
OFFSETTING – A METHOD OF SETTLING OBLIGATIONS OF LEGAL ENTITIES

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Abstract

Offsetting is a specific method of settling mutual obligations, where the same persons are at the same time creditor and debtor one to another, and by means of which obligations are settled up to the smallest value.

Offsetting of mutual obligations is a common way of settling debts, especially in the economic crisis marked by lack of liquidity, among others.

There are different offsetting procedures provided by Romanian legislation, according to residence, size of offset amount and state's involvement in the transaction.

The analysis of each offsetting situations encountered in the practice of Romanian legal entities, highlights a series of particularities that should be properly considered for their validation.

Keywords: offsetting, residents, non-residents, obligations

JEL Classification: M10, M41

1. Introduction

In this article we aimed to analyse the possibilities by means of which a legal entity could reduce receivables / payables disclosed in the financial statements. The research method is based on relevant Romanian legislation and we aimed to disclose to stakeholders the range of tools available to Romanian legal entities.

We consider that our study is also useful in terms of lack of liquidity faced by legal entities in the context of the global economic crisis.

2. Definition of obligation

The Romanian Civil Code (1865), as well as the inspiring European civil codes – the Austrian Civil Code (1811), the Swiss Civil Code (1907) or the Swiss Code of Obligations (1881 and 1911), do not provide a definition for “obligation”. However, there are many definitions in the relevant literature, as follows:

“An obligation represents a legal relationship between two or more persons,

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whereby a party called debtor undertakes to the other party called creditor to perform a positive or a negative activity, i.e. an action or an abstention.”¹

“An obligation is the legal relationship whereby a person is pledged to give, to do or to not do something in favour of another person.”²

“From a legal point of view, an obligation is the relationship whereby a person called creditor may demand from another person called debtor the observance of a certain conduct.”³

“An obligation is the legal relationship whereby a person called creditor is entitled to demand from another person called debtor the observance of a certain determinative conduct, which the latter is obliged to fulfil.”⁴

“From a civil point of view, an obligation is the relationship whereby a party called creditor has the possibility to demand from the other party called debtor the observance of one or more actions, such as giving, doing or not doing, usually falling under state compulsion.”⁵

“An obligation is the legal relationship whereby a person called debtor is bound to another person called creditor to the duty of giving, doing or not doing something, under state compulsion in case the action is not executed voluntarily.”⁶

“An obligation is the legal relationship whereby a person called creditor may demand from another person called debtor the observance of a positive or negative conduct, and in case of breach, the creditor may demand satisfaction by constrain.”⁷

“Broadly, an obligation represents the legal relationship which includes the right of the active subject called creditor to demand from the passive subject called debtor to give, to do or to not do something, and where the latter has the corresponding obligation to give, to do or to not do something, under state compulsion in case the action is not executed voluntarily.”⁸

Further to the definitions above it is admitted that the civil obligation represents the legal relationship whereby the creditor is entitled to demand from the debtor the observance of a determinative conduct of giving, doing or not doing something.

¹ Constantin Hamangiu, I. Rosetti – Bălănescu, Al. Băicoianu - *Tratat de drept civil român*, [Romanian Civil Law], 2nd volume, Națională S. Ciornei Printing House, Bucharest, 1929, page 511;

² Tudor R . Popescu, Petre Anca - *Teoria generală a obligațiilor*, [General Theory of Obligations], Științifică Printing House, Bucharest, 1968, page 9;

³ Renee Sanilevici - *Drept civil. Teoria generală a obligațiilor*, [Civil Law. General Theory of Obligations], Iași, 1976, page 2;

⁴ Ioan Albu, op. cit., page 14;

⁵ Liviu Pop - *Teoria generală a obligațiilor*, [General Theory of Obligations], Lumina Lex Printing House, Bucharest, 1996, page 10;

