

THE IMPLICATION OF THE ACCOUNTING PROFESSION IN THE ACCOUNTING REGULATION FOR "MICRO-ENTITIES" IN THE ACTUAL ECONOMIC CONTEXT: DEBATES AND OPINIONS

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Abstract:

The accounting profession has been and continues to be, undergoing changes in terms of their market place and in the regulatory environment of their different jurisdictions. Based on the study of the recent European literature on the field of the reduction of disclosure requirements for the „micro-entities” and considering the results of a research accomplished by our team in Mures county, Romania, regarding the opportunity for different accounting requirements for the Romanian „micro-entities”, this paper aims to identify the role of the Romanian accounting profession in the accounting regulation for so called „micro-entities”. Whether and in what extent the Romanian accounting professions should be involved actively in the process of accounting regulation? The organization of a debate on this subject by the Romanian accounting regulator with the accounting profession is opportune? Professional accounting bodies are pointing out the trends and future issues that accountants need to be aware of and either explicitly or implicitly, suggest ways in which the profession has to develop. The Romanian accounting profession is prepared for these ways. Some of these questions may find answer in our paper. Our conclusions underline the idea that the active participation of the accounting profession in validating or invalidating some Romanian accounting requirements may be considered an important step.

Key words: micro-entities, accounting regulation, disclosure requirements, accounting profession, simplification, administrative burden

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1. RECENT IDEAS IN THE EUROPEAN FIELD REGARDING THE NECESSITY FOR SIMPLIFICATION AND REDUCTION OF COSTS RELATED TO ACCOUNTING AND AUDITING

In the context of better regulation, the European Commission considered opportune to simplify the legislative framework for European businesses, in co-operation with the European Parliament and the Member States of the European Union. The stated objective is to ensure that the Community legislation in the fields of company law, accounting and auditing corresponds to today's business needs and allows European businesses to compete more effectively and to be more successful in a highly competitive global environment. This initiative represents a part of the Commission concerns regarding the reduction of administrative burdens, especially for the SMEs.

A first step towards this direction was made since 2003, when, by the Recommendation 2003/361/CEE, the Commission defined the micro, small and medium-sized enterprises based on three criteria. The second article of the Recommendation defined the micro-entities as companies with less than ten employees, a turnover below two millions Euros and/or a balance sheet total below two millions Euros [1]. The consultations with Member States however indicated that these thresholds are too high for accounting purposes.

Nowadays, the micro-entities are subjected to the same accounting regulations as large entities, but, over time, the European Union found that extensive reporting rules applied to those entities were not commensurate with their specific accounting needs, created additional costs and might hinder efficient use of capital for productive purposes.

These ideas and suggestions were initially discussed with Member States in the Accounting Regulatory Committee (ARC) during several meetings held since December 2006ⁱ.

The European Council of 8 and 9 March 2007 underlined, in the Presidency conclusions, the importance of reducing the administrative burdens in order to stimulate the European economy, considering the possible advantages that can be created for the small and medium sized entities. The necessity of a joint effort from both the European Union and Member States to reduce administrative burdens was also emphasized. Accounting and auditing have been identified as areas in which the administrative burdens on companies within the Community can be reduced.

As a result of these discussions, in June 2007, the Commission published a report [2] identifying the changes that could affect the accounting directives. One of the measures proposed was to introduce, in the Fourth Directive, a new category of entities, the so called micro-entities and to exempt micro-entities from the application of the accounting directives.

Stakeholders were invited to give their views on whether they agree with the exemption of micro-entities from the scope of the Fourth Directive and on the possible definition for these micro-entities (less than ten employees, balance sheet total below 500.000 Euros and turnover below 1.000.000 Euros).

In March 2009, the Commission of the European Communities issued a Proposal for a Directive of the European Parliament and of the Council amending Council Directive 78/660/EEC on the annual accounts of certain types of companies regarding micro-entities [3]. The mentioned proposal suggests that a category of micro-entities as the smallest enterprises could be introduced into the EU legislative framework. The Commission Proposal defines the "micro-entities" as entities that, at the date of the balance sheet, do not exceed two of the three following criteria: balance sheet total of 500.000 Euros, net turnover of 1.000.000 Euros and/or average number of employees in the financial year of 10.

Subsequently, the Directive 2009/49/EC of the European Parliament and of the Council of 18 June 2009 amending Council Directives 78/660/EEC and 83/349/EEC regarding certain disclosure requirements for medium-sized companies, stipulates the reduction of disclosure requirements for the small and medium sized entities. The objective of this Directive is to reduce the administrative burden regarding certain disclosure requirements for the medium-sized companies and to eliminate the obligation to draw up consolidated accounts.

