SUBSTANCE AND FORM IN ROMANIAN ACCOUNTING REGULATION[1]

DANIELA ARTEMISA CALU, RALUCA GINA GUȘE, LAVINIA OLIMID, VIOREL AVRAM
ACADEMY OF ECONOMIC STUDIES, PIAŢA ROMANĂ NO. 6, SECTOR 1, BUCHAREST, ROMANIA
danielacalu@yahoo.com, guseraluca@gmail.com, l.olimid@cig.ase.ro, viorelavram@hotmail.com

Abstract:
Switching from an accounting system based on compliance and enforcement of strict rules, to a system where the professional judgement plays a key role in the accounting recognition of assets and their disclosure can be a difficult exercise. Throughout history, Romania has moved through a winding path, from the standpoint of accounting judgement. Although there have been attempts of early normalization at the beginning of the twentieth century, that led to the literature addressing some aspects of assets recognition and classification, both form a legal and economic perspective, they have never been implemented (Calu, 2005). By the middle of the twentieth century, the accounting system was a Soviet-inspired one, where practitioners were required to apply "recipes" for asset recognition and disclosure, enforced on a national scale, thus rendering the professional judgement useless. Beginning with 1989, most accounting treatments were still predefined, but certain transactions and events required professional judgement. The regulators have expanded the field of professional judgement through the Romanian Accounting Development Programme, by adopting an economic view for assets recognition and disclosure. The objective of this paper is to show that conceptual contradictions or alternative classification criteria, can preclude the exercise of professional judgement regarding the recognition and disclosure of assets.

Key words: *accounting normalization, recognition of assets, classification of assets, economic approach, legal approach*

JEL classification: *M41, M 48*

1. Introduction

The differences between the common and Roman law, have left their mark on how assets are recognized in accounting (Olimid and Calu, 1999): only when there is an ownership title (the legal approach, traditional on the Continent) or when all benefits and risks inherent to the ownership of the respective assets are transferred (the economic approach, prevalent in Britain and other Anglo-Saxon countries).

In Romania, assets recognition has been approached in both ways. Although there were supporters for both the legal and the economic approach, accounting regulation has been, until recently, under a strong legal influence. Also the nature and extent of disclosures were imposed by the regulator, leaving little freedom for accounting professionals to choose specific forms of presentation.

With the introduction of the "substance over form" concept in accounting legislation, the practices regarding assets recognition have changed, as the legal approach began to leave room for the economic approach. Accounting regulations in Romania have started to include explicit or implicit aspects of economic recognition at the expense of legal recognition, the most recent of these (OMFP 3055/2009) making

[1] This work was supported by CNCSIS – UEFISCSU, project number 161, PN II – IDEI 797/2007 - *Development of Romanian Accounting Regulation Between Heredity and Thanatogenesis.*

use of the “substance over form” principle to explain classifications of assets disclosed in the balance sheet. Therefore, we believe that Romania is moving towards an economic approach for the recognition of assets.

Using historiographical analysis, we shall try to demonstrate that, regardless of the legal or economic approach existing over time in Romania, accountants have not been encouraged to exercise their professional judgement in terms of asset recognition and disclosure. This is due to shortcomings in the conceptual presentation of elements made by the normaliser, as well as to the strictly regulated structure of the balance sheet.

2. Definition, recognition and disclosure of assets in Romania prior to 1989

The issue of asset definition and recognition has been a constant concern for Romanian accounting research. In January 1908, The General Commerce and Accounting Review published a questionnaire regarding the companies’ balance sheets, rewarding with a subscription to the Review the best answers from readers. This definition was as follows: “Asset means all that belongs to us, it consists of investments, such as cash, receivables, notes receivables, treasury bonds, stock of goods, etc.” (RGCC, August 1908). We note that this first definition is strongly influenced by the legal doctrine. In this respect we mention that “to belong to” means “to be the property of a person of thing” (DEX, 1998), or ”to be owned by someone as a result of a claim” (NODEX, 2002). During this time, there were no special requirements for disclosure, each company having its own disclosure procedures.