⁶ Ion P. Filipescu, Andrei I. Filipescu - *Drept civil. Teoria generală a obligațiilor*, [Civil Law. General Theory of Obligations], Actami, Bucharest Printing House, 2000, page 9;

⁷ Ion Dogaru, Pompil Drăghici - *Drept civil. Teoria generală a obligațiilor*, [Civil Law. General Theory of Obligations], All Beck Printing House, Bucharest, 2002, page 10;

⁸ Constantin Stătescu, Corneliu Bîrsan - *Drept civil. Teoria generală a obligațiilor*, [Civil Law. General Theory of Obligations], All Beck Printing House, Bucharest, 2002, page 3;

In terms of the existence of a general theory of obligations specific to commercial obligations, there are two main trends. Where autonomy of commercial law is not recognised, e.g. in English or Swiss systems, and where there is a unique “Code of obligations”, it is obvious that the existence of a separate and specific commercial law obligations theory is not recognised. The French, German and Romanian legal systems provide separate legislation for commercial relationships in the form of “commercial codes”, which also highlight particularities of commercial obligations.

The Romanian Commercial Code contains a relatively small chapter called “General information on commercial obligations” (art.46-59), which comprises a series of rules that derogate from the civil law of obligations, especially related to contract execution. Apart from this brief regulation, the Commercial Code also contains a number of rules dedicated to certain contracts, such as sale-purchase agreements, mandate agreements, etc., which are known in civil law as well, but when tailored to commercial needs they show certain particularities. There are also some rules provided by special laws for certain contracts, which have a commercial nature due to their essence and purpose, and which represent an important source for commercial law, such as consignment agreements, leasing agreements, mortgages, franchises, etc.

During their activity traders conclude a number of legal documents or perform commercial activities by means of which certain rights and obligations arise, are amended or settled. Like civil relationships, commercial relationships are also private law relationships. Thus, both commercial and civil relationships are subject to the same general rules provided by the Civil Code. Nevertheless, there are also certain differences between the two legal relationships. These are governed by special rules included in Chapter V “General information on commercial obligations”, Book I of the Commercial Code. The regulation of commercial relationships by both Commercial and Civil Codes is based on art.1 of the Commercial Code, which states that this law is applicable to trade activities. The Civil Code is applicable where the latter does not provide any guidance.

Commercial obligations may arise from legal deeds or actions. Consequently, although commercial obligations may arise from all known civil law sources, contracts are the most important source.

3. Methods of settling obligations

The Civil Code provides the following means of settling civil obligations: direct execution in kind (payment), debt execution enforcement in kind, indirect execution enforcement (by equivalent), offsetting, merger of rights, payment approval, discharge of debt and fortuitous impossibility of execution.

These methods of settling obligations can be classified by two criteria:

By taking into account if obligations were settled with or without the parties’ will:

- Voluntary means of settling obligations: discharge of debt, conventional payment and offsetting

- Means by which obligations are settled without the parties' will: fortuitous impossibility of execution, legal and judicial offsetting, merger of rights

By taking into account if obligations were settled as a result of completion of creditor's receivable:

- Settling methods that result in completion of the creditor's receivable: offsetting, merger of rights, payment approval

- Settling methods that do not result in completion of the creditor's receivable: discharge of debt, fortuitous impossibility of execution

Direct execution in kind (payment) represents the voluntary execution of an obligation by the debtor, regardless of its object, or an agreement between the person making the payment and the one receiving the payment. According to article 1100 of the Civil Code, the creditor cannot be forced to accept something else than what is owed to him, even if the value of that thing would be equal or higher.

According to this article, the debtor must pay exactly the goods or services owed.

Furthermore, according to article 1101 of the Civil Code, the debtor cannot force the creditor to receive a partial payment, even if the obligation is divisible. This means that payment must be made in full.