In February 2010, the European Parliament discussed (first reading), the Draft Legislative Resolution on the proposal for a directive of the European Parliament and of the Council amending Council Directive 78/660/EEC on the annual accounts of certain types of companies regarding micro-entities, presented by the Committee of Legal Affairs [4].

The mentioned Draft refers to the fact that the micro-entities are often subject to the same reporting rules as larger companies. Those rules put a burden on them which is not in proportion to their size. Therefore it should be possible to exempt micro-entities from the obligation to draw up annual accounts, even if such accounts provide an input for statistical information. However, micro-entities must still be subject to the obligation to keep records showing the company's business transactions and financial situation as a minimum standard to which Member States remain free to add further obligations.

Member States may provide for an exemption from the obligations under this Directive for companies which on their balance-sheet dates do not exceed the limits of two of the three criteria from the proposal for a directive.

At the same time, when implementing Directive 78/660/EEC, Member States should take into account the specific conditions and needs of their own market. So, it is underlined the fact that Member States have the possibility to exempt or not the micro-entities from the obligations stated in the Fourth Directive, taking into account the specific conditions and needs of their own market.

2. STUDY ON THE OPPORTUNITY FOR DIFFERENT ACCOUNTING REQUIREMENTS FOR ROMANIAN MICRO-ENTITIES

In November 2009, the Ministry of Finance issued the Order no. 3055 for the approval of the accounting regulation in conformity with the Fourth Directive of the European Economic Communities [5]. The mentioned Order abolished the Romanian accounting regulation in force until 31 December 2009 (the Order 1752 from 2005 for the approval of the accounting regulation in conformity with the Fourth Directive of the European Economic Communities). Considering the recent release of this new regulation, we expected to find within the provisions of this Order aspects related to the debates at European level.

But, as we pointed out in a paper published in 2009 [6], although the Fourth Directive aims to reduce the disclosure requirements for the small and medium-sized entities, the new Romanian accounting regulation amplifies those requirements and contains even more complex provisions, compared to the "old" accounting regulation.

Next, we present some requirements from the new accounting regulation, which we consider to be burdensome or too complex for the accounting of a micro-entity:

- The presentation of the users of the financial information follows the provisions from the *Framework for the Preparation and Presentation of Financial Statements* issued by IASC. But, the users of the financial statements published by the "micro-entities" are rarely the investors, the employees, the suppliers, the customers and the general public. The real users of the financial statements prepared by the "micro-entities" are mainly the lenders (banks) and the government and other agencies. We consider that it would have been more useful if the Romanian regulation presented the real users of the financial statements, with their specific needs, considering the specific conditions and realities from our country.

- The use of a new concept, "the normal capacity of the production facilities", concept taken from IAS 2 "Inventories". Generally, the determination of the cost of conversion using "the normal capacity of the production facilities" implies difficult calculation. We consider that the effort and the costs to produce this information are too high in relation with the benefits provided.

- A similar issue related to the cost-benefit report is the evaluation of property, plant and equipment and of intangible assets. In the new regulation, the value in use can be established by specialists or by the employees from the technical or economic department of the entity. For the micro-entities, all of those estimations, required to the specialists or employees, increase the costs and also we are not convinced that the financial information will be fairer than before. If so, who will be the user of this fairer information?

- The new regulation presents many aspects according to IAS 36 "Impairment of assets". It presents requirements from IAS 36 in order to assess whether there is any indication that an asset may be impaired and an entity shall consider accordingly the indications related to internal and external sources. We consider that the „micro-entities" do not have the capacity to organize the analysis of impairment and all the techniques presented for those cash flows cannot be realized with the employees of these companies.

- A significant error correction, as stated in the Order, may not be necessary to the real users of financial information provided by „micro-entities". In our opinion, the correction of these errors

may be reflected in the profit and loss account when these errors occur. Even if the error is significant, whose decisions can be influenced?

- We consider that R&D expenses are, usually, not significant in the total assets of the balance sheet, which is why the requests provided in the mentioned Order are not adequate for the „micro-entities”. We consider that a more appropriate requirement can be that from IFRS for SMEs: „An entity shall recognise expenditure incurred internally on an intangible item, including all expenditure for both research and development activities, as an expense when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria in this IFRS”.

- Our opinion is that the complexity of derivatives disclosure is not required for the „micro-entities”. The options, forwards and swap operations may not be used by these companies because the transactions are too complex for the so called „micro-entities”.

- The Order refers to the time-value of money in estimating the value of provisions. Considering the time-value of money, specialized persons must actualize the provisions and this process will generate a supplementary cost on behalf of the „micro-entities”. Does the cost-benefit report justify this approach?

- The extended presentation of the internal control could be justified if the regulation will provide compulsoriness for some companies (classified using the definite criteria) to organize this activity. The internal control can be viewed as a supplementary cost. For some types of entities, a cost-benefit analysis is also required.

