ROMANIAN ACCOUNTING - A TALE OF TWO STANDARDS

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ABSTRACT: *The process of accounting harmonization in Europe has started in 1978 with the adoption of the Fourth Council Directive 78/660/EEC regarding the annual accounts of limited liability companies. The harmonization process continued with the regulation of the consolidated annual accounts with the enactment of the Seventh Council Directive 83/349/EEC. In 2002 the European Parliament has adopted the EC Regulation No. 1606/2002 requiring all listed group entities within EU to apply the International Accounting Standards for their consolidated financial statements starting from 2005. This has led to the use of a dual accounting standardization as listed entities are required to use IAS/IFRS while non-listed entities use the national GAAP harmonized with the 4th and 7th directives. The adoption of the new accounting directive 2013/34/EU does not solve this differentiation as it doesn't allow the option for national accounting regulators the use of IFRS for SMEs. Romania, as a member of the European Union, is no exception from this usage of a dual accounting standard. After the fall of the communist regime, Romania has modernized its accounting system by adopting a French inspired, EU 4th directive compliant national GAAP. Between 2001 and 2005 there was a strong interest towards the adoption of IAS/IFRS that went beyond the scope of EC Regulation No. 1606/2002. This has changed in 2005 when IAS/IFRSs were considered as an option of additional voluntary disclosure. From 2006, Romania has aligned its national legislation to the requirements of EC Regulation No. 1606/2002. The application of this dual standard accounting system has been cumbersome especially for the entities that were required to prepare two different annual accounts, one using IAS/IFRS and one using Romanian GAAP. This obstacle has been overcome in 2012 when certain entities were allowed to prepare their financial statements using only IFRS.*

KEY WORDS: *IFRS; IAS; 4th accounting directive; 7th accounting directive; accounting harmonization*

JEL CLASSIFICATION: *M40, M41, M48.*

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1. THE DEVELOPMENT OF DOUBLE ENTRY ACCOUNTING

Accounting origins can be traced to ancient times and are closely linked to the development of numeration and counting (Brown, 2006).

With the development of trade and the founding of states, some form of organization and keeping accounts has emerged. One of the earliest known law codes, the code of Hammurabi, instated by the Babylonian king Hammurabi (1792-1750 B.C.), discovered at Susa in 1901, contains a number of commerce account keeping regulations (Brown, 2006).

The art of keeping of accounts has flourished in the ancient Egypt and Babylonia. Yet, just the keeping of accounts is far away from the modern accounting system, and can hardly be considered accounting (Stevelinck & Most, 1985).

Modern accounting characterized by the use of a double entry system can be traced back to 15th century Italy. The first known book on double entry accounting belongs to Benedetto Cotrugli and was entitled "Della mercatura et del mercante perfetto, libri quattro scritti già più di anni CX ed bora dati in luce" and it was written in 1458 but not published until 1573.

The father of modern accounting is generally considered to be Luca Pacioli who wrote the first published book describing the principles of double entry accounting. His work - mainly a thesis on mathematics entitled "Summa de Arithmetica, Geometria, Proportioni et Proportionalità" has a chapter dedicated to accounting under the title "Particularis de Computis et Scripturis" ("Particulars of Reckonings and Their Recordings")" (Chatfield & Vangermeersch, 1996).

It is worth noting that Pacioli is not the inventor of accounting. He describes a technique that was common practice for Venice traders for more than 200 years before his work. But his book contributed to the spread accounting throughout Europe. The development of double entry accounting was the decisive event in European economic history (Spengler et al., 2006).

2. THE ACCOUNTING HARMONIZATION PROCESS WITHIN THE EUROPEAN UNION

The process of accounting harmonization in Europe can be traced back to the times of Pacioli when his work "Summa de Arithmetica, Geometria, Proportioni et Proportionalità" has spread throughout Europe influencing the accounting practices on the entire continent.

The first official effort towards the harmonization of accounting in Europe has been the taken in 1978 with the adoption of the Fourth Council Directive 78/660/EEC of 25 July 1978 regarding the annual accounts of limited liability companies (EC, 1978). The directive establishes the extent of financial information that should be made available to the public by limited liability companies and certain forms of partnership in the European Community. The main focus of the directive is to describe the components of the annual accounts (balance sheet, profit and loss account and the notes to the accounts), the publication and auditing requirements of the annual accounts depending on the size of the company.

The regulation of consolidated annual accounts of companies within European Union has been undertaken a few years later, with the enactment of the Seventh Council Directive 83/349/EEC of 13 June 1983 (EC, 1983). The directive defines the circumstances in which consolidated accounts are to be drawn up, the contents of the consolidated annual reports and the accompanying notes, and the publication and auditing requirements for the consolidated accounts.