Debt execution enforcement in kind allows the creditor to resort on means made available by law in order to force the debtor who did not perform the payment voluntarily to fulfil his obligations, in principle, as it was undertaken, thus enabling the creditor to capitalize his patrimonial right. The debtor is pledged to actually perform the obligation that he has undertaken.

Should the execution in kind no longer be possible, then the execution by equivalent in the form of offsetting will be enforced.

Indirect execution (by equivalent) represents the creditor's right to demand and obtain from the debtor the equivalent of the prejudice incurred due to non-performance, late or improper performance of the undertaken obligation.

This means that when it is no longer possible to execute the obligation in kind, the creditor is entitled to compensations or indemnifications, which represent the equivalent of the incurred loss.

Compensations or indemnifications are of two kinds:

- compensatory payments – the equivalent of the loss incurred by the creditor due to non-execution or partial execution of the obligation;

- equivalent compensations – the equivalent of the loss incurred by the creditor due to late execution of the obligation; these compensations may be cumulated with execution in kind, unlike compensatory payments that replace execution in kind.

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obligations are settled up to the smallest value.

Merger of rights is a method of settling obligations, whereby the same person is creditor and debtor of the same obligation. Merger of rights applies to all contractual or extra-contractual obligations between individuals and legal entities. It settles the obligation with all its guarantees and accessories.

Payment approval is defined as the method of settling obligations whereby, at debtor's proposal, the creditor accepts to receive another benefit instead of the one undertaken at the conclusion of the agreement. According to article 1100 of the Civil Code, the creditor's consent is required in order to proceed this way.

Discharge of debt means that the creditor gives up for free on his right to value the receivable against his debtor. In other words, discharge of debt represents a voluntary method of settling obligations, whereby the creditor gives up his right, with the debtor's consent. Discharge of debt is covered in articles 1138 – 1142 of the Civil Code.

Fortuitous impossibility of execution by the debtor is a method of settling obligations, which operates due to the fact that the debtor is in absolute impossibility of executing his obligation out of force majeure reasons. This method of settling obligations is covered in article 1156 of the Civil Code.

4. Procedures for offsetting mutual obligations between legal entities

Mutual obligations between legal entities may be settled by offsetting. The actual transaction varies according to residence, the amount to be offset and the state's participation in the transaction.

4.1. Offsetting between residents

4.1.1. Prerequisites

Offsets between Romanian legal entities are based on offsetting orders, according to Government Decision no. 685/1999 for approving the methodological norms for monitoring debts of corporate taxpayers that are outstanding at maturity date, in order to reduce financial blockage and economic losses ("GD 685/1999"), the Regulation for offsetting debts of corporate taxpayers that are outstanding at maturity date, respectively Emergency Ordinance no. 77/ 1999 on measures for preventing payment default (approved by Law no. 211/2001).

Offsetting of mutual debts is subject to offsetting regulations, based on offsetting orders. Before describing the offsetting procedures, we should clarify the following terms:

a) *non-cash offsetting* – settlement of mutual obligations between two or more legal entities based on offsetting orders, up to the smallest obligation.

b) *offsetting of small amounts* – cancellation of mutual payment obligations below RON 10,000.

c) *closed successive offsetting* – offsetting of obligations resulting from economic transactions of previous periods, which settles debts existing at a certain moment between the parties.

d) *open successive offsetting* – offsetting of obligations resulting from economic transactions between two or more legal entities, for existing liabilities recorded in accounts, except for those that have been brought in courts.

Debts outstanding at maturity date for invoices over RON 10,000 and older than 30 days can be offset only through the Offsetting Department of the Management and Informatics Institute.

For amounts below RON 10,000 inclusively, offsets between corporate taxpayers can be made also without the Offsetting Department of the Management and Informatics Institute, but only based on special offsetting orders.

