

Financial reporting in Romania

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The Romanian financial reporting and auditing requirements are continuing to undergo change and progression to move toward application of standards comparable with the European Union¹. From when market economy changes began in the 1990, it has taken some time for financial reporting in Romania to develop, as for much of the past period it has been directed to the provision of information to the State authorities and has not had as a major focus the provision of information to investors (current and prospective owners), management, financial institutions and other common users of financial reports in an international context. Financial reporting (and accounting in general) in Romania has tended to be more about “form” than about “substance”, that is following the steps, having a relevant piece of paper, dotting the “I’s” and crossing the “T’s”, rather than focusing on whether the figures presented reflect the actual financial position of the reporting entity at the period end and the results from activities during the period being reported on.

In 1999 the Ministry of Finance commenced a project to make Romanian accounting and auditing legislation comparable to international standards and European Union directives on accounting and auditing.

From this project, fundamental changes to legislation have occurred including:

- Harmonization of Romanian financial reporting with the requirements of International Accounting Standards and the European Union 4th Directive - Minister of Finance Order 94/2001 (“MoF Order 94/2001”)
- Harmonization of the financial reporting for Romanian companies not applying MoF Order 94/2001 with the requirements of the European Union 4th Directive - Minister of Finance Order 306/2002 (“MoF Order 306/2002”); and
- The establishment of a body responsible for the training and regulation of the independent audit function in Romania, the Chamber of Auditors - Emergency Ordinance 75/1999 (“EO 75/1999”) as approved by Law 133/2002.

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¹ The comments in this article are provided as an overview and relevant legislation should be referred to and/or appropriate professional advice obtained prior to the reader making any decisions in relation to financial reports issued in Romania or the applicable legislative framework that applies.

Sources of Accounting Principles

Accounting in Romania is regulated by the provisions of Law 82/1991, republished January 2005 (the Accounting Law).

In accordance with the Accounting Law, it is mandatory for all legal entities and individuals authorized to perform activities on their own account to keep accounting records. This provision applies also to subunits such as branches or subsidiaries registered in Romania. These entities or individuals have to keep written evidence of all transactions and record these transactions in their accounting books. The records required by the Accounting Law include: Journal Registers, a Stock-take Register (based on an annual stock-take of assets and liabilities), and a Nominal Ledger (based on analysis of the accounting information posted from source documents or Journal Registers). These documents have to be kept in the Romanian language and the amounts have to be recorded in Romanian currency (ROL). The books and all the accounting records may be in a written or in an electronic format and can be used as evidence in Court and are subject to review by Romanian fiscal and judicial authorities. Accountants should prepare a trial balance from the nominal ledger at least on an annual basis and this is the basis for preparation of periodic financial statements.

Accounting regulations issued require a specific chart of accounts and specific reporting disclosure contents and formats for entities, as indicated in MoF Order 94/2001 or MoF Order 306/2002.

The Minister of Finance Order 94/28 February 2001 “Harmonisation of Accounting Regulations with the European Union 4th Directive and International Accounting Standards” (MoF Order 94/2001) has introduced a requirement for certain Romanian entities to prepare financial statements that reflect the Standards issued by the International Accounting Standards Committee (ISAC) and interpretations by the Standing Interpretations Committee of ISAC and to be in accordance with the requirements of the European Union 4th Directive. MoF Order 94/2001 and subsequent regulations have imposed some non-compliance with International Financial Reporting Standards (IFRS), however at the same time there is an indication for firms that report under MoF Order 94/2001 that they are required to be fully compliant with all applicable International Financial Reporting Standards for the year ending 31 December 2006 reporting .

Fundamental Concepts

Romanian accounting legislation and regulations have been largely based on International Financial Reporting Standards (which include International Accounting Standards) in relation to fundamental concepts to be followed and applied. A number of changes have occurred and are intended in IFRS, as the moves are taken to apply the Standards throughout the European Union and to give them an increasingly prominent position internationally.

MoF Order 94/2001 reporting up to 31 December 2004 has excluded for reporting to the Ministry of Finance and as the basis for the financials to be used for profit distribution purposes hyperinflation accounting (IAS 29) and preparation of consolidated financial statements (IAS 27). The same situation is expected to apply for 31 December 2005 reporting, with reporting for 31 December 2006 to be fully compliant with IFRS. The introduction of MoF Order 94/2001 has seen an increase in the level of disclosure of information in notes and adding additional reporting requirements (including introduction of cash-flow statements and statements of changes in shareholders equity) and an increasing emphasis on provisioning and accruals considerations, although there is still, in some cases, an inclination to limit the differences between accounting and taxation profit.