Based on some provisions from the new Romanian accounting regulation, presented above, we can state that, in our opinion, the new accounting requirements are too complex for the accounting of a “micro-entity”.

In order to substantiate this statement and to test the opportunity for different accounting requirements for the accounting of “micro-entities”, in early 2010 we accomplished an empirical research on the entities from Mures County [7].

We chose the questionnaire as the research method. The questionnaire was delivered directly to the respondents and, in most cases, filled by accountants, especially by those who work as CPA. The sample consists of 203 entities from Mures County. 85 questionnaires were returned, achieving a response rate of 41.88%.

We used the turnover and the total assets value in order to identify the size of the surveyed entities. The thresholds that we considered for the two mentioned criteria were chosen taking into account the thresholds for the micro-entities presented in the EU proposal (turnover less than 1.000.000 Euros and total assets less than 500.000 Euros) and thresholds used in the Romanian accounting regulation (turnover 7.300 Euros and total assets 3.650.000 Euros) in order to differentiate the entities that must prepare a full set of financial statements from those that prepare simplified financial statements.

Next, we present briefly the results of our study, results that reflect the opinions of accounting professionals from Mures County regarding the accounting regulation in case of Romanian micro-entities.

Using the question “Do you consider that the Romanian accounting regulator (the Ministry of Finance) should issue different accounting regulations for the Romanian entities classified in relation to certain thresholds?” we tested whether the respondents agree with the idea of simplifying the accounting requirements. A number of 66 respondents, representing 77.65% from the total number of respondents, answered positively to the idea of different accounting regulations for entities classified in relation to certain size criteria. The idea of simplification, validated by 77.65% of respondents, is also sustained by the answers received for the question regarding the appropriate criteria that can be used in order to define the micro-entities in our country. We presented the criteria proposed to define the “micro-entities” at European level (turnover less than one million Euros, total assets less than two million Euros and number of employees less than 10), and the

respondents were asked if, in their opinion, those criteria can be used in order to define the "micro-entities" in Romania. At the mentioned question, 69.41% of respondents validated the three criteria proposed at European level for the definition of the "micro-entities".

So, the respondents confirmed the need for simplification and agreed with the presented thresholds; still, they were reticent about the possibility of requiring the "micro-entities" to prepare only a limited number of financial information. Almost 53% of respondents consider that the standard format of the financial statements required to the Romanian entities must be maintained. We also noted that, for entities with turnover over 7,300,000 Euros and total assets over 3,650,000 Euros, the idea of a standard format dilute (only 33.33% of these entities are positive to the standard format).

We wanted also to see the opinion related to cash accounting versus accrual accounting for "micro-entities". The results can be surprising because the idea of simplification is not connected with cash accounting for "micro-entities". Accrual accounting is the option for 44.71% of the respondents. It is also interesting that 32.94% consider that the entities should have the possibility to choose between cash accounting and accrual accounting.

So, the answers received confirmed that it is necessary to classify the entities according to their size and to introduce in the Romanian accounting regulation the "micro-entity" as a different category of entity, but we doubt that those who answered "Yes" figured out what simplification would really mean.

In order to test whether the accounting professionals from Mures County consider that the Romanian accounting regulation in force is still too complex relative to the needs of the real users of financial information provided by the surveyed entities, we asked the respondents to identify if the requirements that we presented (taken from the new accounting regulation) are justified or not for a "micro-entity". We included in the questionnaire the following requirements from the Romanian accounting regulation, that we consider too complex for a "micro-entity":

- the recognition of internally generated intangible assets in the research phase or in the development phase;
- the recognition of goodwill;
- the amortization methods;
- the impairment test for the property, plant and equipment and for the intangible assets;
- the fair value measurement of property, plant and equipment at the date of the balance sheet;
- derivatives;
- the use of the normal capacity of the production facilities in order to establish the costs of conversion;
- correcting material errors through retained earnings;
- the assessment of the present value of provisions;
- the necessity of internal control.

Also, the respondents were asked to mention other requirements that they consider unjustified for a "micro-entity", but none of them presented such requirement.

Contrary to our expectations, the results show that the respondents' opinions are generally divided almost evenly. Still, there are some cases where respondents consider that the requirements presented are justified for the accounting of a "micro-entity". We are referring to the requirements about the amortization methods, the correction of material errors through retained earnings and the necessity of internal control. From the total number of respondents, 84.71% consider that the presentation of amortization methods is justified for a "micro-entity", 85.88% and 60% have the same opinion regarding the correction of material errors and, respectively, the necessity of internal control.

However, 62.35% of the total number of respondents considers that one of the presented requirements is too complex for a "micro-entity", namely the derivatives.

We have expected the respondents to believe that the requirements from the accounting regulation are too complex for "micro-entities", but the results of our study invalidated this assumption.