The offsetting procedure presumes a couple of transactions to be performed by legal entities requesting an offset of obligations. They are required to use the internet or magnetic devices in order to send to the database of the Management and Informatics Institute the data regarding payments older than 30 days and with a value higher than RON 10,000, as well as the offsetting claims comprising the situation of outstanding receivables and payables. The transmission of data regarding payables and receivables can be made by using the internet addresses <http://gama.imi.ro> or www.minind.ro, and then they have to chose the menu “Hosted Pages – Portal on offsetting receivables”. For invoices that fall under these conditions the following information should be transmitted:

- tax code of the reporting legal entity,
- tax code of the legal entity - creditor/debtor - towards which the reporting entity has a payment/collection relationship,
- number and date of the invoice issued by the creditor/debtor,
- value of the invoice to be collected by the reporting legal entity from the beneficiary legal entity,
- value of the invoice to be paid by the reporting legal entity to the providing legal entity,
- volume of loans not reimbursed by financing banks at maturity date, including interest,
- volume of outstanding payables to state budget, local budgets, social security budget and special funds budgets, including late payment penalties, as appropriate,
- volume of receivables from legal entities that are fully or partially financed from the state budget,
- volume of loans granted by companies and not repaid at maturity date.

Legal entities that do not have receivables or payables older than 30 days and with a value higher than RON 10,000 lei are not required to send information, but if they want to register with the offsetting system they can also send invoices under 30 days, with values below RON 10,000.

Subsequent to introducing the data above in the system, legal entities must

update all changes permanently, at intervals not exceeding 30 days.

4.1.2. Offsetting regulations

According to GD no. 685/1999 for approving the methodological norms for monitoring debts of corporate taxpayers that are outstanding at maturity date, in order to reduce financial blockage and economic losses, offsets are based exclusively on offsetting orders, which are special documents, numbered by the printing house, kept with strict evidence. In any case, regardless of the outstanding amount, it is forbidden to use other offsetting documents than those provided in the offsetting regulations.

Offsetting orders issued by the Offsetting Department represent supporting documents for registration in accounts of settlement of receivables and payables which have been offset (e.g. 401 Suppliers = 411 Clients). Offsetting orders are attached to accounting bills.

In order to accomplish offsets, subsequent to submitting the data to the Management and Informatics Institute (IMI), legal entities involved or IMI should find a circuit for settling mutual debts. The offsetting inspector appointed by the initiating legal entity by means of a proxy shall come to IMI for closing the documents.

The offsetting meeting takes place at IMI within 3 days after finding the offsetting circuits. The daily meeting ends by mentioning in the minute of meeting (as set out in appendix no. 2.3 of GD no. 685/1999) of all legal entities and amounts involved in the offsetting. The minute of meeting shall be signed for each circuit by the legal entities' representatives and by the offsetting agent appointed by the Offsetting Department, and offsetting orders shall be prepared based on the appendix (as set out in appendix no. 2.1 of GD no. 685/1999). One offsetting order is sent to each legal entity, by mentioning the amount offset with each legal entity.

4.1.3. Records of offsetting transactions

This is done within the Offsetting Department by means of the Offsetting Transactions Register (as set out in appendix no. 2.4 of GD no. 685/1999). This register should contain chronologically:

- the offsetting date,
- the minutes of the meetings containing the legal entities involved in the offsetting and the amount offset for each relationship,
- record of offsetting orders issued to each legal entity, with their number and value.

4.1.4. Dispute resolution and error correction

Disputes shall be solved on days when offsetting meetings are scheduled, by offsetting inspectors who represent the legal entities in the dispute. A minute shall be prepared in order to foresee the measures to be taken by the parties.

Errors shall be solved at the request of the respective legal entity, by analysing the nature of the error and its financial impact for the petitioner. If the parties fail to agree on how to offset payment obligations, the offsetting does not come into effect. If the error impacts on more legal entities, the Offsetting Department will send to all parties involved the corrections to be made, as follows:

- typo errors (incorrect figures) - the document shall be presented in original for cancellation and another correct offsetting order will be issued;
- wrong name of the legal entity with which the offset was made – the respective offsetting order will be cancelled and another offsetting order will be issued.