Significant Accounting Concepts for Investors and Users of Financial Reporting Information

Romanian accounting records have been historically heavily influenced by the use made of the information for taxation compliance purposes. The primary function of financial/accounting details collection and recording process has been seen by many Romanian entities and the management/staff within the entities (both State and private) as being for taxation compliance and taxation reporting purposes. As a result of this, the reported information has tended to reflect a “form over substance” disclosure, that is, greater importance is placed on having particular documents or recording something in a specific way, rather than in “accurately” reflecting the financial position of the enterprise at a point in time or indicating whether the results for the period are an appropriate representation of what has occurred, as International Financial Reporting Standards require.

Romanian accounting law and regulations are not as such at fault, as they both seem to provide for and encourage treatments that are consistent in many ways with international accounting principles. Where problems have arisen has been in how the provisions of the laws and regulations are applied that have reflected the background and outlook of Romanian accountants applying the legislation, where reliance has been on past practice.

MoF Order 94/2001 introduced, among other items, the following issues for Romanian financial accounting and reporting:

- Application of indexation measures to reflect the impact of inflation (both in establishing opening values and on an ongoing basis) – in limited cases, and not for financial statements to be submitted to the Ministry of Finance (except for specific adjustments to fixed asset values in accordance with GD 403/2000 and subsequent regulations GD 1553/2003). Until 31 December 2003 such revaluations were considered to be tax deductible, for 31 December 2004 reporting, while revaluations can occur for financial reporting they will not be considered for tax purposes;
- Deferred taxation, to include the impact of differences between temporary taxable differences arising between accounting and fiscal taxation balance sheet values differing and from the impact of carried forward tax losses;

- Emphasis on substance rather than form;
- Disclosure of related party balances and transactions;
- Differences between accounting depreciation and taxation depreciation;;
- Additional schedule disclosures, such as cash-flow statements and statements for change of shareholders' equity;
- Assessment of impairment of assets;
- Segment reporting;
- More detailed disclosure notes;
- More specific inventory cost valuation calculation;
- Financial instrument reporting.

Consolidated financial statements for a company and its subsidiaries, are currently not required by the legislation relating to completion of statutory financial statements for MoF Order 94/2001 compliant companies. Law 82/1991 (republished in January 2005) requires that the standards in the International Financial Reporting Standards relating to consolidation should be applied commencing with the year ending 31 December 2006.

Historically in considering Romanian financial statements investors should keep in mind:

- A tendency to form over substance in transaction recording;
- Provisions for collection of trade or other receivables (money due to the company from customers or other sources) are limited. In very few companies are there receivables aging schedules, indicating amounts that are current, due within 30 days, between 30 and 60 days, etc.;
- The aggregation of information on Romanian financial statements, with no narrative explanation, may often require more detailed enquiry, such as going back to a general ledger balance listing (a trial balance/balanta de verificare);
- Limited inclusion of provisions for items of inventory that may be sold for less than the carrying value indicated or which may never be sold;
- No account is taken of the diminution in the purchasing power of the lei. This means that non-monetary items, such as: property, plant and equipment (except where revalued) investments, inventory, share capital, individual income and expense items, do not reflect a "real" historical value;
- No separation between freehold and leased land and buildings is indicated;
- Disclosure of "related party" balances at the period end or transactions during the period although required for disclosure are in cases limited in what is included. In addition no consolidation concept exists where one entity has a majority ownership or control in/over another;
- Depreciation of fixed assets is based on historic lei acquisition values (with in some cases Government specified revaluations of the lei values having occurred) at State specified depreciation rates. In many countries tax and accounting rates

differ, tax rates being specified, accounting being based on entity determined “useful life”;

