The Legal Support, Content and Certain Implications of Some of the New Accounting Regulations

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Abstract
Romania is a fully-fledged member of the European Union, a status which brings with it a series of rights but also implies the strict following of the agreed upon obligations. A portion of the government’s attention must always be devoted to the tuning of the legislative framework with a view to align it to that of the other member countries, according to the standards of the community. Periodically, accounting regulations must be emitted, conforming with European directives, through which Romania must remain permanently connected to the accounting innovations which appear on the European arena.

Keywords: Accounting regulation, size criteria, intelligible, relevant, credible, accounting principles.

1. Certain regulations referring to the consolidation of financial standings
The status of member of the European Union confers onto Romania a series of rights but implies that it respect multiple obligations referring to the accounting reflection of operations conducted by economic agents. Order 3055/200954, written by the Ministry of Public Finance, has approved a series of accounting regulations in conformity with European directives, as well as introducing a number of novelties applicable from the date of January 1st 2010.

As a first, the normative act introduces three size criteria, which are to govern the evaluation of economic agents. Thus, the legal persons who, at the date of the accounting audit, exceed the limits of two of the three size criteria, respectively:
- total actives: 3,650,000 Euro;
- net turn-over: 7,300,000 Euro;
- average number of employees during the financial year: 50;

fill out a mandatory annual financial standing comprising of:
- balance sheet;
- profit and loss account;
- the modifications to the owned capital;
- the cash flow standing;
- explicative notes for the annual financial standings.

The legal persons which fulfill the size criteria, as presented above, fill out simplified annual financial standings which comprise the shortened balance sheet, the profit and loss account and the explicative notes for the simplified annual financial standings. The highlighted normative act introduces a certain new elements with regards to account consolidation. Referring to this aspect, a parent company needs to fill out consolidated annual financial standings, if it is part of a group of companies and fulfills one of the following conditions:

1. It owns the majority of stockholder voting rights from another company known as a subsidiary;

2. Is a stockholder or associate of a company and the majority of members of the branch administration which have fulfilled their function during the current and previous financial year and up to the moment of the writing of the consolidated annual financial standings, have been named only as a result of exercising their voting rights;

3. Is a stockholder or associate of a company and singularly owns control over the stockholder or associate voting rights, as a result of a deal with the other stockholders or associates;

4. Is a stockholder or associate and has the right to exercise a dominant influence over the branch, according to the terms of a contract signed with the respective company, or of a clause of the constitutive act or statute, if the regulation applicable to the branch allows for such contracts or clauses.

There are also exceptions, according to which the parent company is exempt from presenting consolidated annual financial standings, such as the case in which at the date of the consolidated audit, the companies who are about to be consolidated do not both exceed, on the basis of their most recent annual financial standings, the limits of two of the following categories:

- Total capital: 17,520,00 Euro;
- Net turnover: 35,040,000 Euro;
- The average number of employees during the financial year: 250.

The exemption from consolidation is not applied if one of the branches which are to be consolidated is a company which has stocks and shares that are admitted for transaction on a regulated market. The control percentage of a company is an important element of consolidation operations, because it allows for the establishment of the list of companies within the consolidation perimeter. The control percentage is expressed by the fraction of voting rights held by the parent company within the other and reflects the power relation which exists between the components of the group. If the actions which make up the joint stock have the same voting right, the control percentage is equal to the part of the capital owned.

There are shares, the owning of which ensures a single vote, known as ordinary shares. Shares without voting rights are known as priority dividend shares. Aside from the outlined shares, there are also shares with a double or multiple vote which augment the power rights of the owners.

In international practice, a maximum of 25% of the joint stock is established as shares without voting rights. Double voting rights shares are officially listed, owned by stable stockholders, which for at least 5 years did not renounce their rights, this category encompassing the founders of the company. It must be stressed that owning a fraction of voting rights is not to be confused with owning a fraction of the capital, because there may be gaps between capital contributions and voting rights. For calculating voting rights the shares without rights are not taken into account nor are the shares of the redeemed company, the ones acquired by the company, those for which the contingent liability payments have not been made, investment certificates, convertible bonds, the rights that the company has over its own self.

