



BACKGROUND

The concern over the high acquisition costs of electricity by utility distributors, particularly in Component A, gained significant importance after the huge currency devaluation crisis in 1999 (TANCINI, 2013, p. 59). Since many energy contracts are quoted in United States dollars, distributors incurred large deficits due to the difference between the purchase price and the sale price in the accounting period, as this acquisition cost could not be automatically passed on to the consumer. From that moment on, the Government allowed these differences to be transferred to the consumer in the following adjustment, which would be recognized as assets in the electric utility distributors' accounts. Finally, Interministerial Ordinance MF/MME No. 25 of January 24, 2002, formalized this procedure and these assets also became recognized as Regulatory Assets.

Years later, after the process of alignment with international standards, which was completed in Brazil in 2010, utility distributors began facing new challenges. The regulatory assets that were previously recognized by Brazilian accounting standards did not fit in with the rules issued by the International Accounting Standards Board (IASB), the agency that regulates International Financial Accounting Standards – IFRS. This is because, according to IFRS rules, on an international scale, and to the Accounting Pronouncements Committee (CPC) in Brazil, an asset is “a resource controlled by the entity resulting from past events and from which future economic benefits for the entity are expected to flow” (Conceptual Framework for Preparing and Disclosing Financial Accounting Reports – CPC 00). Based on this definition, the referred Regulatory Assets would not be covered by this new concept, as they do not guarantee a probable flow of future economic benefits to the entity, but only a mere expectation of the companies.

Thus, by the end of 2014, the same year Brazil concluded its alignment with international public sector standards, a new solution was found to manage Unmanageable Costs. The Federal Government, through the National Agency of Electric Power (Aneel), signed a commitment to compensate the electric utility distribution companies at the end of their concession agreements if there is a balance of unmanageable costs to recover upon the contracts' termination. Accordingly, on November 28, 2014, the Accounting Pronouncements Committee issued Technical Guideline OCPC 08 (Recognition of Certain Assets and Liabilities in General Accounting and Financial Reports of Electric Utility Distributors issued in accordance with Brazilian and International Accounting Rules). CVM Resolution No. 732 regulated this rule on December 9, 2014.

Full adoption of the International Public Sector Accounting Standards (IPSAS) is consolidated in the Public Sector Accounting Manual (MCASP), 6th Edition, valid since the 2015 accounting period.

THEORETICAL FRAMEWORK

INTERNATIONAL STANDARDS IN BRAZIL

The Brazilian translation of the International Public Sector Accounting Standards (IPSAS), referred to as the Brazilian Public Sector Accounting Rules (NBCASP), was approved by Brazilian Accounting authorities through Ordinance No. 634 of November 19, 2013, of the Brazilian Treasury Office. As for the Liabilities, Provisions, and Contingent Liabilities, the Brazilian rule is NBC TSP 19 (IPSAS 19). The document has already been incorporated into chapter 9, part II of the 6th Edition of the MCASP.



In the Federal Government Balance Sheet, the provisions are recognized in the Equity Variation Statements. This statement is of paramount importance in describing the evolution of the entity's equity during the accounting period, in order to issue positive or negative evaluations about given management. According to Silva (2014 apud SANTOS and CASTRO, 2015, p. 5):

An entity's equity income is its management indicator and an object for analysis of the tax objectives attachment in the Budget Guidelines Law, given its influence on the evolution of the net equity over a certain period.

Thus, it is possible to understand that accurately measuring the provision to be recognized is critical to faithfully expressing the Government's equity, as this situation is an essential condition for the public entity's sustainable, responsible management.

LIABILITIES, PROVISIONS, AND CONTINGENT LIABILITIES

NBC TSP 19 defines Provision as "a liability of an uncertain timing or amount." It differs from Liability in that it is a present obligation of the entity, arising from events that have already occurred and from which there is an expectation of resource outflow to a given creditor. Furthermore, there is a third element, Contingent Liability. NBC TSP 19 defines it as follows:

18. Contingent Liability: (a) a potential obligation arising from past events and whose existence shall be **confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity**; or (b) a present obligation resulting from past events, but it is not recognized, because: (i) it is improbable that a resource outflow incorporating economic benefits be required to liquidate the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability. (Emphasis added.)