In 1984, a new directive comes to define the qualifications of persons responsible for carrying out the statutory audits of the accounting documents required by the fourth and seventh Directives (EC, 1984).

A step towards a larger harmonization process transcending EU borders was the adoption of Commission Regulation No 1569/2007 of 21 December 2007 establishing a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities pursuant to Directives 2003/71/EC and 2004/109/EC of the European Parliament and of the Council. This regulation establishes an "equivalence mechanism" in relation to third country GAAPs allowing foreign companies listed on EU stock markets to prepare their annual accounts using their own GAAP instead of using IFRS (EC, 2007).

Recently, the 4^{th} and the 7^{th} Directives were replaced by a new Accounting Directive 2013/34/EU which entered into force on 20 July 2013. Member States were given two years to comply with this new Directive. The new directive sets the requirements for preparation, presentation, publication and auditing requirements for both individual and consolidated financial statements.

In 2002 the European Union has endorsed the International Accounting Standards (IAS/IFRS) through the adoption of the EC Regulation on the Application of International Accounting Standards No. 1606/2002 of the European Parliament and of the Council of July 19, 2002, (EC, 2002; IASPlus, 2013). All companies that were listed on a regulated market, including banks and insurance companies were required to prepare and publish their consolidated financial statements in accordance with IFRSs starting from 2005.

Not all IAS/IFRS are applicable in EU. The European Commission has to endorse every IAS/IFRS standards. For a standard to be adopted and applicable within EU it has to meet the following criteria:

1. the standards does not deteriorate the true and fair view of the assets, liabilities, financial position and profit or loss of individual or consolidated financial statements and
2. is beneficial to the European public good and
3. it meets the criteria of understandability, relevance, reliability, and comparability (EC, 2002)

Almost all IAS/IFRSs are adopted and applicable to publicly traded enterprises within EU, with a certain delay that is due to the imposed endorsement of every standard by the EC. The most notable divergence between EC and IASB has been the adoption of certain provisions of IAS 39 “Financial Instruments: Recognition and Measurement” that required the use of fair value for derivative instruments.

3. ACCOUNTING HARMONIZATION IN ROMANIA

Some authors like Rusu et al. (1991) consider that by 1200 the Italian accounting must have spread to Romania, through the presence of Venetian or Genovese merchants on Romanian territories. Some evidence of bookkeeping was found by Radu (1995) on ancient country estates.

Yet, the practice of double entry accounting can be traced back only to the 17th century when there is evidence of accounting records for some factories in Sibiu, Braşov and Bucharest (Demetrescu, 1972; Ionaşcu, 1997).

Under the communist regime, accounting was used as a tool for the objectives and needs of the centrally planned economy and to safeguard the socialist property entrusted to the enterprise (Makarov, 1983 as cited by MacLullich & Gurau, 2004). The lack of a real price mechanism has led to a neutralization of the accounting as a tool for measuring economic performance (MacLullich & Gurau, 2004).

There was some form of accounting harmonization between the Soviet Bloc countries as the accounting regulators in these countries all looked at Soviet Union for guidance and there was a need of standardization to facilitate trade between countries (MacLullich & Gurau, 2004).

After the 1989 revolution, Romania needed a new accounting standard in line with its passage from a centralized communist economic system to a market economy (Duția, 1995; Bailey, 1995). In 1991, Romanian authorities have signed a cooperation agreement with the French Ministry of Finance and Economy, the French national accountancy body, "Ordre des Experts Comptables" and French national auditing body, "la Compagnie Nationale des Commissaires aux Comptes".

During 1992-1993 the new accounting standards have been drafted by an accountancy normalization department within the Romanian Ministry of Finance, with the assistance of French consultants. During 1993, a pilot group of 75 enterprises has been selected to test the implementation of the new accounting standards.

The year 1994 marks the start of the implementation of the new Romania GAAP. The introduction of a new accounting law in 1991 (RO, 1991) and especially the Government Ordinance no. 704 (Romanian Government, 1993) has marked the passage from a communist accounting system to an EU 4th directive compliant accounting.

In 1999 the Romanian Accounting Standards were revised, with the introduction of Ministry of Finance Order no. 403 (1999) regarding the introduction of a national GAAP harmonized with the EU 4th accounting directive and the International Accounting Standards. The new Romanian GAAP has been applied starting with the financial reports for the year 1999.

The Ministry of Finance Order no. 403 (1999) set up a calendar for the adoption of International Accounting Standards (IAS) in Romania. For the year 1999, a set of 13 companies were selected as a pilot group to apply IAS for their 1999 financial reports. A larger group (comprised of companies listed at Bucharest Stock Exchange, national enterprises, large companies that were considered of national importance and companies with operations on capital markets) was scheduled to apply IASs starting with the financial year 2000. A third group defined using a set of size criteria (total assets, annual turnover, number of employees) was supposed to start using the new standards based on a calendar spanning the period 2001-2005.