The control percentage is calculated by summing up all of the voting rights granted directly or indirectly through a subsidiary under the exclusive control of the parent-company. The control percentage of the parent company over any other company in the group is given by summing up the control percentages of all of the companies in the group which hold participation in the latter. There can be a chain of direct or indirect ownership of voting rights only if there is a control percentage of at least 50% over the company through which indirect ownership is being exercised. Although, if these rights are below 50%, and if the company is assimilated as a subsidiary (actual control) as a convention it has been established that the voting percentage be considered over 50% so that the chain not be broken.
As an example, we may consider the following cases of direct links:

1. Company M owns 45% of the shares of company F. All of the shares owned by M are ordinary shares, with a simple voting right. The capital of company F is made up in part by 25% of dividend priority shares, which is to say, shares without voting rights. Even though, as presented, company M owns 45% of the joint stock of F, in reality the control percentage of company M over company F will be: \(45\% : (100\% - 25\%) = 33.75\%\).

2. Company M owns 40% of the joint stock of company F and these shares alone have a double voting right. With an effective participation of 40% in the joint stock of company F, company M will have a control percentage of: \((40 \times 2):(80 + 60) = 57\%\). The number of shares and the breakdown of voting rights are as follows:

<table>
<thead>
<tr>
<th>Shares Owned</th>
<th>Voting Rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company M</td>
<td>40 shares and 80 voting rights;</td>
</tr>
<tr>
<td>Other shareholders</td>
<td>60 shares and 60 voting rights.</td>
</tr>
</tbody>
</table>

Total 100 shares and 140 voting rights

3. Company M owns 80% of the shares of company F, but 20% of them do not carry voting rights. In this case, even though company M owns 80% of the joint stock of company F, it will have a control percentage of: \((80\% - 20\%):(100\% - 20\%) = 75\%\).

The cases described had as a basis the hypothesis stating that between company M and subsidiary company F, in which the former owns carats, there is a direct link, the control percentage corresponding to the stock percentage owned in case of ordinary shares or being different in case of shares without voting rights or with double voting rights.

If between the parent company and the subsidiary there is an indirect link, through an unique chain, control is determined on a level by level basis. Should the chain brake, meaning that at a particular point the percentage drops below 50%, the previous percentage is annulled and the parent company has no more control rights.

As a rule, if company F in the group is controlled majorly by the group, it bestows on the group the control rights for the company S, in which it owns stock portions. The existence of majority control is validated when the control percentage of the group is at least 50%.

Practically, if a company is controlled by a percentage of 50% by two groups, without one being able to exert over the other an ascendency, during the consolidation the method of proportional integration will be applied, since power is divided.

In order to illustrate, one may consider the following examples:

1. In the chain, company M owns directly a control percentage of 80% in company A. Company A also owns a 55% control percentage of company S. In this case, company M has a direct majority percentage of 80% in company A and indirectly a percentage of 55% in company S, because it holds over A an exclusive and implicit control, it also controls S at a percentage of 55%.

2. Between the three companies on the sole chain, company M holds 30% of company A and company A holds 80% of company S.

In this case we have a break in the chain, because company M no longer exclusively controls company A, therefore the percentage of directly owned control of company A is 30%, and indirectly owned control of company S is 0%.
Annual financial standings must encompass a number of qualitative characteristics so as to be useful for all those who use the information. Financial standings must be intelligible, easy to understand and use, however without being overly-simplified. Information regarding complex issues which are instrumental for knowledge and clarification must not be excluded from annual financial standings just for the sake of maintaining the intelligibility principle. The financial standings must be relevant, in order to influence decision-making and help the diagnostic process and the foundation of predictions. Any financial standing must be compulsory credible, not to contain significant errors, not to take sides, it must inspire confidence in those who use the information thus obtained, it must be in accordance with their economic basis and reality and not just with the judicial presentation style. In order to consolidate the credibility of financial standings, these must be neutral, they must not contain intentionally doctored information, so as to induce a certain idea, in order to form a certain rationale or to influence a decision.

In order to be credible, a financial standing must be complete. An omission, be it intentional or not, may transform the standing into a non-credible one, even a false one from a relevance standpoint. The modification and additions to accounting regulations have as a supplemental role to make financial accounting standings comparable. Regardless of how complex and elaborate financial standings may be, if they lack the common element which makes them comparable with the standings of over similar structures, they appear lacking in content.

Users must be able to compare financial standings in order to identify the trends and performances of the firm. The need for comparability is justified and even necessary to a certain point, it must not transform comparability into a sort of Procrustean bed, which would lead to an abnormal uniformity, ultimately useful to nobody.

Order 3055/2009 discusses the auditing of annual financial standings. According to the regulations therein, the target of financial audit are legal persons who at the date of balance sheet closing go over the value limits of the size criteria, established as follows:

- total actives: 3,650,000 Euro;
- net turnover: 7,300,000 Euro;
- average number of employees during the financial year: 50.