Replacing documents are effective from the same date as initial documents. Correction documents shall be recorded in a special register by the offsetting agent, signed by the Offsetting Department and by two or more involved offsetting agents.

4.2. Offsetting between a resident and a foreign legal entity

4.2.1. Considerations on offsets between a resident and a foreign legal entity

Residents are defined as follows:

- individuals – Romanian nationals, foreign nationals and stateless persons residing in Romania, confirmed with identification documents issued according to the law;
- legal entities established in Romania, as well as individuals - Romanian nationals, foreign nationals and stateless persons residing/domiciled in Romania – who are authorised and/or registered to conduct independent business activities in Romania,
- branches, agencies, representative offices of foreign legal entities, as well as of any other foreign entities registered and/or authorised to operate in Romania,
- embassies, consulates and other representative offices and permanent missions of Romania abroad.

Non-residents are defined as follows:

- individuals – foreign nationals, Romanian nationals and stateless persons residing abroad, confirmed with identification documents issued according to the law,
- legal entities established abroad, as well as individuals - foreign nationals, Romanian nationals and stateless persons residing abroad – who are authorised and/or registered to conduct independent business activities abroad, as provided by

the regulations in force,

- branches, agencies, representative offices of Romanian legal entities, as well as of any other Romanian entities registered and/or authorised to operate abroad,
- embassies, consulates and other representative offices and permanent missions of other states in Romania, as well as international organisations or representative offices of such organisations that operate in Romania.

Offsets of mutual payables/receivables between a resident and a non-resident legal entity do not fall under the provisions of GD no. 685/1999, and in these cases common law provisions of the Civil Code (art. 1091, art. 1143-1153) are applicable.

In order to register them in accounting, the parties should conclude offsetting transactions in writing. The document should contain the dates of the invoices and of other documents related to the amounts to be offset (offsetting order set out in GD no. 685/1999).

4.2.2. Reporting of performed offsets

Offsets of receivables between resident entities performing direct non-monetary transactions with non-resident entities (and not through financial institutions) must be reported to the Statistics Department of the National Bank of Romania. Such offsets are governed by Regulation no. 26/2006 of the National Bank of Romania on statistical reporting of data for the preparation of payment balances, with amendments provided by NBR Regulation no. 12/2009.

Such offsets are non-monetary transactions of the nature of payment balances, taking place without a transfer of funds (e.g. offset of exports with imports or the other way round), and reporting is done on a form for each transaction type.

4.3. *Offsetting of payables with receivables against state budget*

The offset is accomplished when a taxpayer is both debtor and creditor in relationship with the state budget⁹. In other words, the offset is performed between the taxpayer's receivables representing amounts to be reimbursed and the receivables managed by the Ministry of Economy and Public Finance, when in mutual relationships both parties are debtor and creditor.

The offset is done up to the smallest value of receivables and payables existing between the two parties and it can be initiated as follows:

- by the taxpayer at his request;
- by the tax authority automatically or whenever there are mutual receivables, except for negative VAT amounts without refund option; the legal provision on automatic offsets is not imperative, because according to the Tax Procedure Code, the tax control body “may” do such offsets; consequently, taxpayers should not rely

⁹ Bunget Ovidiu Constantin, Pereş Ion – *Control financiar*, [Financial Control], West University Printing House, Timisoara, 2010, page 152;

on tax authorities' initiative and it would be advisable to initiate the offsets themselves.

The following steps are made for an offset:

- i) payables to the same budget are offset first;
- ii) subsequently, within the remaining difference, taxpayer's payables to other budgets will be offset proportionally, in the following order:
 - state budget;
 - risk fund for state guarantees on foreign loans;
 - social security budget;
 - unique national budget for health insurance;
 - unemployment budget.