In 2001, the Ministry of Finance Order no. 403 (1999) was superseded by the Order no. 94 of the Ministry of Public Finance (2001) regarding the implementation of accounting harmonized with the EU 4th accounting directive and the International Accounting Standards. The new order stated that a number of 72 enterprises traded on Bucharest Stock exchange market, 20 national enterprises and 105 listed on the secondary stock market RASDAQ were supposed to use the international accounting standards for their financial reports for the year 2000. The calendar to extend the application of IASs to other companies was the same as the one in the Ministry of Finance Order no. 403 (1999).

The Ministry of Finance order no. 990 (2002) simplifies the criteria for an enterprise to be included in the list of companies that use IASs in their financial reports by including all the companies that for their financial year 2000 exceed two of the following three criteria:

- yearly turnover of over 9,000,000 euro
- total assets over 4,500,000 euro
- number of employees greater than 250

The new criteria extended the group of companies that were required to use international accounting standards to about 1,000 enterprises.

Yet another modification to the list of entities that were required to use the international accounting rules for the financial year 2003 came with the enactment of Ministry of Public Finance order no. 1742 (2002). The new law extended the list by including all the enterprises that were under the supervision of the Romanian National Securities Commission.

During 2003 the list of enterprises that were required to prepare their financial statements according to IFRSs and the criteria for an enterprise to be included in the before mentioned list were modified successively by the Ministry of Public Finance order no. 1784 (2003) and order no. 1827 (2003). The new list of companies encompasses an additional 400 companies that were supposed to use IFRSs starting in the year 2004 (for annual accounts for the financial year 2003).

For the year 2005 the new criteria for a company to be required to switch from using RAS (Romanian Accounting Standards) to IFRS were to exceed two of the following three conditions:

- yearly turnover of over 7,300,000 euro
- total assets over 3,650,000 euro
- number of employees greater than 50

During 2005, Romanian Ministry of Public Finance issued order no. 907 (2005) applicable for the financial reports from 2006 onwards, which replaced IFRSs with RAS (4th EU accounting directive) for all Romanian enterprises except financial institutions that were required to present two sets of reports (one in compliance with IFRS and one in accordance with RAS). IFRSs were allowed as an option for public interest entities.

In 2006 the entities whose shares were listed on a regulated market and were preparing consolidated financial statements were required to use IFRSs for their financial reports from 2007 onward as stipulated in Romanian Ministry of Public Finance order no. 1121 (2006). Public interest entities are still allowed to use IFRSs for their individual and consolidated financial reports as an option for additional disclosure purposes (their legal requirements were to prepare financial reports according to RAS/ EU 4th directive).

Starting with the financial statements for the year 2012, financial institution that operate in Romania and are under the supervision of the National Bank of Romania (NBR), are required to use IFRSs according to NBR order no. 9 and 27 (2010).