The prevailing view was that assets are goods, objects of rights and obligations (Iacobescu and Sorescu, 1928). An opposite view was held by Evian (1940), who defines a company’s assets as “the totality of means that a company employs or «activates with» in order to realize its purpose, ... concrete goods, tangible and valued in money”. One can easily notice that «activates with» resembles to «active» (assets), thus giving the idea of «use».

Amid international discussions on accounting regulation, a committee was established in 1941, at the Ministry of Coordination, with the objective of the accounting “standardization”. Within this committee, two trends of opinion were formed, one around Professor Iacobescu, supporting a legal approach, and the other around Professor Evian, supporting an economic approach to the balance sheet. One of the issues discussed was that of the definition and presentation of assets in the balance sheet. In accordance with the definitions set out above, two balance sheet taxonomies were proposed for assets (Evian, 1946), as follows:

Table 1. Proposed structure of assets in the balance sheet, 1941

Assets – legal approach	**Assets – economic approach**
Values accounts	Adjusting accounts
Debtors accounts	Fixed Wealth Accounts
Losses Accounts	Moving Wealth Accounts
Memorandum accounts (Debit balances)	Periodic Accounts

We note that the order of items in the assets side of the balance sheet is presented only in general terms, without details.

These attempts to regulate accounting were brought to a standstill in 1947, when the Permanent Council of Accounting Standardization was formed. Although a new definition of assets was not proposed, their structure, presented below, shows a legal approach to the recognition of assets, due to the fact that “extra patrimonial” memorandum accounts. By the way assets are structured (Table 2), the stage is set for a detailed disclosure and it outlines the requirements to practitioners of following an imposed pattern.

Table 2. Structure of assets as a result of the 1947 standardization

ASSETS
I. Basic means accounts II. Participations accounts III. Production means accounts IV. Distribution means accounts V. Receivables accounts VI. Investments accounts VII. Cash accounts VIII. Prepayment accounts IX. Losses accounts **TOTAL ASSETS** **Memorandum accounts (extra patrimonial)**

During the 1948 to 1989 period, Romania followed the Soviet accounting model. The definition of assets changed to "material and monetary funds looked at in terms of their economic and financial destination or their specific form of allocation, use and investment in the activity of socialist organizations" (Ristea, 1989), The disclosure of assets was standardised and detailed (Puchiţă et. al., 1981), as shown in Table 3.

Table 3. Selective presentation of assets in the balance sheet, 1981

ASSETS
A.FIXED MEANS (unamortized value, rows 2-3)
B. MOVING MEANS and other assets (rows 6+15+16+24+29 to 34)
I. Stocks and expenses (rows 7 to 14)
II. Temporary constructions
III. Bank accounts and other monetary means (rows 17 to 23)
IV. Receivables (rows 25 to 28)
V. Settlements
VI. Means and expenses to foreign subunits
VII. External participations (account 395)
VIII. Means and expenses for social actions
IV. Settlements with the State budget at ICE
C. MEANS AND EXPENSES FOR INVESTMENTS (class IX)
D. APPROPRIATIONS AND LOSSES (rows 37 to 40)
TOTAL ASSETS (rows 1+4+35+36)

3. An analysis of the definition, recognition, and disclosure of assets in Romania since the 1989 Revolution from the perspective of professional judgement

The enactment of the first Accounting Law (1991) and the entering into force of its Regulation of Implementation (1994), strongly influenced by the 1982 French General Accounting Plan have brought back the legal approach to company assets. Although the assets have not been defined by these legal texts, the literature has assumed the French definition of assets, with its strong legal mark: "element of the patrimony having a positive economic value for the enterprise" (French General Accounting Plan, 1982). Subsequently, OMF 403/1999 and 94/2001 have introduced, at least formally, *The Framework for the Preparation and Presentation of Financial Statements* (IASB, 1989) together with the related definition: “a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity”. After Romania has joined the European Union, the *Regulations Conforming to the European Accounting Directives* have maintained the definitions of elements in the financial statements from the IASB Framework, but they have eliminated the conceptual framework, thus making the application of accounting professional judgement more difficult.