- Property, plant and equipment is recorded in lei at the historic lei value or based on State approved revaluation indices, neither of which results in an equivalent current lei value for the acquisition cost. For 2000 onwards (under GD 403/2000, GD 1553/2003 etc.) valuations on a “fair value” base are allowed (and are tax deductible).
- Investments are included at historic lei at the investment value and not at the “equivalent current lei value” at the acquisition/investment date;
- Foreign currency receivable or payables values are not adjusted by most entities until the end of the year. As a result except for 31 December, for any other period end an accurate foreign currency receivable and payable balance is not indicated. Related to this, unrealised exchange gains and/or losses are only recorded at 31 December;
- Varying from entity to entity, limited use is made of accrual accounts to include all liabilities and expenses that relate to the activities undertaken in a specific period;
- No details of mortgages or security over assets given by the entity is indicated;
- Reconciliation between different information within an enterprise both within the financial/accounting area and between this area and other areas or systems (such as production or sales) is not always performed on a regular basis or in a complete fashion or with differences being followed up and resolved. In many cases more than one system for collecting information by different parts of the entity may occur, with no centralised information being collected for use for different management decision-making, reporting or compliance purposes;
- Inventory valuation for manufactured goods tends to include an excessive amount of overhead compared to the recommendations of the applicable International Accounting Standard. Issues also arise in many entities on the basis used to arrive at standard costs and the means for allocating variances from standard. Inventory valuation is an area, where further development of accounting treatments followed, may be an issue;
- Due to diminution in the purchasing power of ROL, income and expense items from the prior year may not be useful for comparative purposes, unless restated into a historic “hard” currency value (such as US dollars) or indexed. For 2004 reporting this is less of an issue, with inflation decreasing and ROL maintaining its value against Euro and strengthening against the US dollar;
- No details on business relationships or remuneration of senior management is provided and/or no details of transactions with relations or related companies;
- No specific details on amounts due to the State and what is the split between principal and interest, and/or what amounts due may have been rescheduled. In the case of rescheduled amounts, there are no specific details on the terms for ongoing repayments. This area is beginning to improve with more detailed disclosures becoming more common.

With the transition occurring in Romanian accounting, it is important that potential investors obtain explanations on what an accounting policy/treatment and/or a balance is, and if it is an important issue for the investment consideration, then ensure that the explanation is consistent with some form of factual evidence, whether that is to a balance in the financial statements/records, the general ledger and/or other relevant documents or schedules.

Romania has been considered a “hyperinflationary economy” under the criteria outlined in IAS 29. Based on developments in the economy to 31 December 2004, it is now considered that Romania is no longer a hyperinflationary economy, with an effective date for IFRSs reporting to discontinue inflation adjustments to be from 1 January 2004². This means that for IFRS reporting purposes that the measuring unit value at the end of the previous reporting period (most likely to be 31 December 2003) will be used as the opening balance for subsequent year reporting purposes. It is unclear at present how this issue will be dealt with, if there is a significant impact, when IFRSs are fully adopted for MoF Order 94/2001 reporting.

Disclosure, Reporting and Filing Requirements

The Financial Statements (Balance Sheet, Income Statement, appendices (as applicable) and the Board of Administration Report) are prepared for statutory purposes on an annual basis.

MoF Order 94/2001 Reporting

As stated earlier in this article, MoF Order 94/2001 has introduced a requirement for certain Romanian entities to prepare financial statements that reflect the Standards issued by the International Accounting Standards Committee (ISAC) and interpretations by the Standing Interpretations Committee of ISAC and to be in accordance with the requirements of the European Union 4th Directive.

MoF Order 94/2001, was introduced for the year ending 31 December 2000 for a limited number of entities, with more companies being required to apply MoF Order 94/2001 succeeding year³, based on meeting 2 of the following 3 criteria in the preceding year:

31 December year end	Turnover EUR million	Total value of Assets	Average number of employees
2001	Over 9	Over 4.5	250
2002	Over 8	Over 4.0	200
2003	Over 7.3	Over 3.65	150
2004 and subsequently	Over 7.3	Over 3.65	50

² In some cases a later date in 2004, such as 1 April 2004 or 1 July 2004 may be applicable, depending on the last formal reporting completed by an entity.

³ Ministry of Finance Order 1827/2003

An entity can apply to the Ministry of Finance if it wishes to apply MoF Order 94/2001 prior to meeting the requirements as indicated above.

The requirements of accounting in hyperinflationary economies (for which Romania currently qualified under the International Financial Reporting Standards criteria), for the year ending 31 December 2003, entities are required by the new regulations to prepare a general ledger based on unadjusted figures and then to apply adjustments to arrive at an adjusted figure, with both amounts (adjusted and unadjusted) shown in the financial statements. Under the current legislation and regulations only pre-inflation adjusted figures or revalued amounts using applicable Romanian legislation applied as of 31 December 2003 will be used for taxation calculation purposes.