Subsequently, NBC TSP 19 defines the criteria that classify an obligation as a Liability, Provision, or Contingent Liability:

24. In most cases, it shall be clear whether a past event has given rise to a present obligation. In rare cases - in a lawsuit, for example - whether certain events occurred as well as whether those events resulted in a present obligation may be up for discussion. In this case, the entity must determine if the present obligation existed on the date of the **balance sheet, by taking into account all available evidence**, including, for example, expert opinion. The evidence considered includes any additional evidence provided by events after the balance sheet's date. Based on such evidence: (a) when it is **more likely than not that a present obligation exists on the balance sheet's date**, the entity must recognize the provision (if the recognition criteria are met); (b) **when it is more likely that no present obligation exists on the balance sheet's date**, the entity discloses a contingent liability, unless there is the remote possibility of a resource outflow incorporating economic benefits.

Based on these concepts, the chart in Figure 1 correlates the probabilities and accounting treatments of each situation:

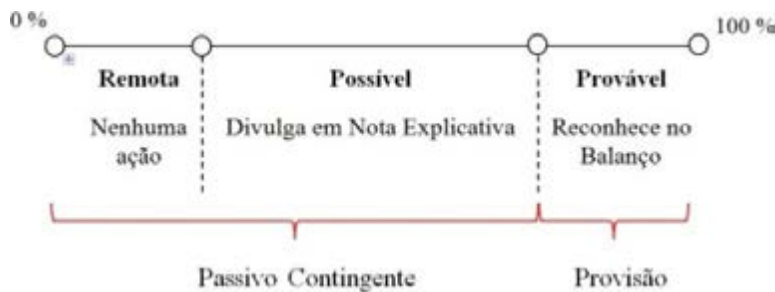
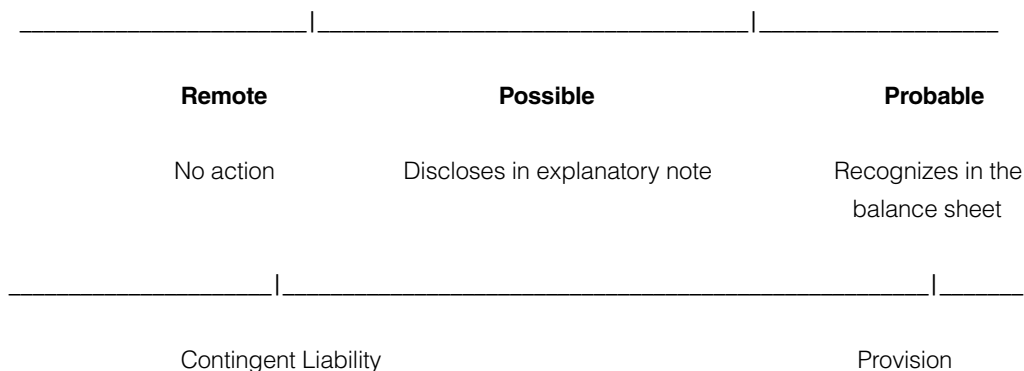


Figure 1 – Treatment of the Event as Probable, Possible, or Remote.

Source: The author.

Translation:



As observed, NBC TSP does not numerically establish what might be considered “Probable,” “Possible,” and “Remote.” In this sense, Cravo (1994 apud OLIVEIRA, 2007) asserts that the term “Probable” would be associated with a 50% to 95% chance of the obligation’s occurrence. The term “Possible” would be associated with the 5% to 50% range, and, finally, a probability of less than 5% would be “Remote.” According to Poeta (2012), there is no consensus on these classifications. The author argues that professional judgment may influence this process, especially when terminology is translated into numbers.

As verified in prior research, there are studies that advocate the use of numerical terms, while others believe that verbal terms of probability are better. The findings from this research do not allow for a conclusion to be made one way or the other, considering each individual’s complexity when making judgments and interpretations [...]. The differences found, specifically in point Y, imply that verbal-numerical and numerical-verbal translation may involve different judgment processes. Consequently, they may have a different impact on accounting statements.

Hence, it appears that there is no categorical definition for the use of numerical or verbal terms associated with the degree of probability for recognizing a present obligation. It is apparent that criteria for this kind of classification may be established in accordance with each type of market and the type of professional judgment inherent to it.



OCPC 08 AND THE RIGHT TO RECOVER UNMANAGEABLE COSTS

Initially, Technical Guideline CPC 08 refers to the regulatory framework that recognizes the right to recover CVA, which was approved by the Aneel Board of Directors in an extraordinary session on November 13, 2014. For the Government, electric utility distributors and licensees that amended their contracts would have the right to recover Component A, currently named Sectoral Financial Assets (AFS).