The recognition of assets and liabilities in accordance with the IASB Framework involves professional judgement when evaluating the type, size and probability of occurrence of economic benefits for the entity, in the case of assets, or of the outflows of economic benefits from the entity, in the case of liabilities. The IASB Framework refers as much as three times to “judgement”: in paragraphs 37 in the case of prudence, 44 relative to the evaluation of benefits and costs associated with accounting information, and paragraph 45 regarding the balance between qualitative characteristics of financial information. In *IAS 1 Presentation of Financial Statements* alone, professional judgement is noted in seven paragraphs of the text and in five paragraphs of the Basis for Conclusions which provides a detailed analysis of the presentation of judgements used by the management in applying the accounting policies of an entity.

Regulation 704 for the implementation of the Accounting Law makes no explicit reference to professional judgement, which can be explained through the import of an accounting system characterized by uniformity. Except for the references mentioned from the IASB Framework that has been translated and incorporated, OMF 94/2001 only mentions professional judgement in paragraph 5.13: “Each enterprise will employ professional judgement in order to assess the level under which an item must not be presented in the balance sheet, but in the profit and loss account. Also, professional judgement must be employed when making decisions regarding the need to account for assets separately of jointly.”

The Regulations Conforming to the European Accounting Directives return to the uniformity specific to the first stage of the accounting reform, by eliminating from their texts any reference to professional judgement.

The presentation of assets has always been regulated to the smallest detail in Romania. Even if the “substance” of the presented elements is no longer the same, “the form” of presentation form the socialist period still remains, as for each asset group, the regulator offers a “template”, for the inclusion of accounts as line items in the balance sheet. Therefore, the presentation of assets through the balance sheet seems to be limited to the application of mathematical algorithms, predefined by a computer program provided by the accounting regulator.

In addition to the measurement of the presented items, the issue professional judgement arises: (i) where there is a possibility that a certain element is presented as a part of two or more balance sheet line items, according to the specific transactions that generated them, or (ii) when the accountants are confronted with leaving the predefined template and with the reclassification of certain elements, in order to apply the IFRS reporting framework.

In the following paragraphs we analyse the main accounting regulations that have been adopted in Romania since 1989 and their impact on professional judgement in terms of: (i) the accounting framework, (ii) the definition of assets, (iii) the presence and meaning of “substance over form”, and (iv) the possibility to present certain elements as part of more than one balance sheet line item as a result of the change of accounting framework.

A. The Accounting Law no. 82/1991 and its Regulation of Application no. 704/ 1993

Reporting framework. It is the first accounting regulation representing a major change in compared to the communist period, with strong influences from the French General Accounting Plan.

Definition of assets. It does not include an explicit definition of assets. In the same period, the French General Accounting Plan offers a definition with a strong legal influence: "an element of the patrimony having a positive value for the enterprise".

Substance over form concept. Absent.

Specific aspects:

- Provides a detailed structure of assets and the classification of elements depending on the degree of liquidity (long-term assets, short-term assets, prepaid expenses).
- The structure of assets includes legal elements, such as own shares.
- The suppliers-debtors item, reflecting payments in advance for stocks, services, etc. is treated as a receivable, in a strictly legal manner.
- Bond premiums are presented as assets, even if this is not their economic substance.
- The detailed information regarding assets is made up exclusively of numerical information, presented as an "appendix" with regulated content.

Professional judgement:

- It cannot be exercised in the case of asset recognition or disclosure.
- It can be exercised in the case of asset measurement, because there is a possibility to recognize value adjustments [the term used in the text was "provisions"] and provisions for risks and charges.

B. The Order for the adoption of the accounting regulations harmonised with the Fourth European Directive and International Accounting Standards no 403/1999

Reporting framework. It is the first accounting regulation in Romania including elements from IAS/IFRS and the Fourth European Directive.