Tax receivables deriving from customs relationships are offset with debtor's receivables representing amounts of the same nature to be refunded. Any remaining differences will be offset with other tax payables of the debtor, in the order required by law.

Regardless of how it was initiated, within 7 days the offset is followed by the written notification of the taxpayer on the measures taken in this respect.¹⁰ Nevertheless, the Tax Procedure Code does not provide this obligation for automatic offsets.

4.4. Offsetting of payables with receivables against local budgets

Currently (June 2010), receivables/payables to the state budget cannot be offset with receivables/payables to local budgets.

However, in April 2010, the Romanian Senate adopted a bill for amending the Tax Procedure Code, which provides that certain amounts to be received by the taxpayer from the budgets of local public institutions/tax authorities will be offset with taxpayer's payables, respectively amounts not paid by the state due to the fact that they were not transferred from the state budget to the local budgets (these amounts represent the value of goods delivered or services rendered by the taxpayer for public investments). This bill is currently with the Chamber of Deputies, and has already been approved by the Budget-Financing Commission.

Conclusions

The analysis of various situations in which legal entities can offset receivables with payables that they have against other legal entities (resident or non-resident) or against the state, makes us to consider that this transaction should be performed with courage, thus contributing to decrease of debts and financial blockage that occur during the current economic crisis. The set-up and development of a company implies contributions required for financial support of assets necessary for business

¹⁰ Government Ordinance no. 92/2003 on Tax Procedure Code, republished, art. 112, para. 7;

activity based on strategic decisions. Usage of various financial sources based on their costs, access and availability, generates both direct (by size and duration of undertaken debts) and indirect (by resource costs) effects on net assets.¹¹

Without being considered a routine method of settling receivables and payables or a method that depends on barter economy, in the context of liquidity crisis, offsetting can be considered a customary method in the practice of legal entities in Romania.

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¹¹ Monica Petcu, Iulia David – *Analiza economico-financiara – Analiza patrimoniului net*, [Economic-Financial Analysis. – Net Asset Analysis], Economica Printing House, Bucharest, 2007, page 76

PRINCIPLES OF TQM IN AUTOMOTIVE INDUSTRY

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Abstract

TQM refers to a management process and set of disciplines that are coordinated to ensure that the organization consistently meets and exceeds customer requirements. TQM engages all divisions, departments and levels of the organization. TQM companies are focused on the systematic management of data in all processes and practices to eliminate waste and pursue continuous improvement. The goal is to deliver the highest value for the customer at the lowest cost while achieving sustained profit and economic stability for the company. While every organization should implement its own specialized form of quality management, there are some basic core principles that guide every quality effort. The single most important element of quality management is the focus on the customer. During this quality process, we will strive frequently to hear from our customers. From this basic concept, that the customer is the ultimate determiner of quality, come the other principles of Quality management. All types of automotive industries, have reduced costs increased process efficiency and improved the quality of their products and services by working to meet the needs of the people they serve through the application of total quality management (TQM) principles. Learning the principles and practices of TQM will help achieve outstanding results and enlist the support of top management in advancing this concept within the organization enabling area managers or supervisors to create a work environment that gets the best from its workers. The proof will be reflected in the results deliver to the customer. With growing global competition, quality management is becoming increasingly important to the leadership and management of automotive industry. Quality management principles provide understanding of and guidance on the application of quality management. By applying following quality management principles, organizations will produce benefits for customers, owners, employees, suppliers and society as a whole.

Keywords: management, total quality management, automotive industry

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Introduction

Total Quality Management is a management approach that originated in the 1950's and has steadily become more popular since the early 1980's. Total Quality is a description of the culture, attitude and organization of a company that strives to provide customers with products and services that satisfy their needs. The culture requires quality in all aspects of the company's operations, with processes being done right the first time and defects and waste eradicated from operations.

Total Quality Management, TQM, is a method by which management and employees can become involved in the continuous improvement of the production

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