IN12. The contract amendment would have, in summary, the following principle: In the event of the concession agreement's termination, aside from recovering damages arising from non-amortized or depreciated investments over the course of the concession agreement, **the remaining balances calculated from items in Component A and other financial components that have not been recovered through tariff cycles shall also be subject to compensation by the Government.** The situation above applies to any form of termination of concession agreements, such as the end of the contract term, bankruptcy, nationalization, lapse, termination, or annulment of the contract. In the case of termination with the remaining balance constituting an obligation of return, this amount shall be compensated with the cited reimbursements. (Emphasis added.)

In light of this situation, the committee issued an opinion (IN13) in order to cease the impediment that existed prior to recognizing temporary differences in distribution tariffs as assets or liabilities.

PRESENTATION AND DISCUSSION OF FINDINGS

ENFORCEABLE PROCEDURES

In the current scenario of public accounts management, procedures regarding the treatment of contingent liabilities that have been adopted by other agencies already exist, as verified in the Federal Government Balance Sheet of 2015. Explanatory note 3.8.2 (p. 117-123) expresses, in addition to other information, that the Office of the General Counsel for the Federal Government is the most representative group under the item "Other Provisions – Long Term" (p. 121).

Thus, to prepare the Tax Risks Statement, article 3 of Ordinance No. 40 of February 10, 2015, of the Office of the General Counsel for the Federal Government, establishes the criteria that give such classifications to contingent liabilities of the Federal Government's potential obligations. This classification occurs basically according to the degree of the decisions on the respective matter of each lawsuit or group of lawsuits. For example:

I – Probable Risk: a) when there is a Binding Precedent against the National Treasury [...]
II – Possible Risk: a) when there is special controversy appeal decided by the Superior Court of Justice or the Superior Labor Court against the National Treasury in cases where there is a legal possibility of the Federal Supreme Court's knowledge on the matter [...].
III- Remote risk: actions that do not fall within the classification provided in items I and II.



It is worth noting that the aforementioned Ordinance determines the lawsuit or group of similar lawsuits to have a sum equal to or greater than BRL 1 billion for the purposes of classification. In the specific case of the Office of the General Counsel for the Federal Government, classification regarding the likelihood of a particular obligation's occurrence is not linked to numerical indicators, which provides subsidies for other Agencies to adopt procedures using this same guideline.

ANALYSIS OF ALTERNATIVES

To analyze the results, we selected electricity distribution companies to compose a sample from the Aneel database, which has 102 companies. The criteria adopted was selection of the companies with the highest electricity supply revenues in the 2015 accounting period. In this study, "highest revenues" are the companies belonging to group A of the ABC classification of supply revenues. Thus, the sum of these companies' revenues covers 80% of the industry, as set forth in Table 1.

It is worth mentioning that when the cost of electricity purchased by the utility is less than the amount calculated for the respective tariff, the company must compensate this amount in the following adjustment. In this situation, the company has a Sectoral Financial Liability (PFS). The difference between what the utility is entitled to receive and what it has to compensate is called either a Net Sectoral Financial Asset (AFS) or a Net PFS, depending on the case.

Table 1 – Supply Revenue Percentage by Electric Utility Company in 2015

Electric Utility Distributor	State	Revenue in 2015	%
Eletropaulo – Eletropaulo Metropolitana Eletricidade De São Paulo S.A	SP	13,872,037,352.29	10.27%
Cemig-D – Cemig Distribuição S.A	MG	11,350,508,188.72	8.40%
Copel-Dis – Copel Distribuição S.A	PR	10,180,067,878.23	7.54%
Cpfl-Paulista – Companhia Paulista De Força E Luz	SP	8,986,272,261.73	6.65%
Light – Light Serviços De Eletricidade S.A.	RJ	8,771,897,067.32	6.50%
Celesc-Dis – Celesc Distribuição S.A.	SC	5,955,387,473.12	4.41%
Elektro – Elektro Eletricidade E Serviços S.A.	SP	5,376,264,466.84	3.98%
Coelba – Companhia De Eletricidade Do Estado Da Bahia	BA	5,184,376,847.21	3.84%
Celg-D – Celg Distribuição S.A.	GO	4,813,179,872.69	3.56%