Definition of assets. Includes a full translation of the IASB Framework and implicitly incorporates an «economic» definition of assets.

Substance over form concept. Present with a dual sense, as an accounting principle and among the secondary qualitative characteristics that insure reliability of accounting information (par. 34, 35). It is stated that, in order to produce reliable information, the events and transactions must be recognized and presented in accordance with their economic substance and not merely their legal form, formally establishing an association with asset recognition.

Specific aspects:

- Liquidity remains the criterion for the classification of assets, but this is no longer correlated with the classification of liabilities (grouped according to the current/non-current criterion), giving rise to potential conceptual confusion among practitioners.
- The recognition criteria stated by the IASB Framework are still present: the probability of future economic benefits and the reliability of measurements.
- Own shares are still placed among assets, even if their economic substance places them among equity.
- The payments made in advance to suppliers to purchase stocks are presented as stock, whereas the payments made for services are presented as receivables. Although the placement in the balance sheet is made automatically, because of the details in the Chart of Accounts, the present regulation does not offer any

conceptual clarifications as to the concepts on which this classification was founded.
- Bond premiums are no longer presented as assets, but as liabilities, subtracted from the total value or the loans.

Professional judgement:
- Reporting according to an imposed template, as well as certain conceptual contradictions or omissions presented above limit the exercise of professional judgement, which can be employed mainly for the preparation of "Notes to financial statements", where descriptive information finds its way, even if the format is still semi-imposed.
- Is present for asset measurement.

C. The Order for the adoption of the accounting regulations harmonized with the Fourth European Directive and the International Accounting Standards no 94/2001

Reporting framework. Represents an improved version of the previous regulation, continues to include elements from IAS/IFRS and the Fourth European Directive.

Definition of assets. Includes the full translation of the IASB Framework and therefore it incorporates the «economic» definition of assets.

Substance over form concept. The observations from the previous regulation stand (par. 5.9, 34, 36).

Specific aspects:
- It maintains the provision regarding the priority of economic substance over the legal form in the recognition process of events and transactions, as well as the recognition criteria: probability of benefits and reliability of measurement.
- States that the balance sheet can include elements that do not comply with the definition of assets, because the definition will be subject to revisions in future standards.
- The observations from the previous regulation are still valid.

Professional judgement is exercised under the same conditions presented for the previous regulation.

D. The Order for the adoption of the Simplified accounting regulations, in accordance with the Fourth European Directive no 306/2002

Reporting framework. Was applied along with the 94/2001 Law, only for the enterprises outside the attached list. On a declarative level, it proposes the harmonization with the European Directives, but it continues to include elements characteristic to the International Accounting Standards, such as the possibility to capitalize the borrowing costs in the case of qualifying assets, or the definition of the term "active market" and its use for describing the revaluation rules for long-term assets.

Definition of assets. Does not define assets.

"Substance over form" concept. Absent.

Specific aspects: Does not include elements of the IASB Framework.

Professional judgement: Makes the exercise of professional judgement more difficult by the lack of conceptual clarifications.

E. The Order for the adoption of Accounting regulations Conformiong to the European Directives no. 1752/2005

Reporting framework. The Fourth Directive, with elements of the International Financial Reporting Standards.

Definition of assets. The elements from the IASB Framework are not present, but the «economic» definition of assets remains and it includes the reliability of measurement criterion (par. 21.2.a).
Substance over form concept. Present, has the status of an accounting principle (par. 49).
Specific aspects:

- The criterion for the classification of assets is “the purpose to which they are intended”, long-term assets being intended for “continuous use”. The definition of short-term assets is largely similar to that of current assets in IAS 1, leading to conceptual confusions among practitioners and academics (par. 119.1).
- Own shares are presented in equity.

Professional judgement: the dissociation from the IASB Framework, even if the economic definition of assets is maintained, represents a step back in exercising professional judgement.