An entity that is preparing its financial statements in accordance with MoF Order 94/2001 is required to have its financial statements audited by a “financial auditor”, as defined in Law 133/2002. The “financial audit” requirement replaces any other audit requirements (such as the Law 31/1990 Censor Committee), where financial statements are prepared and presented in accordance with MoF Order 94/2001. This situation has been further clarified by recent amendments to Law 31/1990, where a “financial auditor” must be appointed for MoF Order 94/2001 financial statement reporting and may replace the Censor Committee for any SA company.

MoF Order 94/2001 details a specified chart of accounts listing to be applied which differs and includes guidance for the mapping of individual accounts to the balance sheet and income statement formats.

MoF Order 94/2001 makes reference, as did previous requirements, for the need to prepare financial statements that reflect the needs of shareholders, prospective investors, management and other uses of financial statements, rather than the past emphasis on meeting the needs of the fiscal authorities.

Dividend distribution is based on the statutory accounting profit. Where MoF Order 94/2001 is applied, the MoF Order 94/2001 financial statement profit is used for the second year of application and then for each succeeding year.

Since the introduction of Romanian Accounting Law (Law 82/1991) the use of accruals, provisions and estimates, has been prescribed, but limited in practice, as many Romanian accounts are prepared more on a tax deductibility basis, rather than having as a focus the preparation of financial statements that are useful for reporting to owners/investors/lenders or for management or other purposes.

Impact on MoF Order 94/2001 reporting of year end 31 December 2003 closing regulations (MoF Order 1827/2003) and year end 31 December 2004 closing regulations (MoF Order 1775/2004)

MoF Order 1827/2003 and MoF Order 1775/2004 cover a number of issues that impact on the preparation, presentation and submission of financial statements for the year ending 31 December 2004.

Financial statements presented under MoF Order 94/2001 to the Ministry of Finance and other State authorities, should not include any adjustments for the application of IAS 29 *Financial Reporting in Hyperinflationary Economies* and SIC 19 *Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*. Romania for a number of years, including 2003, has been considered to be hyper-inflationary for International Financial Reporting Standards, requiring the application of IAS 29. If such adjustments are not included, the financial auditors' report should make mention of this issue, based on guidance issued by the Romanian Chamber of Financial Auditors. For 2004, while Romania is no longer considered to be hyperinflationary, if entities have not made adjustments to prior periods, it is likely the matter will still be mentioned in the financial auditors' report.

The statutory financial statements have to be approved by the Annual General Assembly of Shareholders and are to be submitted to the Trade Register accompanied by the Board of Administrators annual report and the report of the financial auditor. These financial statements would also form the basis for any dividend distribution or other appropriation of profit.

The Orders requires that:

- The balance sheet and profit and loss statement must be presented only in the formats as provided in MoF Order 94/2001;
- The notes to the financial statements must follow exactly the formats as indicated (Chapter III) for Notes 1 to 10 and two additional notes⁴ as indicated in MoF Order 1827/2003, with any additional information that is included to commence from Note 11. This moves the financial statements reporting more to a tabular format, than the more informative combined narrative and table format that is common for financial statements completed in accordance with International Financial Reporting Standards and other international generally accepted accounting principles;
- In situations where IAS 29 is applied, inflation adjustments are not to be posted through the general ledger, being treated as an adjustment made as part of the financial statements preparation, and therefore documented outside of the general ledger.

Application of MoF Order 94/2001

⁴ The two additional schedules for completion include: one on general information on a number of different matters and the second on fixed asset values and related depreciation and provisions.

For companies applying MoF Order 94/2001 the following applies:

a) In the first year that MoF Order 94/2001 is applicable:

i) The entity will complete statutory financial statements under legislation applicable prior to MoF Order 94/2001 by the statutory lodgement date being on or before 30 April following the year end; and

ii) Before the following 30 November, the entity will complete financial statements under MoF Order 94/2001 requirements to comply with International Accounting Standards, the European Union 4th Directive and additional specific MoF Order 94/2001 disclosures.

b) In the second year that MoF Order 94/2001 is applicable, financial statements in accordance with International Accounting Standards, European Union 4th Directive and additional specific MoF Order 94/2001 disclosures are to be prepared on or before 30 May following the year-end.