Electric Utility Distributor	State	Revenue in 2015	%
Ampla – Ampla Energia E Serviços S.A	RJ	4,617,467,887.65	3.42%
Bandeirante – Bandeirante Energia S.A.	SP	3,971,314,776.03	2.94%
Cpfl- Piratininga – Companhia Piratininga De Força E Luz	SP	3,924,624,336.01	2.91%
Celpe – Companhia Energética De Pernambuco	PE	3,766,586,271.67	2.79%
Coelce – Companhia Energética Do Ceará	CE	3,748,900,420.23	2.78%
Celpe – Centrais Elétricas Do Pará S.A.	PA	3,472,664,074.77	2.57%
Ceee-D – Companhia Estadual De Distribuição De Energia Elétrica	RS	3,333,572,057.28	2.47%
Aes-Sul – Aes Sul Distribuidora Gaúcha De Energia S.A.	RS	3,128,359,238.73	2.32%
Rge – Rio Grande Energia S.A.	RS	2,861,397,204.57	2.12%
Total in Category A (18 Companies)		107,314,877,675.09	
Sum of revenues of the 102 distribution companies in 2015		BRL 135,017,152,238.37	

Source: Aneel Portal. Management Information.

Once group A was defined, the Net AFS account balance was extracted from the 2015 Accounting Statements of each electricity distributor, both in current (AC) and non-current assets (ANC). The sum of each of these equity components – the Government's potential obligation in the event of concession agreement termination – is the equity amount to be monitored by the Government. Table 2 presents the Net AFS extracted from each company, which will make up this amount.

Table 2 – Net Sectoral Financial Assets to Recover (by BRL Thousands)¹

Electric Utility Distributor	2015		2014		Effective Term
	AC	ANC	AC	ANC	
Eletropaulo – Eletropaulo Metropolitana Eletricidade De São Paulo S.A	891,472	449,428	140,940	129,566	2028
Cemig-D – Cemig Distribuição S.A	860,466	489,190	843,793	262,882	2045
Copel-Dis – Copel Distribuição S.A	910,759	134,903	609,298	431,846	2045
Cpfl-Paulista – Companhia Paulista De Força E Luz	1,464,019	489,945	588,933	321,788	2027
Light – Light Serviços De Eletricidade S.A.	568,675	43,001	577,458	536,712	2026
Celesc-Dis – Celesc Distribuição S.A.	248,458	196,901	450,566	–	2045
Elektro – Elektro Eletricidade E Serviços S.A.	353,663	59,237	331,271	68,448	2028
Coelba – Companhia De Eletricidade Do Estado Da Bahia	139,122	142,971	608,280	218,748	2027
Celg-D – Celg Distribuição S.A.	141,398	- 56,264	114,325	110,497	2045
Ampla – Ampla Energia E Serviços S.A	459,074	78,706	335,853	79,936	2026
Bandeirante – Bandeirante Energia S.A.	664,410	70,437	383,378	218,164	2028
Cpfl- Piratininga – Companhia Piratininga De Força E Luz	–	–	–	–	2032
Celpe – Companhia Energética De Pernambuco	–	–	–	–	2030
Coelce – Companhia Energética Do Ceará	230,445	73,226	151,480	154,929	2028

1 The CPF Paulista company includes financial information relating to CPFL Piratininga and RGE Energia because it is part of the same economic group. Companhia Coelba includes information concerning the Celpe company as both are part of the Neoenergia Group.



Electric Utility Distributor	2015		2014		Effective Term
	AC	ANC	AC	ANC	
Celpe – Centrais Elétricas Do Pará S.A.	- 35,409	- 27,837	204,441	229,796	2028
Ceee-D – Companhia Estadual De Distribuição De Energia Elétrica	176,669	–	202,562	–	2045
Aes-Sul – Aes Sul Distribuidora Gaúcha De Energia S.A.	260,720	69,074	108,278	18,977	2027
Rge – Rio Grande Energia S.A.	–	–	–	–	2027
Group A CVA sum (18 companies)	7,333,941	2,212,918	5,650,856	2,782,289	

Source: AC and ANC - Financial statements of the respective companies in 2015.
Effective Term - Aneel Portal.