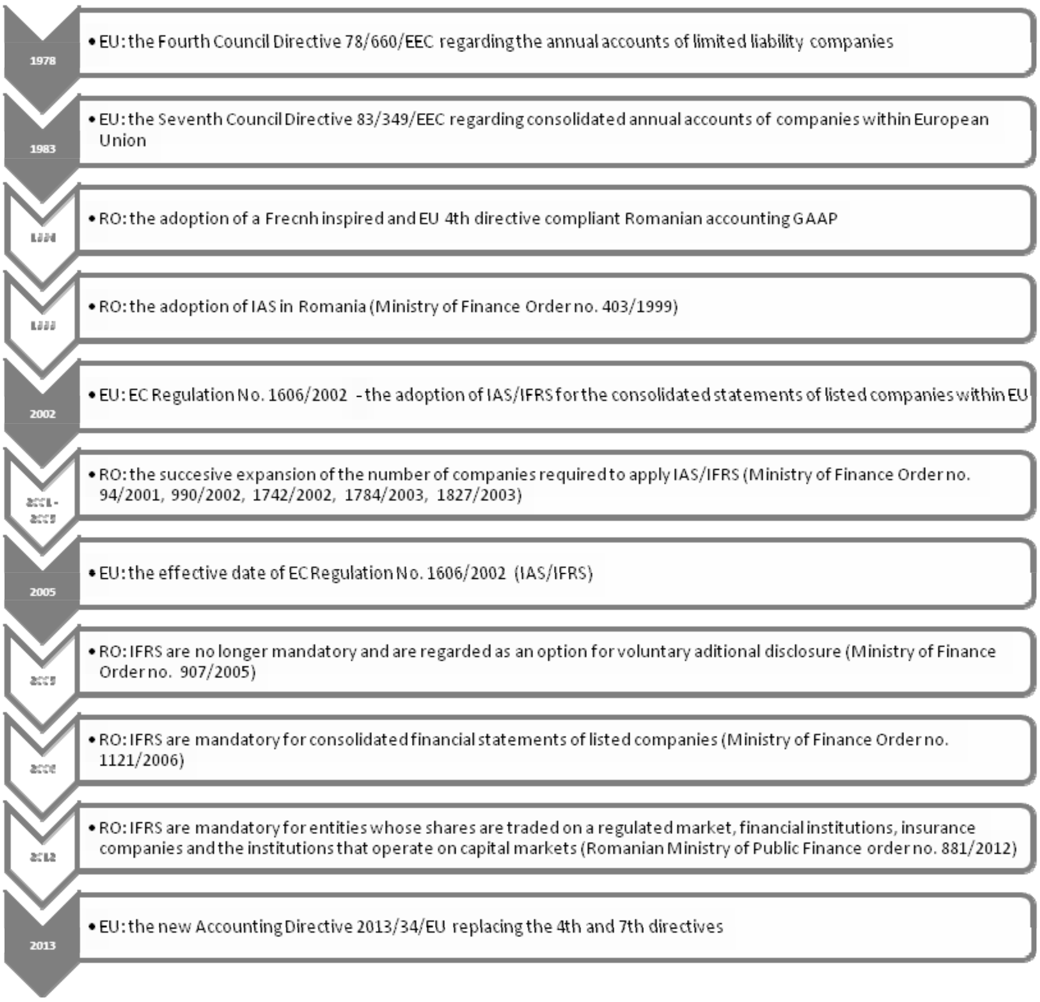

Figure 1. The timeline of accounting harmonization in EU and Romania

The Order no. 881 of the Romanian Ministry of Public Finance (2012) introduces the requirement for the entities whose shares are traded on a regulated market to prepare their individual financial statements according to the IFRSs.

Financial institutions are also required to prepare their financial statements according to IFRSs. These entities are no longer required to prepare financial reports according to RAS and are required to continue to apply IFRSs even after their shares are no longer traded on a regulated market. Insurance companies under the supervision of the Romanian Insurance Supervisory Commission and the institutions that operate on capital markets and are under the supervision of Romanian National Securities Commission are required to prepare two sets of financial reports (one according to RAS and one according to IFRSs) (Romanian National Securities Commission order no. 116 (2011) and the Romanian Insurance Supervisory Commission Bulletin no. 2 (2012)).

The timeline of accounting harmonization in EU and Romania is summarized in Figure 1.

4. CONCLUSIONS

The provisions of EC Regulation No. 1606/2002 of the European Parliament and of the Council that allows member countries to require companies to prepare their individual financial statements according to national accounting standards and the consolidated statements according to IFRS has led to the development of two parallel accounting systems greatly increasing the complexity of preparing financial reports for listed companies throughout Europe (Haller, 2002; Larson & Street, 2004). In Romania, the recent developments introduced by Order no. 881 of the Romanian Ministry of Public Finance that allows entities whose shares are traded on a regulated market to prepare their individual financial statements according to the IFRSs comes to simplify the preparation of consolidated accounts through the use of a single accounting standard for those companies.

Some authors consider the application of IAS/IFRS as being complicated, costly, complex, and burdensome (Larson & Street, 2004; Jermakowicz & Gornik-Tomaszewski, 2006). The switch from a rules based accounting system to a principle based one as is the case of switching from RAS to IFRSs is a more complicated task than just a change of accounting rules and additional guidance might be required (Eichhorst, Steen, van der Tas, & Smits, 2002; Schipper, 2005). This might explain why Romanian accounting regulators have switched back and forth between IAS/IFRSs and the national, continental European rules based accounting system, between 2001 and 2012.

The implementation of IFRS for Romanian public traded companies and insurance and finance institutions in parallel with a national accounting standard harmonized with EU directives does not provide a reasonable level of comparability between the annual accounts of listed and not listed entities. But this lack of comparability is generalized throughout Europe as noted by Flower (2005). The adoption of the new accounting directive 2013/34/EU does not solve this differentiation as it doesn't allow the option for national accounting regulators the use of IFRS for SMEs.

The studies regarding the benefits of the adoption of IFRS in EU countries have come to conflicting conclusions. Brochet, Jagolinzer and Riedl (2012) have found that mandatory IFRS adoption in UK has improved the comparability of the financial reports and has reduced the insiders' ability to exploit private information. Another study carried out by Callao, Jarne and Laínez (2007) on the enterprises included in the Spanish IBEX-35 index has focused on the effects of IFRS adoption on the comparability and relevance of their financial reports and found no improvement. Further studies are needed to determine whether the adoption of IFRS in Romania has improved the relevance and comparability of the financial statements of those companies.

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