In conclusion, our study revealed that, even if the majority of respondents (accounting professionals from Mures County) consider that the simplification of accounting requirements is adequate for entities with turnover less than 1,000,000 Euros and total assets less than 500,000 Euros, still the requirements from the Romanian accounting regulation in force are not considered to be too complex for "micro-entities".

Considering the fact that many respondents are accounting professionals, we believe that, for some of them, the idea of simplification is connected with the idea of implicit diminishing of the work they perform to various entities in the area. A question mark remains regarding the validation of these results, considering the possible subjectivism of respondents.

3. THE IMPLICATION OF ACCOUNTING PROFESSION IN THE ACCOUNTING REGULATION OF "MICRO-ENTITIES"

In the light of the actual concerns at European level regarding the reduction of administrative burdens in case of "micro-entities" by diminishing the disclosure requirements, on one side, and of the recent issue of a new accounting regulation addressed to all Romanian entities as from January 1st, 2010, on the other side, we can not ignore some questions that we have in mind and we will try to answer them, based on European experiences and personal opinions:

Whether and in what extent the accounting profession from Romania should be involved in the settlement of accounting regulation? Is the organization of a public debate with the accounting profession by the Romanian accounting regulator opportune?

It is important to mention the example of an important body of professional organizations, the ICAEW (The Institute of Chartered Accountants in England and Wales), which, based on the concerns at European level, initiated a public debate in order to make sure that the European Union proposal will have a positive impact on the business field. This is an example that can be followed by many professional organizations at European level and, why not, by CECCAR (the Romanian accounting body)!

For 20 years we are witnesses to a process of accounting regulation for which the main actor was and still is the Ministry of Finance. Although we wish for an overture, this thing is not going to happen.

Maybe it is time for the accounting profession, through its representative organism, to be involved more actively in aspects related to accounting regulation. Even if there is no express request, CECCAR, by its organisation at county level, could anticipate certain changes in the area of accounting regulation and validate or invalidate them based on some pertinent answers obtained from the professionals and from the entities they work for. CECCAR represent a force through weight and professionalism, so we can not be ignored! The example of other professional organisations (such as ICAEW) should be followed. The results of a questionnaire can be ignored; but for how long?! The frequent exposure of some results validated at the level of Romanian profession will necessary represent a "voice" that must be heard!

Based on the results from Mures County, we can ascertain a reticence about the simplification of accounting regulation, because this could imply, according to some voices, the diminishing of the activity of the accounting professionals. We believe that things must be analysed with lot of responsibility and the ideas that arise at European level should be brought out among the accounting professionals.

The relief of entities from the obligation to draw up financial statements too consistent and irrelevant (in some cases) for the potential users of financial information, may have positive effects,

by the concentration of material, human and financial efforts on the identification and analysis of certain essential information for the management of "micro-entities".

Initially, the accounting law no. 82 from 1991 presented very few provisions related to the organization of managerial accounting, and the regulations about the organization of financial accounting, "contaminated" with lots of fiscal provisions in continuous change, made difficult enough the entities activity. Those were the premises that conduct to the misunderstanding of the law, regarding the obligation to organize managerial accounting. So, the accounting professional, used to analyse in the light of the obligation to organize managerial accounting, refusing to ask himself about its utility and necessity or, simply, was adapted to the system of cost calculation found at the entity level, without making the effort to ascertain if that is the optimal system for cost calculation. If only the cost calculation is taken into account, the system will be simple; but, if the manager needs more information, a more elaborated system can be built, with various options and possible scenarios.

CONCLUSIONS

We consider that the accounting profession from Romania has the resources needed in order to have amore important position in the accounting regulation process. The idea underlined in the previous section related to the active participation of the accounting profession in validating or invalidating some accounting regulations in Romania can be an important step to follow. The knowledge and the debate of ideas that concern the European Union represent, in our opinion, an act of professionalism. We can not express opinions without analyzing the recent ideas and discussing them. In this direction CECCAR should be more involved.

We are aware of the fact that the Romanian regulator is not willing to make concessions, at least not for the moment. Whatever the present effect of such an approach, the future of accounting regulatory act must be appropriate to the accounting profession.

From our point of view, the entities should have the possibility to use different accounting regulations, even national regulations, the main criteria for this choice should be the enterprises size. The micro-entities could be the beneficiary of accounting regulations issued by the accounting regulations bodies at national level. [8] An accounting regulation established at national level can easily decide the simplification needed for so called micro-entities.

ENDNOTES:

¹ Some of these discussions can be found on the website of the European Commission: *Simplifying the business environment for companies*, http://ec.europa.eu/internal_market/company/simplification/index_en.htm. The final study „Study on administrative costs of the EU Company Law Acquis” is available on-line at: http://ec.europa.eu/internal_market/company/docs/simplification/final_report_company_law_administrative_costs_en.pdf.

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