Banks and Insurance Companies

Recent changes in financial reporting for banks have been implemented to move Romanian requirements into line with European Union directives and International Accounting Standards for Banks (MoF/National Bank of Romania Order 1982/5/2001 and MoF Order 2328/2001 for insurance companies).

Other entities (non-MoF Order 94/2001) Reporting and Filing

For entities other than those applying MoF Order 94/2001 the submission date for annual financial statements are:

- 120 days after closing of financial year for large operating entities (MoF Order 306/2002);
- 60 days after closing of financial year for “micro-enterprises”;
- 60 days after closing of financial year for dormant companies.

For entities reporting under MoF 306/2002, these entities will be required for 31 December 2006 reporting to apply the European 4th Directive regarding annual accounts and the European 7th Directive in relation to the preparation of consolidated accounts.⁵

The “micro-enterprises”, as defined in the Fiscal Code (Law 571/2003), are those entities which meet the following conditions at the end of the prior year:

- Activity is related to manufacturing, services or trading activities;
- Had at least 1 employee and no more than 9 employees;

⁵ Ministry of Finance Order 1775/2004 regarding certain accounting regulations

- Had turnover under Euro 100,000; and
- Are privately owned companies.

For the individuals and family associations who perform trading activities, accounting related requirements observing the double entry principle is not mandatory, the Cash Register is the only record required.

A company which does not have its own accounting department and/or a qualified person in charge of the accounting records, and which has turnover greater than ROL equivalent of EUR 50,000, must contract an authorised person (individual or firm) to prepare its financial statements.

Audit Requirements and Statutory Auditors

As with the accounting regulations, audit standards and practice in Romania have since 1999 been undergoing a process of change that is still developing.

At present there are a number of possible audit requirements:

a) Companies applying MoF Order 94/2001

For completing financial statements under MoF Order 94/2001 they must have their financial statements audited by a “financial auditor”. A financial auditor is an individual or company that is a member of the Romanian Chamber of Auditors.

The “financial auditor” issues a report to shareholders on the MoF Order 94/2001 prepared financial statements at the annual general meeting of shareholders.

For companies that apply MoF Order 94/2001 and where a merger, spin-off or winding up occurs, the related MoF Order 94/2001 financial statements must be audited by a financial auditor.

The Romanian Chamber of Auditors was established by Ordinance 75/1999 (as subsequently approved by Law 133/2002) to establish auditing standards in Romania and to monitor the audit profession in relation to membership and qualification standards including establishment of examinations and membership criteria, ongoing training programmes, ethical standards, and quality review procedures.

The Chamber of Auditors has adopted for application in Romania the International Standards on Auditing as issued by the International Federation of Accountants.

b) SA companies not applying MoF Order 94/2001

For SA (Joint-stock) companies that are not completing financial reporting under MoF Order 94/2001 a financial auditor or a “Censors Committee” as defined under Law 31/1990 (the Company Law) are required

Where appointed, a Censors Committee, comprising three members and the same number of deputies, undertakes work to report on the custody of assets and compliance by the company with applicable Romanian legislative requirements. A report is issued by the Censors Committee (jointly or individually) on the annual statutory financial statements to the annual general meeting of shareholders.

The Censors Committee must always be an odd number in composition, either individuals or appropriate companies and one member of the Censors Board must be a Romanian qualified accountant (either as an individual or as a firm).

c) SRL companies not applying MoF Order 94/2001

If a SRL (limited liability company) has more than 15 shareholders, then a Censors Committee is required.

d) Listed companies

For listed companies, the annual financial statements must be audited by a financial auditor. The report that is completed by the financial auditor is issued to the shareholders and to the Romanian Securities Commission.

Companies completing MoF Order 94/2001 financial statements can have the same auditor for both financial audit reporting and CNVM reporting as long as the relevant “financial auditor” has an additional CNVM (National Securities and Exchange Commission) approved qualification (CNVM Instruction 4/2000).

Denomination of ROL

Starting with 1 July 2005 the bookkeeping will be performed in “new” ROL that will replace 10,000 units of “old” ROL. The conversion of balances in “old” ROL into “new” ROL will be made in accordance with the provisions of MoF Order 1840/2004.