The targets of the statute audit are also annual financial standings filed by legal persons of public interest, as defined by the law. The simplified annual standings are only verified according to the provisions of the law.

2. **The users of financial information**

Financial-accounting standings carry a special significance both from the point of view of those who draw them up as well as third parties, either legal or natural persons who use the information drawn from within of those standings.

OMFP no. 3055/2009, reiterates the defining elements of financial-accounting information, from the point of view of their use. Thus, according to the provisions of the above mentioned normative act, the users of financial information include current and potential investors, hired personnel, creditors, suppliers, clients, state institutions, other authorities as well as the public.

*Investors*, normal or legal persons interested have a major interest in finding out the risks which may affect the profitability of financial transactions. The obvious interest is manifested through the need for information which would allow them to evaluate and decide if they should keep, buy or sell capital instruments. Shareholders are also interested in information which would allow them to evaluate to what extent the entity in question can pay dividends, both in the current financial term and in the future ones.
Employees. The hired personnel and the institutional structures which represent it are interested in information regarding the productivity and profitability of their employers. From their point of view, financial-accounting information must provide hints regarding the capacity of the employers to offer, both presently and in the future, the due salary rights as well as pensions, in-service education and even professional reconversion.

Creditors are interested in information which would allow them to know exactly if the loans and interests may be recovered in accordance to the agreed-upon deals with the beneficiaries.

The Suppliers and other creditors manifest an interest in information meant to assure them that the sums that are due them after the transactions closed with the clients will be recovered at the maturity term. Suppliers and other creditors are generally interested in the entity for a shorter period of time than creditors, with the exception of the case in which they are dependent on the continuing activity of the entity, when it is a major client.

Clients are interested in information referring to the continuity in the activity of an entity when they have a long-term collaboration with the entity or are dependent on it.

State institutions and other authorities are interested in the allocation of resources and, consequently, in the activity of economic or institutional structures.

The public may be interested in information of many types. Through managerial politics, either present or prospective, economic or institutional structures may have an important impact with regards to the ensuring or the limitation of jobs or training opportunities.

3. General accounting principles

The elements presented in annual financial standings are evaluated in accordance with the general accounting principles, considering liability accounting. Therefore, considering the provisions within OMFP no. 3055/2009, the effects of the transactions and other events are recognized when the transactions and events occur and are registered in accounting and reported in the financial standings of the respective periods.

Incomes and expenditures which result directly and simultaneously from the same transaction are recognized as simultaneous in accounting, through the direct association between respective spending and income with the distinct outlining of these expenditures and incomes. The principle of liability accounting is applied also to the respective interest connected to the period in question, regardless of its maturity. The evaluation is the process through which one determines the value at which the elements of the financial standings are recognized in accounting and presented in the balance sheet and the profit and loss account.

The principle of the continuity of activity. According to this principle, the basic idea is that the entity functions on the principle of the continuous activity. This principle implies that the entity continues its activity normally, without entering a dissolution situation or significantly reducing its activity.

An entity will not fill out the annual financial standing on the basis of continuous activity if the leadership decides after the date the balance sheet is due, to either dissolve the entity or stop its activity, or that there is no other realistic option other than the ones mentioned.

The deterioration of the results from the exploiting activity and of the financial situation, after the date of the balance sheet filing, indicates the need to analyze whether or not the assumption of continuous activity is still adequate.
If the administrator of an entity have been made aware of certain elements compromising security regarding certain events which may lead to the inability of the entity to continue its activity, these elements must be presented in the explanatory annotations. In case the annual financial standings are not filled out on the basis of the continuation of activity, this information must be presented along with explanations regarding the way they were filed and the reasons behind the decision according to which the entity can no longer continue its activity. The events or conditions which require the producing of information may appear after the date of the balance sheet filing.

**The principle of the permanence of methods.** The evaluation methods and accounting policies in general, must be applied in a constant and coherent manner from one financial year to another. Modifications of accounting policies may be determined by:

a) the initiative of the entity, in which case the modification must be justified in the explanatory annotations to the annual financial standings;

b) a decision of a competent authority and which imposes on the entity, in which case the modification may not be justified in the annotated explanations, but merely mentioned therein.