F. The Order for the adoption of Accounting regulation Conforming to the European Directives no. 3055/2009

Reporting framework. The Fourth Directive, with elements of the International Financial Reporting Standards.
Definition of assets. Keeps the «economic» definition of assets and the recognition criteria from the IASB Framework.
Substance over form concept: present, has the status of an accounting principle (par. 46, 05, 267.4). Presents several examples where the “substance over form” principle applies: “classification by the user of lease contracts as operational or financial; classification of sale operations as straight forward sale, commission or consignment sale; recognition of revenues and expenses in the profit and loss account or as revenue received in advance or prepaid expenses; classification of financial investments as long-term or short-term; recognition of financial investments in affiliated entities or as other participating interests; classification of discounts offered or received as commercial or financial” (par. 46).
Specific aspects:

- Classification of assets is made by nature and liquidity.
- In addition to the previous version, there is a presentation of users of financial statements and qualitative characteristics, similar to the IASB Framework (without an explicit mention as to the source).
- References are made to the correction of prior period errors through the retained earnings, but also to the principle of intangibility of the opening balance sheet, stating that there is no conceptual contradiction between the two (par. 44.4).

Professional judgement: Represents a step forward in exercising professional judgement, due to the fact that there are justifications for classifications and accounting treatments, based on conceptual issues.

4. Conclusions

The exercise of professional judgement is still a challenge for Romanian accountants. In the first years after 1989, the accounting system in Romania has been dominated by uniformity, and professional judgement has been applied only for the measurement and recognition of adjustments for losses in value or provisions. Assets were disclosed based on a fixed scheme, and the detailing of information through the notes was made almost exclusively in a numerical form. Since the adoption of the Order 403/1999, elements specific to the economic vision have emerged, along with conceptual issues form the IASB Framework. Conceptual controversies and especially the uniformity imposed by the accounting regulator with respect to the recognition and disclosure of assets through financial statements have limited the exercise of professional accounting judgement by Romanian accountants.

REFERENCES

1. Calu, D.A. (2005) – *Istorie şi dezvoltare privind contabilitatea din România,* Editura Economică, Bucureşti
2. Evian, I.N. (1940) – *Teoriile conturilor. Studiu economic şi privat de istorie critică a teoriei conturilor în contabilitate*, Imprimeria Fondului Cărţilor Funduare, Cluj
3. Evian, I.N. (1946) – *Contabilitatea dublă,* Bucureşti
4. Iacobescu, Sp., Sorescu Al. (1928) – *Contabilitate comercială generală*, Bucureşti
5. Olimid, L., Calu, D.A. (1999). – *Patrimoniul ca obiect al contabilitatii - un concept desuet?* Revista Contabilitate şi expertiza nr. 5
6. Puchiţă et al. (1981) – *Organizarea şi conducerea contabilităţii întreprinderilor industriale, EDP, 1981*
7. Ristea, M. (1989) – *Bilanţul în gestiunea patrimoniului,* Ed. Academiei Române, Bucureşti
8. *** – *Revista Generală de Comerţ şi Contabilitate* (numerele din ianuarie si august 1908)
9. *** – *Legea nr. 82/1991 din 24 decembrie 1991 (varianta iniţială şi cele republicate)*
10. *** – OMF 403/1999 *pentru aprobarea Reglementărilor contabile armonizate cu Directiva a IV-a a CEE şi cu Standardele Internaţionale de Contabilitate*
11. *** – OMF 94/2001 *pentru aprobarea Reglementărilor contabile armonizate cu Directiva a IV- a CEE şi cu Standardele Internaţionale de Contabilitate*
12. *** – OMF 306/2002 *pentru aprobarea Reglementărilor contabile simplificate armonizate cu Directivele Europene*
13. *** – OMFP 1752/2005 *pentru aprobarea Reglementărilor contabile conforme cu Directivele Europene*
14. *** – OMFP 3055/2009 *pentru aprobarea Reglementărilor contabile conforme cu Directivele Europene*