According to data from Table 2, the Federal Government has a contingent liability that exceeds BRL 7 billion. Observing explanatory note no. 38 (Constitution of Provisions), p. 150, of the 2015 Federal Government Balance Sheet, we find that in the disclosure of the “most relevant values”, the amounts are those that exceed R\$ 2 billion. In the table above, for example, if termination of the CPFL Paulista and Eletropaulo contracts was classified as Probable and there was a 100% provision of the current assets, the Net AFS, recognized to be around the BRL 2 billion mark, would need to be mentioned in the abovementioned explanatory note.

Consequently, if there are contracts that might be appropriately classified as “Probable,” there will be an increase in provisions, which will, thereby, decrease the Federal Government’s equity income or loss in the accounting period. This is a prudential measure so that, if the contract is not terminated, reversal is positive for the results of the accounting period in which they materialize.

On the other hand, while the “Possible” classification does not make an impact on the Equity Variation Statements and thereby the balance sheet, it alerts all the accounting information users that eventual concession agreement terminations may affect public accounts. Therefore, the constitutional mandate of publicity would be fulfilled, in addition to other basic accounting principles. However, in the event of a “Remote” classification resulting in an unexpected loss, not only would there be a sharp reduction in the Federal Government’s equity, the cash flow of the accounting period when it occurred would also be affected. All of this would still be linked to the problem of disclosure to citizens.

OVERSIGHT PROCEDURES

Once the effects of the compensation of unmanageable costs to electric utilities on the Federal Government Balance Sheet are known, it is necessary to understand that the monitoring and control procedures for these accounting elements can be effective for internal and external control.



In order to ensure reliability, completeness, and other accounting information characteristics, the role of Internal and External Control Agencies is fundamental with respect to the Federal Government and, particularly, to the electricity sector. Baraldi (2012) demonstrates that those who practice “creative accounting” may either underestimate provisions, when they want to artificially improve the results for the accounting period, or overestimate them, when they understand that a dramatically positive result may not repeat itself in the future. Making use of concepts of professional judgment, responsible subjectivism, and other principles, it may even find loopholes in the rule itself so as not to make the due disclosures.

Indeed, External Control needs to verify which premises Aneel is taking into consideration to classify the potential concession agreement terminations as “Probable,” “Possible,” and “Remote,” especially in periods close to the last year of the agreement. Therefore, NBC T 11.15 (Contingencies Audit) provides the premises for verification by assessing the measurement criteria. The second procedure is to ascertain how Aneel is overseeing the constitution of the electric utilities’ CVA balances and whether the Agency is monitoring compliance with the efficiency requirements established in the respective contracts. It is worth noting, according to Tancini (2013, p. 17), that Component A is based on the cost-plus regime. In other words, it is recovered entirely through tariffs and, in this case, promotion of efficiency tends to be impaired within the companies.

CONCLUSIONS AND FUTURE WORKS

The Federal Government’s decision to compensate electric utilities was crucial for these entities to recognize unmanageable costs on their balance sheets, according to international accounting standards. Nevertheless, the electricity sector is very complex and is subject to all kinds of economic setbacks. Given that there are currently more than 60 contracts with electricity distributors approved by Aneel, the accurate accounting of these components is crucial, under penalty of losing control of public accounts.

Therefore, the Federal Government needs to adopt monitoring and control mechanisms to manage sectoral financial assets and liabilities. In this regard, it should be noted that even a potential “Remote” classification does not prevent the Government from providing access every year to the oversight of the sum of sectoral financial assets (and liabilities) of each and every company jointly. After all, the Constitutional principle of publicity must prevail over the non-obligation of disclosure, as provided in certain accounting rules cases.

Thus, the Federal Court of Accounts in the external scope and the Ministry of Transparency, Supervision, and Control; the National Treasury Office; Office of the Attorney General of the Federal Government; the Ministry of Mines and Energy; and Aneel in the internal scope, must adopt methodologies and techniques that enable assessment of how the unmanageable costs are being managed and accounted for within the most rigorous legal and accounting parameters possible. The purpose is to improve monitoring and control of this component of Assets.

Accordingly, we suggest future studies that can create consistent parameters, within the scope of the Government, to demonstrate whether a concession agreement may be terminated or not. In this sense, the metrics for classification of an eventual obligation of the Federal Government as either “Probable” “Possible,” or “Remote” must be established. As for the electric utilities, it is necessary



to monitor which mechanisms are being adopted for the effective recovery of unmanageable costs in the following accounting periods, especially toward the end of the concession agreements.

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Received in 21/10/2016

Approved in 15/05/2018