The modification of accounting policy at the initiative of the entity may be determined either by an exceptional modification intervening in the situation of the entity or in the economic and financial context in which it functions; either by obtaining credible and more relevant information. Some examples of situations which justify the modification of accounting policies may be: admission for transaction on a regulated market of the entity's stocks and shares on the short term or their subtraction from transitioning; shareholder changes, due to entering a group, if the new methods ensure the supply of more faithful information; mergers and assimilated operations made at accounting values, a case in which the harmonization of accounting policies of the absorbed company with those of the absorbent company must take place etc.

A change in leadership does not justify the modification of accounting policies. As a result of the inherent uncertainties in the activity, some elements of annual financial standings cannot be precisely evaluated, only estimated. However, one may ask for estimates of: uncertain customers; stock obsolescence; useful lifespan, as well as the predicted rate of consumption of future economic benefits incorporated into redeemable actives, etc

The estimation process implies reasoning based on the most recent credible information available. An estimate may require the revision if changes in the circumstances on which it was made appear, following new information or better experience55.

**The prudence principle.** When drawing up the annual financial standings, the evaluation must be made on a prudent basis, meaning that in the profit and loss account may only be included the profit registered at the date of the balance sheet filing. One must also take into account all of the debt accumulated during the current or previous financial year, even if they become obvious between the date of filing and the date of its drawing up. Also, all predicted debts and losses during the current or previous financial year must be taken into account even if they become obvious between the date of filing and the date of its drawing up. To this purpose, one also takes into account the possible provisions and debts incurred through contractual clauses. The prudence principle imposes that all depreciations, regardless of whether or not the result of the financial year is loss or profit, must be taken into account as well.

Registering adjustments for depreciation or loss of value is executed on the basis of the expenditures accounts, regardless of their impact on profit and loss.

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The principle of the independence of the financial year. According to this principle, in accounting, one must take into account the incomes and expenditures respective to the financial year, regardless of the date of their cashing or the date of the payments. Also, in the income account, one will also include the claims for which the invoice account 418 Clients - invoices to be drawn up haven’t been drawn up yet; as well as within the accounts of expenditures or goods, the debts for which the invoices have not been received yet - account 408 Suppliers - invoices not received. In all cases, booking in these accounts is made on the basis of the documents which attest the delivery of goods and the services provided, respectively, on the basis of the bills accompanying the goods, situation reports etc.

The principle of the separate evaluation of the elements of actives and debts.
According to this principle, the components of the elements of actives and debts must be evaluated separately.

The intangibility principle. The opening audit for each financial year must correspond to the closing audit for the previous financial year. The modification of accounting policies is implemented only in future years, starting with the financial year following the one during which the decision of modification was made. The modification of accounting policies may be made only at the beginning of a financial year. Modifications of accounting policies during the financial year are not allowed. In the case of modifying accounting policies and correcting certain respective errors in the previous years, the audit of the previous period will not be modified.

The correction, based on the reported result, of the significant errors respective to the previous financial years are not considered a breach of the principle of intangibility.

The principle of non-compensation. Any compensation between elements of actives and debts or between elements of incomes and expenditures is forbidden. All claims and debts must be distinctly registered in accounting, on the bases of justifying documents. Compensations between claims and debts regarding the same entity, made in accordance with legal provisions may be registered only after the accounting of respective incomes and expenditures.

The principle of the prevailing of economics over judicial.
The presenting of values within the audit elements as well as the profit and loss account is made taking into account the economic background of the transaction or the reported operation and not only their judicial form.

The purpose of respecting this principle is the faithful registering in accounting and presentation of economic and financial operations, in accordance with the economic reality, outlining the rights and obligations as well as the risks associated with these operations. Economic and financial events and operations must be outlined in accounting just as they are produced, based on justifying documents. The documents which sit at the basis of accounting registering of economic and financial operations must faithfully reflect the way in which they are produced as well as to be in accordance with reality, respectively. Also, contracts made between parties must contain the means ensuring workflow and respect the existent legal framework. Usually, the judicial format of the document must be in accordance with economic reality.

In rare cases, when differences between the economic nature of an operation of transaction and its judicial format exists, the entity will register in accounting these operations by respecting their economic background.

The principle of the significance threshold. According to this principle, the value of the audit and loss and profit account elements which are preceded by Arabic numbers may be combined if they
represent an insignificant sum, or if such a combination offers an increased level of clarity, with the condition that the elements thus combined be presented separately in explanatory annotations.

In exceptional cases, some departures from the general accounting principles presented may be made. Any such departures must be presented in the explanatory annotations, along with the reasons that sit behind them, as well as an evaluation of their effect on actives, debts, financial position and loss or profit.

References